# Can market sentiment alone drive greener financial practices in banks?

## Markets are designed to maximize returns, so unless sustainability is profitable, it's questionable whether the desired outcome will materialize.

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Banks are emerging as key agents in the push toward a net zero economy. With vast networks spanning industries and regions, they're uniquely positioned to rally firms around climate goals. Their long-term ties with borrowers give them not only insight into business operations and leadership, but also the leverage to drive change.

To this end, eco-conscious shareholders have sparked optimism as they push banks toward greater involvement in green finance. The hope is that environmentally conscious fund providers or stakeholders will push firms, including banks, toward greener behavior.

A paper in the *Journal of Corporate Finance* by Christian Eufinger, Adrian Böhm, Igor Kadach and Yuki Sakasai, all of IESE, suggests this may be wishful thinking. Eco investors' influence often falls short, highlighting the limits of relying on market forces alone to steer banks toward sustainability.

*IESE Insight* spoke with Christian Eufinger to explore why this is — and what might actually work to shift lending practices in a more sustainable direction.

# How successful are eco shareholders in changing the lending practices of banks?

**CE:** Often, policymakers and others hope that owners who express environmental commitments could influence banks' lending decisions. However, we find no evidence of an association between a higher ownership stake by eco-conscious bank shareholders and shifts in banks' loan allocation strategies between firms with low and high emissions.

There are several possible reasons for this:

- **Cheap talk.** Some shareholders claim to be eco-minded by joining initiatives such as the U.N. Principles for Responsible Investment, but this commitment does not translate into meaningful action.
- **Conflicts of interest.** Shareholders may be reluctant to pressure banks too aggressively, fearing potential repercussions in other business dealings with the banks. For instance, a fund may be both a shareholder in a bank and a client that relies on the bank for trading services.
- **Regulatory environment.** The limited impact of eco shareholders may stem from deeper regulatory and structural barriers.

From these, we find the strongest evidence for the third. The limited influence of environmentally conscious bank shareholders may stem from the distinct way investors approach banks, likely influenced by regulatory constraints and the sector's unique governance structures.

# Do banks actually want to be sustainable?

**CE:** Empirical evidence suggests that greener investments don't necessarily pay off under current conditions, meaning banks lack an inherent incentive to pursue them. Most banks engage in sustainability initiatives because of public perception; they don't want to be seen as neglecting environmental responsibility. But this motivation is fragile.

A clear example is how banks have reacted to recent political shifts. In the past few months, several major U.S. banks that previously committed to sustainability initiatives have now distanced themselves from them. This suggests that their previous commitments were mostly a response to outside pressure, too.

# If banks only engage in green finance when it aligns with public sentiment, can we really expect this approach to be sustainable in the long term?

**CE:** Our research indicates that relying on market sentiment alone has clear limitations. Increasing transparency could help strengthen market-based solutions. For instance, promoting financial instruments like green-linked loans, clearly and credibly classified by their environmental impact, would allow shareholders and other stakeholders to better assess whether banks are meaningfully reducing their portfolio emissions.

However, transparency alone is unlikely to be sufficient. For market mechanisms to truly work, they must operate within a framework that assigns a real cost to carbon emissions. Without such a system, policymakers are left hoping that visibility and eco-conscious sentiment will translate into tangible change — a hope that our findings challenge.

This raises a broader question: Should regulators play a more active role in steering bank lending behavior?

One approach under discussion at the European Central Bank (ECB) involves adjusting capital requirements, for example, imposing higher capital charges on loans to high-emission firms. The goal would be to create financial incentives for banks to shift their portfolios toward greener sectors.

However, more direct regulatory interventions face significant challenges. Banks tend to resist being pushed into lending decisions that conflict with their commercial interests, and they may look for ways to circumvent such rules. This can lead to unintended consequences, including increased greenwashing.

Moreover, incorporating climate goals into central banking risks politicizing institutions that were deliberately designed to remain technocratic and independent.

## So what would it take to make green finance truly effective?

**CE:** Our findings suggest that market-based solutions will remain limited as long as green investments are not clearly aligned with financial returns.

To change this, we need political leadership and governments willing to implement economy-wide policies like carbon pricing, emission trading systems or targeted subsidies for green technologies.

These measures are economically efficient but politically difficult. Carbon pricing, for example, raises energy costs and often faces strong public resistance. That's why, in practice, much of the pressure has shifted to regulators and central banks, which are expected to promote sustainable finance through disclosure mandates or green taxonomies. But this indirect strategy assumes that investors will act decisively on the information they receive, and our research shows that this assumption is flawed.

In the end, real progress on climate finance won't come from hoping that better disclosure or shareholder sentiment will do the job. It will require coordinated political will, clear incentives and a willingness to confront the distributional consequences of climate policy. Finance can play a powerful role, but only if the broader policy environment supports it.


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