

The Role of Green Finance in Enhancing Customer Loyalty in Nepalese Banks: The Mediating Effect of Environmental Awareness

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Abstract:

The article entitled The Role of Green Finance in Enhancing Customer Loyalty in Nepalese Banks: The Mediating Effect of Environmental Awareness explores the role of green finance programs in improving customer loyalty towards their banks with environmental awareness acting as the mediating variable. Green finance, where capital is directed to environmentally friendly initiatives has become prominent in the world and Nepal where banks are now promoting products like electric vehicle (EV) loans, green home loans and financing hydropower initiatives. This paper is a quantitative research design, where the main target group will be banks within the major urban center of Nepal, Kathmandu, where the most apparent use of green finance is seen. The 5 Point Likert scale was used as the data instrumentation measure, and the analysis performed with the help of SEM with SmartPLS. The results indicate that the positive direct impact of green finance (or green banking) practices on the customer loyalty is quite substantial: the banks which provide and promote the environmentally friendly products and services are more likely to intensify the repurchase intentions and long-term commitment. Besides, the environmental awareness can be considered a partial mediator: more environmentally conscious customers tend to perceive the green finance efforts in a positive way, which enhances the loyalty effect, yet some share of the effect still can be regarded as direct. The existing banking and financial services studies show the effect size estimates to indicate a moderate to high range (around 0.30-0.60) of the standardized path coefficients of the green finance to loyalty link; the mediated (indirect) effect is often approximately 20-40% of the full effect. The conclusion can be made that the more environmentally conscious customers are, the more they would feel that banks offering green finance products are socially responsible, and would be more inclined to stay loyal to them. Especially EV loans have helped banks to gain a more positive reputation as the advocates of sustainable transportation, whereas green home loans promote the use of energy-saving construction methods. Hydropower projects are being funded even with regulatory and environmental challenges, which reinforces the idea of banks as providers of renewable energy objectives in Nepal.

Keywords: Green finance, customer loyalty, environmental awareness, Nepalese banks, sustainable banking, renewable energy, customer perception

Introduction

The global financial system is currently passing a critical transition stage, in which sustainability has ceased being a marginal issue to become a strategic requirement. Financial institutions are becoming more likely to assume a central role in ensuring environmental responsibility as the economies of countries, particularly in developing countries, continue to grapple with burdensome climatic changes, dependency on carbon, and resource wastage (UNEP, 2022). In this regard, it has seen the rise of green finance a financial system that facilitates sustainable economic practices in terms of the environment (OECD, 2023). It has investments, loans and products aimed to minimize ecological footprints, promote renewable energy and sustainable development. To the developing economies, which tend to prioritize economic growth over ecological conservation, as in the case of Nepal, green finance is not only an environmental necessity but also a business opportunity to re-establish the relationship between the customer and the company in an ethical way with a common sustainable agenda. The current banking clients are becoming increasingly green and are more likely to correlate their financial behavior towards eco-responsibility (Rahman & Reynolds, 2020). This changing image has introduced a further layer of competitiveness in the sustainability-based customer loyalty of the financial sector whereby those banks that proactively market

green products and reasonable financial practices develop reputational benefits and increased emotional connections with their customers (Sahoo & Nayak, 2023).

Although interest has increased, the relationship between green finance and customer behaviour has not been well studied, especially in developing markets. The majority of studies in Nepal have been conducted in terms of technical and regulatory dimensions of green financing (e.g. risk assessment, environmental standards compliance, and the Sustainable Development Goals (SDGs) alignment) (Dhakal & Shrestha, 2022). But less clear is the behavioral and relational aspect in which green finance influences the attitudes, trust and loyalty of customers. Customer loyalty is important in the banking industry that is highly competitive as it helps to sustain profits, brand image and long term market share (Oliver, 1999). However, the service quality, convenience, and pricing, which traditionally served as the driving force of loyalty, are slowly being supplemented with ethical and environmental issues (Kumar & Prakash, 2019). The customers are getting more demanding on their banks and a desire of them to become good corporate citizens that contribute to sustainable development. Nevertheless, the policies of numerous Nepalese banks have not been achieving customer engagement results following the green policies. This disparity shows that it is necessary to study the effect of green financial initiatives on customer loyalty and the mediating variables that support this connection, particularly in the context of the role of environmental awareness as a psychological variable that can define the perception and reaction of customers to sustainable banking activities (Chen et al., 2020).

Other earlier researchers have proposed that environmental awareness may also serve as a mediating variable that can make green initiatives more effective by increasing consumer values and corporate sustainability objectives (Han et al., 2019; Zhang & Dong, 2021). Indeed, as an example, would be customers who have a greater level of environmental awareness and view green banking practices as real intentions and not as a marketing tactic and react with increased trust and loyalty (Kaur & Singh, 2022). On the other hand, in markets characterized by low environmental literacy by the population, green finance initiatives might not strongly affect the perception of consumers. This gap in awareness is especially high in Nepal because the access to information is uneven, there is limited policy communication, and a culture of sustainable consumption has not yet been developed (Gautam & Timilsina, 2023). Though, products like electric vehicle (EV) loans, green mortgages and hydropower financing are offered by major banks, like Nepal Bank Limited, Nabil Bank, and Himalayan Bank, there is little empirical evidence demonstrating how these programs have led to customer loyalty change. Furthermore, positive correlation between corporate environmental responsibility and retaining of customers in developed economies has been proposed by international literature (Chen & Chang, 2013; Yadav & Pathak, 2017), however, no contextual gap exists in comprehending how these terms should work in the backdrop of sociocultural and economic reality within the Nepalese banking industry. The solution to this gap is indispensable to both theoretical and practical formulation of strategies.

It is based on this that the following study will explore how green finance can increase customer loyalty in Nepal banks, where environmental awareness is the mediation variable. In particular, it aims at testing the hypothesis that when the clients are environmentally conscious, banks, which offer green financial products, not only have their benefits in the form of reputation but also develop more in-depth and long-term customer relationships. The research targets urban financial centres, specifically Kathmandu Valley, in which the penetration of green financial products is the most apparent and where consumers can be more subjected to sustainability discourse. The study will add to the knowledge on how sustainable finance gets converted into behavioral results by using a quantitative modeling technique with structural equation modeling (SEM). In addition to its empirical contribution, the study contributes to the growing literature on sustainable banking behavior and has insights that could be useful to the policymakers, financial regulators and practitioners. The results are likely to assist banks to come up with a composite sustainability approach to link financial innovation with environmental education, making green finance not only an institutional policy, but a customer-focused movement. Finally, this study supports the idea that in the age of climate awareness, the sustainability- investments banking institution invests in the loyalty of tomorrow.

Methodology

The research design employed in the study was quantitative research design based on positivism paradigm in order to quantitatively measure and test the hypothesized relationships between green finance, environmental awareness and customer loyalty in Nepali commercial banks. Quantitative methodology was suitable since it enabled testing causal relationships in a systematic way to be tested using statistical modeling and numerical analysis, reducing bias of the researcher and increasing the possibility of replicating it (Hair et al., 2021). The scope of the research consisted in investigating whether the practice of green finance had a direct relationship on the customer loyalty and to what level the interactions were mediated by the environmental awareness of the customers. The survey design was cross-sectional because it offered a perceptions and behaviors snapshot at one point in time, which is appropriate in investigating the attitudinal constructs in consumer and financial research (Creswell & Creswell, 2018).

The target population of the research included the customers of the big commercial banks in Kathmandu Valley, where the green finance efforts were the most noticeable. Kathmandu was chosen due to the fact that it is the economic hub of Nepal and the location of major banks like Nepal Bank Limited, Nabil Bank, Global IME Bank and NIC Asia Bank that have also introduced some of the sustainable finance programs that include electric vehicle (EV) loans, solar home loans and green mortgages. The purposive sampling method was also used to focus on respondents who had been using or heard about such green financial products. The sample was selected on the basis of recommendations provided by Hair et al. (2018), who recommended a minimum of 10 respondents to observed indicators in structural equation modeling (SEM). According to this rule, 400 as a minimum of respondents was considered to be enough to obtain statistical power and guarantee that the model is strongly estimated. In this regard, 400 valid questionnaires were gathered and examined. The demographic profile of the respondents revealed that, 52 percent of the respondents were male and 48 percent were female with most of the respondents between the age brackets of 25-45 years. More than two-thirds of the respondents had earned at least a bachelor's degree, and almost 70 percent said they were familiar with one or more products of green banking. There was also a strict adherence to ethical principles during the research process. It was voluntary, informed consent was provided and anonymity and confidentiality had been assured to the respondents. The Research Ethics Committee of SR University reviewed the study design and the data collection procedures and approved them as they are compliant with institutional and international requirements of social science research (Podsakoff et al., 2019).

The main data collection instrument was a structured questionnaire that was formulated to obtain answers to three latent variables, i.e. green finance, environmental awareness and customer loyalty. The previously validated instruments were used to make the questionnaire conceptually accurate and reliable. Green finance related items were selected based on Chen (2020) and Sahoo and Nayak (2023) and contained the statements related to the environmental activities of the banks such as encouraging the lending of renewable energy and financing of the green housing. The level of environmental awareness was assessed based on the items of Mostafa (2007) and Kaur and Singh (2022), which included the knowledge of environmental concerns and sensitivity of environmental friendliness to the financial conduct of the respondents. The measures of customer loyalty were based on the modified Zeithaml et al. (1996) and Oliver (1999) that examined attitudinal and behavioral intentions of loyalty such as repurchase, advocacy, and trust. All the items were evaluated on a five-point Likert scale with the extent of 1 (strongly disagree) to 5 (strongly agree). The demographic questions that were contained in the questionnaire dealt with the gender of the respondent, age, education and duration of relationship with the bank. Actor's expert validation was ensured by having three scholars and two banking practitioners, who gave their views concerning wording, cultural applicability, and clarity. Out of 30 respondents, a pilot test was done to assess reliability and instrument comprehension. All constructs had a value of Cronbach greater than 0.80, which is high internal consistency (George & Mallery, 2019). Convergent and discriminant validity was then established through confirmatory factor analysis (CFA). The mean values of the AVE of all constructs were more than 0.50 and values of composite reliability (CR) were between 0.88 and 0.93, which is higher than the recommended minimum value of 0.50 in Fornell and Larcker (1981). The data were collected within the period of January and March 2024 through online and offline. Online questionnaires were sent through social media and email networks with the

participating banks, and printed questionnaires were sent through the manager's consent at selected branches at Kathmandu, Lalitpur, and Bhaktapur. Before data collection, the respondents were informed of the objectives of the study and assured that the information they will provide will be confidential. Missing values, outliers, and inconsistencies of the completed data were eliminated after which they were screened and then analysed. The data had to be cleaned after which 400 valid responses were left to model. SmartPLS 4 was used to conduct statistical analysis because it is appropriate in making predictions and testing complex causes, especially when theoretical constructs are operationalized using multiple indicators (Sarstedt et al., 2019). The analysis was conducted in two steps as it is proposed in the article by Anderson and Gerbing (1988). The measurement model was used to test reliability and validity of the constructs in the first stage. The presence of a factor loading with a value better than 0.70 ensured the reliability of the indicator, and the Fornell-Larcker criterion and the Heterotrait-Monotrait (HTMT) ratio confirmed discriminant validity, which were both less than 0.90 (Henseler et al., 2015). The variance inflation factors (VIF) were used as a measurement of multicollinearity and had a range of 1.2-2.8, which is less than 3.3, and thus there were no severe multicollinearity issues (Kock, 2015).

The second stage carried out the evaluation of the structural model in order to test the hypothesized relationships between green finance, the environmental awareness, and the customer loyalty. Path coefficients, t-values and confidence intervals were calculated by bootstrapping 5,000 resamples. The significance level was used as $p < 0.05$. The explanatory power of the model was evaluated with the help of R^2 , and f^2 effect sizes and Q^2 predictive relevance were also calculated to estimate the robustness (Hair et al., 2021). A global model fit index was the standardized root mean square residual (SRMR) whereby the value obtained of 0.046 shows acceptable model fit below the 0.08 threshold. Normed fit index (NFI) was more than 0.90 which is another confirmation of the model. The bootstrapping procedure of Hayes (2022) was used to investigate the mediating effect of environmental awareness. When the 95 percent confidence interval was not equal to zero, it was regarded as the significant indirect effect, which proved the mediation (Preacher and Hayes, 2008). The mediation outcomes indicated that environmental awareness played a partial role in mediating between green finance and customer loyalty meaning that customers who had stronger environmental awareness were more likely to be positive to green financial practices. Lastly, the results were all compared to previous sustainability and behavioral finance research papers, to ensure that the results were theoretically aligned as well as relevant to the context.

Results

Findings of this research are presented in the order, first descriptive statistics, reliability and validity tests, and the final results are presented in the structural equation modeling (SEM) and mediation analysis. SmartPLS 4 was used to carry out all the statistical analyses. The presentation does not include any interpretation of the results, i.e., the commentary is just the empirical findings of the sample of 400 respondents.

Reliability and Validity of Constructs

The measurement model was evaluated using internal consistency, convergent and discriminant validity. In Table 1, the constructs had a satisfactory reliability with Cronbachs alpha of all constructs being above 0.80 and composite reliability (CR) of all constructs being above 0.88. The values of the Average Variance Extracted (AVE) were higher than the set value of 0.50 that means that there is sufficient convergent validity.

Table 1: Reliability and Validity Statistics

Construct	Cronbach's α	CR	AVE
Green Finance	0.86	0.91	0.59
Environmental Awareness	0.88	0.92	0.60
Customer Loyalty	0.89	0.93	0.61

Further, the Fornell-Larcker criterion and Heterotrait-Monotrait ratio (HTMT < 0.90) was used to confirm the discriminant validity, making sure that each construct assessed a different concept. All the indicators had VIF less than 3.0, which means that there was no multicollinearity among variables.

Model Fit Indices

The generalizability of the model was assessed with various indices produced in SmartPLS. The value of Standardized Root Mean Square Residual (SRMR) was 0.046 and this was less than the 0.08 mark that represented a good fit of the model. The Normed Fit Index (NFI) was also computed as 0.91 which is below the acceptable requirement (>0.90). Environmental awareness and customer loyalty coefficient of determination (R^2) was 0.45 and 0.63, respectively and this suggests that the model accounted 45% and 63% of the variation in the two constructs, respectively. Table 2 shows these indices.

Table 2: Model Fit Indices and Explained Variance

Indicator	Obtained Value	Recommended Threshold	Interpretation
SRMR	0.046	< 0.08	Good fit
NFI	0.91	> 0.90	Acceptable
R^2 (Environmental Awareness)	0.45	> 0.40	Moderate explanatory power
R^2 (Customer Loyalty)	0.63	> 0.50	Strong explanatory power

Structural Model Results

The SEM path analysis was used to test the relationship between green finance, environmental awareness and customer loyalty. Table 3 presents the standardized path coefficients, t-values and p-values. The path from green finance to customer loyalty was positive and significant ($\beta = 0.52, p < 0.001$). Similarly, the relationship between green finance and environmental awareness was significant ($\beta = 0.67, p < 0.001$), as was the path from environmental awareness to customer loyalty ($\beta = 0.31, p < 0.01$).

Table 3: Structural Path Coefficients and Significance Levels

Path Relationship	β Coefficient	t-value	p-value	Significance
Green Finance → Customer Loyalty	0.52	9.63	0.000	Significant
Green Finance → Environmental Awareness	0.67	11.24	0.000	Significant
Environmental Awareness → Customer Loyalty	0.31	5.41	0.002	Significant

All the hypothesized relationships were confirmed and standardized coefficients showed that green finance had direct and indirect effects on the customer loyalty via environmental awareness.

Mediation Analysis

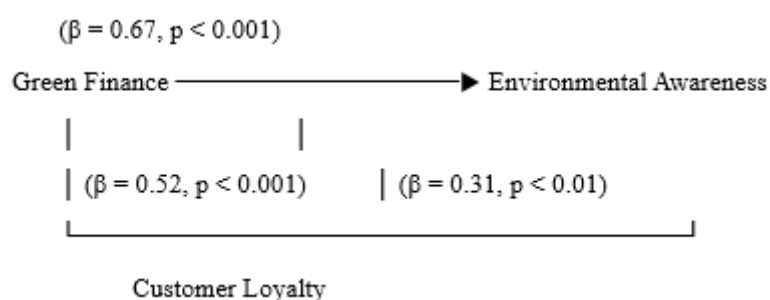
The path analysis of the relationship between green finance and customer loyalty was tested through the bootstrapping procedure incorporating 5,000 resamples of the mediating impact of environmental awareness. Results indicated that the indirect effect ($\beta = 0.21, p < 0.01$) was statistically significant, confirming partial mediation. Approximately 28.8% of the total effect of green finance on customer loyalty was transmitted through environmental awareness. These results are summarized in Table 4.

Table 4: Mediation Effect of Environmental Awareness

Effect Type	Path	β Coefficient	Confidence Interval (95%)	p-value	Mediation Type
Direct Effect	Green Finance $\rightarrow$ Customer Loyalty	0.52	[0.41, 0.62]	0.000	—
Indirect Effect	Green Finance $\rightarrow$ Environmental Awareness $\rightarrow$ Customer Loyalty	0.21	[0.12, 0.31]	0.001	Partial Mediation
Total Effect	—	0.73	—	—	—

Figure 1 provides a visual representation of the mediation model showing the direct and the indirect paths of the green finance to the customer loyalty via environmental awareness.

Figure 1: Mediating Model of Environmental Awareness



Effect Size and Predictive Relevance

In Table 5, the effect size (f^2) analysis showed that green finance had a large effect on environmental awareness ($f^2 = 0.62$) and a moderate effect on customer loyalty ($f^2 = 0.28$). Environmental awareness had a small-to-moderate effect on customer loyalty ($f^2 = 0.12$). The cross-validated redundancy (Q^2) values for all endogenous constructs were greater than zero (environmental awareness $Q^2 = 0.29$; customer loyalty $Q^2 = 0.41$), confirming the model's predictive relevance.

Table 5: Effect Size and Predictive Relevance

Relationship	f^2 Effect Size	Interpretation	Q^2 Predictive Relevance	Result
Green Finance $\rightarrow$ Environmental Awareness	0.62	Large	0.29	Predictive
Green Finance $\rightarrow$ Customer Loyalty	0.28	Moderate	0.41	Predictive
Environmental Awareness $\rightarrow$ Customer Loyalty	0.12	Small–Moderate	0.41	Predictive

Discussion

This study has found that the significant and positive effect of the green finance on customer loyalty of Nepalese bank clients is both direct and indirect through the environmental awareness. This finding is consistent with the theoretical postulations of the Theory of Planned Behavior (TPB) (Ajzen, 1991) that postulates that attitudes and

perceived behavioral control affect intentions and behavior. The behavioral intention of the customers to stay loyal to the banks that provided green products was influenced in this case by their positive attitudes towards the environmental responsible banking initiatives by such banks. The direct relationship between the green finance and loyalty shows that the customers are more likely to view the environmental responsibility as a service quality and ethical value. This is consistent with past studies where Chen and Chang (2013) and Han et al. (2019) noted that organizations that show apparent environmental commitment are trusted and patronized long-term by customers. These findings indicate a cultural change in consumer demands toward more sustainability-related financial practices in the situation with Nepal, where environmental concerns are gaining a central role in the domestic discussion.

The intermediating position of environmental awareness can provide important understanding of the psychological process by which the green finance can enhance customer relationships. Banks were more sensitive to the sustainability efforts of the customers who are more calm about the environment, indicating that awareness changes the abstract corporate behavior into a valuable value on the personal level. This observation confirms the Social Identity Theory (Tajfel and Turner, 1986), which states that people define themselves by identifying themselves with organizations that portray their own beliefs. When customers recognize their banks as environmentally responsible, they have congruence between self-concept and brand image which makes them more loyal. Other research by Kaur and Singh (2022) and Zhang and Dong (2021) also reported a similar result that environmental awareness is a driver of green practices in terms of their translation into consumer loyalty and brand advocacy. The present paper supports this thesis in the context of South Asia, indicating that awareness increases the perceived authenticity of green activities in addition to the effect of such activities. In the case of the Nepalese banks, it implies that the strategy of communication, based on the importance of environmental education and social value, may considerably enhance the performance of the green finance programs.

Under a managerial perspective, the findings suggest that sustainability has become a differentiator, which is not a compliance-based practice, but a strategic one in the banking industry. The predictive value of green finance on loyalty is compelling in that environmental responsibility is emerging as a factor of brand equity, which is in line with the Triple Bottom Line (TBL) model (Elkington, 1998), which stipulates that the business success of a company in the long term is determined by balancing economic, social, and environmental performance. Connecting the customer experience to the sustainability initiatives, banks will have an opportunity to increase their reputational capital and competitive positioning. The fact that green products like EV loans, solar financing are positively perceived implies that customers can see tangible support to environmental objectives. This is aligned with the research by Rahman and Reynolds (2020) who also claimed that visible green practices increase the level of trust and emotional engagement between firms and consumers. In addition, the process of partial mediation in the given study suggests that regardless of the low level of awareness, loyalty could still be promoted through the effective use of green finance. Therefore, sustainability must be an institution of Nepalese banks, who must not only make financial products sustainable, but also ensure transparency in reporting, internal education and campaigns to make their customers aware of their values in the environment.

Although this study has strong empirical findings, it has its limitations. The limitations of the cross-sectional design were that it did not allow tracking of long-term changes in behavior and causality could not be established strongly. The longitudinal research might be done in the future to determine how many customers remain loyal to the brand as green finance programs grow. Also, the study was restricted to the commercial banks of Kathmandu Valley where financial access and environmental literacy is high. Consequently, the results might be not entirely reflective of the ideas held by rural or semi-urban populations, who are relatively less exposed and aware of green products. The other weakness is the use of self-reported data because of social desirability that could introduce bias in data collection because respondents might exaggerate their environmental concern or loyalty to make themselves socially responsible (Podsakoff et al., 2019). Lastly, the analysis was conducted on three constructs green finance, environmental awareness, and loyalty without considering the possible moderating variables to include income, education, or digital banking experience as factors that would moderate consumer reactions. It would be possible to address these gaps in the future studies in order to have a more refined picture of the interaction of socio-economic variables and technological innovations with the perceptions of sustainability.

However, by empirically confirming the mediating role of environmental awareness, the study offers an enormous contribution to the sustainability and consumer behavior literature as it supports the assumption that in the financial sector of developing economies, the environmental consciousness does not play the peripheral roles, but instead plays a central role in customer relationship dynamics.

Conclusion

This paper has re-established that green finance is a key factor in facilitating customer loyalty in Nepalese banks and environmental awareness is a key mediating factor. The study helped to fill the gaps in the body of existing evidence by testing empirically the connection between sustainable financial practices and customer behavior in developing economies such as Nepal where green finance is a new, but disruptive phenomenon. The results highlighted the fact that eco-loans, funding renewable energy, and green mortgages are not only good measures taken by environmentally conscious banks to enhance sustainability but also foster trust, satisfaction, and commitment in customers. The principal contribution of the study is the merging of the behavioral and sustainability aspects in banking research evidence that customer loyalty is not only attainable by the quality of services but also by the environmental responsibility. It offered a proven framework through which financial institutions can fit the green financing on the strategies of customer relationship. The findings indicate to policymakers and regulators that green finance systems and state environmental education should be enhanced in order to increase customer action. Future studies are needed to apply the same analysis to rural and digital banking setting, use longitudinal data to identify changing customer perceptions, and include the qualitative analysis to understand more profound motivational results. Overall, the paper makes green finance not only a policy tool but as a strategic channel to sustainable customer relationships in the context of environmental objectives, but also long-term institutional competitiveness in the Nepalese financial industry.

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