

Sustainable Green Banking Approach: The Need of the Hour

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Abstract

Green banking means combining operational improvements, technology and changing client habits in banking business. It is a win-win situation for all to bring benefits in an increasingly competitive marketplace. Adoption of greener banking practices will not only be useful for environment, but also benefit in greater operational efficiencies, a lower vulnerability to manual errors and fraud, and cost reductions in banking activities. Banks are already offering many of the services necessary for businesses to enjoy these benefits. This paper has made an attempt to highlight the major benefits, confronting challenges, strategic aspects of Green Banking. It has also presented the status of Indian banks as far as Green Banking adoption is concerned. It is found that there has not been much initiative in this regard by the banks in India, though they play an active role in India's emerging economy. Banks should go green and play a pro-active role to take environmental and ecological aspects as part of their lending principle, which would force industries to go for mandated investment for environmental management, use of appropriate technologies and management systems. They must be more vocal about the inherent green value proposition.

Key words: Green Banking, Banking Challenges, Banking Strategy

Introduction

As environmental issues gain greater attention, pressure is being placed on all industries, including financial services to implement "green" initiatives. While green banking is not yet a key reason for most customers to select one financial institution over another, customer demands and greater environmental awareness are driving a number of financial institutions to go green. Environment is a key focus amongst ethical banks (in this field specially called sustainability or green banks) as well as amongst many conventional banks that wish to appear more ethically oriented or that see switching to more environmental practices to be to their advantage. In general bankers "consider themselves to be in a relatively environmentally friendly industry (in terms of emissions and pollution). However, given their potential exposure to risk, they have been surprisingly slow to examine the environmental performance of their clients. A stated reason for this is that such an examination would 'require interference' with a client's activities. While the desire to not meddle in the business of the client is valid, one could also note that banks are required to interfere in the business of their clients regularly to ensure that the clients' business plan is viable before issuing them a loan. The kind of analysis that all banks partake in is termed a single bottom line analysis (this analysis only considers financial performance). It is arguable whether or not performing a triple bottom line analysis (an analysis that takes into account environmental, social, and financial performance) would be any more intrusive in case of banking sector.

As far as internal ethics of banks are concerned, it starts with the well being of employees, employee and customer satisfaction, benefits, wages, unionization fair sex and race representation, and the banks environmental standing. Environmentally the potential combined effect of banks switching to more environmentally friendly practices (i.e. less paper use, less electrical use, solar power, energy efficient) is huge. However when compared with many other sectors of the economy banks do not incur the same burden of energy, water and paper use. In general all banks play an intermediary role in the economy; because of this the possibility for banks to contribute to sustainable development is potentially profound. Banks can also develop more sustainable products, such as environmental, social, or ethical investment funds. In addition, there is great scope for banks to improve their internal environmental performance. In creating environmental and social screens, banks can promote socially/environmentally-gearred companies and penalize those who do not conform to

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these standards. However it is important that these different possibilities (i.e. social/environmental screens, ethical products, and internal environmental practices) be used as a package. If not, there is a danger that banks could simply do the things that make them look the most ethical (i.e. advertise their recycling program) while not changing other areas that would have a larger impact. If the changes are solely driven by customers, the bank will be pressured to offer preferential treatment to what depositors deem as desirable, but will have limited ability to punish undesirable action. Governmental regulation, initiated by an informed and involved public would be an effective way to ensure that all banks follow socially accepted morals and ethics.

The banking sector influences the economic growth and development in terms of both quality and quantity, there by changing the nature of economic growth. Banking sector is one of the major sources of financing investment for commercial projects which is one of the most important economic activities for economic growth. Therefore, banking sector can play a crucial role in promoting environmentally sustainable and socially responsible investment.

Banking sector is generally considered as environmental friendly in terms of emissions and pollutions. Internal environmental impact of the banking sector such as use of energy, paper and water are relatively low and clean. Environmental impact of banks is not physically related to their banking activities but with the customer's activities. Therefore, environmental impact of bank's external activity is huge though difficult to estimate. Moreover, environment management in the banking business is like risk management. It increases the enterprise value and lowers loss ratio as higher quality loan portfolio results in higher earnings. Thus, encouraging environmentally responsible investments and prudent lending should be one of the responsibilities of the banking sector. Further, those industries which have already become green and those, which are making serious attempts to grow green, should be accorded priority to lending by the banks. This method of finance can be called as "**Green Banking**", an effort by the banks to make the industries grow green and in the process restore the natural environment. This concept of "Green Banking" will be mutually beneficial to the banks, industries and the economy. Not only "Green Banking" will ensure the greening of the industries but it will also facilitate in improving the asset quality of the banks in future. Internationally, there is a growing concern about the role of banking and institutional investors for environmentally responsible/socially responsible investment projects. Banking institutions are more effective towards achieving this goal for the kind of intermediary role they play in any economy and for their potential reach to the number of investors. It is of importance to the banking sector to follow certain environmental evaluation of the projects before financing.

A Brief Review of Literature

There are studies showing positive correlation between environmental performance and financial performance (**Hamilton, 1995; Hart, 1995; Blacconiere and Pattern, 1993**). Thus, it is imperative for the banking institutions in the present context to consider environmental performance in deciding whether to invest in companies or advise clients to do so. The formation of different rules for environmental management like resource conservation, clean water act, clean air act, toxic substance control act are also viewed as potentially significant contributor to the recent increase in environmental liability for banking institutions. Adoption of these principles will offer significant benefits to banking institutions, to consumers and also the stakeholders. Credit risks are also associated with lending on the security of real estate whose value has diminished owing to environmental problems (additional loss in the event of default). Further, risk of loan default by debtors due to environmental liabilities because of fines and legal liabilities and due to reduced priority of repayment under bankruptcy. In few cases, banks have been held responsible for actions occurring in which they held a secured interest (**Schmidheiny and Zorraquin, 1996 and Ellis, Millians and Bodeau, 1992**).

There are also few cases where environmental management system has resulted in cost savings, increase in bond value etc. (**Heim, G et al, 2005**). In few cases the environmental management system resulted in lower risk, greater environmental stewardship and increase in operating profit. The banking and financial institutions should prepare an environmental risk and liability guidelines on development of protective policies and reporting for each project they finance or invest (**Jeucken,**

201). They can also have an environmental assessment requirement for the projects seeking finance. Banks also can issue Environmental hazards management procedures for the each project and follow through. The present green consumerism is more concerned with the quality of the products more than the quantity. In future, market will reward those industries or the companies, which emerge as the efficient users of the energy and raw materials and will penalize the less efficient one. Further, the investors in the stock market are equally aware of environmental pollution and would take a stand against those industries/institutions that do not comply with pollution norms (**Gupta, 2003; Goldar, 2007**). So the preferences of the investors will dry up in the case of polluting units and market capitalization will go down significantly. Thus, financial institutions should help developing the right instruments to meet the needs of industry to control environmental impact.

Though **Schmidheiny and Zorraquin (1996)** concluded that banks are not hindering the achievement of sustainability, banks can also play a hindering role for sustainable development because (i) they prefer short-terms payback periods where as sustainable development needs long-term investment (ii) investment which take into account of environmental side-effects usually have lower rate of return in short-term (**Jeucken and Bouma, 1999**). Therefore, sustainable investments are unlikely to find sufficient funding within current financial markets. Thus, government must design proper legislation of environmental rules for banks and ensure enforcement. The problems in India are the legislation is not yet framed and in few cases, things are not strictly enforced, but things can change overnight resulting in major compliance problems for the companies concerned and increased risk for the banks that have lent to them. There should be continuous dialogue relating to environmental matters with relevant audiences, including stakeholders, employees, customers, governments and the public.

Major Benefits of Green Banking

Green Banking comes with a bundle of benefits such as -

- Cash back will be credited to all existing account holders shifting into Green.
- Cash back will be credited to all new customers opening '**Green accounts**'.
- Rationalization of paper use by giving free access to do all the banking transactions through Internet Banking, SMS Banking, Phone Banking and ATM Banking.
- Free Electronic Bill Payment Services.
- E-Remit services for remitting funds to the customers' home country which is a unique service.
- E-Statement will be generated and sent to the customers' email.
- Online Account opening form for opening Green Account.
- Customer can opt for Go Green through various channels through Online Banking, Branches and Call Centre.

Confronting Challenges to Going Green

Green banks support wonderful causes; they do face a lot of challenges as for-profit entities. Just like those socially conscious and environmental mutual funds, they are expected to encounter more obstacles than typical run-of-the-mill bank.

(i) Diversification matters

Green banks will be screening their customers and naturally, they'll be limiting and restricting their business to those entities that qualify. With a smaller pool of customers, they'll automatically have a smaller profit base to support them. If they focus their loans on certain industries, they open themselves up to being much more vulnerable to economic shifts.

(ii) These banks are still startups

Apparently, it takes 3 to 4 years for a typical bank to start making money. Many green banks in business today are very new and are still in startup mode. It doesn't help that these banks are trying to get their footing during a recession.

(iii) Banks are “specialized”

Again, while the main goal of a green bank is to do good by supporting those who are taking care of the environment, the question here is — just how much money is there in these businesses and in the eco-friendly industry? Saving the environment does not necessarily equate to “making a profit”. Hopefully though, this premise is proven wrong in this case and that green banks prove that they can survive, even as they face restrictive requirements for doing business.

(iv) Operating expenses and costs are higher

Green banks require specialized talent, skills and expertise as well, due to the kind of customers they are servicing. Employees, such as loan officers, need to have additional background and experience in dealing with green businesses and consumers. Plus, giving breaks to such clients via discounted loan rates can eat at their profit margins.

(v) Reputation Risk

In all likelihood, due to growing awareness about environment safety, banking institutions are more prone to lose their reputations if they are involved in big projects, which are viewed as socially and environmentally damaging. There are also few cases where environmental management system has resulted in cost savings, increase in bond value etc (**Heim, G et al, 2005**). In few cases the environmental management system resulted in lower risk, greater environmental stewardship and increase in operating profit. Reputation risks involved in the financing of ecologically and ethically questionable projects.

Strategies for Green Banking Approach

Green banking is an integral part of the Bank’s environmental policy as applied through its wider Corporate Social Responsibility strategy. The adoption of green banking strategies will help the bank to deal with these risks involved in their business operation. Green banking strategies involves two components such as (i) Managing environment risk and (ii) Identifying opportunities for innovative environmentally oriented financial products (**IFC, 2007**).

- To manage environmental risk, the banks have to design proper environmental management systems to evaluate the risks involved in the investment projects. The risks can be internalized by introducing differential interest rates and other techniques. Moreover, bank can withdraw itself from financing high-risk projects.
- The second component of green banking entails creating financial products and services that support commercial development with environmental benefits. These includes investment in renewable energy projects, biodiversity conservation, energy efficiency, investment in cleaner production process and technologies, bonds and mutual funds meant for environmental investments etc.
- The banking institutions should prepare an environmental risk and liability guidelines on development of protective policies and reporting for each project they finance or invest (**Jeucken, 2001**). They can also have an environmental assessment requirement for the projects seeking finance. Banks also can issue Environmental hazards management procedures for each project and follow through. International financial institutions like International Financial Corporation (IFC), Japan Bank for International Cooperation (JBIC) have incorporated environmental management into their business operation. All project proposals are classified in terms of its potential environmental impact taking into account factors such as the sector and scale of the project, the substance, proposed project site, the degree and uncertainty of its potential environmental impact. Often, the World Bank’s loans and grants are associated with certain level of commitment of the beneficiary countries to adopt environmental protection measures.
- The perception towards complying with environmentally norms and standards is changing over time. Environmental friendly or green technologies also make economic sense for the banking industry. Adopting environmentally sustainable technologies or modes of production is no more considered as a financial burden; rather it brings new business opportunities and higher profit. Green banking saves costs, minimizes the risk, enhance banks reputations and contribute to the common good of environmental sustainability. So it serves both the commercial objective of the bank as well as its social responsibility.

- Banks need to be more careful in India about the environmental aspects of their clients and products because (a) future of exports and product market are going to go through stringent environmental rules and eco-friendly product will have better market. (b) increased demand for pollution controls equipments will require more financial assistance from banks. (c) Reserve Bank of India (RBI) may follow environmental guidelines for the banks in the lines of IFC and Asian Development Bank etc. (d) recent announcement of the government to use economic instruments for environmental control may include Banks in future. (e) big investment projects supported by international organizations like the World Bank and ADB require Environmental Impact Assessment (EIA). Therefore the banks should begin implementing procedures like (i) assessment of risk due to environment (ii) Environmental audit management (iii) assessment of credit requirement and loan follow up before investing on different projects. However, since banking sector is profit driven, it needs incentives and governmental support to assist environmental protection which is beneficial for the whole economy and society and also to the banking sector itself in the long-run.

Environmental Management by the Banking Institutions

- Now a days, most of the commercial lending process in different parts of the world scrutinizes projects with a set of tools by incorporating environmental concerns in their day-to-day business. The financial institutions should encourage projects which take care of following points while financing them viz., (a) sustainable development and use of natural renewable natural resources (b) protection of human health, bio-diversity, occupational health and safety, efficient production, delivery and use of energy (c) pollution prevention and waste minimization, pollution controls (liquid effluents and air emissions) and solid and chemical waste management and (d) there should be a third party expert to draw a plan for the environment management plan. They should keep following aspects in mind while financing any projects.
- Analyzing the project in terms of scale, nature and the magnitude of environmental impact. The project should be evaluated on the basis of potential negative and positive environmental effects and then compared with the 'without project situation'. There should be an Environmental Impact Assessment (EIA) of each project recommending the measures needed to prevent, minimize and mitigate the environmental negative impact before financing the projects.
- While investing or funding the projects, the financial institutions should assess the sensitive issues like vulnerable groups; involuntary displacement etc and projects should be evaluated in terms of environmentally important areas including wetlands, forests, grasslands and other natural habitats.
- Banking institutions need to evaluate the value of real property and the potential environmental liability associated with the real property. Therefore, the banks should have right to inspect the property or to have an environmental audit performed through the life of the loan.
- Banks also need to monitor post transaction for the ideal environmental risk management program (Rutherford, 1994) during the project implementation and operation. There should be physical inspections of production, resources, training and support, environmental liability, audit programs etc.
- The next round of evaluation includes loan structuring, credit approval, credit review and loan management. Further banks have annual audits, quarterly environmental compliance certificate from the independent third party and also from the government.
- Further the banks can introduce green bank loans and products like (i) investing in environmental projects (recycling, farming, technology, waste, etc) for example reduced-rate of interest on loans to homeowners who install a solar energy system (ii) providing option for customers to invest in environmentally friendly banking products (iii) investing in resources that combine ecological concerns and social concerns.

Enforcement of Environmental Management and Role of the Government

- The financial institutions also should make sure that the customer is ready to comply with environment management plan during the construction and operation of the project and provides regular reports, prepared by in house staff and third party experts. There should be a direct communication between the lenders and monitoring group. However, much less attention is given for the environmental risk management after the post transaction period. Recently, western financial institutions use environmental criteria with credit risk management activities than with formulating overall lending or investment strategy. With the introduction of ISO 14000 and development of information network, it is easier now to the credit officers to compare firms and plants regarding their environmental management and measure the relative environmental liabilities and risks. Though commercial banking has been more attentive to the investment banking than the environmental problems, the environmental liabilities would play a larger role in their investment decision in the near future (Schmidheiny and Zorraquin, 1996). Further, the environmental audits are required to determine the environmental status of a facility, property, and operation and to identify regulatory compliance status, past present problems and potential environmental risks and liabilities associated with the project. These should be done by an independent body or by any environment investigation team.
- But to ensure all these work,, there should be legislation, which will enforce the standards along with training and demonstration skills. Government should enact legislation to force banks to consider producing a formal environmental policy statement and making this publicly available. Though Schmidheiny and Zorraquin (1996) conclude from their primary study that banks are not hindering the achievement of sustainability, banks can also play a hindering role for sustainable development because (1) they prefer short-terms payback periods where as sustainable development needs long -term investment (2) investment which take into account of environmental side-effects usually have lower rate of return in short-term (Jeucken and Bouma, 1999). Therefore, sustainable investments are unlikely to find sufficient funding within current financial markets. Thus, government must design proper legislation of environmental rules for banks and ensure enforcement. The problems in India are the legislation is not yet framed and in few cases, things are not strictly enforced, but things can change overnight resulting in major compliance problems for the companies concerned and increased risk for the banks that have lent to them. There should be continuous dialogue relating to environmental matters with relevant audiences, including stakeholders, employees, customers, governments and the public.

Conclusion

Are Indian banks green and acting ethically with the environment? Not quite. Indian banks have yet to commit to the *'Equator Principles'* a set of environmental and social guidelines to which 62 banks and financial institutions worldwide have become signatories. None of Indian banks have adopted equator principle even for the sake of records. There is certainly a lack of awareness of the Equator Principles in India. It is time now that India takes some major steps to gradually adhere to the equator principles-guidelines that use environment -sensitive parameters, apart from financial, to fund projects. Leading banks are vaguely conscious of the guidelines, however, the public sector is waiting to be led by the Reserve Bank of India and the private sector banks seem to only want to commit if there is regulation or financial incentive. The lack of interest on the issue among Indian consumers is for the failure of banks to declare their commitment to environmentally and socially responsible business. Indian banks need to be made fully aware of the environmental and social guidelines to which banks worldwide are agreeing to. It will be a huge financial burden for banks committing to environmental and social guidelines. However, If Indian banks are to penetrate western markets and participate more in the global economy, it is important that they recognize their responsibilities as global corporate citizens. Banks in India have significant influence over the safeguarding of fragile social groups and environments in Asia. At this time they must seriously consider their attitudes towards responsible lending both nationally and globally. This shows the ignorance in the part of Indian banks about the green banking initiatives at international level.

There has not been much initiative in this regard by the banks in India though they play an active

role in India's emerging economy. Possible policy measures and initiative to promote green banking in India has become the need of the hour. In a rapidly changing market economy where globalization of markets has intensified the competition, banks should play a pro-active role to take environmental and ecological aspects as part of their lending principle which would force industries to go for mandated investment for environmental management, use of appropriate technologies and management systems. The banking and financial sector should be made to work for sustainable development. As far as green banking is concerned, India's banks are running behind time and it is the need of the hour to think it seriously for the sustainable growth of the nation.

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