SUSTAINABLE BANKING

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Pushing its way on to boardroom agendas

A concept that has been making gradual inroads for decades is now seen as a serious business, writes **Patrick Jenkins**

Sustainable forestry, sustainable fishing, sustainable farming – the idea of managing the earth's natural resources in a prudent way has been gaining ground rapidly in recent years, as the world realises that failing to do so could destroy us all.

Now, so the optimists of the world's financial markets believe, there is a unique opportunity to make sustainability an integral part of banking.

Eighteen months on from the depths of the 2008 financial crisis – and with fears of a European sovereign debt blow-up mounting – the concept of sustainable banking is moving into the mainstream.

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For decades, sustainable banking has been making gradual inroads – underpinning banks' commitment to environmental issues, charitable giving and the like. The entries for this year's Sustainable Banking awards – co-sponsored by the Financial Times and the International Finance Corporation – have seen mainstream banks, such as HSBC and Brazil's Itaú Unibanco, shortlisted alongside established ethical brands such as the Co-operative Bank.

Lars Thunell, chief executive of the IFC, says: "Environmental and social concerns are being taken seriously by financial institutions globally, and this year's entries underscore how institutions are incorporating sustainable financing into their operating decisions."

Royal Bank of Scotland, which recently published what it believes is the most detailed sustainability report of any bank, has stepped up its focus on the area, as it retrenches from high-risk activity. It recently created a board-level sustainability committee to push the issues at the highest level.

Andrew Cave, head of corporate sustainability at the bank, says one early example of progress is that employee diversity – with regard to gender and ethnic origin – has now made it on to the agenda of the board.

There is also a renewed push, says Mr Cave, to extend the so-called Equator Principles, which since 2003 have provided a global blueprint, under the auspices of the IFC, for the social and environmental standards required for banks' project finance work.

Many of the world's biggest 15 banks now want the voluntary standards extended to corporate finance.

But if some mainstream banks are taking sustainable banking in its narrow definition seriously, that is only part of the story. For some at least, especially among those hardest hit by the financial crisis, there has been a sharpened focus on the more general sustainability of their way of doing business.

Business is blooming: microfinance is important for street traders in India and other developing countries Alamy

Along with many banks that blew up in the crisis – from Northern Rock in the UK to IKB in Germany to Lehman Brothers in the US – RBS had sought to expand at unsustainable rates.

But with 70 per cent of its shares in the hands of the UK government after a bail-out, RBS, under the leadership of chief executive Stephen Hester, is well aware that sustainablity must become a broad defining principle.

Mr Cave says: "We are fully signed-up to the goal of sustainable, long-term banking. That means providing customers with useful products that deliver an acceptable return for RBS, but with a view to social and economic responsibility, too."

That was hardly the general attitude in the years running up to 2007. By investing in complex derivatives and borrowing at an unprecedented pace in international markets, many successful banks generated profits, as measured by return on equity, that outstripped nearly every other sector – to the delight of investors.

But as the crisis proved, generating ROE of 25 or 30 per cent was just storing up trouble.

Triodos, the Dutch group that has been a flagship of ethical banking for 30 years, thinks its 7 per cent ROE is the kind of figure that other banks should aim for – "our pension fund investors are quite happy with that, it's like a bond with a little bit of upside", says Peter Blom, chief executive.

Mr Blom's big beef is that bank profits should basically grow in line with GDP. "The world has been pushing bank shares and expecting banks to grow far faster than the economies they are designed to support. That is what is not sustainable."

The idea of stripping banking back to its basic role – of "serving the real economy rather than taking from the real economy", as Mr Blom puts it – is one that has gained considerable support in the wake of the financial crisis and the subsequent government bail-outs.

In a famous excoriation of the banking sector last summer, Lord Turner, chairman of UK regulator the Financial Services Authority, said the sector had "swollen beyond its socially useful size".

Certain products – many derivatives, in particular – appeared to play no useful social role, he said.

The global debate that has ensued is simple but profound, highlighting the tension between the social and

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Shortlist for 2010 Awards

Sustainable Bank of the Year
Co-operative Financial Services, UK
GLS Bank, Germany
HSBC, UK
Itau Unibanco, Brazil
Banco Santander Brasil

Sustainable Emerging Markets Bank of the Year
Africa/Middle East
BMCE Bank, Morocco
Equity Bank, Kenya
Nedbank, South Africa
Asia
BRAC Bank, Bangladesh
Industrial Bank, China
YES Bank, India
Eastern Europe
Raiffeisenbank Bulgaria
RZB Group
Industrial Development Bank of Turkey (TSKB)
Latin America
Banco do Brasil
Itaú Unibanco, Brazil
Banco Santander Brasil

Achievement in Basic Needs Financing
Acumen Fund, US
Banco de Galicia y Buenos Aires, Argentina
Mahindra & Mahindra Financial Services, India
One Acre Fund, Kenya
Scotiabank, Peru

Banking at the Base of the Pyramid
Financial Information Network and Operations (FINO), India
Five Talents, UK
MAP International, US
MicroEnsure, UK
Standard Chartered Bank, UAE

Sustainable Investor of the Year
Acumen Fund, US
Calvert Foundation, US
FINCA International, US and Deutsche Bank, Germany
Global Environment Fund, US
Ventureast Fund Advisors, India

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Dedicated to filling large hole left by financial crisis

Interview
Lars Thunell

The IFC has been broadening its role as banks curb lending, its chief executive tells **Sarah Murray**

As the International Finance Corporation continues to focus on lending to and advising the private sector in poor countries and emerging markets, the broader development community is starting to take on something of the IFC philosophy.

"It's a trend that's happening now and I think it's a very healthy one," says Lars Thunell, chief executive of the IFC, the World Bank's private sector finance arm.

The UK's Department for International Development, for example, recently announced a business innovation facility to foster commercial business models benefiting the poor, while the Danish government wants to double its investments in private sector development in Africa by 2014.

Such announcements have come as music to Mr Thunell's ears. "Aid fulfils an important function but if you only have aid, it's not sustainable," he says. "You need the private sector as well."

In developing countries, Mr Thunell believes that financing small and medium sized businesses (SMEs) is vital for accelerating growth. "That's where you get the job creation and that's the backbone of any economy in the world," he says.

Yet, despite these positive developments, the global financial crisis has left a huge hole in financing capacity, with banks imposing constraints on lending and cutting trade finance lines to importers and exporters. "It really hurts small and medium enterprises," says Mr Thunell.

As a result, the IFC has been supplying loans to banks and setting up smaller equity funds and infrastructure crisis facilities, as well as expanding its traditional trade finance programmes.

In addition, it has launched an initiative focused on financing for the supply chain. "SMEs often work with bigger companies, which sometimes are the ones that put it all together," explains Mr Thunell. "But, unfortunately, many international firms have tightened their payment schedules."

And if larger companies are experiencing difficulties obtaining credit, it is even harder for smaller businesses. "So we're working with, not only banks, but also international firms in helping get out to the suppliers," says Mr Thunell.

Meanwhile, many banks have pulled out of funding microfinance institutions, so the IFC is also working on strategies to extend financing and business opportunities to the world's poorest people.

As well as direct financing, this also means helping non-profit microfinance institutions professionalise their operations and use IT and management tools to raise productivity, cutting the cost of administering individual loans.

This advisory role – in addition to providing financing – is one that the IFC has been increasing throughout its operations.

"In everything we do, we try to combine advisory services and the knowledge with the money," says Mr Thunell. "And in recent years, we've taken a more strategic role in the way we add value."

In some instances, the IFC has a more direct hand in the financing side than in others. The institution has, for example, had difficulty finding fund managers prepared to establish micro-equity funds in post-conflict countries.

'In recent years, we've taken a more strategic role in the way we add value'

Lars Thunell
Chief executive, IFC

However, elsewhere, the institution might take on a broader role, acting in an advisory capacity or helping shape markets.

Often, this means working with business associations, stock exchanges and governments to improve investment climates, governance structures and environmental and social sustainability measures.

In Brazil, for example, the IFC worked with the São Paulo Stock Exchange (Bovespa) on a sustainability index, which encourages companies to improve their performance on environmental, social and governance issues.

Meanwhile, the World Bank's annual Doing Business report provides a quantitative measure of regulations necessary for starting a business in 183 countries with the aim of improving the regulatory environment for the private sector.

Mr Thunell sees the need to make it easier to start a business as equally pressing in the poorest communities of the world. He cites city slums, such as that of Mumbai.

"People don't understand that a slum is its own society, with businesses from laundries to barbers," he says. "The question is how can you get that going and make some of these firms more sustainable, so that they can move from the informal sector to the formal sector."

This segment of society has become an increasingly important focus for the IFC in recent years, through partnerships with companies that charge lower fees for services and can reach large, low-income populations.

Increasing the availability of small loans to these populations through microfinance institutions remains a priority, too. And the IFC is looking beyond access to credit to other financial products.

In 2009, for example, it invested in Protecta, a Peruvian micro-insurance company that offers insurance services to low-income households and small businesses.

"Whether you're a small entrepreneur in a slum or a multinational," argues Mr Thunell, "the big opportunity is going to be in domestic consumption in emerging markets."

Five on the shortlist for Bank of the Year

These descriptions of the five institutions on the shortlist for the 2010 Sustainable Bank of the Year are based on information provided by them ahead of tonight's awards dinner in London.

It is testament to **Co-operative Financial Services**' approach to sustainability that, in a time of unprecedented economic turmoil, the business has continued to deliver strong profitability, growth and ethical leadership. This performance reflects a truly embedded approach to sustainability and nearly 20 years at the forefront of the provision of ethical finance and responsible investment. In line with its customers' concerns, the bank has declined more than £1bn of finance that could not meet its ethical policy criteria. At the same time, following its merger with Britannia, it has increased its lending to more than £8bn, including support for renewable technology and the provision of social investment and microfinance.

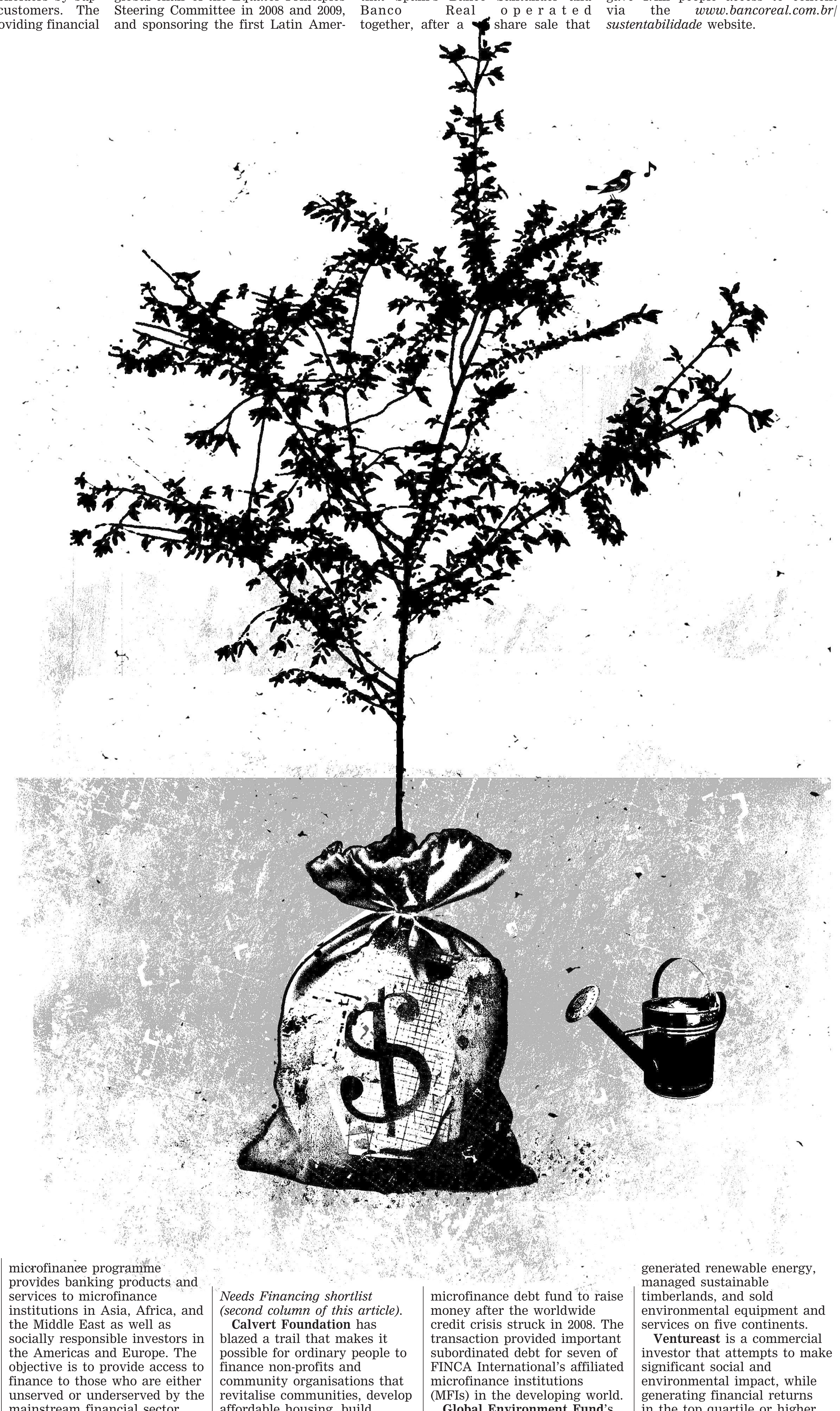
The objective of **GLS Bank**, established in 1974 as the first social and ecological universal bank worldwide, is to invest capital in a meaningful and profitable way. The key factors for the enormous growth and success of GLS Bank (33 per cent growth in total assets in 2009) are its focus on providing finance for the real economy and a concept based on sustainability, trust and transparency. GLS Bank offers the broadest range of sustainable products in Germany, extending from current accounts through financing, investments, securities and investment funds to opportunities for endowment and gifting. It invests its customers' money exclusively in commercially, ecologically, socially and economically meaningful companies and projects.

As a leading international and emerging markets bank, **HSBC** is especially aware of its responsibility to manage its business across the world for the long term by making a real contribution to social and economic development, and by protecting the environment in which it operates. This means maintaining its financial strength, so that it can continue to deliver value to shareholders by supporting its 100m customers. The group's focus is on providing financial services that are competitive, transparent and responsive to customer needs. Marking one of the largest clean technology investments in history, HSBC recently put $125m into Better Place, a leading provider of infrastructure for recharging electric vehicles on a large scale.

For Brazil's **Itaú Unibanco,** sustainability means ensuring the sustainable performance of its businesses, with a principal focus on customer satisfaction and creating value in the short, medium and long term for shareholders, clients and society. Its commitment is strengthened through its partnerships, including serving as global chair of the Equator Principles Steering Committee in 2008 and 2009, and sponsoring the first Latin America implementation of the Carbon Disclosure Project. Its sustainability strategy criss-crosses all its business areas and governance levels, and employs formal sustainability management instruments. Its sustainability policy has been instituted throughout the bank, allowing it to maintain an ethical and transparent interaction with clients, employees, shareholders, investors, suppliers, business partners and the general public.

Banco Santander Brasil underwent a huge transformation in 2009, establishing sustainability as a guideline for business and as the driving force for its growth. This was the first year that Spain's Banco Santander and Banco Real operated together, after a share sale that resulted in Santander becoming the third largest private bank in Brazil. In the midst of this merger and the impact of the financial crisis, the bank invested heavily in sustainability, spreading its use to processes, products and stakeholders. One of the most noteworthy initiatives was the training on sustainability undertaken by almost 37,000 employees from the retail area, to ensure that all product offers are made in a sustainable manner. Another important activity was the new stakeholders' engagement programme, which trained 1,451 executives from 863 client and provider companies in sustainability, and gave 1.4m people access to content via the *www.bancoreal.com.br/sustentabilidade* website.

Contenders in the four other award categories



These descriptions are based on information provided by the institutions on the shortlist for the 2010 Sustainable Emerging Markets Bank of the Year, Achievement in Basic Needs Financing, Banking at the Base of the Pyramid and Sustainable Investor of the Year awards ahead of tonight's awards dinner in London.

Sustainable Emerging Markets Bank of the Year

Africa/Middle East

The recent adoption by Morocco's **BMCE Bank** of the Equator Principles highlights its commitment to sustainable development. The bank recognises that the challenges it faces are better dealt with not only by giving back to the community and environment, but by incorporating such considerations into its methods of doing business.

Equity Bank (EBL) of Kenya has developed a successful sustainability-focused hybrid of a microfinance institution and commercial bank that provides banking services to the previously unbanked in Kenya. This has been achieved with a tailored distribution and innovative customer service strategy that empowers its customers both socially and economically.

Nedbank Group's sustainability strategy brings together economic, environmental, social and cultural concerns. In 2009, Nedbank became the first South African bank to commit itself to carbon neutrality. As a result of the sustainability initiatives undertaken over the past five years, Nedbank Group finds itself more resilient and adaptable.

Asia

BRAC Bank's goal is to provide banking services to the underserved population of Bangladesh by intermediating funds from urban to rural areas. The majority of its financing is to the SME sector with the aim of assisting economic development. In so doing, BBL has generated employment for more than 1m people and contributed to economic welfare by enhancing the standard of living.

China's **Industrial Bank**, based in Fuzhou City, Fujian Province, has incorporated the concept of sustainability into its strategy and corporate governance. The bank has gradually evolved a sustainable development pattern with its own characteristics, applying social responsibility to the provision of services and expansion of its business.

YES Bank, a private sector Indian bank, caters to the "future businesses of India", and is an outcome of the commitment of its founder, Rana Kapoor. Its focus on governance and good corporate citizenship forms an integral part of its strategic vision. The bank's sustainability strategy works on two levels – Sustainability in Thought and Sustainability in Action.

Eastern Europe

Raiffeisenbank (Bulgaria) supports individuals' efforts to cut down energy consumption significantly and to improve energy efficiency. Access to financing and job creation for SMEs, farmers and entrepreneurs was provided last year under two European Bank for Reconstruction and Development (EBRD) Rural Credit Lines.

The **RZB Group's** central and eastern Europe (CEE) sustainability strategy is built on a long-term commitment to the region. It has adopted a strong focus on financing renewable energy projects. The group's decentralised structure and corporate responsibility strategy are founded on the three core challenges associated with regional sustainability in the region – environment; society; and economic sustainability.

Industrial Development Bank of Turkey (TSKB) is a pioneer in renewable energy corporate lending and project financing. In the areas of environmental and renewable energy loans, TSKB has completed the largest number of projects in Turkey. It is the first Turkish bank to be certified with the ISO 14001 environmental management system standard.

Latin America

Social and environmental responsibility has always been present in **Banco do Brasil's** policies and strategies. It made new national and international commitments in 2009, such as membership of Platform Business Climate and the UN Caring for Climate initiative. These are consolidated in BB Agenda 21, which guides the actions of the bank in sustainable management.

For **Itaú Unibanco** *and* **Banco Santander Brasil**, *see entries in the Bank of the Year article.*

Achievement in Basic Needs Financing

Acumen Fund uses entrepreneurial approaches to help solve the problems of global poverty. It seeks to prove that small amounts of philanthropic capital, combined with large doses of business acumen, can build thriving enterprises that serve vast numbers of the poor. The fund believes that pioneering entrepreneurs will ultimately find the solutions to poverty.

Banco de Galicia y Buenos Aires is the only financial entity in Argentina that has adopted the Equator Principles and is ISO 9001 and 14001 certified. Financing of basic needs accounts for more than half of the total lending portfolio. Activities have expanded significantly to reach unbanked segments without lowering risk standards.

Mahindra & Mahindra Financial Services is India's leading non-banking finance company (NBFC) focused on rural and semi-urban areas and is the largest rural NBFC, with a reach that extends beyond its 450 branches. The business model is based on the foundations of social inclusiveness, which serves "bottom of pyramid" customers.

One Acre Fund empowers hungry farming families in east Africa to pull themselves out of poverty. Its innovative approach to lending and repayment helps smallholder farmers double their farm income and increase their food security. The One Acre Fund "market bundle" includes seed and fertiliser on credit and market facilitation.

Scotiabank Peru has strengthened its consumer and microfinance presence with the acquisition of Banco de Trabajo and the launch last year of a specialised channel for microbusiness and consumer finance. This reaches the lowest socio-economic groups and those excluded from the banking system. Corporate social responsibility is fundamental to Scotiabank Peru's business.

Banking at the Base of the Pyramid

Financial Information Network and Operations (FINO) provides small loan products to the entrepreneurial poor in India. These are aimed at people who have no access to formal financial services. The target customers are mainly local fruit and vegetable vendors, street hawkers and subsistence dairy farmers.

Five Talents, a UK registered charity, has played a key role in delivering an innovative "holistic" microfinance pilot project in the village of Lietnhom, southern Sudan, assisting post-conflict transformational development. The project combines training in basic literacy with business skills development, savings mobilisation and the provision of microcredit.

MAP International exploits the latest mobile technologies to enable financial inclusion for the unbanked and underbanked citizens of emerging market countries. It enables governments to deploy the most technologically advanced financial systems for very limited upfront costs, and creates biometric bank debit-ID cards for people in even the most remote areas.

MicroEnsure is an insurance intermediary dedicated to serving the poor throughout the developing world. It serves around 3.5m people with an affordable range of products including life, property, health and weather index based insurance. MicroEnsure's aim is to achieve sustainability for insurance companies, product distributors, and clients.

Standard Chartered's microfinance programme provides banking products and services to microfinance institutions in Asia, Africa, and the Middle East as well as socially responsible investors in the Americas and Europe. The objective is to provide access to finance to those who are either unserved or underserved by the mainstream financial sector.

Sustainable Investor of the Year

Acumen Fund, US – *see entry in the Achievement in Basic Needs Financing shortlist (second column of this article).*

Calvert Foundation has blazed a trail that makes it possible for ordinary people to finance non-profits and community organisations that revitalise communities, develop affordable housing, build micro- and small growing businesses, support Fair Trade farming, further environmental sustainability, and more.

On November 10, 2009, the **FINCA Fund** became the first microfinance debt fund to raise money after the worldwide credit crisis struck in 2008. The transaction provided important subordinated debt for seven of FINCA International's affiliated microfinance institutions (MFIs) in the developing world.

Global Environment Fund's portfolios delivered strong liquidity in 2009. GEF companies also provided greater environmental, social and economic development benefits than ever. They generated renewable energy, managed sustainable timberlands, and sold environmental equipment and services on five continents.

Ventureast is a commercial investor that attempts to make significant social and environmental impact, while generating financial returns in the top quartile or higher. Its investing approach is to enter segments where there is little competition, which leads it to underserved markets such as the rural and digital-divide segments.

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Concept pushes its way on to boardroom agenda

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economic function that the world wants banks to fulfil – whether that be in the form of microfinance in emerging markets or large-scale lending to big business – and the allure of more obscure, higher-profit activity.

"The socially useful stuff," says Michael Raffan, partner at lawyers Freshfields Bruckhaus Deringer, "tends to be low-margin".

Undeterred, regulators and policymakers are poised to make deep-seated reforms to the potential profit of high-risk activity – by forcing banks to hold more capital and liquid funds, and imposing new bank taxes – as well as overhauling the structure of the sector.

In the US, President Barack Obama may yet force through a significant clampdown on the riskiest Wall Street activities, despite stiff Republican opposition.

In the UK, the coalition government led by Prime Minister David Cameron of the Conservatives, and his deputy Nick Clegg, of the Liberal Democrats, has promised root-and-branch reform of the structure of banking.

Big universal banks, embracing retail banking and higher-risk investment banking, could be broken up. Some analysts have predicted that if all the initiatives under consideration were implemented, ROE could fall below 10 per cent.

> Banks should be basic providers of reasonably priced credit, according to politicians

All the while, politicians on both sides of the Atlantic have latched on to one of the core principles of sustainable banking – that banks should be basic providers of reasonably priced credit to the economy, and especially to small businesses, particularly in sectors such as renewable energy and food production that are essential to the long-term health of the planet.

With governments in countries from Germany and the UK to Ireland and the US at least part-owners of big banks, politicians feel they have a unique opportunity to ensure the "social usefulness" Lord Turner spoke of is put into practice.

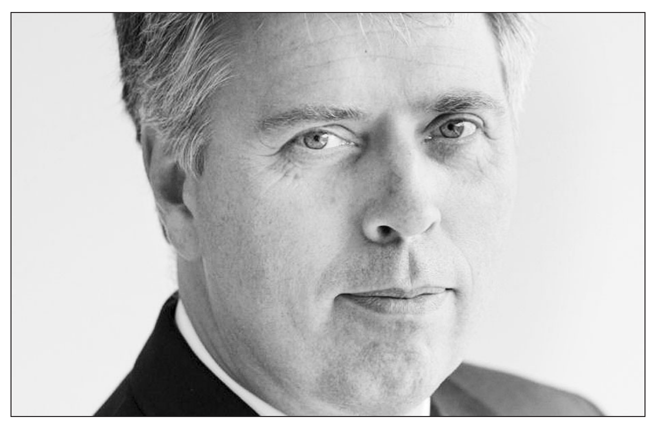
Over the past year, bank lending targets set by governments have been missed, but bankers insist that there are technical reasons for this and that their underlying principles have changed.

So far, that claim has struck no chord with the broader population.

"How are banks going to respond to their pariah status?" asks Mr Raffan. "They've got a good story to tell, but they haven't been as effective at lobbying as they could have been."

Quite how good the story is, some doubt – at least when it comes to hard-core sustainable values in the short term.

For every example of forward thinking – witness Bank of America Merrill Lynch's new high-technology, high-efficiency headquarters in Manhattan – there are discouraging trends, such as RBS's move away from renewable energy financing, as it shrinks its bloated balance sheet.



Peter Blom of Triodos: banks 'not thinking about ethics'

"Before the financial crisis," says Triodos's Mr Blom, "mainstream banking was looking at sustainable banking quite seriously.

"But the crisis has brought many banks back to existential questions and they haven't had time to think about ethics."

Banks 'failing to give credit where it's due'

Small business

Lenders are being urged to be more understanding, writes **Jane Bird**

When Phillip Hofmeyr and his colleague Alex Moore needed £100,000 to set up Snagsta, a social recommendation website, their first thought was a bank loan. But the bank was discouraging and wanted personal guarantees.

"We didn't want to put our homes on the line or pay premium interest rates, so in the end we raised the money from friends and family," Mr Hofmeyr says.

That was in 2007. Since then, banks have received huge financial support from governments which, in return, have asked them to provide more loans to small businesses.

But this has not happened, as Mr Moore's subsequent experience demonstrates. In 2008, he opened two Thai restaurants in London. In mid-2009, after the first year of trading, he applied for a £1,000 overdraft with his bank, HSBC. "We were told we were ineligible," he says.

"This baffled us. The restaurants were doing well, turning over more than £500,000 a year, and set to make a healthy profit."

The bank classified restaurants as "high risk" – a customer category to which it heavily restricts credit. "I was surprised the bank adopted such a uniform approach rather than operating on a case-by case basis," says Mr Moore.

Sharon Vosmek of Astia: banks need to be more patient in early years

Mark Littlewood, founder of the Business Leaders Network, which connects entrepreneurs, investors and advisers, says it is naive of governments to think they can force banks to make loans. "Banks might say they are complying, but they only need to change the terms in a small way to make the loans unacceptable."

One problem is banks' blanket approach and failure to research the business model of individual companies. Banks seem unaware of the funding gap that small businesses experience between start-up and when they are ready to go to venture capitalists for £2m, Mr Littlewood says.

Nor do they understand that many new ventures have non-traditional revenue models. Internet businesses may need hefty initial investment in technology, and depend on advertising and co-marketing deals for revenue rather than on paying customers.

Traditional bank managers also struggle to appreciate that even small high-technology businesses may have staff around the world, or assets in the form of intellectual capital.

Banks in the US are more used to considering these factors, along with management expertise, when deciding to offer loans, says Phil Cox, head of strategy for Europe and the Middle East at Silicon Valley Bank, which provided Twitter with its first chequebook.

European banks have more of a penny-pinching attitude to small businesses and less understanding of entrepreneurs, says Mr Cox. "Often, even when a bank has agreed a loan, this will be drip fed, so the company is continuously under a cloud and wondering where its next tranche of funding will come from."

Banks also often fail to accommodate companies with high growth plans. A small company might sign a lucrative contract with a big customer, under which payment will not arrive for several months, says Sharon Vosmek, chief executive of California-based Astia, an organisation that is focused on women entrepreneurs. "Meanwhile, working capital is needed to meet the payroll."

Many rapidly expanding new businesses are not even given the option of an overdraft or extended credit with high interest rates, says Ms Vosmek. "The bank simply won't recognise that there is any value in a business that hasn't been established for a long time. We need more banks that understand the first one or two years."

The problem is that banks are being put under the political spotlight and asked tough questions about their risk and exposure. This makes them defensive and risk-averse.

Banks are being told to reveal all their secrets about how bad things can get, says Mr Littlewood. "With credits and loans, they go through a process of box ticking, but there is very little creativity or contact between people making decisions and managers dealing with clients."

Lithuania is trying to solve this problem by making available the European Structural Funds it has received as a European Union accession country for use as preferential loans for small businesses.

Mykolas Majauskas, senior economy adviser to Lithuania's prime minister, says: "Small businesses, which are often early stage and without a track record, pose a risk for banks but have a greater propensity to grow."

Under the scheme, entrepreneurs face less red tape setting up businesses and securing loans, and can close businesses down more easily. This makes banks more comfortable that they will be able to get their money out before it has all been swallowed up by lengthy court proceedings.

Lithuania is also making small businesses exempt from VAT and subject to corporation tax of just 5 to 7 per cent.

"Government can't make banks lend their money or force them to finance a company that doesn't fit their risk profile," says Mr Majauskas. "So we have to create an environment with incentives."

Sowing the seeds of success: a Tanzanian woman farmer working in her cornfield David Dorey/Alamy

Helping farmers reap rewards

Food & microfinance

Sarah Murray on new ways to address the issues facing smallholders

In a new strategy to reduce reliance on food aid in the fight against hunger, the US Agency for International Development (USAid) plans to make investments to develop agriculture.

Smallholders using microloans will play a role in this. However, many microfinance and development experts argue that credit is not the only thing these farmers need.

Certainly, microfinance underpins rural economies. "Microfinance is the lubricating system for smallholder farmers," says John Magnay, the agricultural adviser for Opportunity International, one of the world's largest and longest established microfinance institutions.

"Unless they can get access to inputs and finance the production and marketing cycle, they will not be able to produce at optimum levels," he adds.

Banks and microfinance institutions are not the only organisations that support smallholders in their efforts to become more productive. Through contract farming arrangements, suppliers have the potential to extend credit to the smallholders in their supply chains.

"Large suppliers or food processors can clearly link to small farmers and provide them with access to inputs through loans, as a way to get the quality and standards of produce they need," says Maximo Torero, director of the markets, trade, and institutions division at the Washington-based International Food Policy Research Institute.

However, Mr Torero says that greater innovations in contract design are needed to discourage farmers from breaking the contract.

The "group lending" microfinance model pioneered by Grameen Bank in Bangladesh – where if one individual fails to repay, the others in the group are held responsible – could be one way forward.

"Instead of lending to one small farmer, [the company] can lend to a rural producer association for which all members are responsible," he says. "Another way is for the large supplier or food processor to give a warranty to financial institutions so they take higher risks in giving loans to smallholders."

Mary Ellen Iskenderian, chief executive of Women's World Banking and a member of the judging panel for this year's FT Sustainable Banking Awards, sees a far greater role for smallholders in the global agricultural supply chain.

"One important reason that potential hasn't been filled is that the majority of smallholder farmers in the developing world are women," she says.

For women, difficulties in securing property title and land rights are often the biggest obstacle to getting funding and being able to pay for the agricultural inputs they need.

So Women's World Banking encourages the microfinance institutions that are its clients to use things such as household cash flow as the basis for making loans.

Mr Torero also believes lenders need to simplify their processes, with simple credit scoring systems and risk databases to reduce the costs of applying for a loan. "There is a clear need for financial institutions to simplify their credit scoring mechanisms and to adapt their lending plans to what smallholders need," he says.

Meanwhile, many microfinance institutions and non-governmental organisations are starting to package loans with other financial products, such as insurance and savings schemes, as well as education and training programmes.

In Kenya, for example, the One Acre Fund – shortlisted for the Achievement in Basic Needs Financing award – describes its services to poor farmers as a "market bundle".

The bundle brings together farmers to make it easier to gain access to agricultural markets and then provides them with training and supplies of environmentally sustainable fertilisers. It acts as a bulk-selling agent for the farmers and also offers them crop insurance.

Meanwhile, in Malawi, Opportunity International combines microloans with savings accounts and weather insurance products. It also has a programme called the Total Farm Plan, which finances the crops produced for household food, releasing land for cash crops.

"We're also encouraging farmers to plant trees," says Mr Magnay. "So, in seven or eight years, they will have household fuel wood and timber to sell."

Risk management, through micro-insurance, is also being seen as an increasingly important element of what is needed by poor farmers. Like any agricultural business, smallholders face risks such as catastrophic loss from extreme weather, as well as damage to expensive farm equipment.

The challenge for banks or microfinance institutions is that, when it comes to the poorest farmers, administering weather-related insurance for crops and livestock is expensive when the premiums are so low and the cost of assessing the value of individual losses and incidences of fraud is so high.

> The poorest farmers are also those in greatest need of risk management tools

Yet the poorest farmers are also those in greatest need of risk management tools. "There is a correlation between risk-aversion and poverty," says Jim Roth, a partner at LeapFrog Investments, a social investment fund focusing on businesses that provide micro-insurance. "The poorer you are, the more risk-averse you'll be, because the consequence of getting it wrong could be the starvation of you and your family."

One solution is to bundle crop and other agricultural insurance with other microfinance products, something being offered through Global Index Insurance Facility (GIIF) by the International Finance Corporation and the International Bank for Reconstruction and Development (*see box*).

Mr Torero says: "Linking financial services to access to weather insurance could help, as this will reduce farmers' risks and at the same time reduce the probability of defaulting on a loan."

Another innovative way of offering low-cost agricultural insurance – also being used by the GIIF – is through index-based products. Insurers pay out – not on the basis of actual loss – but on when rainfall rises above or falls below a certain level.

In the case of livestock, the payments would be triggered when the average weather-related loss of livestock in a region rises above a certain percentage of the overall herd.

"There are a lot of experiments going on in index-based insurance," says Mr Roth. "It has a huge amount of scope because it can hugely reduce the cost of managing it, compared with crop and animal insurance."

Some initiatives are addressing climate change. MicroEnsure, the insurance agency of Opportunity International and one of the shortlisted organisations for the Banking at the Base of the Pyramid award, is working with the United Nations through the Munich Climate Insurance Initiative to create a $5bn climate change insurance plan.

This will cover people in developing countries who are facing increased incidences of climate-related flooding, drought and other extreme weather events.

These experiments in micro-insurance for smallholders come at a critical time, as the risks that farmers face are likely to rise sharply with the effects of climate change.

Meanwhile, because many poor countries – particularly in Africa – are still net importers of food, the need to expand domestic food production and facilitate global food trade is growing.

Ensuring food security means helping farmers in developing countries not only to feed themselves and their communities, but to contribute to the international supply chain.

Ms Iskenderian argues that, equipped with the right financial and other tools, smallholders can indeed contribute more.

Where women farmers do finally get ownership of the land, increases in productivity can exceed 25 per cent, she says. "So it's a question of unleashing the potential that's manifestly there."

Profile Global Index Insurance Facility

By combining financing with index-based weather insurance, a partnership of development banks is offering financial packages to cover low-income farmers against the catastrophic events, such as floods or droughts, that can wipe out their livelihoods.

"We're trying to put insurance packages together for farmers," says Lars Thunell, chief executive of the International Finance Corporation, the private sector arm of the World Bank. The IFC, along with its sister organisation, the International Bank for Reconstruction and Development, is backing the new Global Index Insurance Facility.

"It's too expensive to do it on a case-by-case basis," says Mr Thunell. "But if you build it into another product and create a package, then it works."

The scheme has been piloted in India, Malawi and Mongolia. In Malawi, for example, small-scale peanut farmers can buy drought insurance when they obtain loans for high-yield seeds. If rainfall falls below historic averages, the farmers receive pay-outs.

Similarly, in Mongolia – where severe winters decimate animal herds – an indexed livestock insurance product pays farmers if the annual mortality rate is above average.

Administering the insurance is cheaper and easier because pay-outs are not based on the destruction of specific farm crops or animals, which would have to be checked individually. Policyholders qualify for pay-outs as soon as the statistical indexes are triggered, rather than having to wait for claims to be settled.

Moreover, the insurance is easier to market and administer because it is part of a broader financial package. Farmers gradually repay the loan. But if their business is hit by a drought or a storm, they are covered against the loss.

"In my world, if you have a mortgage, you have built into it life insurance so that if you die your family can pay off the mortgage," says Mr Thunell. "So why not use the same principle with index-based weather insurance and farm financing?"

Sarah Murray

Bank regulation – don't just rage against the machine

OPINION
LEO JOHNSON

There is a life affirming YouTube video clip of a middle-aged man at work in his office. His computer is not working, so he smacks the monitor around a bit, just as a shot across the bows. Then – lightning fast for a big man – he slams his fists on the keyboard and uses it as a cudgel to sideswipe the monitor and hard drive on to the floor. To the sound of the slow off-screen disintegration of the keyboard, his colleagues return to work.

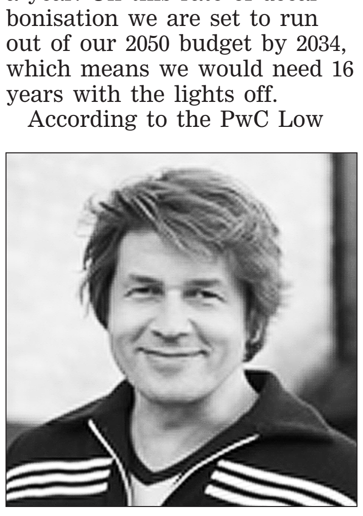
Is there something of a parallel with our current approach to bank regulation? Are we about to mirror the universal but tragic three-act structure of computer rage? Act 1, you realise the machine is not working. Act 2, you express your frustration as systematically as possible (windfall taxes on bonuses, constraints on capital adequacy, Tobin taxes, fiscal responsibility fees, bank breakups etc.). Act 3, at your leisure, you realise it now really does not work, and you sort of needed it.

Not with banks, runs the current orthodoxy – after all, what was their social utility? But let's take the challenge of climate change as a test case. What is the scale of the task and is there a role for the financial sector?

Forget the doom-mongers. of the eco-death cult. If, in 2000, we had started to meet the global target of 80 per cent reduction in emissions by 2050, all we would have needed to have achieved, even with population and global growth projections factored in, was an annual increase in our carbon efficiency of 2 per cent. A piece of cake – but what did we manage? Just 0.8 per cent, or less than half.

The result is that we have gone over our carbon budget. We have accumulated a 13.4 gigatonne (billion tonne) carbon surplus. To get back on track China and the US would have to turn off their lights for a year. On this rate of decarbonisation we are set to run out of our 2050 budget by 2034, which means we would need 16 years with the lights off.

According to the PwC Low Carbon Economy Index, the rate of decarbonisation needed to get back on track is now 3.4 per cent a year, more than four times current progress. But is it doable? Two cases stand out – Russia, which at a time of recession averaged 7 per cent year-on-year decarbonisation, and China, which at a time of growth, from 1990 to 2008, averaged 4 per cent a year. The target of 3.4 per cent, in other words, is doable. The technologies exist, from nuclear to carbon capture and storage (CCS) to offshore wind. The precedent exists for implementing them. But there is one critical barrier – finance.



Johnson: forget doom-mongers

The International Energy Agency puts the global funding requirement for this transition at around $430bn a year above business as usual from now until 2020, and $1,150bn a year from then until 2050. The investments these funds would need to finance include 18,000 additional 3MW windmills and – each year – 20 nuclear plants, 300 concentrated solar power plants and 50 hydro power plants; also, 30 per cent of coal-fired power plants would need to be fitted with CCS technology by 2030.

Unfortunately, when confronted with this task at the United Nations climate summit in Copenhagen last December, public finance delivered only a three-year commitment for emerging markets, totalling just under $10bn a year. About 2 per cent, in other words, of the annual total required. It is up to the architecture of the private sector financial markets to deliver the remaining 98 per cent.

This, then, is one example of the potential social utility of the financial sector – driving the transition to the low carbon economy. But how, in a year in which capital has been so visibly allocated to value distribution not creation, do we make it happen?

The answer is in part to do what the man in the YouTube video did not do – to look inside the machine before destroying it, and diagnose and solve the underlying problem. Banks, at one level, can be seen as morally neutral instruments, designed to discharge capital as efficiently as possible from point A where the return is low, to point B where the return is higher. The reality is that the current economic framework provides a triple whammy that prevents the rapid acceleration of capital into low carbon growth:

- The fossil fuel industry receives a direct subsidy of $340bn a year to keep energy prices low.
- It receives an indirect subsidy through avoiding the full cost of carbon.
- It benefits from an entrenchment effect – the first-mover advantage and economies of scale from its distribution networks.

These three distortions combined reduce the low carbon economy's returns and its attractiveness to capital.

There is a politically satisfying short-term policy option available – to hammer the banks. There is also a more radical option – to address the central market failings that shape banks' decisions about capital allocation. This makes it necessary to reduce the fuel subsidy, capture the cost of carbon through green taxation, and plough the receipts back to create jobs, growth and additional tax revenue in a green economy that can then be financed at scale.

Leo Johnson is a partner, PwC Sustainability & Climate Change, and technical adviser to the FT Sustainable Banking Awards.

Best step forward to cut carbon footprint

Energy efficiency

Banks are seeing the light on reducing their consumption, writes **Rod Newing**

Who left those lights on? Office buildings left illuminated at night leave environmental campaigners fuming

dreamstime

A glance at the skylines of Wall Street and the City of London leaves green campaigners fuming, as lights routinely blaze through the night. With their reputations already dented, this suggests that some of the world's biggest financial institutions care little for energy efficiency or public opinion.

Nevertheless, the move towards carbon reduction, which started as a compliance issue for most banks, is developing into a strategic business opportunity for some of the more enlightened ones.

Francis Sullivan, deputy head of corporate sustainability at HSBC, says: "If we can measure, manage and reduce our own direct impact, we can help clients with both the financial and environmental aspects of their investment strategies."

"We can position ourselves as the bank of choice for the climate change business, which is now the same size as the global aerospace industry. We want to be number one in that sector – and if we don't do it ourselves, we have no credibility."

Banks must reduce their energy consumption, switch as much as possible to renewable sources, reduce business travel and then offset the balance.

Hugh Jones, director for solutions at the Carbon Trust, which works to accelerate the move to a low-carbon economy, says: "Financial institutions estimate that data centres account for 40 per cent of their energy bill. To run an energy-efficient data centre a number of factors need to be optimised, including server utilisation, hardware, utilities, supporting infrastructure and the design of the building itself."

According to Klaus Kämpf, from the sustainable research team at Sarasin, a Swiss private bank, most easy-to-implement and cost-efficient measures have been implemented. "We do not observe many changes in 'behavioural' aspects, such as travel policies, which are influenced by business development and cost considerations, not by awareness of carbon footprint," he says. "The effect of videoconferencing for substituting travel is generally overestimated. Further steps require more investment and effort."

For instance, Deutsche Bank has invested €200m in its Frankfurt head office, Europe's largest building renovation. "Greentowers" will become one of the most environmentally friendly skyscrapers in the world, reducing heating energy by 67 per cent, electrical power by 55 per cent, water use by 74 per cent and carbon dioxide emissions by 89 per cent.

Three years ago, Bank of America announced its intention to invest $20bn over 10 years to address climate change. It had committed more than $5.9bn by the end of 2009. The Bank of America Tower in Manhattan is the first high-rise commercial office building to attain platinum rating under the Leadership in Energy and Environmental Design (Leed) certification system, developed by the US Green Building Council.

HSBC has been carbon-neutral since 2005. In 2009 it emitted 991,000 tonnes of CO_2, 3.8 per cent less than the previous year. Its 10,000 buildings and 170 data centres accounted for 87 per cent of the total, with the remaining 13 per cent coming from business travel. The bank offset this by buying verified emission reductions on the international market.

Bill Thomas, group head of sustainability for HSBC Technology & Services, says that whereas emissions from buildings are reducing, computer use is increasing. A data centre uses 40 times more energy per square metre than a normal office building, and he expects this to double to 80 times over the next two years.

"There is no single thing that will make the efficiency numbers look better, just a lot of little things done a lot of times," he says. "We build new buildings to the highest possible standard, but we still have to work hard to keep them tuned and efficient."

Mr Thomas is angry when he sees other buildings lit overnight, and says another easy action is to encourage employees to turn off their desktop computers when they go home. This brought a saving for HSBC worldwide of 7.3m kWh of electricity and 3.1m kg of CO_2 emissions in 2009. "It is almost free money for the taking," he says.

> 'A big trend among many banks is to require more than just financial viability to approve a loan'

Jon Williams, a partner at PwC, who heads the finance sector sustainability and climate change, points out that the banking industry's direct environmental impacts are modest, compared with other sectors. The problem is that they lend to, and invest in, highly energy-intensive industries.

"They are part of the finance supply chain that enables impactful infrastructure to be built," he says. "They can also help to move capital into renewable energy. If they don't get their own house in order to 'walk the talk', they will have absolutely no credibility to influence their customers, which ultimately could mean withdrawing a loan."

Chris Stubbs, a director at WSP Environment & Energy, a consultancy, says a bank's direct carbon footprint is dwarfed by the projects it funds. "A big trend among many banks is to require more than just financial viability to approve a loan," he says.

"For example, The Co-operative Bank in some cases requires assurances that specific projects will be energy-efficient before it will lend, particularly in developing countries. The World Bank requires that banks record the sustainability parameters of the projects they invest in, so that banking can be described as sustainable throughout."

Banks can also influence customers through specially designed products. For instance, HSBC conducts green equipment financing from Hong Kong. It lends to smaller companies to buy low-energy equipment for factories in mainland China. Mr Williams suggests there could be a huge opportunity for banks to set up service companies with energy suppliers to provide energy-efficient equipment for their clients.

"Increasingly investors are seeking to benefit from direct investment opportunities into the rapidly growing areas of alternative energy and emissions trading," says Mr Jones at the Carbon Trust. "This growth is due to factors linked to climate change policy, such as subsidies for renewable energy investment or generation."

Mr Sullivan says that, although HSBC looks at the energy intensity of large projects, there is currently no consistent framework to account for it. The bank is working with the Equator Principles, the "gold standard" for sustainable project finance.

"We can help our clients to step up to the plate and participate in the low carbon economy," he concludes. "We have to demonstrate that we can manage our environmental footprint effectively if we are going to have any credibility in offering them sustainable financial services."

Sector seeks bonus points from increased donations

Banks and charities

Mike Scott on the pros and cons of giving more money to good causes

The banking industry has not just taken a pummelling financially as a result of the events of the past few years, it has also lost much of the trust and confidence of the general public.

People perceive the industry to be made up of grasping money-grubbers who are paid huge bonuses that they do not deserve.

This has led to a situation where "there is a strong public sense that the business world and the financial community in particular have abandoned values and ethical behaviour," says Richard Spencer, head of sustainability at the Institute of Chartered Accountants of England and Wales.

One of the industry's responses to the wave of opprobrium that has broken over its head has been to boost the amount it gives to charity, either as cash grants from organisations or in the form of bonuses donated by chief executives – or in terms of manpower.

Neville White, senior analyst at Ecclesiastical Investment Management, notes that "community investment by the four big UK banks increased in 2009-10 when it might have been expected to fall, with in excess of £210m being reported."

Nick Anstee, Lord Mayor of London, points out that the number of corporate volunteers in the City rose 24 per cent in 2009.

However, he recognises the sector has further to go in repairing the image of bankers. "We have to explain the industry can be a force for good rather than a force for evil," he says.

There is some doubt as to whether giving more money to charity will help achieve this aim. "A programme of social giving just treats us like idiots," Mr Spencer says. "Many people will see it as guilt money."

"Many of them are trying to redeem their sin," agrees Ros Haniffa, professor of accounting at Bradford University. "It is important to distinguish between short-term or one-off donations and giving that is part of a corporate strategy."

Banks need to leverage their expertise and capabilities rather than just throw money at an issue, says Sophie Hughes, head of sustainability at consultants Fleishmann Hillard. If it is done right, community investing can play a role in rebuilding trust, she says.

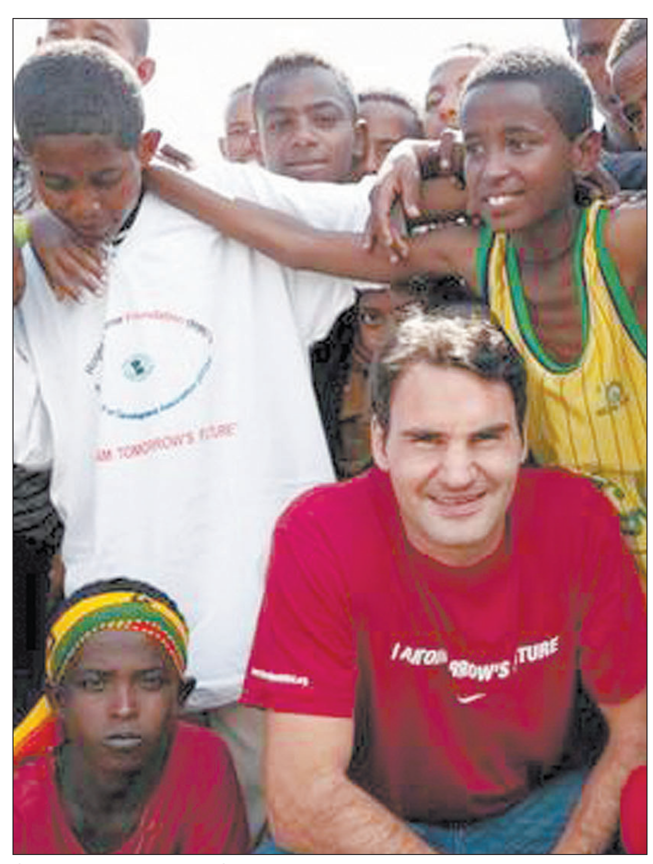
"It is about relationship-building, with employees and with the wider community," she explains.

However, Christoph Ammann, chairman of Bank Sarasin of Switzerland, says: "We do not believe that charitable donations are appropriate to rebuild trust in banks." The bank does give to a number of charities, including the Roger Federer Foundation. However, "charitable donations are not the cornerstone of Sarasin's commitment to being a sustainable bank. Trust cannot be purchased, but has to be gained on a day-to-day basis when delivering on commitments to clients and the public."

> 'A programme of social giving just treats us like idiots. Many will see it as guilt money'

HSBC says a thriving society is critical to its success. "That is why we focus our community investment activity on education and the environment – the fundamental building blocks for the development of communities," it says.

One example of this is its funding of the HSBC Climate Partnership, which gave £100m to a group of non-governmental organisation (NGOs) – WWF, The Climate Group, Earthwatch and the Smithsonian Tropical Research Institute.



Switzerland's Bank Sarasin donates to the Roger Federer Foundation, but says trust cannot be purchased

"This is a real partnership, not something that has been bolted together hurriedly," says Bjorn Roberts, corporate partnership manager at the Climate Group. "Each of the partners is tasked with delivering aspects of the partnership over five years and it fits in with HSBC's wider corporate focus on the business implications of climate change."

Trewin Restorick, chief executive of Global Action Plan, an environmental charity, says he was surprised to be approached about a partnership with Bank of America based on teaching young people about climate change. However, "they had a clear idea of what they wanted to do as a business and where our work fits in to that. The motivation was about encouraging sustainable growth.

"If a company is going to invest in the community, the investment needs to have a connection to the business at some level for it to be completely engaged. It needs to be part of a longer-term strategy," he adds.

However, Mr White notes that "community investment reported by the two UK banks unaffected by state ownership (Barclays and HSBC) represented just 1.8 per cent and 0.75 per cent respectively of underlying pre-tax profits.

Some say that corporate giving is not an appropriate use of company resources. "Directors should not be giving away their shareholders' money," says Professor Brian Scott-Quinn, of the International Capital Markets Association Centre at Henley Business School.

"If shareholders have a duty to make donations, it should be funded out of dividend income in return for a cut in taxes. It is better to take these things out of the corporate arena and into the employee or shareholder arena."