



# CHANGING PARADIGMS: SUSTAINABILITY, THE DNA FOR FUTURE BANKING

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## Preamble

Banking and business paradigms in the recent past have dramatically evolved re-demarcating the competitive boundaries across the world. The term “Sustainability” has not merely become prominent, but rather has emerged as the most articulated word in the corporate world. “What about the sustainability?”, “Can we sustain?”, “Sustainability in value creation”, “Sustainable banks and companies” and “Challenges in Sustainability” are few of the jargons frequently heard from corporate board rooms and in brainstorming sessions.

This article deliberates the significance of the concept of sustainability for the banking industry and how sustainability is pivotal not only from the fundamental viewpoint but also from the perspectives of evolving and emerging arenas to gain competitive advantage for the banks to survive in the future. Analysis and revelations based on the author’s reviews and research have also been embedded in this article.

## Introduction

‘Banking’ is one of the key industries competing fiercely in the oligopoly market structure. The level of competition further aggravates in the industry, especially when the country’s economy is stagnant or engulfed in a quagmire as the potential for growth is hindered. Banks being the vehicle of the economy, striking a balance between the unconducive economic climate, inherent oligopolistic competition, and the growing demand from stakeholders is virtually a “Mission Impossible”. The positive factor is that the banks in Sri Lanka still enjoy a markup of at least 4%-5% over their cost of funds. On a broader scale, the global banks operating in developed countries enjoy negligible mark ups, mostly, less than one percent, which reflects the level of competition in such countries despite having developed financial markets and sound economic policies. Due to this level of unbelievable competition with negligible markups, such banks have purposefully adopted sustainability concepts not only to gain the competitive advantage but also to be congruent with the sustainability goals introduced by global bodies such as the United Nations (UN). Despite the stagnant economic situation in the local banking industry, Sri Lankan banks are yet to experience the real level of competition seen in the global banking arena.



## Changing paradigms

Though the situation is slowly changing, the Sri Lankan banking industry is still considered backward thinking, and the yearning to be innovative and to embrace new concepts to gain first mover advantage is perceived as risky. However, we witness in other countries that emerging technological trends, economic fluctuations, data accessibility and drastic and visible generational shifts have significantly changed the customers' behaviour and their needs. Customer interaction with a bank via a mobile channel occurs 20-30 times per month, while interactions in a branch occurs only 2-3 times per year. Modern customers demand convenient and personalized banking services with a high level of safety, security and digital acceleration.

Even though disruptive marketing and digital transformation are challenging the way banks promote their products and operate their core banking systems, it also offers several invisible yet significant opportunities for banks in the future. Banks with futuristic passion, strive to offer superior customer experiences and invite customers to locations where they wish to be met satisfying their total banking solutions through various channels. For instance, Singaporean banks offer a digital service with deep social integration and allow iGen to remit funds to Facebook friends or to their contacts through their mobile phones. "E-sustainability" is considered as another emerging arena where companies moving towards paperless organizations with virtual offices, with pruned costs, less space and right-sized manpower, while performing under an ecologically friendly atmosphere.

Though the changes related to technology have already taken place or are towards the end of the continuum, paradigm changes in sustainability have only just begun. Hence the potential and scope for sustainability measures are enormous.

## Sustainability, the future DNA

Sustainability is the new business imperative and the banks in the 21st century must consider operating for sustainable development. Subsequent to the introduction of the concept of Sustainable Development at the United Nations (UN) Conference in Rio De Janeiro in 1992, the "Triple Bottom Line" (TBL) concept was introduced by John Elkington in 1994, which reinforced that 03 "P"s namely the Profits, Planet and the People of the Triple Bottom Line (TBL), should aim to measure the economical, societal and ecological performance of a company over a period of time ascertaining the full cost involved in performing business. Based on this, Sustainability can be defined in simple terms as the ability to utilize the resources required to carry out business operations without jeopardizing the potential of these resources for the people of the future generations.

Due to gradually declining resources, global warming, deforestation, destruction of natural resources and major catastrophes such as British Petroleum (BP) oil leakage in the Gulf of Mexico, the focus on sustainability became three dimensional, namely the economical, societal and ecological. From 2000 to about 2010, banks and companies across the world included pages



and pages of written articles in their annual reports and all other official websites and documents on how such companies and banks do adhere to the accepted sustainable concepts, simply to convince and sometimes even to mislead the investors and the stakeholders. However after 2013, with the pressure from the global regulating bodies such as the UN, demand and awareness created by the global buyers, and the increased concern of governments, Sustainability was made a mandatory compliance by the regulators, especially for Multinationals and Listed Companies.

## **GRI and Sustainability**

The Global Reporting Initiatives (GRI) was formed in collaboration with the United Nations Environment Programme (UNEP) as part of its strategy to enhance and promote sustainability across the world. While traditional financial statements focused on the financial performance of an organization, the GRI guidelines on reporting outline the requirement to disclose all material matters pertaining to all types of capitals that are affected by and can affect the business operations, namely, Financial Capital, Human Capital, Intellectual Capital, Manufactured Capital, Societal and Relationship Capital and Natural Capital. Sustainability Accounting practices have been considered to play a pivotal role as it can facilitate the implementation of the sustainability strategy, incorporating sustainability into day-to-day operations and decision-making, and developing relationships with stakeholders based on trust and legitimacy. It comprises internal and external accounting practices and mechanisms devoted to measuring, representing, reflecting and communicating the bank's performance, and embraces environmental, social, and economic spheres of businesses and their relationships.

As per Schaltegger and Burritt (2010), there are five reasons that may encourage organizations to adopt Sustainability Reporting.

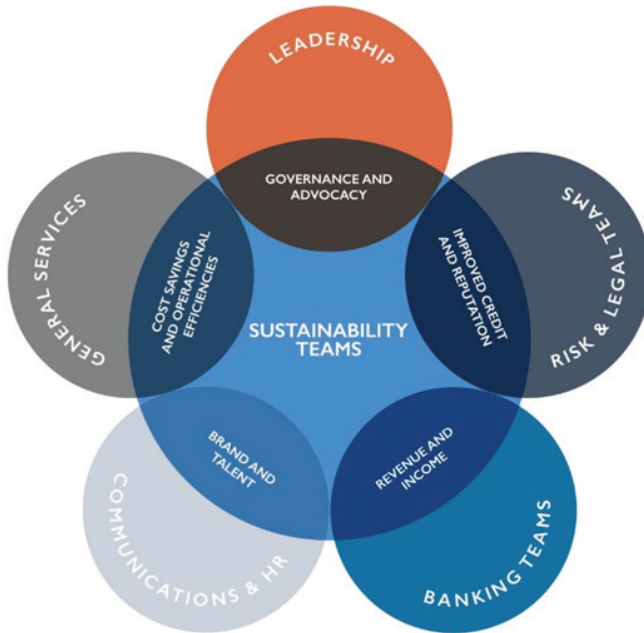
- Greenwashing
- Mimicry and industry pressure
- Stakeholder pressure
- Self-Regulation
- Corporate Ethics

## **Sustainability teams within banks**

The UNEP purposefully and strategically attempts to embed Sustainability as part of the DNA of organizations. In this endeavour, the Finance Initiative Report issued by the UNEP explains the importance of having internal teams within banks for this purpose, encapsulating dimensions of leadership, branding, operations, credits, processes, information technology etc., where each team will have a role to perform on sustainability as well as the day to day operations. Similar to the way in which the concept of Total Quality Management (TQM) was introduced and embedded to the organizational culture several decades ago, banks in Sri Lanka should also pursue a similar approach to inculcate sustainability practices into their daily operations.



**Figure 1: Functional Areas of Sustainability for a Bank**



(Source: UNEP Report, 2016: Finance Initiatives 2nd edition p 13)

Both the above aspects have been captured in the disclosure requirements set out by the GRI Guidelines.

## **Benchmark for sustainability**

The best example of Sustainable Reporting according to the GRI: G4 Guidelines can be seen in the financial statements of United Parcel Service (UPS), a global giant in courier service, fiercely competing with Fedex and DHL across the world. UPS has set their Sustainability targets for 2020 and 2025 along with their vision for sustainability. The company has methodically demonstrated the impact of their sustainability efforts in their annual report, of which a few extracted examples are displayed below.



**Table 1: Extracts from UPS Sustainability Report**

Example	Activity	Extent	Impact	Source
No 01	Alternative Fuel (ecological)	Across 15 countries	Fossil Fuel savings on 1 billion miles	P 05
No 02	26000 + supplier locations (economical)	Across 40 countries	Economic impact of \$2.4 billion	P 06
No 03	Employee (societal) 2.7 Mn volunteer hours and 24,000+ employee participation learn and earn programme	25 years of UPS presence in Mexico	100% Human Rights Campaign highest in the Equality Index in mail and delivery industry	P 07

(Source: UPS 2016 Sustainability Report)

**Table 2: UPS Future Sustainability Goals**

Goal	Target for Achievement		
2020 Community Goals	\$127 Mn Total Charitable Contributions	20 Mn Global Volunteerism Hours	15 Mn Global Tree Planting Initiatives
2020 Workforce Goals	1% improvement of lost time injury frequency	3% improvement of Auto accident frequency	2% improvement on Employee Engagement Index
2025 Environment Goals	12% reduction in absolute Green House Gas emissions	40% as Alternative Fuel as a Percentage of Total Ground Fuel	25% of Total Vehicles Purchased Annually that are Alternative Fuel and Advanced Technology Vehicles

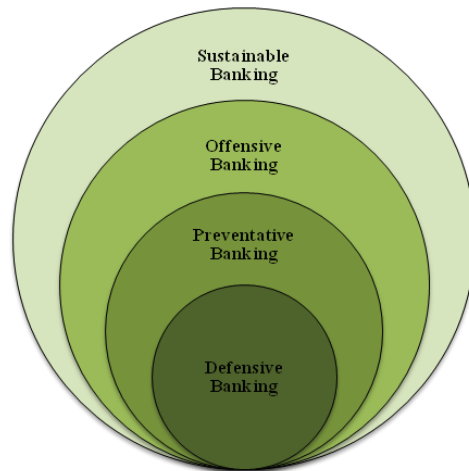
(Source: UPS 2016 Sustainability Report p 9)



In the contemporary world benchmarking is not curtailed to the best practices in the same industry, but it extends across the other industries as well. For instance, in Europe, the level of “patient care” in the healthcare industry is benchmarked against the “guest care” provided in 7 star hotels. In other words, private hospitals in Europe strive to treat their patients as guests at seven-star hotels. The local banks can therefore benchmark the above (UPS) company and their visionary approach to sustainability.

Jeucken and Bouma (1998), by developing a typology for banks, termed four categories of banks with regards to sustainability which is depicted in Figure 2 below.

**Figure 2: Typology of Banking and Sustainable Development**



(Source: Jeucken and Bouma, 1998)

The typology identifies 4 types of banks in relation to the emphasis placed on sustainability, ranging from zero focus on sustainability (Defensive Banking) to the complete integration of sustainable practices to all aspects and functions of the bank (Sustainable Banking). Hence the local banks can decide where they intend to “position” their bank in the sustainability typology circle for the future.

## **Sustainability reporting among Sri Lankan banks**

Unfortunately, when one peruses annual reports of companies and banks in Sri Lanka, many rosy statements can be read elaborating on how such banks or companies have embarked on sustainability and related activities, but nothing has been adequately quantified or rationalized for the company, society and the economy from such sustainability projects.



The author of this article, being a member of several panels of judges for various national awards in the country, has observed that only very few companies and banks have scientifically quantified and rationalized their sustainability efforts and demonstrated the impact by way of contribution back to the society in monetary and economic terms. The results of the brief research carried out by the author revealed the following.

**Table 3: Sustainability Reporting of Banks in Sri Lanka**

Bank	Framework	Quantified	Rationalized	External Assurer	Level of Assurance	Source
Sampath Bank	GRI, OECD	Yes	Yes	EandY	Limited Assurance	Annual Report 2016
People's Bank	GRI	Inadequate	Yes	KPMG	Limited Assurance	Annual Report 2015
HNB	GRI	Yes	Yes	EandY	Limited Assurance	Annual Report 2016
				DNV GL	Moderate Assurance	
BOC	GRI	Inadequate	Yes	KPMG	Limited Assurance	Annual Report 2016
Com Bank	GRI, UNGC	Yes	Yes	Moderate Assurance		

(Source: Author's Work based on Annual Reports)

Close scrutiny of these reports reveals that all 5 Banks follow the Sustainability Reporting guidelines issued by the GRI in 2013. Although private banks take the lead in sustainability compared to state banks, still the envisaged scope for improvement for private banks through measures such as the appointment of a "Chief Sustainability Officer" (CSO) is enormous. Not epitomizing Sustainability as a crucial function of the organization at apex level, is a reflection of ineffective Strategic Planning process in these banks. Banks should adequately and masterly assess the impact of the sustainability endeavours they embark on, from the ecological, economical and the societal perspective. For instance, only 2 out of the above 5 banks have embarked on calculating the Carbon Footprint of the bank. Further, each of these banks claims to follow the triple bottom line concept, which gives an equal significance to People and Plant as well as Profit. Nevertheless, a deeper analysis of the Financial Statements reveal that the quantum expended on Social and Environmental activities under sustainability, does not account for even 0.5% of the PBIT of each of these banks. While accentuating the impact assessment of one of the key criteria to ascertain the contribution to the relevant sustainability dimension, expending less than 0.5% of PBIT is not inspiring.



According to the GRI (Global Reporting Initiatives) guidelines, external assurance must be given by an Independent Auditor on the authenticity of the Sustainable Reporting of the company. The External Assurer can provide either a “Reasonable Assurance” or a “Limited Assurance” on the matters disclosed by the company in its Sustainability Reporting. Each of the external auditors has given a Reasonable Assurance on the financial aspects included in the Banks’ Statements, but only a Limited Assurance is provided on the authenticity of the sustainable practices disclosed by each of these banks which is highly inadequate.

Upon perusal of the reports, it was also revealed that the majority of the local banks do not possess a “Sustainability Vision”. All the information disclosed in the statements is historical. Banks should incorporate their 2020 or 2025 sustainability goals so that a variance analysis at the end of each year can be carried out to assess the projected-vs-actual. This naturally highlights the importance of inculcating Sustainability and Sustainable practices at the Board level, and incorporating them into an organization’s long term strategy for compliance purposes instead of simply phrasing this as terminology. The professional organizations that bestow “sustainability” awards in the country should address these inadequacies from all dimensions namely relevant analysis, comparative analysis, scoping analysis, impact analysis and assessment, association analysis and political analysis with scientifically proven and accepted metrology in econometrics and other relevant spheres, without merely depending on the auditors’ confirmation and “limited assurance”.

Some of the techniques and metrology to measure the ecological sustainability are ecological footprint, life-cycle analysis, material flows, resource accounting and NAMEA (National Accounting Matrix with Environment Accounting) as per the European Environmental Accounting Standards. Techniques to measure the societal sustainability are sustainable livelihoods, participatory processes and social and human capital measurements. Cost-benefit analysis, modeling, regressions, scenario analysis are some of the measuring mechanisms that can be applied to assess the impact of economical sustainability. This amply demonstrates that the existing accounting standards and the GRI-G4 standards currently practiced by the audit firms in Sri Lanka are grossly inadequate to assess the sustainability impact even at elementary level.

## **Inadequacies of the GRI: G4 framework**

Although the GRI guidelines provide the first and only framework for sustainability procedures and practices of organizations, there criticisms are numerous. The shift of GRI from 3.1 to GRI 4 in 2016 has made life tougher for many organizations due to the vast disclosure requirements with regards to both Financial and non-Financial reporting aspects. In spite of such vast disclosure requirements, GRI framework which has failed to overcome its main inherent weakness, does not require companies to actually practice sustainability, but only to disclose the information pertaining to the existing sustainable practices (if any) in the organization which is a glaring flaw. The distinction between the two should be made clear. Under the GRI, an organization can simply state that certain aspects of sustainability are “Not Practiced”, “Not Applicable” or even “Partially Report”, based on the approach it chooses. Imposing no penalty





by the GRI or UNEP for failure to practice sustainable procedures makes the framework impotent and ineffective.

Whilst the GRI-G4 requires external assurance of the sustainability reporting of the banks, the guidelines allow the freedom for auditors to declare a “Limited Assurance” as seen in the previously analyzed annual reports. The GRI-G4 framework does not require the auditors to physically verify or to assess the impact of such sustainability areas. As a result, auditors can merely accept what the client (bank) provides and states. Needless to say, this destroys the very concept of sustainability and “Reasonable Assurance” from the external auditors should be the mandatory and non-negotiable requirement. From an antithetical perspective, external auditors should go beyond the GRI-G4 standards, to assess the impact based on aforesaid metrology and confirm “Reasonable Assurance” to ensure sustainability which is the ideal scenario. But with the given competences and the limitations of the auditors to apply such metrology, actual impact assessment is perceived as a distant dream.

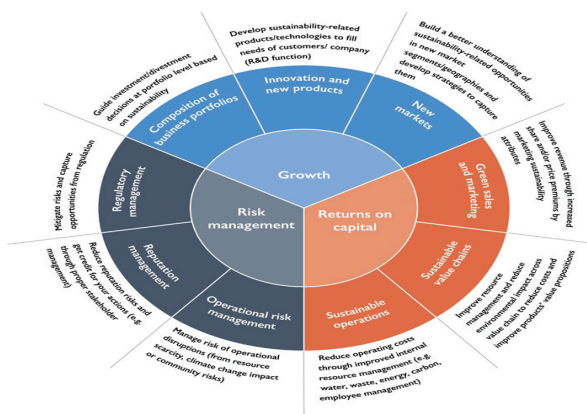
## Value chain and sustainability

Value Chain Sustainability is imperative for the effective management of ecological, societal, and economic impacts and encouragement of sound governance practices, throughout the entire value chain of the goods and services offered by banks.

The UNEP Finance Initiative Report further provides the guidelines for the Creation of Value in terms of sustainable businesses.

Any value chain can be fragmented into three main classifications as depicted below.

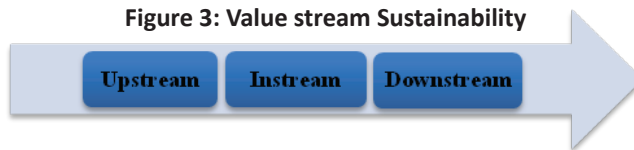
**Figure 3: Value Creation in Sustainable Businesses**



(Source: UNEP Report, 2016: Finance Initiatives 2nd edition p 03)



The above diagram of value creation in sustainability circle is divided into three key areas namely, Returns on Capital, Growth and Risk Management. Each of these areas are further divided into three arenas making up to nine categories to focus on, as per the circle



(Source: Designed by the Author)

The **Upstream** stage comprises input of raw materials supplied for manufacturing the product or delivering the service, and is therefore referred to as the Supply Chain. The input of raw material depends upon the stage of the manufacturing process. For example, Deutsche Bank implemented a well-crafted supply chain strategy, incurring billions of Euros to ensure that sustainable practices are maintained along its entire supply chain. This included aspects such as ensuring zero child labour, healthy and safe working environments, proper waste management systems, no sexual harassment and no usage of hazardous products. Other multinationals such as Reebok, Adidas, Nike etc. also audit their suppliers once in two years especially in Asia before renewing their contracts with manufacturers. In order to ensure the above, proper contract clauses for procurement and supplies, a total cost model drafted to specifications along with the supply chain activities in congruence with the local culture should be developed by the banks.

**Instream** refers to the level of sustainability maintained within the internal operations of a bank. This includes infrastructure and physical facilities, layouts, power generation and energy, which are enhanced through procedures such as purification, reuse of waste water, usage of solar energy, recycling of paper, proper disposal of hazardous electronic equipment etc. most of which are currently carried out by several banks. Most importantly, Instream includes the proper assessment of the impact made by the organization's internal processes on the outside People and Plant elements.

**Downstream** consists of the level of sustainability maintained in the distribution and delivery of the organization's products and services to the customers at the end of the value chain. For instance, customer loans should only be granted for sustainable business ventures focusing ecological, societal and economical businesses. Even the services such as "Housing Loans" should only be granted to construct dwelling houses with proper water purification systems, solar energy etc. Banks can initially target 10% of their credit portfolio to be granted for "sustainable" purposes and then to gradually increase the percentage probably over a period of 10 years. Though this may be viewed as a threat initially due to competition, a collective decision from all the banks or a 'ruling' from the regulatory body will lead this paradigm shift to enhance the effectiveness of sustainability in Sri Lanka.

Institutionalization of sustainability across the banking industry is the best approach for the local banks to embrace sustainability through their entire value chain.



## Conclusion

This article discussed the changing paradigms and the importance of sustainability for banks. Whilst emphasizing the fact that Sri Lankan banks are still in the “infancy” stage of sustainability, compared to other global banking and non-banking giants, soon local banks will have no alternative but to be congruent with the global sustainability standards. Failure to follow suit, would even lead to lose their dealings with the corresponding banks in other countries. For instance, leading apparel brands such as Gap, Victoria Secret, Marks and Spencer, audit sustainability and sustainability practices from their suppliers and as a result most of the leading players in the Sri Lankan apparel industry have been compelled to adhere to their demands. This is how multinationals place enormous amount of pressure for companies and banks operating in less developed nations to adhere to globally accepted sustainability practices.

Hence the changing paradigms in the global “playing field” are beyond our control, and sustainability will be the DNA not only for the banks, but also for the entire business world in the future.

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