

## Social impact: Beyond mere profitability

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For banks, the focus on sustainability has traditionally extended little beyond environmental concerns. But now the impact of lending institutions on wider social issues is coming under scrutiny. "Banks are a reflection of the sectors they lend to and the countries they do business in," says Greg Larkin, banking analyst at Innovest Strategic Management. "They need to be considering the social risks that they are helping to finance."

The biggest of those risks currently is that consumers are becoming overstretched, Mr Larkin says. "As interest rates have edged up, banks have wanted to keep the party going and they have created a lending crisis that has saddled consumers with too much debt, even though the interest rate profile does not justify that."

The over-exposure is now impacting on bank balance sheets for the first time, principally those institutions that have found themselves over-exposed to the sub-prime sector, he adds. "Increasing indebtedness is not just an ethical issue, it is expensive – HSBC had to restate its earnings for the first time in its history earlier this year."

In the US, where wages are stagnant and there is a negative household savings rate for the first time since the Great Depression, how banks manage financial vulnerability will be an important test of their sustainability credentials. Many banks whose customers are struggling to pay are exercising "foreclosure forbearance", says Andrew Savitz, sustainability expert and author of *The Triple Bottom Line*. "This has nothing to do with philanthropy – they are doing it because it is in the long-term financial interests of the company."

Even though many banks span the globe, the services they offer are essentially localised and personalised, Mr Savitz says, so their sustainability efforts should be focused on anything to do with the wellbeing of communities. This includes human rights issues such as forced relocation, child labour and treatment of indigenous people, education, corruption and employee diversity.

One area where banks face a dilemma is in sovereign lending to governments or state-owned companies. This can be a lucrative area, often backed by collateral such as oil revenues, says Kirsty Jenkinson, associate director, governance & sustainable investment at F&C. "There are often concerns, however, when billions of dollars are pumped into a country such as Angola and they do not seem to reappear as infrastructure. Banks do not want to be party to something that destabilises a country, but if they don't invest, they just lose the opportunity to someone else, quite possibly Chinese investors that don't have such high standards or levels of accountability."

Some banks, such as HSBC, incorporate sustainability issues into their operations by offering SRI (socially responsible investment) funds. These vehicles invest in companies that deal with social problems, such as providing low-cost housing or educational products, as well as businesses that are seen to have best-practice policies relating to issues such as corruption or child labour.

Many observers believe that companies that incorporate sustainability issues into one part of their business will eventually find it logical to spread this ethos across their business. "There is an increasing understanding that factors that were previously excluded from business ought not to have been and that their exclusion led to some bad decisions," says David Blood, managing partner at Generation Investment Management. "There is a greater understanding now the sustainability factors are relevant to business."

Banks have an inherent interest in the sustainability of the businesses they lend to because they want a return on their investment, says Prof Alyson Warhurst, chair of Strategy and International Development at Warwick Business School. Risk is now being broadly interpreted to include social and ethical issues, Prof Warhurst adds.

"Risk is increasingly about what is relevant to all stakeholders, not just shareholders. If their

investments produce a detrimental effect on local populations, banks are considered to be partly responsible for what went wrong." As a result, she says, banks do not reward corporate responsibility, but they do punish lack of corporate responsibility by putting conditions on their services.

Banks need to incorporate social due diligence into all their lending decisions, particularly to emerging markets, says Innovest's Mr Larkin.

"Emerging markets have been growing at an amazing rate, which makes them very attractive to banks."

"But because there has not been an emerging market collapse for some time, a huge amount of social risk has been overlooked," Mr Larkin adds. The cracks might first appear in China, he thinks.

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