GIZ's starts new Initiative on Strengthening the Integration of ESG in the Financial Sector

Promoting Responsible Enterprise Finance

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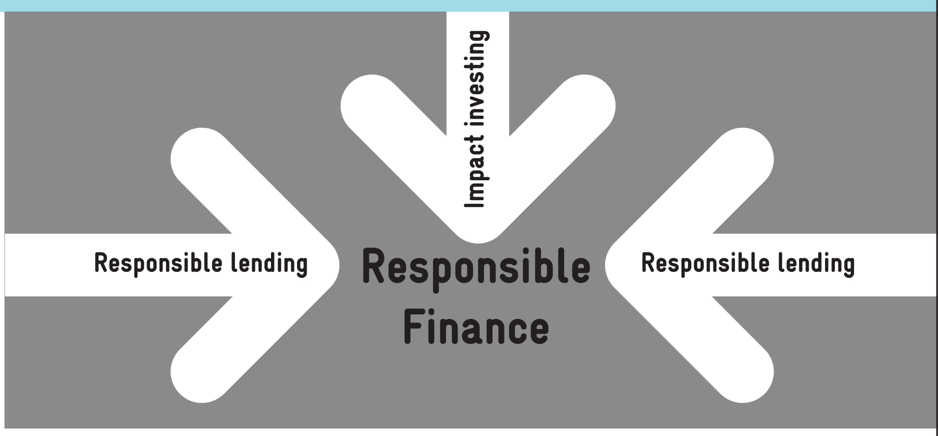
Responsible Finance – What and Why?

Responsible finance is a broad umbrella term for bouquet of strategies employed by financial institutions involving the integration of environmental, social and governance (ESG) criteria and metrics into financial lending and investment decision making. Financial institutions can hence act as key multipliers for promoting responsible business practices and environmental and social compliance.



The Challenge

Global sustainable development challenges such as climate change or poverty cannot be addressed without Responsible Finance – finance that integrates social, environmental and governance concerns into the lending and investment decision making of financial institutions. Responsible financial systems can contribute to the goal of sustainable economic development through promoting business innovation and strengthening economic, environmental and social responsible behavior of businesses. Businesses need access to capital, credit or equity to expand and grow their businesses. By setting the right incentives through non-financial lending and investment criteria, the financial sector acts as a 'multiplier' of responsible business practices and sustainable economic development. Consequently, Responsible Finance cannot be decoupled from the responsible business agenda as ultimately Responsible Finance is a means to the end of responsible business practice.

GIZ's Approach

GIZ is starting a new initiative on promoting "responsible enterprise finance", aiming at strengthening financial institutions to integrate environmental, social and governance (ESG) concerns in their operations and strategic decision making. Within the new Initiative, GIZ will work with banks, investors and impact investors to promote the role of finance for sustainable economic development and innovation. The new initiative supports Small Industries Development Bank of India (SIDBI) and its "Sustainable Banking" activities. Other partners include public and private sector banks, the SME Exchange, investors and financial service providers as well as advocacy organizations with a similar agenda. The new initiative aims to create awareness for the business case of non-financial risk management and ESG integration, increase market transparency, as well as pilot, up-scale and disseminate innovative products and services and bring the lessons to the policy level.

International and Indian Trends of Responsible Enterprise Finance

Recognition of a Business Case for Responsible Finance
- Both Internationally and in India, companies are recognizing the business case for responsible finance.

International Commitment by the Financial Institutions
- 1071 signatories to the UNPRI, only 2 from India
- 206 signatories to the UNEP FI, only 2 from India

Governmental and regulatory drivers
- New EU strategy 2011-14 for Corporate Social Responsibility (CSR) to 'ensure a more responsible and transparent financial system'
- Release of National Voluntary Guidelines in India in 2011 to encourage the mainstreaming of responsible business

Increasing Stock Exchange Listing Requirements
- King Code of Governance (King III) compliance mandatory for listing in Johannesburg Stock Exchange in South Africa
- SEBI mandate on business responsibility reporting for top 100 listed companies, following the NVGs

Translating a commitment into ESG Policies
- Banks and investors apply Environmental, Social and Governance policies to the lending and investment decision making and publicly disclose these policies.

Implementing practices to manage operational and portfolio impacts
- Cooperative Financial Services in the UK pressurized two multinational oil and gas companies to disclose information on the social and environmental risks of their tar sands development

Disclosure of policies, practices and performance
- Driver: Investors and banks increasingly require information on ESG policies, practices and performance of companies
- Indian context: Pressure for disclosure by international investors

Measuring, rating and rewarding Performance
- Out of the world's top 50 financial services companies by market capitalization, the majority of companies are featured on the DJSI and FTSE4Good
- 50 Indian companies listed in the S&P ESG India Index

Challenges in International ESG Integration and Responsible Finance

Global challenges
- Lack of Disclosure and Data Availability
- Data quality & comparability, Standardization of metrics & impact
- Assurance of data
- Research on business case & business case recognition by banks and investors
- Thematic blind spots of risks & opportunities
- Lack of measurement tools

India-specific challenges
- Lack of awareness, understanding, commitment and capacity
- Lack of engagement by the media and other stakeholders
- Focus on operational impacts by banks and not portfolio impacts
- Non-compliance and corruption
- Shareholding patterns & lack of engagement by domestic insurance and pension funds

New trend: Impact investing

Impact Investment is an investment approach by a new breed of venture capitalists and angel investors at the start up or early stage of a social business's development.

Challenges of the impact investing ecosystem
- Information asymmetry & lack of pipeline
- Investment readiness: plenty of ideas but lack of skilled entrepreneurs
- Lack of access to adequate financing
- Transaction costs of sourcing ideas and due diligence
- Scalability of the initial business model to new geographies
- Exits: recouping initial investment
- Defining impact and performance

Need for action:

Banks
- Apply ESG policies to lending decision making
- Train staff on ESG policies
- Audit implementation of ESG criteria
- Monitor adherence after lending
- Change interest rates in case of non-compliance
- Report publicly all the above practices

Investors
- Apply ESG policies to investing decision making
- Train staff on ESG policies
- Audit implementation of ESG criteria
- Report publicly
- Active ownership

GRI
- Actively engage with investors on sustainability reporting data requirements
- Promote the business case for sustainability reporting and its enabling role for responsible finance among investors

Companies
- Make ESG information publicly available
- Third party verifications on accuracy of information

GIZ will work with its partners to promote the integration of environmental, social and governance concerns in the financial sector. It will work with banks, investors and organizations like Global Reporting Initiative as well as with companies to push the agenda forward in India. GIZ is interested in partnerships with organizations with a similar agenda.

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