GREEN BANKING SYSTEM AND PUBLIC SECTOR IN INDIA

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Abstract

Green Banking In India Is almost welcomed by all the financial sector especially In Banking Sector In India. Sustainable development can best be achieved by allowing markets to work within an appropriate framework of cost efficient regulations and economic instruments. One of the major economic agents influencing overall industrial activity and economic growth is the inancial institutions such as banking sector. In a globalised economy, the industries and firms are vulnerable to stringent environmental policies, severe law suits or consumer boycotts. Since banking sector is one of the major stake holders in the Industrial sector, it can find itself faced with credit risk and liability risks. Further, environmental impact might affect the quality of assets and also rate of return of banks in the long-run. Thus the banks should go green and play a pro-active role to take environmental and ecological aspects as part of their lending principle, which would force industries to go for mandated investment for environmental management, use of appropriate technologies and management systems. This paper explores the importance of Green Banking, sites international experiences and highlights important lessons for sustainable banking and development in India. However, we find that there has not been much initiative in this regard by the banks and other financial institutions in India though they play an active role in India's emerging economy. Therefore, we suggest possible policy measures and initiative to promote green banking in India.

Introduction

Sustainable development has emerged as a new paradigm of development in response to the current discourse of development that over-exploits natural environment for economic prosperity. The sustainable development can best be achieved by allowing markets to work within an appropriate framework of cost efficient regulations and economic instruments. One of the major economic agents influencing overall industrial activity and economic growth is the financial institutions such as banking sector. The banking sector influences the economic growth and development in terms of both quality and quantity, there by changing the nature of economic growth.

Banking sector is one of the major sources of financing investment for commercial projects which is one of the most important economic activities for economic growth. Therefore, banking sector can play a crucial role in promoting environmentally sustainable and socially responsible investment (SRI). Banks may not be the polluters themselves but they will probably have a banking relationship with some companies/investment projects that are polluters or could be in future.

Banking sector is generally considered as environmental friendly in terms of emissions and pollutions. Internal environmental impact of the banking sector such as use of energy, paper and water are relatively low and clean. Environmental impact of banks is not physically related to their banking activities but with the customer's activities. Therefore, environmental impact of bank's external activity is huge though difficult to estimate. Moreover, environment management in the banking business is like risk management. It increases the enterprise value and lowers loss ratio as higher quality loan portfolio results in higher earnings. Thus, encouraging environmentally responsible investments and prudent lending should be one of the responsibilities of the banking sector. Further, those industries which have already become green and those, which are making serious attempts to grow green, should be accorded priority to lending by the banks. This method of finance can be called as "Green Banking", an effort by the banks to make the industries grow green and in the process restore the natural environment.

This concept of "Green Banking" will be mutually beneficial to the banks, industries and the economy. Not only "Green Banking" will ensure the greening of the industries but it will also facilitate in improving the asset quality of the banks in future. Internationally, there is a growing concern about the role of banking and institutional investors for environmentally responsible/socially responsible investment projects. Banking and other financial institutions are more effective towards achieving this goal for the kind of intermediary role they play in any economy and for their potential reach to the number of investors. Environment is no longer the exclusive concern of the government and the direct polluters, but also the other partners and stake- holders in the business like financial institutions such as banking institutions can play a very important role in fostering linkage between economic development and environmental protection. To substantiate, quality of service, the implementation of environmental conservation measures, support to the deprived section of the society, concern about the quality of life and nature are the basic principles that the financial institutions are relying on in their business strategy in recent years. The banking operation targets a certain long-term rate of return on their credit and investment. However, every credit extension and investment caries the risk of on-payment and reduction of value (in case of direct investment) due to environmental liabilities. Therefore, it is of importance to the banking sector to follow certain environmental evaluation of the projects before financing.

There are studies showing positive correlation between environmental performance and financial performance (Hamilton, 1995; Hart, 1995; Blacconiere and Pattern, 1993). Thus, it is imperative for the financial institutions in the present context to consider environmental performance in deciding whether to invest in companies or advise clients to do so. The formation of different rules for environmental management like resource conservation, clean water act, clean air act, toxic substance control act are also viewed as potentially significant Non-performing Assets (NPAs) have already occupied the center stage of the present day banking. All the banks are busy in cleaning up the already created NPAs from their asset portfolio.

There have been attempts to adopt sustainable development strategies from various quarters at international level. Multilateral agencies, international consortiums, multilateral financial and development institutions have been advocating for environmental standards and strategies to evaluate investment projects. In the recent years, the international organization for standardization (ISO) has issued series of comprehensive guidelines for incorporating environmental protection and pollution prevention objectives into industrial activity worldwide, known collectively as ISO 14000. It would certainly give the much needed impetus for the banking industry to expand the use of environmental information in their credit extension and investment decisions. In this backdrop, the paper aims to discuss the issues of sustainability in Banking and how banks can play a role for sustainable growth and development, particularly in the Indian context.

Importance of Green Banking

Until recently, environmental concerns were not considered relevant to the business operation of banks and financial institutions. Traditionally, banking sector's concern for environmentally degrading activities of clients is like interfering or meddling in their business affairs. However, now it is being perceived that dealing with environment brings risks to their business. Although the banking and financial institutions are not directly affected by the environmental degradation, there are indirect costs to banks. Due to strict environmental disciplines imposed by the competent authorities across the countries, the industries would have to follow certain standards to run their business. In the case of failure, it would lead to closure of the industries leading to a likelihood of default to the bank. For example the enactment of Comprehensive Environmental Response, Compensation and Liability Act in 1980 (CERCLA)

The UNEP statement by Financial Institutions on the Environment and Sustainable development in 1992 showed that 80% of the signatories (200 financial institutions) made some kind of assessment of environmental risks of investment projects before financing. In the US in late 1980s has resulted in huge loss to the banks in the US as banks held directly responsible for the environmental pollution of their clients and made to pay the remediation cost. This is the reason for which banks in the US are ahead of other countries in integrating environmental concerns into their business operations. In the recent years several other countries (more in Europe) are seen adopting policies that have made banks responsible for the misdeeds of their clients. Therefore, the financial institutions need to engage proactively with the stakeholders on environmental and social policy issues and evaluate the impacts of their client's investment. In turn, that would force the customers to take care of their management of environmental and social policy issues relating to investment. This should cover all project financing activities across all industries. The importance of Green Banking is immense for both the banks and economy by avoiding the following risks involved in banking sector.

Credit Risk: - It can arise indirectly where banks are lending to customers whose businesses are adversely affected by the cost of cleaning up pollution or due to changes in environmental regulations. The cost of meeting new requirements on emission levels may be sufficient to put some companies out of business. Credit risks may be higher due to the probability of customer default as a result of uncalculated expenses for capital investment in production facilities, loss of market share and third party liability claim. Credit risks are also associated with lending on the security of real estate whose value has diminished owing to environmental problems (additional loss in the event of default). urther, risk of loan default by debtors due to environmental liabilities because of fines and legal liabilities and due to reduced priority of repayment under bankruptcy. In few cases, banks have been held responsible for actions occurring in which they held a secured interest (see Schmidheiny and Zorraquin, 1996 and Ellis, Millians and Bodeau, 1992).

Example, in United Kingdom, the breach of terms of the license given by integrated pollution prevention control would lead to prohibition, financial penalties and enforcement notice. All such notices can have significant financial implications for the business and as well as the financial institutions those who have put money into it. Thus banks/financial institutions need to take actions before financing the project. The enactment of CERCLA in USA in 1980s has resulted in huge loss to the banks in USA as banks held directly responsible for the environmental pollution of their clients and made to pay the remediation cost.

Some US courts (H. Thomson) have sought to hold banks and other financial institutions liable for the environmental damage caused by their customer's actions, such as clean up costs and other damages associated with Thus, the banking and financial institutions should prepare an environmental risk and liability guidelines on development of protective policies and reporting for each project they finance or invest (Jeucken, 2001). They can also have an environmental assessment requirement for the projects seeking finance. Banks also can issue Environmental hazards management procedures for the each project and follow through. International financial institutions like International Financial Corporation (IFC), Japan Bank for International Cooperation (JBIC) have incorporated environmental management into their business operation. All project proposals are classified in terms of its potential environmental impact taking into account factors such as the sector and scale of the project, the substance, proposed project site, the degree and uncertainty of its potential environmental impact.

Often, the World Bank's loans and grants are associated with certain level of commitment of the beneficiary countries to adopt environmental protection measures. The perception towards complying with environmentally norms and standards is changing over time. Adhering to environmental norms and standards were considered costly and as a bottleneck to development. If we will consider the economic benefits of these in terms of health care, productivity and insurance then the benefit is much higher than the cost. A study confirms that only IR pollution causes the loss of 200 million working days and the resulting losses in productivity and medical expenses costs around 14 billion pound to the European Union (Stavros Dimas, 2005). If all the impacts of environmental degradation are considered and costs are measured, then we can find the huge economic benefits these protection measures brings in.

Environmental friendly technologies also make economic sense for the industries and actually lessen the financial burden. The cost of pollution is rising with more awareness about these issues all over the world. The polluting industries face more resistance and often forced to close down or face massive boycott by the consumers. This adds to their cost enormously. Environmental concerns are integrated into the international rade policy and often act as trade In Philippines, the Land Bank and also Development Bank of the Philippines has set up a specific environmental unit to analyse environmental aspects of project financing, to finance waste and water projects and to incorporate environmental factors into its lending operations. They also expanded their environmental units for technical evaluation of each projects.

See Chopra et al (2005) for more on Ecosystems and Human Well-Being. barrier for environmentally sensitive goods (ESGs). So adopting environmentally sustainable technologies or modes of production is no more considered as a financial burden, rather it brings new business opportunities and higher profit. Green banking saves costs, minimizes the risk, enhance banks reputations and contribute to the common good of environmental sustainability. So it serves both the commercial objective of the bank as well as its social responsibility. Green banking solves the problem faced by the environmental regulation and enforcements authorities related to size and location of the polluting unit. The authorities have practical limitations on enforcing environment standard on small-scale industries and also industries located in far off places.

Green Banking: International Initiatives

The financial sector's growing adherence to environmental management system is attributed to the direct and indirect pressures from international and local Non Governmental Organisations (NGOs), multilateral agencies and in some cases the market through consumers. In the early 1990s, the United Nations Environment Programme (UNEP) launched what is now known as the UNEP Finance Initiative (UNEPFI). Some 200 financial institutions around the globe are signatories of this initiative statement to promote sustainable development within the framework of market mechanisms toward common environmental goals.

The objective is to integrate the environmental and social dimension to the financial performance and risk associated with it in the financial sector. As the commitment of this UNEPFI statement goes, sustainable development is regarded basic to the sound business management. It advocates for a precautionary approach towards environmental management and suggests integrating environmental considerations into the regular business operations, asset management, and other business decisions of the banks. IFC's environmental unit was established in 1991 for 34 international banks follow codes of conduct in the lines of UNEP, environmental reporting, environmental management systems, environmental policy and environmental risk assessment and guidelines to reduce environmental impact, both internal and external (Jeucken, 2001). In the similar lines, the city of London in 2002 launched the London Principles on Sustainable Finance at Johannesburg Earth Summit. It focuses on the provision for eco-innovation and access to finance for disadvantaged communities. The London principles constitute seven principles that address the environmental and social impact of the financial sector and emphasized such issues as transparency, risk management and equitable access to capital. Similarly, the US Export-Import Bank regularly reviews while financing exports on the ground whether they are environmentally sound. It will be noteworthy to mention that Netherland-based ABN-Amro bank has developed certain Reputational Risk Management (RRM) policies to identify, asses and mange non-financial present within it business engagements. Similarly, some of the big international banks like ABN Amro, Deutsche, Standard Chartered, HSBC Bank etc. look at environment issues discussed under Kyoto Protocol. Going further, the Dutch Government has made a formal request to banks in achieving sustainable development. The dialogue between banks and government was established in 1999 to initiate policies for environmental improvements through the development of new financial products and services.

Similalrly, Earth (FoE) and the Rainforest Action Network (RAN) challenged the industry with high-profile campaign that highlighted cases in which commercial banks were "bankrolling disasters" in 2000 in the US. In 2002, a global coalition of NGOs formed a network named 'Bank Tract' to promote sustainable finance in the commercial sector. This coalition came up with a resolution constituting six principles promoting environmental protection and social justice by banks and this is popularly known as Collevecchio Declaration. The six principles that this declaration advocated included commitments to sustainability, no-harm, responsibility, accountability, transparency and sustainable market, and governance. More than 200 organizations have endorsed this declaration and urged the banks to incorporate these commitments into their business operation. The declaration states that "Finance and Commerce has been at the center of a historic detachment between the world's natural resource base, production and consumption. As we reach the boundaries of ecological boundaries of the ecological limit upon which all commerce relies, the financial sector should take its share of responsibility for reversing the effects this detachment has produced".

All these concerns for sustainable finance or green finance have compelled the banking institutions to devise a common and coherent set of environmental and social policies and guidelines that can be used to evaluate the projects. A small group of banks along with IFC came together to initiate the process of designing the common guidelines in October 2002 and came Up with a guidelines in June 2003 that is known as Equator Principles with 10 leading commercial banks adopting these voluntary set of principles. This equator principle was subsequently updated and the new revised sets of principles are launched in July 2006. The coverage of projects being financed are expanded in this revised set of principles by lowering the finance threshold from $50 million to $10 million. Presently 46 financial institutions from 16 countries with business operation in more than 100 countries have embraced this equator principle. So this principle has become a common standard of project finance that incorporated environmental and social issues in project finance.

Review of Literature

Green Banking aims at greener and a clean future. As stated earlier what is needed in context of this new concept is consumer awareness. Sharma, Gopal et al. (2014) attempt to study the level of consumer awareness of Green Banking initiative in India with special reference to Mumbai. From the primary survey they conducted they find that surprisingly even those people who are using online facilities provided by their banks nearly three fourth of them are unaware of the term Green Banking. They find that among those who are aware of Green Banking term consider it mainly related to online bill payment and cash deposit system. Other Green Banking aspects like Green CDs, solar powered ATM, bonds for environment protection are among few of which consumers are not aware of. They also attempt to analyze the gender based difference in awareness of green initiatives by bank specially E-Statements, Net Banking and Green loans. Using Chi-Square test for hypothesis testing they arrive at a result that both males and females have the same level of awareness with respect to Green Banking. The researchers state that the major obstacle in Green Banking is the technical issues involved followed by lack of education. Jaggi (2014) studies the initiative by SBI and ICICI on Green Banking. SBI has introduced a Green Channel Counter, no queue banking, enhanced commitment towards achieving carbon neutrality, online money transfer, wind farms. Green Products and Services initiative of ICICI Bank includes Neyati Ahuja/ instabanking (anytime, anywhere), vehicle finance and home finance. Moreover these banks have taken other steps for energy conservation like duplexing (two side printing), recycling, CFLs, carpool etc. Nath, Nayak et al. (2014) attempt tostudy the green rating standard given by RBI, the World Bank's environmental and social norms and the initiative taken by bank in adopting green practices. They also list strategies for adopting Green Banking. Green Rating Standard is known as Green Coin Rating. Under this banks are evaluated on the basis of carbon emissions and amount of recycling activities. World Bank has formed environmental and social norms for financial institution. These norms provide ways to reduce environmental impact. Banks are required to do Environmental Impact Assessment, Annual Reporting and adopt sustainable technology. The researchers study and list the initiative taken in respect of environment by different banks in India. If the Indian banks want to achieve some position in global economy then they have to act as good corporate citizens. Sudhalakshmi and Chinnadorai (2014) present the status of Indian Banks in respect of Green Banking and state that though goes green mantra is essential for emerging economies like India but significant efforts have not been taken. Banks are required to include their green aspect in the lending principle. Every step taken today will mean a better global environment in future. So a policy measure to promote Green Banking is needed in India. Indian banks are running behind time in adoption of this green phenomenon. Serious steps are required to be taken in this regard.

Jha and Bhome (2013)conduct a similar survey as stated above to check and thereby create consumer awareness on Green Banking. Conducting interviews and using specially structured questionnaires for survey they state certain steps needed in Green Banking. Online Banking, Green Checking Accounts (ATM, Special Touch Screens), Green loans (low rate to those who wish to buy solar equipments) for supporting environment friendly residential projects, power saving equipments, Green Credit Cards, Paper Saving Mobile Banking are among few steps suggested by them. Green Banking will ensure organization's move towards sustainability.

Rajput, Kaur et al. (2013)aims to understand how Indian banks respond to environmental changes and the action taken in respect of Green Banking. They find that there is a small group of banks in India that lead in environmental aspect. Response of Indian banks towards international initiative for environment is sluggish. In the United Nation Environment Programme Finance Initiative there is no single Indian signatory. Using factor analysis they conclude that risk of failure of business to peers and lack of RBI mandates are the obstacles to moving towards sustainability. The gaps in India are the awareness and consciousness on the environmental issues. Carbon Disclosure Projects -India requires public disclosure of emissions. This disclosure project is active in India. But the response is very less as only 8 signatories are there. The researchers feel that current management system needs to be integrated with the environmental and sustainable issues.

Yadav and Pathak (2013)study the Green Banking approaches opted by private and public bank for environment sustainability. Using case study approach they find that Indian banks have understood the relevance of taking positive steps towards the environment. Moreover results of the study conducted reveals that public sector banks have taken more initiatives as compared private sector with exception of ICICI bank. In private sector only ICICI bank's approach s a sustainable approach.

The activities of the equator banks (banks adopting equator principles) are being reviewed by NGOs worldwide and are being published whenever it is realized that they are not committed to Equator Principle. IFC along with the Financial Times has initiated 'Sustainable Banking Award' since 2006. More than 104 financial institutions out of 151 entries from 51 countries have made it to the final lists of award in 2007. The number of banks applying was up by more than 100 per cent compared to the previous year's 48 banks from 28 countries. All the international initiatives towards integrating environmental concerns into business operation of banks are voluntary in nature and are meant to promote a common good of a better ecosystem. Voluntary commitment has its own shortcoming in a competitive market. Unless the market for green money will increase, the lenders will always have an incentive to procrastinate their social commitment and prioritize the commercial interest in the short run. So demand for green money is a precondition of green banking if it will be voluntary. A Government legislation that makes banks accountable for the misdeeds of their clients will help promote green banking.

Green Banking in India

India is on a higher growth trajectory for last one and half decade and the industrial sector plays the most important role in India's growth story. However, Indian industry faces the challenges of controlling environmental impact of their business i.e. reducing pollution and emission of their clients. Though government has been trying to address the issue by framing environmental legislations and encouraging industry to follow environmental technologies and practices, they would not be enough given the poor track records of enforcement, public awareness and inability to derive competitive advantage by producing eco-friendly products. Incidentally, India's is the world's sixth largest and second fastest growing country in terms of producing green house gases. Delhi, Mumbai and Chennai are the three of the world's ten most polluted cities. The major polluting industries in India are (a) primary metallurgical industries namely zinc, copper, steel etc. (b) paper & pulp (c) pesticides/insecticides (d) refines (e) fertilizers (f) tanneries (g) sugar (h) textiles (i) chemicals/pharmaceuticals etc. The banking operation and investment by financial institutions should take care of environmental management of these polluting industries by improving the overall environment, the quality and conversation of life, level of efficiency in using materials and energy, quality of services and products. In this context, the role of banking sector, which is on major financing sources to the Industries, assumes high importance. The environmental regulations in India can be broadly classified into two broad categories i.e. command and control regulations and liability law. The command and control regulations are ex ante regulations that are designed to dissuade environmentally damaging projects. This regulation is implemented by setting industry specific pollution standards, scrutinizing the projects and granting/denying permissions by the concerned authorities like Ministry of Environment and Forest. The liability laws are ex post in nature and are implemented by enforcing authorities through imposing fines, closing down the defaulting industries etc. However there is no law and rule in India that can hold banks responsible for scrutinizing investment projects before financing and for the environmental damage created by its client. Once legal framework for the environmental pollution standards are formulated in India, the polluting industries either have to close down or have to make necessary investment to comply with the standard. In this process these industries will loose their competitiveness in the international market, which would directly affect Indian economy and the banking sector. Thus in the present context, it is equally important for banks to guard themselves against the conversion of the now performing assets into non-performing one in the future. Realization of these facts by banks will certainty make them fast adopt the concept of Green Banking. The industries, which are ill equipped to control pollution now, are the possible polluters of future. A day may come, when legislation may take a hard stance against these environmental culprits and may order the closer of these units. Almost 150 SSI units around Agra and Delhi were forced to close down for their non-compliance to the mandated environmental standards. In such an eventuality, the industries cannot be rescued from becoming the non-performing ones, as the banking institutions continue to overlook these aspects. We find that industries are increasingly complying with pollution control norms. However, there are equally increasing numbers of industries which have been defaulted and closed down. In the case of default and closed down of industries, banks incur the financial loss due increase in bad asset and liability.

Conclusion

Besides, the public is gaining consciousness of the multifarious problems associated with pollution. So, the public will resort to protest, strike, and agitation to stop the misuse of the environment or in a simple fashion consumers may reject the products produced by the polluting units. Before 1986, there was no provision for public to file a suit against the polluting units but now the citizens are also permitted to file suits. The present green consumerism is more concerned with the quality of the products more than the quantity. In future, market will reward those industries or the companies, which emerge as the efficient users of the energy and raw materials and will penalize the less efficient one. Further, the investors in the stock market are equally aware of environmental pollution and would take a stand against those Similarly, In River Bhadar in Gujarat, after 14 years of public protests, the high court ordered closure of 1200 sari dyeing and printing units till effluent treatment plants are installed.

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