The Role of Commercial Banks in Promoting Sustainable Development

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Abstract

Over the past decades, Sustainable Development issues have become an important decision-making factor and a key focus area for many private institutions, individuals or governments.The modern world is faced with increasingly negative consequences of climate change. At the same time, mitigation and adaptation efforts as well as financial resources allocated for them do not correspond the scope and intensity of record-breaking extreme weather events already occurring.Commercial banks, in general, are well aware that the negative consequences of a climate change pose significant direct or indirect impact to their core business as well as companies they invest in. By integrating environmental, social and governance (ESG) considerations in the business strategy and offering sustainable finance products, financial institutions are ensuring long-term investments in sustainable economics as well as promoting positive changes.This report analyzes how the banking sector can contribute to sustainable development in developing countries, specifically in the context of Georgia. The paper also highlights the main challenges and opportunities related to sustainability issues in the banking and provides several suggestions that can help improve the sustainable ecosystem in Georgia.

Keywords: Sustainability, Climate change, Sustainable Development, ESG, Sustainable Finance.

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Introduction

Sustainable development has been defined in a variety of ways, but the most frequently cited definition comes from the UN Brundtland Commission, which defined sustainability in 1987 as "meeting the needs of the present without compromising the ability of future generations to meet their own needs".

In 1972, the UN Conference on the Human Environment in Stockholm set in motion a chain of events that changed the way countries approached environmental issues. The conference was the first at this level to highlight the links between environmental, economic and social issues, leading to the creation of the UN Environment Programme.

In 1997, United Nations Environment Programme (UNEP) launched a Finance Initiative to promote sustainable investments in financial industry and to help the sector reduce its negative impact on the environment. UNEP FI supports financial institutions develop practical approaches to setting and achieving green targets in areas such as greenhouse gas emissions, green finance, sustainable production and consumption, and financial inclusion to address inequality.

UNEP FI was the first global organization to engage the financial sector in sustainability issues and developed the principles of responsible investment. As of today, more than 500 global banks, investors

and insurance companies with assets of more than US$170 trillion are implementing UNEP FI's Principles for Responsible Banking, and Principles for Sustainable Insurance to deliver more sustainable global economies. (UNEP Finance Initiative, 2024).

In 2015, the United Nations adopted the Sustainable Development Goals (SDGs) as a universal call to action to end poverty, protect the planet, and ensure peace and prosperity for all people by 2030. The 17 SDGs have been adopted by all United Nations Member States. There are 169 sub-goals and targets to be achieved by 2030 or earlier. The goals and targets are universal, meaning that they apply to all countries in the world.

The 17 SDGs highlight the connections between the environmental, social and economic aspects of sustainable development. They are integrated and recognize that actions in one area affects outcomes in others, and that development must balance social, economic and environmental sustainability.

It is also obvious that there will be no sustainable development without sustainable finance. Reorienting private capital towards more sustainable and inclusive investments require big efforts and structural changes in existing financial systems as well as regulatory framework to redesign the way the classical financial system worked before.

Climate risks as one of the key challenges to sustainable development

The SDG Progress Report published by the UN Economic and Social Council in May 2024 demonstrates that the world is unfortunately far behind schedule in achieving its 2030 Agenda.

Of the 135 targets, only 17% are progressing as expected to be implemented by 2030; almost half of the targets (48%) show moderate or severe deviations from the desired trajectory; 18% of the targets have stalled; and 17% have even regressed below the 2015 baseline.

Climate finance, as support provided to developing countries, has increased at a compound rate of 5% from 2015 to 2020, reaching USD 41 billion. While there are a number of estimates and no agreed methodology to account for the USD 100 billion per year target, this target has not yet been reached (UN Economic and Social Council, 2024).

According to the World Meteorological Organization, 2023 has broken every single climate indicator and become the warmest year on record. Global temperatures have risen to 1.45°C, for the first time dangerously close to the 1.5°C lower limit of the Paris Agreement on climate change. The greenhouse gas concentrations reached record high observed levels in 2022. It is 50% higher than pre-industrial levels. The long lifetime of CO2 means temperatures will continue to rise for many years (World Meteorological Organization, 2023).

According to the Global Risks Report 2024 of the World Economic Forum, the risks related to the environment continue to dominate the risk landscape for the short as well as long term periods. The report examines the most severe risks that humanity face over the next decade, amid rapid technological progress, economic uncertainty, climate change and conflicts.

Based on report findings, five environmental-related risks (extreme weather events, critical change to Earth systems, biodiversity loss and ecosystem collapse, natural resource shortages, pollution) were included in the top ten risks that are most likely to cause a significant global crisis over the next 10 years (World Economic Forum, 2024).

As a result, we can see the increasing pressure from multiple stakeholders (customers, employees, funders, government, local communities etc.) on private institutions, including commercial banks, to take environmental, social and governance (ESG) factors into account when implementing business strategy and optimizing their profitability.

The role of commercial banks in supporting sustainable development

Commercial banks can play a crucial role in supporting and promoting sustainable development by mobilizing financial resources for economic growth that is sustainable and inclusive.

According to the Sustainable Finance Market Report by the Global Market Insights, the overall sustainable finance market size reached USD 5.4 trillion in 2023 and is expected to grow at around 22% per annum over the next decade.

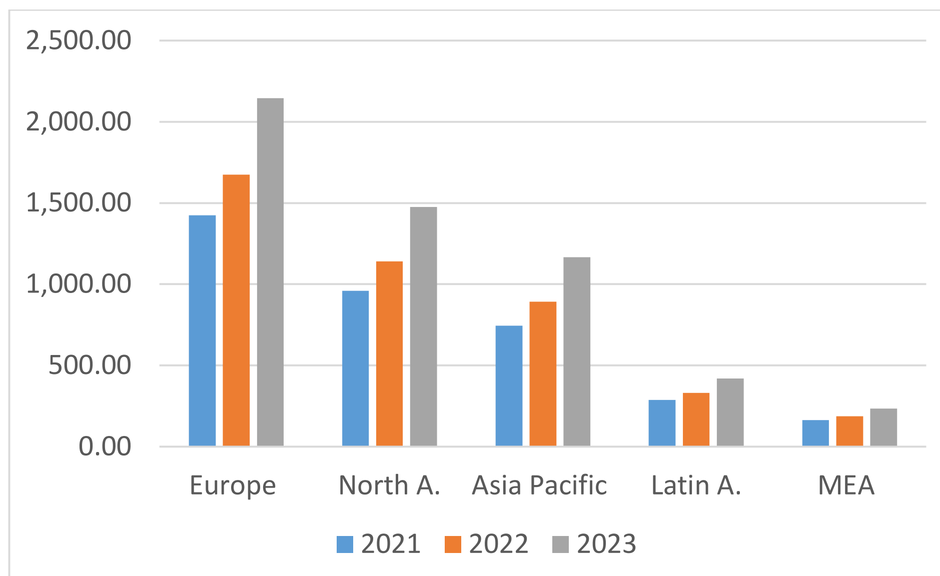
Sustainable finance is a broad term that encompasses financial activities which contribute to sustainable development and includes environmental, social, governance and economic aspects.

Growing awareness about environmental and social issues has become a significant driver in the evolution of sustainable finance markets. Investors are increasingly prioritizing ESG criteria in their decision-making processes. This shift is fueled by the recognition that companies with strong ESG practices tend to exhibit better long-term finance performance and resilience. As a result, there has been a notable increase in the demand for ESG-focused investment funds, which cater to investors seeking both finance returns and positive societal impact (Global Market Insights, 2024).

Chart 1 below shows the sustainable finance market growth in 2021-2023.

Chart 1

Global sustainable finance market growth by regions in 2021-2023 (USD Billion)



Source: Author's calculation based on the report of the Global Market Insights, 2024.

As shown in the Chart, although all regions are demonstrating growth dynamics from year to year, the global sustainable finance market is dominated by Europe with a share of 39%, followed by the North America (27%) and Asia Pacific (21%).

As expected, majority of developing and least developed regions (Latin America, Middle East & Africa) accounted for a critically small market share (13%), illustrating the deep gap between the demand for sustainable finance and available supply size.

According to another study conducted by McKinsey in 2023, to get emissions to net zero, USD 275 trillion would need to be spent on physical assets till 2050. That is about USD 9.2 trillion per year, or about 30% more than the USD 5.7 trillion allocated today. These huge funding requirements present financial institutions with a significant investment opportunity in sustainable finance.

McKinsey estimates that of the trillions of dollars needed to finance the green transition, about one-third would go toward legacy obligations and two-thirds to new technologies. In the near term, significant investments will be especially needed in clean energy to power electric vehicles and decarbonize buildings (McKinsey & Company, 2023).

Georgian banks in support of sustainable development

According to the Aid Atlas Data research by the Stockholm Environment Institute, from 2012 to 2021, the total sum of development finance dedicated to climate change in Georgia amounted to USD 2.68 billion out of a total development finance flow of USD17.2 billion.

The largest sources of climate finance were the European Bank for Reconstruction and Development (USD 1.3bn), France (USD 461mn) and Germany (USD 343mn). The top-three sectors targeted by climate finance were: Energy (USD 917 million), Transport & Storage (452 million) and Government & Civil Society (USD 331 million) (Stockholm Environment Institute, 2024).

Recent years Georgia has adopted a number of regulations and policies to promote sustainable development. In 2019, National Bank of Georgia (NBG) launched the Sustainable Finance Roadmap, the ultimate goal of which is to create a reliable, predictable and stable regulatory framework and prepare the market for the transition to sustainable finance.

In 2022, the NBG adopted the Sustainable Finance Taxonomy and Regulation on Loan Classification and Reporting according to SF Taxonomy. The new regulation officially defines green, social, and sustainable loans and sets the reporting requirements for taxonomy-aligned loans for commercial banks.

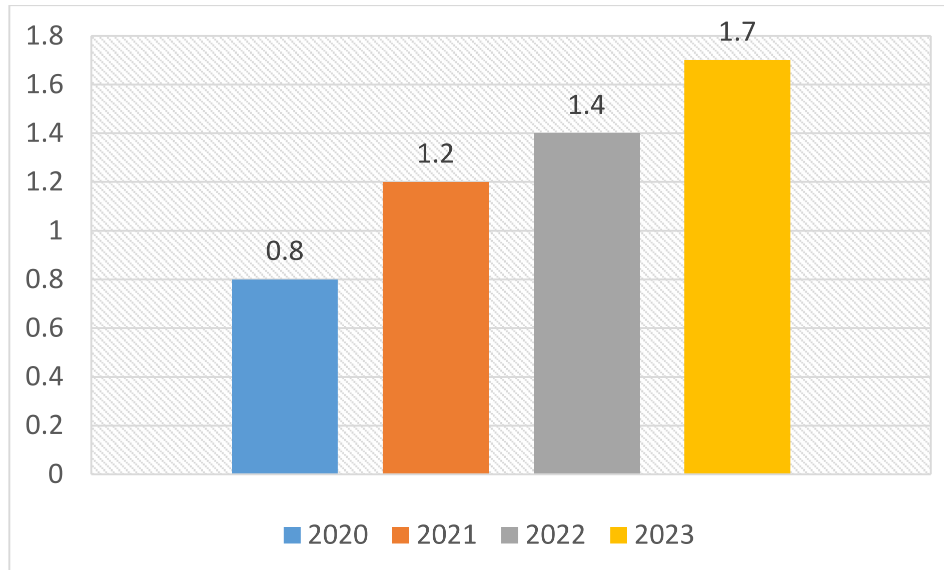
The taxonomy is composed of green and social taxonomies. Green taxonomy provides a list of activities that aim to achieve environmental objectives and contribute to the green economy development. Social taxonomy provides a list of categories aimed at achieving social goals for the target population, including: people with disabilities, eco migrants, displaced persons, socially vulnerable individuals, people living below the poverty line etc.

According to the Sustainable Finance Report 2023, the green loan portfolio of Georgian banks at the end of 2022 amounted to GEL 1.4 billion, which is 15% more than in 2021. The share of green loans in the total loan portfolio was 3.2%, compared to 2.9% in 2021 and 2.2% in 2020. Total volume of green loans issued by Georgian banks during the year amounted to around GEL 0.5 billion.

Based on the analysis of individual banks' annual ESG reports, the green loan portfolio of Georgian banks by the end of 2023 reached GEL 1.7 billion, which is 21% increase compared to 2022. Chart 2 below shows the dynamic of green finance in Georgia during 2020-2023.

Chart 2

Green loan portfolio of Georgian commercial banks in 2020-2023 (GEL Billion)



Source: Author's calculation based on the sustainability data from the National Bank of Georgia.

Since some banks still do not classify the green loans, these figures may be underestimated. Two commercial banks lead the Georgian green lending market: TBC with 46% of total green finance market share and BoG with 43% of green market share. The third is the Basis Bank with around 8% of green market share.

According to the NBG's Sustainable Finance Report 2023, the sectorial breakdown of green financing in Georgia is the following: the largest portion of green loans, 63%, is directed towards the renewable energy sector (57% specifically targeted towards hydropower projects). 17% are directed towards the sustainable transport, followed by sustainable production and trade (8%) and Waste Management (5%). Sustainable agriculture and Green Buildings accounted for 3% of total green loans.

Thus, from the official statistics of the NBG and the annual ESG reports of commercial banks, it is clear that the green finance market in Georgia has demonstrated steady growth over the past few years, in particular, due to increased investment in the renewable energy and sustainable transport sectors.

It should also be noted that the growth in green financing is partially driven by government green initiatives, special subsidized programs of International Institutions and donors involvement.

Conclusion

Commercial banks are well aware about importance of the sustainable development. They see that climate change and other consequences of a warming planet pose significant direct and indirect impact to their core business as well as their customers.

There is an increasing pressure from multiple stakeholders (customers, employees, funders, governments) on banks, to take ESG factors into account while implementing business strategy and optimizing profitability.

Banks seeking to make sustainable finance more affordable in emerging markets, face a number of challenges such as low awareness, regulatory gaps, need for large upfront investments, additional competencies needed, extra bureaucracy, uncertainty around ESG standards, lack of incentives etc.

Climate change creates new type of risks but also opportunities that may positively affect the financial performance of banks as well as businesses they invest in. Banks have an opportunity to grow their sustainable portfolio while providing vital resources to decarbonize the economy and contribute to positive changes.

International Financial Institutions are increasingly prioritizing ESG criteria in their decision-making. This might directly affect the funding structure and position of commercial banks. Growing awareness about environmental and social issues has also become a good driver for banks to expand their sustainable portfolio.

In conclusion, by integrating ESG considerations in business strategy and prioritizing sustainability factors, financial institutions can ensure long-term and profitable investments in sustainable economics and promote positive changes in the society.

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