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Publisher: Management Lab, Australia, 2007

Sustainable Banking v. Accounting Theory

The Sustainable Banking Awards, created by the Financial Times and IFC recognise banks that have shown leadership and innovation in integrating social, environmental and corporate governance objectives into their operations.[i]

The "journey" to sustainable banking can partially be explained with the Enterprise theory. The Enterprise theory views a company as a social institution. Decisions are made that affect a number of interested parties such as employees, customers, shareholders and creditors. It is a bit different from the entity theory because it sees the company as a firm and this firm plays a role in society.[ii] The company viewed through the entity theory on the other hand is just an isolated body that seeks to make a profit. Milten Friedman argued that: "… there is one and only one social

responsibility of business – to use its resources and engage in activities designed to increase its profits…" However the assumptions made by the enterprise theory are not in contradiction with the objective of the firm, which are to make a profit. From this point of view the entity is an abstract that can include shareholders, creditors, employees and the government. In the enterprise theory the management sees itself as the guardian of the company and is responsible for its survival and growth. Those who receive an income from the company have an important stake in the well being of the company.[iii] Therefore the company has a responsibility towards them and not just its shareholders. The focus in terms of the enterprise theory is on the social, economic and environmental impact of the firm.

The integration of sustainability into the banking sector has taken two directions:

1. The integration of sustainability into a bank's core businesses through the integration of environmental and social considerations in terms of product design, mission policy and strategies. Examples include the integration of environmental criteria into lending and investment strategy, and the development of new products that provide environmental businesses with easier access to capital.
2. The pursuit of environmental and social responsibility in a bank's operations through environmental initiatives. improvements in energy efficiency or recycling programs are examples of this[iv].

This view is congruent with the triple bottom-line approach where organisations are seeking to signal their contribution to the sustainability of their activities and of the community, society and environment in which they operate in[v].

Suojanen says that a value-added move towards profits is the best way to show a company's contribution to society. The value-added approach views profit as the result of the cooperative effort of a number of participants. As suggested by Suojanen the Accounting Steering Committee in the United Kingdom recommended a value-added statement to be published by companies to measure the value of wealth created by the enterprise in a given period. However the use of this statement is not very common in Australia yet. In addition there is no standardised practice to carry out a value-added statement. Also, the choice of disclosures is a direct function of the nature and attitudes of the board and management to such disclosures. Further, businesses in more politically sensitive industries (such as gambling and banks in this case) may feel that such disclosures will increase the level of external review and intervention. Furthermore voluntary disclosures reduces the level of comparability between firms and will allow firms to ‘cherry pick’ the information which places them in the best light or draws attention away from other issues.[vi] On the other hand mandating leads to uniformity and a lack of distinction between firm disclosures this may encourage firms to simply comply with the minimum and may encourage firms to manipulate information to enhance their relative performance.

However I would argue that banks have not only social and environmental reasons for adopting triple bottom-line and enterprise theory approaches into their products and strategies because Banks that engage in unethical lending not only risk collateral damage to their reputations, but also their shareholders' capital, if environmental or other liabilities impact the cash flows and residual value calculations on long-term asset finance. Because a lot of customers are asking for it, Banks have recently developed new products such as ethical funds or loans specifically designed for environmental businesses to capture new market opportunities associated with sustainability. For example in many cases,

sustainable funds have substantially outperformed the rest of the market.[vii] This directly leads to higher earnings for the bank. But it is also true that some more active fund managers have begun to play an 'advocacy' role, putting pressure on individual companies to improve their social and environmental performance[viii].

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i www.management-laboratory.com
ii http://www.worldbank.org/mdf/mdf1/poor.htm
iii Accounting Theory 6th Edition; Godfrey, Hodgson, Holmes, Tarca
iv http://www.bsdglobal.com/banking/sus_banking.asp
v Accounting Theory 6th Edition; Godfrey, Hodgson, Holmes, Tarca
vi http://www.iema.net/shop/product_info.php?cPath=301&products_id=7173
vii http://www.bsdglobal.com/banking/sus_investment.asp
viii http://www.bsdglobal.com/banking/sus_investment.asp