Sustainability in retail banking: Revenue protection or creation?

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Financial services and sustainability might sound like an odd couple, but many banks have recently launched products and services driven by social and environmental issues. In this article the authors have undertaken a study of major banks to see how important these kind of products have become, what the future holds and where fresh opportunities lie.

Over the past 12 months, announcements from the European banking sector relating to sustainability issues, particularly climate change, have been prolific. For example, almost all of the large high street banks in the UK have now set ambitious targets to become carbon-neutral – an aim that involves reducing carbon emissions from direct operations to a minimum and offsetting the remaining emissions by buying carbon credits.

In May of this year, Citigroup announced that it will direct $50 billion over the next 10 years to address global climate change. It intends to reach this target through investments, financing and related activities to support the commercialisation and growth of alternative energy and clean technology among the clients and markets it serves, as well as within its own operations.

A further testament to the growing interest in sustainability in banking is the recently launched Financial Times Sustainable Banking Awards. The awards are given to those banks that have demonstrated leadership and innovation around the world by integrating into their financial activities objectives that are social, environmental and represent good corporate governance. In 2007, over 100 banks, in more than 51 countries, applied for the awards.

Whilst many of these announcements have been focused on the operations of these banks – for example, the emissions from direct energy use – a number of European banks have announced ambitious plans to introduce new products and services driven by social and environmental issues such as climate change, social exclusion and financial illiteracy:

- Several banks are offering credit-cardholders discounts and lower-rate borrowing on green products and services. Rabobank takes it a step further by actually calculating the amount of carbon associated with your purchase and offsetting this through renewable energy products.

- Norwich and Peterborough is offering "green" loans on new and existing homes with higher-than-average standards of energy efficiency or on existing homes that buyers plan to make more environmentally friendly.

- Royal & Sun is developing a telematic product which will encourage people to drive in a more "environmentally-friendly" manner. Every month, an in-car global positioning device spits out data about rates of acceleration and braking and the efficiency of routes.

These moves may be sensible. Recent research by the UK Department for Environment, Food and Rural Affairs suggests that 98 per cent of the UK population is now concerned about climate change, and consumer research by Norwich Union suggests that 68 per cent of Britons say being seen to be green is the new way of "keeping up with the Joneses".

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But to what extent do these "greener" products and services offer genuine sources of new revenue or are they in fact more about revenue protection and reputation management? This paper will seek to answer this question by profiling a range of examples and critically examining the potential value these emerging products and services offer to the sector.

Study scope and results

We undertook a short review of 16 retail banks across Europe to understand the prevalence of these products and services (Table 1). Five of the banks were contacted directly and interviewed or asked to complete a short questionnaire. The remaining banks were examined based on information in the public domain.

Whilst the focus of this research is on European retail banks, this paper also draws on examples from two prominent banks in South Africa (Nedbank) and Australia (Westpac). Nedbank was of particularly interest since a recent study by IFC suggests that 35 per cent of commercial banks in emerging markets cite sustainability as a driver for new business.

Table 1: Banks surveyed for this study	
Citigroup	ABN-AMRO
HSBC	UBS
Fortis	Barclays
ING	RBS
Ceska Sporitelna	SEB
Swedbank	Commerzbank
Monte dei Paschi di Siena	Rabobank
Co-operative Bank	Nedbank

We have concluded the following:

- Whilst many of the leading European banks have received accolades for their sustainability performance, actual revenues from products and services driven by sustainability remain comparatively small.
- Many banks expect this segment to grow substantially, driven by the growing "ethical consumer" segment.
- Two different strategies amongst retail banks can be observed: the development of niche products or the development of a fully integrated approach. The dominant European players are following the niche products strategy.
- Leadership in fully integrating sustainability principles across the product and service portfolio remains unclaimed territory for the large European banks.

All of the banks surveyed for this paper reinforced these accolades by claiming that sustainability is a strategic topic for their company both today and in the future and asserted that it is an issue of growing importance.

Let's look at each of these conclusions in more detail.

Actual revenues from products and services driven by sustainability

Almost all of the European banks profiled have received some accolade for their sustainability performance in recent years (Exhibit 1).

All of the banks surveyed for this paper reinforced these accolades by claiming that sustainability is a strategic topic for their company both today and in the future and asserted that it is an issue of growing importance. Whilst it may not be part of their core business strategy, several detected a change in attitude amongst their customers to which they felt they must respond.

In sustainable business, this is where the rubber meets the road. How are companies actually manifesting their sustainability commitments in the products and services they sell? Across the 16 companies examined, more than three quarters have now developed and marketed green products or products intended to deliver specific social benefits. Of the companies surveyed, the range of products covers most retail products but also some commercial loans (Table 2).

Table 2: Illustrative range of products cited by European banks

Cause-related products	Products with preferential terms	Products with lower environmental footprint
Cause-related credit cards Cause-related bank accounts	• Microfinance • Special basic accounts for people in socially deprived regions • Environmental car loans • Climate-friendly mortgages • Eco-loans & solar energy loans • Green loans for environmental or clean technology companies	Green current accounts Green credit cards

The characteristics of these products tend to be as follows:

1. Cause-related products – where an affiliation with a charity or specific cause is made, and the bank pays a sum to the charity each time an account is opened or a credit card is used.

2. Products with preferential terms for environmentally or socially beneficial transactions, such as:

- loans for an environmentally beneficial use – for example, for investment in low-carbon technologies for domestic or commercial purposes;

- low-cost financial products for a low income or disadvantaged group, e.g. microfinance products.

3. Products with lower environmental footprint – where the bank has actively sought to reduce the environmental impact of the actual product. For example, HSBC's Green account is a paperless account.

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Despite the emergence of these products and services, their contribution to overall revenues remains small. Several of the banks surveyed suggested that they contributed between 0-1 per cent and in some cases as much as 5 per cent of total revenues in 2006.

Revenue growth expectations

Almost all the banks interviewed expect revenues from these products to increase, without really being able to quantify them adequately. Some of the comments were:

- *"We expect a boom in the year 2008."*
- *"It will grow 'definitely'. "*
- *"A significant growth is foreseeable."*

However, one interviewee noted that whilst he expects that growth rates will be strong, in the long term these products will always be a moderate contributor to revenues.

Expectations regarding future growth are largely attributed to the growing "green consumer" segment. A new study by Norwich Union (part of Aviva plc) based on interviews with 1,580 full-time workers during July and August 2007 shows over half (56 per cent) now consider unethical living as much of a social taboo as drink-driving. Nine in 10 people admit they tell "little green lies" to pretend they live more ethically. Three-quarters (76 per cent) say conversations at the school gates and dinner parties are now being taken over by ethical one-upmanship, while nine in 10 say they feel compelled to live more ethically.

But the study also found that one in five say they have no idea how to live more ethically. When interviewed about how managing their finances can have an impact, only one in 20 realised that investing in companies that support ethical causes would make a difference.

In a separate survey of 7,237 consumers in the UK examining attitudes to ethical and environmental issues, Allegra Strategies found that almost 60 per cent of the public believe it isn't too difficult for individuals to help prevent climate change - perhaps an indication of the growing belief in the UK that individuals are able to impact on global environmental issues through their own purchasing behaviour.

These data suggest that there is a growing opportunity for savvy retail banks to exploit consumers' desire to act by addressing their current naivety about what options are available to them.

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Two different retail bank strategies

Two different strategies amongst retail banks can be observed: the development of niche products or development of a fully integrated approach. The dominant European players are following the niche products strategy. The pioneers in the development of products and services driven by sustainability have largely been the smaller players in the retail banking sector. These companies have tended to seek to exploit the growing "ethical consumer" market and look to fully integrate sustainability principles across all their products and services.

The UK's Cooperative Financial Services (CFS), with revenues of € 4.3bn in 2006, is one example. Whilst ten times smaller than Barclays, CFS has been leading much of the thinking on sustainable retail banking. CFS has specifically focused on the ethical consumer in developing and implementing its value proposition, with a strategy focused on offering a fully integrated service to the ethical consumer.

Founded in 1872, the UK's Co-operative Bank, now known as Co-operative Financial Services (CFS) has been dedicated to pioneering financial services through an explicit commitment to value, fairness and social responsibility. It has consistently been the UK's market leader on ethical and sustainability issues. Profit generation in pursuit of business sustainability is one of its five key objectives, and it has effectively embedded sustainability across all of its retail products and services. The bank has estimated that the proportion of profit made by customers who state that ethics is the most important or an important factor to them in using CFS is as much as 51 per cent. Furthermore, research by MORI has found that whilst "ethics" is a major determining factor for customers of CFS (27 per cent cite ethics as being influential in opening an account), it is only rarely specified by customers of other banks (1 per cent of customers cite ethics as being influential in opening an account).

Outside of Europe, Nedbank is another example of a small player leading in sustainability. Whilst being one of the largest banks in South Africa, Nedbank is similar in size to CFS. Nedbank has fully integrated its sustainability principles across its business activities. It has sought to work in partnership with the rest of the banking sector in South Africa to offer a low-cost national bank account called Mzansi. Launched in October 2004, the account extends banking to low-income earners and those traditionally living beyond the reach of banking services. These accounts had grown to 475,000 by end of 2006 and now constitute more than 5 per cent of Nedbank's total retail client base.

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In addition, Nedbank has been integrating affinity support into the provision of its mainstream credit cards. These have included affinity support for environmental, sports, arts and culture funds and the Nelson Mandela Children's fund. Its affinity cards now account for more than 10 per cent of the total card market in South Africa. Nedbank expects further growth in its affinity products. It believes growing media and consumer awareness of ethical and sustainability issues have significantly contributed to the growth of these products and services, alongside strong and very visible branding and marketing.

In contrast, the larger European banks such as HSBC and Barclays have responded to the emerging sustainability theme by developing niche products rather than looking to overlay sustainability principles across all their products and services.

Barclays, for example, recently launched the Barclays Breath credit card, which involves a donation of 50 per cent of profits to environmental projects dedicated to reducing carbon emissions, whilst claiming to "offer customers a greener card option". Similarly, HSBC has cut out the frills from its banking to offer current account holders "Going Green", an option where customers use internet banking with no paper-based marketing and no cheque book or paying-in book. In return, HSBC offers, for a limited period, to donate a $10 donation to the WWF, Earthwatch and The Climate Group.

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Unclaimed territory in retail banking

Leadership in fully integrating sustainability principles across the product and service portfolio remains territory as yet unclaimed by the large European banks. None of the large European banks (defined as those with revenues of over € 10 billion) appear to have taken an integrated approach to sustainability across their entire product and service portfolio in the way that the CFS and Nedbank have approached the growing "ethical consumer" market.

Rabobank, a moderate player, comes closest to this approach. Rabobank claims to be a leader in sustainability-oriented banking with a focus on renewable energy, biofuels and clean technology. New products launched by Rabobank include the Robeco Clean Tech Fund, the Dutch climate mortgage and the Rabobank credit card ("Rabocard"), where Rabobank invests an amount in a climate project each time the client makes a payment with the card. Rabobank claims to have developed a strategy to further integrate sustainability into all its activities, including the development of more sustainable financial products.

Another mainstream leader, but outside of Europe, is the Westpac banking corporation. Westpac is a leading retail, commercial and institutional bank in Australia and New

Zealand and listed as one of the Fortune 500. It is ranked in the top 10 listed companies by market capitalisation on the Australian Stock Exchange. Westpac has adopted a strategy of not actively supporting the growth of separate "green products" per se. Instead, it strongly supports the integration of responsible performance into its mainstream products and services. One example is the integration of environmental discounts into its standard home loan package through the EcoNomical Living promotion. This programme helps mortgage customers to reduce their environmental footprint and save money on utility bills by providing discounts and rebates on a range of environmental technologies for homes.

It could be argued that the banking sector, which historically has been known for conservatism and a heavily regulated environment, has not faced major sustainability issues perhaps in the same way as the energy or the automotive sectors. However, the asset management segment already has an established approach to managing sustainability in the context of its investment activities.

Other examples of mainstream products where Westpac has integrated sustainability issues include:

- Offering all credit card customers the opportunity to use their reward points to purchase energy and water-saving devices;
- Offering unlimited fee-free withdrawals and deposits for all customers who hold a Pensioner Concession Card or Health Care Card (The Westpac Basic Account).

Sustainability – niche or mainstream for retail banking?

It could be argued that the banking sector, which historically has been known for conservatism and a heavily regulated environment, has not faced major sustainability issues perhaps in the same way as the energy or the automotive sectors. However, the asset management segment already has an established approach to managing sustainability in the context of its investment activities. It could be argued that this leadership is now drawing forward performance across other segments of the sector, such as retail banking.

Furthermore, it is end-consumers who are demanding banking services, whilst at the same time placing expectations upon their pension trustees to manage their fiduciary duty to take account of the social and environmental performance of the funds they invest in. Funds under a socially responsible investment mandate in Europe have grown exponentially in recent years and have already reached over €1 trillion, and continue to grow.

Investors have been keen on these funds, not only due to ethical imperatives but also because the funds themselves have fared extremely well. The best-performing fund out of more than 300 unit trusts in the UK last year was the Co-operative Insurance Services Sustainable Leaders Trust. The fund returned almost 30 per cent over the year, more than double both the FTSE All Share benchmark and the UK All Companies average.

We expect that sustainability as a theme will grow in importance for consumers when they buy financial products and services. Consumers are becoming more savvy about the relevance of global sustainability issues to the investment activities, products and services of their trusted bank.

Furthermore, a study jointly conducted by the sustainability rating agency Oekom Research and HypoVereinsbank shows that investment recommendations based on stock-picking derived from sustainability criteria pay off. Shares with the highest sustainability ratings rendered in the past six years delivered 35.8 per cent return, while the overall market measured in terms of the MSCI world index had a loss of 24 per cent.

We expect that sustainability as a theme will grow in importance for consumers when they buy financial products and services. Consumers are becoming more savvy about the relevance of global sustainability issues to the investment activities, products and services of their trusted bank. They are also watching more closely the performance of socially responsible investment products that are being professionally managed.

We foresee a gradual growth in these products and predict that far more than 5 per cent and possibly 10-15 per cent of revenues in the next five to 10 years will be derived from these products and services, which will become increasingly commonplace across the industry. In our view there will be three phases to their introduction into the mainstream:

1. Extending niche positions

Large players will continue to introduce sustainability dimensions into their product portfolio but the impact on their balance sheets will be limited. International players will apply their successful micro-finance approaches in the home markets, combined with market-driven ethnological segmentations. In a world of increasing competitive intensity, any emerging opportunities for growth should not be neglected. In addition, there will be a need to be attractive to the emerging mass of socially responsible investors, including for corporate marketing purposes. The shareholder brand will also gain value from this approach, especially when combined with the company's innovation position.

2. Developing an integrated approach

Global attention towards major environmental issues (e.g. climate change, resource scarcity, increased prevalence of disasters), societal divisions (polarisation of rich and poor, globalisation) and ethical behaviours (governance, quality of management) driven by an increasingly ubiquitous online media will continue to strengthen. This will impact market views and will continue to alert stakeholders - public, consumer, shareholder, company and regulatory - with unforeseen consequences.

As emerging codes and guidance on sustainability become formalised and accepted, regulatory measures will be introduced to set the standard for trailing-edge performance. This will be in a similar vein to the Sarbanes-Oxley Act or Basel II.

This in turn will influence the competitive forces on large financial institutions. Consumers will expect the institutions to which they entrust their savings or future security to be acting on these issues in the context of their activities and sphere of influence. We expect this to accelerate the integration of sustainability approaches into strategic and tactical decision-making. Smaller sustainability landmark players may be acquired for "centre of gravity" reasons. The dominant world of capital markets, driven by asset managers and institutional investors, may additionally spur these developments, given that ethical and sustainable behaviour in the "green segment" is being assured and performance remains stable.

3. The unavoidable hand of the state

As emerging codes and guidance on sustainability become formalised and accepted, regulatory measures will be introduced to set the standard for trailing-edge performance. This will be in a similar vein to the Sarbanes-Oxley Act or Basel II, but focusing instead on sustainability matters. First movers and leaders will shape these trends and create markets that are favourable to their own.

Insights for the Executive

Retail banking has a long way to go before sustainability issues are genuinely driving new sources of revenue. Whilst many of the leading European banks have received accolades for their sustainability performance, actual revenues from products and services driven by sustainability remain comparatively small. In the main, sustainability activities remain in the domain of enhancing reputation and risk management rather than being a new source of value creation.

Nevertheless, large banks can learn from a number of smaller players in the retail banking sector that have been pioneers in the development of products and services driven by sustainability. Likewise, the asset management segment of the banking sector already has an established approach to integrating sustainability in its investment approach. Consumers' expectations about the sustainability profile of financial products and services are also growing.

As a consequence, we expect a gradual introduction of these products into the mainstream. While large players initially may extend their current niche positions in sustainability, they will increasingly develop an integrated approach. First movers and leaders who stay ahead of emerging, government-pushed codes and guidance on sustainability may well gain a competitive advantage.

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