CORPORATE SUSTAINABILITY
IN THE BRAZILIAN
BANKING SECTOR

Clarissa Lins, Danniel Wajnberg, Ulrich Steger
and Aileen Ionescu-Somers

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Clarissa Lins
Executive Director
Brazilian Foundation for Sustainable Development
Rua Engenheiro Álvaro Niemeyer, 76
CEP 22610-180
Rio de Janeiro - RJ
Brazil
Tel: +55 21 33 22 45 20
Fax: +55 21 33 22 59 03
E-mail: clarissa.lins@fbds.org

Danniel Wajnberg
Brazilian Foundation for Sustainable Development
Rua Engenheiro Álvaro Niemeyer, 76
CEP 22610-180
Rio de Janeiro – RJ
Brazil
Tel: +55 21 33 22 45 20
Fax: +55 21 33 22 59 03
E-mail: danniel.wajnberg@fbds.org

Ulrich Steger
Alcan Chair of Environmental Management
Program Director, Building High Performance Boards
Global Corporate Governance Initiative
IMD – International Institute for Management Development
Ch. de Bellerive 23, P.O. Box 915
CH-1001 Lausanne
Switzerland
Tel: +41 21 618 0346
Fax: +41 21 618 0641
E-mail: steger@imd.ch

Aileen Ionescu-Somers
CSM Deputy Director
Forum for Corporate Sustainability Management
IMD – International Institute for Management Development
Ch. de Bellerive 23, P.O. Box 915
CH-1001 Lausanne
Switzerland
Tel: +41 21 618 0389
Fax: +41 21 618 0641
E-mail: aileen.ionescu-somers@imd.ch

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CORPORATE SUSTAINABILITY – BRAZILIAN BANKING SECTOR

EXECUTIVE SUMMARY

The purpose of this paper is to analyze the knowledge and inclusion of the concept of corporate sustainability in the main institutions of the Brazilian banking sector. To do so, 67 top executives in the ten largest Brazilian banks were interviewed, and 127 questionnaires were addressed to the interviewees and mid-management. The study included reports and websites of the institutions in order to understand how sustainability practices are being adopted and reported.

While its direct socio-environmental impact may not be strong, the banking sector does have a strong indirect impact, through the financing of its clients’ activities and its relationship with its suppliers. The main role of banks in sustainable development, therefore, is to induce change in the parties with which it interacts rather than through direct changes. In this role, Brazilian banks, considering their considerable size, coverage and job-generating potential, can contribute enormously to a change in attitude of a large part of Brazilian society.

This study reveals that the sector is already including social and environmental considerations when making decisions. However, there is a great discrepancy between practices and reporting in the institutions under study: while some institutions show clear leadership in incorporating sustainability into business activities and disclosure, it is also evident that other institutions are only beginning to consider the socio-environmental aspects of their everyday business. Also, the study found that no tools were used to measure the social and environmental dimensions of institutional performance.

There is evidence to suggest that some socio-environmental products could be better explored by banks. Examples include micro-credit, socio-environmental financing lines, environmental insurance and carbon market-related activities. The report suggests also that, while it was not quantified in this paper, questions of sustainability clearly affect the value creation of these institutions, thereby indicating the existence of a business case for sustainability in the Brazilian banking sector.

After interviewing top executives in the Brazilian banking sector, the conclusion is that those responsible for strategic thinking already acknowledge the importance of the issue and are already making changes in their strategies, modifying their long-term outlooks, organizational structures and business practices in order to adopt the topic of corporate sustainability. However, for the sector to be able to act as a catalyst of effective change, it still has some challenges to overcome.

The major challenge is to increase the awareness of its own employees on the topic of sustainability. The sector is still very much anchored in the idea of social responsibility. For these institutions to effectively advance this agenda, it is necessary to demonstrate to those responsible for
daily business that sustainability lies in introducing corporate responsibility in core business activities rather than in departments or institutions disconnected from the main activities of the companies.

In addition to knowledge, it is essential to upgrade the tools currently used by institutions. Management processes such as performance assessments, credit evaluations or investment decisions need to include better socio-environmental criteria, considering not only qualitative but also quantitative aspects, rewarding sustainable actions and punishing behaviors that do not add value in the long term.

Lastly, there is the challenge of improving transparency in the socio-environmental performance of the banking institutions. Many of the sustainability projects of Brazilian banks are not disclosed and consequently do not receive due recognition by stakeholders. Moreover, the conspicuous absence of indicators in companies’ public documents prevents more in-depth socio-environmental performance assessment. The banking sector needs to be open to dialogue and render accounts to society about all actions of their institutions on the sustainability agenda, including setting working goals. This higher level of transparency will show their true commitment to the topic and encourage society engagement with the institution, contributing, in fact, to better understanding of the role of banks in society.
INTRODUCTION

This paper is the result of research undertaken between December 2006 and August 2007 by the Brazilian Foundation for Sustainable Development (FBDS), with the technical and methodological support of the Forum for Corporate Sustainability Management (CSM) of IMD - International Institute for Management Development, an institution that performed a similar study in Europe, the USA and Asia in the two-year period 2002/2003 in partnership with WWF, the global conservation organization. The study, which was also given research support from COPPEAD Administration Institute of the Federal University of Rio de Janeiro (UFRJ) and sponsored by the Itaú, Itaú BBA and Bradesco banks, used interviews, questionnaires and sectoral public and corporate information in order to assess the business case for corporate sustainability in the banking sector in Brazil.

The ten top banks in terms of total assets in Brazil\(^1\) participated in this study, in addition to the National Bank for Economic and Social Development (BNDES) and the Banco do Nordeste (BNB), given their respective roles in financing the country’s development. Interviews were carried out with key executives from these institutions and questionnaires also were sent to reach the mid-management levels. Thus, altogether 67 executives were interviewed and 127 questionnaires completed. FBDS also examined documents and information disclosed to the general public by the financial institutions targeted in this study, in addition to other sector reports. The complete research methodology is described in Appendix I.

Based on these interviews and questionnaires, as well as on secondary data, an assessment was made of aspects of corporate sustainability in a group of major financial institutions.

The paper begins with a definition of the concept of corporate sustainability to provide the reader with some context. The first section gives

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\(^1\) Santander, HSBC and Votorantim banks did not participate in the interviewing stages nor did they complete the questionnaire.
a brief analysis of the characteristics of the Brazilian banking sector. In the second section, the main issues of the banking sector relating to sustainability are discussed, including the degree to which these are integrated in the banks studied.

The third section presents the results obtained in the companies under study with regard to their sustainability performance, especially in relation to the aspects discussed in section 2. The analysis is divided into the following topics: (i) motivation to build the business case for sustainability; (ii) capacity to implement it; (iii) alignment of the various areas in the organization; (iv) use of management tools, and (v) national and sector characteristics

The fourth section gives the study’s main conclusions and future agenda for sustainability in the banking sector.
CORPORATE SUSTAINABILITY – DEFINITION OF THE CONCEPT

Although the widely accepted definition of sustainable development is “development that meets the needs of the present without compromising the ability of future generations to meet their own needs”, there is a major debate regarding the correct definition of the term corporate sustainability. This is due to its association with terms already known earlier in the business world, such as social responsibility, corporate social responsibility or corporate citizenship.

This study defines corporate sustainability as the integration of social and environmental aspects into business strategy, business operation and stakeholder interactions. It is evident, therefore, that social and environmental activities that are not related to the business operation and strategy, such as work done by the different foundations associated with financial institutions, are not included in the scope of this paper. The emphasis here is on the word integration: the purpose of this study is to investigate how social and environmental aspects relating to everyday business are being addressed by the organizations.

Often associated with the term corporate sustainability, and of the utmost importance in understanding the subject, is the concept of the triple bottom line (TBL) proposed by John Elkington in 1998 in his book Cannibals with Forks. The TBL concept refers to economic prosperity, environmental quality and social progress, and to building metrics that help measure the performance of a company not only in the economic but also social and environmental spheres (see Figure 3).

Corporate sustainability does not necessarily imply higher costs, more bureaucratic processes and lower financial returns. Sustainability is firmly rooted in a business perspective where socio-environmental performance goes hand in hand with economic performance – a change of paradigm that prioritizes permanence and perpetuation of the organization. In some situations, improvement in the socio-environmental performance can generate short-term financial gains for the organizations – see, for example, opportunities from carbon credit trading. In other situations, this improvement may not bring immediate benefits but does give the company long-term gains, which contribute precisely

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Figure 3 – The Triple Bottom Line

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2 Brundtland Report, WCED, 1987
to the ongoing and permanent success of the organization. So, a situation where socio-environmental improvements are primarily linked to economic losses violates one of the three supports of the TBL, and is not sustainable.

Two principles are extremely important in promoting corporate sustainability: corporate governance and innovation. A company can guarantee that the interests of the various stakeholders are preserved only when it has good corporate governance practices, and a sustainable company is one that recognizes and values its internal interdependence not only with internal agents, such as its employees, but also with players outside the company, such as suppliers and clients. On the other hand, innovation is the catalyst of the aforementioned change in paradigm, creating new products, redesigning existing processes and rethinking the business model of the organization.
1. THE BRAZILIAN BANKING SECTOR

1.1 GENERAL CHARACTERISTICS OF THE SECTOR

The Brazilian banking sector consists of regulatory agencies (e.g. the National Monetary Council), supervisory agencies (Brazilian Central Bank, the Brazilian Securities and Exchange Commission – CVM) as well as the operators. Some of the most important operators are conglomerates and independent banking institutions in terms of their size, coverage and job generation. It is also noticeable that there is a strong consolidation of the sector, despite the large number of banking institutions and conglomerates. The ten largest institutions in this sector participating in this study are responsible for 72.77% total assets, 87.10% of the number of branches and 84.41% of the employees in the entire banking sector.

The ranking adopted in this study was announced by the Central Bank in December 2006, where the Banco do Brasil (BB) is first in total assets, total deposit, number of employees and branches. Itaú leads the sector in terms of equity and net income.

The branches in the sector are distributed in around 1500 counties all over Brazil. This gives the sector enviable coverage; few sectors in the economy have such penetration in national territory. In addition to the branches, the banks also have 24-hour machines, in-company banking machines, ATM

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3 The data refer only to the banking sector, as defined by Febraban.

4 In this context, the banking sector under reference consists of the commercial, multiple, investment and development banks and the Federal Savings Bank (CEF).
machines, cooperative and corresponding machines, which are increasing their coverage throughout the country. Some, in the case of Bradesco and Caixa Econômica Federal (CEF), have an agreement with other institutions (post offices, lottery stores), for banking services at other locations.

The sector also directly employs about 539,000 people, in addition to outsourcers and suppliers. According to the 2006 Febraban study, 78.5% of the banks in the survey have around 120,000 suppliers in their portfolio, including large, mid-size, small and very small companies, in addition to local community individuals. These data contribute to reinforcing the indirect impact of the sector on the regional and national economy.

Although Brazil is not considered a strongly leveraged economy, the participation of credit in the GDP was 34.3% in 2006, with a 3.1% increase from the previous year, and on a par with April 1996.

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5 Febraban is the Brazilian Federation of Banks
1.2 CORPORATE SUSTAINABILITY IN THE BRAZILIAN BANKING SECTOR

With no type of extractive or manufacturing activity, or services and products having significant environmental impact, the financial sector is not considered to have high socio-environmental impact. In fact, the London stock exchange FTSE4Good index rates the sector in the mid-impact category, and in academic literature it is considered to have low environmental impact. Despite this, it does have considerable indirect impact through its financing activities (to be discussed further in the next section), and its role of encouraging sustainable development has been gaining recent worldwide recognition.

Banks can create value for their shareholders while also being catalysts of sustainable development. Including social and environmental variables can create value through a series of mechanisms: increase in the value of intangible assets, such as image and brand, which represent an increasingly large proportion of the company’s total value; improvement in attracting and retaining talent; cutting costs thanks to eco-efficiency methods; better risk management, which consequently creates easier access to capital; and provision of groundbreaking goods and services contributing to further income generation. Recognition of these value sources by the financial sector, once considered very resistant to such opportunities, is increasingly visible in the actions of the major players in this market, in Brazil and abroad.

Obviously Brazilian financial institutions recognize the importance of socio-environmental issues. One example is the fact that six of the ten major banks signed the Equator Principles, four of which are national (BB, Bradesco, Itaú, Unibanco) and two international with a strong presence in the Brazilian market (ABN AMRO Real and HSBC), placing Brazil in the forefront of emerging economies in terms of number of signatories. The Equator Principles are based on the project finance policies and guidelines adopted by the International Finance Corporation (IFC). The prime purpose of these policies is to include environmental and social risk assessment in the evaluation of project finance (see Section 2.1.1.1), and its creation in June 2003 is considered a benchmark in the sector’s recognition of the importance of its finance activities in other productive sectors and, consequently, in the environment and society.

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6 See Seroa da Motta, “Regulation, market or social pressure? The determining factors of environmental investment in industry”.
7 The Equator Principles are a financial industry benchmark for determining, assessing and managing social & environmental risk in project financing.
Four Brazilian banks that signed the Equator Principles are also present in the Bovespa Corporate Sustainability Index (ISE) and Corporate Governance Index of the São Paulo stock exchange (Bovespa), while Itaú and Bradesco\(^8\) are also listed in the New York stock exchange Dow Jones Sustainability Index.\(^9\) Both indices consist only of company shares with a record of good environmental and social actions and governance, although the two are based on different criteria.

Some Brazilian banks have also been awarded prizes and important and special reports on the subject. ABN AMRO Real Bank won the Financial Times prize in 2006 as a sustainable bank in an emerging economy, for adopting international criteria to integrate social and environmental aspects throughout the institution, and was also the subject of a recent Harvard Business School case study.\(^10\) Banco do Brasil was awarded the same prize in 2007 but in the category of Latin American countries (instead of emerging countries). Itaú BBA and Unibanco were also mentioned as examples of banks with responsible performance in an IFC report on banking sustainability in emerging countries.\(^11\)

However, despite the recognition of such awards, no study evaluated the inclusion of sustainability in the strategy of the Brazilian financial institutions, by analyzing their progress, operations and the extent to which social and environmental aspects are actually permeating the different processes and products of these companies. The next section of this working paper discusses the investigation of this subject by analyzing public information on sustainability disclosed in annual reports and websites of the companies.

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\(^8\) It should be mentioned that Bradesco was admitted to this index only in 2006, while Itaú has been included since 1999.


2. SUSTAINABILITY PRACTICES OF THE BRAZILIAN BANKING SECTOR

Corporate sustainability can be found in different forms within the financial sector. In some cases, it is more apparent in the creation of new products with specific characteristics relating to social inclusion or environmental preservation, for example. In others, there is a greater effort to change the existing processes, to include socio-environmental risk analysis in the credit risk assessment process, or even use sustainability criteria to select suppliers. A third group of companies is concerned with both dimensions.

At this stage in the study, the purpose is to find the extent to which the sector is adopting practices and developing products that incorporate social and environmental aspects in order to improve not only the socio-environmental performance but also the economic performance of the companies. This description is not intended to be an exhaustive one. However, it is believed that the points analyzed are extremely relevant.

On the other hand, the set of charted practices and products could change over time as new requirements and opportunities arise, or possibly become part of the regulatory framework or even minimum competition requirements. An illustrative example is provided by information security: some years ago, this issue was highly visible and of major importance for financial clients, today most banks announce their information security policies on their website, and it has become a client requirement rather than a cutting edge approach.

Lastly, each topic examined in this section warrants a separate study, considering the many details and prospects that could be explored in greater depth. In order for this study to focus on the sector diagnosis, however, the aim was to achieve a broader view by analyzing the presence of good sustainability practices in banks and in the sector as a whole.

The above practices were divided into two segments: (i) sustainable finance, which includes practices relating to new products and end activities of the business, and (ii) management, consisting of management practices that are not directly related to companies’ income-earning activities.
2.1 SUSTAINABLE FINANCE

2.1.1 SOCIO-ENVIRONMENTAL RISK ASSESSMENT IN FINANCE

Although internal environmental management of financial businesses makes sense from an economic viewpoint, the direct impact of their activities is considerably restricted in comparison with that of their corporate clients. In this way, banks’ financing activities are the main channel having impact on the environment and communities in the financial sector.

When they include a socio-environmental risk assessment in decisions to grant credit, financial institutions diminish credit risk and default of their client portfolio, and assure that the value of their guarantees is not considerably altered. For example, when granting credit to companies in the oil sector, a firm with a high oil spill risk may have to deal with environmental liabilities, which influences its capacity to honor the credit commitment. When identifying this risk, financial institutions can act to guarantee that corporate clients have a risk management plan, otherwise the financing could be ultimately refused. Likewise, a company in the ethanol sector that uses slave labor to grow sugarcane could be a target for labor lawsuits, which may at any time strongly influence its cash flow.

So, by including such risks in its credit analysis, the bank manages its credit portfolio more efficiently and contributes to better financial performance. Moreover, the bank also operates to permit only the implementation and operation of projects and companies that contribute to sustainable development, environmental preservation and improving community living conditions.
BNDES, a bank that provides such funding, announces on its website its policy of “development and ongoing upgrade of environmental risk credit assessment and environmental project analysis, in accordance with the concept of environmentally sustainable development”. According to the information provided, the environmental risk assessment is already part of the financing procedures of this institution. Likewise, the social report of Banco do Nordeste for 2005 also suggests that there are well-defined criteria for the environmental risk assessment of projects.

In Brazil, some players in the sector have already included environmental and social risk assessment in their normal financing practices. However, research of public data reveals that four out of the ten major banks in Brazil have no socio-environmental risk analysis. In addition, only four out of the six banks that conduct this type of analysis disclose indicators relating, for example, to the total value of financing including this analysis, as well as number of analyses, number of approvals, approvals with provisos, or rejections.

### 2.1.1.1 EQUATOR PRINCIPLES

Brazil, as mentioned above, is in a distinguished position in the Equator Principles, since six of the ten major banks of Brazil are signatories, placing the country at the forefront of the emerging economies in terms of the number of participating banks. It is, however, well-known that the project finance share in the credit portfolio of these banks is small; in the case of Bradesco, the projects where the Equator Principles were applied correspond to around 3% of the bank’s credit portfolio.¹²

Furthermore, Brazil is still maturing with regard to the practices of reporting information on the adoption of these Principles. Only three of the six signatory banks disclosed information about value and number of projects in their latest reports. Consequently, the lack of relevant information opens to a more effective and transparent positioning of the institutions in this regard.

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¹² Bradesco is one of the three banks that contributed with the total value of the project portfolio that was assessed according to the Equator Principles.
2.1.2 RESPONSIBLE LENDING

The term responsible lending refers to lending and financing practices that improve, and do not impair, the client’s financial status. Thus, responsible lending involves, at first glance, the load of appropriate sums under reasonable conditions (interest rates and terms) guaranteeing that their clients do not commit a large portion of their income to financing that cannot be honored. This practice also involves financial counsel for the borrower, with advice on avoiding exposure to unnecessary and inappropriate financial risks, considering short and long term objectives.

Responsible lending brings two main benefits to the banks. First, a client heavily in debt today may not be a client tomorrow, while a client borrowing smaller sums, better adapted to his or her income level will tend to continue creating business for the bank. Also, responsible lending brings intangible gains to the company, as it strengthens client confidence in the institution, thereby improving its brand and reputation. However, despite these potential benefits, the question of responsible lending is somewhat more complex.

The crux of the problem is the conflict of interests between the various stakeholders involved. On one hand, commercial managers must achieve very tight goals based on performance assessment systems focusing on quarterly, half-year and annual results. On the other hand, clients have limited understanding of the available finance products and, possibly, little financial know-how. The equation becomes even more complicated with the predatory action of competitors, creating pressure on the institution to achieve better results. So, how can it act responsibly to guarantee the client’s long-term financial health, without detriment to the institution’s results?

Dealing with the question of responsible lending is not a simple challenge. Not only must investments be made in systems that enable the full understanding of the financial status of the client, but the banks’ performance assessment must be reviewed to encourage managers’ responsible behavior, without impairing the value creation of the bank. Moreover, it is important to be constantly

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The term “responsible lending” is also used jointly with responsible banking, including in this scope investment and insurance activities. The discussion in this section certainly also applies to the subject.
aware of those agents who have a closer relationship with the public, and to instruct less informed clients about the value of sustainable activities.

In Brazil, high interest rates and the poor financial status of a large part of the population make this topic especially relevant. The image of the Brazilian financial sector is fairly negative to consumers, who closely associate it with huge profits, bank spread levels far above international standards, and a reputation for unsatisfactory service or collecting unknown charges.

The conclusion drawn from analyzing the public documents of financial institutions is that this issue does not seem to be given due attention by the major Brazilian banks. In comparison, the Australian bank Westpac, leader in the banking sector of the Dow Jones Sustainability Index, devotes an entire section of its sustainability report solely to addressing this issue. It goes beyond the discussion of client satisfaction indices to mention specific actions taken by the bank and includes, for example, facts such as the launch of a 50-employee team to help customers in investment activities, holding financial education workshops with small businesses, and proactive contact with clients of services with altered interest rates to discuss refinance options. The bank also clearly announces its goals for the next year and the indicators used to assess its performance in this field.

2.1.3 MICROCREDIT

Microcredit consists in making small loans to low-income earners who usually have no access to bank loans because they are insufficiently solvent and/or because the cost of managing such loans is considered too high. Microcredit loans enable the beneficiaries to create or expand micro-enterprises or other income generating activities.

The definition of microcredit is “the extension of credit to entrepreneurs and very small businesses, differentiated from other types of loan by the methodology adopted, involving agents, solidarity guarantee and short finance terms.” This type of credit became popular with the success of Grameen Bank in Bangladesh. Its owner, Muhammad Yunus, won the Nobel Peace Prize in 2006 and the microcredit model adopted by his bank was copied by other institutions around the world. By December 2006, Grameen Bank had already approximately seven million customers, 97% of them women. Through its 2,319 branches, the bank offers services to 74,462 villages, covering most of Bangladesh. In 2005, the bank recorded a profit of 20 million dollars and a default rate of less than 5%, in addition to helping save many of its clients from poverty.

The microcredit concept is based on granting loans to low-income individuals who do not have access to traditional bank loans. These people normally have no material goods or fixed jobs to act as a guaranty for loan applications. However, this type of loan is granted to a group of individuals and its prime purpose is to encourage income-earning activities. The guaranty of repaying the loan is given by the group, so that they supervise each other and do the work together, thereby increasing the likelihood of repaying the debt. Consequently, microcredit promotes sustainability for various reasons: (i) it uses a differentiated business model potentially profitable for the creditors; (ii) it meets the credit requirements of a segment of the population that would normally have little access to this kind of service; and (iii) encourages economic and social development in the region.

In 2003, the Brazilian government established a series of measures to encourage public and private banks to grant microcredit. Law no. 10735 was enacted at this time, according to which banks had to allocate 2% of their cash deposits to this kind of credit. Also, the maximum microcredit value should vary according to the specific nature of the microcredit operation, as provided in CMN Resolution no. 3,422, and may be as much as R$ 10,000,00 (ten thousand reals). Should the banks not wish to invest these resources in microcredit, they could remit the sum to other banks to invest it in this form. Resources that are not invested should be retained by the Central Bank without remuneration.15

In Brazil, among the institutions surveyed, five banks have focused productive microcredit programs; in one case, this is still a pilot project. In two other cases, data referring to the value of the portfolio and number of contracts is disclosed, but there is no available information about the profitability of the service. In fact, an examination of the bank reports in this survey shows that this activity has still to be profitable in Brazil.

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The ABN AMRO Real Sustainability Report for 2005/2006, for example, states that this product should reach its balance point by the end of the year when the report is published (2007), although this goal was stated in the previous report (2005). At the same time, the newspaper Valor Econômico published a story in November 2006, stating that Bradesco had abandoned its mandatory microcredit program due to high default rates (18%) and restricted interest (2%), and had returned the required resources to the Central Bank.16

**Figure 12 – Directed Productive Microcredit**

<table>
<thead>
<tr>
<th>Important Facts about Microcredit in Brazil</th>
</tr>
</thead>
<tbody>
<tr>
<td>• In 2003, the Federal Government approved Law no. 10735 that forces the banks to allocate <strong>2%</strong> of its cash deposits to microcredit activities.</td>
</tr>
<tr>
<td>• The total value of cash deposits in 2006 of the ten largest financial institutions is more than <strong>110 billion</strong></td>
</tr>
<tr>
<td>• Only <strong>5</strong> of the <strong>10</strong> largest institutions have directed productive microcredit programs</td>
</tr>
<tr>
<td>• There are <strong>124.5</strong> million people living at the base of the pyramid in Brazil</td>
</tr>
</tbody>
</table>

Considering these facts, the question is: with the base of the pyramid of 124.5 million people17, why is microcredit not yet feasible in Brazil? A series of possible causes were found when examining reports and other publications:

- Over-regulation by the government, especially the restriction of interest rates for this type of loan
- Competition from alternative funding sources (stores, family loans, suppliers)
- Lack of reporting system with information about good payers
- Management problems in the few OSCIP’s (Public Civil Society Organizations) registered for remittance of funds
- Its practice is still in the early stages of the learning curve.18

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16 *Valor Econômico*, 11/14/2006 edition -


18 Note that the Grameen Bank had steady profits only after 18 years of operation.
Despite these problems, the performance of one of the institutions studied is worth mentioning: that of the Banco do Nordeste. BNB’s Crediamigo program has been working in the focused productive microcredit segment since 1998, and the bank announced an income of over R$ 26 million in this activity in 2006. The program has the support of 170 branches and 26 service centers, covering 1,420 counties in Northeast Brazil, North Minas Gerais and Espirito Santo States, and attends 235,729 clients. The excellent performance of BNB in this activity is a benchmark for the sector and shows that it is possible to leverage this market, even with the challenges present in Brazil.

2.1.4 SOCIALLY RESPONSIBLE FUNDS

Socially responsible funds are share portfolios consisting of company securities managed in accordance with the best governance and corporate sustainability practices. Such funds consider that sustainable companies create long-term value for the shareholder, since they are more prepared to face economic, environmental and social risks,\(^{19}\) as well as chart opportunities. In the USA, the volume of socially responsible investments increased 258% between 1995 and 2005, 9% more than the total investments in assets for that same period, to reach a total value of US$ 2.29 trillion in 2005.\(^ {20}\) In fact, there are signs that these funds are as or more profitable than other funds of variable income.

This kind of investment can bring the investor the same or even better return than the average market performance, as illustrated by the fact that the Dow Jones Sustainability Index World, consisting only of shares of companies with good sustainability practices, in 2006 had a considerably better performance than its benchmark (24.08% and 20.7%, respectively). The São Paulo stock exchange in December 2005 also created the Corporate Sustainability Index (Bovespa ISE), whose profitability in 2006 (37.82%) was also higher than the benchmark (Ibovespa, with 32.93% profitability). The Bovespa ISE, also consisting of company shares with good sustainability practices, adopts as an assessment method a methodology designed by the Center of Sustainability Studies in FGV-EAESP (Getulio Vargas Foundation-São Paulo State School of Administration). In general, the methodology aims to evaluate companies’ policies, management practices and performance

\(^{19}\) Source: Bovespa website (www.bovespa.com.br)

assessment according to economic-financial, social and environmental dimensions, jointly with aspects of corporate governance, through a structured questionnaire based on the methodologies of similar indices already available in the New York (DJSI, 1999) and London (FTSE4Good, 2001) stock exchanges. The 2006 portfolio consists of forty-two companies, four in the financial sector (Banco do Brasil, Bradesco, Itaú and Unibanco), responsible for 38.92% of the ISE portfolio.21

In Brazil, six of the ten largest banks perceived the growing demand for socially responsible investments, and responded by creating funds with these characteristics. To date, Santander, Votorantim, Unibanco and the Caixa Econômica Federal do not have this type of fund in their portfolios. On the other hand, ABN AMRO Real gained international recognition in this area when, in 2004, its ethical fund was ranked as the best performer of 210 socially responsible investment funds in the world, with a profitability of 44%, at a time when the SRI funds were approximately 5% of the bank’s variable income portfolio.

Figure 14 shows the profitability of SRI funds managed by the Brazilian bank majors (or related fund managers) for 2006, according to the data provided by CVM. It seems that all funds of this kind had a higher profitability than the Ibovespa,22 suggesting that they are a good option not only for socially responsible investors but also for other investors who are looking for variable income funds with good profitability.

<table>
<thead>
<tr>
<th>Fund Name</th>
<th>Profitability (2006)</th>
</tr>
</thead>
<tbody>
<tr>
<td>HSBC FIA Ações Sustentabilidade Empresarial</td>
<td>46.93%</td>
</tr>
<tr>
<td>BRADESCO FIA Índice de Sustentabilidade Empresarial</td>
<td>45.91%</td>
</tr>
<tr>
<td>BRADESCO Prime FIC FIA Índice de Sustentabilidade Empresarial</td>
<td>37.03%</td>
</tr>
<tr>
<td>ABN AMRO Ethical II</td>
<td>41.41%</td>
</tr>
<tr>
<td>Fundo Itaú de Excelência Social</td>
<td>36.29%</td>
</tr>
<tr>
<td>SAFRA ISE - Fundo de Investimento em Ações</td>
<td>36.03%</td>
</tr>
<tr>
<td>BB Ações Índice Sustentabilidade Empresarial</td>
<td>34.19%</td>
</tr>
<tr>
<td>ABN AMRO Ethical</td>
<td>34.09%</td>
</tr>
<tr>
<td>Ibovespa</td>
<td>32.73%</td>
</tr>
</tbody>
</table>

Source: CVM

21 Data taken from the Bovespa website (www.bovespa.com.br), on 07/23/2007
22 The Safra ISE share investment fund began operating on January 23, 2006; so the comparison of its profitability with that of the other SRI funds is restricted.
2.1.5 SOCIO-ENVIRONMENTAL FINANCING

Another project of the sector relating to sustainability concerns launching finance lines with specific characteristics for socio-environmental projects. Offerings include more attractive interest rates, longer terms or even discounts on the principal. The supply of these special products not only helps improve the economic-financial performance of these institutions (by increasing incomes), but also helps improve the environment and communities. Moreover, with the growing awareness of current socio-environmental problems, such as global warming, it is likely that the demand for products of this type will increase in the coming years.

Examples of products of this kind already offered by major Brazilian banks include finance for projects to reduce solid waste or effluents, exchange liquid fuel for natural gas, vehicle financing for people with disabilities, and financing eucalyptus planting for small rural producers (and subsequent protection of native reserves). Five of the ten largest banks offer financing with these characteristics, although no data on the profitability of these products was available.

2.1.6 CARBON MARKET

In 1997 the Kyoto Protocol was signed at the United Nations Framework Convention on Climate Change to set targets to reduce greenhouse gas emissions by countries considered to be most polluting — the Annex I countries. The Protocol provided market mechanisms by which there could be possible compensation for failure to meet reduction targets, one of which is the Clean Development Mechanism (CDM). The CDM encourages sustainable development in developing countries by setting up projects to reduce the greenhouse gas emissions, namely, substituting fossil fuels with renewable energies (such as biomass and ethanol), methane collection in sanitary landfills, forestation and reforestation of degraded areas, and so on. The Kyoto Protocol allows for the trading of carbon
credits generated by projects of this kind; in 2006 the total value of the carbon market was approximately US$ 30 billion.23

In accordance with the latest report issued by the Ministry of Science and Technology, a total of 2,220 projects are at the same stage of the project cycle of the CDM, 710 have already been registered by the CDM Executive Council and 1,510 are in other stages of the cycle. Brazil ranks third in project activities, with 230 projects (10%), India (692 projects) in the lead and China (594 projects) in second place. In relation to the volume of reduced emissions, Brazil also ranks third, corresponding to 6% of the world total, behind China (48%) and India (24%).

It is therefore clear that Brazil has potential in the carbon market that financial companies could explore. Three main areas for the sector in this activity are worth mentioning: (1) project financing; (2) advisory services on the project’s adaptation to CDM standards, and (3) trading securities. Analysis of companies’ public documents showed that only ABN AMRO Real bank is trading carbon credit securities, as Figure 16 shows.

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23 It is worth pointing out also that the sale of carbon credits deriving from CDM projects on the European stock exchange (EU ETS), however, is not the only one; the carbon market also includes the Chicago climate exchange (CCX), and the Australian Climate exchange New South Wales Greenhouse Gas Abatement Scheme (GGAS), although with a much smaller volume.
2.1.7 ENVIRONMENTAL INSURANCE

Environmental insurance is a reasonably new practice in the worldwide financial sector, mostly found in European banks. The product consists basically of covering expenses incurred by polluting activities, for example, relating to damages and losses caused to third parties, body and material damages, cleaning and even legal costs, which would therefore play a compensatory role in the event of an environmental accident. However, in the actual contracting act, consultants from the insurance institution would indicate problem areas in the insured company, making an accurate assessment of its environmental risk and suggesting possible actions that could already be taken to mitigate this risk. In addition, the insurance company can also monitor the behavior of the insured party to prevent it at some time be engaged in activities that may cause environmental damage.

In Brazil, only one bank (Unibanco) in the study was found to offer this type of product. This could therefore be a better explored market in the future by the major Brazilian financial institutions, depending, of course, on increased demand.
2.2 MANAGEMENT

2.2.1 ECO-EFFICIENCY

Eco-efficiency is an important factor in any company seeking sustainable use of natural resources, since it reconciles the sustainable use of finite resources with efficient production and cost reduction. Banking has a high consumption of paper, due to the need to mail bank correspondence (such as statements, credit card bills, investment balance sheets and promotional material), complete forms, print reports and other activities.

It is worth mentioning that, contrary to popular belief, excessive paper consumption does not have negative consequences for native deforestation, since all paper produced and consumed in Brazil comes from planted and not native forests. On the other hand, increasing the use of recycled paper reduces solid waste and, consequently, reduces pollution. Moreover, the increase in recycled paper consumption is an incentive for paper collectors and encourages social inclusion of the lower-income classes.

However, to increase the use of recycled paper is no easy task. In addition to the acceptance of the clients toward this kind of paper, the use of recycled paper requires adaptation of printing processes, bearing in mind that recycled paper is darker and requires special treatment to maintain the printing quality, requiring more ink. Recycled paper also does not have significant price benefits; in fact, it may even cost more than normal paper.

Higher paper consumption leads to higher ink consumption. Also, consuming recycled paper increases ink consumption, which may or may not be produced with sustainable practices. Ink consumption, therefore, is also relevant in the context of eco-efficiency in the financial sector. Also, bearing in mind that a part of the banks’ printed matter involves printers, a relevant question is: to what extent do banks encourage printing companies to select ink suppliers with sustainable production practices?

Another question relating to eco-efficiency in this sector concerns the energy used by financial institutions. Although most power generation in Brazil is clean and renewable,²⁴ the intensive energy consumption by large institutions (such as banks) is relevant due to the shortage of energy resources currently being faced by the country. The energy-saving measures undertaken by banks is also an important aspect of sustainability for the financial sector. A widely recognized project in the sector was the construction of the Bandeirantes thermoelectricity plant in 2003, the largest biogas plant in the world and the first in Brazil, in partnership between Unibanco, Biogas Energia Ambiental and

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²⁴ Hydroelectric generation accounted for 83% of Brazil’s total electricity supply in 2004.
Eletropaulo. The plant produces biogas from methane gas from the Bandeirantes landfill, producing more than 170,000MWh a year, supplying the Unibanco office buildings and neighboring communities, and helping cut costs (from using this new source of alternative energy) and additional income from the sale of 1,200,000 tons of carbon credits.²⁵

Other eco-efficiency measures, such as the use of water and emissions from solid and liquid pollutants, are not very relevant in this sector given the small volumes, compared to other manufacturing sectors. Even so, the Brazilian financial sector has adopted a series of programs for conscious consumption of resources and solid waste treatment from banking operations. Examining the banks’ public documents does not allow a comparison of eco-efficiency initiatives – again, due to lack of indicators, or lack of standardized indicators – to find the largest consumers of resources and producers of pollution. However, the 2006 Febraban Social Responsibility Report examines all eco-efficiency programs, and shows that banks play an outstanding role in this survey. According to its report, the institutions that answered the Febraban questionnaire in 2006 produced 42% less solid waste and consumed 75% less electricity and 63% less water.

2.2.2 SOCIO-ENVIRONMENTAL CRITERIA IN SELECTING SUPPLIERS

Considering the large number of suppliers to financial institutions, screening suppliers for the inclusion of social and environmental aspects is particularly relevant. A service provider that overworks its employees, for example, could influence work productivity, the quality of the service provided and the operations of the financial institution itself. A motorcycle delivery service that fails to provide its drivers with the proper safety equipment or training can also endanger the delivery of important financial documents. The purchase of paper from native forests, likewise, can give rise to an interruption in the supply of the material in a possible crime against the environment. In many ways the socio-environmental behavior of the suppliers can have a direct influence on the financial result of the Brazilian banks and their image.

These suppliers can be engaged in different ways, ranging from inclusion of contractual clauses on these aspects, to holding meetings and workshops to educate suppliers and raise awareness of the importance of such issues. Nor is this question restricted only to reviewing outsourced management

²⁵ Source: São Paulo City Hall, Municipal Bureau for the Green and Environment.
practices. The relationship must be reciprocal; in other words, it is also important to confirm whether the banks themselves are acting in a sustainable manner toward these companies. How much more is a bank prepared to pay for a responsible supplier? The assumption that socio-environmental responsibility should not generate any extra cost does not always apply.

In Brazil, six of the institutions in the study state in their reports and websites that their socio-environmental screening criteria when selecting suppliers are to reduce labor, operational and legal risks. Some of these institutions have websites devoted solely to dialogue with suppliers, making their selection policies and contractual clauses clear and intelligible. However, there is still considerable lack of disclosure of indicators on eligible and ineligible suppliers, and reasons for exclusion in these selection processes.

2.2.3 DIVERSITY

Diversity in the workforce is an extremely sensitive issue since it concerns not only complying with legal goals, but also comparison of awareness of social discrimination. This discrimination can exist with different degrees of intensity considering the aspects of age, gender, creed, sexual preference and ethnicities.

Although difficult to quantify, diversity in the workforce is regarded as a challenge to sustainability, for two main reasons:

- When companies fail to achieve legal targets, they may be fined depending on the relevant legislation. One of the banks in the study, for example, was fined R$ 500,000 in 2001 for failing to reach the minimum levels of employees with disabilities, pursuant to Law 8213/91.

- In addition to meeting legal targets, organizations can gain additional benefits through a diverse workforce, since it can contribute to mitigated risks and anticipate opportunities, specific or not for minorities.

Figure 19 illustrates the banks’ disclosure of information about diversity-related variables. Most banks do disclose information on diversity. However, details of this information vary considerably from one bank to another, which makes any comparative study impossible. ABN-AMRO’s 2007 sustainability report, for example, provides tables showing the
participation of women of certain ethnicities at different hierarchy levels in the company, while the Unibanco report merely announces the social report according to the IBase model.26

Although the disclosure of this information in itself indicates the transparency of the bank regarding its diversity practices and, consequently, its commitment, the level of sophistication in knowledge and reporting is not a complete indicator of diversity management. It is necessary to perform a detailed investigation to learn the extent to which diversity is truly being valued in the organization.

2.2.4 DISCLOSURE OF INFORMATION RELATING TO SOCIO-ENVIRONMENTAL PERFORMANCE

An important aspect in the socio-environmental behavior of the institution is its transparency in reporting its socio-environmental performance. A company’s transparency regarding its conduct in these two dimensions is indicative of its commitment to sustainable development. Evidence of the importance given by the market to this aspect is the inclusion of socio-environmental disclosure criteria among the requisites for admission to not only the Bovespa Corporate Sustainability Index but also to the Dow Jones Sustainability Index. Companies that do not disclose relevant information would find it difficult to be admitted to the corporate sustainability benchmark index.

In the Brazilian financial sector specifically, this information is disclosed in different ways, and to differing degrees of detail. Although many banks now have a website dedicated solely to reporting socio-environmental information and have a specific report as part of their annual report, there is wide variation in the use of indicators and metrics for reporting performance in these two spheres. While some banks report a series of indicators on their socio-environmental performance, others restrict themselves to a qualitative description of social and environmental programs and actions. In this respect, the performance of ABN AMRO Real bank is outstanding with its sustainability report for the two-year period 2005-2006, and a section at the end of the document dedicated to social and environmental indicators. The 2007 report was produced to the Global Reporting Initiative’s A+ level, the most complete reporting system possible. To date, only 47 companies in the world have produced A+ level reports.27

26 IBase – Brazilian Institute of Social and Economic Analyses. IBase provides a model with sustainability indicators.

The Global Reporting Initiative (GRI), a non-profit non-governmental project, was created in 1997 to make the content of the sustainability reports more relevant, robust and comparable. In 2007, 342 companies published their reports using the GRI guidelines, 18 of which were Brazilian. GRI has, in fact, a supplement listing specific environmental and social indicators for the financial sector. Six of the companies analyzed in this study use the GRI guidelines to prepare their reports, and the same number of companies uses the IBase Sustainability Indicators for Social Reports when they announce socio-environmental information. It can be said, anyhow, that such practices have made progress in a short period of time.
2.2.5 CLIMATE CHANGE

The global warming issue brings threats and opportunities to the financial sector. The main opportunities, mentioned earlier, are related to new products and performance niches, such as financing clean energy projects or activities relating to the carbon market. Additionally, climate change has also prompted financial companies to review their internal processes to reduce their impact on the environment, and to protect themselves from possible natural disasters from the increase in global temperature. This issue now attracts special attention in the questionnaire of Dow Jones Sustainability Index and in bank reports in countries that signed Annex I of the Kyoto Protocol, which therefore have targets to reduce greenhouse gas emissions. Examples of banks that devote the most attention to this topic in their reports are HSBC (worldwide) and ABN AMRO (worldwide).

Although Brazil is not yet part of this group of countries, it is very likely that it will do so in the next version of the treaty. Brazilian banks are beginning to take some initiatives on this subject: greenhouse gas emissions from these institutions are being discussed in the reports, neutrality targets are being adopted and many banks participate in the Carbon Disclosure Project,28 as illustrated in Figure 21.

Another aspect calling further attention from institutions in Annex I countries is the quantifying of financial risks from climate change. In accordance with the Carbon Disclosure Project 2006, the main financial risks of climate change identified by the Global FT 500 companies are related to:

- Physical risks such as damages to assets or delays in projects due to the increase in the number of days with adverse climate conditions;

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28 The Carbon Disclosure Project is a non-profit project financed by the British government’s Carbon Trust and by a group of foundations headed by the Rockefeller Foundation, the objective of which is to inform investors about the relevant risks and opportunities arising from climate change.

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Figure 21 - Climate Change

<table>
<thead>
<tr>
<th></th>
<th>Reports GHG emissions?</th>
<th>Has goal of being carbon neutral?</th>
<th>Participates in Carbon Disclosure Project?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bradesco</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>HSBC</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>CAIXA</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>UNIBANCO</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>BB</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>HSBC</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>ItauBBA</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Banco do Brasil</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>
• Regulatory risks, resulting from stricter legislation regarding companies’ greenhouse gas emissions;

• Competitive risks, arising from possible reductions in the consumer demand for energy-intensive products, or for possible increases in the costs of energy-intensive processes;

• Risks against reputation, deriving from a perception of inertia of institutions that do not take initiatives relating to this problem.

The DJSI questionnaire also addresses this aspect specifically on governance practices toward climate-change questions. However, the banks in the study showed no signs of such activities, which will certainly be a future challenge for Brazilian institutions.

2.2.6 INFORMATION SECURITY

The growing virtualization of money is making it possible for banks to better understand their clients’ consumption habits. Technologies such as magnetic cards, online-banking, mobile banking and e-wallet\textsuperscript{29} are some examples of catalysts of the convergence of the IT industries and financial services.

Although this movement brings with it substantial benefits for the financial institutions and their clients, it is also a major threat to client privacy. Undue transfer of this information to third parties could have undesirable results, ranging from its use for supplying other products to the malicious use of information for different objectives, such as card cloning or even theft and kidnapping.

The Brazilian financial sector, as a whole, is already aware of how important this question is. The websites of most banks in this survey disclose policies relating to security and privacy of information, which is also a major requirement in the questionnaires on sustainability ratios.

\[\text{Figure 22 - Information Security}\]

\(\text{Table 22}\)

\begin{tabular}{|c|c|}
\hline
Bank & Releases policies related to information security? \\
\hline
Bradesco & √ \\
Itau & √ \\
CAIXA & √ \\
UNIBANCO & √ \\
HSBC & √ \\
Safra & √ \\
BancoMetrantim & X \\
\hline
\end{tabular}

\textsuperscript{29} e-wallet is a technology that permits financial transactions through encrypted wireless communications, and keeping personal data in a magnetic card or chip.
2.2.7 MONEY LAUNDERING

Money laundering concerns the privacy of information and ethical working standards. This issue attracts special attention in many countries’ reports (in particular Swiss) on socio-environmental responsibility, since it has been a target of international criticism by facilitating traffic of illegal funds. In Brazil, this question is quite relevant considering the frequent accusations of corruption in the different spheres of society. The ban on money laundering is a legal obligation provided in Law 9613/98.

Likewise, most institutions in the study disclose information on their anti-money laundering policies to different levels of detail.

2.3 CONCLUSIONS ON SUSTAINABLE PRACTICES IN THE FINANCIAL SECTOR

Figure 24 summarizes the survey of sustainable practices discussed in this section. Analysis of public information of the Brazilian bank majors shows that the sector now includes social and environmental aspects in its operating activities. Nevertheless, there is a striking discrepancy between practices and level of disclosure in the institutions analyzed: while some institutions show clear leadership in including sustainability in business and its disclosure, it is also evident that other institutions are only beginning to consider socio-environmental aspects in their daily business.

When analyzing the socio-environmental information there is a visible lack of suitable indicators to measure the social and environmental performance of the institutions.

Source: Bank Reports – FBDS Analysis
Some explanations may be as follows:

- The sector does not keep a record of the performance indicators in the social and environmental spheres, since it does not consider the topic sufficiently relevant;

- The sector keeps an internal record of the indicators, but believes that their disclosure is unimportant since there is no direct or indirect association with the financial performance;

- The sector keeps an internal record of the indicators but prefers not to disclose them, possibly because performance is below the expected minimum level.

It is also believed that there is a growing demand for this kind of information and that, although most of the institutions are still in the early stages of announcing their socio-environmental performance, they are clearly alert to the major concern of society regarding the current socio-environmental challenges. It is expected that, as the social and environmental indicators reach a standard comparable with that of the economic-financial performance and the processes of collecting these indicators are consolidated, the financial institutions will disclose them to the general public on a consistent and ongoing basis.

Moreover, although this study did not focus on the current demand for socio-environmental products, it was found that some of them could be better explored by the banks, such as microcredit, socio-environmental financing lines, environmental insurance and activities relating to carbon markets. However, since they are relatively recent products, it is believed that they will have an increasingly prominent presence in the financial market.

The study suggests that sustainability issues clearly affect the value creation of financial institutions, and the existence of a business case for sustainability is therefore quite evident. However, many of these issues have indirect consequences on the bottom line of the companies by the influence on brand and reputation, capacity to attract and retain talent, or more directly by the stronger attraction of clients and ability to capture resources. This may make sustainability-related gains or losses harder to measure, and consequently hinder a strong business justification for sustainability in the financial sector.
3. EXECUTIVES’ VIEWS OF THE CHALLENGE OF SUSTAINABILITY TO BANKS

In this section, the results of the interviews with the top executives of the major Brazilian banks will be discussed, together with the analysis of questionnaires they completed and a larger contingent extending to the mid-management level. This section was divided into five topics, in line with the CSM/IMD methodology, as follows: (i) motivation for including sustainability in business; (ii) ability to implement the concept within companies; (iii) alignment of the various areas of the organization; (iv) use of related tools, and (v) national and sectoral peculiarities interfering in sustainability.

3.1 MOTIVATION

During the study and interviewing, it was found that the concept of corporate sustainability is reasonably well understood by executives in the Brazilian financial sector. It is apparent that there is still a certain association with the concept of social responsibility, whose approach is quite different from corporate sustainability, since it is anchored in compensatory actions, not necessarily relating to daily business. This association possibly comes from the strong traditional role played by the financial sector in social projects, run by foundations and institutes associated with major financial institutions. In fact, sometimes, when discussing institutions’ sustainability practices, executives would refer to the projects of those organizations instead of those of the actual bank.

There is clearly also a differing level of sophistication in understanding of the concept among the ten top financial institutions. While some had advanced knowledge on the subject, others showed that they are still in the early stages of learning and assimilating the concept. The executives in each institution were in agreement, with a few exceptions. In other words, although the topic was understood to varying degrees among the institutions, the understanding was fairly similar among the interviewees within each institution.
The interviewed executives believe that the inclusion of sustainability in banks’ strategy involves a number of challenges, listed in Figure 26. Some are related to the inclusion of sustainability in the overall organization, such as the challenge of disseminating the concept throughout the corporation and engaging employees, while others focus on specific areas, such as socio-environmental risk assessment or including the poor in the banking services. Other challenges were also mentioned but to a lesser degree, namely the relationship with the large number of suppliers and service providers and the development of indicators to more efficiently measure customer satisfaction.

Among the motivating factors or agents for advancing the sustainability agenda in the financial sector, it was found that pressure imposed by players outside the company is diluted by various members of civil society, including not only consumers but also the media and non-governmental organizations. Some interviewees also mentioned the influence of competitors’ actions, forcing financial institutions to adopt sustainable business practices, but also to disclose them appropriately, so that these projects are visible and recognized by the various agents outside the firm. The regulatory agencies, in turn, have little influence in this arena, in the opinion of the executives. In fact, the interviewees say that the move to include social and environmental aspects in the banks occurs principally from the inside out and not from the outside in, arising, for example, from values of the controlling shareholders and guidelines designed by leaders. This means that, although they recognize that there is an influence from external players, executives see this influence as secondary in promoting sustainability in financial institutions.
When asked about the value vectors for sustainability, it was quite evident that the main driving force of this movement involves internal values of ethics and respect for society. In other words, although items such as reinforcing the brand, having a competitive edge and cutting costs were mentioned during the interviews, the executives stressed the importance of the internal values of the banks as motivating forces of sustainability. This does not mean that the benefits relating to the intangible assets are not considered relevant. In fact, 92% of the respondents said that brand and reputation are key factors for their institutions.

Likewise, in the opinion of the executives in sustainability-related areas, the result of the questionnaires points to strengthening the brand and reputation as a main value vector, followed by innovative goods and services, and lastly to mitigating risks. However, some executives pointed out that, although the sector is traditionally known to be results-driven, the quantification of the sustainability benefits is not perhaps the key factor in promoting sustainable management within the institutions, while the most important factor is the awareness of the leaders and employees. One of the interviewees describes this view in a nutshell: “I’d like to meet someone who wants to show me an account, but I’d also like to mention that I don’t think this is the solution for engaging leaders in this matter.” The statement illustrates the view of some executives that, although it is important to quantify the value of sustainability projects - and it is necessary for sustainability to progress in this area – good socio-environmental practices can advance simply because they are “the right thing to do.”

3.2 CAPACITY TO IMPLEMENT

A factor of the utmost importance in promoting corporate sustainability is the presence of leaders, preferably the company’s top executives, who effectively support this agenda. In some institutions in the study, it was found that the strong conviction of leaders in senior management helped promote the
inclusion of social and environmental aspects in the company strategy. One of these leaders deserves special mention: Fabio Barbosa, CEO of ABN AMRO Real, was identified in all interviews in his institution as the main executive behind this movement in that company. In other institutions, however, different leaders were identified on the topic of sustainability, suggesting therefore that there was no single leader in these organizations.

As Figure 29 shows, the interviewed banks now show signs of adapting their organizational structures to a better approach to the topic, considered important at the current stage of maturation of the institutions in relation to the question. A number of banks have created areas of social or socio-environmental responsibility, committees and commissions of socio-environmental or ethical responsibility with executives from different areas in the institution, and specific sub-areas to deal with issues such as socio-environmental risk and socio-environmental products. The interviewees typically think that the bank structures prefer the sustainability concept. Some banks mentioned that the prevalence of decisions taken in peer groups and multidisciplinary committees plays a decisive role in developing sustainability to pervade the most important processes of the institutions. Concerning the organizational culture of these institutions, most executives interviewed confirmed that this benefits the development of sustainability in their firms, although the sector is better known for its focus on short-term results. As already mentioned, many of these banks have a long history of socially responsible actions, involving employee volunteer projects, which certainly influence the culture of these institutions and increase their consequent desire to implement the concept.

Three strengths and weaknesses were found to be the main internal factors in promoting and preventing the advance of sustainability within the financial institutions, as listed in Figure 30.
Widespread coverage of the sector is considered to be not only a strength, inasmuch as it covers most of Brazil, and also a weakness, since it is harder for the entire organization to assimilate the concept and change processes to include the social and environmental aspects. The financial sector’s capacity for implementation, with its competent and dynamic role, and its past social actions including this factor in its institutional culture were the other two main forces mentioned.

The weaknesses not only include the coverage aspect, already mentioned, but also the banks still feel the need for increased awareness of employees, especially at mid and low hierarchy levels. Lastly, many executives believe that the financial institutions have performed very poorly in disclosing sustainability projects, which are now part of the banks’ daily routine, and therefore fail to enjoy possible benefits from the company’s name and reputation.

3.3 ALIGNMENT OF THE VARIOUS AREAS OF THE ORGANIZATION

One of the key factors for further corporate sustainability is to align the different areas in understanding the concept. It has already been mentioned that there is a reasonable alignment (with few exceptions) of the opinions of the executives in the same company on understanding the concept of corporate sustainability.

It is only natural that in the process of adopting the sustainability concept, there is resistance from different organizational areas. This hinders the inclusion of these aspects in all business activities. However, the study found that there is no organizational area, in the opinion of the interviewees, that offers strong resistance to the topic. It should be mentioned, however, that resistance could still arise because social and environmental aspects have perhaps not yet been fully included in all areas of the organization and so it is still impossible to identify stronger resistance.
Figure 31 shows the composition of the answers to the questionnaires on the barriers against adopted sustainability projects in the institutions. In the perception of the executives, the two main identified obstacles are organizational culture and lack of management know-how on the subject. The result of the questionnaire contradicts the findings from the interviews that the organizational culture of Brazilian banks is in favor of adopting the concept (which was discussed above). This opposition may be explained by the difference between the interviewees and those answering the questionnaires; while the interviews were concentrated at executive level, the questionnaires were answered not only by executives but also by mid-management, showing a possible difference in the perception of these two groups.

Not all banks, however, seem to be at the same implementation stage concerning the inclusion of sustainability in the company’s strategy and its corresponding disclosure. While some executives believe that sustainability is clearly included in the company strategy – or in its strategic pieces such as vision, mission and values – others think that there is still room for improvement. With regard to disclosure of the strategy, most interviewed executives stressed that it was necessary to disseminate the organization’s approach to the most effective inclusion of sustainability not only for internal but also for external publics.

Figure 32 lists the missions and visions of the institutions in this study. Some of the major financial institutions already seem to have incorporated the concept of sustainability in their outlooks or missions in different ways, when they mention issues such as permanence, the country’s development or quality of life of society. However, some institutions still have to place the concept in their strategic positioning tools, which certainly leaves room for improvement in promoting the sector’s viewpoint.
### 3.4 USE OF MANAGEMENT TOOLS

Having identified the aspects of motivation, capacity to implement and organizational alignment for the subject, the use of management tools that support the effective implementation of corporate sustainability in the organization will now be investigated.

The following chart shows the opinion of both groups of respondents regarding the presence of management tools in everyday business. It was observed that the main tools used by the companies are still regulatory, such as values, policies and standards (24.18%), while the gauging tools, for example, environmental management and socio-environmental risk assessment systems have a smaller share (8.31%). However, despite the smaller share of these more quantitative tools, when asked whether the main decisions now take into consideration social and environmental aspects, the executives said that this was already occurring in their institutions. It is believed, therefore, that the social and environmental aspects are very often considered in terms of quality, due to the lack of knowledge and application of proper tools. Other tools mentioned during the interviews include sustainability index questionnaires (e.g. ISE and DJSI), specialist opinions, leaflets on consciousness of credit for clients, client satisfaction surveys, collaborator training, websites (internal and external) on the subject, among others.
Moreover, interviewees also said that performance assessment systems in general have still to include environmental and social aspects in the Brazilian financial sector. The failure to link these tools with socio-environmental considerations can be regarded as a major obstacle for more effective movement of these institutions, since the sector is extremely results-driven, with its employees assessed for their results during the period (quarterly, half-yearly, or yearly). It is believed that, since these aspects are now included in performance assessments of financial institutions and, consequently, in the variable remunerations of the executives, the sector will perhaps take a large step forward in sustainable management.
Some institutions whose executives were interviewed commented on including sustainability elements in their corporate performance assessment systems, such as the Balanced Scorecard (BSC), although further information about this management aspect has not been found in the public documents examined. But when asked about using targets for the socio-environmental performance, a certain disparity is found between the view of sustainability-related executives and that of the other collaborators, as shown in Figure 34 on the right. Almost half the employees who are not directly in contact with departments of socio-environmental responsibility (or similar) fail to recognize the presence of performance targets in these two spheres, while 79% of employees in those areas say the opposite. Apparently, the set goals do not involve the entire organization, or it is possible that communication and dissemination of these goals is not reaching everyone in the company.30

Therefore, both the analysis of the questionnaires and the interviews suggest that there is some room for improvement of the management tools in order to encourage the inclusion of sustainability criteria in the management and assessment of the business.

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30 This comparison is obviously restricted considering the different sizes and compositions of the groups of employees in sustainability-related areas and the other employees.
3.5 NATIONAL AND SECTOR CHARACTERISTICS

The purpose of the last part of the study is to understand the extent to which the national and sector characteristics influence the design of sustainability within the financial institutions, creating opportunities or obstacles.

The main national characteristics influencing the promotion of sustainability, from the executive’s viewpoint, are listed in Figure 35 on the right. These characteristics may have a positive influence when they create, for example, new business opportunities – see the potential of bank inclusion – or negative influence when a certain project to protect the environment is not approved. Therefore, positive influences include the growing consciousness of the local population concerning the subject of sustainability and the opportunities arising from the large contingent of people still outside the financial system. On the other hand, the lack of knowledge due to the poor educational level of the population and low administrative efficiency of the government raises obstacles against the most effective advance of the agenda of sustainability.

Concerning the sector’s characteristics, executives stressed the poor image of the sector in society. This negative image is probably associated with significant profits, high rates of client complaints and the evident understanding about the spreads of these institutions. It means that the sector will make a better effort to disclose its sustainability projects. Moreover, another point consistently addressed during the interviews is the poor performance of the financial system’s regulatory agencies (e.g. the Central Bank and CVM) to encourage sustainability in the sector. They restrict their action to monitoring a few aspects of the management of these institutions where socio-environmental criteria must be included, such as the client satisfaction index. The executives say that the regulatory agencies have still far to go to promote this agenda in Brazilian banks.

Some executives are of the opinion that the movement of competitors is closely followed and, as mentioned earlier, it pressures the institution to adopt better practices and disclose them. However, although the sector is marked by tough competition among the banking majors, and several of them have been publicly addressing the subject of sustainability for some time, the competitive environment in the sector does not encourage the concept of sustainability among these institutions. In the opinion of the interviewees, this is not currently a decisive factor that is making institutions restructure for a more positive approach to the subject.

Figure 35 – Main National and Sectoral

- Growing consciousness of the Brazilian population of socio-environmental problems
- Social inequality
- Poor level of education (general and financial) of the population

31 An example mentioned by one of the interviewees concerns the delay in granting an environmental license for hydroelectric power generation projects.
4. CONCLUSIONS AND FUTURE AGENDA FOR SUSTAINABILITY IN THE SECTOR

Interviews with top executives in the Brazilian financial sector, combined with the questionnaires given to a large number of collaborators in these institutions, offered a privileged view on the status of implementing sustainability in the sector, in order to be able to chart some advances. Of course, the sector has already acknowledged the importance of the matter and is now reacting by modifying visions, organizational structures and business practices in order to include the corporate sustainability issue.

Nevertheless, despite the progress in the sector, some points for improvement were identified, which may be addressed by these institutions in the short and mid-term. Some of the key points, as can be seen in Figure 36, are: (i) education and awareness of employees, (ii) upgrading of tools and (iii) more transparency in disclosing information on sustainability.

First, it is essential to reinforce the awareness of employees and other stakeholders on the subject of sustainability in these institutions. The sector is still firmly anchored in its attitude toward social responsibility, without perceiving that sustainability projects do not necessarily mean higher costs and lower returns for the institutions. In order for the sector to hasten sustainability, the first task, undoubtedly, is to educate and make aware those who are responsible for everyday business, since corporate sustainability corresponds to the inclusion of corporate responsibility in business activities and not in departments or institutions disconnected from the end activities of the companies.

Second, in addition to enhancing employee awareness about the need to balance short- and long-term gains through responsible practices, it is also necessary to upgrade the tools currently used by institutions. Adoption of socio-environmental criteria in different management processes, such as performance assessments, construction of bank branches and corporate credit assessment, will only be efficient when tools are upgraded and based not only on qualitative but also quantitative aspects of sustainability. Behavior contributing to sustainability must be recognized and actions impairing the sustainability of the institution must be appropriately penalized. Since this is an extremely result-driven sector, it is believed that the difficulty in quantifying the benefits of sustainability may be an initial challenge, but will not be a serious long-term drawback.

Third, there is the transparency in disclosing socio-environmental information. As already mentioned above, sustainability reports and websites of the companies in the banking sector have very few indicators like those assessing the economic performance today, which can assess corporate
performance in the social and environmental spheres. Moreover, it is noticeable that a number of sustainability projects of the major financial institutions fail to gain corresponding disclosure and, consequently, due recognition by the consumers and other stakeholders for which the social and environmental behavior of the banks is relevant. It is not enough to only issue reports, hold special events or run marketing campaigns. It is necessary for the financial sector to make a genuine effort to open up to dialogue and render accounts to society about everything their institutions do today and wish to do to encourage sustainability. This greater transparency will show their true commitment to the issue and encourage the engagement of society itself with the institution.

Having overcome these three barriers, the financial sector can then effectively play a leading role in promoting sustainable development and act as an agent of change. Although it does not have a strong, direct socio-environmental impact, the financial sector can influence the various players in society to sow the seed of sustainability in its clients, suppliers and service provider base, ultimately leveraging a change of attitude in a significant part of Brazilian society.
APPENDIX 1 – RESEARCH METHODOLOGY

The methodology of this study was conceived in 2002 by the Forum for Corporate Sustainability Management (CSM) of the International Institute for Management Development (IMD). The methodology is described in four parts: sample of the study, source and data collection, data handling and method restraints. It should be mentioned here that the methodology was applied by FBDS.

Study Sample

The sample of the study includes the ten largest multiple and commercial banks in Brazil, representing more than 80% of the total assets of the Brazilian banking sector. The institutions comprising the sample of this study were: Banco do Brasil, Bradesco, Itaú, Federal Savings Bank (CEF), Unibanco, ABN AMRO Real, Santander Banespa, HSBC, Safra and Banco Votorantim.

In addition to the ten largest multiple and commercial banks, two other financing institutions of vital importance for the country’s development took part in the study: Banco do Nordeste (BNB) and the National Bank for Economic and Social Development (BNDES).

The selection of the ten largest institutions was based on the ranking published by the Central Bank, with a base date of December 2006.
Source and Data Collection

This study used primary data sources by conducting interviews and questionnaires.

The interviews were performed with executives from various organizational areas at selected banks between February and August 2007. Figure 37 shows the composition of the 67 interviews. Itaú and Bradesco banks had the highest number of interviews since they are sponsors of the study and, consequently, arranged for their institutions to be analyzed separately.

The interviews were designed to address the following topics:

- **Motivation**: knowing the concept, susceptibility to external pressures (NGOs, clients, regulatory agencies, capital markets), internal strengths and weakness and information system;

- **Capacity to implement**: leadership, cultural and organizational harmony, areas of lesser/greater resistance, and a preponderance of financial aspects in decisions;

- **Alignment of the different areas of the organization**: outlook, impact and effort of the various areas of the organization to achieving sustainability and identifying any focus of resistance;

- **Use of management tools**: including sustainability in tools that conduct the strategies and performance assessments of the company;

- **Identifying peculiarities in the business sector**: influence of national and sector characteristics in the sustainability design.

The interviews lasted for about 45 minutes, some by phone and others in person. The interviews were recorded on a digital recorder and then transcribed to facilitate the process of drafting the final report.

The questionnaires were sent to all interviewees and each interviewee was asked to pass it on to five people in his or her team. Figure 38 shows the composition of the 127 questionnaires received. It is apparent that the vast majority of questionnaires received were completed by Itaú for the reason mentioned above.
There are two types of completed questionnaires: sustainability officers and general managers. The sustainability officers’ questionnaires were sent to those employees in operational areas directly related to sustainability, such as socio-environmental responsibility, social responsibility or sustainable development. The general manager questionnaire was sent to all other employees.

As mentioned earlier, the study herein was also used as a basis for a Master’s dissertation prepared for the COPPEAD Institute of Administration, and some questions were added to the CSM/IMD questionnaire to also accomplish the objectives of this working paper. In the general manager questionnaire, the added questions were number 15, 16, 17, 18 and 19, while in the sustainability officers’ questionnaire they were numbers 14, 15, 16, 17 and 18.

In addition to questionnaires and interviews, information was collected on the practices of sustainability in the institutions under research. The reports and company websites were analyzed in order to understand the extent to which the practices are effectively disseminated in the Brazilian banking sector. The analyzed reports were as follows:

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<th>Websites</th>
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**Data handling**

The interviews were analyzed on a strictly qualitative basis, examining the statements of the executives in order to understand their points of view on the main challenges for sustainability in the banks. This analysis was presented in the section of the report entitled “Executives’ Vision on Sustainability Challenges in Banks.”
The questionnaires, on the other hand, received descriptive statistical treatment, to check the participation of a certain perception in the set of answers received. All results of this analysis are included in Annex II.

The reports and websites were analyzed on a quantitative basis, but no statistical analysis was done because of the small sample size.

**Restrictions of Method**

The research methodology has a series of restrictions to be considered when interpreting the results.

First, it is important to point out that, as in any qualitative study, this work is subject to bias in the interviewees’ answers. These biases can be related to individual and corporate values, as understood by the executives, at the specific time when the interview was being performed, and so on. Since they are merely perceptions, the answers of the interviewees, therefore, could have been influenced by several variables.

Second, the composition of the questionnaires received and the interviews are also limited. Itaú answered more than half the questionnaires and provided approximately 40% of the interviews in the study. This hinders any kind of analysis that seeks to generalize the answers for the overall banking sector. Therefore, should this bank’s opinion on some of the questions be quite different from the other banks, this difference will certainly impact the research results.

With reference to the analysis of the reports and websites, the disclosure or non-disclosure of a certain aspect does not necessarily mean that it exists or not; it may perfectly exist and not be publicly disclosed. Therefore, for example, possibly more banks are working with directed productive microcredit than those that publicly announce it. Also, the mere analysis of the “presence of the practice of sustainability” is in itself restricted, since it does not distinguish the depth, quality and seriousness with which this practice is actually being implemented in the institutions. The lack of disclosure of indicators, as mentioned above, prevents more detailed analyses.
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