FINANCIAL INSTITUTIONS : MEDIUM TO A SUSTAINABLE WORLD

ABSTRACT

The following study attempts to break down the idea of longevity and sustainability of financial institutions and discover the various aspects needed for the same. It reviews the subprime crisis in context of longevity of financial institutions. It discusses the new needed approach towards longevity and the new age instruments regarding the approach. It also tries to suggest some ideas to be developed further for building a sustainable world.

Relevance of the Study: The re-emergence of financial crises and scandals has raised the question on longevity of financial institutions and the uncertainty of environmental changes has added complexities to the present question. Thus the study of the various reasons that contribute to the long lives of financial institutions is the need of the hour.

Key findings and Implications of the Study: The paper highlights the important role of employees, environmental finance and the new types of assets class in achieving longevity. The study implies that in order to achieve longevity, financial institutions need to work upon three elements, which are profit, employees and sustainability approach. Profit implies 'green profits' that grows continuously, earned legally and doesn't harm the environment. Employees imply all top, middle and bottom level employees. The study implies that a perspective change of and for employees are pre-requisites for a long life of an institution. Sustainability approach implies that both the lifestyle and the investment strategies of the financial institutions should be such that they are affordable by the environment.

KEY WORDS

Environmental finance, environment asset class, cap-and-trade model, moral grounds.

INTRODUCTION

It has not been long that the purpose of existence of financial institutions itself was questioned upon. The subprime crisis of 2008 opened up the nuisances of the financial system. It was a crisis where basic principles were overlooked for relatively short term profits. The short term goals became powerful and drove the economy into plunder. Many people lost their jobs and many lost homes, production was hit badly. All the various factors playing in economy became unstable and uncertain. But, the objective of the government and the various financial institutions was to provide housing facility for everyone. Then why such a noble objective turned into the darkest nightmare for the world? It was because the means became the target and the target became the means. Finance or financial activities were means to achieve the target of having housing facility for the maximum of the population in U.S.A. but instead the financial institutions used the housing objective as a cover to achieve their profit targets. Earlier the existence of finance was to support and facilitate trade. But over a period of time it has developed itself into a mainstream business way more diversified and complex than a facilitator's business. The massive increment in FI's scope of working has increased their role in the economy. Both their power and responsibilities have increased. But financial institutions have used their power more than they have fulfilled their responsibilities. Their idea of longevity is based on the premises of profit or wealth maximization. But financial institutions making big money do not necessarily live a long life. This is evident from the fact that only few companies on the fortune global 500 companies list have a life above 100 years. Some of them are :

- Bank of New York which was founded by Alexander Hamilton is 231 years old.
- Citigroup initially was known as Citicorp financial services is 203 years old.
- Hartford financial services group, the famous fire insurance company is 206 years old.

- State Street which is 184 years old.

Thus we can conclude that generating huge profits do not lead to a long life. And in present scenario global lists like fortune 500 are changing drastically each year with many new entrants and many exits which were not the case 50 years ago. This all indicates that it is not just the huge amount of revenue that accounts for great long trouble free life.

RESEARCH METHODOLGY

This paper uses the present literature on longevity and sustainability of financial institutions to review the reasons for the same. It reviews various research papers, books, reports, websites to study upon the various dimensions of longevity and sustainability of financial institutions. It reviews how the new age instruments benefits the protection of environment. It also tries to put forward its own suggestions for a sustainable world.

REVIEW OF LITERATURE

- **Guerin, M. Roesch, J.M. Servet** studied the myths related to the needs of microfinance and its real objectives, target audience, performance and social rating. They highlighted the risk associated with commercialization of microfinance and privatization of fight against poverty. Authors concluded that microfinance is tool to fight poverty through financial inclusions and needs to be complemented by presence of primary needs and rise of entrepreneurs.
- **Pasquale Arena** studied the emergence of socially responsible investment and how companies can improve their equilibrium through SRI and inner equilibrium of

individuals. The author also suggests solutions for quandary in SRI and its implementations. The author concluded that objective of finance should be optimization instead of maximization and that dynamic balance will be achieved through interaction of public, non-profit and profit sectors.

- **Leo Johnson, Christel Scholten** studied model of Brazilian bank- Banco Real. The authors examine the challenges faced, the principles adopted and the factors contributing to the success of the model and its results. The authors concluded that the banks can bring transformation in society and effectively implement triple bottom line by adopting a similar approach of that of Banco Real.
- **Henri-Claude de Bettignies, Francois Lepineux , Cheon Kheong Tan** studied the reasons for the bad image of insurance industry, the policies of corporate responsibility adopted by some and evaluated the relation between the two by taking a sample of 9 insurance companies. The authors concluded that for improving the image, CR policies have to be aligned with all the activities of company and that trust among various stakeholders have to be rebuilt and maintained.
- **Solene Morvant-Roux** talks about agriculture taking the centre stage in international forums, the shift in the approach of rural finance. The authors studied the role of development banks and other financial institutions in agricultural development. The author concludes that state along with private sectors through new approaches provide credit ad insurance facility to famers.
- **Andy White** studied the need for iceberg balance sheet. The author suggests that innovation is a key to fight all challenges and that heart of innovation lies in environmental technology. The author conducted a case study on automotive sector to validate his points.

- **Paul Dembinski, Fedrica Vigano** studied the internal and external limitations of financialization and suggests the action plan to resist such limitations. The author suggests establishment of long term relations, changing of remuneration system and regulation of market players as solutions to various problems of financialization.
- **Richard Sandoor and his associates** in their two books studied the emergence of new asset class in environmental markets and the ways to capitalize on such new assets for the sustainability of institutions and world through cap-and-trade model.

OBJECTIVES

- To look into the factors that limits the life of financial institutions and linking it with the U.S.A. subprime crisis.
- To decode the idea of longevity and to explore new age instruments for achieving the same.
- To suggest ideas enabling financial institutions to live a long life while creating a sustainable world.

LIMITING FACTORS TO LONGEVITY

The irony is that the factors responsible for increasing the life of financial institutions are the same factors limiting its life. Let us analyse the problematic issues under each factor affecting longevity. Some factors that are evident during crisis are regarded as problems, while some are not pin-pointed because they are regarded as acceptable ideas in the financial industry.

- PROFIT: The primary factor for longevity and the primary factor limiting longevity is profitability. During financial crisis, the magnitude of mortgage bound securities and its related instruments reaffirmed the fact that financial institutions will adopt any way to

make profit. The mind-set to evaluate everything in terms of profit leads to the own fall of the FI.

- STAKEHOLDER: The second factor limiting the longevity of FI is their inability to create value for their stakeholders. In the credit crisis financial institutions adopted a very self-centred approach. They ignored the fact that the relationship between stakeholders and FI is not linear but cyclical. For a long life one has to cater to the needs of everyone including oneself. The various stakeholders of financial institutions are:

  - Shareholders: Generally companies are sensitive towards their shareholders, though in crisis the agency conflict between shareholders and management was evident. Management was working for themselves, for increasing their income through commissions and thus at the end putting shareholders in the suffering basket. In today's scenario, some part of FI's holding is held by other financial institutions. This creates a dependency relationship. Thus giving rise to cartels for unethical purposes.

  - Employees: In crisis of 2008 employees started to work for their own needs. The incentives for greedy works were more than the chance of disincentives. Employees' moral grounds were and are always questioned in financial institutions. This is evident by the number of cases of insider trading, misleading selling for commission etc. The biggest challenge in finance world is to pump ethics in its working.

  - Investors: They are the source of an organisation's bread and butter. During the crisis, financial institutions by and large did not perform their role of making investors more financially stable and secure. FI inability to cater various

customers in a customized manner and hence inability to deliver value leads to their failure.

- CHANGE: The third factor limiting longevity is resistance to accept change. The environment is dynamic having constant shifts in ideologies, changes in economic environment, increasing complexities of financial world and increasing awareness among people. This creates pressure on FIs to enhance their skill of foresightedness. The accuracy with which FI estimate risk and adjust their activities accordingly, forms the basic premise for success or failure. Thus FI's inability to develop a flexible system or to take a proactive role in assessing fore coming risk leads to their failure.

LONGEVITY: DECODED

Over a period of time there has been a shift in the nature of human being and the way market functions. Before, environment (including various stakeholders) and the organisation were put in different boxes. Environment was considered external and that which affects the functioning of the organisation due to its uncertainty feature. But now the approach is changing towards all of them being a part of a single box. The dependency of environment over organisation and of organisation over environment is given more importance and environment is no longer just the determinant of the organisation but also the resultant. The environmental risk has increased manifolds turning economies into diseconomies at a large scale. The uncertainty factor has risen beyond quantification and thus to strike a balance, a newer approach towards longevity is designed: "Sustainable development". The sustainable approach makes financial institutions work in such a manner that they are able to cater to the present needs as well as the needs of the future simultaneously. The sustainable approach has two parts

- PRESENT ORIENTATION: Catering to ‘one and all’. One and all means including all the excluded sections of the society under the FI’s service receiver category and providing facilities to everyone with an equality approach. This would equip present generations for future uncertainties.
- FUTURE ORIENTATION: Catering to ‘future’. This works in two ways
    - Correcting past mistakes
    - Building a better future

Both objectives go hand in hand. The following are the ways to achieve longevity and sustainability.

- .GREEN PROFITS

Humans have to breathe to stay alive. Similarly for institutions to stay alive they need profits. But what kind of profit is needed? FI need green profits for a healthy long life. Green profits have three features. First, they are earned through legal ways free from any mala-fide channels. Second, the rate of change of profits should be increasing over a period of time. Third, the generation of profits should not have negative externalities. The activities through which revenues are earned should not deteriorate the environment rather make the environment healthy. Thus earning green profits is the prerequisite for healthy long life.

- EMPLOYEES (A CHANGE IN PERSPECTIVE REQUIRED):

FI have to work on following elements for sustainability

1. Moral grounds
2. Reducing carbon footprint of organisation

1. *Moral grounds*:

The balances between personal goals, organisational goals and role of the financial institutions have to be stroked right. Financial institutions have to realise the fact that if this problem is not addressed then various scandals and crisis would keep emerging, shortening their pockets and lives. The following steps could be taken:

- ✓ Repeated workshops on ethics, moral reasoning could be incorporated in financial institution's culture to regularly remind them of the fact that why strong moral grounds are needed for progress.
- ✓ Commissions given could be provides on the basis of the quality of customers rather than volume so as to ensure that client's needs and organisational needs are automatically met.
- ✓ A shift in the culture of financial institutions from competition spirit based to more of family spirit based could be initiated. This would increase loyalty and instil emotions apart from anger, stress, anxiety and aggression.

2. *Reducing carbon footprint of organisation*:

First step towards sustainability is to reduce once carbon footprint as reducing that would lower cost, increase life span as future generation and environment would be able to sustain such lifestyle. Apart from the generally adopted techniques, following suggestions could be considered

- ✓ Small green lawns could be owned and maintained where trees named after the employees of the year could be planted.

- ✓ Environmental audit, social audit could be made compulsory. FI could establish a common organisation that could set the framework of such audit. Further, such framework could be approved by government, shareholders and academicians before implementation.

☸ NEW / MODERN TOOLS TO LIVE SUSTAINABLE LIFE:

1. *MICRO LEVEL FINANCING*

The problem of financial exclusion gained importance, this is evident from the events like micro level summit in 1997 and from the wining of Nobel Prize by Mohammad Younus and Grameen Bank in 2006. Access to various financial services by financially excluded strata of population would result in better risk management, and an increase in personal and global income. But the system of micro finance does not only include micro credit but also services like insurance, investment etc.

- ✓ MICRO CREDIT: The idea is simple: to provide credit and saving facility to low income group. But the presence of public, private banks to cater to the needs of low income groups in rural as well as urban sector has not resulted in tremendous achievements as it should have. The objective of micro credit is not to fight current poverty but future poverty. It prevents low income group from falling below the poverty line through financial inclusion. Apart from saving facility, banks should give out credit to emerging entrepreneurs. The provision of micro credit should lead to an increase in small entrepreneurs .This should be treated as one of the criteria to measure success of the banks. It would ensure that people fight against their present status and make a living in a better way and boost the economy as well. This could

increase the range of choices and opportunities available to the excluded strata to stabilize and diversify their all too often irregular source of income. Structured criteria should be set by various stakeholders in the line of supply of micro credit which should neither be too hard nor too soft. They should not put too many restrictions to hamper the process of accessibility of finance. Another way to ensure a safer route could be that banks could collaborate with employers. This mechanism could be implemented in any area where workers are generally agitated or do not cooperate with employers easily. For e.g. when any work requires land acquisition then land could be acquired in usual manner and a further provision can be added to provide a low/nominal rate credit to ensure no agitation from workers.

- ✓ MUTUAL FUND: Today mutual funds market is one of the booming markets everywhere. Mutual funds companies could target low income group and ask for a nominal SIP for e.g. in India it could be INR 50-100. The area covered under such scheme would be large enough to build a good corpus and such money could be invested in small scale industries or small growth firms and government securities. This would have double effects. On one side small scale industries would be recognized as an investment option resulting in improvement of these industries and second, low income people would be able to grow their money for meeting their future needs in a better way. The market would also get boosted with infusion of money.

- ✓ DERIVATIVE MARKET: The real purpose of derivative is to hedge risk. This could be used in two ways :

- The forward contracts of farmer and dealer could be used by farmer to borrow money from banks for agricultural purpose by keeping such derivatives as collateral.

- Special financial institution units can be established. They would buy agricultural products from farmer at particular rate (in form of derivatives) and bundle those according to the price and food item. The bundles then can be further sold through auction or a market mechanism to food industries. Farmers union could be formed so that they are not exploited and quality of crops can be maintained. But for all this financial knowledge must be provided by the government and financial institutions.

2.*ENVIRONMENTAL FINANCE*

It's an emerging discipline of finance. It's the art and science of how different concepts of economics, accountancy and finance can bring about the desired environmental changes. The new discipline of finance targets the improvement in environmental standards through the economic and financial tools and concepts. The scope for environmental finance is huge. It has been getting popular along with the passage of time but has not attracted the much required attention till now.

Due to environmental finance there has been emergence of new asset classes – the Environmental asset classes. Any asset which originates form the environment and which helps to earn future revenues is termed as environmental assets. "Environmental asset classes include the securities or instruments created through the commoditization of environment and natural resource assists, such as emissions rights and water; instruments arising from the monetization of specific environmental attributes, such as renewal energy or energy

efficiency; and equity indices, called ‘sustainable indices’, to reflect the overall environmental performance of their constituents companies.”

Some of the environmental asset classes are: SO_2 and NO_2 allowances, CO_2 Allowances, Renewable Energy and energy efficient assets, Water assets**,** sustainable indices

THE MODEL OF CAP & TRADE

Another name for this is emission trading. It is devised to limit the level of production of environmental pollution. The limit is known as the cap. The allowance is eligible for trade and thus cap & trade model emerged. It is based on the feature of Perfect competition market that cost of production should be internalized. Any activity whose cost is not accounted will result in externalities. It is consistent with polluters pay principle. The simple explanation for the modus operandi of cap-and-trade model is that the firm having less emission reduction cost reduces emission more than the required level and utilises the extra reduction for either future purposes or for selling it to the deficit firm who is unable to reduce its emission till the required level. This system will create the following benefits:

- The overall emissions are reduced to the desired level and for every excess emission, penalty is paid.
- The opportunity to buy and sell allowances will make them even dearer. And hence a firm is motivated to reduce its emissions to have surplus allowances.
- The overall cost of reduction of emission will be less compared to command-and-control approach.

SOME SUGGESTIONS FOR ACHIEVING LONGEVITY AND SUSTAINABLILTY

Systematic risk for overall economy has increased and thus the riskiness of all the projects. Financial institutions are most concerned with their returns over risk. The increasing environmental uncertainty will drive the return-risk ratio to fall as the numerator (return) would increase in proportionally less magnitude as compared to the denominator (risk). The rising global pressure for saving environment would increase the tightening of environmental standards such as standards of carbon emissions, making the situation more complex.

- All financial institutions such as insurance companies, mutual fund etc. should invest in green companies having more sustainable lifestyle. They should invest in future technologies that reduce the risk of climate disasters and in technologies that helps in tracking and preparing for such disasters.
- Banks and saving banks must provide loans for purchase or construction of houses only when the homes are equipped with systems of water harvesting, solar power generation, and earthquake resistance.
- Insurance companies should charge high premium from building which do not possess above mentioned facilities and vice versa.
- Insurance companies should also provide low premium insurance for crops grown with organic technique.
- Insurance company should include pollution's effect on health and life of people while calculating premium for health insurance. There should be a provision where a reduction in health insurance premium would be given if the person plants a tree in specified area through specified agencies.

CONCLUSION

The various crisis and scandals of the past have shown the uncertainty pertaining to the life of financial institutions. The current and future scenario of environmental uncertainty has increased the risk of living and doing business across all sectors and the world. In such unpredictable environment the need of the hour is to use the power of finance to create a better world. Financial institutions play a dual role in the environment; one of analysing investors' sentiments and flowing in that direction and another of influencing the sentiments of the investors and thus change the direction of the market. This power should be wisely used to encourage socially responsible investing by working, investing, living in a sustainable manner.

For longevity of financial institutions sustainability approach towards business has to be adopted. Balancing the need of today while making provision for tomorrow is what sustainability mantra says. But financial institutions can go one step ahead by fulfilling today's needs, building future and gaining from the transition.

For financial institutions, 3 major elements need to be looked upon for Long and healthy life

- Profits which are earned legally and that grow over time without having negative environmental effect.
- Employees' moral, ethical and innovative development.
- Adoption of Sustainable lifestyle by financial institution as an organization as well as in their investment strategies. Bringing out new instruments which provide gain and help to make environment healthier and stable e.g. Environment asset class, green indices etc.

Financial institutions should realise their power and work for a longer healthy life than just making profit. Some have realised and are working for this. They should try and set the norms for the industry and encourage others to live a sustainable life.

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