Research on the Impact of ESG Concept on the Sustainable Development of Commercial Banks Under the Background of Double Carbon

Weijian Yang
Handan Branch of China Construction Bank Co., Ltd, Handan 056000, China.

Abstract: Driven by the "two-carbon" national strategic goal of carbon peaking and carbon neutrality, China has officially entered the transition path of realizing net zero carbon emission goal, which means that scientific and technological innovation, energy strategy, industrial policy and economic structure usher in new changes. With the popularity of ESG concept in the national financial market, our country began to shift from the exploration stage to increase the application of ESG concept in the financial market. As an indispensable part of the domestic financial service system, commercial banks should promote the sustainable development of governance with the help of ESG concept. By exploring the practice of ESG concept in the commercial bank system under the background of "double carbon", this paper summarizes the ESG governance system of domestic commercial banks, analyzes and discusses the opportunities for the banking industry brought by the practice of ESG concept, and puts forward countermeasures and suggestions for the sustainable development of commercial banks in the future.
Keywords: ESG Concept; Carbon Peak; Carbon Neutrality; Commercial Banks; Sustainable Development

1. Concept and Significance of ESG

1.1 Concept of ESG

ESG stands for Environment, Social Responsibility, Corporate Governance, It refers to a value concept, investment strategy and valuation tool that focuses on environmental, social and corporate governance performance rather than solely on financial performance.

The concept of ESG originated in the 1980s as an indicator to screen investors' ethics. In 2004, this term was first proposed in the United Nations, and later it was incorporated into the code of conduct in the category of responsible investment. Several institutions represented by Morgan Stanley International Capital Company successively launched ESG index and rating standards [1]. International mainstream assessment systems such as the Dow Jones Sustainability Index (DJSI), S&P Global Ratings, Hang Seng Sustainability Index (HSSUS), Carbon Disclosure (CDP) and Sustainalytics have been formed. The establishment of these official evaluation systems reflects the increasing emphasis of enterprises on the long-term returns and business opportunities generated by sustainable development, and directly reflects the importance of the implementation of ESG philosophy in the global investment business.

According to the norms of ESG, enterprises need to pay attention to the coordinated development of environment, governance and society in daily operation. Enterprises are required to pay attention to the balanced development of economy and environment, society and corporate governance in the process of operation and management, and make contributions to the sustainable development of economy and society [2]. In particular, the environment generally focuses on climate change, natural resources, environmental pollution, solid waste and renewable energy use. Governance covers corporate practices such as corporate governance, anti-competition, business ethics, and tax transparency, while social covers human capital, product responsibility, supply chain management, and stakeholder communication. From the perspective of formation mechanism, ESG is mainly based on corporate social responsibility theory, competitiveness evaluation theory and sustainable development theory [3].

1.2 Significance

Based on the macro-perspective, with the increasing emphasis on environmental protection in our country, more clear path to realization and strict strategic requirements for the "double carbon" goal have been put forward. The financial system, as the core intermediary in the national macro-system, has responded and issued corresponding policies in order to promote the practice and development of the ESG concept in the system. To provide a strong policy guarantee for green investment under the background of "dual carbon", China Banking and Insurance Regulatory Commission gives full play to its regulatory power in the industry, printing and issuing a number of regulatory policies, and is committed to guiding the establishment of ESG investment concepts through detailed systems of risk identification, information disclosure, supervision and management, etc. Building a sound environment for responsible investment while fulfilling the principles of sustainable finance [4]. As an important part of the financial system, the practice of ESG concept by commercial banks is not only the embodiment of national policies, but also conforms to the regulatory requirements of the industry.

The practice of ESG concept by commercial banks can enhance the ability of risk control and optimize operation efficiency, so as to guide the rational allocation of resources. At the same time, considering the communication between the market mechanism and stakeholders, it is necessary for commercial banks to publicly disclose ESG performance on a regular basis, so as to establish a responsible image and promote their sustainable and high-quality development. In recent years, commercial banks are gradually exploring the concept of ESG into governance [5]. On 22 September 2019, during the UN General Assembly in New York, 140 banks from around the world signed the Principles for Responsible Banking, which aims to implement the 2030 UN Sustainable Development Goals and implement responsible Banking actions. By the end of 2021, more than 260 banks around the world have signed the Principles. With total assets accounting for more than half of the world's total, 14 Chinese banks have signed on, and pledging to use financial power to promote the two-carbon goal and the practical realization of modern and harmonious coexistence between man and nature.

In the emerging market economy, investors and other stakeholders increasingly attach importance to the practice of high-quality ESG concept to reduce investment risks. Despite the cost in the short term, the long-term return potential is unlimited. As the concept of ESG gradually evolves into the main social stream, customers have higher expectations for the social responsibility of commercial banks as intermediaries, which encourages the sustainable transformation of commercial banks. In order to meet the requirements of investors to resist climate risks and pursue sustainable development, commercial banks are increasingly incorporating ESG concepts into their business activities. Since PRI (Principle of Responsible Investment) was proposed in the United Nations, a large number of financial institutions have realized the absolute positive relationship between environmental, social, governance and other prudential sustainable factors on performance. In some industries, the information conveyed by ESG concept is even more valuable than the disclosure of financial reports. With the support of this concept, Commercial banks with high ESG level use non-financial information to demonstrate their operational ability, social responsibility and high concern for sustainable development.

2. ESG Governance System

2.1 Objectives of the Governance System

It can be concluded from the above analysis that commercial banks incorporate ESG into their governance goals mainly because of the acceleration of the two-carbon goals, the governance requirements of regulatory policies and their own high-quality development needs.

The concept of ESG, which focuses on investment and financing, can help commercial banks strengthen differentiated competitive advantages by optimizing service system, improving asset quality and perfecting capital structure, so as to avoid risks caused by environment and society [6]. At present, the scope and depth of application of ESG in risk management of commercial banks are gradually increasing. On the one hand, from the perspective of risk control, for industries with high carbon emissions, they will undoubtedly bear higher transformation risks in the face of changes in policy background and technical indicators caused by the "two-carbon" strategy, while commercial banks, as creditors, will largely face overdue loans or even bad debts that are difficult to recover. In contrast, Green credit has fared even better. According to official data from the People's Bank of China, China's overall non-performing loan ratio has been around 2% in the past five years, while green credit loans are of good quality and the non-performing rate has always remained below 0.7%. On the other hand, from the perspective of investment value, commercial banks with better ESG performance or higher ESG rating may have more investment opportunities. Morgan Stanley Environment, Society and Governance research report shows that financial institutions with high ESG rating tend to have high advantages in financial product safety, corporate governance and financial system stability. Good ESG performance has a positive impact on cost control and profit from it [7]. The double proof of theory and practice makes commercial banks pay more attention to the practice of ESG concept in the process of governance. According to the latest MSCI ESG rating at the end of 2021, Industrial Bank of China has obtained A grade, which makes it the only commercial bank in China's banking industry that has obtained A grade for three consecutive years. Meanwhile, China Merchants Bank has been upgraded to A grade, so a large number of funds track these financial institutions with excellent ESG rating index. What followed was the pursuit of massive funds and extensive attention from investors, which demonstrated the capital market's high recognition of the investment value brought by ESG.

2.2 Construction of Governance System

Board participation: After experiencing the continuous heating up of ESG concept, the board of directors of commercial banks, while facing investment opportunities, also bear the pressure to implement the "net zero" target in action. Boards need to understand that they are not only responsible for the environment, society and governance, but also need to earn the trust of the market by regularly disclosing high quality ESG information to stakeholders. Considering that the governance system of Chinese commercial banks is not mature in the present stage, the following suggestions are proposed.

First, commercial banks should build an ESG management framework to coordinate the management of relevant matters, that is, establish a full-time team to promote the implementation of relevant work so as to give full play to the influence of ESG in the decision-making of the board of directors and provide sustainable suggestions for future development.

Secondly, on the basis of the construction of the governance structure, commercial banks can improve the construction of the internal control management system, improve the internal control system and risk management process to clarify the main responsibility and management responsibility, so that the responsibilities are clear and the measures are in place. At the same time, commercial banks can effectively promote the performance of duties and responsibilities of directors, supervisors and senior executives through various measures such as strengthening job training, pushing regulatory regulations, rights and interests information management, regular information reporting, field investigation, giving play to the role of independent directors and intermediaries, etc.

Stakeholder identification and communication: Based on other factors such as the degree of dependence on stakeholders, the relationship between power and responsibility, and the degree of influence, this paper identifies five main stakeholders of commercial banks, including government, investors, employees, communities and customers. In order to deeply understand the concerns of stakeholders and respond to their demands in a timely manner, commercial banks should actively carry out regular and effective stakeholder participation communication activities, incorporate relevant feedback when considering the formulation of sustainable development strategies, and respond to the concerns of stakeholders through ESG reports.

Judgment of major issues: Major issues can substantially reflect the significant economic, environmental and social impacts of an organization. According to the relevant guidelines of the SEHK on ESG report, commercial banks, as issuers, should determine key performance indicators with environmental, social and governance impacts from strategic, operational and financial dimensions.

3. Ideas and suggestions

There are both opportunities and challenges in practicing the ESG concept. How to seize the opportunity and deal with the challenges of ESG risks and the lack of regulatory mechanism is what commercial banks need to think deeply. This paper believes that the following measures can be taken to make full use of ESG to promote the efficiency of sustainable development.

3.1 Internal Action

Commercial banks should advocate green culture and protect the ecological environment by improving resource utilization rate and reducing energy consumption. For example, the power management of branches was strengthened, LED light source was used to replace traditional luminous devices, and intelligent management system was introduced to greatly save energy consumption in daily office. Promote the paperless office, improve the online business management process, and form a low-carbon office concept on the basis of optimizing the process.

3.2 Improve Mechanism

At the level of improving the existing ESG governance structure, commercial banks should clarify the work responsibilities of each component system. The board of directors is responsible for coordinating the overall ESG affairs of commercial banks, driving the ESG executive committee to formulate sustainable development strategies, supervising the establishment, sustainability and optimization of the management system, and pooling the participation of all functional departments. At the same time, the Sustainable Development Working group under the leadership of the ESG Executive Committee shall, based on the ESG development strategy, formulate key work plans and carry out the daily implementation of ESG work, including ESG data collection, stakeholder communication, regular ESG information disclosure, and the implementation of sustainable projects to support the sustainable development strategy of the Bank.

3.3 Encourage Innovation

Implementing the ESG concept requires not only human input, but also fintech innovation. On the one hand, innovative financial technologies such as big data, cloud computing, blockchain and artificial intelligence can give full play to their technological advantages, collect and analyze massive green finance, help commercial banks optimize capital allocation and increase financing efficiency in the field of sustainable development. On the other hand, with the assistance of financial technology, commercial banks can better extend digital technology to rural education, work, property management, social security and other people's livelihood affairs, comprehensively improve rural governance capabilities, and make contributions to poverty governance in the post-poverty era, highlighting the good image of enterprises actively undertaking social responsibilities, and contributing to the promotion of sustainable development goals.

References

[1] Bansal, M., Samad, TA. and Bashir, HA. 2021, “The sustainability reporting—firm performance nexus: evidence from a threshold model”, Journal of Global Responsibility, Vol. 12 No. 4, pp. 491~512.

[2] Ellili, NOD., 2022, “Impact of ESG disclosure and financial reporting quality on investment efficiency”, Corporate Governance, Vol. ahead—of—print No. ahead—of—print.

[3] Varco, C, 2016, The Value of ESG date: Early Evidence for Emerging Markets Equities, Cambridge Associates Research.

[4] Bahaaeddin Ahmed Alareeni, Allam Hamdan. ESG impact on performance of US S&P 500-listed firms[J]. Corporate Governance: The International Journal of Business in Society, 2020, 20(7):1409-1428.

[5] Beat Reber, Agnes Gold, Stefan Gold. ESG Disclosure and Idiosyncratic Risk in Initial Public Offerings[J]. Journal of Business Ethics, 2021:https://doi.org/10.1007/s10551-021-04847-8

[6] Cerqueti Roy, Ciciretti Rocco, Daló Ambrogio, Nicolosi Marco. ESG Investing: A Chance to Reduce Systemic Risk[J].

Journal of Financial Stability, 2021.

[7] Dai YW. Can ESG Investing Beat the Market and Improve Portfolio Diversification? Evidence from China[J]. The Chinese Economy, 2021, 54(4):272-285.