Banks leveraging digital ESG to support customers' green transformation

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Executive Summary

Digital ESG, an ESG information management platform, is becoming a popular decision-making tool for management. In the financial sector, much digital ESG use is notably focused on customers' businesses. Digital ESG is an extremely effective means to help customers pivot to sustainable operations.

Digital ESG as an information management platform

Growing interest in ESG investing and ESG-focused management is exerting pressure on companies to swiftly identify and address risks and opportunities across ESG issues related to their businesses, including climate change mitigation and human rights. Some companies are building information management platforms that collect and highlight ESG-related information from both internal and external sources (such platforms are referred to below as “digital ESG”). Use of digital ESG can benefit companies by facilitating management decision-making based on objective data and building consensus among staff and stakeholders on ESG issues that are hard to quantify with financial metrics.

Financial institutions and digital ESG

Digital ESG is increasingly being utilized even by financial institutions. Some financial institutions focus their digital ESG programs primarily on their own operations (head office functions) while others prioritize providing digital ESG support to borrowers and other customers' businesses (see graphic).

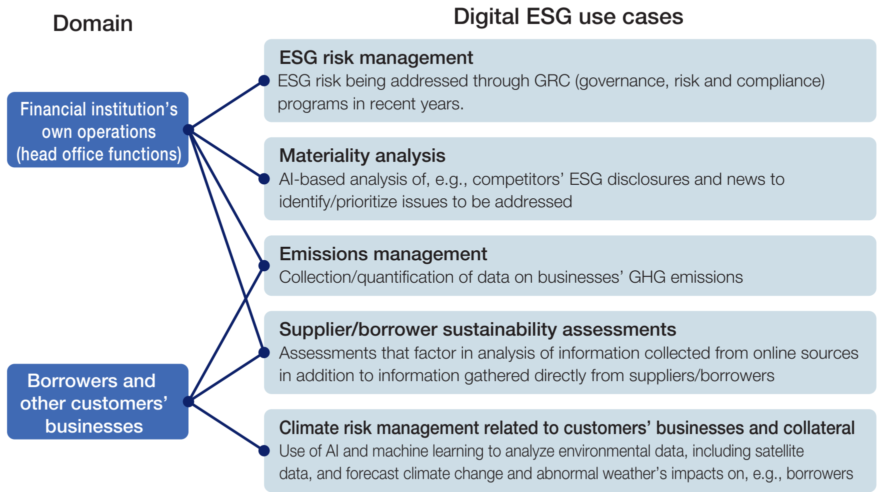
The latter camp has been more prominent recently. Digital ESG's growing utilization has been driven by corporate borrowers' requests for ESG assistance from financial institutions and by use of AI and satellite technologies that have enabled broader information-gathering[1)]. Through digital ESG, financial institutions are increasingly helping corporate customers pivot to sustainable operations.

A case in point is NatWest Bank, which offers a free app called Carbon Planner that provides decarbonization recommendations tailored to customers' individual

NOTE

1) For example, Sumitomo Mitsui Banking Corporation (SMBC), in collaboration with MS&AD InterRisk Research & Consulting, is analyzing flood risk in Japan and overseas based largely on satellite data and upgrading its climate change scenario analytics as one component of its compliance with the TCFD's recommendations. It is analyzing risks associated with climate change and abnormal weather in $90m^2$ blocks using voluminous data on, e.g., the subject site's distance from the shore and nearby buildings' height and density. Even in regions where available information is limited, SMBC can forecast with a high degree of accuracy the impact of financial deterioration and damage to property pledged as collateral in the event of flooding.

Examples of digital ESG use at financial institutions



Source: NRI

circumstances. Customers answer simple questions and input data into the app. In return, they receive advice on decarbonizing their operations through such means as reducing paper consumption, transitioning from in-person to online meetings, embracing telecommuting and using EVs.

Another example is the Spanish bank BBVA. It offers business customers a financial dashboard service to which it added a feature that can measure a business's carbon footprint based on its expenditures on electricity, natural gas and other fuels. Through this service, businesses can not only monitor their emissions over time but also receive advice on reducing costs and greenhouse gas (GHG) emissions.

Digital ESG can facilitate dialogue between financial institutions and business customers

As digital ESG users, financial institutions like NatWest Bank and BBVA are focusing primarily on SMEs. SMEs account for 99% of businesses in OECD-member countries and, by the OECD's estimate[2], at least 50% of the business sector's GHG emissions. Despite SMEs' huge collective carbon footprint, a number of surveys[3] have found that many SMEs either do not adequately recognize the need for ESG action on their own part, including even initiatives to address the particularly urgent priority of decarbonization, or lack the information and know-how to act.

2) OECD, Financing SMEs for Sustainability: Drivers, Constraints and Policies, OECD SME andEntrepreneurship Papers No.35. In Japan, SMEs account for an estimated 10-20% of business-sector GHG emissions.

3) One of which, for example, was a July 2021 survey of SMEs' attitudes toward decarbonization conducted by Shoko Chukin Bank.

Corporate borrowers' GHG emissions are counted as part of banks' carbon footprint in the financed emissions category, a subset of Scope 3. The Glasgow Financial Alliance for Net Zero, a global coalition of leading financial institutions committed to accelerating decarbonization, is seeking to achieve net-zero emissions by 2050. In Japan, the FSA-sponsored Expert Panel on Sustainable Finance has discussed SME support in the context of financial institutions' risk management and support for borrowers/investees.

As pressure to support corporate ESG initiatives grows, financial institutions could conceivably be called upon to provide one-on-one support customized to individual customers' needs. However, such support would be costly and require financial institutions to gain additional know-how. Digital ESG would helpful in both respects. Armed with information acquired through digital ESG, financial institutions could help customers strengthen their businesses and create new business opportunities through effective advice and/or financial services tailored to the customer's operations. For example, such support might take the form of helping a customer to utilize renewable energy or make progress on electrification.

Another idea is collaboration among financial institutions, large corporations and SMEs. In a January 2023 report[4), the University of Cambridge Institute for Sustainability Leadership recommends that banks and large corporations, the latter of which are buyers of SMEs' goods and services, help SMEs to decarbonize. One idea proposed in the report is that SMEs, banks and large corporations jointly build a centralized, shared ESG information repository that includes emissions data as one step towards SME decarbonization.

4) Financial innovation for SME net zero transition: Role of banks and buyers (https://www.cisl.cam.ac.uk/resources/publications/financial-innovation-sme-net-zero-transition-role-banks-and-buyers)

Like financial institutions, large corporations in recent years have been asking their suppliers to decarbonize and comply with their sustainability standards. The suppliers are being asked to disclose information to their large corporate customers through such means as questionnaire surveys. Such disclosure imposes a heavy cost burden on SMEs. In such cases as well, use of centralized digital ESG should be able to facilitate cost-effective information sharing among financial institutions, large corporations and SMEs while also enabling all three to steadily promote ESG in sync with each other. Information alliances among companies linked together via digital ESG would be a fruitful next step for sharing information between financial institutions and their borrowers.

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