Environmental and Social Indicators for Financial Institutions

A Need for Innovation?

Quantitative Indikatoren sind der Ansatz der Wahl, um Einsichten in die sozialen und Umweltaspekte von Unternehmen zu gewinnen. Wir skizzieren eine Innovationsagenda für die nächste Generation von Indikatorsystemen. Diese können zu wirkungsvollen Werkzeugen für Management und Kommunikation werden. Von Oliver Zenklusen und Gilbert Heim

If only what is measured can be managed, quantitative indicators are the approach of choice to addressing the environmental and social aspects of business. For financial institutions in particular, interaction with the economy, society and the natural environment is complex. It defies straightforward quantitative metrics. Indicators may therefore serve as proxies for variables that are not directly measurable. Examples are staff turnover or net jobs created – figures which may provide indicators for the impact of a company on wider society, for human capital and for an array of further variables.

This article, which is intended as a contribution to the current debate, starts with an overview of indicator systems in use today. We then briefly discuss further potential fields of application for environmental and social metrics in the financial sector. After an analysis of gaps and weaknesses, the article concludes with proposed guiding principles for innovation.

Beyond Sustainability Reporting

Today, quantitative indicator approaches are primarily known from their use in environmental, social and sustainability reporting. An overview of recent indicator initiatives aimed at the financial sector is provided in the table. Among the items listed, the guidelines published by GRI, including the corresponding financial sector supplements, may be considered today's lowest common denominator and a global quasi-standard for external sustainability reporting.

Table 1: Overview of environmental and social indicator frameworks designed for the financial sector.

Indicator Framework	Objective / Scope
GRI & UNEP FI 2005	GRI framework plus financial sector supplement (environment): Primarily qualitative indicators for environmental performance measurement.
SPI Finance [Adopted by GRI] 2002	GRI framework plus financial sector supplement (social issues): Indicators for measuring internal social performance and the impact of products and services.
CERES 2003	Environmental reporting guidelines for financial institutions. Primarily qualitative indicators.
EPI Finance 2002	Indicator framework for environmental performance measurement. Designed for use with environmental management systems.
VfU Indicators 2002	Environmental indicators for the internal operations of financial institutions. Version 2005: Focus on greenhouse gases.

Sources: see literature

The actual and potential fields of application of indicator frameworks are far wider, however. In one dimension, they range from financial institutions themselves to their clients, projects and investments. In a second dimension, indicators may be used for a variety of management purposes and at all organisational levels. At the level of individual transactions and clients, indicators may serve the environmental and social analysis of loans and projects, investment ratings or the valuation of assets. At the level of portfolios and business lines, indicators may be used in asset management or for monitoring environmental risk on a bank's books. Finally, for a financial institution as a whole, aggregated indicators may prove useful in external and internal communication, in strategic decision-making or in monitoring reputational and liability risk.

Indicator frameworks may therefore be invaluable tools, with a range of application beyond sustainability reporting. For the financial professional, the primary benefit of quantitative indicators may lie in making intangible issues tangible and thus manageable. Quantitative approaches allow for measuring, monitoring over time and benchmarking with competitors. They can also help to integrate environmental and social aspects into mainstream reporting and decision-making processes.

Gaps and Weaknesses

Judging from our experience with financial institutions, we would identify four key problems with today's approaches: Firstly, there is widespread confusion about the performance of different indicator frameworks and secondly, about the large number of indicators each of these frameworks proposes. Thirdly, indicator systems hardly permit conclusions to be drawn about the core environmental and social issues they are supposed to measure. Few of the approaches are based on sound conceptual frameworks or ensure comprehensiveness with regard to business lines and organisational levels within companies. Finally, the relevant quantitative environmental and social measures are still not integrated to any great degree into mainstream reporting, both financial and non-financial.

Agenda for Innovation

As an answer to the weaknesses identified above and as a starting point for debate, we propose three guiding principles for innovation of environmental and social metrics.

- Clear scope and objective: What is measured, why and to whom is it reported? Metrics for environmental and social issues benefit from a clearly defined purpose. What exactly an indicator measures, and what its implications for business are, should be made clear. The interpretation should be straightforward and unambiguous. Environmental credit risk indicators, for example, should be based on explicit definitions of these risks. Rigorous definitions are also a promising starting point for discussing, measuring and managing issues in fields such as corporate responsibility, social performance and human capital. The process of finding appropriate definitions may itself result in a fundamental revision of sometimes only vaguely framed concepts.

- Relevance: Sound indicator frameworks address a few relevant, and usually difficult, key questions. This ensures that the information supplied supports decision-making and is of interest to external stakeholders. The main challenge, in the words of an SRI expert, is that „it is easier to answer many irrelevant questions than to find answers to the few actually relevant ones“ (1). The relevance of indicators to management can be further increased by the right level of aggregation and by using concepts and a language familiar to financial professionals. Close reference to or even integration into financial institutions' mainstream reporting – both internal and external, financial and non-financial – also support the development of indicator systems which provide relevant information.
- Practicability and efficiency: When putting indicator systems into play, there is usually a gap between the key questions and the data available to answer them. At the level of data collection, this will require trade-offs and a pragmatic approach. However, at the level of key questions, compromises motivated by lack of data run the risk of reducing the indicator system to irrelevance. Over time, asking the right questions might be the best way of encouraging the supply of facts and figures. A further approach to improving efficiency is to produce as few indicators as possible. This is of benefit to the user of indicator frameworks, on the reporting side, as well as being in the interests of readers of indicator-based reports.

By Way of Conclusion

A recent ad campaign by a German bank states that this institution „first takes measurements, then takes measures“. This slogan would lead us to assume that highly effective metrics are at work in this bank. And it may inspire appropriately high ambitions among the innovators of the next generation of environmental and social indicators. ←

Literature

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Note

(1) „Pictet kritisiert Kriterienwust“, Börsenzeitung, issue 74 of 19.04.2005

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