Sustainability and the Financial Sector

Lawrence Pratt
EcoConsulta S.A.
and INCAE Business School
Lawrence.Pratt@incae.edu
Sustainability-Competitive Relationship

COMPANY

Customers (current, future)

(Community)

Owners/Banks

Government

NGOs

Workers

PRODUCTIVITY

IMPACTS

ENVIRONMENT

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Financial Institutions Create Value from Sustainability

1) Risk Reduction
2) Orienting toward new clients
3) Relationships with multilateral and international FIs
4) New Business ("green" and other)
5) Internal Programs
Some Known Risks in Latin America

- Rejection or delay in permits
- Closure of plants by gov, communities or political enemies
- Civil and criminal liability
- Cost increases, and reduced access to capital
- Loss of market (products or processes)
- Protests, *boycotts*, strikes
Typical Latin American Case: Contaminated Sites

Construction of 1,200 “social interest houses” for families left homeless from winter storms.

- **11 Dec 2004** - Request for donations from best clients – $3.8 millones
- **Nov 2005** – All work is stopped.
- Pesticides were buried by the National Cotton Federation – prior owner of the land which the bank took as payment in workout (collateral was 44 hectares).
- Bank invested $2 million to decontaminate 22 hectares where village and school (1,000 students) were located.
- All permits were in order (env and health)
Typical Latin American Case: Contaminated Sites

- The environmental response reduced the risk to the bank, but did not eliminate it.

- 660 tons of earth was removed and taken for incineration.

- Government proposes a “Consent Decree” where occupants accept potential risk to their health and well-being.

- June 2006 – Bank decides to end the business, and assume all the costs (651 already built houses, more than $2 million, and still counting).
Company Valuation

Source: Adapted from Rappaport 1976
Valuation: Environmental Elements

- Energy Efficiency
- Material Efficiency
- “Dematerialization”
- Reduction of Toxicity
Valuation: Environmental Elements

- New products
- New markets
- New clients
- Price premium

Strategic and Policy Decisions

Costs

Earnings

Risks

Cash Flow

Change in Value

Cost of Capital
Valuation: Environmental Elements

- Regulatory Risk
- Risk of Direct action
- "Social license"
- Site contamination
Valuation: Environmental Elements

- Special credit lines
- Company image
- Lower risk profile
- Venture Capital (high growth companies)
Creando valor para el inversionista
This growth in SRI has been fuelled by both the moral argument and, increasingly, by the financial argument, with investors expecting that a socially responsible investment strategy will produce higher returns in the long run.

Socially Responsible Investment

DJSI World – Performance
5 Years, 08/01 - 08/06, EUR, Total Return Index

Source: Dow Jones Sustainability Index Series. http://www.sustainability-indexes.com/
Failure to meet market requirements
Lawsuits
Closure (formal or informal)
Boycotts, protests

Cash Flow

Negative Effects:
• Cash flow
• Reserves
• Costs
Failure to meet market requirements
Lawsuits
Closure (formal or informal)
Boycotts, protests

Site contamination/alteration
Technology that does not meet current demand.
Costs of asset removal

Cash Flow
Value of Collateral

Negative Effects:
• Cash flow
• Reserves
• Costs

Negative Effects:
• Provisions
• Execution
• Dead “portfolio”
Competitive Logic

- Failure to meet market requirements
- Lawsuits
- Closure (formal or informal)
- Boycotts, protests

- Site contamination/alteration
- Technology that does not meet current demand.
- Costs of asset removal

- Controversial Projects
- Systemic risk
- Repeated errors

Cash Flow

Value of Collateral

Reputation of the FI

Negative Effects:
- Cash flow
- Reserves
- Costs

Negative Effects:
- Provisions
- Execution
- Dead “portfolio”

Negative Effects:
- Customer confidence
- “upstream”
- Partners and shareholders

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### E&S Risk Report

Client: 223465  
File#: P-0015  
Transaction: Loan, $8,443,000  
Env & Social Classification: **B (moderate)**

<table>
<thead>
<tr>
<th>Type of Risk</th>
<th>Concern</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk to Cash Flow</td>
<td>Low</td>
<td><strong>B</strong></td>
</tr>
<tr>
<td>Risk to Guarantee</td>
<td>Low</td>
<td><strong>B</strong></td>
</tr>
<tr>
<td>Risk to Reputation</td>
<td>Moderate</td>
<td>Objections from neighbors, media involved.</td>
</tr>
</tbody>
</table>
Tourism Issues

- Non-dominant tourism (eco, anthro, etc.) growing at **25 to 30%** yearly vs. **4%** for “sun and sand.” Now over **5%** of total.
- Profitability equal to or higher than sun and sand
Ecotourism in Costa Rica

Investment: Various from $2 to $6 million  IRR: 18%+

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Reforestation with Native Species - Costa Rica and Guatemala

Investment: Various from $5 to $40 million

IRR: 16%+

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Components of a Sustainability Program

Institutional Strategy and Policy

- Risk Evaluation
  - cash flow
  - collateral
  - reputation
  - market
  - etc.

- Internal
  - energy
  - paper
  - travel
  - trans
  - etc.

Stakeholders

- Stakeholders
  - partners
  - reports
  - sponsorship
  - donations
  - etc.

Products

- Retail
  - mortgages
  - credit cards
  - checking
  - on-line

Commercial Products

- Commercial Products
  - green lines
  - premium
  - for low risk
  - reconversion

Asset Management

- Asset Management
  - funds
  - pension
  - portfolio
  - private equity
The Project’s goals is to improve the competitiveness of the Latin America financial sector through better environmental and management, reduced social and environmental risk, and the design of innovative financial products.
Program Components

• "Guide"
• ESRA training course
• Efficiency course
• Relations with leading Fis (via UNEP-FI)
• Network of regional contacts