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THE ROLE OF FINANCIAL INSTITUTIONS IN THE SUSTAINABLE DEVELOPMENT OF LEBANON

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After years of war, Lebanon is witnessing an era of reconstruction and development. Worldwide experience has proven, however, that development cannot and should not be accomplished at the expense of the environment and natural resources. Thus, guiding Lebanon towards a sustainable development path is a must. Lebanese financial institutions, which are a major player in the market, have the potential to accelerate the sustainable development of the country. This paper investigates the actual role played by Lebanese financial institutions in the quest for sustainable development and offers practical recommendations that should help this sector improve its performance regarding sustainability issues. Copyright © 2002 John Wiley & Sons, Ltd and ERP Environment.

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INTRODUCTION

The idea of sustainable development has been an effective force in bringing new groups into debate about development and the environment, and an increasing number of economists are trying to define sustainability in economic terms (Schmidheiny and Zorraquin, 1996). Until recently, the financial sector has been slow to come to terms with the concept of sustainable development, due to the inability of economists to understand the relationship between financial services and the environment, and to the traditional resistance towards environmental matters, but financial institutions are starting to become more involved in these issues. The wide variety of services offered by the financial sector (banks, insurance companies, rating firms, investment and analysis institutions and accounting firms) allows it to play a key role in the worldwide quest for sustainable development (Cooper, 1999). During the last decade, managers of multinational institutions became aware of the need to evaluate and integrate environmental risks and market opportunities associated with sustainable development (UNEP, 1997a, 1999a).

Since 1991, UNEP has been working with the banking sector to increase environmental awareness and encourage integrated environmental management (UNEP, 1994). UNEP formally launched the 'Statement by banks on the environment and sustainable development' in 1992 at the UN Conference on Environment and Development, the 'Earth summit' held in Rio de Janeiro (Schmidheiny and Zorraquin, 1996). The statement was later revised in May 1997 and became the 'UNEP statement by financial institutions on the environment and sustainable development' (UNEP, 1997b). It promotes the integration of environmental considerations into all aspects of the financial sector's operations and services. As of 4 January 2000, the number of signatories to the statement had reached 166 from an initial number of 44 countries.

In 1995, the idea was extended to insurance organizations when a group of leading insurance and reinsurance companies as well as pension funds developed, in collaboration with the UNEP, a 'Statement of environmental commitment for the insurance industry.' In this statement, companies pledge to balance economic development considerations with those of a sound environment (UNEP, 1995, 1999b). The statement acknowledges the guidelines of sustainable development and the precautionary principle. It also calls upon insurers to incorporate environmental considerations into their internal and external business activities. As of 15 December 1999, the number of signatories to the statement had reached a total of 86 from a modest initial number of 27 countries.

In 1989, 15 major US environmental organizations together with an array of socially responsible investors and public pension groups formed the Coalition for Environmentally Responsible Economies (CERES). CERES pioneered an innovative practical approach toward encouraging greater corporate responsibility with regards to environmental issues. The coalition developed the ten CERES principles in 1989 (CERES, 1989). By endorsing these principles, companies publicly affirm their belief that corporations have a responsibility for the environment, and must conduct all aspects of their business as responsible stewards towards the environment by operating in a manner that protects the Earth. They believe that corporations must not compromise the ability of future generations to sustain themselves. Until today, the CERES principles have been signed by 54 international organizations (CERES, 2001).

Since the late 1980s, the United Nations and International Standards of Accounting and Reporting (ISAR) have done a considerable amount of work to integrate environmental issues into accounting practices. The most comprehensive work was presented in a position paper adopted by ISAR in February 1998. The main chapter, 'Recommendations adopted by the intergovernmental working group of experts on international standards of accounting and reporting', provided guidelines for best practice in accounting for environmental transactions and events (Abu Ghazaleh, 1999).

After the end of the civil war 11 years ago, Lebanon is still suffering from environmental deterioration. The only stakeholders that are active in protecting the environment are local civic societies. Their efforts to halt environmental deterioration through the public policy process are crippled by the nature of the Lebanese political system, which is sectarian. In addition, legislations related to the environment are outdated (1930s). The government is also facing a serious financial crisis, especially with public debt, amounting to 24 billion US dollars (equivalent to 140% of the GDP). Therefore, most investments will have to come from the private sector (local, regional and international), which will play an important role in the development of the country, especially through the privatization of public assets, which is the trend in most third world countries.

The purpose of this paper is to investigate the role that financial institutions (banks, investors and analysts, insurers and accountants) can play in the sustainable development of Lebanon. The aim is to examine whether these institutions are aware of the trend, mostly in developed countries, to incorporate sustainability issues into the operations of financial institutions, and to study to what extent institutions in this sector are willing to prioritize environmental concerns in their operations and commit themselves to sustainability issues.

METHODOLOGY AND SCOPE

The objectives of the study are to develop an accurate picture of (i) the integration of environmental issues in the basic work of different financial institutions; (ii) current practices of the financial sector regarding sustainable development issues; (iii) the environmental management strategies used by financial institutions and (iv) the future consequences of the expected integration of environmental considerations into the basic operations of Lebanese financial institutions.

The work done was divided into four stages. The first stage was an intensive literature review conducted to obtain solid information about the operations of the different financial services targeted in the study. The second stage consisted of developing separate detailed questionnaires for the four sectors (banks, insurers, investors and analysts, and accountants) that are under investigation. The questionnaires were divided into two parts. The first part was common to all four sectors. The second part contained questions specifically relating to each sector. The banking sector questionnaire and the common section found in all questionnaires were developed with assistance from the UNEP office in Geneva, Switzerland. The third stage involved the distribution of the questionnaire to the largest possible number of financial institutions in order to obtain an accurate picture of current trends in the country. The respondents were nine out of 14 banks, five out of 15 insurance companies, five out of eight investment firms and three out of five accounting firms. These were followed by interviews in order to obtain additional clarifications. The number may be small but all of the above institutions are major players in a small country such as Lebanon. In addition, many of the institutions declined to participate in the study because the issue of environmental sustainability is still regarded as extremely sensitive. The fourth and final stage comprised analysing and interpreting the obtained results, and providing recommendations.

RESULTS FOR THE COMMON SECTION

In general, the results reveal a low level of commitment to environmental issues. The percentage of institutions having adopted an international environmental code of conduct or having developed a corporate environmental policy was significantly low (Table 1). No one sector seems to have preceded the others in committing to sustainable development. Some institutions confirmed that they have developed their own environmental codes of conduct due to the difficulties associated with abiding by international standards. These codes were not made available during the survey. A few organizations tried to integrate some environmental considerations into their domestic core activities, but the results show that these efforts are still mostly incomplete and not well organized.

Additionally, the results reveal the absence (except for one bank) of a dedicated environmental department (Table 1). Most respondents explained that the creation of such a department was costly and not affordable at present. Others stated that there is simply no need for an environmental department. The absence of such departments within the organizational structure of financial institutions shows that the financial sector in Lebanon has not yet accorded enough importance to environmental issues. Furthermore, the majority of respondents admitted that they did not try to review their environmental performance and that they have not yet established any specific

Table 1. Commitment to environmental issues

	Banks %	Insurers %	Investors %	Accountants %
Environmental code of conduct				
None	78	40	60	67
ISO 14000	0	20	20	33
ICC	11	0	20	0
BS 7750	0	0	0	0
Own code	11	40	0	0
Establishment of an environment department				
No	89	100	100	100
Yes	11	0	0	0
Environmental exposures				
None	100	60	100	100
Public image	0	40	0	0
Legal compliance	0	0	0	0
Financial losses	0	0	0	0

environmental plans and targets. A few institutions explained that environmental plans were currently under development, but no information could be obtained about specifics. Respondents also stated that they did not face any sort of environmental liability while operating in Lebanon due to the lack of environmental regulations in the country (Table 1). Furthermore, most of them admitted that their internal environmental activities (energy and water efficiency, recycling, reuse and reduction of materials) were mainly conducted for cost saving purposes.

The results also demonstrated that the preferred channels for obtaining environmental information were journals and magazines for bankers, conferences for investors and accountants and televised campaigns for insurers. Surprisingly, the Internet is disregarded as a valuable source of information. Only one of the 22 institutions surveyed (an investment firm) mentioned that it publishes an environmental report on a regular basis. Also a few individuals publish – on a personal basis – environmental articles in the local press, give speeches at conferences or participate in the activities of civic societies.

BANKING SECTOR

The results obtained indicate that all the banks surveyed are completely unaware of the 'UNEP statement by financial institutions on the environment and sustainable development,' even though some of them have branches in the US or in Europe and have already signed and committed to the statement (Table 2). Therefore, it can be inferred that there is some sort of environmental negligence on the part of the Lebanese banking sector.

The survey also revealed that most banks do not have written environmental policies or procedures (Table 2). Very few banks integrate environmental risk into their risk management

Table 2. Environmental management within the bank

	Yes (%)	No (%)
Aware of UNEP statement	0	100
Written environmental policy/procedure	22	78
Integration of environmental risk into risk management	22	78
Monitoring of environmental risk	11	89
Development of 'green products'	0	100

and analysis strategies (Table 2). It was also obvious from their responses that they have, so far, no clear scientific methods for the integration of such risks. Most banks acknowledged facing many problems preventing them from the inclusion of environmental considerations into their core business activities, the most important reasons being the lack of accurate environmental information, and the difficulty relating to environmental issues and translating their impacts into financial terms.

Additionally, most respondents considered that banks are very slow in facing environmental responsibilities, opportunities and liabilities, although acknowledging that environmental issues are relevant to the banking sector and should be integrated into regular banking activities in the future. Many considered that integrating environmental risk into core business does make economic sense, as lenders could be faced with environment-related risks, such as the loss in property value, and the inability of borrowers to repay loans because of environmental problems. However, less than half of the banks surveyed seem to have no environmentally related plans and targets for the near future. In addition, they consider that the banking sector does not have enough investment potential to drive forward higher environmental standards. Only two banks are considering integrating environmental issues into their core activities (Table 2), and two others intend to participate in environmental debates and activities.

Bankers do realize that they have the opportunity to play a proactive role in the sustainable development of the country. Results showed that some banks are starting to find new opportunities in being environmentally friendly. Internally, energy and paper consumption reduction are considered as highly important issues. Externally, several banks realize that the development and exploitation of new markets can be beneficial. One bank is currently offering discounted interest rate loans, but the remaining banks admitted that they have not yet considered developing any specific 'green' products (Table 2). Some banks realize that they can offer wide varieties of environment-related services whether in the retail or in the business sector. For the retail sector, the best options are to provide loans for domestic energy efficiency specifically and to offer more preferential terms on loans for eco-efficient housing. For the business sector, the focus is mainly on financing corporate energy efficiency, but several other opportunities are also taken into consideration. However, the results undeniably suggest that even though most respondents claim to understand the benefits that may accrue from being more environmentally oriented, few truly believe in these benefits or are willing to make the necessary investments and adjustments. Otherwise, the trend towards sustainable development would be much more important in the banking sector.

INSURANCE SECTOR

The results reveal that the insurance sector in Lebanon acknowledges the salience of environmental issues and is expecting to incur enormous costs as a result of the climate change phenomenon. Some insurers declare having already suffered losses due to climate change (Table 3). According to insurers, this phenomenon raises two main concerns: the incurring of large costs, and problems related to the lack of predictability (Table 3). Insurers realize that environmental problems and risks threaten the very basis of the insurance industry, and affirm that the avoidance of environmental degradation and the prevention of environmental catastrophes should be a common goal to all insurers. They acknowledge that investing in environmentally harmful projects does not make good economic sense for insurers (Table 3). Three companies also recognize the need for insurers to modify their traditional way of doing business in order to account for environmental issues, and claim that they are cooperating with environmental groups and climate scientists.

Table 3. Effect of sustainability on the insurance industry

	%	
Concerns created by climate change for insurers		
None	20	
Lack of scientific data	0	
Lack of predictability	20	
Enormous costs	60	
	Yes %	No %
Endorsement of UNEP statement?	0	100
Insurers affected by climate change?	60	40
Insurers exposed *vis-à-vis* environmental issues?	100	0
Investment in environmentally harmful project good economic decision?	0	100
Establishment of environmental action plans?	20	80

Four out of the five institutions surveyed intend to sign the 'Statement of environmental commitment by the insurance industry' (Table 3). They consider that endorsing it is beneficial because it allows their companies to show commitment to sustainable development, promotes public awareness and communication and gets companies involved in regional and international conferences. They also agree that gradual preventive action is economically preferable to a wait-and-see policy.

The majority of respondents also affirm that they provide their clients or potential clients with environmental information or advice, and that they are trying to manage environmental risk in cooperation with their clients. Three firms also indicate that they are providing environmental information to new industries seeking to become established in the Lebanese market. This declaration is rather surprising, since all of them previously admitted having no environment department, environment specialists or corporate environmental policies. Therefore, the assertions of the insurance sector remain questionable. Additionally, respondents declare that they intend to take several actions in order to limit environmental degradation; however, they do not have specific environmental action plans (Table 3). The majority of insurers also acknowledge that they can contribute to limiting greenhouse gas emissions, mainly by demanding environmental indicators from their clients and providing financial incentives for energy-saving companies, thus discouraging carbon fuel use and encouraging renewable and clean energy technologies. Finally, most respondents consider that environmental problems could create new business opportunities for the industry (involvement in new companies developing waste elimination and cleanup technologies, assisting local companies with their international technology and marketing strategies, advising clients and helping them reduce their environmental risks), and could secure them a niche market in the environmental technology sector.

INVESTORS AND ANALYSTS SECTOR

Most investment firms surveyed consider that environmental liabilities are important and they should be taken into consideration in investment decisions (Table 4). They affirm that they are starting to integrate environmental risk when making investment decisions. This contradicts with earlier results (see common section). In addition, no accurate information about the integration of environmental issues into the activities of investors could be obtained.

Financial analysts realize that they are in a position to promote environmental protection, but currently, only one firm rewards eco-efficient companies with a higher share price (Table 4). Furthermore, investors admit that they have moderate information about the effects of environmental issues on their work, and further recognize that none of the mathematical models they use for decision-making contain environmental information (Table 4).

Table 4. Effects of sustainability on investors

	Yes %	No %
Sustainability issues relevant to investors' work?	80	20
Environmental information included in mathematical models used?	0	100
Reward of eco-efficient companies with higher share price?	20	80

It is therefore unclear how investors can integrate environmental considerations into their decision-making processes. These obvious contradictions demonstrate that there is a deep misunderstanding of the concept of sustainable development, even though most respondents claimed to understand the subject.

The survey further reveals that some customers are starting to require environmental information from their financial specialists in order to determine the profitability of certain investments, and to avoid future possible environmental liabilities emanating from the emergence of new laws and legal considerations. Four out of the five firms declare that they are having difficulties obtaining good environmental information due to the scarcity and inaccuracy of available data. In fact, the majority of companies in Lebanon do not publish environmental reports that can be used by analysts. Therefore, environmental information is usually obtained from newspapers, radio, television and to a lesser extent the Internet.

ACCOUNTING SECTOR

Initial results indicate that accountants in Lebanon consider that environmental risks could well reduce the value of a company and could affect the company's overall profitability (Table 5). According to accountants, the identification of the environmental element of a product's total cost is of major importance, since high environmental costs can at times seriously affect the profit and loss accounts, and can represent a high percentage of a product's total cost. The two main factors that could influence the profit and loss accounts are the increased cost of pollution control, and the higher costs for the disposal of wastes. However, all respondents state that, in Lebanon, they are not facing any problems as a consequence of environmental risks (Table 5).

Table 5. Effects of sustainability issues on accountants

	%	
What environmental risks reduce the value of companies?		
None	0	
Contaminated land	67	
Polluted groundwater	67	
Polluted air	67	
Environmentally unsound product	67	
Consequences of environmental risks for Lebanese accountants		
None	100	
Expenditures	0	
Liability	0	
Risks created by increased environmental regulation		
None	0	
Emergence of new laws	67	
Shifts in the market	33	
	Yes %	No %
Environmental laws in Lebanon?	0	100
Environmental certificates (ISO14000 etc) important?	100	0
Include environmental impacts in accountants' work?	100	0

The survey also reveals the absence of Lebanese laws requiring accountants to disclose large environmental expenditures (Table 5). Some respondents claim that they are starting to receive demands from their clients to put a price on environmental risks facing companies, and to verify valuations of land assets and capital equipment.

In addition, the results show that, so far, environmental issues are only minimally (if at all) included in the basic work activities of accountants in Lebanon, and that the recently emerging concept of environmental reporting is not yet being applied. However, it is feared that the emergence of new laws in addition to growing consumer concerns could create a new set of problems for accountants (Table 5). In fact, most accountants think that environmental considerations should be included in the basic accountancy work as part of the annual reporting system. In that sense, two firms state that they are planning to include environmental data in their annual reports, and one firm affirms that it is starting to integrate environmental considerations into its daily business activities. Most accountants consider that a company's financial statement should include information about its assumptions, risks and vulnerabilities because the publishing of environmental related accounting information can greatly improve the firm's public image. However, all firms acknowledge that traditional accounting practices are too limited to deal with environmental costs. Accounting practices are restricted to dealing with legislated social costs, do not account for full production costs, and do not recognize the inherent limits to economic activities. Accountants consider that figures representing environmental expenditures can be misleading, as different firms and different countries have different accounting practices. Thus, figures for environmental expenditures for one company could be misleading and meaningless when compared with others. However, there is a more or less general agreement that environmental expenditures usually represent a failure cost rather than a high degree of commitment to environmental issues.

Two firms state that they are facing difficulties in determining the size and timing of financial penalties resulting from environmental problems. Only one firm admits that environmental accounting is difficult and not well understood by financial specialists.

Regarding environmental standards, accountants in Lebanon believe that environmental certificates (ISO 14000, BS 7750 etc) could improve the performance of accounting firms both on a local and on a global scale. Conformance to such certificates can help make sound environmental accounting decisions (Table 5). One firm considers that 'environmental management systems' usually increase the pressure on accountants to integrate environmental considerations into basic accountancy practices. However, most accountants are completely unaware of ISAR's 'Recommendations adopted by the intergovernmental working group of experts on international standards on accounting and reporting', published in February 1998. Therefore it is obvious that accountants in Lebanon do not possess the know-how needed in order to evaluate environmental risks faced by companies here and abroad.

CONCLUSION AND RECOMMENDATIONS

In general, the Lebanese financial sector has been slow in conforming to the global trend of greater environmental sensitivity and sustainability. This has been clearly demonstrated in the reluctance of Lebanese financial institutions to make the necessary adjustments, whether in their corporate policies, organizational structures, management processes, strategic analysis and planning or even basic marketing and investment decisions. This conservative orientation to sustainability, partly attributed to a misunderstanding of the concept of sustainable development, has in turn prevented the integration of environmental considerations into the activities of this sector.

The steps needed in order to promote and fasten the integration of environmental concerns into the activities of the financial sector are (i) creation of environment departments, (ii) raising the awareness of employees on sustainable development issues and providing them with the training needed to consolidate these considerations into everyday business activities, (iii) integration of sustainable development into strategic and operational decision-making processes, (iv) the Lebanese government should, in collaboration with all parties involved, develop and implement an integrative set of laws (which should be clear, consistent and easy to implement) to guide the financial services sector towards a sustainable development path, (v) formation of discussion groups, meetings and forums in cooperation with civic societies, (vi) participation in international conferences, (vii) requiring or mandating environmental information from clients, (viii) regular publication of environmental reports, (ix) establishment of environmental plans and targets, (x) development of internal and external environmental policies and periodical review of the implementation of such policies and (xi) cooperation with the educational sector in order to obtain up-to-date environmental information. More specific recommendations for the different financial institutions are listed below.

Recommendations for the banking sector

The recommendations for this sector are (i) establishment of specific requirements (such as ISO 14000 certification, environmental reports etc) as a condition for granting loans, (ii) development of environmental management systems (EMS) within banks, (iii) inspection of the environmental performance of subcontractors and suppliers, requiring, for example, energy efficiency practices, (iv) offering environmental incentives, such as discounted interest rates for environmentally friendly projects, (v) development of environmental advisory services for all clients, (vi) lobbying for, and helping to develop, fiscal instruments aimed at improving environmental performance, (vii) signing the 'UNEP statement by financial institutions on the environment and sustainable development' and (viii) conducting or requiring environmental impact assessments (EIAs) of projects before financing them.

Recommendations for the insurance sector

The recommendations for this sector are (i) requirement of accurate environmental information from clients, (ii) declining insurance coverage for environmentally harmful projects, (iii) integration of environmental risk into risk management processes, (iv) endorsing and implementing the 'Statement of environmental commitment by the insurance industry', (v) establishment of environmental action plans (EAPs), (vi) advising clients on ways to reduce their environmental risks and (vii) cooperation with climate scientists and environmentalists.

Recommendations for the investors and analysts sector

The recommendations for this sector are (i) investment in environmentally friendly projects only, (ii) integration of environmental considerations into the mathematical models used for decision making, (iii) supplying clients with environmental information about the companies in which they intend to invest and (iv) rewarding eco-efficient companies with a higher share price.

Recommendations for the accountants sector

The recommendations for this sector are (i) disclosure of large environmental expenditures, (ii) adoption of international standards (such as ISAR's environmental guidance), (iii) inclusion of environmental indicators in standard performance indicators, (iv) collaboration with standard-setting organizations in order to come up with an integral set of operating standards and (v) translating environmental costs into financial terms.

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