Sustainability in South African Banking

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CONFIDENTIALITY CLAUSE

15 September 2003

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Due to the strategic importance of this research it would be appreciated if the contents remain confidential and not be circulated for a period of ten years.

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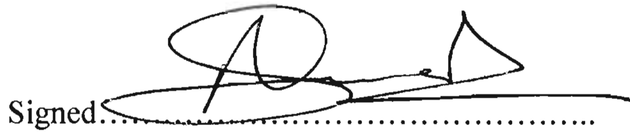

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ABSTRACT

The local banking industry has many challenges to face in the newly democratized South Africa. This study reviews these challenges, with special reference to sustainable business practice. It commences with an overview of the global business environment and more specifically, the challenges facing the international financial services sector with respect to sustainability. The effects of globalisation, as well as modernization, are used as key influencers in determining the external global environment. The international background is used to determine those factors that filter through to the South African banking sector, which is viewed as a new participant to the global economy. Complemented with the above, a high level review is performed of the local specific challenges facing banks in post-apartheid South Africa. This includes the challenge of providing accessible banking to the traditionally un-banked, as well as the implementation of black economic empowerment in the local financial services sector. With the above background in mind local banks are being evaluated on what they are currently doing in leveraging of sustainability in producing stakeholder value. The five capitals framework has been used to identify the level of implementation of sustainability in the current business models of South African banks. This status quo has been used as the foundation for making suitable recommendations to meet both the local and global challenges identified in the first part of the study.

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1. Chapter One

1.1. Introduction

Sustainability poses new challenges to businesses globally as they come under growing regulatory and societal pressure from a wide range of stakeholders to address demands for sustainability, as well as responsibility and accountability. The South African financial services industry, in particular, has to pay increased attention to the issues of social, ethical and environmental risk, corporate citizenship, socially responsible investment and sustainable banking, while at the same time balancing all of these, on an ongoing basis, with wider stakeholder demands and issues of profitability.

The past two years has seen the collapse of smaller banks and the consolidation of the financial services industry at an unprecedented level in South Africa. This may be an indication of their inability to adapt to a changing environment, growing consumer expectations and higher corporate governance standards. The ability of banks in South Africa to adapt to a fast changing operating environment will have consequences for their long-term survival.

This research aims to examine the above by investigating *whether South African banks leverage off the key elements of sustainability in producing stakeholder value.* In doing so the research will examine international best practice and explore ways in which South African banks can innovate in their products and services through sustainability opportunities.

1.2. Background

The increased democratization of the world (both at a macro and micro level), complemented with the globalisation resulting from the technology and the transportation revolution, has created many challenges facing modern business. One of these is the pressure to address sustainability issues pertaining to business practice. The growth in global consumerism makes these pressures an extremely difficult one to manage. "Issues that were once peripheral to decision making and incidental to business success are now fast becoming critical" (Grayson & Hodges, 2001). For example, "The managers of 15 mutual funds joined forces to boycott Mitsubishi over the company's plans to build a new salt evaporation plant near a prime grey whale habitat at San Ignacio Lagoon in Mexico. Mitsubishi operates the world's largest salt evaporation plant at the Lagoon in Baja California and wanted to build a 150 million (USD) expansion facility. Environmental groups led by the International Fund for Animal Welfare launched global efforts to deter the new one from being built. Mitsubishi announced, later on, that they would not proceed with the scheme, despite a favourable environmental impact assessment report, after over a million people wrote in to protest " (Grayson & Hodges, 2001, p77).

Sustainability issues cover a wide variety of topics but primarily focus on issues that would enhance good business practice and consequently provide a long-term framework for operation. Key issues pertaining to sustainability include:

1. Business conduct/governance with respect to various stakeholders;
2. Reporting business conduct (both financial and non-financial) that takes in to account the full impact of business operations on its various stakeholders; and
3. The reorganisation of business that allows companies to contribute positively to society as a whole, via core business (be it either services or products).

The above, "relatively new environment", results in " rising expectations from key stakeholders, who demand transparency and accountability" (Grayson & Hodges, 2001). Banks are not excluded from these pressures to transform and have to increasingly account to their key stakeholders, including shareholders, customers and society (as a whole), in terms of these new demands, placed on business. This is clearly manifested when one reviews the business practices of several banks such as Westpac in Australia and the Cooperative Bank in the United Kingdom (http://www.westpac.com.au and http://www.co-operativebank.co.uk).

As a consequence of the above, various initiatives have been launched globally around financial services/ banking, to address these issues. These include:

1. *Various Banking Charters:* Many countries have attempted to draft charters that steer banks to play a more meaningful role in society, for example the London Principles in the United Kingdom (http://www.corpoflondon.gov.uk) and the draft financial services charter in South Africa. The London Principles is a United Kingdom based initiative that shows what banks can do to support sustainable development. The key principles of this charter, which was launched at the World Summit on Sustainable Development (WSSD) in Johannesburg in September 2002, is envisaged to be rolled out internationally. They include the key issues of economic prosperity, environmental protection and social development.

2. *Socially Responsible Investment (SRI)*: SRI is about linking personal values and societal concerns with the investment decision and taking a longer-term view of investment. It considers both the financial needs of the investor (both individual and institutional) and the impact on society. The above philosophy is activated by:

- Screening investment opportunities based on social and environmental concerns;
- Advocating shareholder activity to promote corporate responsibility and shareholder rights; and
- Investing in initiatives that support the development of society whilst furthering the aims and objectives of business.

Sustainable Asset Management (SAM), an example of SRI, employs an investment philosophy that embraces an evaluation process that includes economic, environmental and social issues. This allows for investment in sustainability driven initiatives. This type of institutional investing only started to gain momentum in the mid-nineties with the establishment of asset manager companies such as SAM in Zurich in early 1995.

Another example of SRI would be Sustainability Indices: were equity stock markets develop indices that track the performance of companies that are viewed to be incorporating sustainable business practices as part of their core business practices and are judged on the following three criteria for inclusion:

- "Working towards environmental sustainability;
- Developing positive relationships with all stakeholders; and
- Upholding and supporting universal human rights" (http://www.ftse4good.com).

Some of the major stock markets have developed indices like the above. These include the FTSE 4 Good (London Stock Exchange) and the Dow Jones Sustainability Index (New York Stock Exchange).

3. *The BASLE Principle of banking*: These are principles of banking (primarily risk management issues), which are adopted by central banks to improve the quality of banking supervision. This charter is embedded in twenty-five core principles that are currently being rolled out internationally to individual banks.

The international drivers mentioned above have resulted in several initiatives being launched locally to align current banking practices with those of our international counterparts. These include:

1. *The Banking Charter (draft)*: The charter, currently in draft form, is an attempt by the banking sector in South Africa to determine what banks can do to contribute to sustainable development within the context of the South African economy, which embraces a first world infrastructure, whilst having to address challenges of a third world society. The charter is a direct consequence of the Government's broad based Black Economic Empowerment (BEE) strategy to overhaul ownership and participation in various industries with a view to reducing barriers to entry to allow meaningful black ownership and participation.
2. *The FinMark Trust*: This trust was created in March 2002 by The Banking Council of South Africa, with initial funding of GBP 5 million (approximately ZAR 75 million) from the UK's Department for International Development (DFID) (http://www.finmarktrust.org.za). The mission of FinMark Trust is summarised in its slogan, "Making Financial Markets Work for the Poor".
3. *The Community Reinvestment Act*: This is draft legislation that is currently being debated, that would allow for incentives for banks (not compulsory), to lend to individuals that do not have access to bank loans (primarily for housing).
4. The development of *SRI* (in South Africa): For example the Edward Nathan Friedland Sustainability Index. Edward Nathan & Friedland, corporate law advisers & consultants, have launched South Africa's first sustainability index based on the following key areas of focus: risk management indicators, environmental indicators, social indicators and economic indicators. This is a precursor to the launch of the JSE Sustainability Index in partnership with the FTSE.
5. The adoption and implementation of the core principles of the *BASLE* convention on banking supervision. This is evident in the creation of banking supervision department at the South African Reserve Bank and it's elevation in status over recent times.

It is evident from the above that the South African banking sector should be in a process of adaptation to incorporate sustainable development, as part of its competitive advantage value proposition, to its various stakeholders. This provides an ideal background/platform for the research study to evaluate whether the local institutions are leveraging off these sustainability drives in order to produce meaningful stakeholder value and in some cases, just to have a "ticket to the game" and to operate as a going concern.

1.3 Motivation for the research

The following are key reasons for the choice of topic:

1. The researcher is currently employed in the South African banking sector by one of the four major banks. Sustainability issues have become a very relevant theme in reorganising banking to meet the changing needs of modern society. This is very evident when one reviews the most recent set of results of any of the major banks and their strategic vision. Consequently, the evaluation of the banking sector's utilisation of sustainability issues in stakeholder value creation is extremely relevant to the researcher (and many banking executives).
2. The recent collapse of several small to medium banking institutions in South Africa have raised questions as to whether these institutions have adequately addressed sustainability issues. This combined with the global practices mentioned above creates a definite appetite for the study.

1.4. Value of the project

The research study is intended to have the following benefits:

1. The study will allow banking executives to review the link between sustainability issues and creating meaningful stakeholder value;
2. It will afford banks the opportunity to evaluate the extent to which they adequately understand and manage emerging social, ethical and environmental risk (as key drivers to sustainability);
3. It will allow South African banking participants to evaluate the extent to which banks are leveraging key sustainability issues in producing stakeholder value;
4. Create debate amongst key banking participants as to the level of implementation of sustainability issues in core operations; and
5. Create awareness of sustainability issues effecting the South African banking environment.

1.5. Problem statement

Do South African banks leverage off the key elements of sustainability in producing stakeholder value?

1.6. Objectives of the study

1. To examine the impact that sustainable business practice has on the various stakeholders of banks in South Africa.

2. To contribute to the current knowledge base with respect to sustainable business practices in the South African banking environment.

3. To examine the global sustainability trends in banking and its relevance to South African banks.

1.7. Research methodology

The research methodology consists of a combination of reviewing existing secondary information and in-depth management questionnaires. Secondary information includes sources such as cases and more commonly known banking information.

Case studies of the South African banking sector, including both currently and previously operating banks, forms the focus of the research for the following reasons:

1. The researcher has been working in the banking sector for the past several years and access to information and specialists is greatly enhanced.
2. The recent collapse of several medium sized banking institutions provides an ideal platform to conduct the research and answer the problem statement.

The main source of data is secondary data, which has been obtained from the following sources:

1. The Internet;
2. Management and banking journals and articles;
3. Regulatory publications (both local and international);
4. Various contemporary textbooks reviewing sustainability business practices;
5. Existing questionnaires and research studies in this field of study

1.8. Limitations of the project

1. The area of study that has been researched is vast and consequently, the research output does not cover all areas of the topic in detail.

2. Management of South African banks are wary of discussing issues relating to sustainable business practices as they believe that details pertaining to this topic is a competitive advantage and they are not willing to make this information available to the public domain. This resulted in a reluctance to complete research questionnaire pertaining to this topic. The researcher has attempted to reduce this limitation by requesting the South African Banking Council to send the detailed questionnaire of this study under its recommendation. However, this has not been successful.

3. Self-administered questionnaires allow for too much interpretation.

1.9. Structure of the study

The research project is presented in the following framework:

- Chapter two

This chapter will focus on global sustainable development and creates the broad based landscape in which the study is performed. It reviews the trends in globalisation and its impact on society and the way we do business. It also attempts to describe the global business environment in which many of our business have to operate. Finally, it introduces the concept of sustainability and attempts to describe the relevance of this concept in the background of the global and local economies in which all businesses operate. It clearly states the benefits of adopting a sustainable approach to business practices. The five capital model of the SIGMA Project (http://www.projectsigma.com) is used, when attempting to contextualize sustainability in any business model.

- Chapter three

An analysis of the global and local banking environment is provided. This chapter explains the framework in which banks are required to operate. This includes a review of best practice as well as regulatory frameworks. It also attempts to contextualize the relevance of sustainability in banking and shows the trends that are developing amongst local and international banks, in an attempt to make market sense of sustainability. The review of the local banking environment includes an overview of corporate governance in South Africa (its relevance to banks); the Government's Black Economic Empowerment strategy as well as the draft financial services charter that is currently being debated at the highest levels. This chapter also includes a brief review of non-traditional banks such as the Village Bank and the Post Office Bank in an attempt to review their successes and failures to address sustainability.

- Chapter four

This chapter provides an evaluation of sustainability amongst South African banks using the five capitals models adopted by the SIGMA project (http://www.projectsigma.com). By doing so, it provides a high-level gap analysis. It also attempts to compare the local practices with that of foreign banks to determine the strengths, weaknesses, opportunities and threats that are prevalent in the South African banking environment.

- Chapter five

Based on the findings of the practices found at local banks, this chapter attempts to suggest practical recommendations for South African banks to adopt, in an attempt to increase stakeholder value via the adoption of sustainable business practices.

1.10. Summary

Banking in South Africa has the challenges of both a developing country (un-banked consumers) as well as that of a developed country (world class infrastructure with first world customer base). This creates additional challenges for local banks when adopting sustainability measures. The global economy and world practices, is at the same time changing. For South African banks to remain relevant they need to address sustainability in various parts of their value chain to ensure that the needs of their social, economic and environmental stakeholders are met. Pleasing shareholders only, was in the past, a difficult task. The additional needs of the other stakeholders like, the community, staff and the environment, poses its own challenges.

The researcher intends to look at these challenges facing South African banks and to conclude whether they are leveraging of these initiatives in producing meaningful stakeholder value. Further, based on the above findings the research intends to suggest recommendations.

2. Chapter two: Global trends

2.1. Introduction

The business playing field has evolved over the years. Companies that want to outperform their peers in the long run have to consider the opportunity and risks that sustainability has to offer. The increasing demand from all stakeholders, and not just shareholders, as was the case in the past, excludes any company from taking cognizance of the concept of sustainability and its potential impacts to the business.

Sustainability is the ability of company to protect and grow stakeholder value in relation to economic, social, ethical and environmental management as part of it core business practices. The concept of sustainability is often confused with company donations and philanthropy as most managers see its major impact as reputation management, in the communities/context in which they operate. The direct consequence of the above is that companies alienate the actual meaning of sustainability from their day-to-day practices and often see it as an after thought to the value chain within any business. The resulting impact is the inability of companies to re-engineer their value, to take cognizance of sustainability, and to reap its related benefits.

The increasingly challenging attitude of all stakeholders (both locally and globally), including shareholders, staff and society to management, creates momentum (as well as pressures) for management to take a serious look at entrenching sustainability into their current business model.

2.2. Globalisation

Globalisation in its simplest definition refers to the fact that the world is becoming more interrelated in the ways that various participants interact with each another. This extension of economic relations between countries creates a world economy in which every national economy is dependent on other countries. This is primarily a result of the advancement in transportation, communications as well as the development of the concept of capitalism, which is based on the quest for the highest profits (very often at the expense of society).

As a consequence of the above, the private sector is expanding its influence on society around the world, whilst the role of governments, which act as advocates of social equity, are beginning to diminish. In a social aligned economic system, globalisation would mean a huge step forward for humanity. The reality however, is that the influences of globalisation are being hijacked by the captains of capitalism in the quest for the highest profits. This makes social equity and development almost impossible and creates a society in which the living standards of the majority continue to decline whilst a small minority becomes wealthy. The effects of the above are clearly evident when one considers that fact that the earth has enough capacity to feed 10 billion humans, whilst approximately 2.4 billion currently live under the poverty line (http://www.marxist.com/Globalisation/sixquestions.html).

A few multinationals control the majority of the wealth of the world and impose their interest to the rest of the world. As a consequence, the world economy does not benefit all its participants equally. Underdeveloped countries are forced to provide cheap raw materials and labour (often under conditions of unfair labour practices) to the global captains of industry.

Global organisations like the World Bank and the IMF have an increasing role to play in facilitating economic equality in society, which often underpins democracy and basic conditions of living. Some of these organisations have taken cognizance of the calls for change. An example of this was echoed in the words of the president of the World Bank in his address to business leaders in Washington in June 2001 " Corporate sustainability today includes recognition of the leadership role that the private sector must take in ensuring social progress, improved equity, higher standards of living, and stewardship for the environment" (http://lnweb18.worldbank.org). He went on to state that the World Bank needed to transform as an organisation " into a global leader on social and environmental responsibility- for other development agencies and the private sector to follow" (http://lnweb18.worldbank.org).

Society driven by an increasing consumer demand for economic justice as a whole has identified this trend and has started to place greater pressure on the private sector to take greater cognizance of the impacts and needs of society as a whole. This is normally through regulatory frameworks or via social pressures. The demonstrations seen in Seattle, Prague, Davos and Nice (where international financial institutions have met) are examples of societal pressures.

2.3. Sustainable development

Figure 2-1: The key elements of sustainability
(Source: KPMG available online at http://www.kpmg.co.za)

One of the solutions to many of the problems outlined in the discussion of globalisation above is the concept of sustainable development. Various definitions surround this concept of sustainable development, however a common thread through many of these definitions is the view that this concept encompasses the view of the economist, sociologist as well as the ecologist. This basically means that success is built on the interaction between financial, environmental and social values. The links between these values were considered to be relatively unexplored until the 1980's.

Historically, environmental and social issues were not addressed, as profit was king. The focus is primarily financial. The consequence of this is that these actions have accumulated over time and its consequent negative impact has manifested itself on society. Clearly this is a sign that when decisions are taken, consideration needs to be given to society as a whole and their impacts, on a longer time horizon. Within this longer time horizon, impacts on society and the environment are more clearly identifiable.

The World Development report is one such initiative by the World Bank that attempts to focus on long-term solutions that includes financial (economic), social and environmental impacts. The report "is about improving well-being and protecting what people value and want to pass on to their children. Its messages, in brief, are these: For people to thrive, assets must thrive. A broad portfolio of assets- physical, financial, human, social and environmental- needs to be managed responsibly if development is to be sustainable" (World Development Report 2003)

The World Development Report is an attempt to report on the health of society beyond financial measures. By focusing on a sustainable solution, it encourages the Bank to have a mandate beyond financial objectives. Some of the key elements of the report, as found in the overview of the document, include the following:

- "Additional institutions are needed to coordinate and ensure an adequate supply of assets that are not spontaneously provided by the markets: environmental assets (clean water, clean air, fisheries and forests) and social assets (mutual trust, ability to network, and security or persons and property" (World Development Report 2003).

- " Competent institutions" (World Development Report 2003) are required for a coordinated approach to identify and signal out problems, formulate relevant policies to address such problems as well as to carry out these policies in a responsible manner.

- Distribution of assets is critical in trying to identify whom such institutions (mentioned above) should service. " Institutions are often absent, or are flawed, when interests are dispersed or when some groups in society are poor or in other ways disenfranchised. It is difficult, but possible to develop policies that increase voice and the access to assets, shifting development dynamics from vicious to virtuous circles and towards greater sustainability" (World Development Report 2003).

The above points create an effective mandate and framework for the private sector firms to advocate economic, environmental and social objectives simultaneously, in producing sustainable solutions. If companies are to play a meaningful role in achieving the vision set out in the World Development Report, then changes need to be made first to mind sets, then strategies and finally to operations. Companies that choose to swim against the tide should prepare themselves for difficult times ahead.

The recent events at Nike are a good example of a company bearing the consequences of not adopting sustainable practices in its value chain. Nike was accused of using sweat shops and child labour in Eastern countries to product merchandise at extremely low cost to benefit from greater gross margins (http://www.saigon.com). Public outcry from these accusations significantly affected the brand of the company and its sales during early 1990s. The company had to re-look at it global sourcing base and spent million of dollars in ensuring that it's supplier base was socially compliant with local laws and regulations as well as human rights.

Another initiative by the global community to preserve the earth is the Kyoto Protocol that was adopted in 1998. This initiative was championed by the United Nations in an attempt to promote sustainable development across the world. The Kyoto Protocol contained legally binding commitments by countries to reduce the emissions of greenhouse gases by industrialized countries as well as the change in behaviour of land usage and the approach to forestry. Countries to this accord are required to reduce their emissions by at least 5 % below the 1990 levels within the period of 2008 to 2012 (http://unfccc.int). This has huge implications for industries that produce green house gases as a waste product. Contraventions of laws and regulations in their local environments could result in substantial fines and in some cases the arrest of company directors for contravening the law.

Various similar other initiatives by the global community are gaining momentum, for example Agenda 21 (http://www.un.org) and the Millennium Development Goals (http://www.undp.org). This requires countries and companies to act in a responsible manner, when producing their goods and services. Companies that do not take cognizance of these changing environments will be left far behind in producing meaningful stakeholder returns as they will be focusing on managing contraventions and fines in a reactive manner, whilst their competitors focus their energies and resources on their core competence and in the process increase their competitive divide.

2.4. Corporate sustainability

The challenges placed by the global community as detailed in the previous section makes the business environment a difficult one in which to operate. This, in addition to the following drivers, creates growing pressure to take responsibility:

- Growth in Non-Governmental Organisation (NGO) activism;
- Raised awareness of corporate responsibility;
- Increased government interest and action (primarily as a result of global pressures resulting from global initiatives, as discussed previously);
- The growing sense that the neglect of sustainability is a huge risk to a business both operationally as well as to brand value creation and protection.

The demands of shareholders have grown to include additional demands of creating sustainable solutions. Companies that embrace these additional requirements are more likely to outperform their competitors and in the process they play an important role in ensuring social progress, improved equity, higher living standards and sustainable use of the limited resources, especially in developing countries. The required development mentioned above needs a new approach to business. The historic focus on creating only economic value is out-dated and will not be permitted in the global environment by the relevant custodians in the space like the United Nations (UN), World Bank and the International Monetary Fund (IMF). This would require that businesses adopt a multi-dimensional approach in incorporating the elements of the five capitals model (SIGMA Project 2001) in their business model:

2.4.1. Financial capital management

Financial capital management ensures sound macroeconomic planning and prudent financial management, resulting in effective utilisation of the limited financial resources of a company. It also reflects the productive power of the other four capitals mentioned below in the form of a monetary asset. This capital is the traditional/historic measure of business performance and its primary stakeholders include shareholders and regulators.

2.4.2. Physical capital management

Physical capital (including buildings, machines, and production processes, tools, etc) creation and maintenance is built around the economic, social and environmental concerns. Effective management of this form of capital can result in goods and services reaching the consumer more quickly as well as the reduction in resources used in the production of goods and services. This form of capital is sometimes also referred to as manufactured capital.

2.4.3. Human capital management

Human capital management ensures that staff is taken good care off and their health, training and respect for their rights are valued. This includes both skilled and unskilled staff. Further, individuals have to be effectively managed. "It incorporates the health, knowledge, skills, intellectual outputs, motivation and the capacity for relationships for the individual. Human capital is also about dignity, joy, passion, empathy and spirituality" (SIGMA Project 2001). Companies are increasing realizing that staff form an intangible asset of business (and not just a huge expense) and without them it is impossible to operate. Damaging human capital can have huge consequences for the business as cited in the example of Nike, previously. Hence the needs and concerns of this asset need to be focus of management's attention.

2.4.4. Social capital management

The needs of society, both locally and globally, need to be taken into consideration when making key business decisions. The effective management of this capital delivers value both to the organisation and society. " Social capital includes for example networks, communication channels. Families, communities, businesses, trade unions, schools and voluntary organisations as well as social norms, values and trust" (SIGMA Project 2001). Within the context of the larger external environment this capital creates a climate of consent or a license to operate within society as a large.

2.4.5. Natural capital management

The utilisation of natural resources in the production process needs to take into account the needs of the environment as well as responsible use of the limited resources. All organisations rely on natural capital; for example, all companies consume energy and use water in the production of products and services. This capital forms the basis of life on which all life forms depend on.

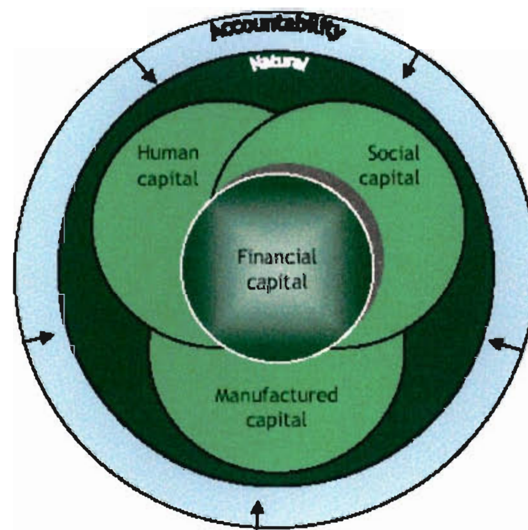

Figure 2-2: The five capitals of sustainability
(Source: SIGMA Project 2001 available online at http://www.projectsigma.com)

By using the above framework/approach to business, companies are less likely to exclude important elements of sustainability. The framework mentioned above is an interrelated one in which some of capitals overlap with each other (as diagrammatically shown above). The framework is also clearly identified and used by the SIGMA Project, a project that identified integrated guidelines for management in addressing sustainability. The United Kingdom Department of Trade and Industry and the British Standards Institution funds and supports this initiative.

Benefits associated by adopting a sustainable business approach, like the five capitals framework mentioned above, include the following:

- Business continuity;
- Improved access to capital;
- Lower cost of raising capital as sustainable companies are viewed to be less risky;
- Reduction in business risks including operational risk, reputational risk, etc;
- Reduction in contravention of laws and regulations and the consequent reduction fines and legal proceedings;
- Reduction in share price volatility;
- Allows management to focus on their core skills and competencies, as well as the business strategy, and not on "putting off fires" as a result of non compliance;
- Brand creation and enhancement in the eyes of various stakeholders;
- Employee satisfaction resulting in improved productivity and loyalty; and
- Maintains and strengthens trust with the community.

2.5. Reporting sustainability

Building a business that embraces the key elements of sustainability (viz. economic, social and environmental) is one challenge. Reporting the effects of these adopted principles throughout the organisations value chain is another. During the past decade there have been thousands of different types of reports that report on sustainability practices in business. " For some, it is a response to pressure from advocates and communities related to specific events or business practices. For others, sustainability reports are an effort to strength reputation and market competitiveness, as well as maintain a license to operate in vulnerable areas. And still others seek to demonstrate a serious commitment to a code to which they subscribe" (Global Reporting Initiative: The 2002 Sustainability Guidelines) and is evident in various parts of their value chain.

The Global Reporting Initiative (GRI) is an international institution that aims to develop and promote sustainability reporting. It incorporates representation from business, accountancy, investment, research, environmental rights and labour organisations from around the world (77 countries) (http://www.globalreporting.org/about/brief.asp). This initiative works in consultation with the United Nations. The intention of this initiative is to use sustainability reporting as a method of allowing companies to publicly account for their economic, social and environmental performance. The GRI creates a common framework in which to report sustainability, similar to the harmonization of financial reporting that has taken place globally. The GRI reporting framework is built around the following key reporting principles:

- Transparency: encompassing full disclosure of information;
- Inclusiveness: engaging all stakeholders in producing sustainable reports;
- Auditability: reported information should contain an audit trail to allow for verification;
- Completeness: there should not be selective disclosure;
- Relevance: report content should be determined by the degree of importance;

- Sustainability context: performance should be reported not only in financial/economic terms but also in ecological and social terms as well;
- Accuracy: reports should strive to have a high degree of accuracy;
- Neutrality: reports should avoid being biased in its approach;
- Comparability: sustainability reporting should be presented in such a manner that allows for meaningful comparison with previous and other repots;
- Clarity: information presented should be unambiguous and easily understandable; and
- Timeliness: reports should be presented on a regular basis that meets the needs of the end user.

Various other global initiatives attempt to report sustainability or elements of it. These include:

- Engaging Stakeholders: The SustainAbility/United Nations Environment Programme (UNEP), launched in the early 1990's to enhance corporate sustainability reporting. This initiative evolves around what and how companies should report;
- The Global Compact Initiative of the United Nations;
- The World Business Council for Sustainable Development (WBCSD) guidelines on Corporate Social Responsibility;
- The Global Corporate Citizenship Initiative of the World Economic Forum (WEF)

Companies that intend to apply the key elements of sustainability throughout their value chain must adopt a reporting framework that allows them to understand the impact of their actions as well as to allow for effective stakeholder communication. However, companies should be cautious at producing sustainable reports that are only intended to please advocacy groups, as they would be surprised at how critical these groups are in applying the maxim "substance over form".

2.6. Summary

The global environment is an ever-changing dynamic environment with the improvements in transportation and technology. Addressing sustainability has become a barrier to entry at the benefit to society and the environment. Companies that neglect to address this focus area are going to struggle to compete and produce meaningful stakeholder value. On the other hand, companies that embrace this new dynamic are going to have the support of their customers, staff, community as well as their shareholders, and in the process be given a "ticket to the game " to produce stakeholder value. One of the ways in which companies can utilise this approach is by adopting the "five capital approach/model" to management, mentioned above. By using this framework, the needs and concerns of most stakeholders are being considered and addressed. Applying a sustainable approach to business means that the organisation needs to measure and report accordingly. The GRI provides a complete framework, which allows companies that adopt sustainability to report according to their relevant stakeholders.

3. Chapter three: The banking environment

3.1. Introduction

The banking environment, both globally and locally, has many similarities and challenges to that of other industries and businesses. However, due to its complicated nature it also has many unique requirements. Application of sustainability has to take cognizance of these unique requirements as well as industry specific trends. This chapter focuses on these unique requirements and trends, both globally and locally in South Africa. It also looks at some of the areas that are common to other businesses that are relevant to applying sustainability in the value chain.

3.2. Global banking environment

The challenges of sustainability mentioned in the previous chapter heavily influence the direction of the global banking environment. Many initiatives are underway to address the issues at heart, in this specialised business environment (which is often the cornerstone to the development of society). This includes the UNEF Financial Initiatives, the London Principles and the Social Performance Indicators (SPI) for the Financial Industry.

3.2.1. UNEP financial initiatives (including the African Task Force)

This initiative was founded in 1992 by approximately 30 banks from around the world (http://unepfi.net/atf/index.asp), with the principle aim of getting financial institutions to engage in dialogue on sustainable development. The founding statement of this global initiative evolved around the premise that the key players in this industry recognize that sustainable development encompasses the interaction between economic and social development as well as environmental protection. Furthermore, it is vital that sustainable banking should not be confined to just a few countries, as banking activities and capital flows are not confined to the national borders within which we live.

These founding principles go on to state that sustainable development is possible, provided that an appropriate framework is provided. Governments in all countries have a critical role to play in aligning banking practices to this framework and enforcing these policies.

One of the core focuses of this initiative originally, was the protection of the environment. This is clearly embodied in its commitment to get financial institutions to integrate environment considerations into their operations, asset management and other business considerations. This is made possible if financial institutions include quantifying environmental risks as part of its normal process of risk assessment and management. Several global banks have become signatories to these principles as part of their drive to make sustainability part of their core business focus. However, it must be noted that the process of getting global momentum on such an initiative takes a long time and once a few influential players in the space takes the lead many others follow. On 31 July 2003 175 financial institutions from around the world had signed this declaration (http://unepfi.net).

In January 2002, the African Task Force (AFT) was launched in Midrand, Johannesburg, in an attempt to role out the UNEP Financial Initiative with a specific regional focus in Africa. Mr. Cas Coovadia, the Chairman of the Banking Council of South Africa and the Chair of the ATF said, " there can be no debate that financial institutions have a critical role and responsibility towards the financing of sustainable development in Africa. The challenge is to develop appropriate strategies for this and to identify areas for financing. These must be developed within the context of conditions in Africa and must not be totally informed by conditions in developed countries" (http://unepfi.net/atf/index.asp). The ATF programme aims to focus on the following:

- Setting sustainability priorities for the African financial institutions
- Creating standards and codes that allow for measurement of sustainability
- Focusing African financial institutions on integrating a triple bottom line approach to their operations

3.2.2. London Principles

The London Principles examine the role of the United Kingdom (UK) financial sector in sustainable development and was created as one of the initiatives that the Prime Minister of the United Kingdom (Tony Blair) presented at the World Summit in Johannesburg September 2002. The main focus of this project is embodied in its key seven principles:

- Provision of access to finance and risk management products for investment and the efficient use of existing assets;
- Promotion of a high degree of corporate governance;
- Inclusion of the cost of environmental and social risks in the pricing of products;
- Exercising equity ownership to promote efficient and sustainable asset use and risk management;
- Exercising equity ownership to promote high standards of corporate social responsibility
- Provision of loans and capital to develop environmentally friendly technologies;
- Provision of access to finance and risk management products to businesses in disadvantaged communities and developing economies.

(Source: http://www.corpoflondon.gov.uk)

From the seven principles above it is evident that the project was intended to identify how to incorporate financial markets into sustainable development rather than the reverse, which is the role of social investing and banking. This is a proactive attempt at incorporating sustainability at the heart of the value chain of a bank. The project went on to identify, and examine in detail, a wide range of financial products and innovation in the UK that would support sustainable development such as socially responsible investment (SRI) and the UK emissions trading scheme. It is intended that that these principles will be rolled out globally into the future in an attempt to build sustainability into the business models of financial institutions across the globe.

3.2.3. Social Performance Indicators (SPI) for the financial sector

As a result of the Global Reporting Initiative (GRI) mentioned in section 2.4, it became necessary for financial institutions globally to develop their own set of indicators to be able to measure and benchmark performance in sustainability. The SPI was that exact such initiative. It supported the GRI but also provided industry specific sector supplement for the financial sector. This project which commenced in early 2001 (http://www.spifinance.com), focused on developing social performance indicators for the financial sector that was to be used for reporting sustainability. 10 financial institutions from across the globe participated in this initiative with the key goals of creating indicators that were:

- Banking specific;
- Transparent;
- Verifiable;
- Inclusive (covers social performance of products, internal and external suppliers and society in general); and
- Easily understood by the relevant stakeholders (efficient communication).

The final document of this project was released in December 2002 and provided comprehensive examples of sustainability indicators from across the world. This report was not complete in its sense of content and methodology but it does provide practical examples of robust indicators that forms the foundation of measuring sustainability in the financial sector across the world. It intended that financial institutions would use these findings as a guideline in producing their own reporting indicators. Furthermore, it is also intended to be used by various stakeholders to gain information on the social performance of financial institutions.

3.2.4. Global example: Westpac

Many of the global initiatives mentioned above have started to gain momentum over the years at several international financial organisations and banks. Listed below is a brief overview of one such example being Westpac: Australia's First bank. It reviews the success this organisation has had in implementing and reporting sustainable business practices.

At Westpac, sustainability is truly part of the company's core focus. This Australian banking giant has assets in excess of 191 billion Australian dollars, 7.5 million customers and 2003 net profits in excess of 2.2 billion Australian dollars (http://westpac.com.au). It aims at delivering for its customers and staff and in the process creating sustainable value for their shareholders. Their business cases for sustainability enhances their longevity and helps them ensure their social license to operate. The evidence of large net profits is a true indicator that it is possible to build sustainability into banking and also meet the needs of stakeholders other than shareholders.

Their commitment to sustainability is evident in the composition of their board and its related roles and responsibilities, the way they run their business, their products and services as well as their transparent manner in which they report their impact to society and the environment. Their 2003 social impact report of 53 pages (http://westpac.com.au/internet/publish.nsf/Content/), details more than 90 social, environmental and economic indicators of sustainability performance and covers the following areas in detail:

- Key social performance indicators: these measures include social, economic and environmental impact of their business
- Employee related reporting including details on training and development, turnover, remuneration (which includes female-male salary ratio), workplace diversity, work life balance, and commitment

- Customer related reporting, including accessibility of banking services, third world debt, socially responsible investment, transparency of fees, improving accessibility of banking for people with disabilities as well as consumer lending with high social benefit
- Community related reporting, including building social capital, financial literacy, fundraising no interest loans for people who cannot afford household goods as well as staff voluntary work in which more than 70 % of their staff are involved in. These staffs are supported with paid leave and flexible working conditions
- Environmental related reporting, including environmental credit risk, greenhouse emissions, stakeholder dialogue, assets under green management and auditing their environmental practices
- Financial related reporting, including value generation, asset quality and financial and accounting controls

A review of the second social impact report of Westpac indicates clearly that there is space for incorporating sustainability in business. This bank is one of the few global industry leaders to have released its results conforming to triple bottom line (i.e. reporting the full impact of the company on society, the environment and the economy) in line with the Global Reporting Initiative. This has resulted in the bank being rated number one amongst all banks globally for inclusion into the Dow Jones Sustainability Index. This sustainability index comprises around 300 sustainability leaders selected from 2 500 corporates included in the Dow Jones Global Index after being critically assessed for sustainability performance.

3.3. Global regulatory environment

Complementing the global developments in banking mentioned previously is the regulatory developments that aim at reducing the risk of banks internationally. Banks are generally complicated organisations and require rigorous risk management frameworks. The requirements form part of the Basel II Accord, which has its roots planted way back in 1998, when it was known as the Capital Accord. The primary goals of this global legislation initiative is to reduce risk in banks by focusing on the following:

- Minimum capital requirements, ensuring that the allocation of capital is more risk averse. This also includes varying capital requirements between banks with different business types;
- Supervisory review of banks both internally and externally; and
- Market discipline through effective disclosure.

(Source: http://www.bis.org/publ/bcbsca.htm)

The requirements of this legislative initiative are very onerous, even though implementation has been pushed backed to 2006. Banks that adopt this new approach to managing credit and operational risk will benefit from reduced capital charges as well improved performance measures, improved risk and operational processors (reducing time and inefficiencies) and increased brand value as analysts and other stakeholders will view the company in more favorable terms. The key success factors that underlie the successful implementation of the BASEL II Accord are:

- The ability of the banks' data and information technology systems to cope with the additional reporting requirements that results from the new approach to risk management;
- Executive level buy in and direction setting for this big change in mindset; and
- Inexperience by banks in measuring enterprise wide risk, as a consequence they may lack the methodology and the necessary systems.

The implementation of the BASEL II requirements is a necessity for all banks if they want to compete in the globalised world. This will be the regulatory barrier to entry and together with the demands of sustainability, creates many challenges for the banking fraternity.

3.4. Socially Responsible Investment (SRI)

Another trend in the global financial services industry is that of Sustainable Responsible Investment (SRI). This is primarily a result of the pressures created from the both regulatory and non-regulatory groups as well as global sustainability initiatives like the Equator Principles, GRI and The London Principles

SRI is about linking personal values and societal concerns with the investment decision and taking a longer-term view of investment. It considers both the financial needs of the investor (both individual and institutional) and impact on society. The above philosophy is activated by:

- Screening investment opportunities based on social and environmental concerns;
- Advocating shareholder activity to promote corporate responsibility and shareholder rights; and
- Investing in initiatives that support the development of society whilst furthering the aims and objectives of business.

Sustainable Asset Management (SAM), an example of SRI, employs an investment philosophy that embraces an evaluation process that includes economic, environmental and social issues. This allows for investment in sustainability driven initiatives. World-renowned/pioneer financial institutions in this space include Domini Social Investments and Calvert Online.

Both these companies offer a variety of programmes that allow both individual and institutional investors to participate in socially aligned investments. These companies actively use their investment shareholdings in different companies, to advocate a change towards more sustainable business practices. They take their responsibilities seriously and vote on all proxies with the financial and social objectives of their respective companies. These companies also extend help to communities by involving themselves in high social impact investments such as affordable housing, community development, micro credit and small business loans

Another example of SRI would be Sustainability Indices: Here equity stock markets develop indices that track the performance of companies that are viewed to be incorporating sustainable business practices as part of their core business practices and are judged on the following three criteria for inclusion:

- Working towards environmental sustainability;
- Developing positive relationships with all stakeholders; and
- Upholding universal human rights.

Some of the major stock markets have developed indices like the above. These include the FTSE 4 Good (London Stock Exchange) and the Dow Jones Sustainability Index (New York Stock Exchange). The aim of these indices is to measure the performance of and facilitate investment in socially minded companies through the development of index linked financial instruments such as mutual or tracker funds or other derivative products. At June 2001 the yield for the FTSE4Good Global Index (that has special selection criteria with regards to environmental sustainability, relationships with stakeholders and supporting universal human rights) was 1.758% whilst the yield for the FTSE Developed Large Cap Index (including all large companies with no industry exclusions) yielded a return of 1.464 % (http://www.FTSE4Good.com). The above confirms an interesting maxim: that investing in sustainably responsible companies tends to offer better returns. However, it must be noted that many of these indices are relatively new and would have to be monitored over a longer time period.

3.5. Recent happenings globally: The Equator Principles

The most recent of events in the world of sustainable banking is the adoption of The Equator Principles on 4 June 2003 by leading banks from seven counties. The adopting banks of this accord included the global players ABN Ambro, Barclays, Citigroup, Credit Lyonnals, Royal Bank of Scotland and Westpac (http://www.equator-principles.cpm). This accord is the result of an initiative by the International Finance Corporation (IFC) the financing arm of the World Bank, which was started in October 2002. This project attempts to present a framework for addressing environmental and social risks in project finance. The adopting of The Equator Principles confirms that the roles of global financial institutions are changing and that they are embracing the elements of sustainability in their core business practices.

The Equator Principles creates clear bottom line standards for responsible investing. The adopting members have committed that they will only provided loans directly to projects if the following are met:

- The risk of the project has been categorized in accordance with internal guidelines based upon environmental criteria of the IFC;
- Environment assessments are required for certain categories of loans;
- The above assessments are to address local laws and regulations, environmental and social conditions, sustainable development and the use of renewable energy sources, protection of human health, use of dangerous substances, occupational health and safety, socio-economic impacts, involuntary settlement, pollution prevention and the participation of affected parties in the design, review and implementation of the project.
- The consultation of all stakeholders including Non-Governmental Organisations (NGOs) and indigenous people.
- The preparation of environmental management plans that are to be independently monitored

- Should the borrower not comply with the environmental and social covenants he would be considered to be in default and the bank would be forced to seek the necessary remedies to revert back to compliance; and
- The principles are to be applied to projects in excess of 50 million US dollars.

(Source: http://www.equator-principles.cpm/principles.shtml)

The above is a huge change for the global banking community. The framework creates the foundation for the adopting banks to put in place internal policies and procedures that are consistent with The Equator Principles. This would allow for the standardization of risk and terminology across banks, force customers to comply with IFC and World Bank environmental and social standards and make these standards part of the legally binding loan agreement. However, this is a very new initiative and its success on society, the environment and the economy has to be closely monitored. The strength in this accord is that there has been a definite commitment to bring sustainability closer to the operations of banks via its product offering (project finance).

3.6. South African banking environment

At 30 June 2002 there were 33 South African banks and 14 subsidiaries and branches of foreign banks in South African as per the KPMG 2002 Banking Survey (http://www.kpmg.co.za). This survey further indicated that the total assets (primarily loans) of the local industry comprised approximately R 1 008 billion and in excess of 80 % of the asset were held by the five largest banks (http://www.kpmg.co.za). The growth in the assets base of the South African Banking sector has been extremely aggressive as viewed in the figure below. Assets have grown from R344 billion in 1994 to R1 049 billion in 2001.

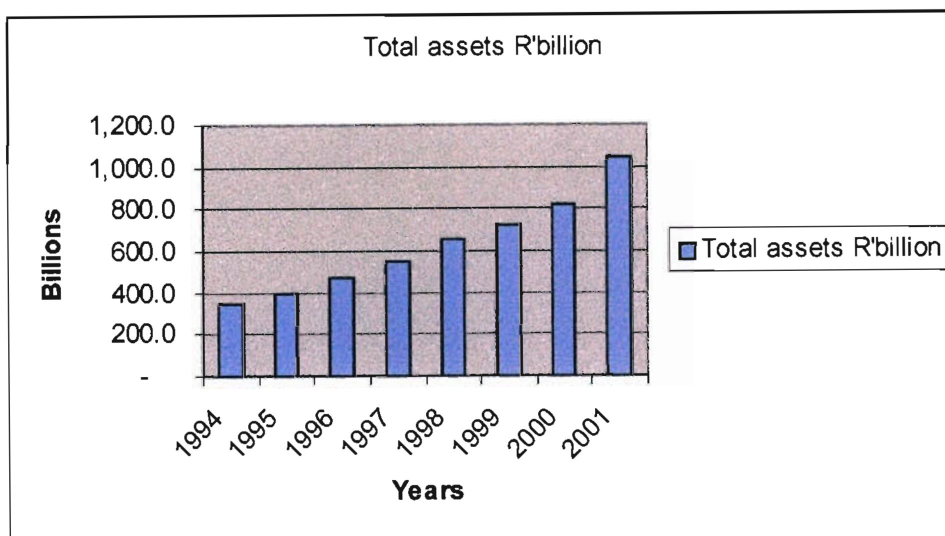

Figure 3-1: The growth in South African banking assets

Source: KPMG Banking Survey 2002, available online at: http://www.kpmg.co.za.

The South African banking model is largely based on the Western European banking models and consequently encompasses a well established banking system, with a sound regulatory and legal framework (which is controlled by the Registrar of Banks) as well as world class accounting and disclosure standards. A few big local banks dominate the majority of the market. This is primarily as a consequence of the economy being closed prior to 1990, as the country had experienced severe sanctions as a result of its segregationist policies of apartheid.

The products and services offered by banks operating in South Africa are comprehensive and in most cases are similar to the products and services offered by large international banks. Banks in South Africa are divided into first tier and second tier banks. First tier banks are organisations that offer a complete range of banking products and services and generally have well-established franchises with extensive distribution networks. Banks in this category include (market share shown in brackets):

- ABSA (19.7 %)
- FirstRand (18.6%)
- Nedcor (17.9 %)
- Standard Bank (17.6%)
- Investec (6.0 %)
- BoE (5.7 %)

Source: KPMG Banking Survey 2002, available online at: http://www.kpmg.co.za.

Second tier banks on the other hand are banks that focus on a particular niche of the market and include banks such as Mercantile Bank, Imperial Bank, TEBA Bank, PSG Investment Bank, Marriott Merchant Bank, Gensec Bank and African Bank.

The Banks Act regulates all banks in South Africa. The South African Reserve Bank who appoints a Registrar of banks carries out this regulations function. "The South African Reserve Bank is the central bank of the Republic of South Africa. It regards its primary goal in the South African economic system as the achievement and maintenance of financial stability" (http://www.reservebank.co.za). The Bank has set up a banking supervision department that oversees this function. The main function of this unit is to " achieve a sound, efficient banking system in the interest of banks and the economy as a whole. This function is performed by the issuing banking licences, and monitoring their activities in terms of the Banks Act" (http://www.reservebank.co.za).

Also found in the South African banking environment is The Banking Council, which is an industry body "whose role it is to establish and maintain the best possible platform on which banking groups can do responsible, competitive and profitable banking. As the representative body, The Banking Council continuously interacts with various government departments, consumer bodies and other interest groups regarding banking issues" (http://www.banking.org.za).

3.6.1. Recent events

The last two years have been very turbulent times in the South African banking environment. There has been a series of consolidations, a few failures of local banks as well as a series of liquidity crisis. During 2002 many of the small to medium banks in South Africa were demised or consolidated. This included significant players such as Saambou, FBC and BoE. A few of the smaller banking players such as Braith Investment Bank handed in their Banking license and concentrated on other core business activities. During this period the participation of foreign banks had decreased for the first time in 6 years. From the beginning of 2002 to the end of March 2003, in excess of 20 banks had exited the South African banking system (http://www.reservebank.co.za).

The collapse of Saambou, the eighth largest bank, during 2002 had sent ripples through the banking sector. Inappropriate risk management coupled with inappropriate management practices had resulted in the collapse of this institution. "The first indications of something amiss was the sale of Saambou shares by two of the banks executive directors. Press coverage triggered media speculation that the share sales were due to management knowing that the bank had been under performing. Saambou's subsequent issue of a profit warning exacerbated the situation. In its announcement, Saambou ascribed the banks poor performance to losses suffered in its micro finance business activities. This was followed by the JSE Securities Exchange South Africa (JSE), announcing that it would institute an insider-trading investigation into the two directors' share sale transactions. Saambou was subsequently faced with steady withdrawal of deposits" (http://www.reservebank.co.za/internet/publications.nsf).

Coupled with the above Unifer announced at the beginning of 2002 that it had lost most of its entire share capital as a result of bad risk management practices in its micro finance unit. This had placed huge pressure on companies involved in the micro finance industry (Saambou being a significant player). Saambou's company share price continued to decline and wholesale depositors continued to withdraw funds. These large withdrawals had resulted in the Registrar of Banks placing the bank into curator-ship. The winding down of the bank created the biggest loss to shareholders and creditors. Most depositors were spared their capital but lost interest income. This had started a panic amongst investors at smaller banks, as seen in BoE during March/April 2002.

The Registrar of Banks could not afford the demise of another bank, as this would exacerbate the already existent contagion in the banking system. Further, the collapse of BoE was considered to be systemically significant and its collapse would have hurt the entire industry significantly. Consequently, the Governor of the Reserve Bank guaranteed all the monies for depositors at BoE. This had reduced the large wholesale withdrawals from the bank. Subsequent to this Nedcor, (one of the big four banks) acquired BoE and became responsible for the funding of its assets, allowing the Governor of the Reserve Bank to withdraw his guarantee.

3.6.2. Corporate governance

The 2002 banking crisis resulted in banks looking more carefully at the way they run their business, as well as looking at the impact of their business on all the relevant stakeholders and not just shareholders. This concern of responsible sustainable business had rolled up to the Governor of the Reserve Bank, who initiated a review of the performance of banks on the background of corporate governance practices. This study was headed up by Advocate JC Myburgh and was issued during April 2003 and followed the framework of the King Code of Corporate Governance (a voluntary code of conduct that is applicable to all listed organisations, certain public sectors enterprises and agencies as well as banks). The key elements of this code included focus on responsible business practice in the following areas:

- The composition and functions of the board of directors (including executive remuneration): The main focus of this portion of the code includes the following recommendations:

    - The board of a company should include a balance of executive and non-executive directors. Majority of the board are to be non-executive, with a sufficient number being independent;
    - There should be a formal and transparent policy for the appointment of new directors;
    - The chief executive officer and chairman should ideally be separate individuals;
    - Directors should receive appropriate training to perform their functions (including updates on changing legislation) and have the necessary skills required;
    - Directors should have unrestricted access to the records of a company and should be supplied with information in a timely manner

- The majority of the non-executive directors should be independent and free from any material business relationship/involvement that could impair their independent judgment;
- No director should be involved in determining his or her remuneration. An independent remuneration committee should be set up; and
- A mandatory audit committee should be set up. A non-executive director should chair this committee.

- Auditing and accounting: The board of a company should present a fair and balanced view of the company's financial position.

- Risk Management and internal control: The board's responsibility includes overseeing a sound system of internal control that protects the various stakeholders. This would include setting up relevant risk strategies with management. Further, a company should have an effective internal audit function.

- Sustainable business practices: Business should promote dialogue with key stakeholders. This would include an effective stakeholders relations function. Companies are also encouraged to focus on social and transformational issues (including black economic empowerment), safety health and the environment as well as ethical practices within the organisation.

- Reporting and communication: Reporting and communication (both internal and external) should be honest and transparent and should reflect the impact of the business on all stakeholders. Directors are responsible for the preparation of financial statements.

The above code has become widely accepted within business in South Africa as a tool for implementing better corporate governance (or in other words the way in which we run our business). Much support was built for this initiative after the collapse of Enron and WorldCom globally, and the collapse of Leisurenet (owners of the Health and Racquet gyms) and Saambou locally. These latter examples were two local companies that had a huge interface with the public and their collapse had caused huge losses to shareholders, depositors (in the case of Saambou), members (gym members in the case of Leisurenet), creditors, employees, as well as providers of debt capital (mainly banks).

Further, this resulted in many social hardships (which often could not be measured in monetary terms). The above had created a huge outcry by the public and had placed immense pressure on business to start taking corporate governance more seriously.

The Myburgh commission, was one of the measures the banking community had adopted to review the extent of corporate governance in the banking sectors. The key findings of the report were

- "The banks are committed to the adherence to and application of high standards of corporate governance;
- Acting on the advice of specialists in corporate governance, the banks on their own initiative from time to time review their corporate governance to ensure compliance with accepted corporate governance principles;
- No serious breaches of corporate governance were found to exist;
- The corporate governance of the banks is sound;
- Vigilance is nevertheless required to ensure continued compliance with the standards governance, which are constantly evolving in South Africa and internationally".

(Source of findings: The Executive Summary of the General Report by Adv J F Myburgh SC in terms of the Banks Act, 94 of 1990, found online at http://www.reservebank.org.za)

3.6.3. Non-traditional banks

The history of South Africa has had a huge impact on the banking sector. The system of apartheid has resulted in some key features within the banking environment. Large sectors of the population have not been able to access the banking system as a result of the following:

- The majority Black, Asian and Coloured population was forced to live with the system of unequal separate development. As a consequence many of these individuals lacked the disposable income to enter the formal banking sector. Bank fees and charges made it impractical for people of colour to use this service;
- Separate development meant that banks would primarily focus their branch network distribution in the traditional white areas, which formed the minority of the population (but had the most disposable income). People of colour were often not allowed into these areas to access the services provided for by banks;
- The opening of bank accounts and the accessing of finance often contained conditions/requirements that were not easily met by people of colour (barrier to entry).

The above banking system gradually changed with the process of democratization. However, it has not adequately advanced to meet the needs of a large part of the population that are primarily people of colour. Further, banking these individuals were not very profitable and as a consequence banks neglected their responsibility of including these individual, into the banking sector. An analysis of this un-banked market by the Finmark Trust reveals the following details about these individuals, which are shown graphically below:

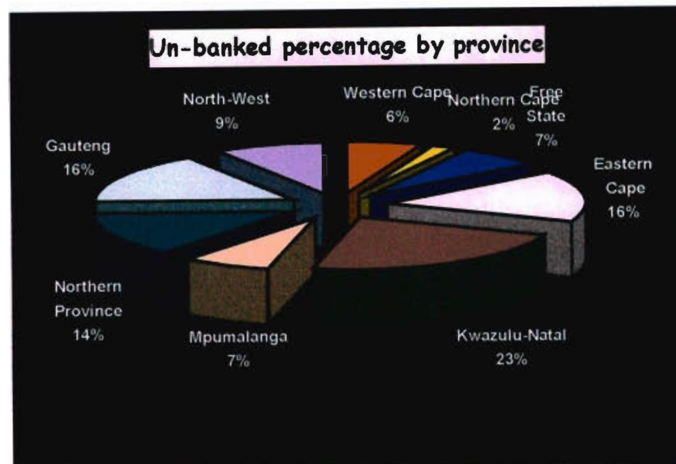

Figure 3-2: The un-banked population percentage by province

Source: FinMark workshop presentation 28 June 2002: The Un-banked Sector available online at http://www.finmarktrust.org.za

It is evident from the above that the distribution of the un-banked population is throughout South Africa, with the highest concentration being in Kwazulu-Natal, the most populace province.

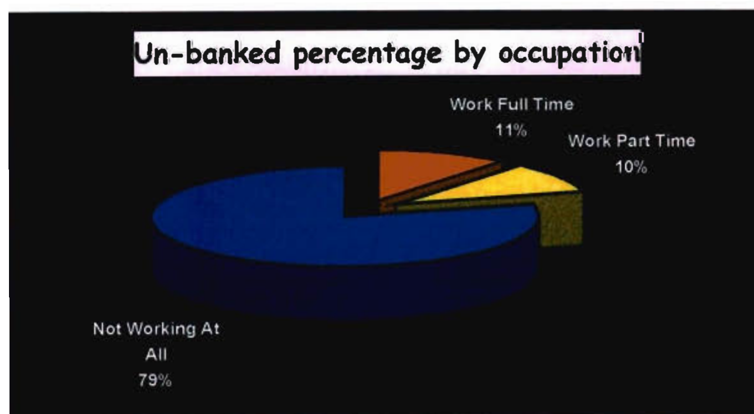

Figure 3-3: The un-banked population percentage by occupation

Source: FinMark workshop presentation 28 June 2002: The Un-banked Sector available online at http://www.finmarktrust.org.za

The above is a stark reality of the un-banked population. More than two thirds of these individuals are not economically active (i.e. not employed). This creates a large challenge for the banking sector to include them in the "banking net", as they have almost no disposable income and would be reluctant to pay fees and charges.

Un-banked percentage by age

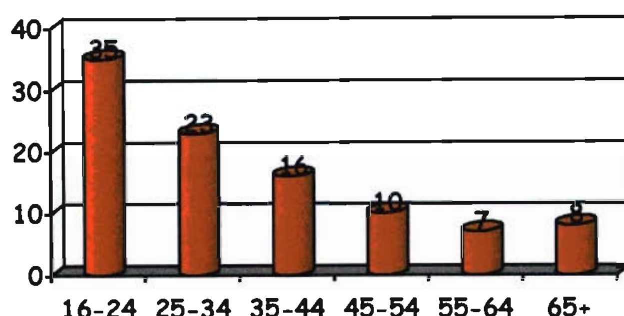

Figure 3-4: The un-banked population percentage by age

Source: FinMark workshop presentation 28 June 2002: The Un-banked Sector available online at http://www.finmarktrust.org.za

The majority of the un-banked population are currently under the age of 34 years, with approximately 35 % being in the youth market (under 24 years). This market is traditionally a very expensive one to the banking system, as most individuals in this group are not working and receive free banking services. Further, the impact of AIDS on the population is significant and with no cure for the disease in sight, the average age of the population will continue to decline.

As a result of the above circumstances, alternative methods (of banking) to the mainstream banks were introduced to cater for these individuals. The Village Bank is one such mechanism. It is a very simplified banking system with very low costs attached to it. This alternative method of banking has been catered for by the amendment of the Banks Act in 1998. It operates as a community initiative with the following key objectives:

- To encourage people to save, even it the amounts are very small;
- Uses the above savings to provide a base from which the community could access funding; and
- To use the above system to address the social needs of the community.

This type of banking is primarily rurally based targeting the remote area (areas in which banks would not be interested to operate) and depends largely on the participation of the community. This type of banking provides a sustainable economic solution to the communities in which they operate as the people that access this type of financial service do not have to travel long distances (with high costs), and also avoiding carrying cash which is high risk, as well as not having to pay high transactional costs.

The Financial Services Association estimates the rural population that is not catered for by the formal sector to be approximately 16 to 18 million (http://www.rurdev.usda.gov). However, the success of the Village bank has been limited as it is still in its pilot stage and its success can only be truly measure after a few years of operation. At the end of 1999 the total portfolio if this initiative included approximately 1900 members with a capital value of approximately R1.655 million.

Another alternative to traditional banks is the Postbank. This is the Post Office Saving Bank. It does not provide provides credit/loans to the public but only offers savings products. It forms part of the post office and is governed by the Post Office Act of 1955. The government is responsible for its solvency. This type of bank provides a wider distribution as post offices are found in more locations than traditional banks.

The main product offered is savings, which has interest of between 1 % and 10 % and the fees are minimal. The minimum balance is R50 whilst the maximum is R100 000 (http://www.finforum.co.za/institut/). It also offers a transmission card account, which can be used at 320 post offices and at over 5000 Automatic Teller Machines (ATMs) via Saswitch. Currently workers in Telkom and the Post Office use this facility predominantly.

Currently Postbank has a deposit balance of approximately R1 billion. This method of savings dates back to the 1800s and allows the customer the convenience of using any one of 2194 outlets (http://www.finforum.co.za/institut/).

These above attempts of finding a banking solution for the un-banked, primarily rural population of South Africa has been given increased attention with the set up of the FinMark Trust. This organisation is one of the main players in the financial sector that has as its objective to promote and support policy that increases access to banking for the un-banked population. This initiative was set up from a grant of 5 million Pounds from the United Kingdom's Department for International Development (http://finmarktrust.org.za). It identified that a large part of the population in South Africa lacked access to banking as they have:

- Limited ways in which to store cash;
- Very little access to finance; and
- Have very little means of insuring their selves against illness, death or loss of income.

The FinMark Trust intends achieving its goals by building capacity of organisations that are involved in the sector that banks the un-banked. It does this by subsidizing training costs or by funding programs that promotes its goals. Further, it conducts research on access to the retail financial markets.

A review of the FinMark website (http://finmarktrust.org.za) shows that the organisation has carried out extensive research on the following topics:

- The relevance of the mortgage instrument to low income housing;
- Financing Black Economic Empowerment;
- Un-banked and technology;
- The past, present and future of the micro-finance in South Africa; and
- Co-operative banking.

3.6.4. Black Economic Empowerment (BEE)

The challenges facing the banking industry mentioned in the opening comments of section 3.6.3 (Non traditional banks) is experienced throughout the economy. The system of apartheid has forcefully restricted the majority of the population of South Africa from participation in the mainstream economy. This had resulted in most of the wealth creation being restricted to the white minority. To meet the needs of all the citizens of the country the economy needs to be transformed in a sustainable manner to reverse the economic impacts of the past. This is not a nice to have but a must, if we as a nation choose to participate in the global economy. Globalisation exposes us to both positive and negative forces. It can entrench the existing inequalities should we not address them in a sustainable manner. Government has led the way by developing a broad Black Economic Empowerment (BEE) strategy.

"Accordingly, government defines BEE as an integrated and coherent socio-economic process that directly contributes to the economic transformation of South Africa and brings about significant increases in the numbers of black people that manage, own and control the country's economy, as well as significant decreases in income inequalities". The BEE process will therefore include elements of human resource development, employment equity, enterprise development, preferential procurement, as well as investment, ownership and control of enterprises and economic assets" (South Africa's Economic Transformation: A Strategy for Broad Based Black Economic Empowerment, p15).

In focusing on the above, the government intends to achieve the following policy objectives:

- "A substantial increase in the number of black people who have **ownership and control** of existing and new enterprises

- A substantial increase in the number of black people who have **ownership and control** of existing and new enterprises in the priority sectors of the economy that government has identified in its microeconomic reform strategy[1]

- A significant increase in the number of new **black enterprises, black-empowered enterprises and black-engendered enterprises**

- A significant increase in number of black people in **executive and senior management** of enterprises

- An increasing proportion of the ownership and management of economic activities vested in **community and broad-based enterprises** (such as trade unions, employee trusts, and other collective enterprises) and **cooperatives**

- Increased ownership of land and other productive assets, improved access to infrastructure, increased acquisition of skills, and increased participation in productive economic activities in **under-developed areas** including the 13 nodal areas identified in the Urban Renewal Programme and the Integrated Sustainable Rural Development Programme.

- Accelerated and shared **economic growth**

[1] These sectors include agriculture and agro-processing, mining, minerals and metals beneficiation, clothing and textiles, automobiles and components, aerospace, information and communication technology sector, chemicals, cultural industries including media, film, music and crafts, as well as high value-added services.

- Increased **income levels** of black persons and a reduction of income inequalities between and within race groups"

(South Africa's Economic Transformation: A Strategy for Broad Based Black Economic Empowerment, p16).

Government intends achieving the above via various mechanisms which include but are not limited to:

- Existing laws such as "The Promotion of Equality and Prevention of Unfair Discrimination Act, Extension of Security of Tenure Act, Restitution of Land Rights Act, Employment Equity Act, National Empowerment Fund Act, Competition Act, Telecommunications Act, Preferential Procurement Policy Framework Act, and the Minerals and Petroleum Development Act" (South Africa's Economic Transformation; A Strategy for Broad Based Black Economic Empowerment, p9).

  More specifically to banks is the draft Community Reinvestment Bill, which is not mentioned in the BEE strategy. This bill assesses banks on their lending performance in previously disadvantaged communities such as townships. In doing so it ensures that home finance is available to low-income borrowers and prevents the avoidance of banks excluding low-income areas from its portfolios.

- Existing programs, policies and strategies such as "the Integrated Human Resources Development Strategy, Urban Renewal Programme, Integrated Sustainable Rural Development Programme, the Tourism Transformation Strategy, the Strategic Sector Plan for Agriculture and the National Small Business Development Promotion Programme" (South Africa's Economic Transformation: A Strategy for Broad Based Black Economic Empowerment, p9).

- New legislation to be introduced that that will provide a framework for BEE (the proposed BEE Bill). This piece of legislation will be complemented with guidelines outlining best practice and a code of conduct.

- "Government will use a 'balanced scorecard' to measure progress made in achieving BEE by enterprises and sectors. The use of a common scorecard by different stakeholders provides a basic framework against which to benchmark the BEE process in different enterprises and sectors. The scorecard will measure three core elements of BEE:

    - Direct empowerment through ownership and control of enterprises and assets.
    - Human resource development and employment equity.
    - Indirect empowerment through preferential procurement and enterprise development.

  The scorecard also allows government departments, state-owned enterprises, and other public agencies, to align their own procurement practices and individual BEE strategies. The scorecard also facilitates the process of setting measurable targets for BEE" (South Africa's Economic Transformation: A Strategy for Broad Based Black Economic Empowerment, p19).

- Further, the above initiatives will be complemented by government making the BEE strategy a core element when it restructures state assets, issues licences and concessions and well as part of the government massive procurement policies.

- Finally, the government intends using industry charters and partnerships with the private sector as an effective tool of promoting BEE. These partnerships and charters will provide innovative solutions to the challenges of BEE, whilst taking cognisance of the specific circumstances around the different sectors.

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- Finally, the government intends using industry charters and partnerships with the private sector as an effective tool of promoting BEE. These partnerships and charters will provide innovative solutions to the challenges of BEE, whilst taking cognisance of the specific circumstances around the different sectors.

> "It is not expected that every sector and every enterprise will develop empowerment charters. However, those sectors and enterprises that continuously engage government in contracts, or are regulated by government, will be strongly encouraged to develop charters that set specific BEE targets and outline concrete plans to achieve these targets. In other sectors, voluntary compliance with the strategy and in particular, the implementation of the scorecard approach will be encouraged, especially in the sectors that government has identified as having significant potential for future growth. Government will seek to conclude enterprise charters with key corporate's in the priority sectors to inject momentum into the BEE process" (South Africa's Economic Transformation; A Strategy for Broad Based Black Economic Empowerment, p22).

Clearly from the above it is evident that the government is serious about empowering individuals and communities that were excluded from the mainstream economy in the past. The issue of the BEE strategy is a definite sign of their seriousness. All economic participations have to take cognisance of these sets of events that's occurring in the economic environment otherwise they may lose that "ticket to the game".

3.6.5. The financial services charter

The financial services industry, which includes banks, have recognised the importance of the government's BEE strategy and consequently commenced with establishing a charter for the financial services industry. The charter, which is currently in its draft form, is expected to be ratified and accepted by the industry before the end of September 2003. This draft charter is aligned with government's broad based BEE strategy and intends to provide a framework as well as establishing principles on which BEE can be implemented in the financial services sector.

The banking sector is the heart to any economic system and consequently the banks have a large role to play in rolling out government's broad based BEE strategy, in an attempt to find a sustainable solution to the economy. In banking participation terms, much has remained the same since the country's first democratic elections in 1994. A large part of the population still do not have access to banking as it is either too expensive, not easily accessible or restrictive in its entry criteria.

The financial services charter is a voluntary initiative by the banking/financial services sector in addressing the challenges mentioned above. The challenges experienced by the mining sector provided good enough motivation for the financial services industry to take a more voluntary approach to rolling out BEE in its industry. The uncertainty of the mining charter wiped out almost R 50 billion-market capitalisation off the JSE in a few days (http://bullion.org.za/level3/NewsDay/2002).

The draft charter has seven key elements to it:

- Human resources development: The charter has identified that disparity in human resources development amongst people of colour is very prevalent. Consequently, targets are being proposed for every level of management to include people of colour by 2008. The financial services industry intends to achieve this by spending a certain percentage of the payroll on the development of people of colour as well as the implementation of mentorship's and learner ship programs and diversity training.
- Procurement: Banks and financial services companies will target procurement strategies that enhance BEE. Targets have also been proposed for a certain percentage of procurement to be sourced from black companies by 2008 and 2014.
- Enterprise development: The financial sector has committed that it would foster new and developing BEE companies via investments and joint ventures.

- BEE Financing: The financial services sector has committed to using both private and public resources to support BEE. Targets have also been proposed in this area.
- Ownership and control: The focus of this area has been black participation in directly owning interests in the financial services sector as well as Board representation. Targets have also been proposed to allow the sector to measure its success by 2008 and 2014.
- Regulatory and Implementation: The financial services industry proposes an oversight committee, comprising the relevant stakeholders as well as individual organisations to report on the progress on implementing the charter annually. Further, independent reviews are to be performed in 2009 and 2015 to assess the level of compliance.
- Access: This forms a large part of the proposed financial services charter, with extremely large technological and resource commitments from banks. The primarily aim is to try and make transactional banking and savings more accessible to the un-banked. The charter proposes the following:

    - A national transacting bank account for the un-banked with low charges
    - A national money transfer product that will meet the need of migratory labour in the country
    - Increased access for the above, with a commitment that financial services will be available, in the form of the above products, approximately 20 kilometres away from the un-banked communities.

(Source: Financial Services Charter (draft 14), 2003)

The above principles found in the draft charter are a large commitment by the financial services industry in addressing some of the needs of the un-banked. However, banks have focused their attention on providing savings and transacting products while shying away from the provision of micro-credit, an important need of the un-banked. The drafters of the charter have proposed a balanced score card to provide a measure of self-assessment, as well as an indicator of level of compliance.

3.7. Summary

The banking environment is unique both globally and locally. The challenges of globalisation, like the anti globalisation movement, places huge pressure on all types of business as mentioned in the previous chapter to look at sustainability more seriously. The banking industry has reacted to these pressures and has developed several initiatives such as the UNEP Financial Initiative, The London Principles, the Social Performance Indicators for the financial sector and more recently the Equator Principles. Many of the global banks have started to implement many of the learnings from these initiatives as seen in the example of Westpac.

More specifically in South Africa the challenges are in addition to the ones mentioned above. It has a mixture of a first world banking platform, built up largely on the protectionist policies of apartheid, as well as a significant portion of its population that live in conditions similar to a rural third world. This section of the population forms a large part of the approximately 16 to 18 million un-banked. Against this background, government has affirmed its commitment to black economic empowerment as a means of addressing the inequalities of the past. Banks play a critical role in assisting government to achieve its goal, as the banking sector forms the heart of any economic system. The draft financial services charter plays a key role in implementing BEE within this once elite sector.

However, it must be noted there are many other challenges that face the banking sector in these volatile times as was noted during the various crises in the banking sector during 2002. This had resulted in many banking failures as well as closures. Banks have a tough time ahead in balancing all these requirements of the various stakeholders and in the process still have to produce meaningful returns.

Some of the other challenges not mentioned in the previous discussions include:

- The volatility of the Rand creates high risks of local banks being exposed to losses;
- The social consequences of high prevalence of Acquired Immune Deficiency Syndrome (AIDS), crime and unemployment are not yet fully understood and creates more volatility;
- The entry of international banks into full functional banking, in South Africa, increases competition significantly, as many of these players can afford to be aggressive as they have the global critical mass;
- The decreasing trend in margins and the increased pressure by consumerism on price list fees are expected to continue;
- The slow pace at which corporate South Africa embraces corporate governance creates the risk that banks will be exposed to a higher rate of corporate failure as seen in the case of Leisurenet and Saambou;
- The pressure being placed on banks to provide micro-lending facilities drastically increases the risk profile of these organisations.

4. Chapter four: Sustainability at South African banks

4.1. Introduction

As mentioned in chapter two of the study all the key elements of sustainability are found in the multi-dimensional five capitals model as developed by the Forum for the Future and the SIGMA project in the United Kingdom. The main elements of this model are:

- Financial capital
- Physical capital
- Human capital
- Social capital
- Natural capital

This chapter attempts to review the business practices of South African banks in the context of the above model and to comment on the level of sustainability practices that are adopted. The main focus is the five major banks Standard, Nedcor, ABSA, Investec and FNB as they make up in excess of 80 % of the banking assets in this country (http://www.kpmg.co.za). Further, the information used in the section comes from copies of the latest annual financials of the said banks, press releases as well as articles on the Internet. Attempts to source information on the current levels of sustainability within South Africa's major banks (via the questionnaire developed in Appendix A) proved to be difficult, as it is the opinion of the writer, that most banks were reluctant to furnish this information, as they believed that this would be revealing parts of their competitive advantage. This was especially so as the writer of this study is employed by one of the large banks. These shortcomings were highlighted in the limitations of the study. Attempts to issue the questionnaire via the office of the Banking Council were also unsuccessful.

4.2. Financial Capital

Financial capital management ensures sound macroeconomic planning and prudent financial management, resulting in the effective utilisation of limited financial resources of a company. One of the best measures to determine whether a bank has had success in this area of sustainability would be to review the results of the organisation over a long period. A recent study of The South African Reserve Bank into the performance of major banks for the period 1992 to 2001 provides an ideal platform. This study was carried out by KPMG as part of the Reserve Bank's corporate governance review performed by Advocate J.F. Myburgh (http://www.reservebank.co.za).

In evaluating the financial performance of banks certain key measures are used. These include:

- Headline earnings per share: a measure of performance for a particular period. It is the earnings attributable to the ordinary shareholders, excluding the effects of capital items.
- Return on average assets: headline earnings, mentioned above, expressed as a percentage of average assets of the bank.
- Return on average equity: headline earnings, mentioned above, expressed as a percentage of average shareholders equity.
- Cost to income ratio: operating expenses, excluding capital items, expressed as a percentage of income from normal operations
- Bad debts as a percentage of total advances: debts/loans that cannot be recovered, which has been written off, expressed as a percentage of total loans.
- Non-performing advances as a percentage of total advances: advances/loans on which no/limited return is being earned. Management is also uncertain about the collection of future cash flows.

4.2.1. Headline earnings per share

Financial year ended	ABSA	Standard	Investec	Nedcor	FirstRand	Average
1992						
1993						
1994						
1995						
1996						
1997	222.20	164.59	447.00	641.00	279.30	350.82
1998	271.30	177.81	672.90	822.00	295.62	447.93
1999	309.70	226.47	989.60	1 024.00	384.78	586.91
2000	310.30	283.45	1 300.90	1 260.00	413.15	713.56
2001	378.70	336.54	1 628.20	1 576.00	527.32	889.35
Average	298.44	237.77	1 007.72	1 064.60	380.03	597.71
Max	378.70	336.54	1 628.20	1 576.00	527.32	889.35
Min	222.20	164.59	447.00	641.00	279.30	350.82

Table 4-1: Headline earnings per share for banks in South Africa

Source: South African Reserve Bank, Corporate governance review, April 2003 available on line at: http://www.reservebank.co.za

The above analysis clearly indicates that the headline earnings per share have been steadily increasing at all the major banks for the last five years. The growth in Investec's headline earnings was the best at 265 % followed by Nedcor (146%), Standard (105 %). FirstRand (89 %) and ABSA (70 %). These growth rates are fairly impressive when on considers that the average inflation rate for the same period was approximately 9 % (Federal Deposit Insurance Corporation, Quarterly banking Profile, 1999:IVQ). When applying the headline earnings lens, it appears that the banks in South Africa have been applying sound financial management and the earnings achieved are sustainable. However, consideration needs to be given to the fact that the South African banking environment has been a closed market with the policy of apartheid. Many large overseas banks had disinvested in the 1980's. Subsequent significant investment of foreign banks has been cautious, even though there has been a flurry of activity to set up representative offices. Many of the large international banks have had a wait and see approach as South Africa is seen as a fledging democracy with an emerging market economy.

4.2.2. Return on average assets

Financial year ended	ABSA	Standard	Investec	Nedcor	FirstRand	Average
1992	0.95	1.11	1.20	0.96	1.15	1.07
1993	0.87	1.28	1.40	1.03	1.38	1.19
1994	0.82	1.33	1.36	1.18	1.25	1.19
1995	0.86	1.39	1.36	1.28	0.90	1.16
1996	0.97	1.45	0.79	1.45	1.15	1.16
1997	1.07	1.47	0.80	1.62	1.22	1.24
1998	1.19	1.37	0.88	1.74	1.10	1.26
1999	1.23	1.40	1.01	1.95	1.21	1.36
2000	1.16	1.37	0.94	2.16	1.42	1.41
2001	1.32	1.31	0.71	2.22	1.62	1.44
Average	1.04	1.35	1.05	1.56	1.24	1.25
Max	1.32	1.47	1.40	2.22	1.62	1.44
Min	0.82	1.11	0.71	0.96	0.90	1.07

Table 4-2: Return on total assets for banks in South Africa

Source: South African Reserve Bank, Corporate governance review April 2003 available on line at: http://www.reservebank.co.za

The percentage of return on assets has been steadily rising for all of the major banks, bar the odd decrease. The percentages may seem low but when one considers the total current base of the banking industry to be approximately R 1 trillion (http://www.kpmg.co.za), one realizes that the returns are quite large in absolute terms. Globally a return of 1 % on total asset is considered a reasonable performance (Federal Deposit Insurance Corporation, Quarterly banking Profile, 1999:IVQ). The above table is another financial indicator that reveals that the resources are being applied appropriately at South African banks.

4.2.3. Return on shareholders equity

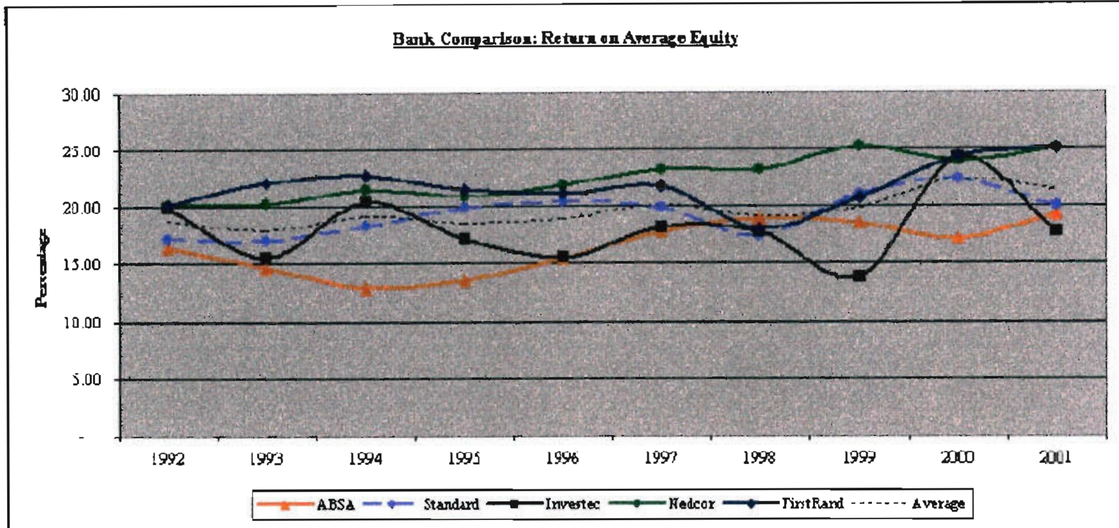

Figure 4-1: The return on equity for South African banks

Source: South African Reserve Bank, Corporate governance review, April 2003 available on line at: http://www.reservebank.co.za

Return on shareholders equity is a measure of return, which shows what shareholders are getting back for investing in a business. Average returns of 18 % to 22 % are considered reasonable when one has to compare with our global peers. For example the average return for Westpac (a leading Australian bank) for the last five years was approximately 18.3 % (http://westpac.com.au). Further, the return of South African banks must be considered in the context of inflation for the same period. Average inflation for the same period was approximately 9 % (http://www.unicef.org). Hence, the average real returns of approximately 11 to 13 % are very favourable.

4.2.4. Cost to income

Financial year ended	ABSA	Standard	Investec	Nedcor	FirstRand	Average
1992	60.23	62.16		65.01	65.61	63.25
1993	85.36	62.06	64.48	65.65	70.16	69.54
1994	67.63	63.27	69.62	66.56	69.42	67.30
1995	70.84	63.54	58.87	66.61	64.66	64.90
1996	70.47	64.91	54.80	61.38	63.84	63.08
1997	67.20	63.11	56.23	58.67	61.78	61.40
1998	65.40	62.03	54.71	56.83	62.89	60.37
1999	63.30	61.61	58.90	51.68	62.40	59.58
2000	63.50	58.80	59.89	50.30	60.30	58.56
2001	63.00	57.26	63.21	49.27	59.50	58.45
Note 3						
Average	68.52	61.84	60.08	58.55	63.88	62.58
Max	85.36	64.91	69.62	66.61	70.16	69.54
Min	63.00	57.26	54.71	49.27	59.50	58.45

Table 4-3: Cost to income ratios for banks in South Africa

Source: South African Reserve Bank, Corporate governance review, April 2003 available on line at: http://www.reservebank.co.za

The cost to income ratio, which expresses total operating costs as a percentage of normal operating income, is one of the more important performance indicators in the banking sector. This is a good indicator to see whether a bank is performing optimally and allows for comparison amongst peers. The trend amongst South African banks clearly shows a downward movement in the cost to income ratio for all the major banks. All of them appear to be working towards becoming more efficient. From the data presented Nedcor has been the most successful of the major banks in decreasing its cost to income ratio. However, the latest six months interim financial statements published recently show that much of the success of Nedcor has been lost in recent months.

4.2.5. Bad debts as a percentage of average assets

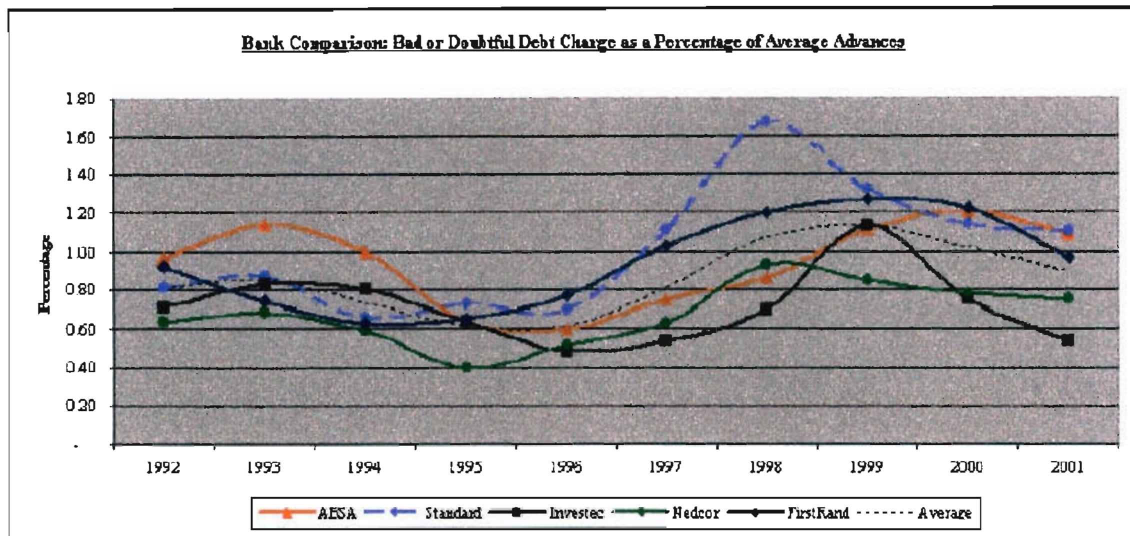

Figure 4-2: Bad debts as a percentage of total average assets for SA banks

Source: South African Reserve Bank, Corporate governance review, April 2003 available on line at: http://www.reservebank.co.za

Bad debts percentage is a good universal indicator of the performance of a bank. It shows how successful a bank is in lending its funds and its ability to collect them (a banks primary function). For the ten-year period under review, it is clear that South African banks have been successful in being able to keep the bad debts percentage (on average) of 0.6 % to 1.2 %. The increase during the late 1990's is primarily a function of the high interest rates that were experienced during the same period. The high percentage of Standard Bank is mainly a result of its large exposures/loans to Russia. It is clear from the above, that on average, South African banks are able to keep bad debt losses to reasonable amounts on a sustainable basis. This skill is often considered a key core competency in a successful banking environment.

4.2.6. Non-performing advances

Financial year ended	ABSA	Standard	Investec	Nedcor	FirstRand	Average
1992	N/A	N/A	N/A	N/A	N/A	N/A
1993	N/A	N/A	N/A	N/A	N/A	N/A
1994	N/A	N/A	N/A	N/A	N/A	N/A
1995	N/A	N/A	2.70	3.42	2.92	3.01
1996	N/A	2.62	2.70	2.80	3.45	2.89
1997	3.90	3.21	1.79	2.79	3.30	3.00
1998	3.30	4.49	2.57	3.00	3.27	3.33
1999	4.30	5.22	3.03	3.27	4.23	4.01
2000	4.90	4.04	2.06	4.66	3.08	3.75
2001	4.40	2.95	1.65	4.46	2.91	3.27
Average	4.16	3.76	2.36	3.49	3.31	3.32
Max	4.90	5.22	3.03	4.66	4.23	4.01
Min	3.30	2.62	1.65	2.79	2.91	2.89

Table 4-4: Non-performing advances as a % of total advances in South Africa

Source: South African Reserve Bank, Corporate governance review April 2003 available on line at: http://www.reservebank.co.za

Non-performing advances are loans on which no/limited return is being earned. Management is also uncertain about the collection of future cash flows. This statistic views how unsuccessful management has been in its lending activities. Hence the lower the percentage the better the performance of the bank. In most cases it is evident that South African banks were able to keep the percentage below 4 %. Bad debts are largely influenced by the interest rate cycle. The higher the rates of interest, the greater the chance of default by customers. A review of the above table indicates that the banks were, on average, able to keep the bad debts as a percentage of total advances between 2 % and 4 5 %. This is well within the global average and is considered favorable when on considers that South Africa is viewed as an emerging market, which is traditionally more risky.

Consequently, a collective analysis of the key financial measures presented above clearly indicate that the South African banks have been reasonably successful in deploying financial resources in creating shareholder value. All of the above indicators show that the five major banks were able, over a long period (10 years) of time, to sustain good financial performance. It is the opinion of the writer that this was largely influenced by the fact that the South African banking environment was a closed market, as a result of the policy of apartheid. However, large banking failures like that of smaller banks such as New Republic Bank, Saambou and Unifer should not go unnoticed together with some of the large inappropriate financial decision by some of the major banks (for example Investec's acquisition of Fedsure as well as Nedcor's acquisition of Didata). It is the opinion of the writer that given the application of true sustainability some of these could have been avoided if the directors of the various banks had chosen a long-term (sustainable) view as opposed to focusing on short-term profits and performance.

The relative stability of the banking environment and the economy over the last decade has indicated to major international banks that South Africa is a potential home for investment and not just for opening representative offices. This is evident in the recent acquisition of Twenty –Twenty, the online bank of the legacy Saambou Banking Group, by Standard Charter the large international UK based bank as well as the presence of Barclays in the credit card issuing space. Foreign banks are going to start competing on a large scale, with local institutions. They will use their global critical mass and strong brands to drive down local banks. This will create the pressure for local banks to compete beyond financial returns for shareholders only, but also for benefits for other stakeholders such as the community and their staff. This would also force the local banks to benchmark themselves against global leaders.

Further, the development of international trends such as The London Principles and the UNEP Financial Initiative as well as the changing local landscape, with the financial services charter, will place greater emphasis on the other four capitals (social, physical, human and environmental). A review of the latest published financial statements shows that many of the large banks are behind in reporting their results in the context of GRI (only Standard Bank has made reference to this framework in their annual report).

However, some of the elements of the GRI framework can be found in different parts of the annual financial statements of the different banks. For example most of the local banks have a value added statement that shows the value created for some of the key stakeholders. The value added statement is part of the statutory reporting requirements in South Africa, which form part of Generally Accepted Accounting Practice.

4.3. Physical Capital

Physical capital (including buildings, machines, and production processes, tools, etc) creation and maintenance is built around the economic, social and environmental concerns. Effective management of this form of capital can result in goods and services reaching the consumer more quickly as well as the reduction in resources used in the production of goods and services. This form of capital is sometimes also referred to as manufactured capital.

In banking terms the above capital would refer to the infrastructure and processes that are deployed in delivering the products and services to the customer. Technology forms a large part of this component, in addition to the physical distribution. Banks deliver their products and services via different mechanisms, which are often referred to as channels of delivery. The various channels include:

- The physical branch network including automatic teller machines;
- The internet; and
- The telephone media

In a South African context, the latter two delivery mechanisms are relatively new and do not account for the majority of the transactions both in volume and value. Further, these channels are often not available to the majority of the population, which are currently materially un-banked. The current branch distribution is primarily focused in urban areas and was built around serving the minority white communities (as a consequence of the system of apartheid, mentioned previously). The largest of these branch networks is owned by ABSA with 753 branches and in excess of 2216 automatic teller machines (ABSA Annual Report 2001).

The draft financial services charter aims to address the above inadequacy. Banks have committed to providing basic transactional services within a distance of 20 kilometers from un-banked communities (Draft Financial Services Charter). However, it is the opinion of the writer that the initiatives of the draft financial services charter do not address the issue of providing responsible finance/funding for these communities, which is critical to capacity building and economic advancement.

The draft financial services charter focuses on providing basic transactional services to the un-banked, which are currently defined as individuals with a consumption of R 360 per month. At this level of economic activity, it is the opinion of the writer, that basic transactional banking service would not be as important as that of raising funds for the financing of domestic goods and appliances (in attempts to improve living standards). The current estimate of providing basic transactional services to the un-banked, amounts to approximately R20 per account (per month). At the estimated consumption level of R360 per month, this service is not affordable by the un-banked customer.

Hence, even though the draft financial services charter goes a long way to cover the physical distribution of banking services to the traditionally un-banked, the actual product offering is not considered appropriate in terms of the social needs of the affected communities. The fact that the provision of micro-finance is a very risky business (as is often alluded to by banks in the press) should not preclude them from finding a sustainable solution.

Physical capital also refers to the efficient and responsible use of resources in the production of banking products and services. As mentioned before, the most expensive cost in the production of banking products and services is information technology. A review of the financial statements of the five largest banks in South Africa reveal that these organisations spend billions of rands on IT expenses annually. The single largest operating expense, other than bad debts, is often their spend on information technology. Very often this expenditure is used to provide product and services that are identical and a distribution network that often overlaps.

The small market size, complemented with the high costs of information technology should prompt banks to consider using one common infrastructure for the delivery of similar products and services. This will benefit the customer in the form of low fees and the shareholders in the form of higher profits. A review of the banking sector activities reveals that this concept of sharing of expenses with different banks is almost non-existent. The noticeable exception being where banks have to interface with each other in switching transactions of their customers between banks. In this space banks have joined forces to share the costs of infrastructure and this is evident in their collective investment in Bankserve and the various payment associations. It is the opinion of the writer that this sharing of expenses could go a much longer distance in obtaining benefits for both shareholders and customers. Banks need to remove the large secrecy from behind each other's operations. The excuse that the individual production process is closely linked to their competitive advantage, needs to be benchmarked against the benefits that could be achieved (if production cost sharing was taken seriously) for customers in the form of lower charges, improved product offering and greater innovation and benefits to shareholders in the form of higher returns.

Many banks have tried to look at cost sharing with organisations in other industries, primarily to share their core competencies and distribution network (and in the process not to lose their competitive advantage with a peer). This has resulted in several joint ventures (JV) such as Pick and Pay Go Banking (a JV between Pick and Pay and Nedcor) and Icanonline (a JVs between MWeb and BoE). However, this cost sharing model with other industries has not been financially successful for many banks (bar the odd exception).

4.4. Human Capital

Human capital management ensures that staff is treated as an important stakeholder. Their health, training and respect for their rights are valued. This includes both skilled and unskilled staff. Further, individuals have to be effectively managed. "It incorporates the health, knowledge, skills, intellectual outputs, motivation and the capacity for relationships for the individual. Human capital is also about dignity, joy, passion, empathy and spirituality" (SIGMA Project 2001). Companies are increasing realizing that staff form an intangible asset of business (and not just a huge expense) without whom it is impossible to operate.

In banking staff form an extremely important part of the business's value chain, as it is primarily a service industry in which a large part of the customer interface occurs via staff. Staff expenses are often one of the larger expenses in a bank's income statement and consequently their management and development needs to be addressed as a high priority.

All four major banks reviewed have codes of conduct in place that entrench a value system. The level of implementation is hard to comment on, as no easily defined measure exist. However, most banks make mention that the value system adopted often manifests itself in the customer experience and directly affect customer retention. Customer retention is often viewed as a business imperative as the cost of acquisition of a new customer is often viewed as more expensive than keeping existing customers and selling new products to them.

Training and development is also a focus area of all four major banks in South African. Key initiatives include:

- Skills development
- Leadership development
- Diversity training

- Industrial relations

The large investment in training is managed against the background of staff turnover. Investment in training and development in an environment in which there is high staff turnover can be very expensive for banks. During the merger of BoE and Nedcor, it was quoted that staff turnover in the combined organisation was expected to be approximately 10 % to 12 % (http://www.nedbank.co.za). Considering that the combined organisation is staffed with approximately 25 000 staff, it is expected that about 2500 to 3000 people will leave the organisation annually. If we assume that each staff member works an average 3 of years before leaving and that approximately R5000 is spent on training each staff member annually, then approximately R45 million is spent on staff that leaves the organisation annually. This is a substantial cost by any standard. Consequently banks have started to pay attention to staff retention by making sure that salaries are competitive, by the use of share incentive schemes (mostly for senior staff) and by ensuring that the working environment is enjoyable.

The white majority dominates the working environment at South African banks. This is mainly as a result of job reservation practices that were part of the system of apartheid. Close onto ten years into our new democracy, banks are still struggling to employ and maintain people of colour, especially in senior positions. Nedcor's 2002 annual report reveals that only 19.7 % of management is of colour. Standard Bank's annual report for the same period shows that people of colour make up 27.7 % of management. This is hard to understand when one considers that more than 80 % of the population is of colour. The position is very similar with the other banks. It is the opinion of the writer that banks have not been very successful in diversifying its workforce both by race and gender, especially at management levels. Further, the number of females employed has also been very low.

One of the larger challenges facing banks in attracting and retaining people of colour is the existing culture at each of the various institutions. Many cultures are not geared at a diversified workforce and are often viewed as not being enabling. Workplace practices, from the serving of culturally inappropriate snacks/meals at meetings to religious holidays need to be properly understood for the entire workforce across different cultural and racial divides.

The draft financial services charter's balanced score cards attempts to address this area of poor performance. One of the performance measures is the number of people of colour at each bank as well as the composition of staff that are female. It is envisaged that targets will be set so that banks can actively drive at changing its staff composition.

4.5. Natural capital

The utilisation of natural resources in the production process needs to take into account the needs of the environment as well as responsible use of the limited resources. All organisations rely on natural capital; for example, all companies consume energy and use water in the production of products and services. This capital forms the basis of life on which all life forms depend on. More especially at a bank, natural capital management can be viewed at an overhead level (using natural resources to run the business) as well as at an operational level via its core products and services.

At an overhead level, consideration needs to be given to the sparing use of natural resources or consumables and services that use up natural resources in their makeup. A review of the latest annual financial statements of all four major banks shows little or no direct mention of the minimization of environmental resources used (as overheads). It is the opinion of the writer that banks tend to think that they have little to do with regards to saving the environment by using natural resources, whether directly or indirectly, sparingly. Apart from saving the environment from wastage, there are potential cost savings that can accrue to a bank from using natural resources sparingly. This can be practiced in a number of ways for example:

- Printing on both sides of paper reduces the usage of paper significantly and creates fewer demands on the trees planted to resource the paper industry. Most bank statements sent to millions of clients only print on one side of the paper.
- Using water and electricity sparingly. Lights can be switched off when not used. One has only to drive down Sandton (financial capital of South Africa) in the evening to notice how all the major banks leave their lights on for most of the night, even if no one is working. It is the opinion of the writer that very often this practice is to show off the large buildings, at the expense of the environment.

The examples above do not sound material to the large corporations but on closer inspection the effect on their businesses and their clients are significant. For example the wastage of electricity on a five story building as a result of all the lights being kept on for the entire night could easily increase the electricity bill by approximately R 20 000 per month. This is R 240 000 annually. This may seen small but consider the amount of products that are needed to be sold, to support the above practice. If a 12 month fixed deposit yields a margin (profit) of 1 % (which in the current interest rate cycle is very conservative), then R24 million worth of fixed deposits need to be sold to pay for the extra electricity used and non of the profits will be left to pay for other expenses or for a return for the shareholders. Hence it is clear that the impact of resource wastage is large on the environment as well as the financial performance of the banks. Very often in large banks these costs cannot be seen.

At an operational level, South African banks appear to be far behind their global peers at ensuring that products and services offered takes into account the impact on the environment. None of the local banks are signatories to the Kyoto Protocol as mentioned in chapter 2. The main focus of South African banks appear to be an environmental review of their existing portfolio as well as focusing on new lending in high risk industries. It appears that the main reason for their focus is not because the loans advanced in these areas could be detrimental to the environment but rather that environmental risk could affect the ability of the customer to pay, as stated by Standard Bank in its 2002 annual report. This appears to be selfish, from an environmental perspective, as well as not in line with global banking institutions. It also appears to neglect the effect on other stakeholders besides shareholders.

4.6. Social capital

The needs of society need to be taken into consideration when making key business decisions. The effective management of society's expectations delivers value both to the organisation and to society. " Social capital includes for example networks, communication channels, families, communities, businesses, trade unions, schools and voluntary organisations as well as social norms, values and trust" (SIGMA Project 2001). Within the context of the larger external environment this capital creates a climate of consent or a license to operate within society as a whole.

The South African economy is no exception to the global consumerism trend. Greater pressure is being put on all types of business to minimize their impact on society and the banking sector is no exception. Coupled with the above are South Africa's unique social landscapes, primarily as a result of the system of apartheid. More specifically to banking, a large part of the population has been excluded from participating in the banking system (as mentioned in chapter 3). South African banks have not been very successful in developing products and services to address the needs of the un-banked population. Most of the current products are geared around saving and the provision of insurance cover (primarily for funerals), with noticeable absence of lending products. This has been clearly highlighted by the South African Communist Party (SACP), during its Red October campaign in 2001, which focused on the banking community's negligence with regards to the un-banked. However, there has been limited success in some areas, for example, Standard Bank currently has approximately 2.5 million E Plan account holders (Standard Bank Annual Report 2002). This account is primarily for the mass market, which has full functionality at ATMs as well as debit card functionality and personal life insurance cover. Currently these accounts have approximately 6 million withdrawals monthly (Standard Bank Annual Report 2002).

However, the number of options for the un-banked community is very limited especially with regards to the provision of finance. Except for ABSA (via its acquisition of Unifer), most of the larger banks have a limited presence in the micro finance market. This is primarily as a result of the greater risk of default at this end of the market.

Consequently, the impact of banks in assisting these communities in capacity building is limited. Even the draft financial services charter does not address the issue of micro finance and its availability (as mentioned previously). As a consequence of the absence of banks in the micro finance industry, several customers are exposed to many unscrupulous practices, by smaller players, in the form of extremely high interest rates and charges. Government has attempted to regulate this industry with limited success via the Micro Finance Regulatory Council. Clearly, banks need to be more responsible in their approach when attempting to bank the un-banked.

It is clear from the above that the existing status quo is that banks have neglected to provide banking solutions for a large part of the population, which is un-banked. This social need is not being fully addressed by the financial services charter due to the noticeable absence of micro- finance as part of the strategic solution. Further, the existing product set of the banks ignores the calls for banking the un-banked. Consequently, non-traditional banks such as the Postbank and the Village bank mentioned in chapter 3 still has a large role to play in meeting the social banking needs of the population.

All the major banks have declared their commitment to black economic empowerment via procurement processes. Banks see procurement as one of the easiest way in which to participate in Black Economic Empowerment. They view their participation as a strategic initiative that allows for business effectiveness and building credibility. Many of the policies are aligned around supporting small to medium sized suppliers in the purchase of goods and services, whilst not affecting quality. In this process banks will be assisting in building capacity.

However, very few of the banks' financial statement or websites indicate the success they have had with this initiative. The one noted was Nedcor, which stated that, 6.6 % (amounting to R 68 million) of its purchases in 2002 was sourced from affirmative procurement (Nedcor Annual Report 2002).

Banks are also starting to place pressure on existing suppliers to embrace black economic empowerment as part of its procurement strategy and are in some cases placing minimum standards. Further, as part of the draft financial services charter banks will be required to pro-actively source a large part of its purchases from previously disadvantaged firms. It is also envisaged that targets will be set for 2008 and 2014.

Social engagement with the communities has had its status elevated over the last few years. This is clearly evident when one reviews the annual financial statements of most major banks. Engagement with communities, which are primarily around charity and donations, take up a large part of the annual report of banks. Further, some organisations such as Nedcor have separate corporate citizen reports that focus specifically on social engagements as well as corporate governance with respect to the King II report and matters pertaining to staff. It is the opinion of the writer that sustainability reporting should form part of the normal financial reporting and should not be a separate process, as seen in the case of Westpac. Many banks appear to want to really tell their story about how they are investing in the communities as a corporate citizen. For example, Standard bank states in its annual report that it has spent approximately R 12 million over the last year on corporate social investment (Standard Bank Annual Report 2002), whilst Nedcor has spent approximately R 38 million in the last year via its foundation (Nedcor Corporate Citizenship Report 2002).

However, it is interesting to note that most of the social spend of large banks were on initiatives outside the financial services sector as well as not being related to its product set. The Nedbank affinities program was one exception which related social spend to the product set and its activity. It went a small way of making business sense of social investment, for example the Green Trust (one of the beneficiaries) allows customers to contribute to the environment by using a range of value-added Nedbank affinity products such as the affinity credit card. A percentage of income generated from this product is given to the Green Trust to protect the environment (Nedcor Corporate Citizenship Report 2002).

A large part of the corporate social spend is often unrelated to the financial services industry. The current involvement in the community is commendable, however the writer is of the opinion that corporate social investment would have a larger impact if it were aligned to the core business of the banks. It would allow the banks to focus their core competencies in their social investment and would have a larger impact on society, as they would be doing what they are good at. For example NBS, the savings and investment arm of the legacy BoE Group targeted a large spend of its social investment at financial literacy at schools. Many of the targeted children had never entered a bank and were shown how to budget and use an ATM, together with the value of saving. By investing in such an initiative the bank was attempting to introduce financial services knowledge to the traditionally un-banked communities and in the process of making a large difference to the communities, it was growing its brand awareness to potential future clients.

4.7. Summary

Sustainability at South African banks is starting to become more and more important. The global pressures together with the local pressures appear to have persuaded the local banks to look at sustainability more seriously. The review of the use of financial capital shows that existing South African banks have on average performed reasonably well in deploying their financial resources for the benefit of shareholders. There have been noticeable exceptions such as the collapse of Unifer, New Republic Bank and Saambou. It is the opinion of the writer that the adoption of sustainability in broad based business models might have avoided some of these failures and could have resulted in better earnings streams for the existing banks.

Further, South African banks have not been very successful in the other aspects of sustainability such as social capital management, environmental capital management, physical capital management and human capital management. Some initiatives such as the draft financial services charter are attempting to address these issues, however, management need to embrace these other capital issues on a proactive basis and include these as part of its core business.

5. Chapter five: Conclusion

5.1. Introduction

The concept of sustainability, in a business context, creates a new dynamic for management. Together with the pressures from society and various regulators, it creates a challenge that needs to be addressed proactively and with urgency. The banking industry is no exception. The past two years has seen the collapse of smaller banks and the consolidation of the financial services industry at an unprecedented level in South Africa. This may be an indication of their inability to adapt to a changing environment, growing consumer expectations and higher corporate governance standards. How banks in South Africa adapt to a fast changing operating environment will have consequences for their long-term survival.

The globalisation of the modern world has assisted in creating increasing demands from all stakeholders and not just shareholders, as was the case in the past. This increasing challenging attitude from all stakeholders (including shareholders, staff, the environment and society) creates pressure for management to focus on sustainability if they want to out perform their peers in the long run. Sustainability is the ability of the company to protect and grow stakeholder value in relation to economic, social, ethical and environmental management as part of it core business practices. This approach to management attempts to address many of the concerns/demands raised by its stakeholders. However, in implementing this philosophy, management is required to have a multi-dimensional approach and capacity incorporating financial capital management, physical capital management, human capital management, social capital management, as well as natural capital management.

Different industries have different roles to play with higher focus in some of the different capitals. Globally, the banking industry has identified the impact of sustainability on the banking value chain. They have started to react to these pressures and have developed several initiatives such as the UNEP financial initiative, The London Principles, the Social Performance Indicators for the financial sector and more recently the Equator Principles. Many of the global banks have started to implement many of the learnings from these initiatives as seen in the example of Westpac in chapter 3.

More specifically in South Africa, the initiatives mentioned above have taken a while to filter down to local banks. This was primarily due to the country being an isolated economy as a result of apartheid sanctions. With the democratisation and normalisation of society in South Africa, as well as the challenges of globalisation, many new challenges face business in South Africa. This includes not excluding certain customer bases, improving staff composition to include people of all races as well as taking a broad citizenship approach to developing South African people and the communities in which they operate. Apart from the provision of banking products and services to various economic participants, banks play an extremely important role in the facilitation of transactions and funding within the economy. They act as an enabler of economic activity. Consequently, they have a larger role to play in addressing the abnormalities mentioned above.

One of the key economic tools that the South African government may shortly be implementing to address many of these development challenges, is a broad based economic empowerment strategy. It intends to facilitate economic transformation and bring about increased participation in the number of previously disadvantage people that participate in the economic world as customers, staff, management or owners. More specifically local banks have started to look at these challenges in creating a sustainable business model. One of the key instruments affecting the local banking environment is the draft financial services charter that embraces the fact that banks are at the heart of the economic system and have a large part to play in the normalisation of the South African economy.

5.2. Key findings and recommendations

The benchmarking of South African banks against the five capitals model shows clearly that in some areas banks have a significant way to go in fully implementing a sustainability model throughout its value chain and it's interface with key stakeholders. Consequently, South African banks are not leveraging off sustainability fully, in producing stakeholder value. Further, many of the local banks are lagging, when compared to their global peers, in introducing sustainability into their business model. The key findings and recommendations are presented in terms of the five capitals models, as this was the model used to evaluate the level of sustainability at local banks.

5.2.1. Financial capital

Financial capital management ensures sound macroeconomic planning and prudent financial management, resulting in the effective utilisation of limited financial resources of a company. The analysis of the results of South African banks via different key performance lenses reveals that the performance of banks has been satisfactory over a long period of time. Further, a comparison to certain international benchmarks reveals that the performance is close to some of the international peers. However, it is clear that the "foundation" for South African banks is a lot different to its international peers. South African banks have ignored some of its key stakeholders such as the community and the consequence is that they have operated with an unfair advantage (when benchmarked against international peers). The correction of this abnormality lies partly in the draft financial services charter. Implementation of this charter will cost the banks a large amount of money in upfront investment and well as ongoing expense. This will impact some of the future earnings. Further, the draft financial services charter does address the issue of micro-finance and if local banks are required in the future required to participate in this market (which in the opinion of the writer is just a matter of time), it will increase the risk profile of the banks (which will be evident in the bad debt losses) and will also

affect their earnings. It is suggested that local banks start to plan to enter the micro-finance market, especially in rural areas, in preparation for the inevitable.

However, non-participation in the draft financial services charter has larger consequences. In many instances it is envisaged that banks, which do not operate within the financial services charter, will not be allowed entry into the financial services sector and would effectively lose their licences to operate. Participation in the charter will, to an extent, level the playing fields with similar overseas banks, and future results would provide a more meaningful benchmark of sustainable earnings.

5.2.2. Physical capital

Physical capital (including buildings, machines, and production processes, tools, etc) creation and maintenance is built around economic, social and environmental concerns. Effective management of this form of capital can result in goods and services reaching the consumer more quickly as well as the reduction in resources used in the production of goods and services.

South African banks focus on physical capital primarily with a view to reducing costs. However, they place the secrecy of their business model before their intention to save costs. It is clearly evident, with the small South African market, that the local banks have in many instances duplicated infrastructure and processing costs in an attempt to provide products and services to their existing clients (that their peers also provide). The small market size by global standards, coupled with the high costs of information technology should prompt banks to consider using one common infrastructure for the delivery of similar products and services. This will benefit the customer in the form of low fees and the shareholders in the form of higher profits. They could differentiate them selves on how they market each of these similar products and the services they offer. Further, the existing distribution network does not allow for accessible banking for a large part of the population (un-banked). Even though the draft financial services charter goes a long way to cover the physical distribution of banking services to the traditionally un-banked, the actual product offering is not considered to be appropriate in terms of the social needs of the affected communities.

Serious consideration should be given to the provision of micro-finance products, in addition to the transactional accounts proposed by the financial services charter. This would go a long way in addressing the primary needs of the un-banked community, which is to build capacity and improve living conditions. The Village Bank, which introduces the concept of the community funding should be explored further. Banks could use their existing investment in infrastructure and processing to set up community banks easier (and at a lower cost), than other organisations would do. In the setup of the first village bank in South Africa, it was noted that the barriers to entry was knowledge around operating a financial services business as well as high set-up costs. As mentioned previously banks already have a large investment in the latter and their core competencies when running financial services organisations. Banks should use this core competency in leveraging off community involvement in producing a sustainable solution to the rural communities, which make up a large part of South Africa's un-banked.

5.2.3. Human capital

Banks in South Africa have implemented various practices to ensure that their staff can pursue stimulating and rewarding careers in their business, and that their rights as individuals are met. This is evident by the high level of compliance with various industrial relations regulations. Banks are built around the intellectual capital they employ and their competitive advantage is based largely on this. Consequently, a stimulating work environment and the appropriate remuneration structures are important to retain staff. In the Deloitte and Touch 2002 Best Company to Work For survey (http://www.bestcompany.co.za), ABSA one of the big four retail banks, was voted the number one employer in South Africa. This confirms banks' intentions of attracting and retaining staff, as they are at the centre of their competitive advantage. However, the composition of the existing staff force does not adequately address groups that have been marginalized in the past, i.e. people of colour and people of the female sex.

The draft financial services charter's balanced score card, which was developed around government's broad based BEE strategy, attempts to address this area of poor performance. One of the performance measures is the number of people of colour at each bank as well as the composition of staff that are female. It is envisaged that targets will be set so that banks can actively drive at changing its staff composition.

A possible tool that could be used across the various organisations to address the above is the process of mentoring. The mentoring program will have as its objectives the following:

- Attracting staff of different race groups and well as staff of female gender;
- Retaining the above staff; and
- Adapting the organisations culture to take into account the needs of these individuals.

New and existing staff members (mentees) from the affected groups can be allocated to senior members of management who will act as a mentor and perform the following:

- Act as advisors and sounding boards for participants on the program;
- Help the participants to navigate the culture and politics of the bank;
- Use their power base to facilitate the expansion of the mentee's sphere of influence within the organisation;
- Be a friend, role model, counselor and coach;
- Address the specific needs of the mentees; and
- Assist with the studies of the mentee.

It is the opinion of the writer, who is a person of colour and who has worked several years at different banks in South Africa, that a more fixed and coordinated approach like the one mentioned above would increase the efforts of banks in attempting to balance their workforce and include groups that have been marginalized in the past. However, top management should be committed to the process and practice what they preach in all business decisions.

5.2.4. Natural capital

South African banks have not taken natural capital management very seriously. This is both at an operational level as well as on an overhead/expense level. Lending products developed, that are currently being offered, often do not take cognizance of the environment. Compliance with environmental laws and regulations is often done reactively. This is evidenced in their approach to lending, which is based on complying with environmental laws (which is often at a bare minimum) to avoid potential losses as seen in the annual report of Standard Bank. This is selfish from an environmental perspective, as well as not in line with global standards such as the Kyoto Protocol.

Further, the concept of Socially Responsible Investment (SRI) has not been part of the core service offering of local banks. Products and services need to be built around supporting the development of our communities and the environment. Further, banks should use their central role in the economy as well as their large investments held as leverage in adopting an advocacy role for the communities and the environment.

South African banks should give consideration, to include the impact on the environment in their product development process as well as in their lending criteria. Further, in the management of costs/overheads and resources, which pertain to the environment, such as water, electricity and the use of paper, serious focus should be given to minimizing the usage with the intention to positively impact on the natural environment.

Local banks also need to look at the business practices of leading international banks that have embraced sustainability, and in the process natural capital management as part of their core business. Westpac and The UK Cooperative bank are excellent examples. Environmental risk assessment forms the heart of their lending practice. Further, the Social impact report for Westpac shows the usage of energy, car fuel usage and paper by the bank, something that is at this stage non-existent in South Africa.

5.2.5. Social capital

The biggest challenge facing South African banks in engaging communities in which they operate, is the challenge of attempting to bank the large part of the population that have been excluded from the banking environment. The draft financial services charter goes a long way in addressing this challenge. Hence, participation in this draft financial services charter should be a high priority on the agenda of local banks. Senior management should ensure that financial and human resources are available to implement this initiative.

However, as mentioned previously the draft financial services charter, excludes micro-finance as part of its mandate. This is a real need in the un-banked community. Many of the local banks are reluctant to play in this space due to the high levels of risk. This should not exclude them from participating in this market but they should rather focus their energies on finding a less risky but innovative solution. Local banks should research countries such as India and Australia (with regard to the native population) that have had success in this area of banking.

Further, banks' investments in communities via social spend should move away from the traditional philanthropy approach (unrelated to banking) to one that is more closely aligned to their core competencies. This will give them the opportunity to have a larger impact in the communities in which they operate as seen in the case of NBS as mentioned in the previous chapter.

5.3. Summary

It is becoming clearer that meeting the needs of stakeholders, like that of the other local communities, the environment and staff, has started to become increasingly important. South African banks are lacking in their response to the needs of these other stakeholders as seen in the review of the five capitals of sustainability. They are not leveraging enough off sustainability, in producing stakeholder value. The system of apartheid created an external environment that promoted a large part of this business ethic. The democratization of the country and the globalisation of the world have placed significant focus on local banks to look at sustainability more closely and to take into account the needs of the various stakeholders. However, the pace at which the local banks are addressing these external environmental impacts appears to be slow. This is largely due to the banks viewing sustainability as being separate from mainstream business. They need to incorporate this challenge into the various parts of their value chain on a proactive basis.

Management at these banks needs to embrace sustainability as a first step and need to understand that the paradigm in business has shifted. Close attention should be paid to international trends, as, in a globalised world they would soon follow to South Africa. Should management choose to ignore the issues surrounding sustainability they run the risk of losing their right to participate in the economy, either legally or socially. Social pressures should not be discounted as these can have a material effect, as seen by the awareness created by the Red October campaign of the South African Communist Party, during October 2002. This pressure, more in the form of bad publicity towards banks, has persuaded banks to get to the drawing board and work on the draft financial services charter at greater speed.

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7. Appendices

Appendix I: Research questionnaire

University Of Natal, Durban

Graduate School Of Business

MASTER OF BUSINESS ADMINISTRATION
(Questionnaire)

Do South African banks leverage off the key elements of sustainability in producing stakeholder value?

Akash Singh (student number: 202 5252 04)

Supervisor: Professor Elza Thomson

Section 1: General

Question	Answer
1. Does the Bank experience difficulty in making market sense of sustainability in the context of its current business model?	
2. Does the bank believe that the implementation of sustainability in business will make South Africa a more favored investment destination?	
3. Has the Bank fully implemented the King Code of Governance?	
4. Do you believe that the South African Banking environment is heavily regulated? If so please supply an explanation.	
5. Has the Bank commenced significantly with the implementation of the BASLE II framework?	
6. What was the company's annual expenditure in the last financial year on social issues? This excludes salaries of employees but includes skills development, as a percentage of payroll and costs or expenditure on community development.	

Question	Answer
7. Does the Bank have a policy for the following: • Ethics • Corporate citizenship • Code of Business Practice • Aids • Health and safety • Skills development and training • Empowerment	
8. Does the bank fully comply with the following Acts: • Skills Development Levies Act • Employment Equity Act • Skills Development Act	
9. Are the shares of the Bank or its holding company widely held? Please state the percentage holding of the largest shareholder.	
10. Do you believe that the South African banking environment is ready to implement sustainability into their business models?	

Section 2: The Four Capitals

Please rate your company success for each of the statements provide. The answers to the questions should be substantiated with explanations, details and examples in the right hand column. Should you have details that are not electronic, they can be faxed to me on 011 295 0599. My electronic address for the submission of the completed questionnaire is akashs@nedcor.com.

Human capital

Human capital refers to the people that make up an organisation (employees). It incorporates health, knowledge, skills and motivation of employees. It also incorporates values and integrity.

	Company success						
	Very High	High	Medium	Low	Very Low	No Basis	Example/Details/Description
1. The bank has a code of conduct, incorporating a set of values, that is effectively implemented							
2. Employees have access to adequate training							
3. The Bank has respect for human rights and dignity throughout its operations.							
4. The Bank fully understands human values across the various different race / cultural groupings							
5. The organisation implements diversity programs that enables it to access a variety of human talent whilst providing an enabling culture							
6. The bank ensures health and safety of all its employees, including physical and mental well-being.							
7. The bank provides a reasonable living wage to all its employees and practices fair labour practices							

Social and Environmental Capital

Social capital refers to the fact that a bank operates with society as a whole. It includes families, communities, businesses, trade unions, the physical environment as well as social norms, values and trust.

		Company success						
		Very High	High	Medium	Low	Very Low	No Basis	Example/Details/Description
8	Social and environmental matters are discussed at a Board level							
9	A member of the Board takes responsibility for social and environmental matters							
10	The bank ensures that it is aware of new legislation and ensures compliance with it as well as compliance with all existing legislation							
11.	In following the laws and regulation of the country, the organisation applies the maxim of substance over form.							
12	The Bank has an officer responsible for social stakeholder engagement							
13 s	The Bank has an effective consultation process with social stakeholders							
14 1	The Bank has programs that support the development of communities in which they operate.							

		Company success						
		Very High	High	Medium	Low	Very Low	No Basis	Example/Details/Description
15.	The Bank enquires into the social practices of its suppliers, contractors as well as corporate customers							
16. 2	The bank requires its suppliers, contractors and corporate customers to meet minimum standards with respect to social issues							
17.	The Bank offers reasonably priced products that allows for accessibility, primarily for the under banked market							
18.	The Bank actively minimizes the negative social impacts of its product set							
19.	The Bank implements stringent social and environmental criteria in its lending practices to corporate/business clients							
20.	The Bank does not adopt a sell and forget approach to its product set.							
21.	Customer's needs are taken into account when developing products and services.							
22.	The Bank currently offers products geared to socially responsible investors, be they individual or institutional customers. If the Banks does offer the above products, please state the criteria used to determine what is socially responsible (e.g. Empowerment, Gender Impact, Job creation, Green etc)							
23.	The Bank's current product set materially promotes social change (e.g. community development)							

Manufactured Capital

Manufactured capital refers to the processes and resources used by a Bank in producing products and services.

			Company success					
			Very High	High	Medium	Low	Very Low	No Basis	Example/Details/Description
24	1	Products and services are developed and delivered in manner taking into account the various stakeholders needs.							
25		Product and services are developed taking sustainability issues such as social, human and environmental consequences.							
26	2	The organisation uses infrastructure, technologies and processes in a way that uses resources in the most efficient manner.							
27		The organisation forms partnerships within various parts of the value chain to make more efficient use of resources.							

Financial capital

Financial capital covers those assets that take the form cash and can be quantified and exchanged. It reflects the productive power of the three previously mentioned capitals.

		Company success						
		Very High	High	Medium	Low	Very Low	No Basis	Example/Details/Description
28	1 Financial capital is deployed taking into account the four previously mentioned capitals (viz. human, social, environmental & manufactured)							
29.	The Bank ensures equitable use of wealth created amongst various stakeholders							
30	2 In making critical operational decisions the bank assess the wider economic impacts of its decisions.							
31.	The Bank has adopted triple bottom line in reporting its broader impact on society, the environment and its economic impact.							
32	The Bank demonstrates a proactive approach to sustainability when making financial decisions							

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