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IMPACT OF ESG POLICIES IN BANKS PROFITABILITY

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Abstract
This article examines the impact of ESG policies on bank profitability. It is substantiated that in modern conditions it is advisable for banks to balance when making decisions on providing loans between traditional borrowers and companies of the "green" economy, bearing in mind that the risks of climate change affect the activities of economic entities in different ways. Conclusions are made that the development of corporate clients of banks in accordance with the principles of environmental, social and corporate governance (ESG) will have a positive effect on the financial results of companies and the sustainability of banks.

Keywords: sustainable development, risks, bank efficiency, ecology, environmental, social and corporate governance, ESG

INTRODUCTION

As a result of the large-scale coronavirus crisis, which has had a negative impact on the economies of countries around the world, the concepts of sustainable development and ESG have become more relevant than ever. The key reason was the fact that most European countries, South Korea, and Japan have focused on "greenness" in their post-crisis recovery programs. The CIS countries, being part of the global economic community, are also affected by the "green revolution" and are actively involved in the development of national ESG financing systems [1].

ESG — principles of environmental, social and corporate responsibility (ESG - Environmental, Social, Governance), which should be a key aspect of the activities of both non-financial and financial organizations, and which institutional investors take into account in the process of making investment decisions. ESG is a global trend of the XXI century, and environmental responsibility ("E") is the most relevant factor in the ESG triad from both the point of view of society and investors, and, as a result, has a direct impact on the functioning of the financial sector, in which banks act as "pioneers" in the process of transition to a sustainable economy (Fig. 1).

These circumstances have gradually formed a new approach to the process of improving society and private business, which is defined as sustainable development, providing for a responsible attitude to nature, favorable coexistence with the society in whose territory the organizations are located, as well as building ethically correct relationships inside and outside the organization, called in foreign literature Environment, Social and Governance - ESG. This way of business is often defined as socially responsible behavior. Companies are expected to respect the traditions and customs of people who live in the region of their operation, promote

the development of local culture and education, pay taxes to local budgets in accordance with the law.

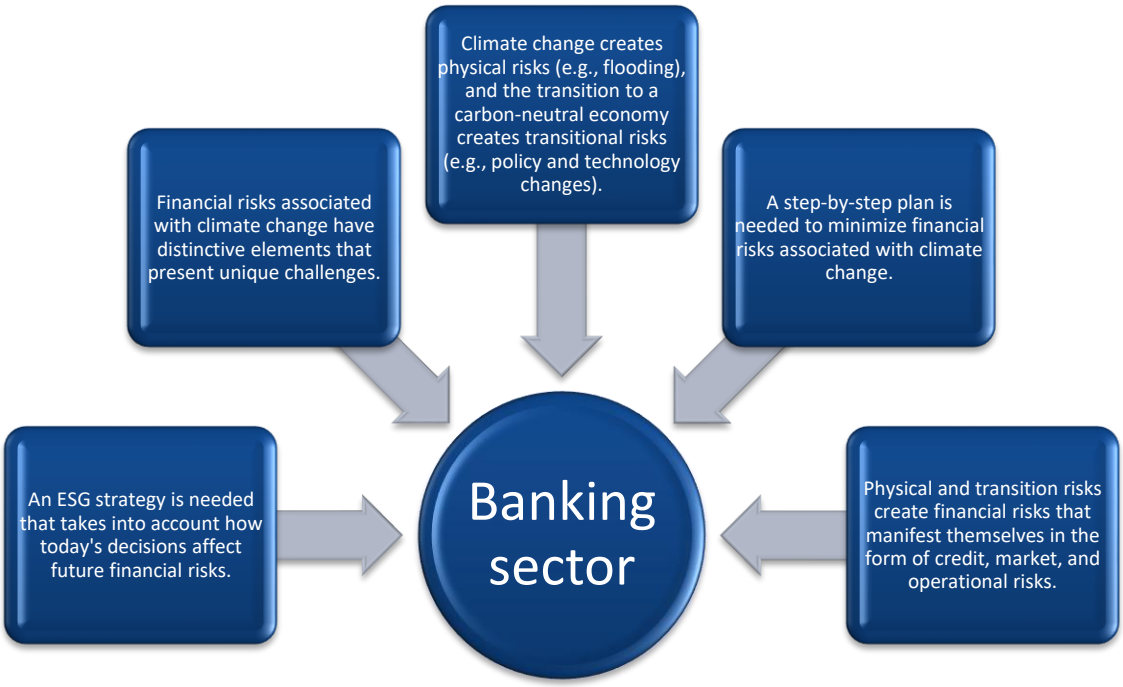

Fig. 1. The role of the banking sector in the framework of ESG transformation

Many companies adopt a code of ethical conduct that provides for fair competition, a non-discriminatory model of hiring personnel, a fair system of remuneration for employees, ensuring equal opportunities for their career growth, cooperation with suppliers who comply with these principles. While the implementation of the above measures is often not difficult for a company, especially if without their implementation it is not possible to receive a large order and establish long-term relationships with customers, and also does not require large financial costs and is local in nature, environmental protection measures are usually very capital-intensive and long-term [5]. At the same time, the inaction of an economic entity or the implementation of environmental protection measures have an extraterritorial effect, since the negative or positive consequences of their implementation have a tangible and rapid effect in the region where the enterprise is located, and if it is large, then on the entire country, continent or planet. Climate change affects five socio-economic systems: quality of life, productivity, food systems, material assets, infrastructure services and the environment [4]. This is why the concept of sustainable development in the context of the £5C agenda has become a social paradigm, and the activities of business structures to minimize the impact on the climate is of great importance not only for the companies themselves, but also for society and nature as a whole.

Understandably, states do not want to burden businesses with additional cash payments that reduce the ability of companies to finance investments and develop new industries, and create

jobs. However, if we take into account the preferences of retail consumers, as well as the focus on exporting a significant part of the production capacity of enterprises in the fuel and energy, metallurgical, chemical, agricultural complexes of the country and the restrictions imposed by other countries on the "carbon footprint" of the products they import, businesses are forced to take these circumstances into account, and they cannot abstract themselves from the global trend towards greening production. Even if companies do not incur losses from the carbon tax when producing and selling goods, they will feel the negative consequences of its full introduction when exporting due to a decrease in profits. For example, the consulting company KPMG estimates the annual additional financial burden on the CIS export territory during the implementation of the European Green Deal project in the period 2020-2030 at 9-11 billion euros [2].

It is advisable to consider that state support for the development of environmentally friendly production cannot last long. As a rule, it is provided at the stage of the beginning of consumption of the corresponding product in order to create motivation among consumers. But when the scale of production increases, the cost of production accordingly decreases to a level acceptable for business and the opportunity arises to sell such a product at market prices, such support is minimized or completely canceled, as, for example, this happens in China with respect to state subsidies for electric cars, wind and solar power plants.

Another type of risk associated with natural changes and cataclysms is the disruption of logistics chains, which reduces the reliability of the existing system of raw materials and supplies of a global nature, which forces consumers to look for local alternatives. The international supply system has developed as a result of the deepening of the international division of labor, which has significantly increased the specialization of enterprises in the production of one type of product, ensuring the maximum reduction in the cost of goods with the maximum volume of production, which allows for its automation. At the same time, the concentration of production in one or several places of the supplier of goods for the entire global market increases the dependence of consumers on both the well-being of the supplier and the state of the routes for the delivery of goods. The growth of the production of goods in one place leads to an increase in the volume of its transportation, which pushes logistics companies to increase the volume of one-time transportation by increasing the carrying capacity of ships to reduce the cost of transportation of one container. As a result, the global transport infrastructure is in some cases not always ready for such changes: for example, when the 400-meter container ship Ever Given ran aground in the Suez Canal in the spring of 2021, the concept of ensuring reliability of supply and the practice of working on the move to minimize warehousing and reduce the working capital of the customer of such goods required a serious rethinking [3].

The absence of goods means the inability of production to generate profit, which poses a much greater threat to the company than saving on the price of goods produced by a highly specialized company and on the cost of their transportation. As a result, there will obviously be a diversification of production locations for raw materials and materials and their delivery routes, even at the expense of price, but to increase the reliability of the delivery of the goods

themselves, including by reducing the risk of delivery disruption due to weather anomalies, which will ensure both the fulfillment of obligations to customers and the generation of planned profits.

The impact of ESG policy on banks' profitability can be seen using the example of Uzpromstroybank. The international rating agency Sustainable Fitch assigned Uzpromstroybank an ESG rating of "3" with a total score of 59, noting that the bank actively implements the principles of environmental, social and governance policies to ensure sustainable development. As noted in the agency's report, in recent years the bank has paid special attention to financing "green" projects aimed at protecting the environment. Work is also ongoing to support inclusivity and ensure equal opportunities in the system, as well as to bring corporate governance practices in line with international standards. In particular, bank loans are directed to projects in the field of energy efficiency, rational use of renewable energy sources and environmentally friendly transport. Thus, it is planned that the share of "green" loans in the bank's loan portfolio will increase to 30% by 2030. Fitch's sustainability report particularly highlights the bank's commitment to the principles of equality and inclusion in the social sphere, provision of favorable working conditions, fair wages and employee satisfaction within the system. "Corporate governance in the banking system is characterized by transparency, clear separation of powers between management bodies and compliance with international standards. This ensures a high level of control and decision-making, and strengthens the trust of clients and partners," the agency concluded. Overall, the agency confirmed that with the ESG rating, the bank strives for economic development that combines social and environmental responsibility. Thus, ESG ratings are assessed by agencies on a scale from 1 to 5, where 1 is the highest score.

Banks, being an important structural component of the economy, cannot but respond to society's requests for sustainable development. At the same time, as commercial organizations responsible for preserving and increasing temporarily free funds that the population and businesses have placed with them, banks are forced to take an extremely balanced approach to accepting the above risks. Banks cannot afford to stop lending to enterprises in all industries that de facto pollute the environment since their products are in demand by society, and they are financially efficient, i.e. reliable borrowers who bring income to banks. At the same time, companies that produce environmentally friendly products and are not always able to make a profit over a long period or their financial well-being is based on government subsidies, or companies using renewable energy sources and exposed to the threat of extreme weather conditions can hardly be characterized as solid borrowers. In these circumstances, banks will integrate ESG risks into their traditional risk management systems (credit, operational, liquidity) to navigate between the expected increase in regulatory pressure on loan collateral: the Basel Committee on Banking Supervision of the Bank for International Settlements in its report on the impact of climate-related financial risks on the banking system in April 2021 indicated its intention to determine the need to clarify the regulation of banks, in particular capital requirements, in light of the long-term nature and unpredictability of climate change [4] and the desire to reduce these risks by providing loans to traditional borrowers to reduce

damage to the environment and looking for opportunities to earn money on credit support for new, environmentally friendly industries. If the problem of accounting for the unpredictability of climate change for companies using traditional technologies can be solved by banks by introducing into the financial analysis the emerging quantitative indicator of risk assessment in the form of the price of greenhouse emissions, hoping for gradual climate change, then for environmentally friendly enterprises, although the sale of greenhouse quotas they receive helps to solve the problem of financial efficiency, does not solve the problem of how to assess the level of their vulnerability to climate deterioration, which destroys their ability to reliably generate electricity, for example, from the limited rare earth elements used in the production of equipment for environmentally friendly production. Banks are still forced to assess risks in these cases only within the framework of qualitative and scenario parameters, and upon reaching financial payback - without state or non-market subsidies. The objectively necessary trend towards sustainable development significantly complicates the work of banking institutions, primarily in their credit policy concerning manufacturing companies, the income from servicing which makes up about a third of the total revenue of the global banking industry. Banks are not able to change the work of borrowers themselves, but can only encourage their movement towards sustainable development with their loans.

Support for "green" projects has its risks, as well as lending to companies that are not yet environmentally friendly, the refusal of which can cause irreparable damage to the financial stability and reliability of the banks themselves. Such a result is not acceptable for society, the banks themselves, and their shareholders. As a result, banks will take into account ESG risks, quantitative assessment tools that have begun to appear, to facilitate the achievement of carbon neutrality by the projects they finance and the countries in which they operate, providing debt support to both traditional enterprises and environmentally friendly organizations to create conditions for sustainable economic development, because strategically, the development of corporate clients of banks in accordance with ESG principles will have a positive impact on the financial results and stability of the banks themselves.

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