

THE IMPORTANCE OF ESG IN BANKING THROUGH AND AFTER COVID 19 IN N. MACEDONIA

Abstract: Environmental, Social and Governance practices have gained an increasingly high profile in the recent years. The social aspect and its increasing role has been amplified in the period of pandemic of COVID-19, with banks playing a critically important role in providing essential support to customers and businesses as well as protecting their staff.

The pandemic has highlighted the relevance of existing social challenges: access to healthcare, financial security, financial inclusion, and issues of social justice and equality.

Therefore, the main purpose of this paper is to better understand the role of the banks in performing the ESG activities regarding social aspects, as well as to explore other future challenges and expectations for the banks. The case of Macedonian banks activities during the Covid 19 pandemic and the challenges that they will face in the future is presented as a support of the research. The banks in North Macedonia contributed in a large scale to the social efforts to overcome the problems and challenges imposed by the pandemic.

Keywords: banks, ESG, social, sustainable, pandemic

JEL Classification: G30, G32, G21, M14, Q01

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Introduction

Environmental, Social and Governance (ESG) practices have gained an increasingly high profile in the recent years. The transformation of the Corporate Social Responsibility activities into wider area covering environmental and governance issues, kept the social aspect and its increasing role. This has been amplified in the period of pandemic of COVID-19, with banks playing a critically important role in providing essential support to customers and businesses as well as protecting their staff.

As financial intermediaries banks play important role in society. Thus they help in the development of the sustainable economies and their success is intrinsically intertwined with the long term prosperity of the society they serve. Only society based on empowered people building better future, inclusive society that uses its natural resources in sustainable manner and customers trusting the banks can achieve prosperity on the long run.

Having in mind the differences appearing in economic, gender and literacy inequality, as well as the striking environmental issues it is of utmost importance that any contributor, including the banks bears the share of future measures and actions. In the same time the governance is of no lesser importance as all the other activities in ESG arena should be aligned with good corporate governance with adequate stakeholders support. It is considered that an integrated ESG strategy will be a key to any financial institution, all components of ESG will be essential, the environmental and climate change agenda will come strongly into focus. The behavior is considered to be of utmost importance taking into consideration how organizations acted during the pandemic, that will have huge influence for how customers, stakeholders, investors, employees judge them long into the future and banks that don't pursue a ESG agenda could have severe consequences on the long run.

Banks are highly regulated institutions, with operations under supervision of numerous regulators, with inherent risks in all banking activities and the adequate governance of the banks is an important factor of their success.

In achieving their goals for ESG compliance banks have to align their business strategy to be consistent with individuals' need and society goals, especially Sustainable Development Goals (SDGs). Providing their services to customers banks have to work responsibly and to encourage sustainable practices by their customers, thus enabling economic activities that create shared prosperity.

Through interviews, data collection and other available sources the research will cover a range of different activities as well as significant number of bank's direct financial contribution to the community.

Regarding the future challenges that the banks in North Macedonia will face after the pandemic in the area of ESG, the most important aspects of reporting as mandatory obligation through the listing, EU directives concerning banking groups' members and other investor related issues will be elaborated.

1. THE IMPORTANCE OF ESG

1.1 The importance of social component of the ESG concept

There is no doubt that there is a need for investment in social sustainability and that COVID 19 pandemic gave an example of importance of active role of different parties in the Traditional ways of financing social welfare, such as government spending and stable systems of social security, remain fundamental. However, policymakers realize that private investments also have a role to play. Practically speaking, this means that investors should prevent any social harm from being done by insisting that companies implement systems to ensure human rights are respected. It also means that investors should help improve the provision of basic goods and services, especially for vulnerable people and groups.

The resulting lack of funding for social needs has been aggravated to a considerable extent by the COVID-19 pandemic. According to the World Bank's 2020 Poverty and Shared Prosperity Report¹, COVID-19 is likely to have pushed between 88 and 115 million people into extreme poverty — which means living on less than \$1.90 a day — around the globe in 2020.

On the other hand, the pandemic has shown that private investment can be crucial for social progress: it was private investment coupled with government support that enabled companies to conduct the medical research that in turn made it possible to develop a vaccine against COVID-19.

¹ Poverty and Shared Prosperity 2020, Washington, DC; World Bank Group, 2020

1.2 The Role of Banks in ESG practices

Acknowledging the important role that banks have in the financial mediation, as well as their support in economic growth, through support to the businesses and retail, it is inevitable to put the banks in the middle of the challenges in environmental and social issues and response by all the related parties. As highly regulated sector as well as shareholding companies listed on the stock exchanges, banks have unique position to be mediator between the problems and the solutions in area of ESG and through transparent reporting in that regard to spread the word of the action needed.

The main framework for banks activities in the area of ESG can be found in the UNEP Principles for Responsible Banking, that are aligning the banks with the main society's goals presented in the Sustainable Development Goals(SDGs) and the Paris Climate Agreement. These principles are to be accepted as footprint for responsible banking and their aim is to provide main guidance how to that. ²

Having in mind that in the recent years the banks have lost a great deal of public sympathy and have suffered a lot due to 2008 financial crisis, it is of utmost importance to rebuild trust and to increase engagement with clients, customers and employees.

1.3 The social aspects of responsible banking

The principle of responsible banking largely covers the area of social dimension of banking. The aim of this principle is to introduce on a large scale the support of the bank to its clients for reducing negative and increasing positive impact of adopting new technologies, business models and practices in providing them with better and fairer banking activities. This is especially relevant not just for increasing customer satisfaction, but for improving banks reputation, decreasing risk exposure in that regard and ultimately to influence the investors choices.

In line with all the previously mentioned the banks have to develop strategies to support sustainable behavior, consumption choices among its retail customers, new products and services or sustainability related incentives including contractual conditionality. In order to achieve that banks have to do their most to ensure that retail customers have knowledge and skills to

² Principles for Responsible Banking, UNEP Finance Initiative, Geneva, 2021

effectively manage their finances and to offer financial literacy programs and support.

On the road to set a social taxonomy³ in area of ESG it is important to include the following task: to describe the provisions that would be required to extend the scope of the Taxonomy Regulation beyond environmentally sustainable economic activities to cover other sustainability objectives, such as social objectives; to identify social objectives related to ‘employee, health, human rights, equality and nondiscrimination matters’; to suggest approaches for developing substantial contribution criteria and how not to do significant harm; to give some initial consideration to the merits of identifying economic activities that significantly harm social sustainability (‘significant harm social taxonomy’); to consider other objectives that could be covered, such as objectives linked to business ethics, governance, anti-bribery or tax compliance matters, as well as discussing the merits of covering those objectives. It is also necessary to take into consideration on the overall relationship between the social and environmental taxonomies, including potential overlaps.

Being focused on the environmental agenda it is important to put the social taxonomy to other relevant EU legislation, including the Corporate Sustainability Reporting Directive (CSRD) and the Sustainable Finance Disclosure Regulation (SFDR).

Further, when considering these international principles and standards from the perspective of a social taxonomy, their usage can be divided into two dimensions. On the one hand they define the benchmark for processes integrated in economic entities to avoid and address negative impacts on human rights. On the other hand, they provide a definition of what constitutes relevant contributions by business to fulfilling economic and social rights like providing certain products and services that can contribute to the fulfilment of the right to an adequate standard of living.

Respect and support for human rights could be called the horizontal dimension of a social taxonomy, since their implementation involves processes that need to be horizontally integrated into an economic entity to obtain positive outcomes for affected stakeholders. Products and services essential for adequate living conditions could on the other hand be called the vertical dimension of a social taxonomy, as they concern products and services of an economic entity and can be related to economic activities.

³ Draft Report by Subgroup 4: Social Taxonomy, European Commission, 2021

Apart from these aspects, the governance of economic entities should be considered, again meaning processes integrated into economic activities that can enable positive social outcomes. Relevant international instruments here include the UN Convention against Corruption, the EU Convention against Corruption involving Public Officials, the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the OECD Guidelines for Multinational Enterprises.

When we connect these dimensions with banking activities, we can see that the principles for responsible banking are significantly aligned with the objectives of social taxonomy.

If we take these principles as a starting point we can go in more elaborated explanation of the role of banks in improving the social needs.

According the first principle for **Alignment**⁴ the banks are expected to align their business strategy to be consistent with and contribute to individuals' needs and society's goals, as expressed in the Sustainable Development Goals, the Paris Climate Agreement and relevant national and regional frameworks.

Strategic alignment is focused on bank's business strategy towards being consistent with, and contributing to, the Sustainable Development Goals (SDGs), the Paris Climate Agreement and other relevant national, regional or international frameworks, such as the UN Guiding Principles on Business and Human Rights, where a bank is best positioned to do so through its business. These frameworks articulate globally agreed goals and challenges for building a more sustainable future. By aligning its strategy with society's goals, the bank shows that its business, and the products and services it provides, can support a sustainable future while achieving long-term business benefits. It signals that the bank accepts its shared responsibility for shaping and securing our future.

The second principle concerns the **Impact and Target Setting** and refers to continuously increase the positive impacts while reducing the negative impacts on, and managing the risks to, people and environment resulting from our activities, products and services.

In order to put this purpose into practice, banks need to identify, assess and improve the impact on people and environment resulting from their activities, products and services. If the banks want to increase positive impact while reducing negative impact on people and environment, they need to incorporate assessment of impacts on all three dimensions of sustainability (environmen-

⁴ Principles for Responsible Banking, UNEP Finance Initiative, Geneva, 2021

tal, social and economic) into business decision-making at strategic, portfolio and transaction levels. Further on, in order to achieve that the banks need to set targets as an essential component to scaling up banks' contributions to society's goals.

One of the most important principles in terms of treatment of clients and supporting social issues is the third principle regarding the **Clients and Customers**. According to this principle the banks are expected to work responsibly with their clients and customers to encourage sustainable practices and enable economic activities that create shared prosperity for current and future generations. If this is transposed to retail segment as one of the most vulnerable in respect to the social issues, this means that the banks activities should be focused to identify where a bank could encourage and support sustainable behavior and consumption choices., to map bank's retail customers, and for each major segment, identifying the existing and potential sustainability-related behaviors and actions where a bank can provide support and/or incentives. It also considers identifying retail customer segments with low financial literacy, and potential retail customer segments that are under-served by banks. Based on this analysis of retail customers bank should develop a strategy and identify steps to take. For example, bank can consider expanding and adapting its current offerings to the "bottom of the pyramid" through loans acceptable for low income individuals, low-cost savings products and transactional services.

Having in mind that there is a common consensus that there is a low level of literacy among the retail customers, the bank should help retail customers acquire the knowledge and skills to effectively manage their finances, e.g. through financial literacy programs. Your bank can consider working with customer advocacy organizations on such programs.

In regard to the third principle that is concerning the connection with **Stakeholders**, the banks are expected to proactively and responsibly consult, engage and partner with relevant stakeholders to achieve society's goals. The best explanation in regard to social component can be found in the model of establishing partnerships with third-parties, to deliver solutions for sustainable production and consumption beyond your bank's current customer and client base. Such partnership can be found in cooperation with technology providers and FinTech firms to provide digital technology for new solutions that contribute to financial inclusion, greater access to credit and improved data security. These partnerships can be with firms that provide sustainability-related products and services, social entrepreneurs who drive social innovation to meet society's goals.

The Fifth principle speaks about the **Culture and Governance** in the banks, as well as the requirements set out in the important Policy documents.

According to this principle the banks are required to develop governance structures that enable and support effective implementation of all six principles, including an appropriate structures, policies and processes in place to manage important impacts and risks, and to enable to achieve targets. For the reporting purposes the banks are required to disclose measures implemented to foster a culture of responsible banking among its employees. A major European bank measures the share of its lending portfolio that strictly contributes to at least one of the 17 SDGs among which is a number of individuals that have benefited from a financial education session provided by that particular banking group.

The last, sixth principle **Transparency and Accountability** refers to bank's accountability to their employees, investors and society as a whole, a public disclosure of the achievements which ultimately enables internal and external stakeholders to assess contribution to society and the progress the bank is making. On the other hand the transparency and reporting helps build confidence in bank's sustainability-related commitments and helps to distinguish the bank from its competitors. This also increases the bank's potential for success in achieving the targets, ensuring the effectiveness of the approach, motivating employees, competing with peers, driving innovation.

2. RESEARCH OF ESG CONDUCT IN THE MACEDONIAN BANKS DURING COVID 19 PANDEMIC WITH EMPHASIS OF THE SOCIAL COMPONENT

2.1. Methodology

The banks in North Macedonia contributed in a large scale to the social efforts to overcome the problems and challenges imposed by the pandemic. The activities undertaken by the banks for financial support of different areas and forbearance measures that banks have put in place during the pandemic have been a fundamentally important aspect of enabling industries and communities to overcome the difficulties imposed by the pandemic. The research was conducted through:

- A Questionnaire answered by the banks regarding the social issues:

- All the banks (13) operating in N. Macedonia, were involved in the questionnaire;
- The issues of the social component such as employment rights, equal salary, gender equality etc. were not observed as irrelevant for the covid19 influence on the bank's behavior in the time of pandemic
- Other available data, mostly official data from the National bank of the Republic of North Macedonia (NBRNM)⁵, were used in the research
- Specific activities of the Development Bank of NM are not taken into consideration under this research, as they are part of Government Support Program

The questionnaire covered most important topics regarding the bank's involvement in help for the clients and community in time of Covid 19.

Having in mind the utmost importance of protecting the pensioners when collecting their pensions, the banks agreed that they will contribute that way that they will pay the pensions few days in advance in order to reorganize the groups of pensioners each day to provide physical proximity protecting their health. The last group will be paid on the first day of regular payment, so that the pensioners are receiving money on timely manner. That was a cost for the banks knowing Pension and Disability Insurance Fund of N. Macedonia will transfer the funds few days later that the payments.

2.2 Results

On the question "Did you pay in advance the monthly pensions" all the banks participating in the payments answered YES. In the past pandemic period and continuing onward, the banks credited the Government for this purpose around

In order to support the numerous Government programs focused on deploying funds for different kind of support of companies and individuals in time of pandemic, some of the banks did advance payment of the corporate tax for the year 2020. On the question 'Did you pay in advance the corporate tax for year 2020 and in what amount', 5 banks answered YES and amount reported was more than 3,8 million EUR , although not all of them gave precise answer.

⁵ <https://www.nbrm.mk/>

Table 1. Answers to the first question of the questionnaire

Did you pay in advance the corporate tax for year 2020	Out of 13
YES	5
NO	8

Source: Authors calculations

During the pandemic there was a government project for issuing domestic payment cards for buying domestic products (domestically produced goods and services, for support of companies) and social venerable individuals were eligible for the cards. That was a project that has almost none economic benefit for the banks, but they participate in it in order to support the community. There were more than 250.000 cards issued in less than 10 days.

Table 2 Answers to the second question of the questionnaire

Did you participate in DPC project	Out of 13
YES	8
NO	5

Source: Authors calculations

On the same manner there was a project for payment of financial support through the same category of citizens and most of the banks participated.

Table 3 Answers to the third question of the questionnaire

Did you participate in project for payment of social benefit	Out of 13
YES	11
NO	2

Source: Authors calculations

One of the biggest problems during pandemic period was a pressure on the health system, both in financial and products terms. The banks donated more than 220.000 euro for that purpose, both in financial help and in equipment.

Table 4 Answers to the fourth question of the questionnaire

Did you donate for medical purposes during Covid 19	Out of 13
YES	7
NO	6

Source: Authors calculations

Another problem that surfaced during the pandemic and remote activities introduced in that period was a lack of computers among children, especially in social vulnerable families that could not follow the lectures. For that purpose a lot of institutions contributed through donations of laptops for these pupils. The banks were among the once participating.

Table 5 Answers to the fifth question of the questionnaire

Did you donate for laptops to pupils during the pandemic	Out of 13
YES	7
NO	6

Source: Authors calculations

Having in mind the importance of the physical proximity for protecting people for the spread of Covid 19 a lot of activities for increasing physical distance were introduced. In order to discourage clients to come in the banks premises, banks canceled the payment of fees and commissions connected to e-payment services.

Table 6 Answers to the sixth question of the questionnaire

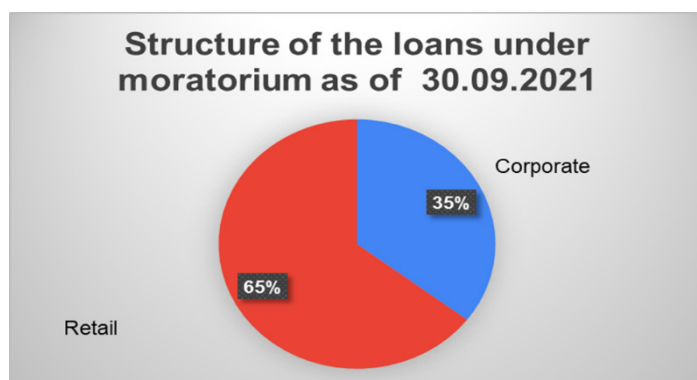
Did you cancel payment of fees and commissions for e-payments	Out of 13
YES	8
NO	5

Source: Authors calculations

The forbearance measures that banks have put in place during the pandemic have been a fundamentally important aspect of enabling industries and communities to overcome the difficulties imposed by the pandemic.

The total amount of the loans under moratorium, prolonged servicing of credit exposures amounted 147 billion denars, predominantly granted in retail sector.

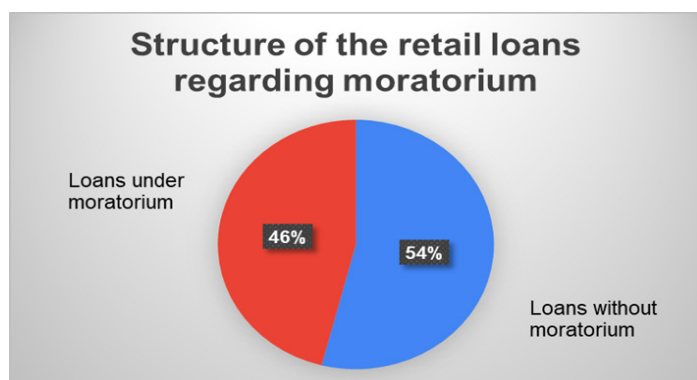
Figure 1 Structure of the loans under moratorium as of 30.09.2021



Source: Authors calculations

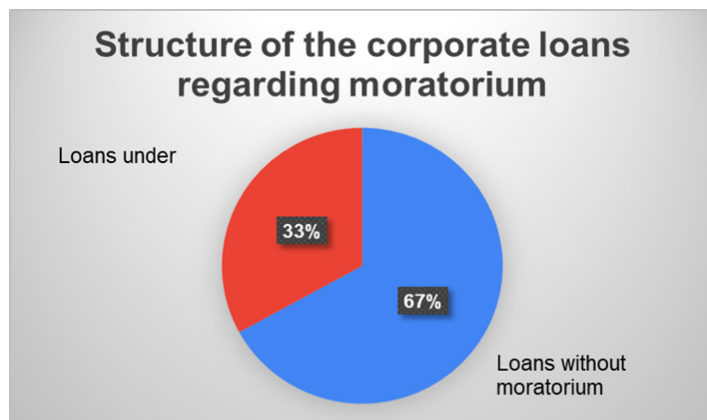
Comparison of the sectorial structure of the loans under moratorium, underlying the vulnerability of the individuals/ retail.

Figure 2 Structure of the retail loans under moratorium as of 30.09.2021



Source: Authors calculations

Figure 3 Structure of the corporate loans under moratorium as of 30.09.2021



Source: Authors calculations

2.3 What is next?

Out of 13 banks, 7 banks are listed on the Macedonian Stock Exchange. As such they will have a mandatory reporting obligation under the Corporate Governance Code for Companies listed on the Macedonian Stock Exchange.

With the new Code⁶ under Section 6: Stakeholders, Sustainability and Social issues certain demands regarding the compliance are expected. So, the banks listed have to report about the compliance with the principles set or to explain the reasons for not being in compliance. According this section it is expected that The Supervisory and Management Boards of the banks shall cultivate a corporate culture that encourages a responsible attitude towards the environment and social issues; approve a strategy to promote sustainability; and ensure that its business model and risk management systems take account of the potential environmental and social impact of its activities.

It is also expected that the banks shall have internal acts relating to its responsibilities for environmental and social issues and policies and procedures that enable it to identify material factors and assess the impact on the company's activities. These policies shall be reviewed at least annually by the

⁶ Corporate Governance Code for Companies Listed on the Macedonian Stock Exchange, Macedonian Stock Exchange, Skopje, 2021

Supervisory and Management Boards, and shall be published on the company's website.

Conclusion

Based on the research we can conclude that the banks in North Macedonia are very active in addressing social problems within their scope of activities and their contribution in time of pandemic was big and important for the community, both in financial and in activities terms.

So, if we go back to the last Principle of responsible banking which is dealing with the response of the banks with the speed and scale necessary to address global challenges, as well as requirements for leadership, buy-in and active support of the Board of Directors, the CEO, and senior and middle management we can see that the banks in North Macedonia are in right path. We strongly believe that by complying with the Code they will be in a position to establish a business culture and practice in which all employees will understand their role in delivering the bank's purpose and integrate sustainability in their work and their decision-making.

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