strategy&
Part of the PwC network

Achieving environmental, social, and governance impact

The business agenda of the future for GCC banks

Contacts

Abu Dhabi

Aurelien Vincent
Partner
+971-2-699-2400
aurelien.vincent
@strategyand.pwc.com

Dubai

Jorge Camarate
Partner
+971-4-436-3000
jorge.camarate
@strategyand.ae.pwc.com

Beirut

Dr. Yahya Anouti
Partner
+961-1-985-655
yahya.anouti
@strategyand.ae.pwc.com

About the authors

Dr. Yahya Anouti is a partner with Strategy& Middle East, part of the PwC network. Based in Beirut, he is a member of the energy, chemicals, and utilities practice in the Middle East. He leads Strategy& Middle East's efforts on environmental, social, and governance (ESG) work. He specializes in resource-based sustainable development and energy-related strategies, and supports governments, national oil companies, international oil companies, and utilities in Asia, Africa, Europe, the Middle East, and the United States.

Jorge Camarate is a partner with Strategy& Middle East. Based in Dubai, he leads the financial services practice in the Middle East. He has over 15 years of strategy consulting experience in business strategy and operating model design for universal banks and life insurance companies. He specializes in retail and commercial banking, private banking and wealth management, and life insurance.

Aurelien Vincent is a partner with Strategy& Middle East. Based in Dubai, he is a member of the financial services practice in the Middle East. An expert on ESG, he has a decade of strategy consulting experience in organization, transformation, risk, and postmerger integration. He has worked with an array of clients including banks, funds, regulators, and development finance institutions in Western Europe and the Middle East.

Adrien Concordel, Yasma Haddad, and Dima Sayess also contributed to this report.

EXECUTIVE SUMMARY

The concept of environmental, social, and governance (ESG) issues is well known in the Gulf Cooperation Council (GCC)[1] countries, which are engaged in an ambitious transition toward more sustainable economies. Still, the concept has yet to register sufficient impact in the GCC banking sector despite substantial increases in ESG reporting and awareness of the related benefits for the environment and society. For GCC banks, ESG awareness represents a business opportunity that can improve the bottom line and that will require significant investments by businesses across industries.

GCC banks, like their global peers, are experiencing growing pressure from stakeholders such as regulators, employees, investors, and customers to increase their ESG activity. ESG lending could include supporting the development of renewable energy assets and the reduction of emissions, enabling the circular economy or using ESG principles to reduce greenhouse gas (GHG) emissions and operating costs, for example, by cutting back on business travel.

To grasp the ESG opportunity, GCC banks can move quickly to incorporate ESG principles into their business strategy and create the necessary structural changes in their operating models to pursue these new strategies and capture value. To embed ESG issues into a winning business strategy, GCC banks can adopt a four-point plan:

1. Baseline the existing business and operating model, and stakeholders' expectations (including current and future needs/requests from customers, investors, and employees)

2. Define a target for ESG aspirations and strategic initiatives to reach it, and quantify the economic impact of ESG initiatives

3. Adopt policies and integrate sustainability into the business strategy in a consistent manner

4. Develop a road map for each initiative and report externally and internally on the ESG agenda

GETTING A HANDLE ON ESG

The 26th United Nations Climate Change Conference (COP26) concluded in November 2021 amid considerable urgency about the need to take action against climate change. GCC governments have announced their participation, with the United Arab Emirates (UAE) committed to net-zero emissions by 2050, and Bahrain and Saudi Arabia aiming for net-zero by 2060. Greater attention to ESG issues is part of the effort made in response to climate change globally.

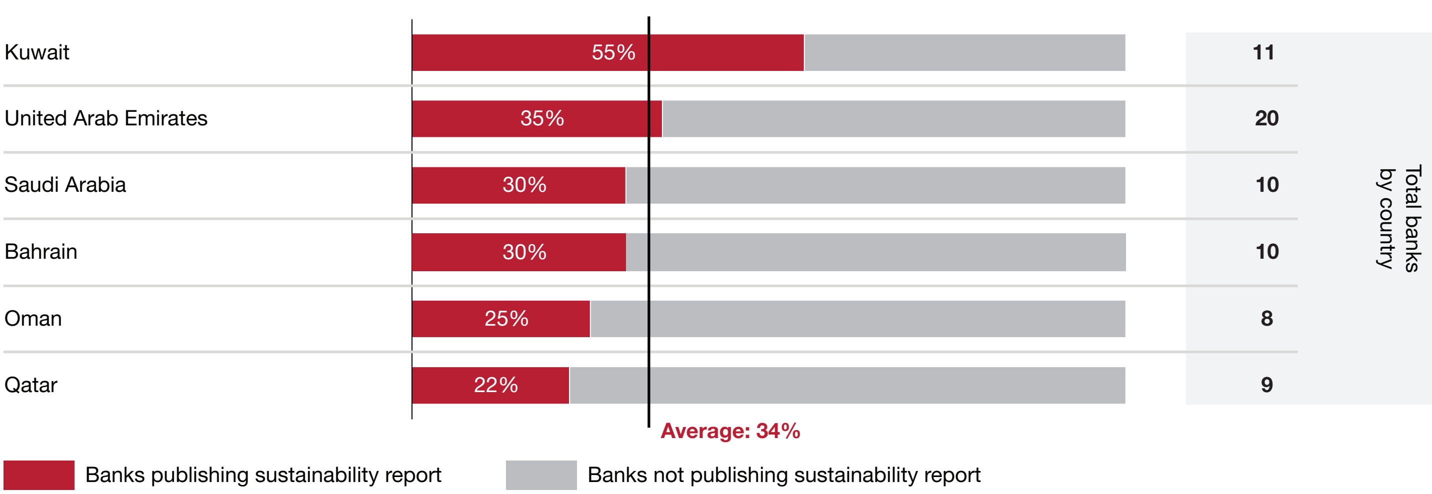
Although the concept of environmental, social, and governance (ESG) issues is well known in the GCC countries, which are engaged in an ambitious energy transition toward a sustainable energy system, it has not yet had sufficient impact among GCC banks.

In the GCC, banks too often confine ESG efforts to reporting. In that area, GCC banks have improved considerably compared with a few years ago. One-third of GCC banks now publish a sustainability or ESG report, versus none five years ago (*see Exhibit 1*).

However, GCC banks can do more. GCC banks can now build on that important first step. ESG is about more than reporting, more than doing good for the environment or even for society. It is also a business opportunity, because ESG initiatives require significant investments by businesses across industries and offer opportunities to reduce costs, increase productivity (e.g., by motivating staff), increase the top line through new customer acquisition, and increase revenues from ESG-sensitive customers. By leading on ESG issues, banks can generate ESG and bottom-line impact.

EXHIBIT 1

GCC banks' ESG reporting has increased from almost zero five years ago
(2020)



Note: Available data. Sample represents 80% of all banks.
Source: Strategy& analysis

WHY ESG MATTERS NOW

The ESG business opportunity has emerged as more corporate leaders and consumers accept the importance of embracing ESG's core dimensions — and are making it a priority to do so. Additionally, ESG-related investments are becoming more widespread because they consistently deliver solid returns.

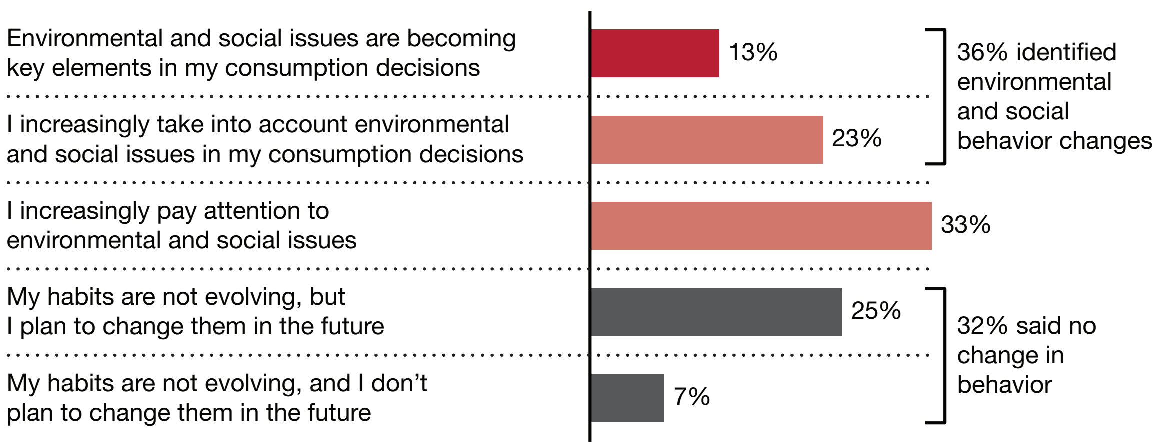
There has been a marked and swift change in attitude among business leaders across industries. According to a 2021 PwC survey conducted in Brazil, Germany, India, the U.K., and the U.S., 92 percent of business leaders believe companies that commit to ESG policies will outlast competitors that do not.[2] A total of 87 percent of business leaders name improving ESG performance as one of their organization's core strategic objectives, according to PwC's 24th Annual Global CEO Survey. Sixty-five percent are planning more ESG investments in the next two years.[3]

One major reason that corporate leaders care is that their customers care. Increasingly, customers are basing more of their purchasing decisions on a company's ESG performance. For example, we conducted a survey in Saudi Arabia and the UAE of 1,000 consumers in 2021 and found that 36 percent of respondents are already basing some of their purchasing decisions on a company's ESG performance (*see Exhibit 2*).

EXHIBIT 2

ESG awareness is growing in the GCC

Changes in respondents' behaviors



Note: Survey covered over 1,000 customers in Saudi Arabia and the United Arab Emirates across 10 industries.
Source: Strategy&

Adding to the ESG momentum is investment performance. ESG indices have often performed similarly to, if not better than, their parent indices and had lower volatility. Overall, global sustainable investment assets grew from US$13.3 trillion in 2012 to $40.5 trillion in 2020, with shares of global professionally managed assets increasing from 21 percent to 35 percent during that time frame.[4] In 2020, the Dubai Financial Market launched its first ESG index.[5] The value of green bonds issued in 2020 in the Middle East was almost twice that of those placed in 2014.[6] Similarly, in 2020 the Saudi Electricity Company placed the first green bond that was compliant with Islamic law (sharia) in international markets.[7]

> One major reason that corporate leaders care is that their customers care

ESG ADOPTION AMONG BANKS IS GROWING, UNDER PRESSURE FROM FOUR KEY STAKEHOLDERS

Like other industries, the global banking sector is increasing its ESG activity. In part the change is a result of pressure from a variety of stakeholders: regulators, customers, employees, and investors.

- **Regulators** are pushing for mandatory ESG reporting and for the incorporation of ESG considerations into financial decisions. For instance, the Securities and Exchange Board of India has mandated ESG reporting for the top 1,000 companies by market capitalization by 2023.[8] The E.U. issued the Sustainable Finance Disclosure Regulation, which includes rules for sustainability-related financial reporting.[9] In the GCC, local regulators are partnering with the U.N.-led initiative on Sustainable Development Goals and the Sustainable Stock Exchanges initiative and launching working groups to shape future ESG regulation. As an example, the Central Bank of the United Arab Emirates has launched the Sustainable Finance Working Group along with the Abu Dhabi Global Market to establish the standards that will support the country's commitment to becoming net-zero by 2050.[10]
- **Customers** of all ages are becoming more interested in how banks tackle the ESG agenda. According to an Allianz survey in 2021, 64 percent of millennials, 54 percent of gen Xers, and 42 percent of baby boomers believe that ESG issues are important when it comes to financial investments.[11]
- **Employees** are also pushing for inclusion, diversity, and gender pay parity at banks. This ESG issue is well aligned with corporate goals because pay parity aids recruitment and gender diversity, which is associated with increased talent acquisition, employee retention, and higher productivity. According to a European Banking Authority survey for European financial institutions in 2018, financial institutions with more gender-diverse management teams had a 1.3 percentage point higher return on equity.[12]
- **Investors** are increasingly committed to sustainable investment opportunities, and many banks are already moving toward greener finance. For example, Goldman Sachs announced it is committed to "target $750 billion in financing, investing, and advisory activity" for sustainability over the next decade.[13] GCC banks are increasingly seeing international investors pulling out of Middle East investment projects on the sole basis of poor ESG performance.

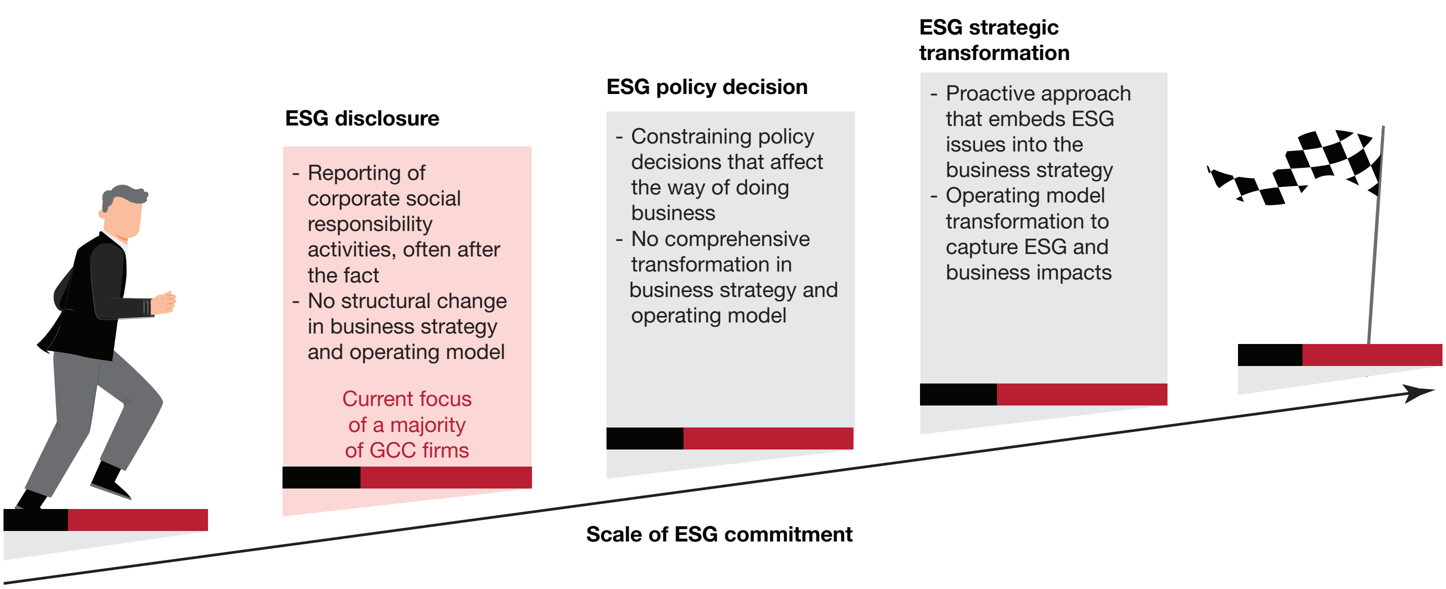
In response to these stakeholder demands, many banks are adopting strict disclosure frameworks. For example, more than 2,600 organizations have expressed their support for the recommendation of the Task Force on Climate-related Financial Disclosures (TCFD), an increase of more than 33 percent since 2020. These supporters include 1,069 financial institutions, responsible for assets of $194 trillion.[14] Also, some banks are taking bold moves beyond disclosure. For example, Morgan Stanley has cut its direct GHG emissions by 36 percent since 2006 and switched to renewable energy across all global operations.[15] Triodos Bank, which is a leading green finance house, exclusively finances sustainable enterprises and has already achieved net-zero for its own operations.[16]

GCC banks can do more

Although there is more ESG reporting among GCC banks, they tend to lag behind global counterparts on ESG issues. One reason is the GCC lacks the regulatory incentives that have driven ESG investments elsewhere, for example, tax deductions or beneficial regulatory treatment. More work can be done on the understanding and standardization of ESG in the GCC.[17] However, there are improvements. According to a 2021 PwC survey, 46 percent of CEOs in the Middle East aim to increase their investments in ESG and sustainability initiatives over the next three years.[18] GCC banks can now move quickly to embed ESG issues in their business strategy and create the necessary structural changes in their operating models to pursue these new strategies (*see Exhibit 3*). Then they can capture the value of implementing those changes, as some banks in the region have already done (*see "How one bank embedded ESG successfully into its strategy"*).

EXHIBIT 3

Moving from ESG disclosure to strategic transformation



Source: Strategy&

How one bank embedded ESG successfully into its strategy

A bank in Europe and the Middle East decided to adopt ESG principles and capture the ESG business opportunity as part of its strategy, mostly in response to its board and main shareholders' requirements. The bank operates in retail, wholesale, and business banking. It also publishes an annual sustainability report.

The management responded by establishing a baseline and embedding additional ESG initiatives in a structured manner into the business strategy. That involved:

- Assessing stakeholder expectations, including customers' expectations and incremental willingness to pay for ESG products and services, and what impact social policies such as gender equality would have on employee productivity
- Creating a baseline of the current business strategy, internal capabilities, and risk (including balance sheet exposure to climate risk)
- Analyzing the competitive landscape and ESG leading practices in banking globally and regionally

The bank then defined its ESG-related ambitions and goals, such as its target ESG rating. It prioritized ESG initiatives according to feasibility, impact, the perceptions of key stakeholders, and the effect on value creation. It translated the new ESG strategy into changes in the operating model. Finally, the bank developed a road map of initiatives and got the management team fully on board.

The results of this ESG strategy effort were targets for improvement over a five-year period of more than 20 percent in the bottom line and a drop of more than 50 percent in the carbon footprint and climate risk exposure.

HOW GCC BANKS CAN SEIZE THE ESG OPPORTUNITY

GCC banks are moving ahead on their ESG agendas because they are under pressure from stakeholders and for business reasons. Indeed, GCC banks can seize opportunities and boost their bottom line by capturing a wide array of ESG-linked initiatives. They can lend to support development of renewable energy assets and the reduction of emissions, or finance affordable housing and mortgages. Banks can also use ESG principles to reduce operating costs by, for example, reducing business travel (and hence GHG emissions) and recycling waste.

Meanwhile, they can manage risk and compliance costs more efficiently. They can achieve this by reinforcing their "know your customer" processes and compliance policies, and by integrating ESG into their risk management framework. The latter would involve identifying and quantifying climate risks associated with their loan portfolio, and by staying on top of any regulatory initiatives that might entail new ESG reporting and accountability requirements.

Pursuing ESG goals can also be a powerful way to attract and retain talent. According to the 2021 PwC Consumer Intelligence Series report on ESG issues, employees are more likely to want to work for a company that stands up for the environmental (84 percent), social (83 percent), and governance (86 percent) issues that they care about, all other things being equal.[19] The benefits of employee satisfaction include better loyalty, more innovation, and greater productivity. Meanwhile, the alternative to seizing this value is most likely experiencing value erosion across all these dimensions.

Embedding ESG into strategy

To embed ESG issues into a winning business strategy, GCC banks can adopt a four-point plan.

1. **Baseline the existing business and operating model, and stakeholders' expectations**
   It is critical for banks to understand the ESG factors material to their specific business model. For example, corporate lenders should be more concerned about climate than providers of personal banking services, for whom social and financial inclusion may represent a much greater ESG risk and opportunity. Banks should also understand the preferences of their different key stakeholders — clients, employees, investors, and regulators — and their sensibilities with respect to different initiatives. These preferences should be taken into account when choosing ESG initiatives to maximize the business impact.

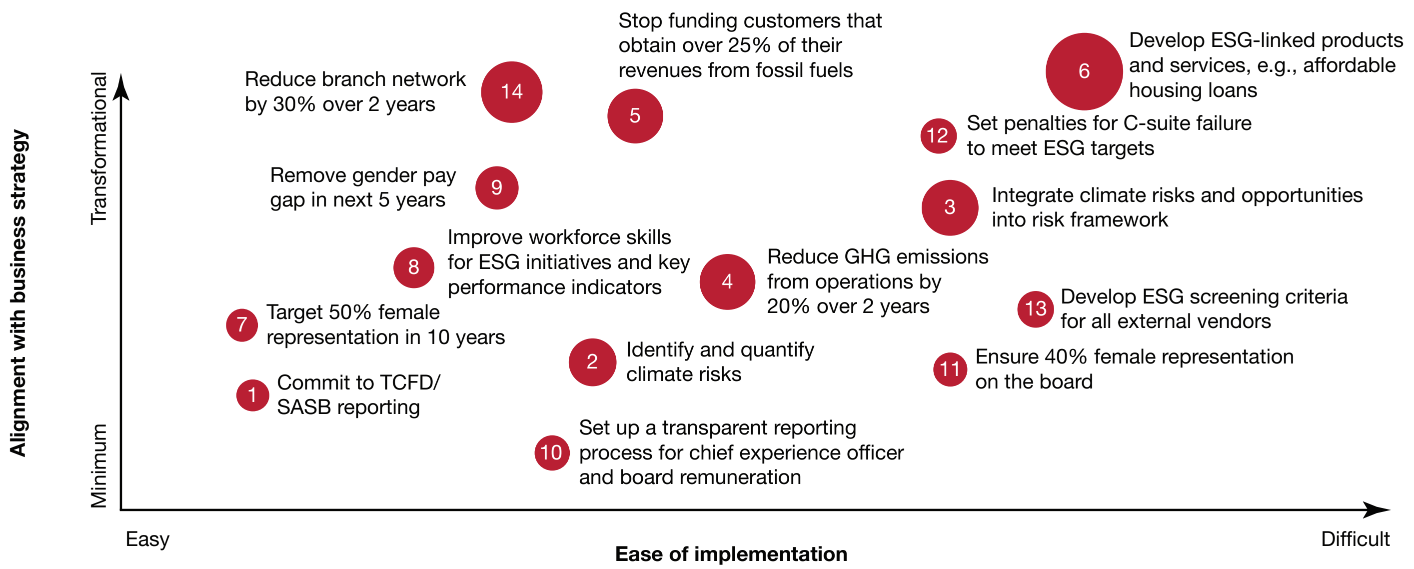
   Banks can use a comprehensive framework to use in assessing these choices. The framework allows banks to go beyond the correlation between strong ESG standards and overperformance, and to spot root causes. Using this framework, banks can grasp the potential impact of ESG on their business. The framework also helps banks as they take the four steps that embed ESG in their strategy.

2. **Define a target for ESG aspirations and quantify the ESG impact**
   Banks then should look beyond the often-daunting costs and constraints imposed by ESG initiatives and think concretely about how ESG will improve their performance. They should not rely on mere perceptions of value. Instead, they should quantify the likely economic impact of ESG activities and reprioritize resource-consuming initiatives, thereby achieving higher returns. Expertise is critical if they are to develop accurate and relevant economic estimates, and to understand how consumers will value ESG perception. This expertise then allows banks to assess the likelihood for the ESG initiative to translate into a tangible financial benefit for banks. Then banks should set ESG targets that reflect their ambitions.
3. **Adopt policies and integrate sustainability into the overall strategy in a consistent manner**
   Banks should embed ESG opportunities into the overall business strategy and operating model. They should identify and prioritize the necessary changes in their business and operating model to capture the most promising ESG and business opportunities. Banks should prioritize changes on the basis of how well ESG initiatives align with their business strategy and the ease of implementation (*see Exhibit 4*).
4. **Develop a road map for each initiative and reporting on the ESG agenda**
   Finally, banks should develop a road map for each initiative (priority, time line, ownership, etc.), with management fully on board for the implementation plan. Some initiatives will have a short-term focus (e.g., those driven by regulatory time lines), and others may require a multiyear, phased approach.

Banks should communicate with stakeholders and update them on a timely basis throughout the implementation process. Communication should improve, as it will have to bridge the gap between historical ways of measuring performance and new, longer-term ESG concepts. One approach is to adopt the principles of the International Integrated Reporting Framework[20] to bring together the financial and ESG information most material to the business strategy and value creation. Using these integrated reporting principles can demonstrate to stakeholders how ESG initiatives and company financials connect.

EXHIBIT 4

Building a portfolio of business value–adding ESG initiatives



Note: Size of bubble = business impact, ESG = Environmental, social, and governance, GHG = greenhouse gas, SASB = Sustainability Accounting Standards Board, TCFD = Task Force on Climate-related Financial Disclosures.
Source: Strategy&

CONCLUSION

In an environment of urgency over climate change, GCC countries are accelerating their diversification away from fossil fuels, and are increasing attention to ESG issues. GCC banks have a vital role to play in these national efforts. Banks can contribute to ambitious national net-zero goals by demonstrating leadership on ESG, while seizing the business opportunities that ESG concerns create and improving their bottom line.

ENDNOTES

1. The GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.
2. PwC, "Beyond compliance: Consumers and employees want business to do more on ESG: How business can close the expectations gap," 2021 (www.pwc.com/us/en/services/consulting/library/consumer-intelligence-series/consumer-and-employee-esg-expectations.html).
3. PwC 24th Annual Global CEO Survey, "A leadership agenda to take on tomorrow," 2021 (www.pwc.com/gx/en/ceo-agenda/ceosurvey/2021.html).
4. Global Sustainable Investment Alliance/OPIAS Research, Global Sustainable Investment Review 2020 (www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf).
5. "Sustainability Report: Part of Dubai Financial Market (PJSC) Annual Report 2020" (www.dfm.ae/docs/default-source/dfm-documents/dfm_sustainability_report_2020_en.pdf).
6. International Finance Corporation, "Green Bond Impact Report: Financial Year 2020" (https://tinyurl.com/366nsay2).
7. Saudi Electricity Company, "Saudi Electricity Company Successfully Issues US$1.3 Billion Green Sukuk in the International Markets," September 12, 2020 (www.se.com.sa/en-us/pages/newsdetails.aspx?NId=1016).
8. Securities and Exchange Board of India, "Business responsibility and sustainability reporting by listed entities," Circular No.: SEBI/HO/CFD/CMD-2/P/CIR/2021/562, May 10, 2021 (www.sebi.gov.in/legal/circulars/may-2021/business-responsibility-and-sustainability-reporting-by-listed-entities_50096.html).
9. European Commission, "Sustainability-related disclosure in the financial services sector: What the obligations are for manufacturers of financial products and financial advisers towards end-investors: Regulation on sustainability-related disclosure in the financial services sector" (ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/sustainability-related-disclosure-financial-services-sector_en).
10. Abu Dhabi Global Market, "UAE regulators and exchanges issue High-Level Statement on Sustainable Finance to advance national net-zero goal," November 5, 2021 (www.adgm.com/media/announcements/uae-regulators-and-exchanges-issue-high-level-statement-on-sustainable-finance).
11. Allianz, "Socially Responsible Investing and ESG: It's Not Just a Millennial Trend," 2019.

12. European Banking Authority, “EBA calls for measures to ensure a more balanced composition of management bodies in institutions,” February 3, 2020 (www.eba.europa.eu/eba-calls-measures-ensure-more-balanced-composition-management-bodies-institutions).

13. David Solomon, “Goldman Sachs Update on Our 2030 Sustainable Finance Commitment: Year One Progress and New Initiatives,” March 4, 2021 (www.goldmansachs.com/media-relations/press-releases/2021/announcement-04-mar-2021.html).

14. Financial Stability Board, “2021 Status Report: Task Force on Climate-related Financial Disclosures, October 14, 2021” (www.fsb.org/2021/10/2021-status-report-task-force-on-climate-related-financial-disclosures/).

15. Morgan Stanley, “Morgan Stanley Announces New Goal of Carbon Neutrality for Global Operations by 2022,” September 20, 2017 (www.morganstanley.com/press-releases/morgan-stanley-announces-new-goal-of-carbon-neutrality-for-globa).

16. Triodos Bank, “Our vision on impact,” (www.triodos.com/vision-on-impact).

17. Gulf Bond and Sukuk Association roundtable, “Islamic Finance and ESG Investing in the Arabian Gulf Region,” in CFA Institute, Principles for Responsible Investment, “ESG Integration in Europe, the Middle East, and Africa: Markets, Practices, and Data,” 2019 (www.gulfbondsukuk.org/wp-content/uploads/2019/03/UNPRI-ESG-integration-March-2019.pdf).

18. PwC, 24th CEO Survey—Middle East findings, “Tomorrow starts today: Middle East CEOs are applying the lessons from COVID-19 to seize the growth opportunities ahead,” 2021 (www.pwc.com/m1/en/ceosurvey/2021/ceo-survey-24th-web-ver.pdf).

19. PwC, “Beyond compliance: Consumers and employees want business to do more on ESG: How business can close the expectations gap,” 2021 (www.pwc.com/us/en/services/consulting/library/consumer-intelligence-series/consumer-and-employee-esg-expectations.html).

20. Value Reporting Foundation, “International <IR> Framework” (www.integratedreporting.org/resource/international-ir-framework/).

Strategy&

Strategy& is a global strategy consulting business uniquely positioned to help deliver your best future: one that is built on differentiation from the inside out and tailored exactly to you. As part of PwC, every day we're building the winning systems that are at the heart of growth. We combine our powerful foresight with this tangible know-how, technology, and scale to help you create a better, more transformative strategy from day one.

As the only at-scale strategy business that's part of a global professional services network, we embed our strategy capabilities with frontline teams across PwC to show you where you need to go, the choices you'll need to make to get there, and how to get it right.

The result is an authentic strategy process powerful enough to capture possibility, while pragmatic enough to ensure effective delivery. It's the strategy that gets an organization through the changes of today and drives results that redefine tomorrow. It's the strategy that turns vision into reality. It's strategy, made real.

strategy&
Part of the PwC network

www.strategyand.pwc.com/me