Banks Can Bet Big on Social Impact

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Financial institutions that lead on social tend to outperform. But there is no “net zero” for social—and banks are struggling to seize the opportunity.

Imagine a world in which banks are seen as key actors in solving some of the biggest challenges facing society—rather than as a source of them. And where their social performance not only helps address big problems, but also strengthens their financial performance. Such a reality is within reach; banks just need to seize it.
Social challenges around the world are gaining in urgency. The fallout from COVID-19, continued civil unrest, and a looming global economic downturn have only reinforced the view that increasing inequality is a pressing systemic risk. At the same time, as governments and business mobilize to address climate change, it is becoming clear that environmental and social issues are inextricably linked. Not only does a warming planet threaten to worsen global inequities, but the failure to ensure an equitable energy transition also limits the odds of success for far-reaching climate action.

Financial institutions are uniquely positioned to have a broad and sizeable impact on many social challenges owing to their critical role in society. They serve as fiduciary stewards, allocators, and distributors of capital across the global economy and directly impact the ability of people to manage their money and build wealth. At the same time, there is a clear and expansive business case for creating solutions to address social issues—including gaining access to new and fast-growing markets, improved financial performance and cost of capital, enhanced ability to attract talent, and reduced reputational and regulatory risk.

Yet aside from a few forward-looking institutions, most banks today apply a rather limited lens to this opportunity. They tend to devote the most attention to the set of “S” topics that are included in current environmental, social, and governance (ESG) rating agency frameworks—such as focusing on DEI goals in leadership and hiring, developing culturally relevant marketing strategies, or ensuring consumer data protection. Certainly, these are critical topics. But we believe banks can take a more comprehensive view of their social performance and fundamentally reimagine their role in society. To achieve this, they must look at all the ways in which banks shape the world through each line of business, from retail and small business lending to capital allocation decisions to the social impact of their corporate borrowers and investments.

This is a complex undertaking with multiple topics that often require different solutions in different locations. Unlike the climate domain, which is guided by clear
targets and frameworks, there is no “net zero” for social. However, banks can start their journey by assessing three areas of opportunity to advance social impact: their employees, their customers, and the impact created further down the line by their corporate clients and investments. From there, banks can develop a blueprint for action, a step we will explore in a detailed report in early 2023.

The Business Case for Integrating Social Into the Core Business

In recent years climate, not social, has been at the center of bank sustainability strategies. Yet, in the same way that there is a compelling business case for climate action, a case for social is becoming more evident. Banks that seize the social opportunity stand to reap significant rewards in terms of both value creation and risk management. The imperative for acting on social issues is even stronger given the interplay between climate action and social inequity. (See “Why Climate Action Demands a Social Lens.”)

There are complex linkages between climate change and social issues, connections that should be understood when designing strategies for addressing them.

Climate change will disproportionately impact the world’s poor and marginalized communities. By 2030, it is estimated that as much as $300 billion will need to be invested annually to address immediate threats including flooding, wildfires, and droughts. At the same time, if climate action does not include a social lens, it may worsen some inequities. For example, some communities may be left behind as sectors such as agriculture transform or industries such as coal mining decline. In addition, gender inequality could also be exacerbated: BCG research finds that climate mitigation and adaptation strategies as designed today could delay the attainment of gender equity by 15 to 20 years—in part because women are institutions creating solutions to address social issues.
underrepresented in the fast-growth green economy. A lack of adaptation or a just transition could have significant ripple effects, including civil unrest and the undermining of democratic governance in some parts of the world.

These social challenges could in turn stymie further climate progress. In the absence of an energy transition that protects the vulnerable and ensures the costs are equitably distributed, political and public support is likely to fall short of what is needed. The bottom line: successful climate action demands close attention to social impact.

**VALUE CREATION**

Banks leading on social can go beyond altruism. When done well, it can create value in a number of ways.

**Access to Growing Markets.** Banks can push into new markets or expand their share in existing markets across a number of business segments. For example, the market for global social and sustainably-linked bonds has tripled since 2019—topping $1 trillion in 2021 and creating an attractive opportunity for corporate and investment banks. In addition, banks that expand lending to credit-worthy women- and minority-led small businesses are also tapping into a rapidly growing segment of the market.

Meanwhile, the growth in assets under management for sustainable funds—including those tilted toward the issuer’s performance on social issues—has outstripped the market over the last few years. From 2016 through 2020, assets managed under sustainable investment strategies jumped 55% to $35 trillion, according to the Global Sustainable Investment Alliance. During the same period, conventionally managed assets grew just 20%. In addition, there is evidence that investors in funds managed with a sustainable lens are “stickier” than those who invest in traditional assets. In the first three quarters of 2022, ESG funds and ETFs saw inflows of roughly $140 billion versus outflows of $330 billion from traditional funds, according to Morningstar.

**Improved Financial Performance and Cost of Capital.** There is a proven correlation between bank performance on social metrics and improved total shareholder return (TSR)
and reduced cost of capital. BCG assessed financial institution performance in the three components of ESG, identifying those that were leaders (in the top 20%) and laggards (those in the bottom 20%) in each category. We then looked at TSR performance for each group. The analysis revealed that the greatest difference in TSR was observed between the leaders and laggards in social—a difference of more than 4 percentage points. (See Exhibit 1.)

In addition, when looking at performance in social, the leaders had a weighted average cost of capital (WACC) that was 77 basis points lower than the laggards. (See Exhibit 2.)
Enhanced Talent Attraction and Retention. Banks that lead on social are also likely to have a better chance of attracting and retaining talent. Case in point: more than three-quarters of employees and jobseekers say they consider a diverse workforce to be an important factor when they are assessing companies and job opportunities.

In addition, the focus on DEI tends to be even greater among younger employees, a critical talent pool in the years ahead. According to BCG’s 2022 Global Diversity & Inclusion Assessment for Leadership (DIAL) survey, more than 27% of respondents 25–34 years old have decided not to apply for a position or declined a job offer due to a company’s DEI culture—significantly higher than those in older age groups. The share is even higher, 32%, for employees at financial institutions.

RISK MANAGEMENT

Weak performance on social elements creates real risk for banks.
First, banks face expanding social regulatory and reporting requirements, raising the prospect of fines or other penalties if they are not in compliance. Social regulations for the financial industry are not new. For example, in the US the Community Reinvestment Act (CRA) requires banks to report on how they meet the credit and banking services needs of the entire market, including low- and moderate-income communities. Banks in India must finance micro, small, and medium enterprises at discount rates.

However, while such regulations are well-established in many parts of the world, the regulatory and reporting bar will be raised further in the coming years. The European Financial Reporting Advisory Group (EFRAG), for example, is expected to require large companies, including financial institutions, to report on the social impact of their activities along the value chain—including as it relates to their “own workforce, workers in the value chain, affected communities as well as consumers and end-users.” Meanwhile, the European Commission has proposed a new due diligence directive that will require companies (financial included) to identify negative human rights and environmental issues from their activities—including actions along their value chain. Although both initiatives are still taking shape, it is clear banks will be increasingly held accountable for the actions of those they finance.

Even without increased regulatory scrutiny, bank reputations already suffer if the institution is linked to questionable activities of its commercial clients. Financial institutions, of course, have taken reputational hits in the past due to activities such as overly aggressive mortgage lending, questionable retail marketing tactics, and discriminatory practices. But more recently banks are being held accountable for the actions of their clients. Civil society support organization BankTrack, for example, benchmarks banks based on the UN’s Guiding Principles on Business and Human Rights, highlighting where bank business activities are linked to human rights abuses. ShareAction researches and publishes information on bank and asset manager sustainability activities and will begin ranking banks on their social performance in early 2023.

As banks manage increasing regulatory and reputational risk, they must also factor in other risks. They are frequently called out if their social commitments are deemed to be window-dressing or “social-washing.” On the flip side, financial institutions and
companies in other sectors also face potential political headwinds, particularly in the US, related to their ESG focus. For example, investment firms that are removing heavy emitters from their portfolios have been caught up in the ESG backlash, and companies that take a stand on hot-button social issues have also come under fire.

Widening the Lens on Social Issues

Given the significant rewards and potential risks at stake related to performance on social topics, banks must bring a comprehensive and disciplined approach to their strategies in this area. However, BCG has found through client conversations and work in the sector that social issues at most financial institutions today are addressed in a scattered fashion, creating an imperative to bring organization and rigor to their efforts.

Social is, of course, complex. Unlike climate there are literally dozens of social topics that a bank must take into account for itself, its clients, and companies they invest in. In addition, definitions and standards of social issues—and the right mix of actions required to address them—can vary by country.

To this end, we recommend banks start by assessing their business opportunities for social impact in three categories or “spheres.” This approach, inspired in part by the three-scope categorization of greenhouse gas emissions that shapes climate action, can enable banks to develop strategies at the business unit level that have real impact. (See Exhibit 3.)
Sphere one encompasses the social impact a bank can have within the walls of its organization. This can include actions to support workplace inclusion and diversity, enhance overall employee well-being, or drive equitable pay and career progression.

Sphere two covers the impact a bank can have through direct interactions with clients or suppliers. Actions in this sphere include efforts to expand financial inclusion for underserved populations, lending to minority-owned small and medium enterprises, and the assurance of human and labor rights in supplier operations.

Sphere three would be those activities further down the value chain. This includes the social impact of the bank’s large corporate customers, the social performance of the companies an asset manager invests in, or the actions of governments with which the bank does business.

Once banks have insight on the full scope of their potential social impact, they should then identify areas where they can really move the needle and where there is a sound business case for action. This will enable them to develop strategies across all of their business units that go beyond just tracking inputs, such as commitments to lend a certain
dollar amount to women-led businesses, and instead measure actual impact. Our upcoming report in 2023 will explore these strategies across all banking business segments, including retail and small and medium-sized banking, asset management, wealth management, and wholesale and capital markets.

There is a compelling business case for banks to integrate addressing social issues into their core business. However, given that financial institutions can create a range of impacts in myriad ways—from internal DEI programs to small business lending to supporting a client in the issuance of a social bond—it can be challenging to get a full view on where an individual institution should put its effort.

To begin the process of taking a more strategic and comprehensive view of potential societal impact across all three spheres, bank leaders should ask a few questions:

- What social topics does the bank see as both a high priority and a topic on which it can have impact?
- Which segments of the bank can have an influence on those social topics—and is there a business case for doing so?
- How well is the bank currently performing on these topics? Are there any critical gaps in the strategy?
- When making social commitments, has the bank moved beyond measuring output to measuring impact?

Answering these questions can help banks begin the journey to enhance business performance and amplify positive societal impact. If they step up and seize the social opportunity, they can build businesses that are energized by purpose and valued not only by shareholders but also by society.

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GSIA statistics are tracked on a biennial basis. Sustainable investment strategies include ESG integration, corporate engagement and shareholder action, norms-based screening, negative/exclusionary screening, best-in-class/positive screening, sustainability-themed investing, impact investing, and community investing.

US regulators, for example, are working to strengthen and modernize the CRA, including an increased emphasis on smaller loan sizes and investments and covering activities related to online and mobile banking, branchless banking, and hybrid models.

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