NAMIBIAN BANKS AND ENVIRONMENTAL RISKS IN LENDING PROCESSES

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LIST OF ABBREVIATIONS

BON	Bank of Namibia
CERCLA	Comprehensive Environmental Response Compensation and Liability Act
CSR	Corporate Social Responsibility
EBRD	European Bank for Reconstruction and Development
EIA	Environmental Impact Assessment
EMA	Environmental Management Act
EMS	Environmental Management Systems
EP	Equator Principles
ERM	Enterprise-wide Risk Management
GDP	Gross Domestic Product
GRI	Global Reporting Initiative
IFC	International Finance Corporation
LP	London Principles
MET	Ministry of Environment and Tourism
NGO	Non-Governmental Organisation
NSX	Namibia Stock Exchange
SD	Sustainable Development
UN	United Nations
UNEP	United Nations Environmental Programme
UNEP FI	United Nations Environmental Programme Finance Initiative
WB	World Bank

DECLARATION

I Jonas Jacob Nghishidi (Student # 2011164775) hereby declare that this mini dissertation submitted by me for the degree of Masters in Development Studies (MDS) at the Centre for Development Support, Faculty of Economic Management Sciences, at the University of the Free State (UFS), is my own independent work with the exception of the references duly cited. This dissertation has not been previously published or submitted by me or any other person to the UFS or any other university. I furthermore cede the copyright of the dissertation in favour of the University of the Free State.

Jonas Jacob Nghishidi
Windhoek
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DEDICATION

This dissertation is dedicated to my parents, Saima Nashea Kadhikwa-Nghishidi and Josef Haufiku Nghishidi, who raised me and provided the foundation for endless opportunities. Your constant encouragement, support and guidance have resulted in this work.

ABSTRACT

This paper examines how banks in Namibia are incorporating environmental risks into their lending processes.

Over the last decade considerable work has been undertaken in banks in various parts of the world to consider the environmental impact of projects they finance as part of their lending decisions. Loans are the very nature for the existence of banks and therefore, the proper management of loans is a key priority for banks. Since most projects financed by banks are associated with a certain degree of environmental impact translating into risks, these risks can result in a decrease in the borrower's repayment ability, a weakening in the value of the security and potential risks to the bank's reputation.

In Namibia, no literature exists documenting how banks have performed in incorporating environmental risks into their lending processes as well as documenting banks' environmental reports as part of their corporate social responsibility. A qualitative research method through interviews was used for the study, where open-ended questions were administered on five banks in Namibia.

The findings indicate that incorporating environmental risks remains a huge challenge for Namibian banks due to the lack of in-house capacity to undertake such a process, coupled with their lack of environmental awareness and training. Furthermore, the lack of awareness of environmental risks are further exacerbated by the fact that most bank people dealing with lending processes have not undergone environmental risk assessment training or related training associated with risks in lending processes. There is a need for banks in Namibia to consider developing integrated reporting systems that consider an enterprise-wide risk management (ERM) framework recognising the interconnectedness of different risks and establish clear organisational reporting structures in order to ensure processes and policies are in place to manage these risks.

Keywords: Sustainable Development, Sustainable Banking, Environmental Risks, Environmental Impact Assessments, Corporate Social Responsibility.

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CHAPTER 1 - INTRODUCTION

1.1. Background

This paper examines approaches by banks in Namibia to incorporate environmental risks into their lending decisions. For a long time, environmental risks were hardly regarded as relevant to the financial sector in general (Mazahrih, 2011: 17). Caldecott & McDaniels (2014: 6) noted that within the last few decades this view has changed, and banks have recognised that the sector is increasingly affecting, and is affected by, environmental issues. Environmental risk has been defined in various ways, mostly reliant on the area and scope to which the concept is being applied. For example, Freeman & Kunreuther (2002: 196) define environmental risks as hazards that display scientific uncertainty, irreversibility, latency of effect, and a high likelihood of a catastrophic effect. However, since this paper centred on the adoption of environmental risks in lending decisions, it follows the definition of Smith (1994: 2) and terms them as financial risks that may affect the present value of their loan portfolio.

Mazahrih (2011: 17) noted that many resource-based entities were pressured at the end of 1980 by the governments of the day with lobby groups to reform their attitude towards environmental issues as a result of the negative impacts on society, which resulted in the incorporation of environmental considerations into every stage of a product's life cycle. Similarly, Jeucken & Bouma (1999: 21) observed that the last two decades have seen the banking industry experiencing similar challenges and changes, due to the acknowledgement by stakeholders that banks are inseparably linked by their lending and investment practices to commercial activity that degrades the environment. Furthermore, the link between financial risks that these environment based risks might bring to the overall value of the lending portfolio.

Banks in Namibia face challenges associated with the country's economy. Mining and agriculture industries, for instance, cause significant environmental degradation, and bank's financial economic activities have environmental costs. According to Sherbourne (2010: 17), the structure of the Namibian economy has changed and became more diversified. At independence in 1990, half of the country's gross domestic product (GDP) was generated by just three sectors, namely mining, agriculture and government and by 2007, these three sectors accounted for just over one third of GDP with the mining sector set to continue to dominate the economy for some time. Ministry of Environment and Tourism (2006: 15) cautioned that water extraction, mining and agriculture industries are notorious for causing significant environmental degradation.

In 2007, in response to threats on the environment through mining, agriculture, deforestation and urbanisation, the Namibian government promulgated the *Environmental Management Act* (EMA) (No 7 of 2007) to provide 1) a process of assessment and control for activities which may have significant effects on the environment and 2) to cater for incidental matters. The EMA compels all state and private institutions including private persons who are undertaking projects in the respective fields[1] to obtain an environmental clearance before commencement of a project through undertaking an environmental impact assessment. Jeukens & Bouma (1999: 22) cautioned that as the largest financier of such projects, banks run the risk of the cancellation of projects they have financed in case of non-compliance to national legislations by project implementers, thus it is of the utmost importance for banks to consider environmental risks when taking lending decisions.

Given the lack of scholarly literature in Namibia that concerns approaches by banks to incorporate environmental risks into their lending decisions, the importance of environmental risks in the banking industry and the role the banks can play in mitigating such risks remain unexploited and undocumented. In this situation, banks are exposed to additional risks (both credit and reputation).

[1] Land use and transformation, water use and disposal, resource removal, including natural living resources, resource renewal, agricultural processes, industrial processes, transportation, energy generation and distribution, waste and sewage disposal; chemical treatment, recreation and any other area which the Minister considers necessary for the purpose of listing.

1.2. Problem Statement

According to Mazahrih (2011: 18), the adoption of environmental risk management techniques and procedures has become an important item for banks in recent years, driven largely by the increasing concern by various stakeholders about the negative impact of environmentally unfriendly business activities. Morimoto (2012: 7) observed that even though the adoption of environmental risks into lending processes is not a new phenomenon, banks who are adjusting to this approach are mainly from developed nations, with few exceptions in the developing world. This latter statement has been reinforced by the Equator Principles Association (2016) noting that there are currently eighty four (84) banks in thirty five (35) countries that have officially adopted the risk management framework called the Equator Principles (EPs) for determining, assessing and managing environmental and social risks in projects. According to the Equator Principles Association (2016), banks that have adopted the EPs are predominantly from Europe, accounting for 42% of the total followed by North American banks (16%), Latin America (12%), while Africa accounts for 11% of the total, primarily dominated by South African banks (FirstRand Limited, Nedbank Limited and Standard Bank of South Africa Limited).

Environmental issues have gained considerable attention from the commercial communities over the last few decades (Lundgren & Catasus, 2000: 186). The focus of the attention has been as a result of environmental crises, such as global warming, the greenhouse effect and deforestation that pose major threats to human survival (Hackston & Milne, 1996: 77) and as such, environmental concerns are no longer only national issues. Mazahrih (2011: 19) is of the view that the degradation being imposed on ecosystems, human well-being and businesses' financial position has translated into pressure on government and financial institutions such as banks, to respond to environmental risks and mitigate environmental damage. For the entire African continent, it has been estimated that 4–12 per cent of GDP is lost due to environmental degradation, with 85 per cent resulting from soil erosion, nutrient loss and changes in crops (Olson & Berry, 2003: 3).

Given that loans make up the largest percentage of the assets for a bank, their sound management is paramount for financial market stability. Conventionally, banks use financial instruments to measure the efficiency of their lending decisions and to ensure that payments are made on time. Jeucken & Bouma (1999: 22) cautioned that each lending operation may involve environmental risks depending on the nature of the project being financed and its locality. The lending operation by a bank may result in adverse environmental outcomes that may translate into a reduction in the borrower's repayment capacity, a decline in the value of the collateral, a direct bank liability for environmental damage caused by its borrowing clients and potential risks to the bank's reputation.

An extensive literature on environmental risk management in the banking industry has been undertaken in other parts of the world (Amalric 2005; Bai, Faure & Liu, 2013; Banhalmi-Zakar, 2011; Biswas, 2011; Capella, 2002; Coulson & Monks, 1999; Delibasic, 2008; Hansen, 2006; Hoijtink, 2005; Jeucken, 2001; Mazahrih, 2011; Morimoto, 2012; Scholtens, & Dam, 2007; Thomas, 2008; Wright, & Rwabizambuga, 2006). However, there is no literature documenting how banks in Namibia have performed in incorporating environmental risk management frameworks into their lending processes, particularly in light of the implementation of the Environmental Management Act (EMA) No 7 of 2007 requiring environmental clearance certifications of certain projects and as part of their corporate social responsibility. The lack of such research makes it difficult to comprehend approaches by banks to mainstream environmental risks into their broader risks management frameworks as well as the contribution of the banking industry towards sound environmental management.

The implications for not incorporating environmental risks into lending processes by the banks are that they banks might be exposed various types risks that negatively affects the competitive advantage in terms financial position, media coverage, pressure-group relations, present and future compliance and an ethical image. Given the lack of research on environmental risks in lending processes in Namibia, this paper aims to make a contribution towards sound environmental risk management in banks from a Namibia perspective.

1.3. Study objectives

Primary objective

To investigate the environmental risk management approaches adopted in the lending processes of selected Namibian banks.

Secondary objectives

i. Assess environment risk management processes pursued by selected banks in Namibia;
ii. Assess the capacity development measures on environmental risk management by selected banks in Namibia; and
iii. Document the challenges faced by banks to incorporate environmental risks into lending decisions in selected Namibian banks.

1.4. Research methodology

In order to achieve the objective of the study, a qualitative research approach was applied to the study. The study primarily focuses on the approaches by banks to incorporate environmental risks into lending processes as well as reviewing environmental issues in the context of Corporate Social Responsibility. Based on the literature review and the findings of the study, it becomes possible to propose certain approaches that the banking industry as well as the regulators can undertake in order to address environmental risks in the broader risks management frameworks of banks.

The study was conducted in five banks in Namibia through interviews using a semi-structured questionnaire. Furthermore, additional materials that could provide information about the banks, their lending practices and their approaches to incorporate environmental issues into lending processes were also collected from the banks and the annual reports of 2014 from all banks were used for this purpose.

1.5. Outline of the study

The study is divided into five chapters.

Chapter 1 is the introduction to the study. It introduces the research, including the background, presentation of problem statement, study objectives, the research methodology, as well as the outline of the study.

Chapter 2 consists of a literature review that provides an overview of corporate social responsibility and its drivers, followed by the history of sustainable development and the banking industry and includes the key voluntary environmental initiatives relevant to lending. The relationship between the banking industry and the environment, the associated risks as well as the approaches pursued by banks to manage environmental risks are then discussed. Finally, a conclusion is made.

Chapter 3 outlines the methodology adopted in this study. It presents the study design. The use of a qualitative method to meet the objectives of the study is explained. Details of the data collection and analysis are also included. The chapter also includes information about the ethical issues that were consolidated and a conclusion is made.

Chapter 4 presents the results of the empirical work. The chapter provide a description of the individuals interviewed from the banks and their respective positions. This chapter categorises the findings into broader interview questions as per the guiding framework discussed in Chapter 3. The approaches to environmental risks management by the banks are described. The perceived drivers for incorporating environmental risks into lending processes are highlighted. The capacity development measures on environmental risks management are also described. The challenges faced by the banks to incorporate environmental risks are also described. All the subsection in this chapter is followed by discussions and reference is made on other similar studies for better interpretation of the results.

Chapter 5 presents a final discussion, conclusions and recommendations.

1.6. Conclusion

There are a range of financial institutions playing various roles in economic life, such as central banks, commercial banks, and development banks. Because there is a close relationship between banks and development initiatives which directly and indirectly are a source of environmental issues, the focus is, accordingly, on banks in Namibia.

The geographic scope of this research is Namibia. With Namibia's growth in primary and related industries a number of environmental concerns have arisen that are both risks and opportunities affecting the banks' lending portfolios. Thus, as banks play an intermediate role in the economy, it is important they strengthen their risk assessment and management systems in order to reduce their own operational risk while seeking new market prospects. Banks can play an important role in reducing their indirect impact on the environment when making lending decisions.

The thesis focuses only on the risk management of indirect environmental impact of banks activities with regard to lending decisions. The direct impact of banks' operations resulting from using paper, energy, and water, are not investigated, as these issues are much less significant than lending activities in their impact on banks' financial and environmental performance.

CHAPTER 2 - LITERATURE REVIEW

2.1. Introduction

Since the 1960s, environmental issues have gained more attention and have resulted into pressure on government and the private sector to mobilise and manage environmental issues (Banhalmi-Zakar, 2011: 12; Mazahrih, 2011: 18). In response to this pressure, governments initiated environmental regulations and the formalisation of subjective approval of projects that have potential extensive negative impacts on the environmental. On the other hand, the private sector including banks responded by adopting environmental management tools that allowed them to fulfil environmental regulations, such as Environmental Impact Assessments (EIAs). Banhalmi-Zakar (2011: 12) noted that several financial corporations decided to move beyond compliance and started to develop further tools that allowed them to manage environmental risks associated with their activities to a greater extent, voluntarily.

At present, the environmental risk management strategies by these financial corporations are being pursued in the same pattern, either seeking to fulfil regulatory commitments, or serving to proactively move companies beyond compliance. However, as in many instances regulatory requirements do not apply across the board and as such certain sectors are not affected by the requirements. Jeucken (2001: 12) is of the view that there are no legal obligations for banks to implement environmental management measures because banks are not considered as having substantial impact on the environment. Instead, as narrated in Chapter 1 of this study, the impact of banks on the environment is secondary. The outcome of the activities of their customers could be of concern, however. Consequently, the environmental management practices of banks fall in the realm of Corporate Social Responsibility (CSR) (Banhalmi-Zakar, 2011: 12).

2.2. Defining Corporate Social Responsibility

According to Chahoud (2007: 17), the concept of CSR is based on the idea that not only public policy but companies, too, should take responsibility for social issues. While there is no universal definition of CSR, a commonly applied definition is a commitment to improve societal well-being through discretionary business practices and contributions of corporate resources (Du *et al.,* 2010; Kotler & Lee, 2005; Mackey *et al.,* 2007; McWilliams & Siegel, (2000). Coetzee and Crous (2016: 171) further elaborated on the definition and noted that CSR refers to how ethically companies are managed when creating wealth, not only for the company itself but also for all stakeholders of the company. In addition, companies are required to report on the quality of their management (see figure 1) of both people and operating processes. Thus, beyond making profits, companies are responsible for the totality of their impact on people and the planet. People constitute the company's stakeholders: its employees, customers, business partners, investors, suppliers and vendors, the government, and the community. Increasingly, stakeholders expect that companies should be more environmentally and socially responsible in conducting their business.

According to Saha & Darnton (2005: 118), companies manage environmental issues related to their operations for various reasons ranging from avoiding fines, reducing costs that stem from environmental regulations, to responding to external and internal pressures and taking advantage of the market opportunities that lie in environmental management. Banhalmi-Zakar (2011: 12-13) is of the view that one way for companies to demonstrate that they are actively involved in environmental management is by implementing environmental management tools such as EIAs, Environmental Management Systems (EMS), environmental policies, environmental auditing, signing up to environmental initiatives and publishing environmental (sustainability) reports.

Coetzee and Crous (2016: 171) noted that companies need to report the nature and extent of their impact on the market, workplace, environment and community, as well as include measures for how the company intent to achieve these elements of its overall strategic and risk management practices (refer to Figure 1). Upon achieving this, companies are seen to be good corporate citizens.

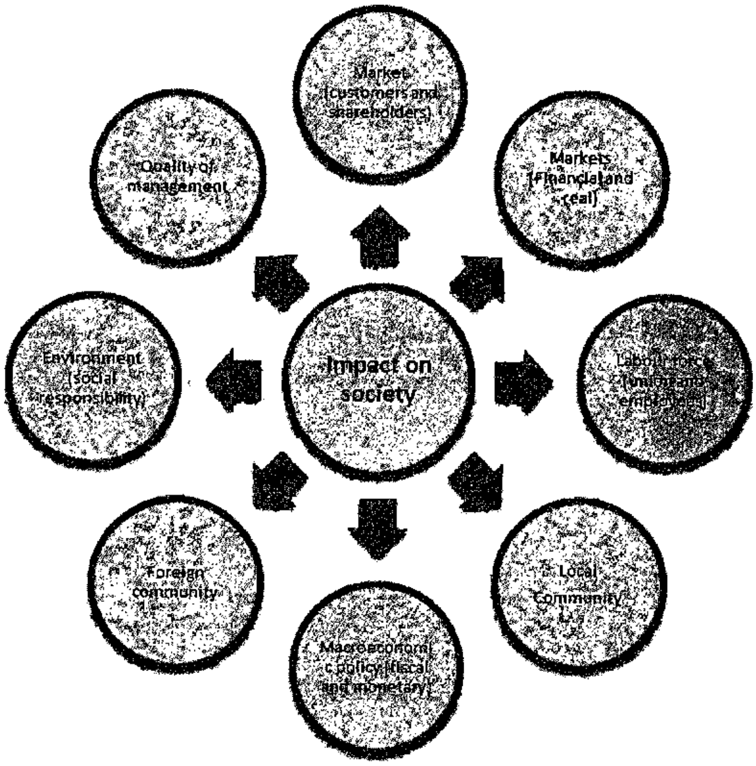


Figure 1: The impact of business on society

(Source: Coetzee and Crous, 2016:171)

2.3. Drivers and determinant factors for CSR and the banks

Arguments exist on why companies engage in CSR and this is both internal and external in nature. Hoang & Thanh (2014: 9) in their literature review paper on CSR in the banking industry identified two sets of drivers that might promote social responsibility actions within the firm, namely national and international drivers. National drivers mean pressures from within the country and include cultural tradition, political reform, governance gaps, socio-economic priorities, crisis management, and market access. On the other hand, international (external) drivers have a global origin and include international standards, investment incentives, stakeholder activism and supply chains.

2.3.1. National (internal) drivers

Internal pressure such as cultural tradition means that CSR often draws strongly on deep-rooted indigenous cultural traditions of philanthropy, business ethics and community embeddedness. According to Hoang & Thanh (2014: 9), cultural tradition might be realised in a manner more or less than intended given the type of bank culture in place, thus, bank culture is argued to moderate the relationship between strategic planning and CSR. The socio-political policy reform process has a large bearing on CSR since it drives business behaviour in the direction of incorporating social and ethical issues; therefore political reform is the driving force that influences CSR activities.

CSR can also be directly shaped by the socio-economic priorities in which banks operate and the development priorities this creates. Hoang & Thanh, (2014: 9) noted that often, CSR is considered a mechanism to plug the governance gaps left by weak, corrupt or under-resourced governments that have failed to address social ills properly. The government, non-governmental organisations (NGOs), social advocacy groups have a significant impact on banks' CSR activities (Edwards, 2004; Matten & Moon, 2008; Burke *et al.*, 1986; Campbell, 2007). Labuschagne *et al.*, (2005: 5) cautioned that the concept of sustainability at the operational level is more complicated especially in developing countries, since often social criteria do not receive enough attention to be incorporated in CSR reporting. Hoang & Thanh (2014: 10) also emphasise that leaders' educational qualifications and family background affect CSR decisions since a leader's attitudes towards social and environmental issues can affect the culture and philosophy of the organisation. Thus, it can be emphasised that CSR manager's attitude toward engaging CSR is one of the foremost determinants of the bank's CSR initiative.

Matten & Moon (2008: 405) studied why corporations in the United States and Europe approach and practise CSR differently and established that it was because the national business system of the two regions which was the product of differences in financial, political, educational and labour systems, as well as culture, was different. The authors found that American companies have a long tradition of stewardships and giving back to society through voluntary programmes and strategies to respond to stakeholder pressure, while companies in Europe have always operated in a more regulated environment and individual firms have developed strong ties with the state, unions, and the church

2.3.2. International drivers

According to Hoang & Thanh (2014: 10), international standardisation is a mechanism to self-regulation and CSR codes, guidelines and standards are a key driver for companies wishing to operate as global players. Qi Lai (2006: 3) indicated that global competition incentives, laws and regulations and globalisation are the driving forces for incorporation of CSR in international standardisation.

2.4. History of sustainable development and the banking industry

According to Coulson & Monks (1999: 3), the recognition of sustainability as an agenda item of banks started in the 1980s with the establishment of the Comprehensive Environmental Response Compensation and Liability Act (CERCLA) of 1980 in the USA. This act compelled owners of contaminated/polluted sites to be responsible for the cleaning up of sites including restoration. Weber *et al.,* (2008: 155), indicated that despite the inclusion of an exemption clause of lenders from ownership status, some banks in the USA were forced to enter into court procedures and recorded financial losses as a result of their investments. These financial implications made banks to realise that their clients' environmental impacts could affect their financial success and woke them up to the fact that they could become liable for their clients' businesses.

During the 1990s, the role of banks in stimulating sustainable development was recognised and increased substantially. With the hosting of the Rio Earth Summit in 1992, several key issues transpired that included the development of guiding principles, statements, standards and international programmes related to sustainable development. According to Bouma *et al.*, (2001: 14) the main initiatives included the UN Environment Programme Financial Institutions Initiative on the Environment (UNEP FI), the EPI-Finance 2000, Wolfsburg Principles, London Principles, and the Equator Principles.

A survey on 50 banks examining the integration of environmental risks into the credit risk management process conducted by Weber *et al.*, (2008: 150), found that banks which signed the UNEP statement tended to be more aware of environmental issues than those which did not sign it, and that they were less vulnerable to environmental risks and competitive disadvantages.

2.4.1. Key voluntary environmental initiatives relevant to lending

2.4.1.1. United Nations Environment Programme Financial Institutions Initiative on the Environment (UNEP FI)

The role of financial institutions in stimulating sustainable development was recognised and increased substantively during the 1990s (Mazahrih, 2011: 55). In 1992 at the Rio Earth Summit the UNEP FI was established. Bouma *et al.* (2001) noted that UNEP FI is a partnership between the UNEP and the private financial sector to improve and promote relationships between the environment, sustainability and financial performance. Bai *et al.*, (2013: 97) highlighted that UNEP FI focuses on stimulating clean and renewable energy investment by financial institutions, but excludes other environmental issues, such as climate change, biodiversity loss, and hazardous emissions. The initiative attracted around 160 signatories across the globe and in order to become a signatory to UNEP FI, the financial institution needs to sign either one of the UNEP FI statements on SD, depending on the principal operations of the company. Criticisms of whether signing the statement made a difference or not has been on the rise. In a survey conducted on 50 European banks by Weber *et al.*, (2010: 42), to assess the mainstreaming of environmental risks into the credit risk management process of banks point thereto that banks which signed the UNEP statement tended to be more aware of environmental issues and less exposed to environmental risks and competitive disadvantages than those which did not sign it.

2.4.1.2. The London Principles (LPs)

The LPs were established in 2002 as a response to the outcomes of the Johannesburg Earth Summit 2000 by the City of London Corporation. According to Mazahrih, (2011: 56), the principles encourage reflection on the cost of environmental and social risks in the pricing of financial and risk management products, exercise equity ownership to promote efficient and sustainable asset use and risk management, and provide access to finance for the development of environmentally beneficial technologies. However, Mazahrih (2011) cautioned that the LPs ignore an essential part of the managerial role in setting up environmental policy and other management tasks, such as training and auditing, which UNEP FI 2000 has already covered and they are repetitive.

2.4.1.3. The Equator Principles

The Rio +20 conference in 2012 reaffirmed political commitment to further environmentally considered development steps for a better future for all generations coupled with voluntary commitments through declarations by financial institutions towards ensuring environmental sustainability (Morimoto, 2012: II). In a time of growing need to emphasise social and environmental issues in developing countries, a group of leading private financial institutions established common environmental and social standards for project financing called the Equator Principles. Scholtens & Dam (2007: 1309) noted that the Equator Principles is a risk management framework, adopted by financial institutions, for determining, assessing and managing environmental and social risk in projects and is primarily intended to provide a minimum standard for due diligence to support responsible risk decision-making.

According to Equator Principle (2016), the Equator Principles have now been adopted by 84 banks in 36 countries covering over 70 percent of international Project Finance debt in emerging markets. Morimoto (2012: 39) noted that as of September 2012, there were 76 Equator Principle Financial Institutions (EPFIs) made up of European Banks (42 percent) North American (18 percent) and African (15 percent) showing an increase in the appearance of diverse members year after year in comparison to 2004 EPFIs where participation was from 13 countries in comparison to 32 in 2012. In Africa, the participating banks are Access Bank Plc, BMCE Bank, Ecobank Transnational Incorporated, Fidelity Bank Plc, Nedbank Limited, Standard Bank of South Africa Limited, Arab African International Bank, Mauritius Commercial Bank Ltd., and FirstRand Limited. Papadoulous (2009: 10) highlighted that most banks in developed countries have adopted the Equator Principles as they find themuseful in helping banks to document their own risk exposure. However, Wright & Rwabizambuga (2006: 90) observed that project financiers in the developing world have not adopted the Equator Principles with the same enthusiasm as their counterparts in developed countries.

According to Hansen (2006: 7), the Equator Principles have been designed flexible in nature to allow the EPFIs to retain the discretion to develop policies and procedures that are tailored to the institution and in particular the project under review. This has assisted with the rapid adoption of the principles by financial institutions. De Jong *et al.,* (2007: 21) are of the view that one of the key attributes for the adoption is the stringent legislations being adopted by various governments related to environment management with increased risk management. Furthermore, banks have a large incentive to manage the risks of their investments carefully to ensure repayment of the loan since a project that creates environmental degradation exposes the borrower to liability.

2.5. The relationship between the banking industry and the environment

When interrogating the relationship between the banking industry and the environment, one is confronted with the question of what do banks have to do with environmental issues. Several studies indicate a positive correlation between environmental performance and financial performance (Bai *et al.,* 2013: Amalric, 2005). According to Bai *et al.,* (2013: 93), environmental risks can lead to economic and reputational losses for banks if their clients stop halfway with a project as a result of environmental problems, or have been punished for violating environmental regulations. As a result, banks may not get their loans back and have to face reputational risks. In addition, Amalric (2005: 7) noted that environmental risks may have huge bearings on project returns, when, for example, the life expectancy of a project is shortened by unforeseen ecological processes and social risks in the form of local resistance against the development delaying operations. In other terms, these environmental and social risks thus pose a significant financial risk to lenders, especially given that project finance arrangements specify that lenders have little recourse beyond the revenues generated by the project itself. The collateral in these arrangements is lower than in normal credit transactions; credit risks are automatically higher and there is a direct link between the social and environmental risks of the project and the credit risks borne by the banks (Lozinski, 2013: 1500).

Therefore, it is imperative for banks in this context to take environmental issues into consideration when they make decisions to invest in companies or when advising their clients in the framework of risk management. According to Biswas (2011: 33), the development of legislations including regulations for environmental management, for instance the Resource Conservation Act, the Water Management Act, the Toxic Substance Control Act and the Environmental Management Act are all seen as potential significant contributors to the recent increase in environmental liability for banking establishments. Kamijyo (2004: 36) is of the view that the adoption of sound environmental management principles will offer significant benefits to banking institutions, to consumers and also to stakeholders. It is therefore pertinent to highlight why banks need to be concerned about the degree of environmental risks involved for any proposed project that they are requested to finance.

Heim & Zenklusen (2005: 3) highlighted that there are cases where the environmental management system have resulted in cost saving, increase in bond value resulting in lower risks, greater environmental stewardship and increase in operating profit. It is therefore prudent that in order to manage these risks properly, banks would have to undertake costly, in-depth environmental and social risk assessments in their due diligence processes. Furthermore, in recent years, banks have become conscious that their financial activities have an impact on the environment and that they have a responsibility towards mitigating such impacts. Thompson & Cowton (2004: 199) are of the view that banks are considered as facilitators of manufacturing activities which may have negative impacts on the environment. Jeucken (2001: 64) theorised, "customer risks are also bank risks and can affect their own continuity", and, in the same vein, "customer opportunities are also opportunities for banks". This implies that the responsibility of the bank is to assess the customer's risks, which may reduce the customer's viability. For instance, new environmental laws and an enforced government intervention can, in turn, become risks for banks. According to Mazahrih (2011: 63), the role of the bank is therefore to make sure that their operations consider the actual and potential environmental damage resulting from the borrower's activities, and the effects of such activities on society. Thompson & Cowton (2004: 201) cautioned that businesses acting irresponsibly are threatened by client backlash and boycotts, and people are encouraged by the media to engage in actions against such businesses.

In the same vein, Jeucken (2001), and Thompson & Cowton (2004), suggest that the banks must pay attention to opportunities in pursuing sustainable development, viz.:

- lending to environmental friendly and social projects, and accepting the challenge of developing new products that customers need in response to market demand, for example renewable energy
- strengthening communications with stakeholders and signing environmental declarations and statements;
- rejecting financing controversial projects that have negative environmental and social impacts;
- promoting sustainability issues internally and externally. This can be done by signing up to environmental initiatives including the Equator Principles.
- as valuers, pricing environmental risks and estimating returns;
- as lenders, considering environmental pioneering projects;
- as powerful stakeholders, influencing governments and the managements of companies as lenders to, and shareholders of, companies.

- interacting with different players who promote sustainable development, especially non-governmental organisations, who can have a supportive role by sharing knowledge and experience in caring for the environment;

2.6. Environmental risks facing the banking industry

Jeucken (2001); Richardson (2002); Thompson & Cowton (2004) noted that one of the key reasons why banks address the environment in lending is because it has the potential to represent risks. These risks are known as environmental risks. According to Capella (2002: 35), environmental risk is a generic term that covers many types of risks for businesses, however in banking lending, environmental risks refer to very specific issues defined as facilitating elements of credit risk arising from environmental issues

2.6.1. Classification of environmental risks

2.6.1.1. Direct Risk

Direct risk refers to the responsibility of banks for cleaning up a site (contaminated) that was acquired when the company financed by the bank filed for bankruptcy (Thompson, 1998a: 130). According to Thompson (1998b: 248), banks have direct risk from potential liability as a result of the borrower's conduct and activities. While the polluter pays principle is generally accepted in compliance and legislations, in some developed countries, the financier (bank) becomes directly responsible for the environmental damages.

2.6.1.2. Indirect Risk

Indirect risk arises when the borrower is unable to repay a loan as a result of spending on managing and rectifying the environmental impact of a project (e.g. environmental penalties, upgrading project equipment to meet environmental standards and regulations). This kind of risk occurs when legislatures tighten their environmental legislation, consumers change their preferences, the public increases pressure on businesses to be aware of their environmental impacts, and additional costs are required to maintain clean facilities and production processes.

2.6.1.3. Reputational Risk

Reputational risk is associated with large- scale projects that are difficult to predict in nature as well as quantifications. The corporate world faces problems in terms of credibility, accountability and transparency. The source of the environmental risk as part of these problems is the banks that have increased expectations when providing financing to borrowers who have environmental impacts on social, health and economic issues. Failure to consider these impacts can damage a bank's reputation, result in negative publicity, and lead to its missing out on acquiring new clients, adverse media exposures, customer boycotts and having its existing clients leave (Thomson, 1998a; Jeucken, 2001).

2.6.2. Approaches by banks to manage environmental risks

The cross examination of literature on how banks are incorporating environmental risks into lending processes revealed that a number of tools and techniques are applied by banks to manage these risks. Barannik (2001: 249) in his research on environmental risks in the banks found that environmental audit and environmental assessment were the key environmental risk management tools used by banks in the United States of America. In addition, environmental insurance was also identified as an important retroactive risk management tool that is particularly important for large-scale projects realised in developing countries that face higher than normal risk.

Tarna (2001: 150) also provided some insight on the type of environmental risks management practices used by European banks and it was found that the majority of banks use environmental checklists or risk rating processes when making lending decisions. Furthermore, EIAs were also used especially in project financing practices.

In a case study on environmental practices on the Lloyds Banking Group undertaken by Coulson (2001) it was found that the bank created a special department, called Group Environmental Risk Department, mandated to assist the credit managers in assessing environmental risks and keeping up-to-date with new developments arising as a result of environmental risks. Furthermore, internal environmental procedures were developed through a handbook and distributed to all bank branches with a supporting aid system for staff. A training programme was also launched to further capacitate the staff on how and why environmental risks are an integral part of credit risks management for the bank. However, Banhalmi-Zakar (2011: 47) cautioned that one impediment to the spread of environmental risk management in mainstream banks, such as the one described in Lloyd TBS has been identified as the costs associated with its implementation and practice.

In research on environmental risks into lending processes in New Zealand on Westpac Bank, Mazahrih (2011) noted that the research provides some evidence that Westpac incorporates environmental issues into lending decisions and is aware of environmental risks and opportunities. At the operational level, the bank assesses environmental risks before approving loans and finances projects with high environmental benefits. With regard to motivational drivers, the findings indicate that the bank's incorporation of environmental issues into lending decisions is motivated by multiple reasons: managerial, financial and environmental. However, the environmental information reported was not consistently and sufficiently communicated to stakeholders.

2.7. Conclusion

The literature indicates that environmental management practices of banks are part of CSR since there is no legal basis for banks to incorporate the impacts of their lending on the environment. CSR is seen as an alternative for the private sector to address environmental concerns within their lending practices. CSR in banks have emerged mainly as a result of the risks it represented in lending. Lending is a key process of banks and it has been argued that it can serve to provide an opportunity for banks to influence the outcomes of projects through setting up due diligent processes in order for their clients to adhere to and implement environmentally sound measures within that specific project.

The type of risks that the environment can represent to banks and specifically to lending process has been well documented. In the USA, banks have to face since they (banks /lenders) were held accountable for the damage caused by their clients in certain instances. This has led to the development of due diligent processes and documentation of such liabilities was undertaken by the banks (Griggs 1994; McCammon 1995; Missimer 1996).

Some scholars, such as Coulson and Monks (1999), Thompson (1998a), tried to illustrate the link between bank lending processes and risks posed by the environment. This has resulted in the classification of environmental risks into the three categories: reputational risk, direct risk and indirect risk.

Attempts to incorporate environmental issues into bank lending processes have sparked debates. Banhalmi-Zakar (2011: 46) that banks have an incentive to comprehend the environmental risks and opportunities inherent in their lending decisions. Therefore, integrating environmental issues into banks' lending decisions has the potential to improve both environmental and financial performance. While there is evidence in the literature that suggests that most banks have developed various ways to try to manage the risks represented by the environment it is not known what this management entails. This study was designed to address this gab in knowledge about how banks in Namibia are incorporating environmental risks into lending decisions.

CHAPTER 3 - RESEARCH METHODOLOGY

3.1. Introduction

The overall objective of the study is to assess the approaches by Namibia's banks to incorporate environmental risks into lending decisions. The objective of this paper thus is to identify internal environment risk management approaches, capacity development measures on environmental risk management, and challenges faced by banks to incorporate environmental risks into lending decisions in Namibia. In order to address the objective of the paper a qualitative research approach was deployed for this exercise in several banks in Namibia.

3.2. Study design

A qualitative method was deployed in order to meet the objective of investigating how banks in Namibia are incorporating environmental risks into lending decisions. According to Mazahrih (2011: 149), qualitative methods tend to allow more in-depth and detailed investigation than quantitative methods of a phenomenon. They also provide a way of gathering data that is seen as natural rather than artificial. Reedy & Ormrod (2010: 136) noted that qualitative research therefore aims to choose information-rich cases relevant to the research question.

The sample size and composition was selected through a non-probability technique using a judgemental sampling. According to Bless *et al.*, (2009: 56) judgemental sampling is a non-probability sampling technique where the researcher selects units to be sampled based on their knowledge and professional judgement. This type of sampling technique is also known as purposive sampling and authoritative sampling. According to De Vos, *et al.*, (2005: 202), purposive sampling is based entirely on the judgement of the researcher, in that a sample is composed of elements that contain the most characteristics, representative or typical attributes of the population.

An interview administered questionnaire was used to gather information pertaining to internal environment risk management approaches, capacity development measures on environmental risk management, and challenges faced by banks to incorporate environmental risks into lending decisions in Namibia from individuals selected to represent each bank in the survey. According to the Bank of Namibia (2014) there are nine licensed commercial banks in Namibia, namely Bank Windhoek Limited, EBank Limited, First National Bank Namibia Limited, Nedbank Namibia Limited, Standard Bank Namibia Limited, SME Bank Limited, Trustco Bank Limited, Bank BIC Namibia Limited, and Letshego Bank Limited. However, a desktop review including research on the websites of the licensed banks revealed that Trustco Bank Limited, Bank BIC Namibia Limited, Letshego Bank Limited and EBank Limited have no commercial activities pertaining to project financing at the time when the study was undertaken, hence their exclusion. In addition, two state-owned banking facilities namely the Development Bank of Namibia (DBN) and The Agricultural Bank of Namibia were included for this study because they are also involved in financing projects. Out the seven banks classified for the purpose of this study, only five banks agreed to be interviewed, namely Bank Windhoek, NedBank Namibia, SME Bank Limited, Development Bank of Namibia and Agribank of Namibia as listed by the Bank of Namibia (BON, 2014).

3.3. Data collection

3.3.1. Interviews

Interviews were undertaken in the natural environment of the participants, meaning within the banks where the participants work, that is the head office of each bank. The interviews were conducted with the head of departments concerning lending and risk management or an allocated staff member dealing with risk management in the banks. Open-ended questions were critical in extracting as much information as possible, in trying to understand the banks' approaches to environmental risks in their lending decisions through the participants. Responses to open-ended questions were captured by interviewer notes.

The interviewing of the study started in early September 2015. Interviews generally lasted between 45 and 60 minutes and were recorded using detailed notes. No recordings were carried out during the interviews due to the request that the researcher received from the participants. Interviews were organised by the researcher through a letter of request for each bank to allocate a senior staff member through the Managing Director/Chief Executive Officer. Prior informed consent was sought at each bank.

Participants were asked a series of open-ended questions during the interviews. Mack *et al.* (2005: 6) noted that semi-structured interviews enable the researcher to use open-ended questions and probing that give participants the opportunity to respond in their own words rather than forcing them to choose from fixed responses. Open-ended questions are the recommended method in qualitative research because they allow participants to construct the meaning of the situation in addition to describing events, processes, experiences and opinions in detail (Creswell, 2014: 15). Leedy & Ormrod (2010: 148) noted that a qualitative interview is fundamentally a conversation between the researcher and the interviewee, where the researcher has a particular plan to talk about certain issues. It is not imperative for the questions to be formulated and asked in the same way and in the same sequence. Instead, the researcher should know the topics and issues he or she wishes to address and ideally the interviewee should do most of the talking.

3.3.2. Interview Plan

In order to ensure that the key topic and issues are covered, 14 open-ended questions were prepared before the interviews. Additional questions were formulated during interviews to probe further on certain issues that warrant details. The interviews started with preliminary questions about the participant's position, their role within the organisation and the number of years in that position. After the introductory questions, the researcher proceeded to ask questions on the topic of interest. An example of the questions is provided in Table 1.

Table 1: Indicative interview questions and their broad intent in terms of the objectives of the study

Broader intent of interview questions	Example of interview questions
To identify environmental risk management processes (policy measures, environmental reporting processes, strategies and drivers)	Does your bank have an environmental management policy in place? Does the bank produce sustainability /environmental reports based on its operations? (e.g. CSR report) How does your lending appraisal processes address environmental risks?
To determine capacity development measures in the banks	What environmental training does your credit department receive? Has your bank undertaken any environmental training in the last 3 years? Describe what you consider as the keys to successful environmental training for lending staff.
To understand challenges faced by the banks to incorporate environmental risks into lending processes	Describe the challenges faced by banks to incorporate environmental risks into lending processes. What are the complexities for the credit department to address environmental lending issues?

Source: Author

The broad intent of the interview questions corresponds with the study objectives as highlighted in chapter 1 of this document. The study has also made an attempt to further probe operative aspects of project lending and bank organisation. Although it is understood that such questions made no reference to the environment, they provide crucial information to understand internal processes of banks in terms of why it is perceived that environmental impacts of projects were or were not a concern and how they were dealt with. Bringing such questions to the front is necessary considering that the researcher had no prior experience to banks' lending processes and that neither the bank document nor the literature available on the practices of banks on how they carry out project lending. By asking these questions, the researcher became familiar with common terminologies, abbreviations and acronyms that informants used. They also helped the researcher understand the main concepts of project lending and the rationale behind many of the activities involved in the process. This also provided an understanding of how bankers constructed the notion of environmental risk and environmental impacts of projects.

In addition to the interviews, documents that could provide information about the banks, their lending practices and the approaches pursued by banks to incorporate environmental issues into lending processes were collected from the banks. Annual reports of 2014 from all banks were used for this purpose. According to Banhalmi-Zakar (2011: 60), annual reports are considered major evidence of the bank's documents as a source of collecting data related to environmental disclosure. Moreover, annual reports are regarded as important documents in corporations because of the high degree of credibility they lend to information reported within them, their use by a number of stakeholders as a source of economic, social and environmental information, their recognition as a medium through which companies can report their responsible behaviour, and their widespread distribution (Unerman, 2000: 668).

3.4. Limitations to the study

Detailed information about environmental risk management as other management strategies of banks including the practices and regulations are considered confidential and is, in fact, difficult to obtain. Environmental risk in comparisons to other risks within the banks is often viewed an insignificant risk hence personnel within the banks to provide details on environmental risks management in lending processes was challenging. Accordingly, most information complementing interviews undertaken as part of this study material about the bank's environmental performance or risks management measures had to be obtained from annual reports.

3.5. Research Ethics

Bryman and Bell (2007: 132) argue that "discussions about ethical principles in business research and perhaps more specifically transgressions of them tend to revolve around certain issues that recur in different guises." Bryman and Bell (2007: 132) present the four main focus areas as follows:

- i) Whether there is harm to participants;
- ii) Whether there is a lack of informed consent;
- iii) Whether there is invasion of privacy;
- iv) Whether deception is involved.

For the purpose of confidentiality, the identities of the banks interviewed are not disclosed in the paper. The data to be provided in the interviews are sensitive and can compromise the competitive position of the banks with regards to the pursuit of environmental sustainability. Anonymity of respondents will be maintained. To ensure that this is achieved, names of study participants interviewed will not be indicated on the interview guides.

The study has not revealed the name/s of the bank(s) that have demonstrated weakness in terms of mainstreaming environmental risks in their operation. Instead, the banks were referred to as, say, either Bank A or Bank B.

3.6. Conclusion

This chapter has described the methodology used to determine how these banks incorporate the potential environmental impacts of projects in their lending practices and decisions, and to describe how they do this. It includes the study design including unit of sample, data collection approach, data analysis and the ethics for this study. It also explained why a qualitative research using mixed methods was deemed suitable for the study. It provided the underlying reason for using interviews supplemented by the annual reports .The reliability and validity of the qualitative research was addressed. Data preparation for analysis, interpretation and conclusions was also described.

The participants in this study included those who were directly involved in project lending. A total of five bank staff members were interviewed; mostly occupying managerial positions in their respective banks except one bank that allocated a junior staff member (assurance provided by the bank that the staff is well vested with the study topic). These individuals were identified by the management of the bank based on their involvement with the study topic. Interviews were semi-structured and included open-ended questions. This process accommodated differences among participants in terms of their roles and responsibilities in project lending, as well as their background and knowledge about environmental issues. The results of the analysis are presented in the next two chapters.

CHAPTER 4 - EMPIRICAL FINDINGS

4.1. Introduction

In this chapter, the findings of the study are presented, gathered through interviews with the participants from the banks. For this findings section, the presentation of the data collected has been categorised according to the following themes:

1. Approaches to environment risk management
2. Perceived drivers for incorporating environmental risks into lending processes
3. Capacity development measures on environmental risks management
4. Challenges faced by banks to incorporate environmental risks

4.2. Profile of the respondents

4.2.1. Positions of respondents and gender

Table 3 shows the current position of the respondents in the five banks interviewed as well as gender representation thereof. All respondents interviewed occupied senior managerial positions in the respective institutions. Four out of five respondents were males.

Table 2: Position of participants from the banks

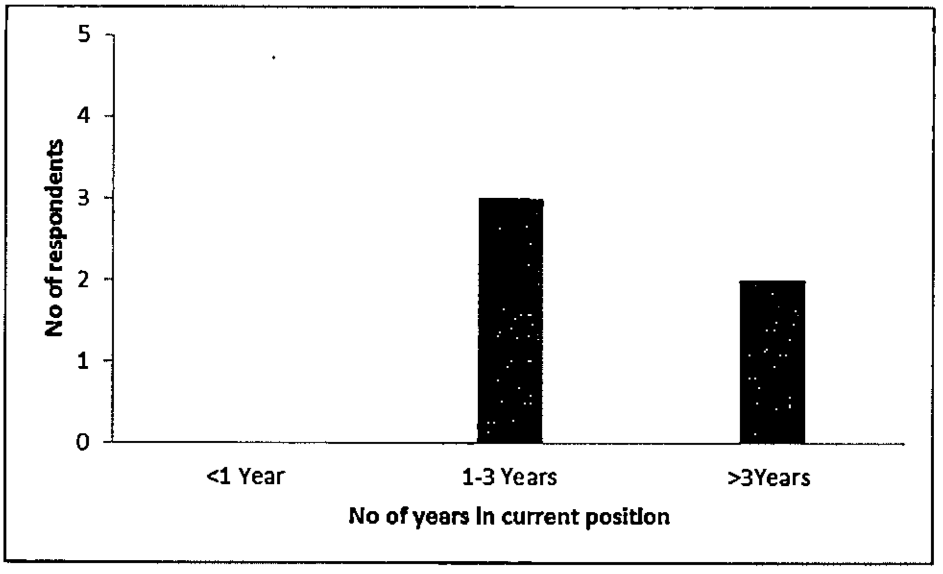
Bank	Position	Gender
Bank A	Credit Manager of Business Banking	Male
Bank B	Head of Financial Risk	Male
Bank C	Head of Risk and Credit	Male
Bank D	Head of Credit Risk	Male
Bank E	Senior Credit Analyst	Female

Source: Author

4.2.2. Number of years of participants in their current position of work

Three out of the five respondents have one to three years' experience in the current position, while the other two respondents have above three years of experience in their current position. Of all the participants interviewed for this study, there was no individual who has served less than a year in their current position.

Figure 2: Number of years of each participant in their current position



Source: Author

4.3. Approaches to environmental risk management by banks

4.3.1. Internal environmental policies

In order to assess the commitment of banks to sound environmental management, the participants from the banks were asked to provide an indication of environmental policy measures that they have in place. Four out of the five participants indicated that their banks have environmental policy statements in place compared to one that indicated that they have not crafted one yet.

When asked about what has led the bank to have such a policy statement in place, the participant from Bank D noted *"given our position as one of Namibia's leading lenders and the commitment to CSR, our bank has a duty to manage and influence the way in which our national resources are being used and as such we are dedicated to consider environmental issues in all aspects of our business or ventures, including assessing risks associated with certain projects."*

Furthermore, this statement above was also echoed in the bank's annual report of 2014 noting that the *"bank does not finance speculative investments, businesses that have a negative social impact and projects that may be damaging to the environment and the bank considers sustainability and the environment critical to Namibia's future, in keeping with Namibia's policies on the sustainable use of resources and the environment."*

The participant from Bank A said that *"the bank is primarily driven to include such a policy statement in its operation since the Constitution of Namibia is the first constitution to include a provision for environmental protection and hence the realisation that protection of the environment is paramount to the sustainability of our resources."*

The participant from Bank A noted that its annual report is produced at the group level and highlights detailed measures undertaken by the bank to further strengthen environmental management in Namibia. In their 2014 annual report, the bank echoed that it has a premier corporate conservation fund that continues to support projects aimed at safeguarding the country's pristine environment for future generations.

Although only one bank indicated that it does not have an environmental policy in place, only two of the five banks were able to reveal through the interviews or their annual report the existence of such policies. The fact that two of the banks interviewed could not provide the underlying reasons for having initiated such policies leaves a grey area to understand the key drivers enabling banks to pursue such an initiative. The analysis of the key drivers for banks to have an environmental policy in place points to those external factors such as conditions imposed by lenders and national legislations are the influencing instruments for such action. These findings however contradict Prakash (2000), who investigated two American pharmaceutical companies who have adopted environmental policies by implementing voluntary measures such as environmental audits, ISO 1400 standards and upgrading of underground storage tanks. In his detailed assessment, Prakash (2000: 690) found that the adoption of environmental policies within firms are not necessarily influenced by external factors although they can be critical, but internal factors due to the concept of power and leadership based theory. According to Sharma (2000: 684), power-based theory is the defined ability of manager A to influence outcomes in the wake of opposition from Manager B and the selective adoption are power-based if policy-supporters are either hierarchically superior or can capture the top management and convince it to adopt their perspective. Prakash (2000: 147) resolved that factors external to firms may have a critical, though not a deterministic role and calls for the need to focus on the key role those leaders play in shaping their organisation.

4.3.2. Environmental reporting by the banks

Only two banks indicated that they produce sustainability/environmental reports based on their operation in comparison to three banks that indicated that they do not produce the said reports. Bank B indicated that its report is actually a corporate social investment report and have supported environmental related measures through association fees and supporting non-governmental organisations promoting conservation of flagship species such as the rhino. Furthermore, the participant highlighted that the bank sees this as a major investment to ensure that the survival of the rhino is secured for the foreseeable future

The participant from Bank D highlighted that their bank does not produce a sustainability report, however further interrogation of the annual report of 2014 indicates that the bank has reported on environmental management measures and support. The bank's 2014 annual report highlighted that *"The Bank considers sustainability and the environment critical to Namibia's future, in keeping with Namibia's policies on the sustainable use of resources and the environment."*

Some banks understand the need to report to the public what they are doing in terms of addressing environmental issues within their operations as part of their CSR and this is reflected in their annual report on measures they undertake and the views expressed by their representatives. On the other hand, there is a general lack of awareness or engagement of annual reports with respect to reporting on environmental issues undertaken by the banks including incorporation of environmental risks into lending processes revealing that internal communications were lacking. It appears that there are no concerted efforts and plans by some banks to create awareness on CSR and participants from certain banks might be detached from noting the noble efforts undertaken by their banks towards CRS and in particular environmental management measures implemented. This is not surprising since Branco & Rodrigues (2006:11) indicated that CSR reporting by banks like most companies tend to overlook internal stakeholders including staff and concentrate on external stakeholders when disclosing CSR practices in order to legitimise their behaviours.

4.3.3. Environmental risk management strategies for banks

In terms of incorporating environmental risks into lending decisions, only three banks noted that they do consider environmental risks in their lending decisions, whereas two banks do not make such provision. The participant from Bank D added that *"the bank takes an operational approach to sustainability and the environment. If projects are judged likely to have an impact, the Bank will require an environmental impact assessment (EIA), as well as certainty that the project adheres to all legislation and regulatory mechanisms."* Furthermore, the participant from Bank D noted that *"the* *project initiator or proponent is responsible for ensuring that the EIA report is done whereas the bank takes ownership of categorising such project based on the magnitude of the risks associated with the project."*

It was further noted in order to better manage the sustainability and environmental risk that may be indirectly inherent in its financing activities, Bank D has initiated the development of an Environmental Policy which was supposed to be unveiled in 2015 and intended to be focused on five areas, namely sustainable use of non-renewable resources, development and preservation of renewable resources, development of communal resources, environmental health, and climate variability. The participant from Bank D highlighted that although there is no minimum financial threshold, the bank is in the process of developing a policy that will serve as a guiding tool for threshold consideration when undertaking risk assessments.

Participant from Bank B indicated that the bank has adopted the International Finance Corporation (IFC) standards for identification and managing environmental and social risks. However, it was indicated that although it has been adopted, these standards have not been implemented or applied to any specific project since the bank has no technical capacity internally to implement it and no training has ever been implemented to that effect.

The participant from Bank E specified that the bank had a checklist to establish the foreseen environmental impact, regulation requirements and risks associated with projects to be financed. However, the checklist has been cancelled by management because its value to the risk assessment processes was not grasped. Furthermore, the participant indicated that the bank requires all large- scale projects to have an EIA in place before they are financed by the bank. However, the bank was unable to reveal what constitutes a large- scale project in this respect.

The participant from Bank A noted that the bank considers environmental risks in its lending processes and the bank has on two occasions refused to finance projects because due diligence processes such as EIAs had not been followed. Furthermore, Bank A has also sourced external expertise on environmental risks assessment on a specific project in order to make an informed decision based on technical information provided. It was further indicated that EIA reports were often available at the time when project proponents sought financing.

The participant from Bank E indicated that at this stage, the bank has not been able to implement environmental risk management measures into its lending processes since the bank was only recently issued with its operational licence and as such it has been preoccupied with setting up its operational systems.

When asked how successful has each bank been in incorporating environmental risks into lending process, all participants indicated that they have performed fairly. The participant from Bank B noted that more could be done by their bank to improve the incorporation of environmental risks into lending process in light of the Environmental Management Act no 7 of 2007 since it has a significant bearing on how banks are financing projects. The participant from Bank A is of the view that their bank has done fairly in this respect considering that they have established fund providing grants to environmental non-governmental organisations (NGOs) and research institutions to implement environment related projects in accordance with national strategies related to biodiversity, land management and climate change.

Most banks surveyed indicated that they consider environmental risks when making lending decisions. These findings are reinforced by the tools used by banks in their lending processes. Notable instruments highlighted at least by two banks, are the International Financing Corporation (IFC) guidelines and standards and the Environmental Impact Assessment (EIA) as required in the EMA of 2007. According to International Financial Corporation (2014: 20), IFC is a member of the World Bank Group and the largest global development organisation focused solely on the private sector in developing countries and has established the Sustainable Business Advisory (SBA) unit that works with companies to adopt environmental, social, and governance practices that create a competitive edge, which can help transform markets and enhance benefits to communities. Karch (2014: 516) noted that the IFC Performance Standards are designed to provide guidance on how risks and their accompanied impacts are to be identified, and further guide on how to prevent, mitigate and manage risks and impacts as a model of doing business in a sustainable way. It is worth noting that the bank subscribing to the aforementioned standards is not required to adhere to the said standards since the bank is not a signatory (Equator Principles, 2016). While most banks have indicated that they incorporate environmental risks into their lending decisions and some have come up with categorisation of environmental risks that might emanate from client projects, it is worth noting that the categorisation of the risks is not harmonised and is disorganised. The discrepancies in the approach and methodology of categorising risks and environmental risks exposure survey put into question the effectiveness of the exercise within those banks.

4.3.4. Perceived drivers for incorporating environmental risks into lending processes

Four out of five participants representing the banks pointed out that risk management is the primary driver for banks to incorporate environmental risks into lending decisions. National legislation and regulations, conditions imposed by lenders and organisational values were observed to be the second most important drivers that have enabled banks to incorporate environmental risks into their lending processes. The third important driver for environmental incorporation was stakeholder/public demands, company/business plans and objectives and personnel as key drivers. International commitments, cultural/traditional reasons, company requirements, and potential environmental events and issues were the least considered to be important drivers to incorporate environmental risks into lending processes.

The participant from Bank A noted that their bank's *"environmental risk is one of several risks that any bank must consider as a priority since major environmental issues linked to a project financed by the bank can enhance the level of risk that they become the most prominent credit risk and as such risk management remains the key issue driving the incorporation of environmental risk in lending processes."*

The participant from Bank D added that the driver for incorporating environmental risks into lending processes has also been largely driven by conditions imposed by the lenders, stressing that *"the bank has requested a loan from the African Development Bank to finance its activities and part of the loan requirements is the need to implement the Integrated Safeguards System requiring the bank to have a* *formalised environmental and social department to oversee environmental risk management processes in the bank."*

Furthermore, the participant from Bank D revealed that the bank has realised that the EMA no 7 of 2007 has impacted the lending process of the bank. The participant from Bank D noted *"although the bank has been cautious of the impact of environmental issues on certain projects financed by the bank, the bank did not take the impacts of such in detail since there were no penalties or ban due to the absence of a regulatory framework but with the enactment of the Environmental Management Act, our bank now needs to take precautionary measures to ensure that project proponents meet the required standards thus mitigating risks associated with that specific project.* It was therefore highlighted that conditions imposed by lenders and national legislations are the key drivers for Bank D to pursue the incorporation of environmental issues into lending processes.

As per the finding of the study, only one bank indicated that they employ EIAs as part of their risk management strategy in lending decisions. Banhalmi-Zakar (2011: 195), Jeucken (2001: 11) identified EIA reports as one of the few environmental management techniques that were potentially available to banks and can be used to determine if the banks would be exposed to environmental risks when they financed projects. Kariuki (2015: 31) cautioned that whereas EIA processes can be a good tool for ensuring that environmental and social issues are considered in the planning phases of projects, their application faces numerous challenges. First, the project developer/proponent plays a major role in the EIA process to ensure that the core aim of the EIA is truthful and authentically fulfilled. Secondly, the Ministry of Environment and Tourism through the Department of Environmental Affairs is the only body mandated by the EMA Act of 2007 to issue Environmental Clearances. As a result of the organisational restructuring process there is currently lack of internal capacity to fairly assess EIA reports and ensure that due diligence processes are followed through. Kariuki (2015: 31) is therefore of the opinion that EIA clearance licences are not true indicators of whether a client has complied with environmental laws and regulations or not. The internal technical capacity of staff to scrutinise risks emanating from EIA reports by the banks is questionable since there are no dedicated units that can comprehend and provide sound advice when projects are being screened for funding. While EIA reports currently appear to be minimally used by banks, the paradox is that, whereas they are closely associated with the government approval process, banks indicated EIA certificates to be of the utmost importance to them. Banhalmi-Zakar (2011: 195) noted that non-realisation of projects are identified by banks as a major risk, affecting the basis for the loan, the cash flows of projects, and loan repayment. In addition, only one bank indicated that they had imposed conditions on two loans requiring the borrowers to provide confirmation that approval from all relevant authorities (including the Ministry of Environment and Tourism) had been granted prior to approval of the loans. The fact that one bank indicated that EIA reports were available at the time when project proponents sought financing provides best practice tools to assist in environmental risk assessment in lending processes.

Risks management, national legislation and regulations, conditions imposed by lenders and organisational values were identified as the primary driver for banks to incorporate environmental risks into their lending decisions by participants of the various banks. As indicated in the literature review, the drivers for banks to incorporate environmental risks are both national and international and evidence to this is the revelation by the banks that some banks have started reconsidering their lending approach with the introduction of the environmental management legislation since it can have a negative impact on loan repayments if due diligence processes are not followed through by project proponents. Furthermore, since some banks want to obtain loans from external financial institutions, there are certain requirements that these banks need to meet in order to qualify for such loans and this includes developing institutional structures responding to environmental risks associated with projects and developing policy statements committing banks to sound environmental management and as such banks are forced to incorporate environmental management processes in their operations. Missimer (1996: 6) noted that regulation has been a key driver in the recognition and management of environmental risk in lending. Environmental risks posed a major concern in the US at the end of the 1980s. Barta & Eri (2001: 124) also pointed out that multi-lateral development banks such as the World Bank (WB) and the European Bank for Reconstruction and Development (EBRD) pressured commercial banks to adopt their guidelines on environmental assessments of projects. Thompson & Cowton, (2004: 203) in their survey on banks found that the main reasons why banks incorporate environmental criteria into lending decisions is to avoid or mitigate environmental liabilities, manage environmental risk, and ensure compliance with regulation.

International commitments, cultural/traditional reasons, company requirements, and potential environmental events and issues were considered to be the least important drivers to incorporate environmental risks into lending processes in this study. Thompson & Cowton (2004: 199) also indicated that achieving sustainable development and to satisfy the needs of stakeholders were acknowledged as important to a lesser extent in their survey with banks.

4.3. Capacity development measures on environmental risks management

All participants indicated that their respective bank has not received any environmental related training. The participant from Bank D indicated that their bank has an environmental policy which is accompanied by the establishment of a managerial position for environmental and social development within the bank in order meet the conditions imposed by the lender. However, the participant from Bank D pointed out that *"the EMA no 7 of 2007 needs to serve as the basis for incorporating environmental risk into the lending process and as such, there is a need to create awareness on the Act and an implication for those projects listed by the schedule of activities in the Act requiring EIAs. The creation of such awareness will further strengthen the risk management aspect of the bank and further ensure that projects follow due diligence processes"*

Bank A's participant indicated that "*our bank strives to be a leader renowned as a green and caring bank which strives to achieve this by establishing an environmental offset mechanism through a grant initiative supporting environment related projects nationwide guided by national environmental management strategies including research. However, due to lack of internal capacity to manage such a process, the bank has outsourced the grant management to a leading conservation NGO in Namibia.* Furthermore, the NGO also provides a steering function with the marketing manager of the bank serving on the steering committee. Bank A therefore has not undertaken any training even with the noble environmental programme in place.

The participant of Bank C noted that capacity development measures related to risk management is in place in the bank; however, an environmental risk training programme for lending purposes has not been discussed in the bank perhaps because the bank's operating licence was just issued in 2012.

Although Bank B has adopted the IFC standards for identification and managing environmental and social risks, its participant indicated that it has not been implemented and training to apply this standard has not been carried out. The participant from Bank B noted "*although the bank has adopted the IFC standards, the bank is not a signatory and as such the necessary training undertaken with the signing has not been carried out.*"

This study revealed that no training was undertaken at the time of the study pertaining to environmental risks in all banks that participated in the study. Banhalmi-Zakar (2011: 155) found similar results and highlighted that training on environmental risks were rare and only few staff attended them because the banks viewed them as too time-consuming compared to the benefits they offered. Furthermore, it was noted that one impediment to the incorporation of environmental risk management in mainstream banks has been identified as the costs associated with its implementation and practice. Wright & Rwabizambuga (2006: 95) cautioned that screening and monitoring environmental and social impacts of projects financed incurs considerable costs for the banks. However, Scholtens & Dam (2007: 1320) maintained that the costs of training and retaining CSR staff in banks is analogous to professional advisory fees paid to external environmental consultants and such training might provide opportunities to fund projects with environmental and social impacts which they would not in the absence of in-house expertise. According to Mazahrih (2011: 295), the absence of environmental education limits the capability of the bank to comprehend the potential environmental risks and opportunities. In other words, being environmentally conscious is important to exploit new technological opportunities emerging, while simultaneously reducing environmental risks resulting from staff's lack of environmental knowledge, which may cause credit, operational and compliance risks.

Weber *et al.,* (2005: 77) considered training of credit officers in assessing environmental issues as decisive. They argue that credit officers who perceive and evaluate companies' environmental risks are able to incorporate environmental risk assessment criteria into the lending processes. Feldman *et al.,* (1997: 88) revealed that a positive relationship exists between environmental performance and financial performance. They suggest that companies can capture more opportunities to improve their financial and environmental performance by undertaking knowledge and skills development within their workforce and enhancing their information-management capabilities.

One of the banks indicated that they have adopted IFC standards for identifying and managing environmental and social risks. According to Banhalmi-Zakar (2011: 91), banks are required to implement an environmental review programme and send some of their staff members to environmental training sessions. However, the said bank has only adopted the standards but has not signed the portfolio framework agreement with the IFC and as such it is not mandatory to send its staff on training related to environmental risks in lending processes.

4.4. Challenges for the banks to incorporate environmental risk

In order to understand the challenges faced by the banks to incorporate environmental risks into lending processes, participants were asked to discuss the challenges the banks the challenges their bank faces in incorporating environmental risks in their risk management frameworks. The participant from Bank A said "*environmental issues are complex for the bank and the challenge is the lack of industry guidelines to guide banks on how to incorporate environmental guidelines specifically in a Namibian context. The environmental management legislations also need to be contextualised for the banks to grasp the risks.*"

The participant from Bank B indicated that the bank has long-term relationships with clients, and as such, find it difficult to refuse clients finances/loans based on environmental assessment studies.

Although the Bank D is now in the process of operationalising a dedicated environmental and social department within the bank, the participant from the bank noted that the bank has been largely challenged to incorporate environmental risks into lending process due to a lack of a dedicated department/section to assist in the assessment of environmental risks. The participant from Bank D said *"the bank has established some environmental checklists for assessing potential projects long before the introduction of the Environmental Management Act of 2007; however, no detailed lessons can be derived from such an exercise and as such the issue of incorporating environmental risks into lending processes remains a new phenomenon and is challenging to the bank but the bank is hopeful that this shortcoming will be addressed once the dedicated structure to deal with environmental and social issues is in place."*

Lastly, the participant from Bank E noted that the understanding of national legislations pertaining to environmental management is a challenge for the bank. Furthermore, awareness of environmental issues and associated risks are also a challenge to the bank and these include formal training sessions for staff in order to ensure that environmental risks are incorporated into lending processes.

The participants from the banks highlighted different challenges they face in integrating environmental risks into lending decisions. Incorporation of environmental risks into lending processes, interpretation of national legislations pertaining to environmental management, capacity to review environmental assessment reports relating to project financing, and the lack of mechanisms to support banks in incorporating environmental risks into lending processes due to lack of industry guidelines and best practice where identified as key challenges for the banks.

The understanding of national legislation and awareness of environmental issues are intertwined, thus the need for banks to understand the current legislative regime pertaining to environmental issues and their implication to the banks. While environmental legislations are well developed in Namibia, the implementation of such legislations seems to be relatively slow probably because of government's competing priorities. One of the most important barriers shadowing incorporation of environmental risks into lending decisions is the lack of information and tools available to banks to be used as guiding instruments for enhancing incorporation of environmental risks into lending processes. According to Capella (2002: 30), lack of information prevents managers from detecting their mistakes in credit analysis, thus not entirely realising the negative consequences that can occur. Banhalmi-Zakar (2011: 41) found that one impediment to the spread of environmental risk management in mainstream banks is the costs associated with its implementation and practice.

Coulson (2001: 23) noted that in order for banks to overcome the challenges associated with environmental risks governance in commercial banks, precautionary principles must be applied. The precautionary principle says we should attempt to anticipate and avoid damages before they occur or detect them early. However formulated, each version of the precautionary principle is based on underlying values and three core elements:

- potential harm—predicting and avoiding harm, or identifying it early, should be a primary concern when contemplating an action;
- scientific uncertainty—the kind and degree of scientific uncertainty surrounding a proposed activity should be explicitly addressed; and
- precautionary action

4.5. Conclusion

This chapter presented the study's findings as related to the research questions and objectives. It is apparent that banks are challenged by all kinds of risks. From the interviews, it is clear that these risks (legal, market, environmental, credit, liquidity, reputation and operational) are all integral in the day to day activities of the Namibian banking industry. The primary drivers for banks to incorporate environmental risks into lending decisions are risks management, national legislation and regulations, conditions imposed by lenders and organisational values. The national legislations promoting sound environmental management are still in their infancy stages of comprehension by the banks and as such the risks affecting the banks as a result of those national legislations had not been incorporated into their lending processes.

CHAPTER 5 - RECOMMENDATIONS AND CONCLUSION

5.1. Introduction

In the previous section it was shown that banks in Namibia are challenged with the incorporation of environmental risks into lending decisions. Furthermore, there is a lack of environmental consciousness among banks, both in terms of the environmental impacts of their internal processes and environmental impacts deriving from projects they financed. However, based on an analysis of recent legislative changes in Namibia, it can be argued that Namibian banks should establish procedures and rules for including environmental considerations in their business practices and environmental risk identification as part of their overall credit risk. Detailed information on incorporating environmental risks will lead to better risk management and have positive effects on environmental awareness in case of the banks and their clients as well.

Based on the findings of the study, the following recommendations have been divided into two categories for the following stakeholders: banks and regulatory bodies.

5.2. Recommendations for banks

- *Develop environmental risk management training programmes for management and operational staff within the credit and communication department*

The findings of this study indicate that all banks surveyed have not undertaken any environmental management training over the last three years. According to Mazahrih (2011: 307), employees' training is critical to the success of improving the bank's environmental performance. These training programmes should be applied at senior management, middle management as well as at operations staff particularly those staff members dealing with lending processes and the training must have a strong emphasis on environmental risk identification and how to interpret various environmental reports. The implications for not incorporating environmental risks into lending processes by the banks are that they might not enjoy a competitive advantage in terms of improved financial position, improved media coverage, positive pressure-group relations, assuring present and future compliance and providing an ethical image.

- *Develop best practices, procedures and guidelines for incorporating environmental risks into lending processes*

Policies, procedures and guidelines play a very important role by defining an organisation's guiding principles, providing detailed task instructions and forming the basic structure of business operations; hence there is need for all banks to develop internal guiding documents for assessing environmental risks. The EMA no 7 of 2007 needs to serve as the basis to develop such guidelines and this can be developed under the guidance of the Ministry of Environment and Tourism in partnership with the Banker's Association of Namibia (BAN). The procedures need to classify projects based on the perceived magnitude of their impact on the environment so that further precautions are taken by the banks to mitigate failure for loan repayments. Furthermore, documenting best practices on environmental risks in lending processes done elsewhere will assist the banks in developing and refining their lending processes so as to incorporate environmental risks.

On an internal level, the incorporation of environmental risks into lending processes has to be fuelled from within the bank to provide better results, as opposed to being imposed. The possible entry point is the recognition of the risks involved in incorporating them within the environmental issues in credit analysis and to develop the right tools (procedures, criteria, and checklists) to the credit risk department of the banks as well as environmental awareness of all staff. The commitment of the top management is also a prerequisite to encourage banks to establish their corporate responsibility, in order to enable the bank to gradually make the conversion towards the incorporation of these issues and deal with one of the toughest predicaments faced by banks: lack of information.

- *Designate a staff member, or a small team, in the credit department to deal with loan applications that carry environmental risks or opportunities*

Although some banks indicated that they have staff designated to deal with environmental risks since it is in the interest of all banks, the team or staff member will need to be capacitated in environmental management and risk assessments in order to be able to execute his/her mandate.

5.3. Recommendations for the regulatory agencies/government

The findings of this study revealed that no specific government role on environmental risks management in the banking industry was highlighted. It is therefore recommended that:

- Government should establish incentives for banks to engage in environmental financing. Specific measures could include, for example, more governmental support, such as tax credits and a policy of charging banks' credit at a lower interest rate.
- Additionally, since government is in charge of controlling regulatory institutions for the banking industry, government could consider establishing appropriate policies to ensure the effective practice of environmental risk management in banks through disclosure on environmental and social issues. Many countries have begun to implement detailed legislation to protect the environment and Namibia is not an exception, and has sought to raise environmental standards and more tightly regulate business activity with such legislation as the Environmental Management Act no 7 of 2007 in Namibia. The refinement of the EMA regulations to cater for the banking industry will further enhance the implementation of the EMA at the same time reduces exposure of banks to environmental risks associated with projects they finance.
- The Namibia Stock Exchanges (NSX) should also consider requesting their listed banks to follow Global Reporting Initiative (GRI) guidelines. The aim of the GRI guidelines is to assist reporting organisations and their stakeholders in articulating and understanding contributions of the organisation to sustainable development through their reports. While each reporting system has its own limit, the advantage of using GRI Guidelines for reporting provide a holistic framework that addresses broad performance – social, environmental and economic – as to how an organisation is reporting to stakeholders. They guide an organisation's approach to proving its impact and

since it is used widely internationally as a generally accepted reporting framework and, as such, provides a method for increased comparability.

5.4. Conclusion

This study has offered insight into how Namibia's banks incorporate environmental risks into lending processes by way of exploring aspects relevant to environmental management, environmental risk assessment and potential environmental opportunities, and motivational drivers.

Beyond the results already stated, the study has also detected differences amongst the banks on how they identify environmental risks in their lending processes. The methods vary from no consideration of such risks to sophisticated assessment especially through the recognition of their existence, national legislation requirements, conditions imposed by lenders and organisational values. The outcomes of this study confirm the findings of Jeucken & Bouma (2001: 10), in which they observed that the management of environmental risks in the lending processes are still in an infancy stage of development though it is incorporated in most banks in one way or another.

Analyses of the lending practices in the banks interviewed have shown that there is lack of environmental risk considerations in the banking industry in Namibia. While environmental issues are implicitly incorporated in the credit management processes of some banks, banks in Namibia are not prepared for possible future challenges primarily in relation to new national environmental legislation (EMA no. 7 of 2007). As long as environmental issues are not considered properly and environmental risks assessed individually and not only in light of clients' legal compliance, banks in Namibia are exposed to risks, both financial and reputational, they don't account for.

Since there are a lot of grey areas with respect to incorporation of environmental risks into bank's lending policies, future research should consider more case studies to explore the relationship between the bank's financial performance and its environmental performance. Further research could also be embarked on to quantify the potential green bond market, which could provide banks management with a potential supply of business that has not been realized. It is acknowledged that research to incorporate environmental risks into lending processes is in its infancy stages in Namibia. Nevertheless, with increased internalisation and globalisation of environmental issues and associated risks, banks cannot afford to neglect the management of environmental issues in the future. Thus, scholars need to bring up-to-date their research agendas. While, in this study, the researcher only identified and categorised approaches to incorporate environmental risks into lending processes, future researchers need to focus their studies on the implementation of environmental policy, environmental audits, and bank's environmental risk management structures.

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APPENDICES

APPENDIX 1 - STATEMENT OF INFORMED CONSENT

The purpose of this study is to assess how banks in Namibia are incorporating environmental risks into lending decisions. This research project is being conducted in order to complete a Master's Degree in Development Studies in the Faculty of Economic and Management Science at the University of the Free State in South Africa.

In order to participate, your informed consent is required. You will be asked to make a decision whether to participate in the project. If you want to participate and agree with the statements below, the completion of the questionnaire signifies your consent. You may change your mind at any time and leave the study without penalty even after the study has begun.

This project has been approved by the Faculty of Economic and Management Sciences. Approval of this project only signifies that the procedures adequately protect the rights and welfare of the participants.

I understand that:

1. My participation is voluntary and I have the right to refuse to answer any questions.
2. My confidentiality is protected. My name will not be linked to the study. There will be no way to connect me to my electronic submission. If any publication results from this research, I would not be identified by name.
3. There will be no anticipated personal benefits because of my participation in this project. There is a minor risk in the time that it takes to complete the study. Some questions may be of a sensitive nature.
4. My participation involves reading a face-to-face interview and the interview is estimated to last 1 hour.
5. The research is being conducted to complete a research component and the final report will be presented to the University of the Free State before end of October 2016.

6. Data will be kept on a password protected computer and will be erased when the research has been completed.

I am 18 years of age or older. I have read and understand the above statements. All my questions about my participation in this study have been answered to my satisfaction. I agree to participate in the study realising I may withdraw without penalty at any time during the survey process. Submitting the survey indicates my consent to participate.

If you have any questions you may contact:

Student Researcher:
Jonas Jacob Nghishidi
Tel: +264812910884 (jnghishidi@gmail.com)

APPENDIX 2 - INTERVIEW QUESTIONNAIRE

GENERAL/INTRODUCTION
What is your current position in the bank?
How long have you been in your current position?
Could you please outline your experience working with environmental risks in the bank? Other sectors?
Could you please tell me about the level of significance that the bank attaches to environmental issues? ➔ Follow up: How important is it for incorporating in the bank's core business activities?
ENVIRONMENT RISK MANAGEMENT APPROACHES
Does your bank have an environmental management policy in place? ➔ Is it publicly available?
Does the bank produce sustainability/environmental reports based on its operations? (e.g. CSR report) ➔ Are these publicly available?
How do your lending appraisal processes address environmental risks? ➔ Do you base your lending criteria on any standard [Equator Principles, IFC performance standards, World Bank safeguard policies]
Before extending credit to a client, does the bank carry out an environmental risk exposure assessment of a potential client or project? ➔ What does it entail?
What are the perceived drivers for incorporating environmental risks management into your bank's lending decisions? ➔ Which is the most significant to the bank?
Has the bank ever refused to extend credit to a client due to negative environmental impacts? ➔ What were the key issues that the bank looked at?
How successful has the bank been in incorporating environmental risks into lending processes? (Poor, Fair, or Good? ➔ Why that rating?
CAPACITY DEVELOPMENT MEASURES

What environmental training does your credit department receive?
Has your bank undertaken any environmental training in the last 3 years? ➔ What were the key topics of the training?
Are your department staffs familiar with any of the Environmental and Social Risk Management System? E.g. Equator Principles, UNEP FI, Etc.
Describe what you consider as the keys to successful environmental training for lending staff?
CHALLENGES FACED BY BANKS TO INCORPORATE ENVIRONMENTAL RISKS
Describe the challenges faced by banks to incorporate environmental risks into lending processes.
What are the complexities for the credit department to address environmental lending issues?