ESG

Finance: How a non-bank lender is integrating ESG

By Arina Musthafa / The Edge Malaysia
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Hamada: Lenders like Orix are under no pressure from the central bank to implement ESG policies and practices, we are doing this by virtue of our desire to contribute back to society. (Photo by Shahrill Basri/TheEdge)

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Banks are under pressure from Bank Negara Malaysia, investors and environmental activists to integrate environmental, social and governance (ESG) values into their business models and become more resilient against future challenges.

For instance, Bank Negara encourages local financial institutions to manage climate risk to ensure that their ability to provide financial services will not be significantly affected by the threat of climate change. In response, banks have been implementing solutions such as phasing out financing for coal companies, companies involved in deforestation and companies with high carbon emissions.

However, there is less pressure on non-banks that also provide financing, although that does not mean they have not been following the trend. For instance, Orix Leasing Malaysia Bhd — which offers automobile rental and leasing, technology equipment rental, hire-purchase financing and factoring, among other services — has been doing so.

The company has been operating in the country for 50 years and mainly serves small and medium enterprises (SMEs). Its president Shin Hamada says the company chose to adopt ESG practices in order to create a positive impact on society and support greener businesses, equipment and facilities.

"Although lenders like Orix are under no pressure from the central bank to implement ESG policies and practices, we are doing this by virtue of our desire to contribute back to society by recognising the importance of our environment. Thus, we self-imposed these ESG regulations," he says.

"It started with reducing and limiting Orix's exposure to business areas with high environmental risk. Orix's sustainable and responsible financing guidelines state the reduction of credit balances in industries with high environmental impact such as fossil fuel mining, oil palm plantations and forestry, including timber processing and sales. The total receivables for the specified industries have been capped since 2021, and thereafter [we plan] to further reduce the exposure by 2030."

Because of this, Hamada says, Orix's SME customers are more aware of the importance of ESG and gear their investments towards contributing to ESG practices, such as investing in renewable energy (RE) sources by installing photovoltaic panels.

Seeing ESG as a business opportunity

This focus on ESG criteria is not just about risk management but also presents opportunities for Orix. For instance, there has been a general increase in demand from Orix's customers for the leasing of hybrids and electric vehicles (EVs), says Hamada. The company aims to have 15% of its fleet acquisitions be hybrids and EVs by 2024.

"We recommend our customers use hybrid vehicles as of right now. The market for EVs is still in the emerging stage and Orix is studying infrastructure matters related to EVs," he says.

Additionally, "for the financial year 2024, Orix is targeting 12% of business volume to be from the financing of ESG-favourable equipment and industry. The ESG-favourable equipment includes photovoltaic panels, energy-efficient lighting and cooling systems, air filtration systems, solid or fluid waste treatment systems, electric forklifts, electric buses, hybrids and EVs, and light and heavy commercial trucks with green engines", he says.

Other areas that Orix is interested in include biomass collection from coconut fibre and coco peat, the production of RE technology components, the production of recycled and biodegradable products, and recycling and waste management solutions, among other things.

According to Hamada, Orix promotes economic inclusivity by providing greater financial access to SMEs and adds that, as a non-bank financial institution, Orix has more flexibility in its lending.

"Newly established SMEs that are operating in new growth areas with minimal track records are usually not favoured by conventional banks. However, as a non-bank financial institution, Orix has the flexibility to assist and enable the growth of such businesses by providing customised or innovative financial solutions if they comply with our ESG and credit policies," he says.

"Previously, we funded SMEs in the robotics and automation field, which was relatively new then. While banks shied away from financing the new industry, we saw the growth potential and provided the much-needed financial support to grow their business. Their revenue has increased approximately fourfold within the last five years."

Screening for ESG criteria

Hamada says various aspects are incorporated into the analysis of Orix's customers during the due diligence process.

"First, we conduct screening of our potential customers through a reputable independent database against a wide range of areas, such as global sanction lists, global regulatory and law enforcement lists, and negative media coverage," he says.

After that, Orix will interview the key management or ultimate beneficial owner of the assets. This is "part of the management analysis, which includes identifying possibilities of forced labour, child labour, human trafficking or any other practices that may be deemed a human rights offence".

"One last touch before we agree to finance our customer is to identify the nature of business and categorise the customers into ESG-favourable and unfavourable industries as part of the industry analysis," he says.

This is similar to Bank Negara's Climate Change and Principle-based Taxonomy that is imposed on financial institutions.

The core of Orix's sustainability goals focuses on care for the natural environment, respect for human and labour rights, and promoting diversity and inclusion while caring for the well-being of employees, as well as upholding the highest business ethics, according to Hamada.