Ethical Banking

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Without Abstract

Synonyms

Ethical investing, Green banking, Impact investing, Socially responsible investing, Sustainable banking, Social banking

Definition

Ethical banking is a fairly broad term that refers to the bank's business integration with sustainable development goals or social, environmental, and ethical (SEE) criteria. In other words, ethical banking aims to encompass a sustainable and ethical banking system involving eco- and social-friendly practices. Both internal and external driving forces may motivate conventional banks to transform into ethical banks. Internal driving forces may rise from shareholders, board of directors, and employees. External driving forces may come from the general public, governments, local societies, nonprofit-making governmental organizations (NGOs), customers, and competitors. Although there are no clear definition and regulatory rules that distinguish ethical banks from conventional banks, ethical banks voluntarily follow some ethical beliefs/principles in their finance and investment projects. Ethical banks may also be stimulated to develop more sustainable products, for instance, green funds or environmental, social, or ethical investment funds. Ethical banks value their universal existence by providing transparent corporate information and positive social and environmental impacts to the public. In general, ethical banks seek to promote fair-trade opportunities and provide social enterprise supports and ethical consumerism while making financial and lending decisions. The term "ethical" can be used interchangeably with social banking, green banking, or sustainable banking. For example, banks can claim themselves as ethical banks by supporting local green initiative projects. According to the definition of Schultz (*2010*) in the Green Bank report, green banking involves banks' engagement in eco-friendly conscious practices. It aims to reduce carbon footprint from their banking activities, such as online banking or paperless banking applications.

Business Objectives

Business ethics will become irrelevant if banks choose profit maximization as the primary business objective. One way to enhance the operation of banks' business is to incorporate social, environmental, and ethical (SEE) issues by building up corporate social responsibility (CSR) guidelines within the traditional banking business model (San-José et al. *2011*). However, this is not precisely to be all-inclusive ethical commitments when making financial decisions. According to San-José et al. (*2011*), ethical bank owners can decide the company's rules and objectives on the aspects of SEE issues. The business acts by following its moral beliefs, standards, and regulation to determine its essential value. The decision from the owners related with ethical issues is a big challenge.

Various synonyms have been used in practice with the concept of ethical banking, such as Triodos banking, Islamic banking, green banking, sustainable banking, and environmental or social banking. All of them have an ethically related business objective. For example, Triodos Bank, established in the Netherlands in 1980, is a specialist ethical savings bank. The aim is to invest in businesses that seek to address social and environmental issues, such as solar energy, healthcare, and charities. In addition, savers can make an agreement on their investments to finance a particular industry or project; business loans are limited to the organizations which are involved in sustainable development projects. It is well known that a firm's corporate governance performance and its social, environmental impacts have become the leading performance indicator in the industry. According to the Association of British Insurers' (ABI) study in 2008, firms with good corporate governance produced 18% higher returns than firms with poor corporate governance; shareholders suffer from low returns by investing in a poorly governed firm (Selvaggi and Upton *2008*). San-José et al. (*2011*) identify that transparency of information, placement of assets, guarantees, and participation make ethical banking different from other traditional banks (such as saving banks, commercial banks). The objective of ethical banking seeks both economic and social benefits, which can fit into a socioeconomic model.

The Environmental Issues

Due to the emphasis on environmental issues, banks initially concentrate on the "direct" or "internal" issues related to banks' business processes, such as electricity, water, and paper usage issues. The potential energy saving of banks is enormous, as can be seen from the achievements of these proactive companies. For example, Dutch banks agreed with the Dutch government to cut their energy by 25% from a 1996 baseline by 2006 and achieved a successful result (Jeucken and Bouma *1999*). UBS and NatWest Group achieved similar result. Some of the financial services firms also use renewable energy to improve their internal environmental performance. For example, the Rabobank Group uses solar energy. The Co-operative Bank in the UK introduced the first biodegradable credit card in 1997, in support of Greenpeace (Jeucken *2001*). Generally speaking, banks' energy-saving actions are cost-effective, not because of legislative pressure. Credit Suisse has developed an instrument to measure its environmental impacts, which summarized that energy usage is by far its most profound impact, accounting for 90% of all cumulative pollution within the organization (Jeucken *2001*). UBS used a similar approach named "Environmental Performance Evaluation." Other environmental reports from banks also conclude that energy is one of the most significant aspects. The measurement of environmental performance and comparison of that performance between banks, however, remains challenging.

Furthermore, banks have been disinclined to promote environmental focus from the external side. Banks recognize these as “external” issues or “indirect” issues associated with the products of banks provided. The banks’ products themselves do not pollute the air, water, and land and even do not produce hazardous chemicals. Instead, it is the users who can have an impact on the environment. The funds’ channel through the banks’ lending schemes may indirectly cause environmental damages. Banks, therefore, need to have an incentive to understand the environmental implications when making lending decisions, primarily how the loans will be used in practice. As debated by many scholars, banks’ lending activities could be associated with potential threats to the natural environment (Sarokin and Schulkin *1991*; Thompson *1998*). Thompson and Cowton (*2004*) also argued that a bank’s lending portfolio impacts the natural environment. Overall, how banks perceive and deal with its social and environmental responsibility associated with their lending activities is still under debate in recent decades.

Future Directions

It is very objective to determine what is ethical and claim to be an ethical bank. It is impossible to have a universal definition that distinguishes ethical banks from conventional banks. Ethical banks are regulated similarly to traditional banks and must abide by the same regulatory rules. Although many ethical banks voluntarily become ethical, certain levels of supervisory and regulatory ethical policies or ethical codes of conduct are needed to set up the rules. According to Cowton and Thompson (*2000*), banks who signed the United Nations Environment Programme (UNEP) statement did not act significantly different from the non-signatories. Hence, an external regulatory body or monitor body needs to be in place to set minimum acceptable legal standards. Certain degrees of enforcement methods should be in place to make ethical codes to be more effective.

Cross-References

- Banks and the Sustainable Development Goals
- Business for Social Responsibility
- Corporate Social Responsibility
- Definitions of CSR
- Environment, Social and Governance (ESG)
- Environmental Impact
- Ethical CSR
- Finance and CSR
- Inclusive/Selective/Compliant Finance/Banking
- Islamic Banking
- Islamic CSR
- Social Responsibility

- Social Responsible Investing and Finance

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