CHAPTER 2

Ethics and Finance: The Unresolved Puzzle

Abstract This chapter moves from recent critiques of mainstream finance and provides an excursus on the role of ethics in finance. By underlining how several scholars have questioned the essence of neoclassical approaches based on rational behaviors and profit maximization, the chapter focuses on the emerging role of alternative approaches and on the themes of social finance and social banking.

Keywords Mainstream finance • Ethics • Social finance • Social banking

2.1 Introduction

The global financial crisis illustrated that the expansion of the financial sector, the phenomenal sophistication of financial products, and the unprecedented velocity of financial transactions have together profoundly altered the relationships between finance, the economy, and society (Lagoarde-Segot 2017, p. 113).[1] Three main facets of the international financial system—under the ideological conditions of neoliberalism—led to the crisis: social irresponsibility, intransparency, and unsustainability (Benedikter 2011).

Irresponsibility, morally dubious behavior, and financial misconduct have had a disruptive impact on society. The emerging fields of social finance and social and sustainable banking represent attempts to include broader considerations of fairness, social values, and social justice in financial market operations.

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https://doi.org/10.1007/978-3-319-73389-0_2

This chapter provides an excursus on the role of ethics in finance. By showing how several scholars have questioned the essence of neoclassical approaches based on rational behaviors and profit maximization, the chapter focuses on the emerging role of alternative approaches and on themes of social finance and social banking. Finally, the appendix provides an overview of the two most important social banks to describe their main characteristics.

2.2 Concepts of Ethics Applied to Finance

The concept of ethics—and especially of a lack of ethics in business behaviors—has been brought to the fore by the crisis (Dembinski 2009; Lewis et al. 2010; Van Hoom 2015) and is considered to be an important future challenge (McCosh 1999; Stückelberger 2012). Although finance raises many ethical issues, the academic study of ethics has received little attention from scholars in the finance and business disciplines (Boatright 2010). Boatright (2010 p. 3) clarifies this issue: "*The neglect by finance scholars is understandable given the research paradigm in the field, which not only excludes normative questions from study but also demands the use of particular analytical tools and methodologies. For most finance scholars, the task of addressing ethical issues is simply not what they are trained to do.*" The ways of thinking in finance owe much to the general field of economics. Thus, finance scholars have developed the general economic conceptual framework to assume a distinctive finance-oriented view of the world (Kolb 2010).

San-Jose and Retolaza (2017) argue that the debate about ethics and finance is still open and that scholars are divided between those who consider this relationship to be an oxymoron and those who consider principles and values to be the basis of finance. In the first case, the relationship between ethics and finance is considered an oxymoron because the financial market structure leads to the maximization of profit grounded in self-interest (Dobson 1997; Werhane and Freeman 1999; San-Jose and Retolaza 2017). In this vein, Dobson (1997) highlights how something has gone wrong in the transition from the "self-interest" approach used by Smith and Hume to the "self-interest" approach used in the finance paradigm, and that traditional finance is based on rational agents that are individualistic, materialistic, and competitive (Dobson 1997). The view of business as "*amoral*" and thus the need for a separate discourse of "ethics" is described by Freeman (1994) and Werhane and Freeman (1999) via the "separation thesis" that pervades business ethics. The separation thesis is based on the following idea: "*the discourse of business and the discourse of*

ethics can be separated so that sentences like, 'x is a business decision' have no moral content, and 'x is a moral decision' have no business content" (Freeman 1994, p. 5). Freeman offers a provocative explanation, clarified by Wicks (1996), for why the normative core of business research is perceived as fundamentally at odds with the pervasive wisdom on business and with the academic literature on management, while Sandberg (2008, p. 230) defines values as "*embedded in social contexts from which they cannot be removed*".

It seems clear that one of the main critiques of mainstream neoclassical theory is that it has failed to incorporate into its corpus notions of altruism, morality, and ethics; that economic agents are completely self-interested in terms of their underlying motivational structures (Altman 2005); and that opportunism is built into financial economics in a most fundamental way (Dobson 2010).

In this vein, academics argue that contemporary economic theory is flawed (Etzioni 1988) or in need of revision (Altman 2004; Henrich 2004; Kahneman et al. 1986a, b), while others consider financial economics to be incompletely detached from ethics and value (Dobson 1991). From a theoretical point of view, Kolb (2010) identifies two more recent developments that have also involved ethical issues and, namely, issues of enterprise or integrated risk management and behavioral finance. In particular, behavioral finance developments are the result of advances in psychology that yield a more realistic understanding of people's actual financial decisions. The result has been to replace the simple view of *homo economicus* as a perfect utility maximizer with a more complex conceptualization that managers must consider in their efforts to increase firm value (Kolb 2010). Oberlechner (2007) provides an extensive review of psychological research relevant to the ethical decision-making process, while Prentice (2007, p. 17) highlights that "*the flourishing field of behavioral finance indicates that people often do not engage in optimal decision making when investing. The same cognitive biases and mental heuristics that cause suboptimal investing may also cause people to make unethical decisions. For that reason, good intentions are necessary, but they are not sufficient for finance professionals who desire to act ethically*".

2.3 Critics of Mainstream Finance

The recent financial, economic, and social turmoil calls for a profound reconsideration of finance theory (Lagoarde-Segot 2010; Porter and Kramer 2011; Rappaport and Bogle 2011; Bay and Schinkus 2012; Shiller 2013; Krugman 2014; Lagoarde-Segot 2014; Lagoarde-Segot 2016) by questioning the assumptions and paradigms of mainstream literature

(Paranque and Pérez 2016; Lagoarde-Segot 2017; Lagoarde-Segot and Paranque 2017). One of the most interesting effects of this particular market crash is that finance theory has been directly blamed for the crisis (Fabozzi et al. 2014; Zingales 2015; Carè et al. 2018). Specifically, standard models are being questioned because they do not take into account the whole picture and especially neglect the behavioral and "human" aspects of the markets (Colander et al. 2009; Jorion 2009; Lawson 2009; Kirman 2010; Vasile et al. 2011).

The origins of modern finance are generally dated to the development of modern portfolio theory (MPT) in the 1950s and its dominant perspective is the efficient market hypothesis (EMH)[2] (Preda 2017). Mainstream academic finance is based on the following theories: (1) efficient market theory, (2) portfolio theory, (3) capital asset pricing theory, (4) option pricing theory, (5) agency theory, (6) arbitrage pricing theory, (7) capital budgeting policy, (8) capital structure policy, and (9) dividend policy (Smith and Clifford 1990; Bettner et al. 1994). Bettner et al. (1994) note that the common threads across theories and policies of mainstream academic finance include the following:

1. An underlying cause and effect mechanism animates all financial activity, and connections exist between initial conditions and final outcomes.
2. Connections are determinable, and then outcomes can be predicted with certainty.
3. All relevant human behavior is governed by the cause and effect mechanism.
4. All financial activity can be quantified, and the logic of statistical analysis and inference applies to all measurements.
5. All human beings have equal access to the institutions and systems within which financial activity is undertaken (p. 3).

The concepts of rationality and efficiency are central to contemporary economics and finance, and scholars take individuals' choices as a starting point in their analyses (Hsieh 2010).

Critiques of mainstream finance can be analyzed based on three perspectives: individual behaviors, the analysis level, and the overall conceptual framework (Paranque and Pérez 2016).

According to the individual behavior perspective, the main critiques of mainstream finance are based on the fact that it does not consider "human aspects" that may foster fear and greed (Shefrin and Statman 2000) and immoral and inappropriate behavior among financial market agents

(including supporting entities, such as rating agencies and regulatory institutions) (Szyszka 2011). In this sense, classical examples of various deviations from "rationality" have been revealed by behavioral research since the 1970s. In the last 40 years, behavioral researchers have won Nobel Prizes and accumulated evidence that renders it difficult to deny that these theories challenging the underlying assumption that agents are fully rational represent a credible alternative paradigm (Gippel 2013).

Finance theory has also been criticized for the weak design of its theories (Paranque and Pérez 2016). Findlay and Williams (1985) provide a cogent critique of mainstream finance theory by arguing that its assumptions are manifestly contradicted by observations and that the capabilities of a theory to explain depend upon the methodological approaches it adopts. In the same vein, Blommestein (2009) states, "*Testing an economic theory in quantitative form requires the introduction of all sorts of ad hoc statistical or econometric modeling assumptions in order to arrive at a fully specified empirical model. This ad hoc nature of economic model building generates a significant degree of specification uncertainty. […] Semantically insufficient theories, therefore, make it very hard to formulate reliable empirical models. In other words, the big problem with economic theories is not that they are too simplistic or that so-called 'unrealistic' assumptions are being used, but it is their semantical insufficiency (low degree of testability)*" (p. 71). To describe how "mainstream finance" maintains its hegemony, Keasey and Hudson (2007) bring to light that "*researchers take data from the outside world, often ignoring the rich complexities of the context which has given rise to the data, and creates puzzles where the data does not fit into the traditional core of the subject. These puzzles then act as catalysts for research activity as researchers try to 'solve' them. As a description of this research process we use the metaphor of 'A House Without Windows'*" (p. 933). In the metaphor used by Keasey and Hudson (2007), the community of finance scholars lives inside the house and their debates and models are internally consistent, but they require "new facts" if the debate is to be kept alive. However, rather than attempting to view the actions of individuals firsthand or to engage in debates with individuals who are involved in financial decision-making, the finance community prefers to stay safe and to use data from the world outside. The problem is that these data feeds are interpreted from their shared paradigms. In this way, anomalies give rise to new debates that attempt to reconcile them with the existing paradigm (Keasey and Hudson 2007).

2.4 From Critics of Mainstream Finance to Social Finance and Social Banking: A New Humanistic Approach

The 2007/2009 financial crisis has shaken investors' confidence in established market ideologies by renewing interest in the impacts that investments may have and by renewing interests in what could be considered "alternative finance". As noted by Shiller (2013, p. 10), finance should be defined not merely as the manipulation of money or as the management of risk but also as the stewardship of society's assets. The author argues for the need to envision new ways to rechannel financial creativity to benefit society as a whole. Indeed, this shift toward social finance can, in its essence, be considered part of a basic mind-set shift under the influence of the crisis, one that highlights a new "financial humanism" taking the form of a heightened responsibility for sustainable development in the social and environmental spheres (Benedikter 2011).

In the academic literature, social finance can be considered a relatively new development in the international banking and finance sector (Benedikter 2011; Hangl 2014; Joy et al. 2011; Lehner and Nicholls 2014).[3] According to the conceptual approach applied by Weber (2012, p. 3), social finance is "an umbrella term for financial products and services that strive to achieve a positive social, environmental or sustainability impact". Moore et al. (2012, p. 116) note that "social finance refers to the deployment of financial resources primarily for social and environmental returns, as well as in some cases, a financial return".

Social finance is based on a set of values that gives priority to ethical and ecological choices, social utility, public interest, local development, and long-term returns over short-term profit maximization (Vandemeulebroucke et al. 2010). In particular, Nicholls and Pharoah (2007, p. 2) underline that it refers to more than just the flow of money into social or environmental projects, as it is conceived as an ethos of the way money is used. A deeper understanding of social finance has not been facilitated by the numerous terms applied to the concept of intentional investing for positive social impact (Harji and Hebb 2010). Social finance, social investment, and impact investment are commonly used as synonyms (Moore et al. 2012). Höchstädter and Scheck (2015) stress that social finance and social investment are not perfectly congruent with

impact investing. Instead, these authors consider impact investing to be a subtype of social finance/investment (Höchstädter and Scheck 2015). As the main distinction between conventional and social finance, the latter uses financial services and products to achieve a positive impact on society, the environment, or sustainable development (Weber 2012; Weber and Duan 2012). Social finance can be generally classified into three main categories: (1) social banking, (2) impact investing, and (3) microfinance (Weber and Duan 2012). Social banking is conducted by social, ethical, or alternative banks and partly by cooperative banks and credit unions (Weber and Remer 2011). In contrast to conventional banks, social banks provide loans to create a social or environmental benefit (Edery 2006; da Silva 2007). Social banking is not a new phenomenon in the finance landscape. The notion of social banking has its origins in religious and ethical movements and represents an alternative means of engaging in banking. Social banks grew exceptionally in the years of the financial crisis (Benedikter 2011; Weber 2011) and are considered an alternative and more resilient way of banking.

2.5 Social Banks: Definitions and Practices

The term "social banking"—also referred as "alternative", "ethical", "green", "sustainable", and "values-based" banking—describes banking and financial services designed to contribute to the development and prospering of people and the planet today and in the future (Institute for Social Banking 2017). As noted by Weber and Remer (2011) and by Tischer and Remer (2016), a clear definition of social banking does not exist, essentially because each alternative term used has a "slightly different center of gravity" by placing the focus on different aspects of social change and development (Benedikter 2011). Thus, De Clerck (2009, p. 214) states: "*Social, ethical, alternative, sustainable, development and solidarity banking and finance are denominations that are currently used to express particular ways of working with money, based on non-financial deliberations. A precise and unified definition of these types of finance as such is not available and perhaps not possible because of the different traditions from which ethical finance actors have emerged*."

Weber and Remer (2011) highlight that "*social banking sounds like an oxymoron, combining what does not belong together. To others banking is inherently social and to them the phrase social banking is almost tautological.*

Some refer to social banks as those that serve socially oriented or charitable clients. Others use the term social banking to refer to banking based on the new social media, such as the Internet and related software. In some regions social banking is equated with government banking, in others it is equated with microfinance. Finally, some argue the social part in social banking could and should be replaced by sustainable or ethical, whilst others insist that these terms are not to be used interchangeably" (p. 1). Social banks are financial intermediaries that focus on noneconomic criteria (Cornée and Szafarz 2014) and that deliver financial services to individuals and organizations that have positive social, environmental, or sustainable impacts (Weber 2012; Weber and Duan 2012). Their business model is based on two principles: achieving a positive impact on society and achieving a sustainable financial return (Guene and Mayo 2001; Geobey and Weber 2013). Social banks follow the concepts of social finance and blended value and use business practices designed to generate social or environmental benefits (Weber 2011; Weber and Remer 2011; Weber and Duan 2012) by differing from traditional banks on a series of characteristics (e.g., legal status, size, and goals) (Benedikter 2011; Weber 2011). Milano (2011) identifies several types of social bank:

- Ethical and alternative banks
- Banks of philosophical/theological nature
- Banks of economic/social nature
- Microfinance institutions
- Banks that do not accept interest
- Children's banks

Benedikter (2011) identifies "financial humanism" as the constituent philosophy of social banking and highlights two major aspects to be considered to understand it: the importance of culture and the concept of ethics. The concept of culture is included in the concept of sustainability,[4] which implies a significant difference in respect of traditional banks that need to change their way of doing banking to be sustainable while social banks born around this concept. With regard to the second aspect, money is conceived not as a value itself but as the expression of a social relationship based on mutual trust and help. In particular,

> *Social banking is indeed decisively centered about changing the consciousness of consumers and the broad public regarding what money is and how it can be best used. Since it wants to provide and increase the societal insight into the connections between money, society, politics, culture, and education in order to*

reach out for a more just and balanced world, it follows the basic principles of enlightenment: rationalization and emancipation for the largest possible number of people. (Benedikter 2011, p. 50)

As described by Becchetti (2011), social banking entails a change in corporate goals so that they are based not on profit maximization but on the creation of social and environmental value together with economic value and distinguished for their driving principles: transparency, communication, and participation (Von Passavant 2011). These three principles are applied in all bank operations. The Institute for Social Banking highlights the following characteristics of social banks:

- Catalog of social, environmental, and ethical criteria to prevent or support activities that respectively harm or foster the common good
- Core banking—traditional banking practices and values; a focus on certain traditional activities—namely, in the savings and loans business
- Focus on the needs of communities in the real economy and civil society
- Nonmonetary values guiding all business activities
- Ownership structures preventing dependence on dominant individual interests
- Participatory organizational structures and customer relations
- Proactive dialog with stakeholders and engagement in public discourse
- Promotion of giving as a central ingredient of renewal and development
- Rejection of profit maximization principles and of speculative activities
- Strategies that limit risk exposure and ensure resilience
- Set salary ratios (top-bottom) of approximately 10:1 with no or a very limited and equitable bonus systems
- Transparency and accountability (Institute for Social Banking 2017).

However, the main feature of social banking is highlighted by Benedikter (2011), who explains how the triple bottom[5] line approach is integrated into social banking: "*social banks are defined by applying three different standards to judge investment and lending opportunities that take into account three different criterions, all of them equally considered:*

- *Profit (respectively, economic rationality; there can't be losses that threaten the development of the bank as a whole),*
- *Environment (natural habitat, protection, and sustainable handling of resources),*
- *People (the primacy of the community and the balanced advancement of society, seen as a whole)*" (Benedikter 2011, p. 51).

De Clerck (2009, p. 220) provides an overview of the most globally important social banks. In particular, the author lists the following:

- ShoreBank, USA
- GLS Bank, Germany
- Triodos Bank, UK
- Freie Gemeinschaftsbank in der Schweiz, Switzerland
- Merkur Bank, Denmark
- Wainwright Bank and Trust Cy, USA
- Alternative Bank Schweiz, Switzerland
- Cultura Sparebank, Norway
- Ekobanken, Sweden
- Banca Popolare Etica, Italy
- Charity Bank, UK

The phenomenon of social banking is not new to the finance landscape, but it grew exceptionally during the years of the financial crisis (Benedikter 2011; Weber 2011).[6] Indeed, in recent years, social banks have not been affected by the financial crisis in the same way that mainstream financial institutions have. Relaño (2011) highlights that although social banks and traditional universal banks are regulated by the same authorities, must abide by the same rules, and must compete within the same market, they are not the same type of financial institution. Traditional banks and social banks are completely different because the former focus on profit maximization while the latter aim to combine financial surpluses with social returns (Relaño 2011; Mykhayliv 2016).

Moreover, social banks, except to the extent required by regulators, are not typically active on the interbank or wholesale markets and finance themselves with customer deposits by seeking to invest in organizations with similar values, including making proportionate investments in other values-based banks (Benedikter 2011; The Vienna Group 2015).

2.6 Reconsidering Banking and Finance Research: Is It Time for a Kuhnian Revolution?

This chapter highlights how, following the 2007/2008 turmoil, academics are posing several questions on the role of finance in society by questioning the classical assumptions of neoclassical finance theory. The financial crisis is also a crisis of trust in the banking system (Sapienza and Zingales 2012)

in terms of leading banking professionals, political control mechanisms, and the rationality of consumers and investors (Stückelberger 2012). An absence of diversity in research paradigms arguably translates into a body of knowledge that presents important limitations to attempting to make sense of important phenomena (Gendron and Smith-Lacroix 2015). The crisis cast doubt on finance studies that were often based on abstract mathematical and reductionist methods of research and limited by rigid models and theories (Colander et al. 2009).

Through the growing movement criticizing mainstream finance, several scholars argue that a significant diversification of the methods, concepts, and practical tools developed in academic finance is needed (Bay and Schinkus 2012; Alijani and Karyotis 2016; Lagoarde-Segot 2010, 2014, 2015; Paranque and Pérez 2016).[7] Critiques of traditional finance also refer to its epistemological approach. Lagoarde-Segot (2016) highlight that finance researchers "restrict their work to a monolithic approach derived from positivism" (p. 91) and that "*academic finance is indeed rooted in objectivist ontology: the financial world, just like the natural world, is assumed to be made of stable and tangible entities (*e.g., *financial markets, financial institutions, money…), which are external to the observer. Finance research considers that financial institutions (banks, money, markets…) and financial behavior (risk-return optimization) exist independently of individual or collective representations of the social world*" (p. 90). By using a positivist approach, modern finance does not include "*moral and ethical considerations and reflections on social well-being*" (Lagoarde-Segot 2015); in a neoclassical financial scheme, *"personal interactions and authority are absent. Consequently, all behavior is ethically neutral"* (Blommestein 2009, p. 72). In criticizing this methodological and epistemological approach, Lagoarde-Segot (2015) stresses that *"academic finance has moral, philosophical and political aspects"* (p. 97) and highlights that the subjectivist ontology represents a core assumption of the domain of finance that adopts methods of the social sciences. In this case, "*notions of ethics, values, and intentionality become key-concepts*" (Lagoarde-Segot 2015, p. 106). In particular, as stated by Gippel (2013), the 2007 financial crisis is viewed by many scholars as an "impetus to search for new paradigms and thus may be described in a Kuhnian sense as a *crisis*" (p. 128). From Kuhn's (1962) point of view, science progresses through *paradigm-shifting* and "normal" science. More specifically, Bloomfield (2010, p. 26) clarifies that "*a paradigm provides a theoretical framework for researchers to test and bolster (or modify) through what Kuhn*

calls "normal science". Normal science establishes the validity of the paradigm but may also uncover anomalies —observations inconsistent with the paradigm. New paradigms become successful only if they can explain anomalies of sufficient quantity and importance in a sufficiently simple way". In this sense, a clear picture is provided by Stout (2005) who states that "*to describe the current state of finance in the terms of Thomas Kuhn's classic The Structure of Scientific Revolutions (1970), the old paradigm of an efficient market is crumbling. But the outlines of a new paradigm are visible in the resulting cloud of intellectual dust*".

This intellectual dust is currently animated by academics who are trying to promote a paradigmatic shift that can surpass the limits and rigid assumptions of mainstream finance.

From the analysis of literature in the field of ethics and finance, one major question emerges: Are classical finance models able to depict what occurs in the real world? Several scholars have highlighted that the relationship between finance and ethics is still unresolved and find the source of this question in the methodological and epistemological basis of mainstream finance. Carè et al. (2018) describe how alternative finance is becoming more central by including eight emerging themes of finance research within this broader concept; they further highlight how the habitus of finance academics appears to be ready for a change despite historical resilience to new theories and knowledge. Among emerging trends, Carè et al. (2018) proposes social banking and social finance, which are considered to be relatively new developments in the international banking and finance landscape. The authors also stress that the increased number of papers published on this subject in recent years can be viewed as a sign of an understanding of the meaning, importance, and potential of this thematic area.

Despite the fact that the main objective of this chapter is not to provide an answer to this question, previous paragraphs tried to point out a series of insights on what is occurring in research on banking and finance. A Kuhnian revolution is a slow process, but the path has been opened. Indeed, the new and emerging fields of behavioral and social finance represent an attempt at a paradigmatic shift. Through this new lens, finance may be viewed as a means not only to maximize profits but also to benefit and positively impact society. In this sense, social finance represents not merely a new means of engaging in finance but an alternative way of thinking about finance.

Social finance scholars view social banking as a new alternative model to traditional banks. However, studies demonstrate that social banks are a typical European phenomenon with many years of history.

Social banking is not a new phenomenon, and we note that it comes from the ancient term "Monti di Pietà", but in this time period, characterized by the need for alternative business and finance models, social banks may represent an interesting source of learning. These banks are characterized by the aims declared in their own mission statements: to create a positive impact on society while running their operations in consideration of this aspect. This phenomenon should not be underestimated. Social banks have been resilient in times of crisis by doing something good, but they are a limited phenomenon, and their business approaches differ considerably from those of traditional banks.

Appendix 2.1: Banking on Value—The Case of Triodos Bank and Charity Bank

This section provides an overview of two social banks: Triodos Bank and Charity Bank. These cases are analyzed to highlight the main characteristics of social banks and of these two banks in particular.

The selection of cases is not random but rather follows an information-oriented selection approach (Flyvbjerg 2006). The cases are selected so that they are relatively similar in regard to the matter for analysis. This selection process highlighted Charity Bank in the United Kingdom and Triodos Bank based in the Netherlands as two very interesting cases. In particular, they provide extensive information about their impact measurement and reporting approaches.

The Case of Triodos Bank

Triodos Bank is a European social bank registered in the Netherlands, and since the 1980s, it has distinguished itself by specializing in financing innovative environmental and social enterprise initiatives with social and environmental aims (Cowton and Thompson 2001; De Clerck 2009; Dossa and Kaeufer 2014; Bouma et al. 2017). Triodos Bank had tried to position itself as a humanistic alternative to other banks to demonstrate that saving, investing, and lending can be combined with social and environmental progress (de Graaf 2012, p. 159). Many authors

consider Triodos to be an excellent example of the European tradition of "social banking", which has evolved to meet the particular needs of the social economy that often face difficulties in obtaining finance from the traditional providers (Weber and Remer 2011; Cowton and Thompson 2001) by trying to restore a sense of relationship between depositors and borrowers which tends to be broken in conventional banking practice (Cowton 2002; Cowton and Thompson 2001). The Triodos website states:

> *Triodos Bank was founded on sustainable principles, so sustainability is in our DNA. For us, sustainable banking means using money to bring about positive and lasting change; placing value on people and planet, as well as profit. We do that by financing companies, institutions and projects that add cultural value and benefit people and the environment, with the support of savers and investors who want to help make the world a better place – as well as a good return on their money. Crucially, our definition of sustainable banking means that this is all we do: we only invest in sustainable enterprises and we only use the money entrusted to us by savers and investors – just like banks used to do, in the days before derivatives and credit default swaps.*

Triodos Bank's mission can be summarized as follows:

- To help create a society that promotes people's quality of life and that has human dignity at its core;
- to enable individuals, institutions, and businesses to use money more consciously in ways that benefit people and the environment and promote sustainable development; and
- to offer customers sustainable financial products and high-quality service (Triodos Bank Annual report 2016, 2017, p. 1).

Risk, Return, and Impact: The Triodos Approach

Triodos' business approach focuses on delivering sustainable social, environmental, and cultural impacts as well as risks and returns via the following business principles:

- Promoting sustainable development—considering the social, environmental, and financial impacts of everything we do;
- respecting and obeying the law—in every country where we do business;
- respecting human rights—of individuals, and within different societies and cultures; supporting the aims of the United Nation's Universal Declaration of Human Rights;

- respecting the environment—doing all we can to create and encourage positive environmental impacts;
- being accountable to all our stakeholders for all our actions; and
- continuous improvement—always looking for better ways of doing things in every area of our business (Triodos Bank Business Principles 2016b, p. 1)

Unlike traditional banks, which primarily focus on risks and returns to avoid negative outcomes and maximize returns to shareholders, Triodos Bank uses impact, risk, and return from a long-term perspective (Triodos Bank Annual Report 2015, 2016a). Triodos' investment strategy revolves around six main sectors:

- Energy and climate
- Emerging markets
- Inclusive finance
- Sustainable food and agriculture
- Arts and culture
- Sustainable real estate
- Socially responsible investments

Triodos Investment Management[8] also invests in listed companies with above-average environmental, social, and governance (ESG) performance.

Risk Management

The aim of Triodos Bank's risk management activities is to ensure the long-term resilience of the business (Triodos Bank Annual Report 2016, 2017). Its risk appetite is based on three objectives that complement its goals and guarantee a sustainable banking model. They are to (1) protect the bank's identity and reputation, (2) maintain healthy balance sheet relations, and (3) maintain stable growth. A risk governance framework and a three-line defense model have been put in place. The three lines of defense model involves

- first-line functions: responsible for managing the risks of operations;
- second-line functions: ensure that risks are appropriately identified and managed; and
- the third line of defense: (the internal audit function) provides independent and objective assurance of Triodos Bank's corporate governance, internal controls, compliance and risk management systems.

The director of risk and compliance is fully responsible for second-line risk management and compliance activities and reports directly to the chief financial officer. Such activities are supervised by the Audit and Risk Committee of the Supervisory Board.

Impact
Under the Global Alliance for Banking on Value (GABV),[9] Triodos Bank has developed an impact scorecard that is designed to measure

- basic requirements of a sustainable bank such as its mission and approach to transparency;
- quantitative factors, such as the proportion of the bank's assets committed to the real economy; and
- qualitative elements that provide an account of how a bank translates its sustainability agenda into its actual work.

Return
In recent years, Triodos Bank has faced stiff competition from conventional banks showing a growing interest in sustainability as a market opportunity. Despite this, Triodos continued to grow its sustainable loan portfolio by 13% in 2015. Its total loan portfolio, which includes short-term lending to municipalities, increased by 22% while its assets under management grew by 19% in 2015 (Triodos Bank Annual Report 2016, 2017).

The Case of Charity Bank

Charity Bank was founded in 2002 to support charities and social enterprises with loans and to provide people with opportunities to save in line with their values (Charity Bank 2017/2018 Loans Portfolio Report 2017a). Charity Bank was founded with the charitable mission to lend money to charities and social enterprises, and it was the first charity to be granted a banking license from the Financial Services Authority, rendering it unique as the only not-for-profit bank lending exclusively to charities (Buttle 2008). Shareholders are led by Big Society Capital and the Charities Aid Foundation and include a number of charitable trusts and foundations (Charity Bank Annual Report 2016, 2017b) that are committed to supporting the social sector. Charity Bank's balance sheet increased by 15.3% during 2016, while on the assets side, loans to charities,

community groups, and social enterprises increased by 27.9%, with 72.8% of the balance sheet being used to make charitable loans. With respect to liabilities, deposit levels increased over the years, growing by 12.9% in 2016 (Charity Bank Annual Report 2016, 2017b). Charity Bank's principal risks and uncertainties lie in its exposure to

- the political and economic environment and changes in the government's approach to social policy;
- credit risk and the concentration of such exposure in one sector, with a resulting lack of portfolio diversification;
- a mismatch between the tenor of its loans and the maturity of its deposits and the risk of depositors withdrawing deposits upon notice ("liquidity risk");
- interest rate mismatches on its assets and liabilities;
- funding risk and particularly the need to fund increases in the loan book via capital raising and deposits from savers; and
- key person dependencies arising from its small size (Charity Bank Annual Report 2016, 2017b).

Social Impact Assessment

Charity Bank seeks both social and financial returns and has systems and processes to ensure that its decision-making processes help it achieve both (Charity Bank Social Impact Statement 2017e). The bank assesses the social impacts of the organizations to which it lends by considering how the organization will benefit of the loan and how the people it is working with will benefit of the loan (Charity Bank Measuring our social impact 2017d). In doing this, the bank considers three areas that are most relevant to its borrowers:

- *Mission focus*—Does the organization have a clear idea of what it is trying to achieve?
- *Organizational capacity*—Does the organization have people with the right expertise and sound systems of governance?
- *Financial resources*—Does the organization have the finances necessary to service the loan and meet its business plan objectives? (Charity Bank Social Impact Statement 2017e).

Table 2.1 presents an overview of sectors through which Charity Bank grants loans.

Table 2.1 Charity Bank: Loans per sector since 2002

Sector	*Amount of money*	*Number of loans*
Arts	10.998.080£	75
Community	28.153.154	173
Education and training	17.219.737	89
Environment	9.265.037	54
Faith	24.929.167	93
Health and social care	33.691.502	154
Social housing	62.398.181	184
Sport	8.402.945	54
Total	195.057.803	876

As of September 2017

Source: Charity Bank website (https://charitybank.org)

Loans are granted to the following types of organizations:

- Loans for any purpose and on any terms to any entity that is itself a charity and provides a public benefit;
- loans for any purpose and on any terms to any entity that meets Charity Bank's criteria as a social sector organization;
- loans on a mixed-motive basis where there is more than an incidental noncharitable (or private) benefit; and
- loans to other organizations without a charitable purpose and that are not social sector organizations under circumstances where the potential borrower can adequately demonstrate to Charity Bank that
  - the loan, if drawn, will facilitate material worthwhile social impact that could not otherwise be achieved or is a refinancing of such a loan;
  - the borrower passes Charity Bank's due diligence process; and
  - the loan documentation incorporates protections to maintain the organization's commitment to its intended social impacts or requires Charity Bank to be prepaid if it ceases to maintain its stance on supporting social impacts (Charity Bank CSR Policy 2017c).

Looking for Similarities and Differences

Although both Charity Bank and Triodos Bank can be classified as social banks, they have different characteristics and mission statements. Triodos Bank delivers retail banking services (e.g., payment cards) in addition to loans and investment funds, while Charity Bank delivers savings accounts and loans to charities while actively excluding loans made to for-profit

Table 2.2 Mission statements and impact assessments of Charity Bank and Triodos Bank

	Charity Bank	*Triodos Bank*
Mission	To lend money to charities and social enterprises	To help create a society that promotes people's quality of life and that values human dignity at its core To enable individuals, institutions and businesses to use money more consciously in ways that benefit people and the environment while promoting sustainable development To offer customers sustainable financial products and high-quality services
Impact assessment	The bank assesses the social impacts of organizations to which it lends by considering how organizations will benefit from loans given.	Impact scorecard

Source: Our elaboration

enterprises. This is a crucial difference and implies that Charity Bank will refuse certain projects that may be accepted by Triodos Bank. Table 2.2 highlights the main differences in terms of mission statements and impact assessments.

Despite their many differences, Triodos Bank and Charity Bank have a common claim of contributing to positive social and environmental outcomes. Transparency is a strong value attached to their business activities. Both banks provide information on specific projects that they lend to through storytelling.

Notes

1. The principal features of financialization include (1) the increased significance of the financial sector relative to the real sector; (2) the transfer of income from the real sector to the financial sector; and (3) increased income inequality and wage stagnation (Palley 2013).
2. On the concept of EMH as an artificial construct, see Howden (2009).
3. Several authors note that the academic literature on the topic of social finance is limited and "under-theorized and in need of conceptual framing" (Nicholls 2010; Antadze and Westley 2012). New academicinstitutions such as the Skoll Centre for Social Entrepreneurship at the Said Business School

of Oxford University in 2003, the Waterloo Institute for Social Innovation and Resilience (WISIR), and the Liege UniversityCentre for Social Economy have been established. This trend is not only attributable to increased interest from academics in innovations in the financial sphere but also to a growing awareness that investment insound academic research and teaching is a decisive pillar for developing mainstream "cultural" attitudes toward money and finance in a more inclusive and balanced direction.

4. On the concept of banking humanism, see Pirson et al. (2016).
5. For further information on the triple bottom line, see, among others, Elkington (2002) and Willard (2012).
6. On the origins of social banks, further information may be retrieved from Maccarini and Prandini 2009; Becchetti 2011; Benedikter 2011; Milano 2011; Weber 2011; Weber and Remer 2011; Weber and Duan 2012; and Weber 2016.
7. On the need to reconsider the role of finance studies and following a seminar held at the KEDGE Business School in Marseille (France) in May 2015, the "Postcrisis Finance Research Manifesto" was launched, and it states: "The ongoing economic, social and environmental crisis has revealed the need to redefine the function of finance. Academic finance bears significant responsibility in this process addressing the interaction between finance and society. As a response, many private actors have broadened their definition of 'value' in order to include environmental and social elements into their management and asset allocation practices. Such practices, however, appear incompatible with the current theoretical and methodological foundations of academic mainstream finance, which is heavily influenced by logical positivism and the methodological individualism hypothesis based on the maximization of the shareholder utility function. Academic finance focuses on the micro level and emphasizes econometric modelling rather than adopting a longer-run view incorporating the lessons from economic history. This paradox challenges us to reconsider the epistemological and theoretical foundations of modern finance, and, in particular, the dominant role played by shareholders. It is our responsibility to question the idea that social welfare and ethics are simply the result of shareholders value maximization and to enrich finance research, particularly with perspectives and contributions from other social sciences" (Lagoarde-Segot 2017, p. 122).
8. Triodos Investment Management is a globally active impact investor that includes Triodos Investment Management BV and Triodos Investment & Advisory Services BV, which are both fully owned subsidiaries of Triodos Bank NV.
9. The Global Alliance for Banking on Values is an independent network of banks founded in 2009 that use finance to deliver sustainable economic, social, and environmental development outcomes. For further information, see: http://www.gabv.org.

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