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Does Ethical Banking Hold the Potential to be the Future of Banking?

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Abstract

Banks are expected to play a major role in socio -economic and environmental progress of a country; yet, they have by and large neglected their societal and environmental responsibilities, thereby contributing mainly towards economic gains. As such, banks were blamed by civil society for not doing enough for the environment etc. They were also found wanting in providing services to lesser-privileged sections of society, thus unfairly excluding the category from the benefits of basic financial services. The economic downturn exacerbated their plight and exposed the banking sector's irresponsible attitude. Naturally, there has been a public outcry for banks to act more responsibly in the future. The mood of the public seemed to reflect the yearning for an alternate banking model, in order to discharge social, environmental and economic responsibilities effectively. As a result, an *Ethical Banking* came to be accepted as an alternative, as this model encompasses all three elements -economy, environment and society. Ethical Banking strives to achieve the triple bottom line - planet, people and profit. These banks envisage financial inclusion and also deliver eco- friendly banking solutions to customers. The main objective of this study is to determine whether ethical banking has the potential to be the future of banking. The significance of the study is also to find out how ethical banking may be adapted as the most suitable banking concept of the future. This study is a desk research, in the form of a literature review. The review identifies that Ethical Banking holds the potential to be the future of banking. The outcome of this research, highlights the importance of banking to be ethically oriented, in order to maintain sustainability for the future.

Key words: Ethical Banking, Future of Banking, Generation Z, Millennials, Socio- Economic Responsibility

Introduction

The Financial crisis in 2007 provided an opportunity for banks to reassess their business model. It brought governance and ethical issues of the banking industry to the surface. Weightage was given to morals and ethics in the banking sector as a consequence. It also paved the way for ethical orientation in the banking industry. Opportunities arose for experimenting with alternative banking strategies. A *values-based* banking was compared with the existing *value-added* banking. The banking sector sought to think in terms of an ethics based social culture. An ethics-based culture could lead to higher public trust in the system. Over the years, the lack of confidence of the public in the banking industry was alarming and this was hindering public goodwill. Although banks were perceived as trustworthy institutions in the past, over a period of time, their credibility had suffered, due to various speculative strategies adapted by them. With the increasing social and environmental consciousness of people, there was a requirement for a different form of banking to accommodate all three socio -economic and environmental objectives into the banking business. Hence, ethical banking was considered as an alternative banking model. Ethical banking is an evolving concept, as it is values-based; thereby, it can hasten the restoration of customer confidence.

Ethical Banking works well with civil society and other organizations. It will therefore be supported by civil society, unhappy with the conventional banking strategy of the past, which was governed strictly by a financial bottom line. Ethical Banks concentrate on projects that not only give economic value but also provide social value. So, ethical banks differentiate themselves by striving for the triple bottom line instead of the single bottom line. They assess loans as per the triple perspectives of financial, social and environmental criteria. Ethical banking, in the true sense, are by banks run by the people for the people, making it a truly participatory banking system. Ethical banks emphasize on equality and thereby manage community resources optimally to uplift people's lives (Novaković and Liović, 2016). These banks engage in a values-based banking business. They attempt to better societies. Ethical banks strive to achieve financial inclusion of all sections of society. They work for the financial wellbeing of all. Financial inclusion means that all the adult population is allowed access to financial services as per their requirements. Financial exclusion in many societies has had far reaching consequences such as increase in poverty, malnutrition and negative physical and mental health issues. Banks have been continuously neglecting these aspects. Financial inclusion can eliminate inequality among people and reduce poverty. It also involves promotion of local savings which results in investments in local businesses through financial intermediation (Babajide et al., 2015). Having a banking relationship by maintaining a savings account to store money or entering into some banking transaction can be identified as formal financial inclusion (Demirguc -Kunt, et., al 2017).

Slowly and steadily a trend has been set and people have become aware that there is a need for financial institutions to engage in socially and environmentally responsible practices. Banks are considered ethically oriented if they are concerned with the environmental and social impacts of their dealings also. The investments of ethical banks make society sustainable ecologically, culturally, economically and environmentally. A socially inclusive economy can raise the earning capacities and standards of living of its countrymen. It was observed, that there had been a remarkable increase of ethical banks operating in Europe especially after the financial crisis of 2007. As ethical banking provides a whole range of banking activities, it is now being accepted as an alternative banking model to conventional banking.

A well-run ethical bank can be a role model to any other business organization that aspires to function as an ethical business organization. Ethical banks go above and beyond the conventional banking boundaries to earn not only economic profits but social and environmental returns too. Ethical banks have a different set of norms and value systems, as opposed to conventional banking systems. Ethical banks invest in community–focused activities; also, not forgetting that there is a 'climate emergency'. Their future customers will consist of Millennials and Generation Z. Their aspirations and priorities are distinct. As such, Millennials and Generation Z's thinking being different from the two preceding generations, they are more ethically conscious than them, thereby opting for ethical banks over conventional banks. Given the foregoing, the main aim of this research paper through literature review, is to determine whether ethical banking holds the potential to be the future of banking. It is evident that an ethical bank can sustain its business model and thus become a classic banking model of the future.

Methodology

This study is desk research based on literature reviews. Researches reviewed literature pertaining to the past thirty years. In order to access relevant literature from published articles, search was carried out through on-line web sites such as Emerald Insight, Science Direct, Willey online library, JSTOR etc., which included journal articles, working papers and text books. Most relevant key words were constructed. For the search, the terms 'ethical banking', 'future of banking', Generation Z, Millennials, 'socio-economic responsibility' were used. Ethical banking was the main focus of the study. Our search helped us discover over eighty articles. Published articles that were not relevant to ethical banking were not considered. In the process, twenty articles with little or no relevance to ethical banking and future of banking were eliminated. Sixty articles were finally selected and reviewed. The articles selected represent the period before and after 2007's financial crisis.

Literature Review

As banks act as intermediaries to direct financial capital into investments in various sectors and projects, they by and large have a social responsibility (Schuster, 2001). Banks were expected to demonstrate responsible behavior in performing their day-to-day activities; so, banks were criticized for their behavior and the role they played. It was Jeucken, (2001) who suggested that there was a need to re-invent the role of banks. Banks which follow ethical principles and standards are said to enjoy an edge over the others and can win confidence and trust, which also help them in their long-term survival (Safakli 2011). Banking is a trust-based business. Chiami and Fullenkamp, (2002) opine that a bank being considered as trustworthy is vital for its long-term continuity. Hurley, Gong and Waqar (2014) noted that, the internal environment of an organization plays a key role in building trust. It is the employees of banks who build trust among customers in the banking industry (Wallace et al., 2013). Banks play an agent's role of their constituents; therefore, Banks should demonstrate morally sound behaviour (Donaldson ,1989; Chami et al.,2002). Ethics was not considered as important in business as in banking. The finance industry did not give serious consideration to ethics (Boatright, 2008). In banking business too, there was not much of attention paid to ethics (Cowton and Thompson, 1999; Cowton, 2002; Edery, 2006). Banks' unethical practices were exposed by the financial crisis of 2007. The banking sector has been pressurized by the public since the financial crisis, to orient themselves ethically and to follow ethical principles. Following the ethical principles, can be an additional support to banking regulations (Belas, 2012). Fessman, (2013) identified that the cause of the financial crisis was due to the financial systems' fragility; an alternate system of banking can be the solution for same.

Olgu, (2014) opined that the financial crisis may have not affected efficient banking and financial systems that much more. Allen and Santomero, (2001) stressed that during the financial crisis, it became obvious that banks, through their acts, could have an impact on both the society and the economy. Asikhia, (2016) stated that countries should focus on ethical issues pertaining to banks, in light of the fact that bank collapses lead to loss of customer deposits. Banks must aim for sustainable development. Banks can promote sustainable development of economies by playing the role of financial intermediaries (Bouma et al., 2001). Banks have been neglecting the environment and society's needs on their way to achieve higher returns. It was noted that banks were required by civil society to be cautious in their lending, which otherwise, could damage the environment (Barnes, 2009). Sarokin and Schulkin, (1991), Smith (1994), confirmed that the academic community too, was concerned re-the banks' negligence of the environment. Engaging in good environmental and social behaviour, gives organizations a definite advantage over others that have poor environmental and social practices (Salzmann, 2013).

An alternate banking model which can work towards progress in socio-economic and environmental areas, was needed. An ethically conscious banking model was also in operation. The banks that adhere are called ethical banks, which work for the upliftment of economy, society and environment (San-Jose et al.,2011). Ethical banking is a European Concept (Tischer and Reimer (2016). The aim of ethical banks is to create a sustainable world. Ethical banking can become an inspiration to others in the industry and thus, motivate the entire banking sector to work towards the same objective (Scheire C and De Maertelaere S ,2009). Ethical banking aims for the triple bottom line (Tse,2011) and is therefore, focused on sustainable development which is economic, social and environmental development together. These banks are governed by a socio-economic model (Tischer D and Remer S.,2016), (San-José L, Retolaza JLand Gutierrez-Goiria J 2011).

The International association for Social Banking (ISB) highlights the basics for being an ethical bank, with non-financial objectives, transparency and stakeholder involvement; differentiating it from conventional banks which aim for financial returns only (ISB,2011). The cost of operation of ethical banks is higher than conventional banks (Relano,2008). Ethical banks are inspired not only by economic gains but by ecological and social gains as well (Jayasekera and Pushpakumari,2020). Ethical banking considers transparency to be a key value. It maintains transparency as a policy too, where relevant details of social acceptability of bank lending are published for public scrutiny (Novaković and Liović, 2016). Ethical banks' total loan portfolios are transparent (Cowton CJ, and Thompson P,2001). High transparency is maintained by ethical banks, details such as where /whom and how the aggregate customer deposits are invested, details of other investments and placements and improvements to assets are also provided (Cowton and Thompson 1999; Cowton (2010). Ethical banks are becoming popular due to their involvement in upliftment of societies. Customers are motivated to invest in ethical banks due to their socially oriented investments, despite the low returns received on such investments (Callejas-Albiñana.et.al.,2017). These Banks operate as any other conventional bank, but follow ethical principles. Ethical banks have low liquidity risk levels as they maintain sufficient liquid assets (Barbu and Boitan 2009). Ethical banks accept moral responsibility for disbursement of funds generated through customer deposits and investments to socially acceptable borrowers (Harvey, 1995). Favourable socio-economic and environmental outcomes are ethical banks' main responsibilities. Ethical banks promote banking relationships subject to screening for satisfying their ethical requirements, hence ensuring financial inclusion of society's desired entities. Financial inclusion was considered as one of the key pillars among the nine key pillars of the Global Development Agenda at the G20 Summit in Seoul. Financial inclusion is the process which increases the efficiency of financial intermediaries along with the desired quality and quantity; creating opportunities to improve people's lives and the economy (Babajide et al., 2015).

A remarkable growth was seen in the number of ethical banks opened. Kholer (2015) noticed that ethical banks are in demand and in the future, the number of ethical banks in operation will increase. This was attributed to many reasons. The media coverage, public interest and interest of politicians had helped the organic growth of ethical banks (GABV,2012). The academia and the media attribute the growth of ethical banks to reaction to the financial crisis in 2007 (Hargreaves,2008; Carboni 2011; Benedikter 2011and Goff 2012). As small savers accepted this model, it became popular, which in turn resulted in the increased number of ethical banks in operation after the 2007-2010 crisis; this helped to double the asset base of ethical banks (Benedikter, 2011a). The financial crisis of 2007 did not affect ethical banks (Paulet. et.al., 2015). The consequence of the crisis was that ethical banks increased their customer base (Tischer, 2013). Ethical banks were able to demonstrate their strength during the financial crisis (Benedikiter, 2011b). The ethical banking concept is now practiced by many in the banking business. (Webber and Remer, 2011) (Ijeoma 2014), (Rodriguez Gutierrez 2013), (Borgia, 2013).

Ethical banks aim to differentiate from traditional banking activities. (Cowton and Thompson, 2000). They are inspired to achieve not only economic profits but environmental and Social returns too (Benedikter, 2011a). In order to establish a sustainable socio-economic and environment-centered banking system, instead of having one which aimed only for-profit maximization, ethical banking was the answer. Ethical Banks consider all three costs, the social, environmental and economic costs (Chew et. al,2016). The financial sector has an ideal guide in the ethical banking concept, in its endeavour for sustainable development (Tischer D and Remer S,2016). Surroca. et al., (2010) maintains that there is a distinction between ethical banks and conventional banks, in that realizing both financial and social objectives are the prime aim of ethical banks. Wagemans.et al., (2013) noted that prior to making investment decisions, shareholders of ethical banks consider not only the economic criterion but environmental and social criteria as well. Also, Cornée S and Szafarz A, (2013) consider that these banks are much safer. Ethical banks are acceptable not only for the trust placed by customers in their banking staff, but also because they are capable of making economic and social gains (Davies,2001). It is not conventional banks that can contribute to improve society and the environment, but ethical banks which are considered as the banks which can contribute towards social and environmental sustainability (Ruiz et al.,2014). Ethical banking can be viewed as an alternate for traditional banking (Karl,2015).

The future of banking depends on its customers. The majority of future customers will belong to Millennial and Generation Z categories. These two generations are environmentally and socially oriented. Millennials are keen to deal with organizations that are aiming to make a positive impact on society, to create a better world (Jonson,2015). Interesting facts were revealed by the Millennials Business Relationship Survey, which highlights how and why they establish and maintain business relationships; as per the findings, 42% prefer organizations whose products/service make a positive impact on either the environment and/or society and 36 percent prefer the organizations that were ethical (Deloitte Global Millennial Survey 2019). They prefer not to associate with brands that do not follow environmental guidelines. Younger generations seem to have more ethical awareness (Eisingerich et al., 2011; Freestone and Goldrick, 2008; Twenge et al., 2012). As these two generations prefer to deal with organizations that can make a positive impact on people's lives, ethical banking will be their preferred choice in banking. The banks that are ethically oriented will be successful in the future. Therefore, ethical banking can be considered as the future of banking and has the potential to be accepted as a banking model of the future.

Results and Discussion

Banks are being blamed by the public, for not owning-up for their indirect involvement in degrading the environment and neglecting part of society. It was noted that banks were required by civil society to be conscious regarding their lending policies, which could damage the environment (Barnes, 2009). Sarokin and Schulkin, (1991), Smith (1994), confirmed that the academic community too was concerned about banks' negligence of the environment. Banks are perceived as responsible corporate citizens. Banks act as intermediaries to direct financial capital into investments in various sectors and projects; they by and large have a social responsibility (Schuster, 2001). Banks are also expected to follow ethical principles. Those which follow ethical principles and standards are said to be having an edge over the others and can win confidence and trust, which also help in their long-term survival (Safakli 2011). Ethics was not considered as important in business. The finance industry did not give serious consideration to ethics (Boatright, 2008). In banking business too, there was not much attention paid to ethics (Cowton and Thompson, 1999; Cowton, 2002 and Edery, 2006). As such, the public was looking for a different kind of banking operation which was guided by ethical principles. There was an alternate banking model which was ethically driven and known as ethical banking which worked for the benefit of economy, the society and the environment (San-Jose et al., 2011). The objective of ethical banking is to achieve success in all three areas of the economy, society and the environment. Ethical banking aims for triple bottom line (Tse,2011). It also strives to achieve sustainability. It is not conventional banks that can contribute to improve society and the environment, but ethical banks, which are considered as those that can contribute towards social and environmental sustainability (Ruiz et al, 2014). The aim of ethical banks is to create a sustainable world and this can motivate the entire banking sector to work for the same objective (Scheire C and De Maertelaere S ,2009). Ethical banking is an environmentally and socially beneficial banking model. It is inspired not only by economic gains, but by ecological and social gains as well. (Jayasekera and Pushpakumari,2020). The financial sector has an ideal guide in ethical banking in its endeavour to achieve sustainable development (Tischer D and Remer S.,2016). Ethical banks grew steadily. These banks faced the economic meltdown without any problem. The financial crisis in 2007 did not affect ethical banks (Paulet. et.al., 2015). The usefulness of values-based banking was realized during and after the financial crisis. As a consequence of the crisis ethical banks increased their customer base. (Tischer, 2013). The remarkable growth of ethical banking was ample testimony to the people's acceptance of ethical banking as the alternative. Kholer (2015) noticed that ethical banks are in demand and envisaged that in future, the number of ethical banks in operation will increase. Small savers accepted this and it became popular among them, which resulted in an increased number of ethical banks in operation after the crisis (during 2007-2010). This helped to double the asset base of ethical banks (Benedikter, 2011a). The future of banking will depend on the likes and dislikes of the future customer. The Millennials and Generation Z are customers of the future. These two generations are ethically driven and have their own values. Millennials are keen to deal with organizations which work to make a positive impact on society, for a better world. (Jonson,2015). The new generations have more ethical awareness ((Eisingerich et al., 2011; Freestone and Goldrick, 2008; Twenge et al., 2012). As such, the banks that make that difference will have an advantage over other banks. Ethical banks which aim to generate gains in economic, social and environmental areas will be preferred by these two generations who will dominate the customer base of the future. Ethical banking is futuristic. It is evident from the literature reviewed that ethical banking can be established as having the potential to be the banking of the future.

Conclusion

Banks have a responsibility towards the economy, society and environment. It was noted by the public and civil society that banks have failed in the discharge of this duty over the years. Banks were expected to follow ethical principles but failed in this aspect too. There had been a growing demand for ethically oriented banking. Ethical banking emerged as a different banking model. Ethical banking aims for triple bottom line. These banks have stood the test of time. During the financial crisis they were the least affected. This is a sustainable banking model. Future customers, the Millennials and Generation Z are an ethically oriented generation that wishes to have a positive impact on society and the environment. Banking which makes a positive impact could be their preferred choice. Ethical banking satisfies this need. From the study it can be concluded that ethical banking has the potential to be the future of banking. There had been many instances of research carried out on ethical banking in the West, but few instances only in the Asian context. No research pertaining to the topic was found in Sri Lanka. This research paper attempts to fill that gap. The findings may inspire policy makers to encourage ethical banking practices. The study will also help them to ethically orient banking business for its future survival. It is recommended that for any future research, these findings be tested empirically.

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