Social Banks and their Profitability: Is Social Banking in line with Business Success?

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Abstract

Social banking is conducted by social, ethical or alternative banks, financial cooperatives, and credit unions. In contrast to conventional banks, social banks conduct their business to create a positive social, environmental, or sustainability benefit. This study analyses both, the missions of social banks and their financial figures. Based on data of the members of the Global Alliance for Banking on Values, a global association of social banks and microfinance institutions, we conducted a qualitative analysis of the missions of the member institutes. Furthermore we explored whether their loans and investments follow their social mission and whether this business strategy is able to achieve attractive financial returns. The results suggest that the banks follow the mission of social finance and prefer social impacts over financial returns without neglecting financial sustainability. With respect to financial indicators social banks are, though being still small, in the years 2007 to 2012 more profitable than conventional banks or credit unions and presented stronger growth than their conventional counterparts. Regarding their financial health all institutes in the sample meet the Bank for International Settlements (BIS) capital ratio. We conclude that it is possible to follow the concept of social finance and to be financially sustainable, if social banks provide the tangible and intangible resources.

Key Words: Social banking, ethical banking, blended return, shared value, credit union, financial return, capital ratio, resource-based theory

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Introduction

On its website the Swiss Alternative Bank states that it invests in, and finances, sustainable projects and businesses and that it does not insist on maximizing profit. Instead, it places a rational emphasis on sustainability and ethical principles (www.abs.ch). Alternative Bank is a social, ethical, or alternative bank that offers products and services related to social banking such as loans for social enterprises, renewable energy projects or social housing. In contrast to conventional banks, social banks provide loans in order to create a social or environmental benefit (da Silva, 2007, Edery, 2006). Thus, social banks follow the concept of social finance. According to the Global Alliance for Banking on Values (GABV), a global association of social banks, social banking follows the subsequent principles:

1. “Triple bottom line approach at the heart of the business model
2. Grounded in communities, serving the real economy and enabling new business models to meet the needs of both
3. Long-term relationships with clients and a direct understanding of their economic activities and the risks involved
4. Long-term, self-sustaining, and resilient to outside disruptions
5. Transparent and inclusive governance
6. All of these principles embedded in the culture of the bank”

(http://www.gabv.org/about-us/our-principles)

Social finance and especially microfinance as a subgroup of social finance is broadly discussed since Muhammad Yunus, one of the best-known representatives of microfinance, was awarded the Nobel Peace prize in 2006. Since then microfinance and social finance became known as a market based means that is able to fight poverty (Yunus and Weber, 2007). However, microfinance, mainly located in developing countries, is not the only business related to social finance. During the last years in industrialized countries social banks demonstrated an impressive growth regarding their balance-sheets and their market share (Remer, 2011). But social banks are still a niche phenomenon. In 2012 the total amount of the balance sheet of the members of the GABV, was a little more than $ 68 billion (see www.gabv.org). According to GABV’s website the members of the organisation serve about 10 million clients. On the one hand this is an impressive number. On the other hand it is still a small fraction of the total market.

Previous Work

But what is so specific about social banking? Generally banks have some kind of social responsibility (Schuster, 2001) because they channel financial capital into different sectors and projects. Obviously, they have a strong impact on the economy and on the society (Allen and Santomero, 2001) as we experienced during the last financial crisis. Different concepts exist, however, about the connection between social or environmental impacts and banking or financial services. On the one side of the spectrum we find pure
social finance that has one explicit target, achieving a positive social impact without considering any financial return. Usually philanthropic grants base on this concept. On the other end of the scale we find financial products and services that only strive for high financial returns without taking any social impacts into account. This is the case for the majority of financial products and services offered by conventional banks and other financial institutions.

In contrast to social banking, socially responsible investment (SRI) integrates some social, environmental or governance inclusion or exclusion criteria into investment decisions and thus is located between philanthropy and conventional finance though it is a very heterogeneous field (Sandberg et al., 2009). It integrates social or environmental criteria into the set of investment indicators (Koellner et al., 2007) and includes ‘social’ screening, community investment and shareholder advocacy (O'Rourke, 2003) in the investment process to guarantee higher and more sustainable financial returns. However, main goal of SRI is not to achieve a positive social impact, but to guarantee attractive financial returns by investing in securities that take long term sustainability concerns into account (Weber et al., 2011), and to channel capital toward activities that have a broader social, environmental or sustainability benefit and thus foster sustainable business (Buttle, 2007, Weber, 2006).

Social banks invest in a way that generates social and environmental returns in the first place. Usually, only projects or clients that take this hurdle are analysed with respect to their financial returns. Consequently, social banks look for a blended value return (Harji and Hebb, 2009, Emerson, 2003). Another definition of social banking by Kaeufer defines social banking as “addressing some of the most pressing issues of our time” (Kaeufer, 2010, p.2). Therefore, to summarize the definitions, social banking:

- Focuses on achieving positive social, environmental and sustainability impacts,
- bases all its business and its operations on the triple-bottom-line concept, and
- uses financial products and services to achieve a blended value return.

A core financial service of social banks is loans for creating a social, environmental, or sustainability benefit. The average asset to loan ratio of social banks being members of the GABV was 71.5 per cent between 2007 and 2012, demonstrating the importance of the lending business of social banks. Again, these loans follow two basic principles (1) achieving a positive impact on the society, the environment and sustainable development and (2) achieving a sustainable financial return.

The first modern social banks were founded in the 1970s in order to emphasise financial ethics and with the goal to use finance as a means to influence society and business (Milano, 2011). These banks often have a philosophical background like the anthroposophist German GLS. Others base on environmental, social or ethical principles like the Swiss Alternative Bank, or on development
issues like microfinance institutions. Another group, such as Vancouver City Savings Credit Union (VanCity), a credit union based in Vancouver, is community based and emphasises the integration of the communities or their members.

Theoretically, the activities of social banks can be explained through resource-based theory (Wernerfelt, 1984) and its specification ‘environmental resource-based theory’ (Hart, 1995). The theory states that internal tangible and intangible resources such as environmental and sustainability knowledge is able to create successful products and services on the short-term that are able to serve as models for further expansion. Empirical studies demonstrated that internal resources are an important condition for successful business and environmental performance (Russo and Fouts, 1997).

Based on the background and theory, we will present and analyse representatives of the GABV and will concentrate on the following two research questions:

1. Do the mission, the history, and the products and services of social banks indicate business practices in line with the concept of social finance that tries to achieve both social impact and financial return?
2. Do the financial indicators suggest that social banks fulfil the second part of the concept of social banking, that is creating a sustainable financial return?

Methodology

In this study we analysed the members of the GABV. According to its website (www.gabv.org) the GABV is a global membership organization consisting of the leading sustainable banks. All members have a commitment to find solutions for international problems, to promote an alternative to the current financial system, and to improve the quality of life (www.gabv.org). The member banks of this organisation are presented in Table 1.