

## THE TWOFOLD BETRAYAL OF CO-OPERATIVE BANKING

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The aftermath of the subprime mortgage crisis has accelerated a pre-existing process of ethical approach in the banking industry. Today, all banks claim to be socially, environmentally and economically committed with the philosophy of sustainable finance. Nevertheless, the paper will show that, beyond outward similarities, there are three different types of banking approaches, each reflecting a distinct business model:

1. Banks whose ethical/social approach is mainly based on what they say. This can be illustrated in the case of universal banks, which usually show an outstanding CRS reporting but few changes in their business model.
2. Banks whose ethical/social approach is based on what they are. This can be illustrated with the case of co-operative banks, which often put forward their different business model as regards other financial institutions by emphasizing their juridical status and their commitment with the values of the social economy.
3. Banks whose ethical/social approach is based on what they do. This can be illustrated by a new and still fairly unknown type of banks which emerged in the mid-1980s: the so-called ethical banks. They publish modest CRS reports and they do not emphasize a declamatory commitment with the principles of the social and solidarity-based economy (even if in most of them have a co-operative status), but as the analysis of the balance sheet will show, in their banking practice they go far beyond the other two types of banks in the objective of a socially responsible finance.

This intermediate situation of traditional co-operative banks reflects a twofold betrayal which will be argued in more detail in the paper. In methodological

terms, the paper will compare the banking situation in two countries (France and Germany) by examining three types of sources for each of the above-mentioned categories of banks:

- a) The social and environmental reporting
  - b) The conformity or not with the principles of the social and solidarity-based economy
  - c) The different types of financial activities as reflected in their balance sheet.
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  - The paper submitted can be attached to topics 5 or 6.

# THE TWOFOLD BETRAYAL OF COOPERATIVE BANKING

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## 1. Introduction

The aftermath of the subprime mortgage crisis has accelerated a pre-existing process of ethical approach in the banking industry. Today, all banks claim to be socially, environmentally and economically committed to the philosophy of sustainable finance. Nevertheless, the present paper will show that, beyond outward similarities, there are three different types of banking approaches, each reflecting a distinct business model.

First of all, there is number of banks whose ethical/social approach is mainly based on *what they say*. This is mainly the case of most universal banks, which usually show an outstanding CRS reporting but are not ready to change in depth their traditional business model. Secondly, we have other group of banks whose ethical/social approach is based on *what they are*. Cooperative banks are very much like that. They often put forward their different business model as regards other financial institutions by emphasizing their juridical status and their commitment with the values of the social economy. Finally, there are banks whose ethical/social approach is based on *what they do*. This can be illustrated by a new and still fairly unknown type of banks which emerged in the mid-1980s: the so-called ethical banks. They publish modest CRS reports and they do not emphasize a declamatory commitment to the principles of the social and solidarity-based economy (even if most of them have a co-operative status), but as the analysis of the balance sheet will show, in their banking practice they go far beyond the other two types of banks in the objective of a socially responsible finance.

The main hypothesis of this paper is thus that cooperative banks are in an intermediate position. On the one hand, they claim to be the champions of CSR, but the number and quality of their initiatives in that sense will show that they are not. On the other hand, cooperative banks also claim to be the most ethical and socially-oriented institutions. The structure of their balance sheet will show, on the contrary, that there is another type of banks which fit better with the original spirit of the social and solidarity-based economy. This intermediate position of cooperative banks thus reflects a twofold betrayal, the details of which will be argued in the following pages.

## 2. Methodology

Before going through the analysis, it seems first appropriate to clarify briefly some few remarks concerning the methodology. In this regard, it has already been said that the main objective of this paper is to study how the banking industry conceives their business activities according to three different approaches. Each of these banking patterns is determined by taking into consideration three different variables, which in turn are measured by examining three corresponding sources:

- *What they say*. - The banks' CSR discourse will be apprehended on the basis of their social and environmental reporting. Their promises at that level will then be compared with their practices for implementation. As a guiding tool, we have summarized the

banks' CSR policies in table 2, which is largely based on the method used by Bert Scholtens.<sup>1</sup> Despite its limitations, already pointed out by the author himself, this methodological framework has at least the advantage of being easy to apply to the different banks and hence gives us a common ground for assessing their CSR policy at a glance from a comparative perspective.

- *What they are.*- As regards the conformity or not of the different banks with the principles of the social and solidarity-based economy, we have used as a benchmark the criteria set up by the International Cooperative Alliance (ICA) in 1995.<sup>2</sup> Therefore it is not just a question of juridical status, but mostly of assessing to what extent the different activities of banks are consistent with a certain number of principles and values.
- *What they do.*- Beyond the narrative analysis of CSR policies or the normative approach based on principles and values, the reality of how banks are committed to sustainable finance is ultimately reflected in their balance sheet. For an analysis of this document, its multiple items have been summarized, both in the assets and the liabilities side, in four sections. As shall be seen in due time, the different percentages in each of these sections are liable to indicate the existence of distinct banking models.

Table 1: Description of the balance sheet in four blocks

ASSETS	LIABILITIES
Interbank operations	Interbank operations
Clients' transactions	Clients transactions
Financial transactions	Financial transactions
Reserves	Equity

The main argument of this paper can easily be generalized to most of Western European countries. Since they have all faced a global change in the financial context during the 1990s, it is fairly easy to find parallelisms in the reaction of different banking industries around Europe. Examples of such common trends will of course be evoked in the paper. But for the concrete application of the above-mentioned methodology (CSR tables, analysis of balance sheets, etc), we have decided to test the particular case of the banking industry in Germany. The choice of this country has not been made at random. Germany is a big European country with a fairly diversified banking sector. It suffices to remind that this country was not only the cradle of the cooperative movement and the place where the first universal banks took shape,<sup>3</sup> but has also been a pioneering nation in ethical banking. As a consequence, it has not been very difficult to find one outstanding example for each of the three categories of banks which we want to analyze.

The GLS Gemeinschaftsbank, founded in 1992 with headquarters in Bochum, will be the representative of ethical banks. The choice of this institution has come out straight away, since the GLS Bank is at the present the only existing example of ethical banking in Germany. This is the main reason whereby we have decided to compare the GLS Bank, not with the ensemble of German cooperative and universal banks, but only with one example of each. In that sense, the Deutsche Bank, which is the largest and one of the most internationally well

<sup>1</sup> B. Scholtens (2009).

<sup>2</sup> <http://www.ica.coop/coop/principles.html>

<sup>3</sup> See the classical works of W. Huth (1918) and R. Tilly (1966).

known financial institutions in Germany, has been taken as a representative of stockholder universal banks. Finally, among the numerous cooperative institutions, we have chosen to test a Volksbank, which are one of the most long-established organizations of this type.<sup>4</sup> In particular, we have taken the case of a medium-size entity which possesses 23 branches: the Volksbank Baden-Baden Rastatt eG.

### 3. Universal banks and CSR discourse

To say that banks really care about sustainable development has now become a commonplace. They all claim to be the most virtuous institutions as far as the environment and society are concerned. Plenty of initiatives are indeed addressed to these matters. In terms of environment, for instance, many banks would put forward their commitment to reduce their consumption of electricity by using energy efficient bulbs or their efforts in recycling paper from photocopies. Active employee travel policies with concern to commuting and air travel or with fair sex and race representation in the institution are not exceptional any more. Nevertheless, all these actions just concern the direct impact of banks on the planet and society. Most of them are fairly easy to implement and are not very expensive, giving moreover an instantaneous “green image”. But they are not the most important to take into consideration. Far more critical, though less visible, is the indirect impact of banks through the clients and projects they finance. Without intermediary financial institutions like banks, the Three Gorges Dam on China’s Yangtze River, or the Baku-Tbilisi-Ceyhan oil pipeline, linking the Caspian Sea to the Mediterranean through Azerbaijan, Georgia and Turkey, would never have been possible. When civil society realized this, pressure for recognition of environmental and social responsibility largely shifted to the banking sector. The so-called Collevocchio Declaration (2003), a global coalition endorsed by more than 200 organizations to promote sustainable finance in the banking sector, is in that sense an outstanding example.

The response of banks to this challenge did not take long to come. In June 2003, the International Finance Corporation and ten of the world’s largest banks launched the so-called Equator Principles, which is a set of environmental and social benchmarks for managing environmental and social risk related to project financing.<sup>5</sup> Another important tool used by banks for compiling with the demand of social and environmental accountability, but which now falls within the investment domain, is the Socially Responsible Investment (SRI). The idea is not new. It had emerged in the US by the end of the 1920s, but its exponential development has coincided with the recent success of concepts such as business ethics and socially responsible finance.<sup>6</sup> So in a similar manner as firms have been trying to comply with the goals of sustainable development through the concept of CSR since the 1990s, banks have been attempting to fulfil this very same demand since the 2000s by means of different devices adapted to the financial domain. Some of the most important ones are listed in the first column of table 2.

Table 2: CSR performance of different types of banks (2009)

	Deutsche Bank	Volksbank Baden- Baden	GLS
1. Sustainability report	1	1	1
2. ICC Business Charter on Sustainable Dev.	0	0	0

<sup>4</sup> See A.H. Kluge (1991).

<sup>5</sup> For further details, see : [www.equator-principles.com](http://www.equator-principles.com)

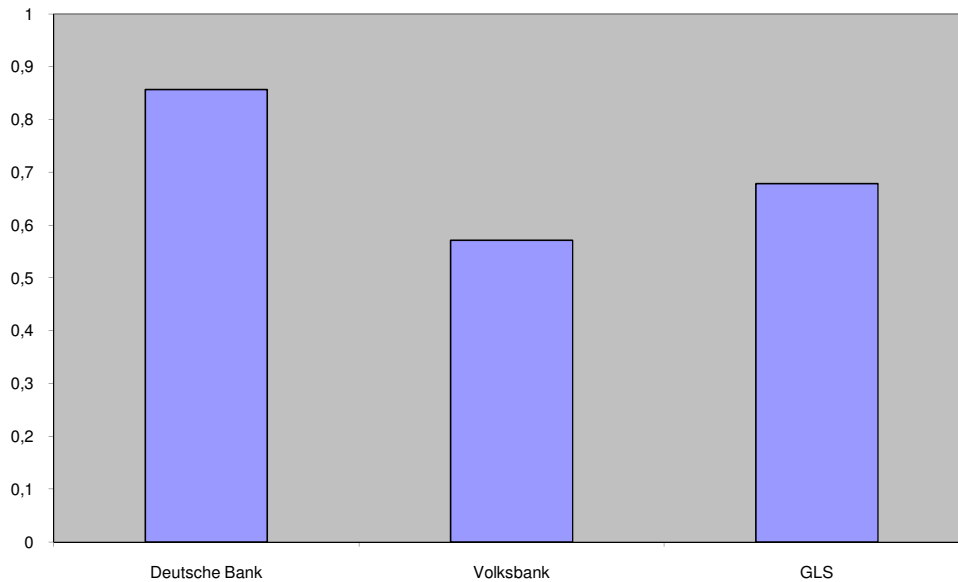
<sup>6</sup> E. Loiselet (2000).

3. UNEP Finance Initiative	1	0	1
4. Equator Principles	0	1	0
5. Global Compact	1	0	1
6. "Who Cares Wins" report	1	0	0
7. Certified environmental management	0	1	1
8. Certified environmental management	1	0	0
9. Environmental policy	1	1	1
10. Supply chain management	1	0	0
11. Quantitative environmental targets	1	0	0
12. Transparency of environ. Performance	1	1	1
13. Environ. risk management in loans	1	1	1
14. Exclusion of specific sectors	1	1	1
15. World Bank guidelines	1	0	1
16. OECD guidelines	1	0	0
17. Socially responsible investing (SRI)	1	1	1
18. Socially responsible saving	0	1	1
19. Sustainable financing	1	1	1
20. Microcredit	1	0	0
21. Environmental advisory services	1	0	1
22. Climate products	0	0	1
23. Other sustainability products	1	0	1
24. Sponsoring (NGOs, community,...)	1	1	0
25. Community involvement	1	1	0
26. Training on SD to employees	1	1	1
27. Diversity and opportunities	1	1	1
28. Feedback from employees	0	1	1
29. Business ethics principles	1	1	1

If we check to what extent the different types of banks apply these elements, simply by giving them a “digital” score (0 or 1) according to their compliance or not with the issue under consideration, it appears very clearly that Deutsche Bank is the most virtuous institution in terms of responsible finance (see table 2 and figure 1).<sup>7</sup> In fact, Deutsche Bank is the only of the three institutions publishing an annual CSR report of more than 140 pages. In contrast, the *Nachhaltigkeitsbilanz* of the GSL Bank, for example, is just a two-pages-chapter of its corporate report. More generally speaking, universal banks are normally very good in communicating about CSR. The problem is that this ostentatious proclamation of good intentions on sustainability is often used for “greenwashing” purposes. In many cases there is indeed a gap between what the banks say and what they actually do in their in their day-to-day practice.

Fig. 1: Graphic resolution of the banks’ CSR performance.

<sup>7</sup> Had we introduced a more nuanced assessment system, with scores ranking from 0 to 4 for certain policies, the difference between the Deutsche Bank and the others would have been still more noticeable.



It is fairly easy for a bank to announce its commitment to responsible finance as a primary goal of their overall strategy. It suffices to issue a certain number of ethical funds to its clients, to devote some money to social patronage, to promote a number of internal environmentally-friendly attitudes, to adhere to international principles which do not compromise the core of the business, and finally to publish an annual extra-financial report in which all these initiatives are highlighted. But one thing is to “look green” and another quite different to “be really green”. A pioneering critical study entitled *Shaping the Future of Sustainable Finance* (2006), gives clear evidence that the above-mentioned initiatives are no guarantee of sincere commitment. After reviewing the environmental and social policies adopted by 39 key banks from around the world, their conclusions are not very promising.<sup>8</sup> It seems that banks are adopting an environmental rhetoric with little commitment to changing their performance. With few exceptions, bank policies are lagging significantly behind relevant international standards.

The critical point is implementation. Writing a good CSR policy is far easier than putting it every-day practice. For example, the Deutsche Bank says to be very concerned with the well being of their employees but, symptomatically, 7.3 % of them left the bank in 2008 for a new job elsewhere.<sup>9</sup> No such a turn over exits, despite lower wages, in the other two banks considered in this paper. More importantly, a considerable number of universal banks seem not to realize the contradiction existing between their CSR policies and some of their investing and financing decisions around the world. In the particular case of the Deutsche Bank it is rather shocking observe that, despite their pious words explaining how they contribute to achieving sustainability in the planet, the German institution is fully involved in a series of controversial activities. Either by direct lending or simply as underwriter of the issuance of shares or bonds by a particular company, Deutsche Bank has indeed actively participated in dubious corporate financing projects. Three examples will illustrate this point.<sup>10</sup> The first concerns the production of cluster munitions. Due to the indiscriminate targeting of this explosive device, civilians account for 98 % of the victims and thus represent

<sup>8</sup> A. Durbin, S. Herz, D. Hunter, J. Peck (2006).

<sup>9</sup> Deutsche Bank (2009, p. 40)

<sup>10</sup> For these and other examples, see J.W. van Gelder and S. Denie (2007, pp. 117-138)

a direct contravention of international humanitarian law. Despite this, Deutsche Bank has given repeatedly credit facilities to various producers of this weapon, like Textron or Rheinmetall. Likewise, Deutsche Bank has contributed to finance the controversial mining techniques of the American company Freeport McMoran, which is devastating the extraordinary diverse ecosystems and unique endemic species in New Guinea. Finally, it is not anodyne to note that Deutsche Bank was the only Western bank to hold the accounts for the Central Bank of Turkmenistan during the period of Saparmurat Niyazov, a notorious dictator and leader of an oppressive regime violating the human rights of its citizens. And yet, the German institution has never clarified how this financial support for Niyazov's Turkmenistan fits with its voluntary human rights commitments under the UN Global Compact.

There is thus an obvious gap between the theoretical intentions on sustainability, as expressed in the CSR reports, and the practical consequences of certain financial activities. The main reason explaining this inadequacy is that universal banks have tried to satisfy the customer's simultaneous demand for profitability and ethics. Unfortunately, this is just not possible, at least in the short term. So those banks which are not ready to renounce the dogma of maximization of profits can only be engaged in the idea of sustainable finance in a rather superficial manner. This is so far the most common attitude amongst universal banks. Obviously, most of them offer their clients the possibility of investing in a wide range of ethical funds and do have a number of credit lines especially devoted to environmental or social issues. But their general strategy has not changed. In their mind, the development of these new products must nonetheless serve the main invariable objective: more benefits. In fact, since the idea of greening the environment is now in fashion, traditional banks have used this tendency to win new clients and to cover a new demand, and thus make still more profit.

The most challenging task for banks is to put their money where their mouth is. A simple way to checking if the CSR policies of a given bank are really integrated in the day-to-day operations is to examine the structure of their balance sheet. So moving from theory to practice, we are now going to apply the analytical described in the methodological part (see table 1) to the case of the Deutsche Bank as a representative of universal banks. The following results are thus obtained:

Table 3: Deutsche Bank (2008)

<b>ASSETS</b>		<b>LIABILITIES</b>	
Interbank operations	4 %	Interbank operations	6 %
Clients' transactions	15 %	Clients transactions	11 %
Financial transactions	74 %	Financial transactions	73 %
Reserves	7 %	Equity	10 %

Source: Deutsche Bank's annual report. Calculations made by the authors.

For the purpose of the present paper, we shall focus the analysis on two items: clients' transactions and financial transactions. As regards the former, we see that the value on the liabilities side (11 %) is lower than that of the assets side (15 %). This means that there is a deficit of resources due to a dominance of credit granting activities. In other words: savings collection in the Deutsche Bank is smaller than loan distribution. This is fairly characteristic of a universal institution like the Deutsche Bank. Had we examined the balance sheet of a *Sparkasse*, we would certainly have seen the opposite result in this area.

The second element worth mentioning is the very high percentage devoted to financial transactions. This fact clearly illustrates that the core of the business for the Deutsche Bank is no longer savings collection and the project financing through loans, as it used to be the case before the 1980s. Rather, their main field of activity is now concentrated in the global financial market. In fact, the percentage of financial transactions is so prominent that, rather than universal banking institution, the Deutsche Bank looks more and more like an investment bank. As a confirmation of the previous point, it should be noted that the value of the off balance sheet, if only measured by the total of OTC derivatives, represents more than ten times the total assets.<sup>11</sup>

All these facts evidence that the business model of the Deutsche Bank is shaped by the ultimate goal of maximizing profits. They do so mainly through trading activities in the global financial market. It is thus not surprising that their CSR policies do not always match the inner logic of their financial operations. These latter ones make part of the core of their business, whereas the ethic and sustainable discourse seem merely conceived as cosmetic devices.

#### **4. Cooperative banks and their values**

Cooperative banks ought to be different from universal banks, namely because of their history and their values. The specific way in which cooperative banks are organized, their particular system of governance, the ultimate goals and underlying principles sustaining their activity are indeed very divergent from that of stockholder banks. Without going into detail through specific lists of such principles, such as the one proposed by the International Cooperative Alliance (ICA), we can summarize the different nature of cooperative banks by saying that they pursue a twofold objective: providing to the community (members/customers and local population) with both economic and social benefits. This means that, unlike stockholder banks, whose primary goal has always been to maximize financial profits and capital return to shareholders, cooperative banks are not just aimed at obtaining economic surplus but also social added value. As a financial institution, they are obliged to consider their performance in terms of profitability, solvency and efficiency. But as an association of persons united under cooperative principles, they must also take into account the adequacy of their economic performance with the social needs and aspirations of its members and the community at large. Cooperative banks work *with* capital, but not *for* capital. If they combine economic wealth with social welfare this is simply because the true object of cooperative banks, like other social and solidarity-based organizations, is the *man* (or society in general) rather than just material means.

The problem is that this fundamental difference between universal and cooperative banks is diluting over time. The social dimension, which was particularly prominent in the seminal period of cooperative banks (19<sup>th</sup> century), has been attenuated in more recent times. From the 1990s onwards, the evolving process of globalization is implicitly imposing a number of important changes in the financial industry, thus inducing a general repositioning of all banks. Cooperative banks have been unable to escape to this global constraint and are now suffering of a real risk of mimetic isomorphism with the private sector.<sup>12</sup> Cooperative members, for example, are gradually transformed into simple clients (members and non-members are treated equally). The decision-making process is moving away from the grassroots and the general assemblies are now becoming an almost symbolical body. Simultaneously,

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<sup>11</sup> Deutsche Bank, *Annual Report 2009*, p. 158.

<sup>12</sup> J.P. DiMaggio and W. Powell (1983). Cf. R. Palomo and I. Carrasco (2001).

cooperative managers have more and more difficulties in translating the abstract tenets of the cooperative discourse in the 19<sup>th</sup> century into an operational practice for the 21<sup>st</sup> century. Their business work is currently ruled by a commercial rationale which leaves little room for the traditional values of solidarity, self-help, etc. For all banks, the net income is now seen as one of the best indicators of success and the increase of the market share has become a full-time obsession. It seems as if the present-day macroeconomic context obliged to choose between cooperation or competition, traditional values or economic efficiency. Symptomatically, when one enters nowadays in a cooperative bank and looks at the products and services offered, one can scarcely see any difference with its universal counterparts.

In the most extreme case, the pressure of the recent global context over cooperative banks has led to a process of demutualization.<sup>13</sup> The transformations of the UK building societies during the 1990s would be in that sense an outstanding example, but similar developments also occurred in the US, Canada, Ireland, and Australia.<sup>14</sup> Without going that far, out of Anglo-Saxon countries we find various types of semi-demutualization. This intermediate position comes about when a financial holding is organized partly as a stock company and partly as a mutual or cooperative society. In France, for example, the response of the now called BPCE Group to the recent consolidation of the banking industry has been to create a hybrid institution composed of the two traditional cooperative banks (Caisse d'Épargne and Banque Populaire) and a joint stock bank (Natixis) in charge of raising capital in the financial market.<sup>15</sup> The result has been a substantial enhancement of their competitiveness, but also the introduction of agency conflicts between the divergent logics of members and shareholders.<sup>16</sup> Eventually, it has also meant to undermine their original cooperative identity.<sup>17</sup>

Some authors think that there is not such a degeneration of the cooperative principles and values. They say that, under the global market pressures, there is certainly a transformation of their original spirit, but only in the sense of a renewal of their cooperative mission. Invoking the theory of a life-cycle, they admit that most European cooperative banks have reached an advance level of maturity. Their original *raison d'être* does not apply any more, but has suddenly shifted into a new outward-community orientation: the corporate social responsibility (CSR). It is thus through their contribution to a sustainable development and responsible banking that cooperative banks can reaffirm their original identity by other means. Accordingly, cooperative banks are seen as the “champions” of CSR in their own way, i.e. the *cooperative social responsibility*.<sup>18</sup>

This view, however, does not really seem to match reality. In many respects, universal banks have advanced cooperative institutions in terms of social or environmental innovation. Table 2 and figure 1 clearly show that, in Germany, Volksbanken are lagging behind other types of banks in terms of CSR, at least when measured by the traditional indicators. This situation is not exceptional. In France, it was a universal bank (BNP Parisbas) that first signed an agreement with ADIE (Association for the development of economic initiatives) long before that the microfinance system applied to developed countries became fashionable. It was again one private financial institution (Axa) that first put in place a real policy in favour of disabled

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<sup>13</sup> E. Redler (1994), E. McKnight et al. (1996).

<sup>14</sup> J. Cook, S. Deakin, A. Hughes (2001). Cf. F.R. Chaddad and M.L. Cook (2004); K. Davis (2007).

<sup>15</sup> E. Albert (2008). Cf. J.N. Ory, E. Gutner, M. Jaeger (2006); D. Duet (2004).

<sup>16</sup> E. Paulet (2010).

<sup>17</sup> M. Roux (2002).

<sup>18</sup> C. Gijssels and P. Develtere (2008, p. 17). See also N. Richez-Battesti, P. Gianfaldoni, G. Gloukoviezoff and J.R. Alcaras (2006).

people or affirmative action policies in employment. Cooperative banks have since then taken similar initiatives, but following at a certain distance the pioneering way set forth by universal banks. So to say that cooperative banks are the “champions” of CSR remains, at the best, unclear. One can even suggest that, in some cases, the reverse is actually happening. Unlike the common view stating that cooperative banks are generally engaged in less risky activities,<sup>19</sup> the last financial crisis has shown that groups like BPCE were fully engaged, through Natixis, in speculative derivatives trading. Heavy losses have also result of their involvement in the Madoff investment scandal on Wall Street. All this is not only at the antipodes of what they say in their CSR commitments but, most importantly, it is against one of the most basic cooperative principles since the creation of the Rochdale Society of Equitable Pioneers (1844): the primacy of people and labour over capital.

This gap between the promises of cooperative banks and what they actually do is confirmed by the inspection of their balance sheet. Table 4 shows the results of applying the same analytical grid for the case of Volksbank Baden-Baden Rastatt. As we can see, there is a positive result in the balance between the clients’ transactions in the liabilities side (60 %) and in the assets side (47 %). Contrary to the previous case (universal banks), this fact reflects an excess of resources: savings collection from clients are more important than loans distribution. Cooperative and mutual banks usually function this way.

Table 4: Volksbank Baden-Baden Rastatt eG (2008)

ASSETS		LIABILITIES	
Interbank operations	12 %	Interbank operations	19 %
Clients’ transactions	47 %	Clients transactions	60 %
Financial transactions	33 %	Financial transactions	12 %
Reserves	8 %	Equity	9 %

Source: Annual report. Calculations made by the authors

As far as the transactions in the financial market are concerned, one may immediately note that the percentages by the Volksbank Baden-Baden Rastatt are clearly lower than those shown by the Deutsche Bank, even if they are not negligible either. This evidences that for *Volksbanken* trading in the stock market is not the core of their business. Nevertheless, they will not hesitate to carry out certain operations in the financial market to improve their profitability. These two elements, dominance of saving activities and a moderate use of the public stock market, are characteristic of a savings bank with cooperative status like the Volksbank Baden – Baden Rastatt eG.

A comparative analysis of the balance sheet of universal and cooperative banks thus shows a certain reversal as regards the core of their respective business model. Whereas for universal bank the main activity is trading in the financial market, cooperative banks are focused on the traditional activities of credit granting and savings collection. But in the end, both banks make ample use of all kind of businesses. The percentage of financial activities in the case of the Volksbank, though not the most important, is not negligible either. The same applies for universal banks as regards the clients’ transactions. One could thus conclude by saying that universal and cooperative banks differ in the *quantitative* percentage of their banking activities, but the overall business model that both apply is *qualitatively* identical. They just represent variations within the same paradigm. So, in the last analysis, cooperative and

<sup>19</sup> Cihák and Hesse (2007).

universal banks are not that different. Even if cooperative banks continue to claim that they share fundamental values which make of them a very special kind of financial institution, the figures show that in their day-to-day practice cooperative banks are quite similar to their universal counterparts. The only financial institution really at variance from the mainstream logic of maximizing profits is another type of banking entity which we may call “ethical banks”.

## **5. Ethical banking through real facts**

Before seeing the concept of ethical banking, let it first be reminded that ethical banks are above all banking institutions. Even if this might seem an obvious tautology, it is often forgotten that a bank is not just a financial institution. In most jurisdictions, banks are regulated by government entities and require a special bank license to operate. In order to obtain it, governments impose a series of requirements which typically include a minimum of initial capital endowment, a certain level of capital ratio, the approval of the bank’s business plan, etc. Other financial institutions like building societies, credit unions or microcredit associations are regulated under separate rules and requirements. Therefore, they are not allowed to offer the same kind of services. This is not the case of ethical banks, which are in all senses wholehearted banking institutions. They operate in the same market than commercial banks, play under the same rules and comply with the same requirements. Ethical banks and universal banks are thus in principle direct competitors, whereas other financial institutions like credit unions are not. As a consequence, one cannot say for instance that the financial activities of Garrigue, a solidarity-based capital risk fund in France, constitute an alternative to traditional banking since they are not playing in the same floor. They cannot just be compared.

Ethical banks, on the contrary, can indeed be considered an alternative to the business model of conventional banks. They actually play the role that cooperative banks do not play anymore. Schulze’s and Raiffeisen’s original initiatives came to light because the existing institutions of their period failed to meet a segment of the population’s needs and aspirations. Similarly, ethical banks were created in the mid 1980s in response to a particular market niche so far unfulfilled: people who wanted to give real sense to their money and did not believe any more the good intentions generally conveyed by CSR policies which are not followed by facts. People who are not confined to the traditional banks’ attitude of “trust me” but demand “show me”.

So the difference of ethical banks is not based on the size of their CSR report. Since, as already seen, to obtain the appearance of “green bank” is quite simple and not necessarily very expensive, ethical banks are not interested anymore in declarative paper policies. Table 2 and figure 1 show that, in this regard, ethical banks are far less performing than universal banks. This is because they make little efforts in communicating how virtuous they are in terms of sustainable development. Beyond the CSR rhetoric, ethical banks prefer to focus on the real impact of all their banking activities. In that sense, it has already been mentioned that it is impossible to satisfy, at least in the short term, the customers’ simultaneous demand of increasing financial returns on the one hand, and greater ethical, social and environmental involvement on the other. In face of such a conflicting dilemma, universal banks have clearly taken up a stance in favour of profit maximization. Owing to process of semi-demutualization

and mimetic isomorphism, cooperative banks are increasingly making similar kind of choices.<sup>20</sup>

Quite the reverse, in the balance between profitability and ethics, ethical banks put the former at the service of the latter. They believe that profitability should not be only measured in terms of financial performance. Social and environmental returns should also be taken into consideration. In other words, ethical banks integrate ethics within their whole financial project. They are thus ready to accept the idea of working with narrower profit margins if this is compensated by further social or environmental added value. It would not be surprising, for instance, that they accept to work with lower levels of financial collateral or higher monitoring costs if the project they finance is worth of it in social or environmental terms. So in order to make a distinction between traditional and ethical banks, one should not focus on the volume or variety of SRI products (almost all banks issue them), but on the ultimate goal guiding their activity. For ethical banks, this leading principle can be summarized in one single maxim: less profit, more sense.

In more precise terms, one of the most outstanding facts that make ethical banks different from other banking institutions is that they usually refuse to participate in the speculative operations of the financial market.<sup>21</sup> They consider that this economic logic is responsible for many international crisis, social inequalities, and ecological problems. Social banks can occasionally sell SRI funds, namely because of the clients' demand, or held to maturity some financial products for the purpose of covering potential needs of liquidity. But, unlike their traditional counterparts, the participation of ethical banks in the stock market is generally insignificant, simply because it is not the core of their business. And when they do take part, their trading activities are confined to long-term and non-speculative operations.

As a result of the previous point, ethical banks concentrate their activities in the original business of banks: savings collection and credit distribution. In this regard, ethical banks privilege the social, ethical or environmental dimension of the projects they finance. So, unlike traditional banks, whose lending policies are normally based on a single bottom line screening (assessing exclusively the financial performance), ethical banks usually put in place a triple bottom analysis (environmental, social and financial performance). Particular attention is thus given to projects in areas of the social and ecological housing, organic farming, renewable energies, small and medium-size companies, etc. In these domains, social banks are ready to take higher risks and accept to finance certain projects which have been previously refused by traditional banks. More generally speaking, ethical banks encourage solidarity between depositors and borrowers to enable loans at reduced interest rates for projects which are worthy in social, ethical or environmental terms. Eventual problems of imperfect or asymmetric information are counterbalanced by the general policy of focusing their activities at the local or regional level. It is because they know the very well the region, the projects and the people they finance that social banks are ready to take higher risks. Very much like the original cooperative movement in the 19<sup>th</sup> century, this is entirely consistent with their community involvement.

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<sup>20</sup> Let us take for example Rabobank, the most important cooperative banking group in Europe. Despite being a signatory of the Equator Principles and the general tenet of their CSR discourse, the Rabobank is involved in the financing of the Singaporean company Wilmar International, whose activities in the palm oil business are clearing tropical forests and destroying endangered species like the orangutan. See J.W. Gelder (2007).

<sup>21</sup> For a more detailed characterization of ethical banking, see F. Relano (2008).

All these characteristics shape a distinct business model, which is ultimately reflected in the structure of their balance sheet. Table 5 shows the results of applying the analytical grid for the case of GLS Bank. If we make a comparison in the very same points as with the other two banks, one may immediately notice that, like cooperative banks, the balance between the clients' transactions on the liabilities side (81 %) and the assets side (72 %) is positive. This means that there is a dominance of savings activities. As far as the financial transactions are concerned, one can easily observe the existence of extremely low percentages (the exact figures are 0, 57 % on the asset side and 0, 06 on the liabilities side). This fact indicates that the GLS bank does not participate actively in the global financial market.

Table 5: GLS Bank (2008)

ASSETS		LIABILITIES	
Interbank operations	23 %	Interbank operations	11 %
Clients' transactions	72 %	Clients transactions	81 %
Financial transactions	1 %	Financial transactions	0 %
Reserves	4 %	Equity	8 %

Source: Annual Report. Calculations made by the authors.

Table 5 thus shows that GLS Bank is not conducting its business in the same manner as others banks do. If a last piece of evidence were necessary, it suffices to note that the value of the off-balance sheet in the case of the GLS Bank bears no comparison to that of the Deutsche Bank. If we look at the total amount of futures and swaps contracted by the GLS Bank to hedge the institution against the different kinds of risk, its represents just 6 % of their total assets (remember that it was more than 1000 % in the case of the Deutsche Bank!).<sup>22</sup> Ethical banks such as GLS Bank are thus at variance with conventional banks not only in theoretical terms (principles, values, etc.) but also in the practice of their financial activities.

## 6. Conclusion

Ethical banks and traditional banks (universal or cooperative) are regulated by the same authorities. They all have to abide by the same rules and to compete in the same market, but they are not essentially the same kind of financial institution. When looking at their sustainable development reports or their CSR communication, one might indeed be confused as to who is more deeply and sincerely committed to the perspective of responsible finance. But as the evidence of the balance sheet shows, only ethical banks really do what they say. This is because their business model is substantially different.

Cooperative banks are thus in a sort of intermediate stage. On the one hand, they are not as good as universal banks in terms of CSR. On the other, a process of mimetic isomorphism has led them to pay a growing attention to their financial performance. They have thus partly lost a valuable heritage stemming from the mid 19<sup>th</sup> century which is now actually incarnated by ethical banks. This is the twofold betrayal which summarizes the present identity crisis of cooperative banks.

<sup>22</sup> GLS Bank, *Geschäftsbericht 2008*, p. 29.

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