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# **Banking with Integrity**

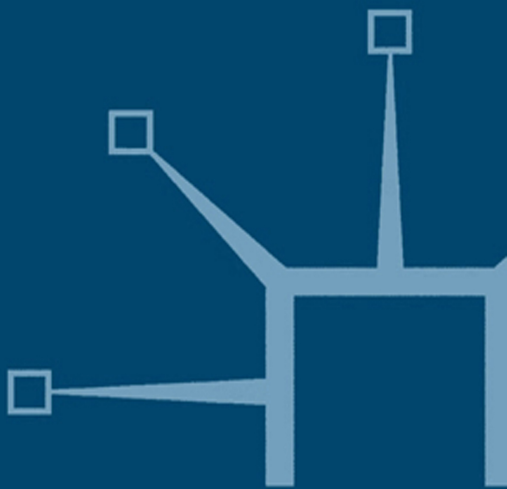
## **The Winners of the Financial Crisis?**

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Heiko Spitzeck

Michael Pirson

Claus Dierksmeier



# Banking with Integrity

## *Humanism in Business Series*

The Humanistic Management Network is an international, interdisciplinary, and independent network that promotes the development of an economic system with respect for human dignity and well-being.

The Humanistic Management Network defends human dignity in face of its vulnerability. The dignity of the human being lies in its capacity to define autonomously the purpose of its existence. Since human autonomy realizes itself through social cooperation, economic relations and business activities can either foster or obstruct human life and well-being. Against the widespread objectification of human subjects into human resources, against the common instrumentalization of human beings into human capital and a mere means for profit, we uphold humanity as the ultimate end and principle of all economic activity.

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As practitioners, we act towards the implementation of a humanistic economy on an individual, corporate, and governmental level.

As citizens, we engage our communities in discourse about the benefits of a human-centred economy.

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# Banking with Integrity

## The Winners of the Financial Crisis?

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and

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# Contents

<i>List of Tables</i>	vii
<i>List of Figures and Boxes</i>	viii
<i>Foreword</i>	ix
<i>Notes on Contributors</i>	xii
1 Introduction <i>Heiko Spitzbeck, Michael Pirson, and Claus Dierksmeier</i>	1
2 ABN AMRO REAL – A New Bank for a New Society <i>Patricia Palacios and Michael Pirson</i>	21
3 Banca Popolare Etica <i>Antonino Vaccaro</i>	36
4 Banca Prossima <i>Alessandra Dal Colle and Marco Morganti</i>	48
5 Branch Banking and Trust: Community Banking Based on Core Values – Can It Survive? <i>Stephanie A. Snyder and Jennifer J. Griffin</i>	64
6 CEI Capital Management LLC <i>Fiona S. Wilson, James E. Post, and F. Robert Wilson</i>	76
7 Cooperative Bank of Chania <i>Theodoros A. Katerinakis</i>	91
8 GLS Bank: Successfully Sustainable <i>Eva Schneeweiss</i>	107
9 Industrial Credit and Investment Corporation of India (ICICI) Bank: The Emergent Bank of the Emerging Economies <i>Radha R. Sharma and Philip Abraham</i>	115
10 People's United Bank <i>Anuj Gangahar</i>	129

11	ShoreBank Corporation: Let's Change the World <i>Fiona S. Wilson and James E. Post</i>	141
12	Triodos Bank – Mission-Driven Success Pays Off: From Dutch Enfant Terrible to European Business Leader <i>Frank Jan de Graaf</i>	158
13	Wainwright Bank and Trust Case Study – Humanistic Management in Practice <i>Christine Arena</i>	169
14	Investment Banks that Prospered <i>Anuj Gangahar</i>	182
15	Conclusion: Living Alternatives – Banking with Integrity <i>Heiko Spitzeck, Michael Pirson, and Claus Dierksmeier</i>	192
	<i>Index</i>	207

# Tables

1.1	The consequences of the financial crisis for selected banks	5
1.2	The continuous loop of crisis and regulation	9
1.3	Cases presented in this book	18
2.1	AMRO REAL's new business model	32
3.1	Key financial indicators in euros	44
4.1	Management in the banking industry: traditional model vs. Banca Prossima's humanistic model	61
7.1	Personality engagement initiatives	102
7.2	Corporate statements of CBC in campaigns	103
9.1	Comparison of management practices of foreign banks versus ICICI	126
12.1	Key financial figures	161
13.1	Humanistic management in the banking industry	180
15.1	Competitive advantages used by banks during the crisis	195
15.2	Mission statements of portrayed banks	197
15.3	Principles adopted by the portrayed banks	199
15.4	Civic lobbying of some banks	202



# Figures and Boxes

## Figures

1.1	The widening income gap	16
2.1	Bank of value concept	23
7.1	Scope and figures of CBC in Greece (Crete and Attica) and the distribution of cooperative banks in 13 Greek regions	93

## Boxes

3.1	Banca Etica's values	39
3.2	Banca Etica's mission	40
3.3	The Social Balance Sheet (Bilancio Sociale)	42
4.1	Consorzio PAN – Progetto Asili Nido (Crèche Project)	51
12.1	The mission of Triodos bank in 2002	163

# Foreword

In his book *The Black Swan: The Impact of the Highly Improbable*, published in 2007, before the extent of the global financial crisis became apparent, Nassim Nicholas Taleb wrote:

We have never lived before under the threat of a global collapse. Financial institutions have been merging into a smaller number of very large banks. Almost all banks are now interrelated. So, the financial ecology is swelling into gigantic, incestuous bureaucratic banks, so that when one fails they all fail.<sup>1</sup>

In *The Necessary Revolution: How Individuals and Organisations Are Working Together to Create a Sustainable World*, also written before the full extent of the crisis became apparent, Peter Senge and his co-authors compare the current Industrial Age to financial bubbles:

We are all familiar with financial bubbles, the metaphor invented by economic historians to make sense of a recurring puzzle: How is it that financial overexpansion and collapse occur time and again, drawing otherwise bright and clever people into ruin?

The answer is that during a period of expansion, in effect, two parallel realities develop, one inside the bubble and one outside. Both feel equally real to those who live within them. But the more the bubble grows, the more people are drawn into its powerful reinforcing beliefs and perceptions. Eventually, those inside the bubble become so absorbed by their reality that they literally can no longer understand the point of view of those outside.<sup>2</sup>

The crisis which began as a financial one has spread and led to strikes against foreign workers, violent demonstrations and civil unrest in countries as diverse as the United Kingdom, Greece and China. Already, the crisis has left commentators and politicians struggling with thesaurus and history books, to describe the gravity of current events and find comparisons. By now, it is clear that we are entering an era of consequences for the reckless global explosion of credit and the creation of ever more esoteric financial instruments, the risks of which either were not understood in an era of global connectivity – or those who did

understand them were unwilling or unable to alert the rest of the world to the dangers.

Some of the human consequences of the crisis are already all too clear:

- Lengthening dole queues
- Life-chances rapidly diminished – particularly for some older workers who may struggle to find significant employment again
- Repossessed homes and substantially increased demand for social housing
- Rising xenophobia and economic tribalism
- Disappearance of recent global financial services brands and the effective nationalisation of some other banks in Ireland, Britain, the United States, and elsewhere
- The effective emasculation of once-mighty investment banks
- Long-term debt obligations for taxpayers for decades to come

In addition, millions of people have already seen their life savings and pension pots slashed, and many will have to delay retirement, perhaps for many years. The Madoff scandal alone has destroyed several large philanthropic foundations and seriously damaged others, reducing flows of money and resources to good causes in the United States.

The consequences underline the human crisis caused by irresponsible behaviour of some banks in the increasingly global financial industry. With hindsight, it is easy to see the accumulating crisis. In the heat of perhaps the greatest market bubble the world has known, most of us were unaware, relaxed as the good times seemed to roll – or, in the case of the few who did see, unable to make their voices heard.

Robert Zoellick, president of the World Bank, has said that the world could look back on these years as simply the Decline – or, handled wisely, as the Age of Responsibility.

In order for future generations to look back on an Age of Responsibility we need to combine profitable business with responsibility throughout the business model – the cases within this book do just that. The challenge for politicians, regulators, the financial industry, banks, rating agencies, business schools, investors and citizens is how to help to move in the right direction.

Hence the value of publications like this book which attempt to provide an analysis of why some banks prospered during the global financial crisis and what we can all learn from their experiences.

The Doughty Centre for Corporate Responsibility is pleased to be associated with the humanistic management network through our visiting

fellow Dr Heiko Spitzack. We do not necessarily endorse either all the analyses or all the recommendations – but we commend the book as a contribution to debate about how to avoid so-called Groundhog Days of further financial crises.

**David Grayson, CBE**

*Doughty Centre for Corporate Responsibility  
Cranfield School of Management  
Cranfield University, United Kingdom  
[www.doughtycentre.info](http://www.doughtycentre.info)*

## Notes

1. Nassim Nicholas Taleb, *The Black Swan: The Impact of the Highly Improbable* (2007, Penguin edition, 2008), p. 225.
2. Peter Senge, Bryan Smith, Nina Kruschwitz, Joe Laur, and Sara Schley, *The Necessary Revolution: How Individuals and Organisations Are Working Together to Create a Sustainable World* (Nicholas Brealey Publishing, 2008), pp. 34–5.

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# 1

## Introduction

*Heiko Spitzeck, Michael Pirson, and Claus Dierksmeier*

In medicine, an illness is diagnosed by reading signs and symptoms. One way for the doctor to gain a higher degree of confidence in the diagnosis is to check whether there is a family history of similar conditions. In addition, the doctor can examine people who live in similar conditions yet who are not ill (if available). Such people can help the doctor assess, through comparison to the patient, whether genetic or behavioural factors are more the cause of the illness.

The process of increasing confidence in the initial diagnosis by looking at healthier parts of a population takes centre stage in this book. Before we examine banks that have weathered the recent storm in the financial markets better than most, in this introduction we offer an initial diagnosis. Over the following pages we will take a look at some of the symptoms, confirm that financial markets actors have a family history of being in the centre of economic crises, and provide select arguments in support of our initial diagnosis. In the end, we will suggest a treatment that would allow for a healthy financial service sector aligned to societal aims and value creation.

### **Symptoms of disease in the financial services industry**

Judging from the front pages of newspapers around the world, there was nothing especially memorable about 9 August 2007. In most of the northern hemisphere, people were enjoying their holidays and the mood was relaxed. On that day, however, the European Central Bank injected 94 billion euros of liquidity into the European banking system. Days before, the US Federal Reserve (Fed) had administered a shot of \$100 billion to the American financial market. What had happened?

The aim of both the Fed and the European Central Bank was to assure liquidity in the market as banks curbed lending to each other. Commercial banks had suddenly lost trust in each other's ability to service their loans. This lack of trust was well warranted as market participants either did not understand some of the products on their own balance sheets or understood that, regardless of their highly sophisticated character, they had an ultimately flawed basis: vastly expanded sub-prime mortgage lending in the booming US housing market. Be it for not fully understanding their own products, or by actually understanding that they entirely depended upon the impossibility of an everlasting housing boom, the expectation grew that this bubble was about to burst.

Sub-prime lending describes the lending of credit to borrowers who do not meet 'prime' underwriting guidelines. These are borrowers with an increased level of risk due to, for example, a history of loan delinquency, limited debt experience, or recorded bankruptcy. In addition, borrowers received loans that were beyond their means. Mortgage brokers handed out mortgages knowing that the borrowers might not be able to sustain repayments, based on the idea that future price increases in the housing market would absorb the risk of homeowners' running into trouble. They would enable homeowners to borrow even more money to service the loans they should not have received in the first place or, alternatively, the lender could repossess a valuable asset. As wrong as these practices may seem, they would not have been a major risk for the whole banking sector if sub-prime lending had been limited. In the United States, however, it amounted to about 20 per cent of the nation's mortgage lending and constituted the basis of a wide range of investment products. Alan Greenspan later called this common practice 'predatory lending.'<sup>1</sup>

In the years before 2007, American bankers and politicians alike enjoyed talking about the 'democratization of credit' as credit was given increasingly to everyone, be it through sub-prime mortgage lending or the use of credit cards. This allowed consumers to maintain spending levels that could not have been upheld through their incomes alone and led to an unsustainable negative savings rate in many households. Also, banks invented new mechanisms to make more use of these credit arrangements and bundled poor-quality loans into securities, the so-called mortgage-backed securities (MBS<sup>2</sup>), which were then traded globally. These packages were formed by calculation of the default-risk under conditions of growth. The system worked as long as housing prices were rising and cheap money was made available by the Fed allowing

poor-quality borrowers to repay their debt, if not through their own incomes, then through accumulating more debt. This process fostered economic growth from which others like building companies, furniture retailers, and the banks' shareholders benefited. However, as housing prices started to fall, many homeowners found themselves in trouble. In a falling housing market, lenders 'rediscovered' the concept of not lending more than a borrower can repay, and without being able to continue borrowing more money to service previous loans, a lot of sub-prime lenders went into default. This caused a chain reaction.

As a drastically increasing number of lenders were not able to pay their mortgages any longer, the market for MBS collapsed. The problem was not so much that they had become worthless – the properties were still there, after all – but that it had become impossible to assign a value to them. Hence within a very short period of time they had become virtually untradeable. As we have seen earlier, roughly 20 per cent of US mortgage lending was in the sub-prime market. So what happened to the other 80 per cent? The difficulty was that traded securities were backed by a mix of sub-prime and prime mortgages in an attempt to spread the risk. This allowed banks to obtain a prime rating for MBS with a relatively low sub-prime backing, which would in turn allow banks to offer presumably low-risk, high-yield investment opportunities. At the same time, it provided a neat answer to the question of how to make money from all those mortgages that should not have been issued in the first place. Even up to this point, though, the consequences of a downturn in the US property market might not have been as severe. During the earlier housing boom however MBS were continuously repackaged and sold from one bank to another, leading to a situation in which at some point no one knew anymore what was actually in them. Some clearly remained prime MBS; some were clearly junk; but in between there was a large amount of products for which no one was able to promptly provide details on the 'B' (backing) of MBS. They came to rely entirely on the eternal continuation of a housing boom in order to even retain their value. For as long as an overall market moves only up, one does not need to worry so much about the specific parts of that market one is exposed to. The very moment prices fall, though, one becomes very interested in knowing exactly what the exposure is. The inability to provide such details on the spot then brought any trading with MBS to a halt. Given that no one knew which bank was exposed to what degree of risk, all banks were seen as existentially at risk and no bank was willing to provide credit to any other bank. Banks were closing down the interbank lending market, which is vital for a functioning

financial services sector. Trust – the lubricant of financial markets – was lost, and in our globally interconnected and interdependent financial markets the crisis spread like a bushfire.

More than 300 mortgage lenders and 20 banks filed for bankruptcy by late 2009, and over \$3 trillion had to be depreciated (Lechner, 2009). But not only second-tier firms, those that are not too big to fail, ran into trouble. The crisis cut right through Wall Street, the City of London, and many other financial centres around the world, hitting well-established finance institutions, as some of the most famous examples below demonstrate (Table 1.1):

Soon the financial crisis spread into the real economy as credit dried up. Companies found it more difficult to secure financing, leading to uncertainty over the ability to carry out planned investments and, in many cases, to their deferral or suspension. The consequential effects on the job market led to a rise in unemployment, and those who had a job did not know whether it was at risk. Just as corporate credit dried up, so did retail banking. The unavailability of personal loans, in combination with insecurity over jobs and gloomy media coverage on the economy, led to a sharp decline in consumer spending. Bigger expenditures such as cars were postponed, retail purchases were reduced, and demand for services declined. A classic downward spiral was triggered by the reduced availability of credit, leading governments to conclude that even more money had to be injected into the economy, in part by providing cheap money to banks, hoping it would find its way into the real economy through relaxed lending standards (which had turned very stringent very quickly during the crisis), and in part by directly or indirectly supporting big business through, for example, the bailouts of US automakers or incentive schemes for new car purchases in some European countries. All of these measures had one purpose: the restoration of trust. Trust in banks' ability to repay loans they give each other; trust in businesses' creditworthiness; trust in lenders to adhere to some basic rules when deciding on a credit application; trust in governments' ability to uphold the welfare state and guarantee the safety of personal savings in times of crisis.

The human cost of the financial crisis and its repercussions are as severe as its macroeconomic consequences. Financial institutions such as Lehman Brothers had been considered safe havens for pension fund investments. Their bankruptcy lowered the value of pension funds, which in turn lowered pensions received by the elderly by up to 30 per cent (Lechner, 2009). The wave of real-estate repossessions that was sweeping the United States left many of the most vulnerable homeless; others

Table 1.1 The consequences of the financial crisis for selected banks

Country	Financial institution	Date	Description	Consequences
US	Bear Stearns	March 2008	Acquired by JP Morgan Chase for \$1.2bn to avoid insolvency.	Share price fell from \$57 (13 March) to \$10 (29 May).
	Merrill Lynch	September 2008	Acquired by Bank of America for \$50bn.	Ceased to exist as an independent bank.
	Lehman Brothers	September 2008	Filed for bankruptcy.	Largest bankruptcy in U.S. history.
UK	Northern Rock	September 2007	Asks the Bank of England for emergency financial support. Customers queue in order to put their money elsewhere.	<ul style="list-style-type: none"> <li>• Nationalization</li> <li>• CEO resigned</li> <li>• Taxpayer liability \$150 billion</li> <li>• 1300 jobs cut</li> </ul>
		February 2008	Nationalization of Northern Rock	
	HBOS	January 2009	Acquired by Lloyds TSB.	To allow the merger and to avoid another Northern Rock, the government waived competition law considerations.
	Bradford & Bingley	September 2008	The bank was partly nationalized; its savings business was sold to Santander.	Value dropped from £3.2 billion in March 2006 to £256 million in September 2008.

were forced to relocate with family members. According to an OECD report (OECD, 2010), in the summer of 2010, unemployment in the OECD countries stood at 17 million people higher than in 2007. In addition to the personal hardship – financial and emotional – it creates,



every job lost has added to countries' post-crisis debt burden: not only are governments more indebted through the bailouts and stimulus packages, they face reduced tax revenues and potentially expanded welfare costs. As the secretary-general of the OECD, Angel Gurría, states in the same report, 'Cutting unemployment and fiscal deficits at the same time is a daunting challenge.' As experienced time and again in economic crises, it is the weakest who are hit hardest, and in today's global economy this is true not only within nations but also between nations. The IMF called the global financial crisis a setback in Millennium Development Goals progress (IMF, 2010). UN Secretary-General Ban Ki-Moon saw it necessary to urge wealthy nations to not fall short on pledges made in support of the poorest nations before the crisis (United Nations, 2010), and in many poor countries home-grown-export-led success stories were wiped out as international buyers stopped ordering or cancelled existing orders.

Summing up the societal consequences, HSBC CEO Stephen Green said,<sup>3</sup> 'Banks have clearly done things wrong. Some of the practices did not contribute, by any reasonable standards, to human welfare.' The key insight of the history of the 2008 financial crisis and its consequences is that the financial industry is a lifeline for a modern society. If it fails, we all face serious consequences in our day-to-day lives.

### **The historic roots of the 2008 financial crisis**

As stated in the beginning of this introduction, it often helps solidify a diagnosis to examine whether a medical condition is aligned to a family history of similar health problems. For this book, that means that we may gain some valuable input from taking a brief excursion and highlighting some previous financial market crises,<sup>4</sup> all of which left a deep mark in the real economy and all of which were resolved with substantial efforts from taxpayers bailing out banks. Also in all cases banks were yielding high returns through the very conduct that later was determined to be the root cause of the crisis, while the weakest in society were hit hardest by its effects. So let us take a step back in time.

According to Lehman Brothers, in the 18th century we saw 11 banking crises, during the 19th century there were 18, and in the 20th century there were 33. If we were to think that this represents a trend, as sufficient prominent voices suggest, we had better buckle up and brace ourselves. The 2008 financial crisis may well have been just the beginning of a 21st-century financial crises frenzy. If, however, we are to gain some level of security that this does not represent a trend, we direly need to

learn from the current crisis as well as from previous crises. Below we list only a selection from the last 150 years that may offer some lessons to further guide our diagnosis of the ills in our financial system.

### **1860–1900: Creation of the lender of last resort**

Overend, Gurney & Co. acted as a discount bank in London (Elliott, 2006). Its key business was providing money for commercial and retail banks. After one of its founders retired, the bank invested in railways and other industries and significantly reduced the short-term cash holding its operations required. As soon as stock prices went down, the bank was short on liquidity, and because the Bank of England refused a bailout, Overend, Gurney & Co. went into liquidation in 1866. Due to its refinancing role for other banks, its bankruptcy had serious consequences for smaller banks. Unable to refinance themselves, some of those had to cease business, despite being solvent financial institutions. In consequence more than 200 companies and smaller banks went out of business. Walter Bagehot suggested reforming the financial system and institutionalizing the Bank of England as a ‘lender of last resort’ in order to prevent spillovers from the failure of individual banks. In this way the ‘Barings crisis’ of the 1890s was addressed. Investments of the Baring Bank in Argentina defaulted and forced the Bank of England to rescue Barings by providing £18 million. The rescue forced the Bank of England to suspend the British Bank Charter Act, which bound the issue of money to the equivalent held in gold.

The major societal learning from this crisis was that the collapse of individual banks could affect other financial institutions and lead to an erosion of trust of the whole banking system. In order to keep trust in the system in times of crisis, the central bank was institutionalized as a lender of last resort. Said differently, from the 1890s onwards, English banks could no longer go bankrupt; they would be bailed out by the state and thus, ultimately, by the taxpayer.

### **1929: The Wall Street crash**

The Wall Street crash in 1929 led to the Great Depression of the 1930s (Galbraith, 1955). Driven by the prospects of new industries such as broadcasting and automobile manufacturing, many middle-class citizens, as well as institutions, invested in shares, expecting to make a fortune. The bubble burst at the end of October 1929, and by 1932 90 per cent of the value of publicly traded companies was lost. Some 11,000 of the 25,000 banks in the United States collapsed in this period. It took 25 years before the Dow Jones industrial average recovered to

its 1929 level. As share-ownership was widespread, citizens had to cut spending drastically. By 1932 the US economy had declined by half, and 30 per cent of the workforce was jobless. In March 1933 President Franklin Roosevelt initiated his 'New Deal.' Under the New Deal, the government raised tariffs and introduced extensive regulation of financial markets and the banking sector. Among the most important laws stemming from the New Deal was the Glass-Steagall Act (see below). Also the Securities and Exchange Commission (SEC) and the Federal Deposit Insurance Corporation (FDIC) were set up.

One of the Wall Street crash's major lessons is that excessive speculative investment leads to 'bubbles' in financial markets – a bubble must, at some point, burst. Tighter controls and regulation were set up to avoid such speculative excesses.

### **1985: The savings and loans crisis**

Under the conditions of financial deregulation of the 1980s, US savings and loan institutions (S&L institutions) were allowed to enter into more complex financial transactions. In order to compete with big commercial banks, these S&L institutions engaged in risky business activities, which caused their demise in 1985. The US government created the Resolution Trust Corporation to take over all assets and liabilities, leaving the American taxpayer with a \$150 billion bill. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 introduced new regulation in the savings and loan industry; however, it did little to shield the country from the 1990/1 recession that is widely attributed to the aftershocks of the S&L crisis. In total the S&L crisis cost \$153 billion, of which US taxpayers paid \$124 billion and the financial services industry paid \$29 billion.<sup>5</sup>

What we can draw from the S&L crisis is that deregulation is in itself a risky business. Policies providing for financial markets institutions to generate upside opportunities without facing an equivalent downside risk may turn into costly adventures for taxpayers. When backed by a lender of last resort and left to their own devices, financial market actors expose themselves to risks they would otherwise be less likely to.

### **1987: The electronic trading crisis**

The US stock markets fell by 22 per cent on 19 October 1987, and markets in Europe and Japan followed suit. The widespread belief that insider trading and company takeovers on borrowed money dominated the markets, in combination with an economic slowdown of the United States, triggered a sell-off in stocks. This was exacerbated by newly

introduced electronic trading systems executing orders automatically. As a consequence, so-called circuit-breakers were installed to limit automated trading, and new laws against insider trading were enacted.

The electronic trading crisis demonstrates that fraudulent behaviour of even a small number of market participants leads to an overall loss of trust. Combined with technology that reduces the capacity for intervention based on human judgment, such loss of trust can generate almost instant systemic impact. To address this, new regulation was set up, and automated systems inserted predetermined breaks to limit the systemic effect.

The general pattern that emerges when we analyze the historical roots of financial crises is that regulation follows crisis after crisis, suggesting that purely regulatory responses are of limited impact (see Table 1.2 for a summary).

*Table 1.2* The continuous loop of crisis and regulation

The crisis		... and the legal consequences	
1866 and 1890	Collapse of Overend, Gurney & Co. caused the collapse of another 200 companies in the UK.  Barings crisis forced the Bank of England to bail out by injecting £18m.	1890	The British Bank Charter Act was suspended to avoid a run on the banks.
1929	Wall Street crash in New York due to massive speculative trade. The institution 'stock exchange' lost public trust.	1933/4	The Securities and Exchange Act establishes a regulatory body governing the stock exchange.  Enactment of the Glass-Steagall Act.
1985	S&L crisis	1989	Financial Institutions Reform, Recovery, and Enforcement Act
1987	Electronic trading crisis	1987	NYSE introduced 'circuit-breakers' to avoid herding.
2008	Global financial crisis triggered by the default of sub-prime mortgages in the US	2008	Banks like Fortis, Glitnir, and Bradford & Bingley were partly nationalized.  US Emergency Economic Stabilization Act of 2008

## **Patient diagnosis: the root cause of financial crises lies in opportunistic behaviour of banks and their management**

The revision of the 2008 financial crisis and the brief excursion into some of its antecedents over the last 150 years suggests parallels in their root causes that cast doubt over our effectiveness in developing a financial services sector that seeks to assume the role of a facilitator to the real economy. What persists is opportunistic behaviour, and such behaviour manifests itself in predominantly three forms: (1) increasing profitability by promoting the illusion that one can make money from money, engaging investors in risky business; (2) establishing executive compensation schemes that incentivize opportunistic behaviour; and (3) lobbying for lax regulation based on the argument that tighter regulation leads to a reduction in competitiveness of financial services firms. Over the following pages we will take a look at what opportunistic behaviour entails before we review a selection of the behavioural patterns in which it manifests itself.

Opportunism describes conscious behaviour that takes selfish advantage of circumstances while showing little regard for principles, values, and norms. In an admittedly simplified summation, opportunistic behaviour of banks aims at the privatization of profits and the socialization of losses.

Seizing opportunities to gain financial advantages goes along with abandoning certain principles which were previously espoused. Because of the abandonment of principles inherent to it, the term 'opportunism' is often used pejoratively. Opportunistic behaviour is *unprincipled*: it chooses the means applied to achieve an end based purely on the efficiency and effectiveness in which they are expected to lead to the desired end; often in full awareness of negative consequences that one could not rationally justify; and with great disregard for the rights of those who lack the power to enforce their rights. Opportunistic behaviour acts on the one 'principle' that might be right, it brushes aside questions of legitimacy and chooses from all options that can be chosen given by the agent's power, the *opportunity*, to actually exercise them.

The financial crises ever so clearly demonstrate that we need financial institutions to work in service of the real economy and society at large. When we experience shocks in the financial system, innovations, for example, stemming from investments come to a halt and pensions of people who steadily saved during their working lives

are at risk. Financial institutions are a means to an end. However, those market actors sharing responsibility for financial crises use other people's investments and savings for their own purposes, not in service of a greater good but in the pursuit of self-serving goals. They do not act based on the view that they service the people who entrust them with their money and for that service they can charge interest or a fee; they act based on the view that they must maximize their own returns and for that they must pay interest or a fee to those who entrusted them with their money. In short, rather than seeing themselves as service providers to the real economy, they see the real economy as the money supplier to them. In contrast, banking with integrity rejects opportunistic behaviour; it stays faithful to some central principles and sees the *raison d'être* of financial services actors in the provision of services to the real economy in order to generate societal benefit.

### **Profitability and the illusion of making money from money**

Any diagnosis starts with checking the basics. We need not worry about a patient's occasional headache when we see vital functions are not in order. So let us take a look at the very basics of our financial system, admittedly in a simplified manner, but at times it helps to take the bird's-eye perspective to gain orientation.

Money is defined as a *means of exchange*. The reason we like money so much is that it is a whole lot easier to carry around a piece of paper than, say, a bag full of tradable goods. And what if I wanted to have something that someone else wants to trade, but I have nothing in my bag he or she wants in exchange for what I have to offer? Money does the trick; it allows us to exchange anything we have too much of for anything we want more of, as long as we can offer things of equivalent value to the things we want. This can, however, only work if we do not begin to print more money than the total value of goods and services we produce. On occasion, however, I may need more money than what my surplus tradable goods or services are worth, and then I may want to borrow money from someone who has more of it than he or she currently needs. That's where banks come into play, as they allow me to go to one place where all people who have excess capital deposit their money. The bank will then want to know what I intend to do with the money, and if they believe that I will be able to pay back the initial loan and a little extra to reward the lender for the risks entered into and the bank for the service provided, I will be able to borrow. The person who

entrusts excess capital to the bank will need the confidence, though, that the banker will actually take a good look at what my intentions are with the money I borrow. The guiding principle for bankers ought to be to find investment opportunities that are promising a risk-reward ratio determined by the interests of the excess capital holder and not by the interests of the banker.

Banks are only holding other peoples' money in order to reallocate it where someone is short of it, but this shows the potential to generate a surplus in the future. It is not the bank's money that is being loaned, and there is no basis for financial services providers to argue that they should feel entitled to engage in self-serving business against the interest of the depositor. Consequently we must see banks as service providers: they do not themselves produce any goods. But that is exactly what some would like to make us believe. Some banks act as if they 'produce' money from money, but no matter how sophisticated the tools, how eloquent the arguments, or how shiny their financial district offices, this cannot work. We cannot produce additional money without producing additional goods and services of the equivalent value. If we do, we simply increase the nominal value of goods, their price tag, through inflation. Money in itself is worth the value of the paper it is printed on; what counts is the amount of goods and services that exist to back it up: all of that which is exchangeable for that money.

What opportunistic financial market actors want to make us believe, though, is that we can design clever financial products that would indeed allow us to turn a 10-euro note into a 20-euro note *without* also having generated goods and services worth an additional 10 euros. On this very fundamental level, it seems clear that any 'success stories' of 'making' money without also generating some additional value in the real economy needs to be scrutinized and stripped from the smoke-screens geared towards selling this illusion. The first form in which financial market actors' opportunistic behaviour manifests are these attempts to make money from money, and whenever they manage to convince enough people that this would be possible, a bubble is created that, sooner or later, will burst.

### **Deregulation of the financial industry: Cui Bono?**

Opportunistic behaviour misuses demands for deregulation and market liberalization. The aim is not to selectively allow for more market freedom in order to be more effective in servicing the real economy. The aim is to allow for more opportunism; to increase the capacity to choose from a greater variety of options by disposing of burdensome controls

and regulations that hinder the execution of some options that may promise high rewards, to financial services actors and not to society. Such opportunities also carry greater risks, which are obviously often ignored knowing that a lender of last resort will step into the breach if and when necessary.

The Glass-Steagall Act, touched upon earlier, was passed in 1932 to fight the effects of the Great Depression. To enhance protection against speculation, the separation of commercial and investment banks was added in 1933 – known as the Banking Act. The act was repealed by US President Bill Clinton in 1999 and allowed for, for example, the merger of Citicorp and Travelers Group to form Citigroup, a company once considered ‘too big to fail’ (Kaufman, 1990).

The repeal allowed commercial lenders to underwrite in their retail business and trade sub-prime MBS in their investment business. They were as well enabled to use the money from other parts of their business (such as personal savings) for use in gambling by the investment-banking branch. In addition, ‘retail banks’ frequently held fully owned subsidiaries in the investment-banking arena and actively channelled funds received through retail operations into sophisticated investment products. In good times, these subsidiaries were the stars of retail banks, but as soon as investment banking suffered the effects of the crisis, bankers argued that this business was not really part of their bank, trying to avoid the need to recognize that they had failed their retail customers, that they had acted against the interest of their depositors.

Some observers therefore argue that the repeal of the Glass-Steagall Act is directly responsible for the financial crisis because it did away with one of the most important control mechanisms separating retail and speculative forms of banking. The arguments brought forward by the financial industry to repeal the act are enlightening – demonstrating in whose interest the proposed changes were<sup>6</sup>:

1. Commercial banks are losing market share to other financial institutions outside of the United States which operate in less regulated environments. The act limits the banks’ international competitiveness.
2. Trading of MBS is considered a low risk, as they are based on diversification. Therefore, a separation of commercial and investment activities is not necessary.
3. In the rest of the world, the separation is not practiced, and lessons from their regulatory environment can be integrated into self-regulation and national regulation.



These arguments play on the competitiveness of the banks in an international market and in no way make reference to the provision of benefit to society at large. There is reason for doubt, though, over arguments that call tight regulation per se an obstacle to competitiveness. The pharmaceutical industry, for example, can be regarded as highly competitive, yet many of the world market leaders come from countries where very stringent regulation determines the fate of any new products. Pharmaceutical companies from these tightly regulated markets are successful not despite, but because they are facing public counterparts that go to lengths to ensure that a new medication does not pose a public health risk. These measures generate public trust and serve firms as a high quality–low risk seal on their products. However, when it comes to our economic health, we think the best way forward is to adopt a *laissez-faire* stance on regulation. Would you like to buy some medication in a country where policymakers believe that the best way to ensure pharmaceutical companies do not launch any potentially harmful products is to provide only minimal assistance on the decision of whether or not a product is safe?

Clearly globally consistent regulation of financial services offers, or at least consistency within the main financial centres, is desirable, perhaps even necessary to ensure a level playing field. And it is achievable. The argument that the moment a country tightens the regulatory environment, the whole industry relocates or is put out of business in the rest of the world is hard to follow, especially in a knowledge-intensive industry dependent upon a whole range of first-class infrastructure, such as the financial services sector. The repeal of Glass-Steagall can therefore be considered a significant event of systemic de-learning caused by opportunistic lobbying of the financial industry.

However, money supply, interest rates, and the rules of engagement in financial markets are in the realm of central banks and public regulators; they share responsibility for crises. Regardless of the lobbying pressures they were under, they have failed to realize their mandate when financial market actors are put in a position where they can exercise options that cause harm and hardship to the citizens who depend upon a functioning financial sector.

Alan Greenspan was chairman of the Federal Reserve Bank for more than 18 years and known as a free-market icon.<sup>7</sup> He called the 2007 crisis a ‘once-in-a-century credit tsunami.’ In a hearing by the SEC, Greenspan’s policy was criticized for regulatory mistakes and misjudgements. Greenspan acknowledged that he made a mistake in believing that banks, operating in their own self-interest (opportunism) would protect shareholders and institutions. He said that the financial crisis had ‘turned

out to be much broader than anything that I could have imagined' and 'I still do not fully understand why it happened.' This realization may be indicative for many people working in the financial industry.

What has happened and what still is happening is that we allow financial market agents to act strictly opportunistically. We somehow maintain a belief that providing a regulative environment that allows for gearing all efforts towards the goal of achieving the highest returns for their own institutions or for their individual benefit will by some magical process automatically lead banks to produce the most desired results for everyone else. The classical neoliberal paradigm, proven time and again to be a dysfunctional basis of orientation regarding the regulation of financial services providers, still governs much of our thinking.

### **Executive compensation: the systemic effects of incentives based on greed**

On the level of the individual bank manager, opportunistic behaviour is encouraged by incentive systems, which are disconnected from the societal consequences of mismanagement. They encourage the deployment of mechanisms whose only purpose is to generate the highest possible short-term returns, giving no consideration to the question of whether these returns add, are neutral to, or extract value from society.

The degree of truth in the claim that financial market actors aim at privatizing profits and socializing losses can be seen most drastically in executive compensation schemes. While banks asked for government bailouts in 2007 and 2008, some managers still claimed their contractually guaranteed bonuses. These claims have led to public outcry, fuelled, for example, by the following cases:

- Despite filing for bankruptcy under Chapter 11, Lehman Brothers' New York staff set aside \$2.5 billion in bonuses.<sup>8</sup>
- The Royal Bank of Scotland announced a £28 billion loss on 19 January 2009.<sup>9</sup> Media reports of the bank's intentions to award its executive with nearly £1 billion for this performance prompted an outrage in the United Kingdom.<sup>10</sup>
- United Banks of Switzerland (UBS) announced that it would pay its employees a total of 2.2 billion Swiss francs in bonuses despite reporting a record loss of 19.7 billion Swiss francs.<sup>11</sup>

While these examples demonstrate how far financial executives have distanced themselves from willingly assuming responsibility for their own business decisions, criticism about executive compensation

schemes is nothing new. What is new, and an encouraging sign, is that executives now publicly recognize and admit that executive compensation schemes have to change. Duncan Niederhauer, chief executive of NYSE Euronext, said, 'It is quite clear that some of the compensation models at these firms have to be not just incrementally changed but completely overhauled.'<sup>12</sup> Even Stephen Green, chairman of HSBC, realized that there had been a 'huge and growing disparity between levels of income'.<sup>13</sup> A major indicator for judging the adequacy of executive pay is the relation between workers' pay and executives' pay. This measure has been tracked in the United States for over 40 years and demonstrates a widening gap (Figure 1.1).

While top earners in a society have easy access to basic goods as well as good education, excellent lawyers, and private doctors, the bottom 60 per cent are struggling with the necessities of life. In order to finance their daily expenses, they are increasingly forced into debt. Consider the average US credit-card debt per household, which rose from \$4301 in 1994 to \$15,788 in 2009<sup>15</sup> (by some commentators believed to be the cause for the next crisis). The bottom earners have to take loans in order to buy the car, which takes them to work or to build the house to have shelter for the family. They are also very sensitive to changes in the economic climate, as they are the first to lose their jobs because of their low qualifications. They cannot afford to send their children to 'good' schools, and students from these families need to take loans. The average US college graduate has about \$20,000 in debt.<sup>16</sup> The

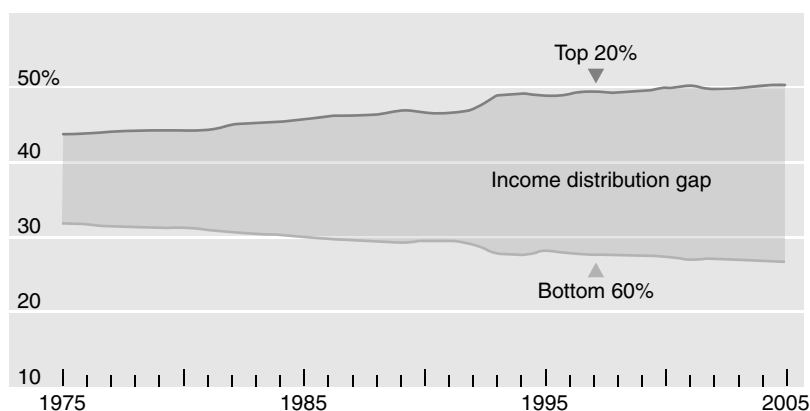


Figure 1.1 The widening income gap<sup>14</sup>

income inequality in the United States can be considered a factor in creating a receptive market for sub-prime mortgages.

Nobel laureate Joseph Stiglitz further holds that executive compensation schemes encouraged irresponsible behaviour. 'Paid by stock options executives have an incentive to increase the market value which is easier by increasing reported income than by increasing true profits, which are bound to real business.'<sup>17</sup> In order to increase reported income, executives aim to get liabilities off the balance sheet or book unearned income. Also, speculation held the potential for quick profits, and successful 'gamblers' were highly rewarded. MBS were another case in point. In these securities, risks were continuously repackaged and sold in an attempt to increase profits without generating any value. The underlying assets in the real economy – real-estate properties, in this case – and perhaps ways to increase their value by improving them were never part of the deal. What was part of the deal was to have an elegant way of getting rid of risks in their own balance sheet by passing them on to someone else after repackaging them in ways aimed at obstructing the buyers' ability to actually understand the inherent risks. This practice satisfied stock-market analysts as well as conditions for bonuses, and, in combination with the awareness of having a lender of last resort ready to step in at times of need, opportunities for personal enrichment were created without having to fear an equivalent risk of personal loss.

Setting aside moral arguments over the question of what ratio between executives' and workers' pay is still justifiable, executive compensation schemes in the financial services sector have generated far-reaching systemic impact. They encourage both the development and the marketing of investment products that are entirely indifferent to any impact they generate other than the resultant return for individuals, all the way from the retail banking client 'advisor' selling pensioners highly risky certificates as the right way to safeguard their life's savings to the trader selling repackaged MBS to other banks or institutional investors. The systemic consequence is that vast amounts of resources and efforts are engaged with financial market activities that are showing no interest in generating societal value, that see the real economy as little more than the necessary money supply for their dealings.

Current incentive systems de-professionalize the banking industry, as they encourage individuals to concentrate on activities with the sole purpose of fostering their own financial benefit. Traditional professions include divinity, medicine, and law. Because of the highly skilled work of professionals, membership in professional bodies comes

with prestige and social recognition. Professions are characterized by their specialized knowledge, which require long-term education and qualifications. Their purpose is deeply social, as lawyers defend justice, medical doctors care for health, and priests work for salvation. Professional bodies are autonomous and have a code of ethics in order to discipline members for unprofessional conduct. The most famous of these codes of ethics is the Hippocratic Oath of the medical profession, established in the fourth century BC. It contains the following lines: 'In every house where I come I will enter only for the good of my patients, keeping myself far from all intentional ill-doing and all seduction [...].'<sup>1</sup> As exemplified in this oath, unprofessional conduct refers especially to opportunistic behaviour and in most cases to situations in which professionals enrich themselves through the exploitation of others. This is exactly what current incentives encourage: they are an offer to sell professional integrity. Would you trust a doctor who has a proven track record of showing greater interest in his fees than in your health?

### **Is our diagnosis correct? can we design a cure?**

Our symptom analysis led us to the diagnosis of opportunistic behaviour of banks and their management. If this diagnosis holds, we should expect that banks acting with integrity are less affected by the financial crisis. Analyzing their structures, policies, executive compensation schemes, and behaviours should enable us to derive some useful inoculation against future crises. Therefore, this book takes up the stories of banks which – in our view – are demonstrating an integrity-based approach to banking (see Table 1.3). Thus we wish to deliver a proof of concept that humanistic management is possible – also in the financial sector. For reality proves possibility.

*Table 1.3* Cases presented in this book

<b>Bank</b>	<b>Country</b>
ABN AMRO Real	Brazil
Banca Popolare Etica	Italy
Banca Prossima	Italy
Branch Banking & Trust	US

Continued

Table 1.3 Continued

Bank	Country
CEI Capital Management LLC	US
Cooperative Bank of Chania	Greece
GLS Bank	Germany
ICICI Bank	India
People's United Bank	US
ShoreBank Corporation	US
Triodos Bank	Netherlands
Wainwright Bank & Trust	US
Investment banks including J.P. Morgan, Banco Santander, and BNP Paribas	US Spain France

## Notes

1. 'Greenspan admits "mistake" that helped crisis', Associated Press, 23 Sept. 2008.
2. Often described as collateral mortgage obligations (CMO)
3. "'Don't demonize banks', urges HSBC chairman Stephen Green', *Telegraph*, 30 Jan. 2009.
4. The information on previous crises was taken from Steve Schifferes, 'Financial Crises – Lessons from History', BBC News, 3 Sept. 2007, and Jon Henley, 'Show us the money', *Guardian*, 19 Sept. 2007.
5. The figures refer to losses resulting from the S&L crisis between 1986 and 1995 and are taken from Timothy Curry and Lynn Shibut, 'The Cost of the Savings and Loan Crisis: Truth and Consequences', *FDIC Banking Review* 13, no. 2 (Dec. 2000).
6. Taken from the congressional note, available under: <http://digital.library.unt.edu/govdocs/crs/permalink/meta-crs-9065:1> (accessed 2 Mar. 2009).
7. Information for this paragraph has been taken from 'Greenspan admits "mistake" that helped crisis', Associated Press, 23 Oct. 2008.
8. David Prosser, 'Fury at \$2.5bn Bonus for Lehman's New York Staff', *Independent*, 22 Sept. 2008.
9. BBC News: 'RBS shares plunge on record loss', 19 Jan. 2009.
10. David Milliken, '\$1.47 Billion Bank Bonus Prompts UK Outrage', Reuters, 8 Feb. 2009.
11. Financial Times Deutschland, Trotz Rekordverlust – UBS verteilt Boni von 2,2 Milliarden, 10 Feb. 2009.
12. Lisa Jucca and Nichola Groom, 'CEOs Say Overhaul of Bank Bonuses on the Cards', Reuters, 30 Jan. 2009.

13. Larry Elliott, 'HSBC Chief Says Widening Pay Gap Contributed to Collapse of Trust in Banks,' *Guardian*, 30 Jan. 2009.
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# 2

## ABN AMRO REAL – A New Bank for a New Society

*Patricia Palacios and Michael Pirson*

Succeed by doing the right things, the right way.

Value Proposition ABN AMRO REAL

‘Two roads diverged in a wood, and I – I took the one less traveled by and that has made all the difference,’ said Robert Frost in his poem ‘The road not taken’ in 1918 (Frost, 2002, p. 270). The road not taken leads to the unexplored; a pathway that usually involves taking higher risks. At the same time, these risks can present opportunities; competitive advantages that can reposition an organization and place it in an entirely new spectrum. ABN AMRO REAL, one of Brazil’s top five largest privately owned banks, is among those leading financial institutions to have chosen a distinct pathway by placing corporate social responsibility at the center of all their business activities. Their business model has revolutionized the South American banking industry, demonstrating to others how an organization can be profitable while maintaining an ethical attitude. In 2008 the bank was declared ‘the most sustainable bank of the year’ by the Financial Times and the International Finance Corporation (IFC) (IFC Press Release, 2008). This case study will illustrate how ABN AMRO REAL became successful by placing corporate social responsibility at the center of their business activities and the lessons that can be learned from their management practices.

### **Envisioning a new bank for a new society**

ABN AMRO REAL traces its roots to Banco da Lavoura de Minas Gerais, a financial group in Belo Horizonte Brazil founded with the aim of providing farmers with financing opportunities. In 1925 Banco da Lavoura de Minas Gerais moved its head office to São Paulo, where it assumed



the name Banco Real. From that time, Banco Real expanded its operations until it had the biggest branch network in the country in 1975. In 1998, the bank was acquired by ABN AMRO S.A., the Brazilian subsidiary of a Dutch financial group, which had begun its activities in 1917 as Banco Holandês da America do Sul. ABN AMRO REAL, the merged bank, had over two million retail customers and employed over 17,000 employees in 1998.

Fabio C. Barbosa, the president of FEBRABAN, the Brazilian banking association, and newly appointed head of ABN AMRO REAL, faced the challenge of integrating the merger after the acquisition. At a time when several other acquisitions were taking place in the banking sector, competition was strong. Many of their bigger competitors did not only have a better technological infrastructure, but also stronger brand recognition. At the same time, poverty combined with a poor infrastructure, a high level of income disparity, and increasing environmental deficiencies afflicted the country, although Brazil was defined as one of South America's leading emerging economies. Mr Barbosa believed 'there is limited value in succeeding in a country which does not enjoy the same success itself' (Barbosa, 2006). Given the competitive landscape in the industry and the huge societal problems, he knew it was possible to establish a new bank; a bank that would not only be distinguished from its competitors, but, most importantly, would have a new identity that could transform the society. Such a bank would be respected and admired by all its stakeholders, not only its investors.

Inspired by the vision of creating 'a new bank for a new society,' Mr Barbosa and other senior executives of the bank believed they could succeed by 'doing the right things, the right way.' 'The right way' meant placing corporate social responsibility at the center of their business activities to make an impact. They wanted to move beyond mere philanthropy, and intended to demonstrate that it was possible to be profitable and at the same time create value for the society. Their emphasis on 'value creation' led them to introduce the *bank of value* concept in 2001 (Figure 2.1).

The *bank of value* concept was developed by a group of senior executives of ABN AMRO REAL, including Mr Barbosa, Jose Luiz Majolo, COO, and Maria Luiza de Oliveira Pinto, Executive Director of Sustainable Development. Underlying this new concept was the belief that, by having an ethical approach to business, the bank could achieve total customer satisfaction, and, ultimately, all stakeholders would benefit. It was a business model in which everyone would win. Embedded in the group's business model was their mission: 'To be an organization renowned for



Figure 2.1 Bank of value concept

Source: ABN AMRO REAL website.

providing outstanding financial services to our clients, achieving sustainable results and the satisfaction of individuals and organizations, who together with us contribute to the evolution of society' (ABN AMRO REAL Website, 2008). However, merely being satisfied was not enough for the bank. It strove for total customer satisfaction, which was considered an unending mission and implied a continuous improvement process (Banco Real Sustainability Report, 2003–2004, p. 29).

### Placing sustainability at the center of their business activities

While the *bank of value* concept was applauded by many, some executives were skeptical of the new business model, mostly because they did not consider the idea of 'everyone a winner' to be feasible. Like most unexplored pathways, this one was also filled with many uncertainties. Nevertheless, although there was some initial resistance, most senior executives, including Mr Barbosa and Ms Pinto, stuck to the new way of doing business, as

they believed this was the 'right thing to do.' This was contrary to the old way, which emphasized transactions, while the new way meant focusing more on the type and quality of customer relationships.

For their vision to be successfully implemented, the relevant senior executives knew it was crucial to establish an internal team dedicated to ensuring that corporate social responsibility would be ingrained in all their business activities. Consequently, a committee was appointed to discuss and develop ways that could bring about the desired change, while work groups from various areas of the bank carried out the implementation of the projects. In 2002, the committee created under the *bank of value* concept was divided into three committees: management, market, and social action. While the management committee was responsible for eco-efficiency, employee diversity, and suppliers, the market committee was focused on the products, customers, and credit risk analysis. The social action committee was accountable for social investment and community involvement.

A crucial step had been taken by appointing committees that would serve to integrate the bank's new business model. However, before aiming to transform the outer world, the management knew they had to change the company from within. The bank's business processes were therefore analyzed and redesigned to make them more socio-environmentally sustainable. In 2001, ABN AMRO REAL introduced their '3Rs' eco-efficiency program (*reduction, reutilization, and recycling*). Most of the bank's efforts to reduce its environmental footprint were primarily focused on reducing water and energy consumption, and the usage of recycled resources, such as paper, batteries, and ink used for their printing devices. Through these initiatives, energy consumption was reduced by 12 percent during the last three years; currently, approximately 90 percent of all the paper used is derived from recycled paper (ABN AMRO REAL Website, 2008). As a way of compensating for their emissions generated by travel, the executives introduced the 'Floresta Real' program – an initiative targeted at the reforestation of the Atlantic Forest, which mainly follows the course of the Juquiá River in the interior of São Paulo. Since this area of São Paulo ranks among the lowest in terms of sanitary conditions, education, and development, the harvest generated by these plantations would help generate income that would improve living conditions in the community.

Although these initiatives helped the bank become more eco-efficient, the management knew that placing corporate social responsibility at the center of all their business activities meant much more. A key determinant to creating 'a better bank for a better society' was to mobilize others to adopt more sustainable practices. The management knew that they

could not be as successful alone, but, by sharing corporate social responsibility with others, they could come closer to making their vision a reality. This meant, for example, that the bank would only engage with those customers who shared the same principles, otherwise those principles would be meaningless. Consequently, the bank screened out those customers whose activities would pose high socio-environmental risks. This process generated much resistance at first, as many managers thought the bank would lose a significant client base and their assets would decline.

Nevertheless, the bank executives stuck to their principles and developed a socio-environmental risk department in 2002 to better screen and monitor their commercial clients' socio-environmental risks. Among the main areas assessed were safety and medical care in the workplace, outsourcing hazardous and polluting processes, and child or forced labor (ABN AMRO REAL Website, 2008). In addition, periodic compliance checks via questionnaires were required for companies in certain industries, such as agriculture and the transportation of hazardous chemical products. Thereafter, the socio-environmental department carefully assessed these questionnaires. The exclusion of clients only followed if they were engaged in certain sectors, such as the manufacturing of weapons, whose nature would not comply with ABN AMRO REAL's corporate principles, or if the company had failed to adopt the bank's suggestions regarding more sustainable measures.

Of the 2,112 credit applications received in 2003, 11 were refused for non-compliance with ABN AMRO REAL's socio-environmental obligations. Between 2004 and 2007, another 36 credit applications were rejected (Sustainability Reports, 2003–2004, 2005–2006, 2007). Although, in the end, the number of credit applications rejected represented only a small percentage of the total number of applications received, it was a crucial step to demonstrate to all that the bank's principles went beyond their financial pursuits (Mansur, 2008). At the same time, ABN AMRO REAL was among the ten initial banks in 2003 to have voluntarily adopted the Equator Principles, which are a set of guidelines established by a group of financial institutions to ensure that the projects they finance are structured in a socially responsible way and reflect sound socio-environmental management practices (The Equator Principles Website, 2008).

### **Engaging their staff to make a difference**

To further succeed in its mission, management conceived the initial structure to ensure that corporate social responsibility was incorporated at all levels of the organization. The buy-in of ABN AMRO REAL's staff

was most important for the continued implementation of the vision. Senior executives of the bank believed that a more engaged and motivated workforce, proud to work for ABN AMRO REAL, would independently enact responsible business decisions. The staff would then provide a better service to their customers, who would in turn be more satisfied. In order to develop a culture that reflected the values and principles of the bank, its staff's level of socio-environmental awareness had to be raised. Education was considered the best method to achieve this. Consequently, the senior management decided to form a directorate of education and sustainable development by temporarily unifying the sustainability and education departments in 2003. The main goal of this unified department was to train the staff on the topic of sustainability and to ensure that it was also incorporated in all the training programs at ABN AMRO REAL. In the following years, the bank also partnered several training specialists from other organizations to enhance the training experience of its staff. Later, other technological methods, such as online education programs, were also introduced to reach a greater audience. Once senior management considered the task accomplished and the staff sufficiently trained on sustainability, they decided to dismantle the directorate of education and sustainable development in 2007 and again form two separate departments.

Training was essential to mobilize the employees to implement the bank's vision, as was their engagement. ABN AMRO REAL encouraged and supported its staff to work towards finding solutions that could enhance their socio-environmental performance. This has given rise to some innovative projects that have not only demonstrated remarkable results in terms of profits and enhancing their socio-environmental performance, but have also increased employee engagement and motivation. Among the projects that were introduced was the Escola Brazil Project, which was founded and run by a group of employees (ABN AMRO REAL Website, 2008). This volunteer program was primarily aimed at improving the quality of public school education in Brazil and at helping these institutions adopt more sustainable practices. Later in 2002, the Amigo Real Project was also introduced and run by a group of staff members. Like the Escola Brazil Project, the Amigo Real Project was designed to strengthen the community's service systems and improve the lives of those children and adolescents in need (ABN AMRO REAL Website, 2008). This program became very successful. It has been calculated that between 2002 and 2005 the Amigo Real Project collected 22 million Reals (approx. USD 9.4 million) for children and adolescents in need. ABN AMRO REAL's efforts to engage their employees have brought

formidable results: according to an internal study, employee satisfaction increased from 68 percent in 2004 to 91 percent in 2006 (ABN AMRO REAL Website, 2008). The Great Place to Work for Institute also ranked ABN AMRO REAL among the top ten best companies in Brazil for camaraderie and employee pride in 2008 (Mansur, 2008).

### **Bringing sustainable solutions to the market**

ABN AMRO REAL did not only introduce several initiatives to enhance its socio-environmental performance, but also strove to have an even greater impact through product stewardship. It introduced new sustainable solutions by actively interacting with external parties (Hart, 2007). In 2001, ABN AMRO REAL launched its Ethical Fund, an equity fund aimed at obtaining high returns by investing money in companies demonstrating exemplary sustainable business practices. As one of Latin America's pioneer funds addressing socio-environmental needs, the Ethical Fund registered a 163 percent rate of return between 2001 and 2004 in comparison to São Paulo's average Stock Exchange (Bovespa) rate of 131.6 percent for the same period (Sustainability Report, 2003–2004, p. 44). According to Bloomberg Financial Information Services, of the 210 socially responsible investment funds they monitored worldwide, ABN AMRO REAL's ethical fund performed best in 2004. Their remarkable success led others in Brazil to become interested in launching similar funds. That same year, for example, Banco Itaú launched its Fundo Itaú Excelência Social (Itaú Social Excellence Fund) (Bovespa Corporate Social Sustainability Index, 2010).

*Example:* Among the companies to have benefited greatly through the support of ABN AMRO REAL was DryWash, a Brazilian company founded in 1994 that has revolutionized the cleaning industry (ABN AMRO REAL Website, 2008). By using Carnaúba wax, which is derived from the Carnaúba palm, an indigenous plant, the company introduced a new method of 'washing' cars that did not require the usage of water or harmful chemicals, while efficiently removing dirt from vehicles without damaging their surface. As a way of helping the company to enhance its infrastructure and product line, ABN AMRO REAL financed some of their activities and helped them gain access to a socio-environmental credit line provided by the International Finance Corporation (IFC). Over the first ten years, DryWash was able to save 450 million liters of water through their innovative technology, and their revenues exceeded

their expectations, reaching USD 2.7 million in 2005 (World Resources Institute, 2006). When choosing to open an account with ABN AMRO REAL, the company considered 'sustainable conduct' as one of the main criteria. 'If a bank has sustainable practices, then the likelihood that the institution really cares about the client is higher,' said Lito Rodriguez, founder and president of DryWash (Portal Exame, 2006). By supporting DryWash to introduce sustainable products that could be of benefit to society, ABN AMRO REAL not only contributed to the success of the company, but it also gained a valuable customer.

ABN AMRO REAL decided to provide financing options with special conditions for their commercial clients interested in improving their socio-environmental performance. These credit options were made available to corporate clients provided they were targeted at enhancing the clients' socio-environmental performance.

Financing projects to help its corporate clients introduce more sustainable measures proved to be extremely lucrative for the bank, helping it increase its customer base with those who shared the same values. By 2007, ABN AMRO REAL's corporate portfolio amounted to 34,337 million Reals (approx. USD 19,354 million), indicating an increase of 32 percent compared with the previous year. At the same time, its number of current accounts increased by 32.5 percent between 2001 and 2007 (Sustainability Report, 2007). Like DryWash, several other companies benefited greatly through the bank's support. These special credit options were another way in which ABN AMRO REAL could demonstrate how everyone could benefit.

With all the costs that went into assessing credit line options to support companies' socio-environmental development and the expenditure on training the bank's credit analysts, many stakeholders were skeptical and questioned whether the bank would benefit from the socio-environmental risk assessment in the end. After analyzing several companies, many of the bank's experts came to the conclusion that companies with socio-environmental problems are also most likely to have financial problems (Sustainability Report, 2005–2006). Christopher Wells, head of the bank's socio-environmental risk department in Latin America, explained that, by avoiding loans to those poor-performing companies, and even turning them down when necessary, it could outperform banks that did not consider environmental issues when lending to companies (Schneider, 2009). These benefits are partially reflected in the bank's insolvency rate, which is comparatively

lower than the market average. For example, in December 2007, ABN AMRO REAL had an insolvency rate of 2.8 percent compared with the 4.3 percent market average (Sustainability Report, 2007). In addition, it would gain by increasing its brand attractiveness and, consequently, the bank would gain more customers who shared the same values and principles.

The bank did not, however, limit its support to corporate clients, but also helped those at the base of the pyramid. Together with Acción International, an NGO with vast experience in microfinance, ABN AMRO REAL created a joint venture called 'Real Microcredito' in 2002. It was founded before the Brazilian government started investing in microcredit incentives and before Muhammed Yunus won the Nobel Peace Prize (Sustainability Report, 2005–2006, p. 55). Micro-lending (small loans provided to the poor) was intended to spur economic growth by financing productive activities that would help the low-income community generate income. The bank's first micro-lending project was in Heliópolis favela, the biggest low-income community in São Paulo (Metaonginfo, 2002). To gain access to these loans, those in need were not required to go to the bank itself. Ten representatives were sent to work at the Heliópolis favela to contact those interested, while various other volunteers also contributed to making this project successful. Over time, the number of microcredit clients increased, from 85 in 2002 to 53,421 in 2007 (Sustainability Reports, 2002–2003, 2007).

ABN AMRO REAL's consistency and transparency in incorporating corporate social responsibility in all its business activities quickly led to its gaining credibility from its stakeholders. The International Finance Corporation (IFC) was among those impressed by the bank's social commitment. In 2004, ABN AMRO REAL was granted 51 million Reals (approx. USD 21.6 million) to support its sustainability investments – an amount rarely approved by a financial institution (IFC Sustainable Report, 2004). With this funding, the bank could expand its sustainability portfolio basis for an even greater impact. It was also the first time a bank enjoyed complete autonomy to perform its socio-environmental risk analysis with the funds granted – a task that was generally done by the IFC.

### **Shortening the journey by sharing best practices**

Over time, other companies could no longer overlook the fact that, in order to remain competitive in the market, they had to contribute to societal goals. For many, however, the challenge remained finding new sustainable solutions to enhance their socio-environmental



performance. ABN AMRO REAL, however, knew that by collaborating with its stakeholders and sharing best practices it could be of help. More than being merely supportive of others, ABN AMRO REAL knew that alone it could not accomplish much, but, together with its clients, could achieve much more and shorten the journey to make a real difference. Consequently, the bank introduced the 'Espaço Real de Práticas em Sustentabilidade' – a program designed for the public, and especially for companies, supporting them in rethinking and redesigning their business processes in a lucrative and innovative manner, integrating financial results with corporate social responsibility. Companies would benefit not only by sharing best practices with a leading financial institution that had successfully integrated sustainability into its business processes, but also by exchanging experiences with other participants.

The 'Espaço Real de Práticas em Sustentabilidade' program offers events, which are open to the public, that promote reflection and debate on topics pertaining to sustainability. Some of the meetings are specifically designed for the public to ask questions and to learn from the views of renowned specialists from around the world. Among the leaders to have participated in these events in the past were Stuart L. Hart, author of 'Capitalism at the Crossroads' and Eduardo Gianetti, Brazilian economist and author of 'O Valor do Amanhã' ('The Value of Tomorrow'). ABN AMRO REAL has expanded the offices previously used for training its employees to offer free introductory sessions to all who are interested in gaining knowledge of sustainability. For those who are unable to attend these events in person, ABN AMRO REAL has introduced video chats and online courses to extend its best practices to a wider audience. As a way of further engaging its stakeholders and of keeping these practices vivid, the bank has appointed a council comprised of leaders in their respective areas, such as Alexandre Hohagen, general director of Google Inc. in Brazil.

The examples above illustrate how ABN AMRO REAL has taken a greater leap forward towards developing a more sustainable world by engaging its stakeholders. In much the same way, the bank also encourages others to engage their stakeholders to have a greater impact. ABN AMRO REAL has therefore created the 'Prática de Engajamento com Stakeholders,' a guide for companies to support them in the development and creation of initiatives that help engage others. At the end of this guide, the bank provides a checklist that allows companies to diagnose and reflect on their management practices in order to find better ways of enhancing their stakeholder engagement.

Several of the bank's initiatives have also been targeted at the sharing of its best practices with its suppliers. For example, it created an Internet

portal to foster communication and to nurture the relationship with its suppliers. A document called 'Parceria de Valor' ('Partnerships of Value') was created to foster the exchange of best practices. In addition, in all its supplier contracts ABN AMRO REAL has stipulations that specifically prohibit any actions or business practices that do not comply with its corporate principles, such as discrimination, child labor, and slavery.

### **Acting today, thinking of tomorrow**

ABN AMRO REAL had made significant steps towards enhancing its socio-environmental performance. At the same time, the number of employees engaged either fully or partially in sustainability increased over the years. In 2007, there were 407, mostly due to the microcredit expansion (Sustainability Report, 2007, p. 94). But the road ahead was a long journey. The bank executives knew that strong leadership from the top was not enough. For the initiatives to endure and the bank to continue its long journey, it was crucial to build and train effective leaders across all departments; leaders who could drive sustainability in the future, not only within the company itself but also beyond the boundaries of the bank. With this in mind, in 2007 they launched the Sustainability Development Leadership program, which was aimed at amplifying the bank's product and service line to stimulate the innovation of new, sustainable business solutions. Initially 2,200 managers were trained, but the bank later expanded this program to encompass other 130 leaders of other functional areas, such as the corporate communication department (Jornada Real, 2007). After successfully completing the program, the leaders applied the knowledge gained in their respective functional areas and proactively looked for future solutions that would help them take a greater leap forward towards enhancing their financial as well as their socio-environmental performance.

For ABN AMRO REAL, leadership meant also forecasting future trends and making them a present need. Since its financial products for sustainability increased from 217 million to 825 million Reals (approx. USD 122 million to 465 million) in 2007 – reflecting a total growth increase of about 280 percent – the bank knew there was a high likelihood that the demand for sustainable products would increase in the coming years. At the same time, post-secondary education in Brazil was experiencing a high drop-out rate due to high tuition fees. Acknowledging the adage that 'every social problem is a business opportunity in disguise,' ABN AMRO REAL saw this as an opportunity to tap a new market and create a new sustainable product solution (Cooperrider, 2008, p. 1). Together

with the IFC, the bank set up a student lending facility for 50 million Reals (approx. USD 21 million), from which students can borrow money to attend a participating university and repay the loan after their graduation (IFC, 2008). Taking into account Brazil's high demand for university graduates, this initiative seems very promising. According to Guy Ellena, IFC director for health and education, it is the first time one of Brazil's large banks has developed products to exclusively support university students, establishing a distinct market segment (IFC, 2008).

The idea was not just to help university students; educating future generations and increasing their awareness of sustainability was seen as a part of the mission. This is why ABN AMRO REAL created an entertaining website for children aged between five and 12 called 'Brincando na Rede' (Playing on the Net). This tool was aimed at triggering children's interest in learning to navigate the Internet, thus contributing to their education and raising their awareness of sustainability.

### **The road less traveled that made all the difference**

Looking back at the road traveled, ABN AMRO REAL's new business model (Table 2.1) had proved successful. As demonstrated below, its net income and assets grew steadily between 2002 and 2007. In comparison with 2002, its net income had grown by approximately 80 percent to USD 1,677 million. Since 1998, the bank's investments in training, technology, and the re-engineering of its business processes, as well as the rising number of clients, have enabled it to increase its efficiency significantly. From 68.3 percent in 2002, its efficiency ratio decreased to 49.2 percent in 2007.

In 2007, the bank's surveys revealed that 74 percent of its clients were satisfied, including 36 percent who were totally satisfied (ABN AMRO

*Table 2.1* AMRO REAL's new business model

	2002	2003	2004	2005	2006	2007
Net Income (USD in millions)	341	392	467	616	958	1,677
Total Assets (USD in millions)	10,431	19,090	23,184	32,455	56,503	89,931
Efficiency Index	63.8%	58.1%	60.0%	57.3%	50.9%	49.2%

*Source:* Adapted from ABN AMRO REAL Social Sustainability Report, 2007. All USD/Real conversions reflect the exchange rate on December 31 that year.

REAL Website, 2008). The number of employees grew to approximately 27,000, and their satisfaction level was estimated to be well over 90 percent between 2005 and 2007 (ABN AMRO REAL Website, 2008). The bank went from number 11 in the list of the greatest places to work for in Brazil in 2006, to number 6 in 2008 (Great Place to Work For Website, 2008). The bank also received recognition for its efforts. In 2006 alone, the bank won a total of 49 awards, including the Eco 2006 Award from the American Chamber of Commerce (ABN AMRO REAL Website, 2008).

Several factors contributed to the bank's success. Behind the integration of the new business model was a strong leadership that mostly originated from the senior bank executives. Among those leaders were Mr Barbosa and Ms Pinto, who had had the vision and power to ingrain corporate social responsibility and place it at the center of all their business activities. Mr Barbosa was admired by the public and regarded as a role model for his social commitment.

*Success Factors:*

- Strong leadership by senior executives
- Sharing best practices to have a greater impact
- Engaging others to increase their sustainability portfolio
- Education on sustainability to ensure that the bank's vision was carried out throughout the organization

In addition, by sharing best practices that allowed others to benefit from its learning journey, the bank could accelerate the adoption of more sustainable practices by others – a catalyzing effect that facilitated the bank's greater impact. The bank's ability to engage others in its road to sustainability and to focus on innovation to increase its socio-environmental performance likewise contributed to its success.

At the same time, the bank faced several challenges. In sharing its best practices externally, and considering that many of its competitors had adopted more sustainable practices over time, many feared the bank would lose its dominant position as a sustainability market leader. In addition, when launching so many different initiatives, the problem was how to keep track of their progress and measure their impact over time.

In 2007, Grupo Santander acquired ABN AMRO REAL, making it the fourth largest Brazilian bank. Other mergers followed as part of the Brazilian financial consolidation wave: Banco Itaú merged with

Unibanco to form Brazil's and Latin America's largest bank, while Banco do Brazil acquired Nossa Caixa (Latin American Herald Tribune, 2009). Competition remained strong and the challenge was how these banks could strengthen their brand differentiation to uphold their leading position. Once again, Mr Barbosa – now the head of Santander Brazil – was faced with the challenge of integrating two merging organizations. Many wonder how the integration is going to be carried out and, most importantly, whether sustainability will remain at the center of all their business activities. As Mr Barbosa looks ahead, there are many roads, which all lead in different directions, but fundamentally the right one is clear. This road could imply choosing a distinct direction away from the others. Nevertheless, this road could again be the one that could make all the difference in future.

*Lessons learned:*

- Educate and build leaders who can drive sustainability in the future
- Forecast future trends and make them a present need
- Engage staff to increase the innovation of sustainable solutions
- Share best practices with stakeholders to have a greater impact

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# 3

## Banca Popolare Etica

*Antonino Vaccaro*

### Introduction

This chapter is a story of *another* Italy. It is an Italy that is unknown to most people, far removed from the scandals and media preoccupations that inevitably affect our perception of the reality. It is the story of a group of individuals who, day after day, work in the background in the pursuit of a better world, based on the ideals of social justice and common good. It is the story of Banca Etica, an Italian cooperative bank, which is first and foremost a community of people who have transformed the dream of ethical banking into a reality. This is the story of a successful bank whose activities consider important ethical issues, such as respect for the environment, solidarity, and responsible investing, while maintaining continuous and stable positive financial performance. This chapter is a tribute to those men and women who contributed to the creation and the development of Banca Etica, and also to everyone before and since who has nurtured an understanding of economics and business centred on the intrinsic human values.

### A brief history of a great story

Banca Etica is just the latest outcome of the tradition of social entrepreneurship that has characterized the Italian socioeconomic system and culture since the Middle Ages. Around the late 1970s, the *Società MAG* (Self-management Mutual Association) was created to support (financially and sometimes operationally) socially oriented projects.

In December 1994, the MAG movement and 21 not-for-profit organizations founded the 'Association toward Banca Etica' (*Associazione Verso la Banca Etica*), which became a cooperative company in June

1995. Three years later, in December 1998, the new association had accumulated the 6.5 million euros required to create an official cooperative bank (*banca popolare*), which was given immediate recognition from the Italian Central Bank (Banca d'Italia). This was the first time in Italy's history that an institution whose main strategic objective was developing and commercializing sustainable and socially responsible financial products was officially registered as a bank.

On 8 March 1999, Banca Popolare Etica opened its first offices in Padoa. This was the first step in a continuous and successful expansion throughout the Italian market and territory. By the end of 1999 it had offices in Brescia and in Italy's most important Italian financial centre, Milan.

A year later, in December 2000, Banca Popolare Etica achieved two important objectives: first, the official founding of Etica Sgr, an asset company, whose mission is to develop and offer financial products that address the ethical mission and the values of Banca Popolare Etica; second, the opening of a Rome branch of the bank. Over the next three years, Banca Etica opened four more branches, in Venice, Florence, Treviso and Bologna, and established the Foundation for Ethical Responsibility (Fondazione Culturale Responsabilità Etica) as a part of the group.

In 2005, Banca Etica began to expand its activities geographically, taking advantage of the opportunities offered by membership of the European Union. First it launched a series of projects with two cooperatives: la Nef, coopérative de finances solidaires, located in France, and Fiare, located in Spain. These international collaborations helped the bank to increase its international visibility and to create some synergies related to its core activities, and in particular to develop joint projects on microcredit and financial support to not-for-profit international organizations. Continuing up to 2008, Banca Etica opened several more branches in Turin and in the south of Italy, in Bari and Palermo.

In 2009, Banca Etica has 12 branches and a very active group of financial promoters (*banchieri ambulanti*), who not only sell ethical financial products in the Italian territory, but also work actively to promote the development of a culture of responsible investing. Banca Etica currently has 32,227 clients 4772 of which are firms. Its capital is 25.7 million euros, and it currently manages around 600 million euros of savings. Banca Etica is a group comprised of three institutions: Banca Popolare Etica, Etica Sgr and Fondazione Culturale Responsabilità Etica. Etica Sgr is an asset management company that provides three main types of services. First, it manages ethical investment funds; second,



it interacts with other asset management companies to improve their ethical standards; third, it provides consultancy services to other firms and financial institutions interested in ethical finance. Fondazione Culturale Responsabilità Etica is a foundation that promotes research and divulgation activities related to business ethics, corporate social responsibility and environmental issues. Banca Popolare Etica is the body that manages the relationships with clients.

### **What makes Banca Etica so different? Values? Mission?**

Before looking at how Banca Etica operationalizes its ideal of ethical banking, we need to briefly discuss its values and mission, which are the pillars and references used by managers, employees and collaborators in day-to-day decision making, activities and strategic planning.

Box 3.1 reports the five statements constituting Banca Etica's Declaration of Values. The first concerns the economic consequences of financial businesses: banking should be performed taking account of all the consequences, both economic and non-economic, of financial activities. In other words, according to Banca Etica, decision-making processes must consider the consequences of its activities including externalities such as pollution or damage to people's health.

The second statement refers to credit, efficiency and sobriety. Banca Etica adopts a fairly tough and very distinctive stance in maintaining that 'credit, in all its forms, is a human *right*'. This perspective clearly identifies the very essence of the service provided by Banca Etica compared to 'traditional' banks. When credit is understood as an individual right, traditional processes for credit granting lose sensibility. For Banca Etica, these rights and processes are replaced by a logic centred on providing a service to civil society and, in particular, to its more disadvantaged members. It maintains that ethical responsibility should address not only efficiency but also sobriety, the latter value mostly unknown in the context of 'normal' banks.

The third statement addresses the importance of common goods and distributive justice in promoting profit-sharing. In particular, the Declaration of Values stresses the importance of distributing profit '*between all people that guaranteed its creation*', which further differentiates Banca Etica from 'traditional' banks wherein the distribution of profits is based on two main criteria: share ownership, and position in the hierarchy.

The fourth statement refers to transparency as an important, fundamental ingredient of all activities in ethical banking. And the

fifth statement refers to the importance of stakeholder engagement: shareholders *and* clients should to be encouraged to participate in the bank's decision processes. In other words, Banca Etica considers the ethical expectations of all its stakeholders are important indications for its decision-making processes. This statement of the Declaration of Values is operationalized through very careful and accurate stakeholder engagement processes, as explained below.

*Box 3.1* Banca Etica's values

- Ethically oriented finance is sensitive to all consequences (economic and non-economic) of its financial activities.
- Credit, in all its forms, is a human right; efficiency and sobriety are components of ethical responsibility.
- Profit related to ownership and exchange of money should be driven by a common good principle and distributed fairly among everyone involved in guaranteeing its creation.
- Transparency in all activities is a fundamental requirement of any activity related to ethical finance.
- Not only shareholders but also clients should be encouraged to contribute to the decisions made by the bank.

(Author's translation of *Bilancio Sociale* 2008, p. 30)

Box 3.2 reports the five elements of Banca Etica's mission statement. We highlight three in particular.

First, Banca Etica's mission is to provide a new, very different service to civil society, one whose main features include transparency, solidarity and participation. The mission statement stresses the idea of an economy that addresses environmental and social evaluation for decision making and the importance of the cultural impact of its activities.

Second, Banca Etica's mission statement stresses the importance of being *proactive* in relationships with creditors – for example, stimulating creditors to develop competences – and to guarantee a service that overcomes the traditional notion of precision and addresses other important ethical values such as sobriety and respect for individual needs.

Third, Banca Etica's mission is focused on guaranteeing credit to institutions in the third sector and particularly those whose work provides 'social value'. This element clearly differentiates the role of Banca Etica in the Italian socioeconomic system.

**Box 3.2** Banca Etica's mission

- Pioneering a new banking idea of a place where transparency, solidarity and participation are addressed in order that the bank becomes a cultural tool for the promotion of an ideal economy that considers fundamental environmental and social evaluations for managerial decision making.
- Stimulating creditors to develop competences, capabilities and the autonomy necessary to assume responsibility at the economic, social and environmental levels.
- Guaranteeing investors precision and efficiency in the management of their money, attention to the use of resources (sobriety) and profit-sharing.
- Working to address individual needs, environmental protection and local specificities in order to improve quality of life.
- Guaranteeing credit to third-sector firms, people and projects that are endeavouring to provide 'social value'.

(Author's translation of *Bilancio Sociale 2008*, p. 30)

## Five distinctive dimensions

It is possible to identify at least five clear dimensions that characterize Banca Etica's business. They represent the operationalization of its values and mission in day-to-day business activities. The first concerns the typologies of financial products and services offered by the bank to its customers. The second is related to the types of institutions and projects that are favoured in access to credit. The third concerns the attention paid to transparency and stakeholder management. The fourth concerns environmental sustainability and green management, and the fifth dimension focuses on the centrality of people.

**Ethical products and services.** Banca Etica adopts a two-stage evaluation criterion to analyse the ethicality of other institutions. This criterion is used to select those products and services that can be commercialized by the bank (shares, derivatives, etc.).

As a first step, the bank performs the 'negative screening'<sup>1</sup>: it checks whether a firm pursues one of ten activities that are considered irreparably unethical. These activities are weapons production, animal testing, agriculture and farming with genetically modified plants and animals, energy production from nuclear technologies, production of cigarettes and other tobacco products, production and sale of fur clothing, infringement of the International Code of Marketing concerning human breast milk, eradication of trees and other vegetable material growing in protected areas, management of gambling games, and

pesticide manufacture. The second step in the evaluation process is a combination of negative and positive screening which is based on the application of a 50-dimension framework that explores firms' activities in three main areas – environment, government, and society.

In addition to this two-step evaluation framework, Banca Etica continuously monitors the financial activities of its customers and partners and in some cases takes ad hoc action to prevent unethical activities. For example, in 2009 the Italian government, led by the ever-controversial Silvio Berlusconi, approved a new law (Decreto Legge numero 78, 1 Luglio 2009) that allows the re-entry of bailed-out capital. Banca Etica will not accept any foreign capital with unknown origins despite this new law which is seen by many, especially the Banca Etica Board, as immoral.

**Access to credit.** Banca Etica focuses its lending efforts on organizations operating in the 'third sector.' It privileges four critical areas. The first is represented by institutions operating in the sectors of health, education and social integration. The second concerns environmental projects and preservation of historical monuments. The third is represented by projects for international cooperation, fair trade and commerce for solidarity and the fourth area focuses on initiatives aimed at improvements to quality of life, sport and culture. In addition to these four major areas, Banca Etica has begun to guarantee credit to projects or organizations that support organic agriculture and green electricity and to small entrepreneurs or professionals whose activities should provide significant *service* to civil society. Banca Etica also lends to individuals, but only people with very specific needs. For example, it grants loans to people with disabilities who need money to obtain plans and restructure their apartments, and to individuals interested in constructing green electricity generators for domestic power supplies.

**Transparency and stakeholder engagement.** Banca Etica has very distinct policies in place to maintain high degrees of corporate transparency and effective stakeholder engagement. Transparency is guaranteed through a multichannel approach. For example, the annual balance statement is integrated with a 'social balance sheet' (Bilancio Sociale), which is a very accurate and detailed document that provides information on the bank's activities and their impact on civil society (see Box 3.3). The social balance sheet details the criteria used for borrowing and lending, and the working conditions of its employees. The bank also provides continuously updated detailed information for stakeholders and other interested persons on its website. All the official documents, such as agreements with other institutions, balance

sheets and social balance sheets, can be accessed via the website, and the bank also responds to personal requests for information on its activities and products and services. In addition, the financial promoters (*banchieri ambulanti*) are active in providing detailed information about the bank and its dealings in response to enquiries from interested stakeholders. Face-to-face contact is seen as an important, unique channel of communication and interaction. Finally, Banca Etica is energetic in its efforts to advertise its activities in the local and national media in order to provide continuous information on its progress to civil society. This multichannel approach is matched by the bank's multilevel stakeholder engagement approach. It invites investors and clients to contribute to decision making at different levels. For example, customers can choose the area (e.g. green projects, microcredit) in which their money deposited in the bank accounts will be invested. By the same token, Banca Etica uses commissions (*commissioni*) and working groups (*gruppi di lavoro*) to gather and analyze perceptions and expectations of customers and other stakeholders concerning its activities. The results of these researches are lately used during annual meetings to make important strategic decisions concerning the future of the bank.

### Box 3.3 The Social Balance Sheet (Bilancio Sociale)

The Social Balance Sheet is an official document published every year by Banca Popolare Etica to integrate the information disclosed in the traditional balance sheets. This document is made available on the corporate website and in paper-based form. It provides detailed information concerning the activity of the Banca Etica Group and in particular its financial and social performances. Although its structure and content is modified every year in order to address stakeholders' informational requests, it is generally divided in six parts: social and economic context, history and identity of the firm, financial results, social results, activities conducted by other organizations of the group and additional information about boards and committees. The most extensive and detailed section is the fourth, concerning social results. It is divided in eight subparts which address respectively the following issues: identification and dialogue with stakeholders, relationships with shareholders and other financial supporters, relationships with clients, relationships with employees (who are referred to as 'collaborators', relationships with suppliers, relationships with other financial institutions, activities and initiatives with local communities and, finally, green projects and environmental protection.

**Green management.** Banca Etica addresses environmental concerns in very different ways. First, its headquarters in Padoa was designed

following green principles: it has a low environmental impact and makes use of natural resources (such as solar energy for electricity production through photovoltaic panels). Second, Banca Etica focuses a significant amount of its lending on green projects. Between 2007 and the 2008 it borrowed more than 10 million euros to fund green energy projects. Also, Banca Etica is involved in several divulgation and research projects aimed at improving the environmental behaviour of households. For example, Banca Etica is a member of 'Energy-Conscious Households in Action', a multinational project financed by the European Union, which is exploring new approaches to reducing consumption of electricity, gas and water.

**Centrality of and respect for human persons.** Banca Etica takes great care to address the centrality of and respect for humans. This priority is underlined in its annual social report and several other internal and official documents. We found several policies and initiatives through which top management operationalizes this priority. For example, the bank allows for flexible working times to accommodate its employees. They may work part-time or full-time, and according to various schedules (e.g. the bank allows some employees to start work early and also to leave earlier). Banca Etica has implemented SA 8000 certification, which guarantees respect for fundamental labour rights and adherence to good health and safety standards within the bank and throughout its supply chain. It has clear policies related to the application of the sobriety principle and limits the amount of expenses that can be claimed for hotels and subsistence on business trips, expenditure on office furniture, and so forth. A very important area is salaries: the banking sector is notorious for having huge salary differences. In some 'traditional banks', top managers receive remuneration that is 1000 times or more higher than the salaries of the lowest-paid employees. For example, JPMorgan Chase & Co. CEO Jamie Dimon received a stock bonus valued at nearly \$16 million for 2009.<sup>2</sup> Banca Etica has set a limit to the difference between the highest and lowest salaries to a maximum of sixfold. This is a very low ratio, even compared to other ethical banks, where the difference is seven times.

## **Ethical and profitable banking: it's just possible**

Analysis of Banca Etica's financial indicators shows that ethical banking can be compatible with profitable business. Table 3.1 presents five indicators related to the bank's activities between 2004 and 2008. All

*Table 3.1* Key financial indicators in euros

	2004	2005	2006	2007	2008
Assets	348,395,750	412,996,970	452,828,290	525,639,078	611,995,091
Debt	326,212,780	393,794,306	431,459,043	500,406,315	585,790,787
Debt/ Assets (%)	94	95	95	95	96
EBIT	–	1,445,801	2,551,553	6,100,335	2,370,284
Net income for the period	110,092	305,089	1,261,754	3,352,631	1,269,947

Source: Catarina Sales, *Humanism Practices in Modern Business – The Case of Banca Etica*, Msc. Thesis, Lisbon 2009.

the indicators point to good financial performance; Banca Etica also navigated the financial crisis well and maintained positive values for EBIT (earnings before interest and taxes) and net income. There are four areas that are worth highlighting. First, Banca Etica has shown continuous assets growth to double their original value along the five-year period. Second, Banca Etica has maintained a high and stable ratio of debt to assets, which is an indication of an adequate match between fund-raising and credit activities. Third, EBIT increased between 2005 and 2007, but in 2008 it dropped back to the 2006 level due to the economic crisis. Fourth, and most importantly, Banca Etica's annual net income has been always positive and has increased some 12-fold between 2004 and 2008.

### **Is everything right? problems and challenges for Banca Etica**

Although Banca Etica truly represents a best practice of ethical banking, it also posits some concerns related to its activities and its role in civil society. Among others, I would like to briefly mention three of them, which are according to my understanding of this financial institution the most challenging and interesting.

The first problem concerns the identification of ethical versus unethical activities. Italy is experiencing a dramatic change in its demographic composition which is driven by an intensive migratory flow of people from Africa and the Far and Middle East. In other terms, Italy is increasing its degree of cultural, religious and ethnical heterogeneity. Moreover, new challenges and problems related to technological

innovation and social change are currently dividing public opinion and in turn increasing differences of ethical perceptions and expectations among the public. As a consequence, in the future Banca Etica will face some problems to properly identify the threshold between ethical and unethical activities in a way to address the increasingly heterogeneous ethical perceptions of the civil society. For example, Banca Etica today considers energy production from nuclear technologies as an unethical activity, a perspective that is taken by other ethically oriented institutions such as Triodos Bank in the United Kingdom. However, many experts and a part of the general public advocate nuclear technology as *the* clean and sustainable source of energy for the future. Such kinds of misalignments concerning the ethical nature of activities/products/services between Banca Etica and its stakeholders, or part of them, can be a serious threat for the current and future development of this institution.

A second problem in the activities of Banca Etica concerns the management of internal processes and procedures to address ethical requirements and standards. This study has shown that Banca Etica is extremely careful in the ethical screening of all its activities. For example, as already mentioned, the examination of the ethical nature of other businesses follows a two-step process which is composed by a more than 50-level examination. By the same token, sales training follows a very long and careful training process. This meticulous approach has some drawbacks related to the sustainability of such complex activities whenever the firm will increase the size of its business in term of customers' number, products/services offered to stakeholders and geographical scope. Indeed, complex procedures lead not only to higher costs but also to slower response to market needs and higher number of errors.

A third problem is related to the portfolio of product and services offered by this institution. At the current date, Banca Etica cannot be considered a 'normal bank'. Indeed, it offers a quite limited set of products and services and, unfortunately, most of the Italian population would struggle to use its services and products, as this bank has just 12 branches located only in large cities. This fact is confirmed by the number of customers and total assets (respectively 32,227 and 600 million euros in 2008), which are much lower than those of other ethically oriented cooperative banks such as the British Triodos Bank, which recently reached 155,000 clients and over 3.7 billion euros in assets, and the South African Al Baraka, which had more than 40,000 clients and \$6.3 billion in assets at the end of 2008. In this sense Banca Etica is still in an embryonic stage, and it needs to further develop its business



model, to extend the portfolio of services/products offered to the market; much more important, it needs to expand its territorial presence. In other words, Banca Etica has to develop its activities in order to offer products and services that are comparable and competitive with those offered by other, 'traditional' financial institutions.

## Conclusions

What lessons, if any, can be learned from Banca Etica? And what are the challenges that Banca Etica is posing in our global society? It is not easy to provide straightforward answers to these questions, but I think we can draw some conclusions that will be informative for managers and policy makers and be useful for *responsible* citizens.

The first lesson to be drawn from the example of Banca Etica is that ethical banking is both possible and financially sustainable. Banca Etica represents best practice in how to operationalize effective and efficient ethics in finance.

The second lesson is related to the bank's corporate governance model. Banca Etica is organized as a community of individuals that develops and offers products and services to society. The focus of the bank is not shareholders' profits or management of different, conflicting stakeholder expectations, but developing a social network of individuals who *serve* civil society and support the common good.

The third lesson is related to the cultural and educational contributions of firms in our society. Companies that adopt aggressive marketing techniques and offer certain products and services affect the culture in society and especially the *forma mentis* of younger generations. Banca Etica is demonstrating there is another way to affect the culture of society. Banca Etica is providing an *agorà*, a forum for people to meet, learn and interact. It is providing a space for people to develop new, ethically grounded ideas and to implement them through the infrastructures and contacts offered by the bank. Banca Etica provides a reality that can be analysed through pragmatic and responsible lenses as opposed to the illusions and mirages offered by 'only for profit' and 'competitive' companies.

I want to end this chapter by briefly addressing the second question I posed at the beginning of the section. I believe that, first and foremost, Banca Etica is challenging the 'traditional' banks. Although still small, Banca Etica has achieved continuous growth and is attracting increasing support from civil society. An increasing number of consumers consider the service provided by Banca Etica to be very valuable; they

particularly welcome its values, mission and business philosophy. It is likely that 'traditional' banks will have to reconsider their activities, by addressing more clearly and in a more focused way the ethical expectations of consumers. And Banca Etica represents a best practice model.

We can also safely aver that Banca Etica is providing new challenges (or opportunities, depending on one's perspective) to firms in other sectors. The idea of a firm as a community of people is not new, but effective implementations of this ideal in society are rare. Companies in all sectors can adopt this perspective and use the Banca Etica model as their reference.

Among the several challenges offered by Banca Etica, there is a final one which deserves our attention. It concerns our role as members of civil society. I believe wholeheartedly that initiatives such as Banca Popolare Etica should be encouraged and supported by everyone who is able to do so. *Social progress is designed by a few brave people*, an ancient Italian motto maintains. But social progress cannot go forward without input from many more people.

## Notes

1. Negative screening concerns the identification of businesses/activities that are considered unethical, such as pornography and tobacco. Positive screening, on the contrary, identifies positive impacts of the activities of a firm to the community. More detailed information about ethical screening can be found in S. Fowler and C. Hope, "A Critical Review of Sustainable Business Indices and their Impact", *Journal of Business Ethics* 76, no. 3 (2007), 243–52.
2. [http://www.huffingtonpost.com/2010/02/05/jpmorgan-ceo-jamie-dimon\\_n\\_450455.html](http://www.huffingtonpost.com/2010/02/05/jpmorgan-ceo-jamie-dimon_n_450455.html) A very interesting discussion about the distortions in executive compensation can be found in R. Rajan and L. Zingales, *Saving Capitalism from the Capitalists* (Crown Business, 2003).

# 4

## Banca Prossima

*Alessandra Dal Colle and Marco Morganti*

### **Introduction**

In November 2007 Intesa Sanpaolo created Banca Prossima<sup>1</sup> as the first European bank exclusively dedicated to the not-for-profit sector, settling 80 million euros in equity for its start-up. Intesa Sanpaolo has a long tradition in the not-for-profit sector with a market share of around 18 per cent, but it felt the sector had evolved to the point where it needed a dedicated financial intermediary.

The timing was the worst one can imagine: clouds were beginning to gather on the international financial front, and the integration process following the merger between Banca Intesa and San Paolo IMI – which originated Intesa Sanpaolo – were threatening to bog down anything beyond day-to-day running.

At the time of writing this case study Intesa Sanpaolo can be considered a winner of the crisis, as it managed to maintain its operations<sup>2</sup> without help from the government. Banca Prossima may be considered a true challenger to the crisis, as it managed to start up in such a difficult environment while dedicating itself to a core, old-fashioned, costly and human-capital-intensive activity – namely lending – in favour of a sector traditionally characterised by extremely cautious attitudes to change, diverse fields of activity, heterogeneous levels of financial assets and financial expertise and basically very few things in common except a ban on the distribution of profits.

In September 2009 Banca Prossima's outreach is national thanks to over 220 of its professional staff, chosen both for their skills and for personal experience as volunteers in not-for-profit organisations. It can count on three branches, 52 financial corners which serve as a base for

their dedicated bankers and the support of over 6000 Intesa Sanpaolo branches all over Italy.

Banca Prossima's mission is carried out along four main strategy directives:

- Increase customer satisfaction for currently served organisations (and get new ones) through tailor-made products and services distributed by dedicated professionals
- Interpret and share in a 'peer-to-peer' fashion the needs of the not-for-profit sector, internalising the main features whenever possible
- *Be a bank* – that is, operate by lending and not grantmaking
- Engage all available interests and efforts (social enterprises, government and local authorities, foundations) in multi-stakeholder projects which are more effective for society at large.

In less than two years of full operation Prossima has reached 2.5 per cent of the potential market. At the end of September 2009 Banca Prossima's growth was in the region of 95 per cent year over year in clients' assets, for a total of 485 million euros, of which 310 million euros was in direct deposits, and over 150 per cent year over year in outstanding credit.

Due to its start-up phase Banca Prossima has not yet reached its break-even – and the current crisis might shift the target forwards – although the quality of its assets is quite good, with over 58 per cent of its lending with above-average credit-risk rating and just four loans in loss status, for a total amount of 0.29 per cent of disbursed loans.

### **Banca Prossima: social innovation in banking**

Intesa Sanpaolo Group came into existence with the Extraordinary Shareholders' Meeting approving the merger of Banca Intesa and San Paolo IMI held on 1 December 2006.

At the end of June 2009 Intesa Sanpaolo, with a market capitalisation of over 36 billion euros, held total assets in excess of 638 billion euros and outstanding loans in excess of 386 billion euros, serving nearly 11 million domestic clients in its 6175 Italian branches and 8.5 million clients in its selected retail banking presence in Central and Eastern Europe and in the Mediterranean basin.

Its business model relies on the hypothesis of specialisation and responsibility that means its Domestic Commercial Banking division<sup>3</sup> includes 11 banks with a definite geographic target, 2 banks with a

specific sector target – one of which is Banca Prossima – and 8 other financial intermediaries specialised in complementary services. Each entity of the group has its own equity and targeted return on equity.

Intesa Sanpaolo Group has a long tradition of active involvement with its stakeholders, as several of the banks that have merged in the group originate from savings banks or pledge banks. Such institutions emerged in the early 19th century (although many were already in existence in the 15th century) and were engaged in two areas: credit enterprises and charitable concerns, both activities being carried out within their local communities. Following legal changes<sup>4</sup> in the 1990s both savings banks and pledge banks went through the separation of the banking and charitable activities. The former activities were allocated to the savings banks and to the pledge banks which thus became ad-hoc joint-stock companies – for all intents and purposes, private commercial enterprises governed by the Civil Code and banking laws, just like other banks – and the latter were passed to the banking foundations. As of September 2009, five of the largest shareholders of Intesa Sanpaolo are banking foundations, and the culture of ‘restitution to communities’ which makes up their own history also permeates Intesa Sanpaolo’s relationship with communities, as reported in the yearly Social Report.

In 2003 Banca Intesa created a specialised unit – the Bank & Society Lab – whose mission was to develop projects with a high social impact within Banca Intesa. The Bank & Society Lab was headed by Marco Morganti, formerly in charge of projects in the social and cultural fields at Poste Italiane (the Italian state postal service), and its mission was set in facilitating access to credit for individuals and enterprises. Examples of interventions in the former sector are loans in favour of the prevention of usury, loans to university students, loans to migrant entrepreneurs, mortgages for temporarily employed and loans to families caring for disabled elders; in the latter area the Bank & Society Lab has contributed to projects such as the Progetto Asili Nido (Crèche Project – see Box 4.1), ‘Dopo di noi’ (sheltered residence for mentally disabled persons who survive their parents) and Talenti Foundation (real estate servicing the mission of religious orders).

In the end the lesson learned from the Bank & Society Lab’s incursions into projects in favour of credit-constrained enterprises was twofold. Firstly, these enterprises were frequently ‘small’ in turnover and/or shareholders’ assets, and this was frequently correlated with their being forbidden to distribute profits. Secondly, for a large commercial bank, however well placed in the territory, they were either too difficult to reach – because of their culture, mission or language – or too costly to serve, as their financial needs were nonstandard. If that

was to change, one needed dedication – so that these enterprises were not marginal clients in the mass of retail customers – and scale, if the whole project had to stand up on its own feet.

*Box 4.1* Consorzio PAN – Progetto Asili Nido (Crèche Project)

**The need** In Italy too few mothers work, because there are not enough affordable and good-quality social services for the family.

**The intuition** The need is multifaceted, as it is wrapped around quality in services that must be (1) guaranteed, in order to convince mothers to leave the care of children in favour of paid employment, and (2) affordable, otherwise the opportunity cost would not make it worthwhile for mothers to go for paid employment. Quality in services is difficult to gauge, but it is the only (intangible) asset of a social enterprise entering this business.

Partners with different skills have to agree to pool their specific know-how in order to effectually evaluate and support the start-up of such enterprises.

**The solution** In 2004 PAN is set up as a not-for-profit consortium between Banca Intesa and the three main cooperative networks in Italy. PAN's mission can be summarised as implementing children's and parents' rights to a balanced environment in order to grow, showing that care services, as a subset of social services in general, can be economically viable.

**Who does what**

- The social entrepreneur presents her project to one of the partner networks.
- The network partner assists the entrepreneur in the start-up of the activity and presents her to the consortium for the affiliation to PAN. The new member then accepts to provide its services according to a quality manual set forth by the consortium.

Banca Intesa (now Banca Prossima and Intesa Sanpaolo) provides start-up loans and loans for refurbishing to the social enterprises with no further guarantee other than 5%, supplied by the network partner.

Intesa Sanpaolo also provides loans to PAN's customers, allowing them to spread childcare costs over a longer period of time.

**The results**

- Over 300 crèches currently care for 8738 babies.
- They employ over 2000 people.
- On 30 June 2009 Intesa Sanpaolo Group has over 4.7 million euros in credit outstanding towards PAN crèches.

In the meantime, the approval of Legislative Decree 155 on 24 March 2006 defined 'social enterprise' as any organisation<sup>5</sup> pursuing a social goal in set areas of society and forbidden to distribute profits to its owners in any form. This lit the spotlight on not-for-profits, or the 'third sector',<sup>6</sup> and estimations on the 1999 census data underlined that the third sector in Italy was by number of businesses, people and turnover top in Europe, together with the UK third sector: 250,000 operating organisations, generating about 48 billion euros in revenues, employing a workforce of 4,250,000 shared between: 750,000 employees and 3.5 million volunteers. It is highly participated by women (60%) and young people (65% younger than 40). After the education sector, it has the greatest percentage of people with third-level education (70%).

Furthermore, comparing EU and Italian expenditure only in four sectors of welfare services (care of disabled persons, senior citizens, children and social housing), the potential for growth in Italy can be estimated at 40 billion euros. A University of Trento study which the Bank commissioned underlined that 'The possibility that expenditure in social services in Italy is lifted up to European standards thanks to public money is simply untenable, considering the situation of Italian government finance (...). Citizens who today buy social services from Social Cooperatives already select themselves out of state-provided social services. It is as if a functional segmentation is currently operating and the degree of satisfaction by those services is high'.

The strategic proposition that seemed to emerge was that the non-distribution of profits, resulting from both legal requirements as well as the 'ethics' of not-for-profit, might prove as efficient an incentive to professionalisation as free competition.<sup>7</sup> Therefore offering specialised financial services to a sector with an outlook of growth both in dimension and in quality of services offered made sense. Furthermore, according to some views, the not-for-profit sector seems to show a more limited risk of slipping into the pits of extreme standardisation<sup>8</sup> and excessive specialisation<sup>9</sup> of other mature services, hence ensuring a stronger appeal to consumers' needs and a lower volatility in revenues.

The OECD<sup>10</sup> defines social innovation as anything that 'can concern conceptual, process or product change, organisational change and changes in financing, and can deal with new relationships with stakeholders and territories'. In this framework Banca Prossima aims its attempt to social innovation serving a new stakeholder (the social enterprise) in a new way – with co-production and sharing its values, energies and profits as will be outlined in what follows – bringing about product and organisational change for a new way of financing.

## Beliefs, choices, and actions

It was at once clear that Banca Prossima was not to be a corporate social responsibility initiative but a sustainable business servicing growing social enterprises. The business proposition was based on the analysis outlined in the previous section and on the belief that social enterprises are ‘good’ for the domestic economy,<sup>11</sup> as well as for the global one, for that matter. When the business proposition was to be moulded with an ethical one in order to set up a consistent mission, it appeared that a definition of ‘ethics’ should have been necessarily home-made, as no uncontroversial and universally accepted definition of what a specialised ‘ethical’ bank should be was found. Banca Etica, a ‘banca popolare’<sup>12</sup> active in Italy since 1998, which targets undifferentiated retail customers provided that they identify themselves with the ethical proposition of the bank, had precisely followed this path, choosing to base its identity on a self-styled definition of ethics.<sup>13</sup>

The choice of specialisation posed a further challenge to Banca Prossima, as the definition of ‘ethics’ had to be not only meaningful to all social enterprises but also really shared by them, common knowledge – part of their DNA, so to speak.

The social enterprise sector in Italy has a long tradition and a diverse origin. Social enterprises working for the ‘common good’ originate from the Catholic Church, the trade unions, the cooperative movements, and more recent expressions of the civil society like responsible consumers, environmentalists, and active senior citizens; all actors are extremely proud of their history and feel strongly about ‘their own way’ of doing not-for-profit business. Doing business ‘ethically’, for different people, may mean doing business in a non-wasteful way, not doing business at all but sticking to grantmaking, serving the poorest or the most needy unconditionally, giving the members the largest advantage over non-members, spreading the common good of right, culture, among the general public, or yet something else.

Hence self-styling a definition of ‘ethical’ bank, besides being an extremely overconfident approach to entering a sector – in the true for-profit practice of the traditional banking approach – was doomed to fail, as it would not be shared by all potential clients and therefore not inclusive enough. Any self-styled definition, in addition to putting the bank on shaky grounds, would have undermined at least two of the pillars of the triple-bottom-line approach: people (both clients and workers) – running the risk of being unfairly elitist – and profit, as the resulting target market might have been too narrow.



With a leap of faith, it was then envisaged to submit to the stakeholder for whom ethical values were the main reason of existence: social entrepreneurs, a compelling example of the famous saying ‘where [social] enterprise leads, finance follows’.<sup>14</sup> Banca Prossima was not to be ‘ethical’ in itself, but it was to be as much ‘ethical’ as its customers, to whom it was exclusively dedicated.

In article 4 of its Articles of Association it was then set that

[...] the Company’s purpose shall be the creation of social value, ensuring at all time the sustainability of its operations in compliance with the law and the criteria of sound and prudent management. To this end, the Company shall finance the most deserving not-for-profit initiatives aimed at providing services to individuals, disseminating culture and education, promoting access to and safeguarding the environment and the arts and providing access to credit and employment.

The Company shall cooperate with public and/or private entities on initiatives aimed at promoting the common good by making available its human and financial resources.

In order to promote the growth of the social economy in Italy and understand and respond to its challenges, the Company shall avail itself of the advice of a dedicated group of representatives of not-for-profit organisations who shall provide guidance in its solidarity and development initiatives [...].

As far as the not-for-profit question was concerned, Italian regulation basically prevents an Italian bank to be a not-for-profit itself. Remedies include setting up as a cooperative bank, whose objective is to provide participants with services ‘at favourable conditions’ and limits distributable profits, but it is local in scope, or as a ‘banca popolare’<sup>15</sup> which has wider purview but it follows the one head–one vote rule. It was difficult to comply with the legal limits of each of the two models while being affiliated to a large banking group, which allows for providing a large credit potential. Accordingly, Prossima was incorporated as a joint-stock bank.

On the other hand, Prossima shared the belief that a constraint to take possession of profits is a good indicator of the *voluntas* to produce ‘common good’ in itself, as well as being strongly felt as a key factor in the distinctive identity of social entrepreneurs.

Banca Prossima then set itself as a forerunner of what is known as low-profit model, embracing a ‘fair’ distribution of profit *à la* Saint

Martin.<sup>16</sup> Article 28 of the Articles of Association in fact states, 'The net profits shown in the accounts, net of the legal reserve and of any other provisions which the Company is required to set aside under the applicable laws in force at the time, shall be distributed as follows:

- a) a share equal to the cost of capital invested by the Bank shall be allocated to a non-distributable statutory reserve to be calculated in accordance with the accounting methods generally employed by the market;
- b) the net yearly dividend allocated to shareholders shall not exceed 50% of the profits approved by the shareholders' meeting, net of the provisions set out under letter a) above;
- c) all remaining profit shall be set aside for solidarity and development initiatives and allocated to a specific Fund for Development and the Social Enterprise. This risk and contingency Fund shall be employed – according to the procedure described here below – to cover losses arising from solidarity and development loans granted by the Company at below-market rates or to persons who do not have, or have only limited access to traditional credit facilities. [...]'.

Such a commitment for the future was not considered empathic enough, so Banca Prossima obtained a further loan from Intesa Sanpaolo for 10 million euros, pledging its future earnings, in order to be able to use the fund at the beginning of operations. In fact, despite all the efforts in the development of human capital, tailor-made contracts, and credit valuation procedures taking into account to the production of 'common good', actual lending to social enterprises – which may be too small, too young, faced with risky projects, or faced with an unfavourable environment – may still prove unfeasible.

At the end of August 2009 the fund was used for 6.1 million euros, or 61 per cent of the fund, guaranteeing loans to 298 clients for a total outstanding amount of over 28 million euros. By sector, over 21 percent of the fund guarantees loans in social assistance (elderly people, childcare, etc.), followed by 20 per cent to social cooperatives. Geographically, about 20 per cent of the fund guarantees loans to social entrepreneurs based in the southern regions of Italy, which are usually considered more risky, hence possibly more subject to credit squeeze.

The Fund is also a direct evidence of the role of catalyst for growth that Banca Prossima aims at playing within the social enterprise sector. In fact, this is a quite differentiated set of businesses: some old and established, with a strong local reputation, a regular cash flow and lots of

staff; some young, with first-time, cash-strapped entrepreneurs starting business in uncharted sectors or undeveloped territories. Through the operation of the Fund, Banca Prossima actually creates within-sector mutuality: for each euro it earns on established social entrepreneurs, 50 cents will feed the Fund, forming a guarantee in favour of new social enterprises. It is as if established social business would offer a guarantee to new ones, thanks to the operations of Banca Prossima and its 'low profit' mission.

### **From words to deeds: individuals as co-innovators and technicians**

The main strategic question for Banca Prossima was how to combine the strict requirements of banking practice, both regulatory and technical, with the innovative charge of its Articles of Association and the new and changing needs of the social enterprise. The only way the bank could manage it was through its co-workers, who act as the day-to-day true link between the stakeholder 'patient capital' and the stakeholder 'clients'. Easier said than done when pay, career paths and even single tasks are strictly defined by labour law, financial regulation or group policies.

The first step was to choose people who in addition to possessing strong and full-rounded banking experience – ranging from payment services to lending to asset management – shared the same 'culture' as the social enterprises. Banca Prossima has chosen its relationship managers among Intesa Sanpaolo's employees according to an innovative criterion: personal experience as volunteers in not-for-profit organisations. This is because there is no division or priority between passion and technical experience: a relationship manager is a banking professional and a volunteer, and the social entrepreneur needs them both together as they come. Many employees of Intesa Sanpaolo are interested in joining Banca Prossima: in 2009, an internal job posting for work in Prossima would attract on average nine candidates.

The second was the role 'relationship managers' that has been created outside the group organisation manual. On the one hand, this was forced by the service model, as Banca Prossima has decided to go to its clients rather than the other way round, and so it has just three fully fledged branches (in Milan, Rome and Naples), although it serves the whole national territory with 52 financial corners within Intesa Sanpaolo branches, which its people use as base. On the other hand, this professional role does away with excessive specialisation, as one

person (the relationship manager) is fully in charge of another person (the social entrepreneur) and has to find within the organisational world it is set in (i.e. Banca Prossima within Intesa Sanpaolo Group) – what best suits the client's needs and preferences. The relationship manager is also where co-innovation is cocooned: due to her continual and deepening relationship with social entrepreneurs in her geographical area, the relationship manager is in an ideal position to report on new demands and new ideas as well as function as aggregator across several local social entrepreneurs. She also acts as selector of projects according to the stage of maturity and decides whether to carry them through *in loco* or ask for assistance from the head office. The experience of the Bank & Society Lab, in fact, has been passed through Prossima and so projects are never sent down from the top; each project grows from the bottom up, through the work of partners. These projects are also shared through a dedicated Internet community as well as dedicated sections at yearly general staff meetings so that the best practices can be spread all over the territory. At the 2009 staff meetings, a new development was started whereby stories will be collected along the main theme of how the bank has effectively helped clients to create 'social value'. This collection will be merged with the results of a working group set within Prossima, the corporate social responsibility unit of Intesa Sanpaolo Group and some partner universities on the measurement of 'social value'.

People at head office are 'relationship managers' too, as they are mainly in charge of the relationship with Intesa Sanpaolo's head office and are incubators of innovation as well as the colleagues on the territory. In fact one of the general problems in lending to social entrepreneurs is that these businesses do not usually have strong equity and may lack financial professionals, so they need specialised valuation tools. Banca Prossima is developing a credit-rating model for social enterprises which takes into account both the legal and fiscal peculiarities of these businesses, and it complies with Basel2 criteria.

Banca Prossima's valuation model does not contrast with standard banking valuation models, as it completes them with elements typical of the not-for-profit world (e.g. fund-raising capability, success in attracting government and private grants, the share of market revenues vs. non-market activity, the governance model). It thereby opens a new chapter in the valuation tools for the social enterprise again as a co-production with social entrepreneurs: they provide systematic accounting even though they have neither legal obligation to do so nor any need for tax purposes, and Banca Prossima develops a dedicated

model so that these numbers ‘speak’ the language of regulatory purposes. Banca Prossima put its expertise at service not only of its clients but of the whole universe of social enterprise, as it took part in the working group of the National Agency for Nonprofit, which developed the accounting standard for social enterprises.

The third ingredient is external guidance and assessment via the Solidarity and Development Committee, a statutory committee of currently eight members nominated by the shareholder, the European Parliament and the president of the National Agency for Nonprofit. In the committee sit scholars and former managers or professionals of the not-for-profit sector. Its main tasks are to contribute to the design of the operation strategy and assessment of effectiveness for the Fund for Development of the Social Enterprise and to see that Banca Prossima’s operations maximise the production of ‘common good’.

Summarising, when asked about an image that could describe Banca Prossima’s strategic view on its people, Marco Morganti, Banca Prossima’s CEO, cited staging a musical production. First of all, he maintained that this is because Banca Prossima’s people, like actors in a musical, must be full-rounded professionals: they have to be able to play a part, to sing and to dance professionally. In other words, they have to manage a relationship with ‘ethical’ people, speak their language and understand their needs, not merely sell products or get preset term sheets signed. Secondly, he continued, it is as if Banca Prossima’s people were all on the stage, most of the time with not much difference between the soloist and the chorus member. There is hardly any hierarchy there; almost the only rule is that everybody acknowledge that each other’s role is essential for the relationship to be commonly beneficial for all the stakeholders. Hence they act accordingly, doing what is to be done rather than limiting themselves to what their job description says. And consequently, it is hardly possible to think about a organisational chart<sup>17</sup> that fully encompasses the dynamics – Morganti would rather use something like a choreography, which records the movements of a dance.

It is very clear that although each person plays a role, however heuristically set, the final picture cannot be anything else than the irreplaceable combination of these unique individuals.

## **Remuneration policies**

As far as remuneration is concerned, Banca Prossima follows Intesa Sanpaolo Group guidelines, so the minimum remuneration for newly

hired personnel is that laid down by the CCNL (national collective bargaining agreement)<sup>18</sup> for the various personnel categories.

Top management pay follows the policy set by the Remuneration Committee of the Supervisory Board of Intesa Sanpaolo Group.<sup>19</sup>

For managers' pay, a gradual process of harmonising has begun within the group, and the data produced by these assessments has allowed group management to draw up a remuneration policy based on the principles of (1) equality, through a reduction in pay inequalities and harmonisation of pay packages; (2) merit, through closer connection with the work performed and displayed managerial potential and (3) sustainability, through containment of the costs stemming from application of the remuneration policy within limits that are compatible with cost objectives.

Furthermore, as a business pertaining to the domestic commercial banking division, Banca Prossima was asked to apply the new incentive system based on promoting individual contributions, the pursuit of excellence and equity combined with meritocracy and business growth envisaged by the group. However, after a dedicated climate survey that underlined a clear preference of Banca Prossima's people for team-based rather than individual-based indicators for incentive pay, Banca Prossima decided to change the calculation methodology accordingly.

In conclusion, for personnel policies, as for other areas, the room for manoeuvre for a legal entity belonging to a large group is quite limited, so the economies of scale and the reputation effect of starting an activity afresh while belonging to an established player find, in the need to conform to the group policies, a counterbalancing effect. In this field, the importance of people's intrinsic motivation cannot be sufficiently stressed: the former Intesa Sanpaolo employees operating as volunteers in the not-for-profit sector who offered their CV to join Banca Prossima believed in the mission proposed; they knew that they were going in a small organisation which might have the same deficiencies and rigidities as Intesa Sanpaolo only on a smaller scale. They might be able to change little in what the man on the street will claim of any large bank (too complex procedures, too much standardisation in lending, careers mainly based on seniority, etc.) but that little something they must try on themselves.

In order to preserve this motivation and 'proximity' of all the co-workers in Banca Prossima, part of the training offered to the employees is not only commercial and technical but includes at least one yearly general staff meeting dedicated to building a common culture, exchanging information and experiences and keeping the mission alive.

Activities of the general staff meeting included group work targeted to copywriting a TV ad in which service to a client could best express Banca Prossima's mission, staging a Q&A to directors and proposing process innovations to facilitate the sharing of experiences of the different specialised activities within the bank.

### **Banca Prossima, Intesa Sanpaolo group and the financial crisis**

Because of its recent start-up, Banca Prossima was not fully hit by the current financial crisis, and at the end of September 2009, after not even two years of full operation, 6040 institutions were Banca Prossima customers, or 2.5 per cent of the potential market; 485.7 million euros in clients' assets were deposited and/or invested through Banca Prossima; 323.5 million euros of credit was outstanding 58 per cent of which was in the credit-risk category of 'very low' to 'medium low'.

The fallout of the crisis on the real economy is making itself felt on social enterprises too, and the main difficulty voiced by clients is the delay in obtaining payments, especially from local authorities. The pace of loans under financial stress has been slightly accelerating; however, at the end of September 2009 only four loans were in loss status, for a total amount at risk of 0.29 per cent of credit outstanding.

Notwithstanding the favourable credit performance, Banca Prossima has not yet reached its break-even, and the difficult market environment might delay it further. The main expense items relate to personnel. They include not only wages, but also costs of training. One also has to take into consideration that the level of service Banca Prossima offers its clients is higher than for the average retail bank, hence the productivity is necessarily lower with respect to that reached by mass services.

As far as the group's reaction to the crisis is concerned, on 20 March 2009 Intesa Sanpaolo decided to start procedures for the issuance of up to 4 billion euros of Tremonti bonds,<sup>20</sup> with the aim of having an 'insurance policy' against a further collapse of the markets that could endanger its ability turn to the markets to meet eventual internal needs and/or loan demands and to deliver on targeted capital management actions. Tremonti Bonds were looked upon as a 'bridge' – and so to be repaid as soon as possible – until capital management actions (e.g. partial or full disposals, setting up partnerships, listings) on non-core assets were finalised.

At the end of September 2009, however, Intesa Sanpaolo decided<sup>21</sup> not to issue the Tremonti bonds, as its market valuation had improved

Table 4.1 Management in the banking industry: traditional model vs. Banca Prossima's humanistic model<sup>22</sup>

Traditional model	Banca Prossima's model
Single bottom line	Statutory creation of social value within a group with a tradition of triple-bottom-line reporting
Serves shareholders	Serves patient capital investors and stakeholders
High reward model	Low profit ( <i>à la Saint Martin</i> )
Lack of ethical oversight	Solidarity & Development Committee
Exclusive client base	Client base: working for the common good
Product-centric	Relationship-centric
Procedure orientation	Emphasis on client needs
Preset terms	Made-to-fit
Hierarchical structure	Teams on the territory
Emphasis on marketing	Emphasis on stakeholder engagement
High employee turnover	High internal job posting success rate
High customer default rate	Low customer default rate

substantially and its credit default swap was the lowest among leading European banks.

In addition, the latest analyses show that Intesa Sanpaolo can count on more than 200 basis points of Core Tier 1 ratio and Tier 1 ratio to be generated by capital management actions on non-core assets, and the value of non-core assets has grown compared to initial estimates to more than 11–15 billion euro, considering either the book value or a reasonable market value. This means that even with only half of the planned actions (resulting in at least 100 basis points), the Intesa Sanpaolo Group has the capital base to sustain the foreseeable loan growth level and to increase lending further by over 60 billion euros, an increase which is hard to imagine for the short term even in the presence of a very sustained economic recovery (Table 4.1).

## Notes

1. At the time of writing, Banca Prossima is 100% owned by Intesa Sanpaolo.
2. For a detailed statement of 2009 Q3 results of Intesa Sanpaolo Group, see [http://group.intesasanpaolo.com/portallisir0/isInvestor/en\\_risultati\\_2009/20091126\\_Resoconto\\_Intermedio\\_9M\\_en.pdf](http://group.intesasanpaolo.com/portallisir0/isInvestor/en_risultati_2009/20091126_Resoconto_Intermedio_9M_en.pdf).
3. Its other divisions are Public Finance, Corporate and Investment Banking and International Subsidiary Banks.



4. Specifically the implementation of the first and second European Directives on credit concerning the freedom of the establishment and banking de-specialisation.
5. Before the reform, the possibility of setting up as a commercial activity under not-for-profit form was limited to social cooperatives which could only operate in social assistance or employment of disadvantaged workers.
6. 'Third sector', 'not-for-profit' and 'social enterprise' will be used to mean the same thing.
7. For intrinsic motivation by workers in a not-for-profit setting, see C. Borzaga and E. Tortia, 'Worker Motivations, Job Satisfaction, and Loyalty in Public and Nonprofit Social Services', *Nonprofit and Voluntary Sector Quarterly* 35, no. 2 (2006): 225–48. For general equilibrium results, see E. L. Glaeser and A. Shleifer, 'Not-for-Profit Entrepreneurs', *Journal of Public Economics* 81 (2001): 99–115.
8. On the dangers of an excess of technology and consumer determinism for profit and not-for-profit enterprises see J. Green, (2007), *Democratizing the Future: Towards a New Era of Creativity and Growth*, <http://www.design.philips.com/philips/shared/assets/Downloadablefile/democratizing-the-future-14324.pdf>.
9. On the different approach to consumers by not-for-profit enterprises see V. Pestoff and T. Brandsen (eds.), *The Co-production: The Third Sector and the Delivery of Public Services* (London: Routledge, 2007).
10. OECD LEED Forum on Social Innovations. [http://www.oecd.org/document/53/0,3343,en\\_2649\\_34459\\_39263221\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/53/0,3343,en_2649_34459_39263221_1_1_1_1,00.html)
11. Although relevant for the future of Banca Prossima, the actual debate on the role of the social enterprise and the evolution of the welfare state is not the core of this chapter. Relevant literature is widespread, and interested readers could refer to the bibliography supplied by EMES (European Research Network) at <http://www.emes.net/index.php?id=47#1528>.
12. See note 15.
13. See <http://www.bancaetica.it/Lang/Content.ep3?LANG=EN>. See also the case on Banca Popolare Etica in this volume.
14. J. Robinson, *The Rate of Interest and Other Essays* (London: Macmillan, 1952).
15. According to Bank of Italy data, 245 of the nearly 800 banks operating in Italy at the end of June 2009 were incorporated as joint-stock companies, 38 were 'banche popolari' and 426 were cooperative banks. The corresponding distributions for branches was 26,560 (78%) to banks incorporated as joint-stock companies, 3020 (9%) to 'banche popolari' and 4172 (12%) to cooperative banks.
16. According to William Caxton's English translation of the Golden Legend, Saint Martin was born during the reign of the Emperor Constantine the Great and was a soldier. It happened that he was stationed in the city of Amiens during a winter of unusual severity. There was great suffering among the poor, and many perished from cold and hunger. St. Martin was riding through the city gate one day, when he passed a naked beggar shivering on the pavement. Immediately he drew rein and spoke pityingly to the poor creature. The young soldier was wearing over his coat of mail a long mantle. Slipping this garment from his shoulders, he divided it with

his sword, giving half to the beggar. That same night, as he slept, he had a vision of Jesus clad in the portion of his mantle. And Jesus, turning to the angels who accompanied him, said, 'My servant Martin hath done this'. This is the reason why he is always cited as a perfect example of fairness.

17. For further evidence on the constriction of functional charts to describe relationship in a humanistic management framework, see Humanistic Management Symposium at <http://www.humanisticmanagement.it/variazioni.html>.
18. The CCNL (National Collective Labour Contract) for the sector covers all the group's employees in the Italy.
19. See page 49 and following of Corporate Governance Report and Information on Ownership Structures, available at [http://group.intesasanpaolo.com/portallsir0/isInvestor/en\\_governance/20090420\\_Relgovernance\\_asseti\\_Proprietari\\_uk.pdf](http://group.intesasanpaolo.com/portallsir0/isInvestor/en_governance/20090420_Relgovernance_asseti_Proprietari_uk.pdf).
20. Tremonti bonds are special bank bonds to be subscribed by the Ministry for Economy and Finance.
21. For all the details, see the press release at <http://www.group.intesasanpaolo.com/scriptIsir0/si09/contentData/view/content-ref?id=CNT-04-00000003F8D5> or searching for Trimonti at <http://www.group.intesasanpaolo.com>
22. From C. Arena, 'Wainwright Bank & Trust Case Study', in *Humanistic Management in Practice*, ed. E. von Kimakowitz, M. Pirson, H. Spitzack, C. Dierksmeier, and W. Amann (Houndmills, UK: Palgrave Macmillan, 2011).

# 5

## Branch Banking and Trust: Community Banking Based on Core Values – Can It Survive?

*Stephanie A. Snyder and Jennifer J. Griffin*

### **Introduction**

Branch Banking & Trust (BB&T) is proud of its heritage as a community bank. BB&T's success, historically, stems from underwriting personal and real-estate loans for retailers, commercial businesses, and households within local markets. BB&T has always been proud of its 'small-town USA' beginnings as a mercantile business in Wilson, North Carolina. As a community bank, close to its clients and customers, it did not rely extensively on sub-prime mortgages that contributed to the recent recession. And yet as the global financial crisis progressed, BB&T cut its dividend, saw its profits drop considerably, and began reworking its business model.

The initial financial crisis in fall 2008 disproportionately affected community banks with significant exposure to sub-prime mortgages. BB&T was spared this fallout. After the initial 'flight to quality', BB&T gained market share in 2007 – 8 with deposit growth as other community banks failed. Focused on being financially sound with dogged adherence to its ten core values, BB&T CEO Kelly King stated in 2008, 'We've got a tremendous amount of work to do in incredibly trying times, but I firmly believe that BB&T is poised – probably as well as any other financial services company in the country – to come out on the other side of this recession in a very favorable position. I honestly believe this company's best days are ahead of us.'

As the worldwide recession lingered, however, high unemployment rates, high foreclosure rates, and high rates of debt within individual American households – the heart and soul of community banking – increased the stress on BB&T's business model. BB&T's stock price

swung from a high of more than \$40 per share in fall 2008 to less than \$15 per share in spring 2009.

This paper examines whether CEO Kelly King's assertion that the bank's best days still lie ahead can, indeed, be supported in the current economic climate with BB&T's current business model. In light of BB&T's response – higher fees, even more conservative lending policies, and aggressive collection efforts – to the economic downturn, heightened scrutiny and increased regulation of the financial services industry, we assess whether this long-standing member of community banking will turn away clients, turn off employees, retreat from customer service, and undermine its future success.

More specifically, we examine whether the corporation's long-standing conservative credit culture can effectively support a business strategy able to weather a prolonged economic downturn. Supporters argue that consistent, values-based leadership ensures daily decisions reinforcing BB&T's good standing and ability to grow. Antagonists suggest otherwise: a conservative credit culture with increased scrutiny from regulators as a superregional bank has forced large-scale changes to its business model and has become an unhelpful partner to clients during an economic downturn. Our conclusion is that BB&T is indeed likely to survive and to continue growing, by acquiring weaker banks caught up in the sub-prime mortgage meltdown, but with a toll on employees (negatively affecting turnover, loyalty, and service capabilities) and its customer service ethos. Future claims to be a community bank will be tenuous, at best.

### **BB&T's legacy: Small-town beginnings**

After the Civil War, Alpheus Branch, the son of a wealthy planter, started a small mercantile business in Wilson, North Carolina. He soon partnered with Thomas Jefferson Hadley in 1872 to form a bank, Branch and Hadley. The bank helped to rebuild small businesses and family farms devastated by the war, and its roots in local, rural areas grew strong and deep. Farmers were able to finance seed purchases for their cotton fields and began to experiment with a new cash crop: tobacco.

In 1889, Branch, along with his business partners, secured a state charter from the North Carolina legislature for Wilson Banking and Trust Company, later renamed Branch Banking and Company. After Branch's death in 1893 the bank changed its name to Branch Banking and Trust (BB&T) Company, as it remains today.

As World War I began, BB&T sold Liberty Bonds and made loans. It became one of North Carolina's larger banks. In the early 1920s new offices were opened and it expanded its services to include insurance and mortgage loans. From 1914 to 1923 BB&T increased its assets by 307 percent.

The stock market crash of 1929 caused most of BB&T's competitors to fail. BB&T, however, kept growing by doubling the number of its branches and creating a bond department from 1929 to 1933. Prosperity after World War II helped BB&T. Through the late 1940s until the 1960s, the bank grew slowly and steadily through mergers and acquisitions by focusing on farmers and small businesses throughout North and South Carolina. BB&T expanded to 60 offices in 35 cities. By 1994 BB&T had 263 offices in 138 cities in the Carolinas. A 1995 merger with Southern National Corporation created the basis of modern-day BB&T with 437 branches in 220 cities that now included the Commonwealth of Virginia.

In 2008 BB&T accepted \$3.1 billion of the so-called bailout money from the sale of preferred shares to the Troubled Asset Relief Program (TARP) of the US Treasury. It was proudly one of the first banks to buy back those shares in 2009. Chairman and former CEO John A. Allison commented that the bank had been forced to take that money, claiming that excessive government regulations had caused the financial collapse (DePillis, 2009).

Shortly after exiting TARP, with the assistance of the Federal Deposit Insurance Company (FDIC) BB&T acquired the loans and deposits of Colonial Bank. The acquisition included approximately \$26 billion in assets and over 340 branches. BB&T was temporarily the eighth largest bank in the nation but soon sold off its Nevada branches to drop back down to tenth. It remains a mid-Atlantic-based bank with geographical expansion spreading south to Alabama and west to Texas.

BB&T continues to expand its presence throughout the southeastern United States by offering an array of banking, investment, and insurance services. As of December 2010, it had \$157 billion in assets and more than 30,000 employees operating in approximately 1800 offices across 12 states and in Washington, DC. This growth reflects an increase of \$20 billion in assets – while adding approximately 300 more offices yet employing 1000 fewer people – from year-end 2008. 'Doing more with less' is a mantra taken seriously at BB&T. Layoffs, termed 'organizational restructurings,' have occurred at branches in some of the most depressed areas of the country, such as eastern North Carolina.

## Ownership and leadership

BB&T, a superregional mid-Atlantic bank, has 692 million shares outstanding. Less than 2 percent of stock is owned by insiders; less than 1 percent is held in mutual funds; and less than 40 percent is owned by institutions such as Barclays and Vanguard. The vast majority is held by individual shareholders.

A team of ten executives leads BB&T. These officers, with only one exception, joined BB&T in the 1970s and 1980s. Promotion from within is strongly supported at the bank. Choosing Kelly King to become CEO as of January 2009 reconfirmed the importance of stability with a long-term focus as part of BB&T's conservative culture. Leaders are chosen who are well versed in BB&T's history, culture, and ways of doing business.

Most executives join the bank by entering BB&T's Leadership Development Program. This six-month training program at the company's 'BB&T University' allows associates to learn fundamental financial skills as well as become immersed in BB&T's culture. Stressing BB&T's ten core values, the program reinforces the ways in which the corporate values are reinforced in day-to-day decisions. Many graduates proudly display their certificate of completion on their office walls. BB&T continually invests in education and is thereby promoting the bank's ten core values.

## BB&T's philosophy: ten core values

Employees of the bank frequently hear senior executives incorporate BB&T's ten core values into each discussion. These values on which the bank relies are dubbed 'the BB&T Philosophy': reality, reason, independent thinking, productivity, honesty, integrity, justice, pride, self-esteem, and teamwork. These values are routinely engrained into employees' day-to-day decision making from the day they are hired via incentives, investments, and discussions. See Exhibit I.

According to the bank's website ([www.bbt.com](http://www.bbt.com)), its vision is 'To Create the Best Financial Institution Possible' and 'Be the Best of The Best.' Its mission is 'To make the world a better place to live by:

- helping our **Clients** achieve economic success and financial security;
- creating a place where our **Employees** can learn, grow and be fulfilled in their work;
- making the **Communities** in which we work better places to be;
- Thereby: optimizing the long-term return to our **Shareholders**, while providing a safe and sound investment.

*Exhibit I* BB&T's ten core values

1. BB&T's first core value is **reality**. Decisions must be made by understanding the facts of a situation. Being grounded in reality has perhaps steered BB&T clear of taking unreasonable risks.
2. The second, closely related value is **reason**. Objectivity comes from logical thinking, which requires mental focus. Employees must be committed to avoiding logical contradictions.
3. **Independent thinking**, the third core value, reminds each employee, client, and investor to take responsibility for his or herself. Creativity can be a by-product of independent thinking, which is the stimulus for positive change and human progress. Such thinking also helps avoid groupthink.
4. **Productivity** is expected of employees and directly relates to the profitability of the organization. BB&T philosophy states, 'The tangible evidence of our productivity is that we have rationally allocated capital through our lending and investment process, and that we have provided needed services to our clients in an efficient manner resulting in superior profitability'.
5. The fifth value, **honesty**, is consistent with reality. When people become disconnected with reality and shun facts, failure results. In everyday decision making at the bank, employees must say what they mean and mean what they say.
6. In addition to honesty is **integrity**, the sixth core value, which stresses acting consistently with the principles of the organization. The example given for integrity is not chasing short-term gain because it will mean long-term detriment for the company.
7. **Justice**, or fairness, is the seventh value. This encompasses employees being objectively evaluated and rewarded. That is, those who contribute the most should receive the most. This is a key tool to retention, because employees who view their managers as unjust become unsatisfied with their job. Falling under the value of justice is BB&T's commitment not to discriminate against individuals based on such factors as race, sex, and nationality.
8. Close adherence to the first seven values cultivates the eighth value: a **sense of pride**. Pride is something that the bank wants all employees to have.
9. **Self-esteem**, or self-motivation, is the ninth value. Employees should act in a logical manner for their long-term self-interest and have a strong work ethic.
10. Finally, the tenth value is **teamwork**. Being mutually supportive is how work is accomplished. Integrated effort is the only way BB&T can be successful. All ten core values are simultaneously combined to achieve the company's vision.

The ultimate purpose of Branch Banking and Trust is ‘to create superior long-term economic rewards for our shareholders.’

These words would ring hollow were it not for the supporting management systems reinforcing the focus on long-term return to shareholders.

BB&T purposefully integrates four stakeholders – shareholders, clients, employees, and the community – as part of its core vision and mission. Without any one of these stakeholders, optimizing returns to shareholders would not be possible. John Allison, BB&T’s recently retired chairman and CEO, stressed the importance of shareholders. Because shareholders are taking a risk by investing in the bank, the bank has a responsibility to do everything it can to create a return for investors. BB&T’s strategies to optimize returns have traditionally been based on providing excellent client service, ensuring that the right employees are in place, and understanding that economic results are closely tied to the success of the communities in which the bank operates.

Healthy communities have been key to BB&T’s historical success. BB&T has traditionally invested in its communities, sharing in the mutual, and reflected, success of its local communities. From 1997 to 2005, BB&T was ranked by the U.S. Small Business Administration as either the number one or the number two ‘small business – friendly’ financial holding company in America ([www.bbt.com](http://www.bbt.com)). BB&T’s community development fund increased steadily until the 2008 recession. BB&T consistently makes appropriate loans to low- and moderate-income (LMI) individuals. Every year since 1977, BB&T has been assessed under the Community Reinvestment Act (CRA) as either Outstanding (the highest rating) or Satisfactory (second highest)<sup>1</sup>.

The current prolonged economic downturn is testing BB&T’s conservative credit culture and its ability to viably integrate the needs of clients, employees, community, and shareholders. Is BB&T, in its current form, able to weather the downturn? The next section examines the current economic downturn, how it affects BB&T, and BB&T’s responses based on its conservative credit culture. We argue that the bank’s conservative credit culture and its movement away from its community banking roots has unnecessarily translated into aggressive collection techniques that are unsustainable in the long term and damaging to the firm’s short-term prospects by encouraging a flight (by shareholders, employees, and clients) from BB&T.



## **BB&T's conservative credit culture and the economic downturn**

In 2008 the US Congress passed the US Troubled Asset Relief Program (TARP) to alleviate pressure on medium-sized and large banks during the global economic slump. TARP offered participating banks federal loans with favorable terms in return for preferred stock holdings. The government, as a preferred stockholder, required a 5 percent annual return on the amount borrowed. TARP, nicknamed the Toxic Asset Relief Program, was originally estimated to cost US taxpayers \$300 billion to shore up the financial services industry.

John Allison, BB&T's former CEO, urged lawmakers to consider including superregional institutions such as BB&T in the TARP funds. These superregional banks had done well while larger troubled institutions (e.g., Lehman Brothers, Goldman Sachs) were shaping Congress's impressions during the bailout. Allison focused on two key points. First, while financial institutions on Wall Street were at the heart of the global economic slump, financial institutions focused on Main Street were thriving. And second, all market corrections are not necessarily bad. Market corrections can help weed out poorly run companies.

In 2008, BB&T received \$3.1 billion of the TARP money. Given the increased media scrutiny of banks that accepted TARP funds, banks were extremely careful in explaining how they spent or appeared to be spending TARP money. Kelly King, BB&T's CEO, ultimately deplored the conditions imposed by TARP and found them 'offensive and disruptive to the long-term business plan.' In the first quarter of 2009, BB&T was one of a few banks that returned TARP money to the federal government. BB&T stated it was financially fine for the foreseeable future.

Yet, the empirical data suggest otherwise<sup>2</sup>. BB&T's net income plunged more than 42 percent in 2009 from a year earlier. BB&T's stock price plummeted to less than \$15 per share in spring 2009 (from more than \$40 per share in 2008) and as of the third quarter of 2011 has not recovered to pre-2008 levels, hovering around \$19 per share. BB&T cut its dividend in 2009 to less than one-third of its 2008 levels. BB&T, which acquired an average of 12 organizations annually from 1999 to 2007, completed only two acquisitions in 2009 and 2010: an insurance agency and a non-bank acquisition. Its rating in *Fortune's* 2010 Most Admired Companies in the superregional bank category was sixth, out of six companies. By 2011, BB&T had slipped within the superregional bank category from the 'Most Admired' list to the 'Contenders' list.

BB&T changed numerous employee benefits starting in 2008. One of the most significant adjustments was a change from defined benefit retirement programs to defined contribution retirement programs – shifting the retirement burden and stock-market risk to individual employees (SEC, 2011). Employees also saw increased health care costs and were faced with extensive restructuring that created a continually stressful work environment.

BB&T's community development lending increased during the initial throes of the recession, from \$499 million in 2007 to 731 million in 2008. Community development lending, however, remains unreported for 2009 and 2010 as of the third quarter of 2011. BB&T's investment and reinvestment in communities has wavered; its commitment to community – once touted as one of three key stakeholders (clients, employees, and the community) in its core vision and mission – has significantly changed in tangible (reporting statistics) as well as intangible (pride among employees) ways.

Much of the company's recent corporate giving has been done through the Lighthouse Project, which was created by CEO Kelly King in 2008. The Lighthouse Project is chosen by teams of employees within each local community. Resourced with up to \$100 and two volunteer hours per project, it has been well received by the employees. During the past several years, BB&T has also donated over \$10 million to the Ayn Rand Institute and American universities to expand study on free enterprise, capitalism, and objectivism, with former chairman John Allison's support.

BB&T's customer base is also changing. BB&T, which lost customers by increasing fees, has expanded into the prepaid debit card market as a new profit center (Wallace, 2011). That is, rather than growing through new customers, a traditional venue for a community bank, BB&T is competing with payday lending companies by offering prepaid cards to individuals without a bank account.

Overall, BB&T's relationships with key stakeholders (employees, clients, and the community) as essential to its vision and mission have irrevocably changed during the global financial crisis. Returns to shareholders have also decreased dramatically. The changes in BB&T's business model are likely to continue. But at what cost?

## **Community banking in today's highly leveraged competitive climate**

BB&T has survived while many of its erstwhile community banking peers (e.g., Riggs, National Mortgage, and Wachovia) can't say the same.

Similar to surviving community banks and now superregional banks, BB&T cut costs and refocused on shareholder value in the face of a slow economy.

Cost-cutting measures included a focus on expense controls, canceling award banquets, and eliminating unnecessary meetings. Executive compensation was also affected. In 2009 the executive leadership did not take bonuses based on BB&T's 2008 performance, even though the bank outperformed its peers. Did increased costs or increasingly important public perception of a growing bank with so-called fat-cat bankers play a role?

BB&T restructured numerous commercial real-estate loans and expanded its insurance business. Challenges still remain. Underperforming assets remain an issue at BB&T. Continual oversight by senior executives has led to hiring additional oversight services, increasing fees for clients, and expanding consumer help lines. The bank has increased collection efforts significantly.

A conservative credit culture has translated into additional levels of oversight for each loan. Co-approvers are usually involved. Additional oversight systems are in place across each of the 36 regions involving additional personnel from headquarters in Winston-Salem, North Carolina. When problems arise, several officers in the bank give immediate attention to working with the client to resolve issues. Many of these changes were enacted due to increased FDIC oversight. The FDIC, the federal government agency that regulates BB&T, is likely to continue its close scrutiny of BB&T, as the bank is the largest in the FDIC portfolio.

To ensure long-term success, the bank has renewed its emphasis on managing with integrity and managing by the numbers. Expenses are carefully scrutinized and, if not related to core values, eliminated. Profit centers are closing business, as needed, to maintain steady revenue streams.

At the same time, the bank is putting continued focus on meeting regulators' expectations. FDIC approval, and continual good standing with regulators, is necessary for the bank's future growth. Regulators, including the FDIC, will have a significant voice in approving (or not) BB&T's future growth through mergers and acquisitions.

BB&T currently faces the challenges of being stuck between being a community bank and being a large national bank. Stemming from its small community bank foundation, it has historically decentralized many decisions, oversight, and governance systems. With its growth in the last decade and aspirations to continue to grow, regulators are

demanding additional centralized credit systems now that BB&T is a national player.

Managing the centralization of management systems has been a struggle. Relationships with employees, clients, and regulators have significantly changed in the past few years. As banks consolidate and more national banks emerge, BB&T is a test case for whether an erstwhile community bank can remain true to its original beliefs, values, and critical stakeholder relationships while growing. We see cracks in the values-based infrastructure.

## What next?

As of the third quarter of 2011, BB&T is the 11th-largest financial holding company in the United States ([www.bbt.com](http://www.bbt.com)). Can it credibly be called, and operate as, a community bank much longer?

BB&T's intensified focus on growth with concomitant changes in employee and client relationships has significantly changed its business model. Aggressive collection techniques and changed employee relations have undermined the values-based business model. Managing with integrity has traditionally included an explicit concern for clients, employees, and shareholders. Credibility of caring for clients, employees, and shareholders is wearing thin.

All banks rely on clients to pay back loans with interest on a timely basis. While in the past loans might have been denied, the conservative credit culture has turned an increasingly discerning eye on aggressive collection techniques. Increasing fees and adding ambiguous 'miscellaneous fees' on payouts while not previously disclosing those payout fees on monthly bills are stretching BB&T's credibility with clients.

While clients have many banking options, superregional banks such as BB&T are doubly vulnerable. First, they tout themselves as being different by offering a genuine, trust-based commitment to their local, community clients. Second, a conservative credit culture has unnecessarily translated into aggressive collection techniques, employee layoffs, and centralized decision-making, which are not always conducive to building trusting relationships. Anger and retribution toward BB&T and other superregional banks is likely to be doubled or tripled by clients and businesses that have been spurned. Time will tell whether this bank remains committed to its many and varied communities, clients, and employees in deed or in word only.

With fewer loans and more losses due to unrecoverable loans, *how* a bank encourages repayment matters. Encouraging repayment is

especially important if a community bank is reliant upon repeat business from loyal customers within small communities. BB&T's investments in local communities have significantly decreased over the past three years. Once the local economies recover, will local households and former clients remember how they were treated and choose to return, or not? To survive the current crisis, will BB&T remain profitable by eliminating employees and cutting costs? By moving further away from the high-touch, local customer care of community banking, will BB&T be 'stuck in the middle' as a superregional bank without a local presence and without the scale and size of national banks?

### **Acknowledgment/note**

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### **Notes**

1. The Community Reinvestment Act (CRA) of 1977 encourages US banks to make loans to low- and moderate-income borrowers and small businesses in the areas in which the banks conduct business. The CRA was passed partly as a response to unfair lending practices by banks and partly to further homeownership in the nation – a long-standing public policy goal. Meeting the credit needs of a bank's local communities, including the credit needs of those in low- and moderate-income (LMI) neighborhoods, was seen as a key responsibility of regulated financial institutions. Congress recognized that without equitable access to credit, many Americans would not be able to achieve the American dream of home ownership (Koerber, 2011).
2. Publicly available data, [www.bbt.com/bbt/about/financialprofile](http://www.bbt.com/bbt/about/financialprofile).

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# 6

## CEI Capital Management LLC

*Fiona S. Wilson, James E. Post, and F. Robert Wilson*

Helping to create economically and environmentally healthy communities in which all people, especially those with low incomes, can reach their full potential.

Coastal Enterprises Inc. mission statement

This case study is based on interviews with CCML management team and board members in the fall of 2008 and in the spring of 2010. The authors sincerely thank the executives of CCML for generously sharing their time and insights.

### **Introduction**

For a small, nine-person organization based in Maine, a highly rural state that has 17 acres of woodlands for every member of the population, CEI Capital Management LLC (CCML) has a large footprint and strong social and environmental impact. Acting as a social triple-bottom-line-orientated financial intermediary, CCML has become recognized as a national leader in the federal government's New Markets Tax Credit (NMTTC) Program. Using federal tax credits (subsidies), CCML selects and helps facilitate a variety of triple-bottom-line project-financing investments, in mostly rural, low-income, and otherwise economically challenged locations across the United States. CCML has become known and respected for the role it plays in helping to encourage and channel needed private-market capital into designated low-income areas by providing 20 to 25 percent of project cost as extremely patient, low-cost equity generated by selling the tax credits to economically motivated investors, ultimately helping to bring jobs and other economic opportunities to these disadvantaged communities.

It is a social business, presenting a strong example of how a humanistic approach to the private-capital markets can harness the power of the financial industry for social and environmental ends. As a for-profit subsidiary of a nationally recognized not-for-profit community development organization, Coastal Enterprises Inc. (CEI), the after-tax profits of CCML flow up to help support the operating costs of the parent nonprofit. More importantly, the core business model and strategy of CCML directly furthers and supports the overall social and environmental mission of the parent organization.

This case explores the mission, strategy, and core business model of this innovative organization and identifies the factors that contributed to its track record of success in the financial industry in the years leading up to the fall of 2008, a period characterized by fierce competition in the NMTC industry. The case also explores the unprecedented set of new challenges for CCML created by the economic recession of late 2008–10. The robustness of CCML's core model certainly appears to have been the foundation that allowed it to continue to prosper amid an unprecedented period of uncertainty and turbulence in the financial markets. At the same time, CCML was also quick to make some fundamental changes to its operational strategies during the downturn, which appear to have contributed to the record results it achieved in 2009 and 2010. By 2010 CCML had over \$600 MM in NMTC financing capacity under management, and it was the largest allocation in both 2009 and 2010. CCML has proved to be an outlier in the industry, closing more investments and placing more NMTC allocation than ever before. At the same time, it has also improved its operating margin. Perhaps most importantly, it did not compromise its mission and continued to deliver strong environmental- and social-impact benefits through the types of projects it financed.

### **Origins: an unusual route to the financial industry**

The founder of CCML, Ron Phillips, planned to become a minister, but found a very different path for his calling: to found a nonprofit community development entity (CDE), Coastal Enterprises Inc., and later its for-profit subsidiary, CCML. While the linkage between these two paths may appear tenuous, Phillips describes how it is rooted in his early training in the seminary. He describes vividly the impact that the civil rights movement had on his values, noting the stark contrasts he witnessed in the early 1970s between Columbia University and the surrounding neighborhood of Harlem. During his time at the seminary,



Phillips studied Christian-Marxist dialogue and was exposed to ideas about the connections between human rights, social justice, and economic systems. The idea that 'capital was an essential lever for social justice' became central to Phillips's thinking and gave rise to his view that capital could, indeed *should*, be 'invested alternatively' in ways that would be more beneficial to people and communities, or that 'capital should have... embedded in it, or explicit to it, a social purpose.'

After moving to Maine in the mid-1970s, Phillips was drawn to help develop a nonprofit community development corporation (CDC) for the largely rural area. Phillips explains the concept was to 'tap into the entrepreneurial spirit that existed and pervaded throughout the state.' He saw it as a way to ignite local talent and local potential through providing access to resources as well as capital. Phillips founded the nonprofit Coastal Enterprises Inc. (CEI) in 1977 and has worked for over 30 years to eliminate the gulf between rich and poor and to level the playing field. Over the years, CEI has developed in many directions in pursuit of its core mission to provide financing and capacity-building help to small businesses, natural resources industries, community facilities, and affordable housing that could help grow employment and economic opportunity in Maine.

Despite the progress made by the parent organization, Phillips describes the ever-present struggle in terms of having the appropriate conditions and resources to achieve that mission. Chief among these needs are a regulatory environment conducive to community economic development, access to flexible capital, and access to private-capital leverage that creates the necessary liquidity, or the flow of capital, to allow entities like CEI to keep investing in projects that can enhance the health of the local community. Phillips explains the basic premise is not only to bring federal dollars to local needs to help economic development, but also to help 'leverage' those limited dollars with the much larger pool of private capital. He sees access to the conventional private capital market as the opportunity to create real change.

Fueled by this thought, he brainstormed with a close-knit group of other CDCs about how to attract more private capital for community development purposes. The group was aware of the success of the Federal Low Income Housing Tax Credit Program and decided to pursue an analogous tax-credit program for community development. The group was successful in getting Congress to approve a special pilot demonstration project, and, based on the initial success, this led to an annual program, the NMTC Program, administered through the US Treasury's Community Development Finance Institutions Fund, passed through

Congress in late 2000. This new federal tax-credit program paved the way for the creation of a subsidiary of Coastal Enterprises, known as CEI Capital Management LLC, in 2002.

### **Mission and model: channeling the power of private capital to economic development**

Ron Phillips saw that the newly approved federal NMTC Program would create a unique opportunity for CCML to address the ongoing economic situation in Maine and other states. Specifically, he saw it as a way to help attract and channel much more private capital toward projects in the economically distressed communities in which CEI worked. As such, this would be a new and innovative way for CEI to further its mission. Former chairman of the board Mike Payson says:

I am sort of a believer in our system, but I also recognize the reality, which is that our system doesn't work for everybody ... as they say, it takes money to make money, and if you don't have access to capital, or to education, or to the other sort of ingredients of success in our system, then it is just not going to work.

In order to make the system work, Payson recognizes that 'there has to be a way to address the distribution at the low end, those who are left behind by our system.' As such, Payson sees the mission of CCML as helping promote entrepreneurship, business, and employment in areas that otherwise might not be able to achieve the same results.

Under the terms of the NMTC Program, taxpayers who make investments in qualified low-income communities can receive a credit against federal income taxes equivalent to 39 percent of the project cost over a seven-year period. The NMTC Program is somewhat unique in that the federal government selects appropriately qualified intermediaries, through a competitive application process, to be the recipients of the tax-credit allocations. It is these intermediaries who then decide which projects will receive the tax credits. In this case, the parent, CEI, is the NMTC applicant and then 'sub-allocates' its allocation of credits to CCML, its for-profit subsidiary. CCML then markets and allocates these credits to investors who are willing to invest in low-income areas in return for some tax incentive. CCML operates in the complex nexus of tax-credit investors, the commercial debt and equity capital markets, entrepreneurial project developers, and the federal government's Community Development Finance Institution

(CDFI) Fund, which administers the NMTC Program. Strong working relationships with each of these are necessary to bring the model to fruition.

CCML furthers the mission of CEI by the intrinsic nature of its core business model, being a vehicle that brings capital into rural, low-income areas, capital that otherwise would have likely gone elsewhere. The basic premise of the model focuses on the potential to align the interests of multiple stakeholder groups while creating the desired social outcomes: Socially and environmentally conscious businesses or projects in low-income areas have access to needed development capital at reasonable rates, while private investors can earn attractive rates of return while meeting a vital community need. The current managing director, Charlie Spies, sees the NMTC Program as a tool that allows CCML to access the scale and power of the mainstream capital markets by using the subsidy that is provided through a tax credit to move private capital into low-income areas. The result, he explains, is more sustainable community-based businesses, not just from an economic perspective, but from a social benefit perspective.

The founding managing director, Steve Weems, describes the philosophy as one of ‘pushing the system in the right direction.’ Weems explains that at a fundamental level the group is exploring the ‘role of capitalism in our lives’ and explains that the CCML model creates a vehicle for business leaders who ‘want to do the right thing’ but who are ‘driven by somewhat more narrower day-to-day imperatives.’ Weems says of most large traditional companies: ‘if you can bring them some way to achieve some other socially and environmentally desirable outcomes...they’re more than happy to do it and embrace it and will be good partners in helping you get good projects done.’

## **Implementing the vision**

In the years leading up to the economic downturn of 2008–10, the NMTC industry was fiercely competitive among those applying to receive tax credits. This included both for-profit and nonprofit economic development organizations, as well as commercial banks of all sizes, state agencies, and municipal organizations. At the same time, there was a healthy supply of projects in disadvantaged communities, with all other aspects of their financing in place, seeking new market subsidies. Implementing the vision – staying true to the original mission and model while delivering strong results among this strength of competitive forces – required CCML to carefully consider and intentionally

design its operating policies. Indeed, it appears that certain, unique aspects of CCML's operating policies have played important roles in the success of the organization.

Most NMTC intermediaries have a focus on urban real estate, while a small handful, including CCML, have a rural focus. While CCML is now involved with projects across the United States, its almost exclusive and intentional focus on projects in rural areas allows it to utilize the deep knowledge gained over 30 years of its parent's operations in rural Maine. It has also allowed CCML to build up strong expertise in the unique challenges and opportunities involved in developing NMTC projects in these types of areas. CCML has a unique approach to its investment criteria. While many other NMTC intermediaries use the aforementioned qualified low-income area as the primary criteria for allocation of their tax credits to projects, CCML evaluates each potential project based on a broad range of stakeholders. Managing Director Charlie Spies makes it very clear that CCML's approach addresses the needs of each stakeholder group. As with other NMTC intermediaries, the first criterion in evaluating a potential deal is the 'but for' test. This test is intended to protect the taxpayers and the Department of the Treasury as stakeholders and is the test that ensures that valuable tax credits are not being used to help subsidize projects that would have transpired anyway. By following the standard 'but for,' CCML sees that it is working to ensure that the New Markets tax credits are allocated appropriately and as intended by the Department of the Treasury to economic development-enhancing projects that simply would not have been possible without the NMTC subsidy.

Spies describes how CCML is also strongly focused on projects that have 'high mission content' *over and above* investing in low-income areas. From inception, CCML has aimed to take its investment criteria further than the basic philosophy of the NMTC Program around investment in low-income areas. CCML brings a perspective to its underwriting that is fully consistent with its parent's mission and approach, and it evaluates a project's merit in three areas, which it refers to as the '3 E's': economic, social equity, and environmental, essentially a triple-bottom-line approach. Social equity refers to a project's potential for 'helping a community access a more equitable share of needed resources and services.' Evaluating potential impact in this area includes such questions as how the project will enhance a community or targeted population by creating or sustaining jobs, help raise an area's overall income levels, or provide educational opportunities. Because CCML works in rural areas, it also looks to see if the project

will help sustain traditional but particularly challenged industries, such as fishing, farming, and forestry. Environmentally, CCML looks at the emergence of industry best practices and certifications as guides in its investing, seeking projects that have features that enhance or promote conservation and sustainable use of natural resources, that make use of sustainable forestry practices in timberlands management and harvesting, or that include the creation of conservation easements over undeveloped areas. CCML's website states:

We are practical in applying this mission underwriting perspective; not every project is expected to meet all of the criteria. Some projects and deals are compelling enough in just one or two of these areas. We do think there is great value, however, in taking a wider view of what constitutes a 'sound' investment and a 'good' deal.

Because CCML goes further in focusing on high mission content to its deals, the outcome, according to Spies, has been that CCML is 'held up now as an example of a very high mission content allocatee.' He explains how this reputation has improved the company's ability to network and develop beneficial partnerships in terms of access to capital and interesting deals. He says, 'We've been able to use that to our advantage, even though we tend to do deals that are a little bit harder.'

According to Spies, the organization is constantly looking to find innovative ways to embed or 'engineer' more social mission into potential deals. He gives an example of a deal to finance a new hotel in a low-income area. Although the hotel will create employment and bring economic benefits to the region, he says it 'really didn't have a lot of mission when we got a hold of it.' He explains how CCML, in its role as coordinator of the deal, has required the use of some of the 39 percent subsidy to create workforce-development programs for immigrants in that area, including English as a second language and cultural skills programs. These will not only help the hotel obtain a qualified workforce but will help the immigrant community 'get a foot in the US.' Spies says, 'The extent we've been able to do [what] hasn't been done before is one of the ways we measure our success. Every time we close one of those deals that people go, 'Wow,' that's one to be held up in the industry as a whole.' Payson concurs that in this particular deal, CCML 'built in mission external to the deal...they took a deal that might not pass the 'but for' test, might not have as much mission as we would like, and they built the mission into the deal in the form of that employment agreement.'

Although CCML has a very structured process by which it assesses all potential deals, there is also some level of subjective and instinctive judgment. One example of a project that CCML helped finance that would probably never have been undertaken without the tax credit subsidy involved a consumer food co-op with ‘an incredibly strong tie to local community–supported agriculture and suppliers.’ Although it was not a classic example of a deal that would interest CCML, Weems says:

It just seemed to feel right because it ties so much into a smaller scale, sustainable, more local, more socially conscious way of thinking and living ... it’s an example of trusting that some of the benefits, and some of the impacts that may accrue, you can’t even know what they are, but the enterprise itself is positioned in such a good place and its objectives are so solid in terms of a sustainable future ... So it’s worth supporting.

Spies describes a deliberate approach to ‘being in a center with spokes going out to each one of those [stakeholders]’ and says that this approach is one of the key ways in which CCML adds value to the process, by intentionally coordinating the interests of the multiple stakeholders. As Spies explains, the interests of each stakeholder group are often not perfectly aligned, but at the same time he says CCML will deliberately seek out projects with ‘stakeholders that are more aligned than not.’ Indeed, seeking out the right type of partners in potential deals, specifically those who share CCML’s commitment to a broader type of social value creation, is seen as critical to maintaining mission. Weems gives an example of a deal in which the partner, a developer, shared the broader social mission aspect of the deal and therefore held ‘really fast and true to the mission content of the project, even when it was under financial pressure to be scaled back and dumbed down ... they really just had a sense of something that transcended the pure [financial] business elements of it.’ He adds: ‘So that was a group you want to work with ... those are the ones worth putting your time in with.’

At the same time, Spies describes the inevitable amount of alignment of interests once a deal is underway. For example, he explains that the effective 39 percent subsidy that the tax credit creates has to be shared out among all of the stakeholders – a tax credit to the investors, an acceptable rate of return for lenders, capital at a more reasonable rate to the project being financed. As Spies says, the subsidy has to be shared but ‘not necessarily equally’ and describes a balancing act. He says that

CCML spends a lot of time explaining to the parties involved, including meeting with the larger community where a deal is located, to make sure they are comfortable that the 'business itself is serving that community.' This is often accomplished with local working partners in the communities. Strong governance systems also contribute, with both an independent board and an advisory board that represents low-income communities.

CCML also sees its nonprofit parent, CEI, as an important stakeholder, and this means fair compensation in terms of CCML's services is always a consideration. This is important because although CCML is a strong example of an organization in which the nature of the social change is embedded in, and happens as a result of, the core product or service, CCML also delivers an additional benefit to its parent. All profits of CCML flow directly back to help support the broader social programming and mission activities of CEI. Weems says: 'I've never had any doubt that [making a profit is] one of our purposes in life...I've not been conflicted in the slightest about all that, as long as you're getting benefits on both [the social and financial] side, and they add up to a lot, it's a good project.' Payson explains how the investment criteria used also assess the degree to which CCML has the ability to extract 'fair and reasonable' economic compensation from the deal.

According to Spies, having a team and an overall culture around mission-related investing is critical to fulfilling the promise of CCML's philosophy. He describes a very 'thoughtful' approach to hiring and to creating an intentional culture at CCML. 'When we hire people... one of the big things that we look for is why someone is interested in working here.' Spies further explains that leadership will not hire somebody unless they are comfortable that the person has both the technical skills and the commitment to the social mission. He believes that CCML invests with the expertise and skill of professional investors, but blend this with hardcore belief in triple-bottom-line underwriting criteria. Spies views his team of 'world class' professionals, who first and foremost consider themselves as fiduciaries of the low-income community, as integral to the outcomes achieved.

## **Outcomes**

As of July 31, 2010, CCML had closed 39 NMTC project financings, 33 in the northeastern United States and 6 in other states, using \$398.7 million of NMTC investment capacity, triggering total private capital investment in low-income communities of \$1.1 billion. With its 2009 allocation of

\$125 million, CCML has now been awarded a total of \$606 million in New Markets tax credits. In the last two annual rounds, CCML received the single largest allocation of credits. Spies explains that the Treasury published the '50-50 report' outlining 50 NMTC deals in 50 US states and 'we have 3 projects out of that 50 highlighted in that report, so for a little organization from Maine to get 3 out of the 50 we feel is pretty good in three different states.' Weems also explains that the success of CCML has meant that CCML's topline is contributing between 35 and 40 percent of CEI's total revenue, generating at least \$1.5 million per year of profit for the support of CEI, and it has also massively increased its assets under management. In the context of shrinking funding from foundations and other philanthropic sources, Weems explains, 'that's a huge source for them.'

Payson also explains the 'tremendous' social benefit of these results, leveraging 'probably a billion dollars in capital and the money is going into targeted designated low-income areas.... funding businesses and creating jobs that otherwise would not have been created.' Phillips agrees that CCML's successful track record has helped CEI address the third challenge of accessing private-capital markets. He says: 'It gets you to larger sums of capital...to have more of an impact on communities and people.' He says it ultimately helps you 'build alternative economic systems.' Spies agrees that the scale of the NMTC Program is crucial in that it allows them to work with projects that attract major capital sources, including global capital market sources, to low-income areas. Spies says they can 'feel good about the fact that it really does seem to be making a difference in terms of how capital flows. So I think the fact that it mobilizes private sector dollars using a tax credit...and it's done at a scale that allows meaningful changes within a community.'

## **The economic recession of 2008–10: lessons learned from a winner**

The events of the unprecedented turmoil in the world's financial markets are well known. This section will discuss the specific effects of the crisis on the NMTC industry and how CCML responded. What is perhaps most interesting is that CCML achieved its record results in 2009 and 2010, running counter to many in the industry. It achieved this performance by being proactive and creatively adapting its investment strategy while still delivering strong triple-bottom-line benefits.

As the downturn began to set in, entrepreneurs and developers put many projects on hold, while other projects simply fell apart in the



realities of the new financial landscape. This meant that on the demand side, the number of eligible projects seeking New Markets tax credits was dramatically reduced. The slowing on the demand side was exacerbated on the supply side, when the Treasury Department released an additional \$3 billion of NMTC allocation in 2009 as part of the stimulus plan. The net result of these forces meant increasing competition among NMTC intermediaries like CCML, with less 'good' projects than available NMTC allocation. The few surviving projects were increasingly hard to close because new debt for projects became very hard to obtain as banks dramatically slowed their lending operations. The added complexities of the NMTC Program meant that the flow of debt for new markets transactions was almost frozen for a period, and resumed at only a trickle. The same was true for the other partners that CCML relies on, such as tax credit investors and private equity. The closing of strong NMTC deals is crucial to any NMTC intermediary like CCML because its allocation in subsequent years is predicated on its rate and quality of placement of its existing allocations.

CCML responded in highly creative ways. In general, to obtain commercial financing, this meant being flexible and adaptable, undertaking more commercially oriented projects with stronger underlying credit than it would have done in the past, with strong partners who were proving financially resilient in the downturn. In order to maintain its placement rate of NMTC allocation, CCML took an active decision to find 'shovel ready' projects with good basic potential for job creation in low-income areas. CCML also actively sought to build a larger pipeline of active deals, based on the pragmatic view that, because of the new complexities of economy, fewer projects would come to fruition. This approach allowed CCML to maintain its closing velocity and manage its portfolio to avoid undue financial and reputation risk. Before 2009, CCML had never closed more than \$60 million of NMTC allocation in any given year. In 2009, while the NMTC industry overall invested 20 percent less allocation than in 2008, CCML invested 70 percent more than in its previous best year.

At the same time, CCML deliberately used its organizational capabilities even more creatively in this new reality, navigating and aligning the interests of very diverse stakeholders to 'engineer in' additional features of the deal to ensure that the quality of its placement allocation was maintained, and so that every project still achieved adequate social impact in terms of jobs, community support, or promotion of social equity. Three projects in particular characterize CCML's behavior and strategies during the great recession of 2008–10. For example,

CCML facilitated the acquisition of 29,000 acres of a section of the Great North Woods in northern Maine by Lyme Timber (a timber-management organization and timberland investor). In addition to protecting the land from the threat of vacation-home development, and ensuring the land's long-term preservation as sustainable working forest accessible for year-round outdoor recreation, CCML carved out funding and land for the development of affordable housing for the local working population, who were being priced out of property ownership by vacation-home development. The deal 'died' in midstream as a participating bank changed its underwriting criteria, but CCML reacted by restructuring the transaction and bringing additional resources into the deal.

Two other deals – for development of a new hotel (a Marriott in Concord, New Hampshire) and for the rehabilitation of an abandoned public market in Portland, Maine, for a publicly traded company – would not have traditionally been transactions with sufficient triple-bottom-line benefit for CCML to consider. However, in the 2008/9 markets, these deals were at the margin of achievable financing and presented interesting opportunities for CCML. To bring them in line with CCML's social and environmental mission, CCML 'engineered in' additional social benefits by negotiating significant commitments of segregated funding and project developers' resources to promote additional social programs. These included a new immigrant workforce introduction program available to all hospitality businesses in the local area and an employment training program for disadvantaged groups within the community at the tenant company. In addition to providing financial support and resources, these projects created strong links between for-profit ventures and the not-for-profit community in their areas, relationships that might otherwise never have been realized. Interestingly, Spies explains how in some of these more commercially oriented projects, the developers originally saw NMTC as simply 'part of the cost of capital.' Through their work with CCML, they became converts to the social- and community-benefit aspects of their approach.

Several other themes characterize CCML's behavior during the recession. CCML constantly worked to structure and manage the deals, often completely restructuring deals in midstream, to resolve problems that occurred in the uncertain and shifting conditions that pervaded the financial markets. Even with the added pressures of the financial marketplace, CCML also allocated resources to its internal practices, looking for continual improvements in basic processes to set it up for

success in the recession and beyond. It developed more standardized but more formal processes for screening deals, both to more effectively manage the flow and to ensure continued high mission content. Because of the complexities of closing any NMTC project, CCML began seeking input from lawyers and other advisors much earlier in the process, to help increase the chance of the project's ultimate survival. Although CCML's governance and advisory systems were already strong, it actively sought to strengthen its governance and stewardship of mission as it entered into more mainstream projects.

CCML also put considerable effort into further strengthening its relationships in 2009 and 2010, seeing them as crucial to its success and to its access to strong projects and capital sources. Although it had always had strong informal relationships with working partners, it sought to deepen and formalize these partnerships. It was more deliberate about analyzing the particular strengths and strategic role of each of its working partners and, rather than taking a 'cookie cutter' approach, invested time in figuring out how to work most effectively with *each* partner individually. CCML also deliberately *broadened* its partnership base during the recession, actively developing relationships with accounting and law firms, as well as investors. This not only helped increase CCML's access to good projects, but brought it excellent sources of knowledge in a fast-changing environment. Rather than becoming more insular as it managed in a significantly more challenging environment, its more efficient internal processes allowed it to become more externally focused. It developed a regular meeting of 'thought leaders' with its working partners. It also spent time helping others in the NMTC industry. Spies explains that CCML believes in 'karma' and that 'doing the right thing, and helping people, will come back to help CCML in the long run.' He says that success in this industry is 'all about the relationships' and that CCML aims to set the 'gold standard' for the industry.

In summary, CCML is also a strong case study of an organization that has demonstrated a strong culture of resilience and tenacity during turbulent times, leading not just to survival but to better performance. CCML was able to do so because of the strength of its business relationships, technical expertise, and culture of dedication to getting deals done while achieving social impact. The organization's ability to assess the prevailing market conditions, to take a pragmatic view of the possibilities, and to continually adapt to the environment to achieve its mission in that context were vital. Its basic structure and approach has allowed CCML to not just survive, but to do even better, in the

economic downturn. CCML had worked on its 'engine' before the 2008–10 recession, so when it hit the stormy waters, the ship worked even when stressed, as opposed to organizations that discovered their equipment did not work in the middle of the storm. At the same time, CCML did make important changes to its operational strategies during the downturn that appear to have contributed to its performance during this period, and has strengthened the organization to continue to prosper into the future.

## Looking to the future

Phillips envisions CCML continuing its focus on rural deals nationally but sees 'even more innovative' ways to use to help make projects possible in areas such as alternative energy and regional agriculture. Spies says his priorities also involve trying to stabilize and make the New Markets tax credit a permanent piece of legislation (currently the program is approved on an annual basis). Weems expresses a desire find other ways to use CCML's 'specialized form of investment banking,' 'broadening out the investment banking work of CCML to include other sources, other subsidy programs, other sources of capital and other project types that it's working on...but under the general umbrella of triple-bottom-line investing in low-income areas.' Indeed, Spies says that he hopes CCML's legacy will be that it is 'considered one of the leaders in the new markets industry in terms of shaping a very strong program which effectively combines private-sector capital with social benefit in low-income communities.'

## Conclusions

CCML represents how it is possible to harness and redirect the mainstream private-capital market such that it can work toward positive social outcomes for a broad group of stakeholders (and not just financial ends for a narrow group of shareholders). In other words, CCML has shown that it is possible to innovate and push the boundaries of the mainstream financial sector so that it can work for humanistic ends.

The type of social and environmental mission-focused patient capital made possible by CCML represents an emerging asset class. It is one that helps redress the inequities of our society, in which some have extreme excesses of wealth and others live in poverty, using the power of the mainstream investment markets to support opportunities for disadvantaged communities.

In its design, CCML harnesses capitalism and melds it to serve a broad group of stakeholders beyond shareholders and owners, thus embodying a more socially conscious form of capitalism. Its core business model does not see the creation of economic wealth and the creation of social wealth as incompatible. Indeed, because the nature of the social change is embedded in, and happens as a result of, the core business model, the future social impact of the organization is assured.

# 7

## Cooperative Bank of Chania

*Theodoros A. Katerinakis*

### Introduction

In an era of turbulence, the domino effect in the globalized economic environment, and interconnected institutions, established economic entities and local societies are failing. At the end of 2009 the Dow Jones industrial average returned to the 10,000 mark but the financial crisis was alive and kicking in the banking business. In the United States – the root country of the crisis – the Federal Deposit Insurance Corporation (FDIC), managed by Sheila Bair (the voice of the passbook holder<sup>1</sup>), serving as the underwriter of savings and lending in the banking system, has a fund that is technically broke (as of September 2009). Banking terminology is dominated by ‘resolutions’ – meaning failure and sale – and a ‘back to basics’ approach in business is widespread. In the rinsings of the crisis, fall 2009 headlines in Europe have captured the bankruptcy of DSB, a Dutch bank that failed because of a rush of depositors to withdraw.

But beyond Wall Street, banking functions have an often unseen side that underpins local communities (‘Main Street’): cooperative banking that shares a tradition of mutuality and deals with ‘day-to-day’ operation, as implemented by the Cooperative Bank of Chania, branded as Bank of Chania (CBC) on the Greek island of Crete. Crete is a special case in the insular environment of Greece for its wealth of decentralized institutions; Crete is a region where *strong communities ameliorate weak institutions*,<sup>2</sup> where transactional ethos is grounded in keeping your word and face and being accountable on that, as a *poetic of living*.<sup>3</sup> In Chania, the historic capital of Crete, CBC is a protagonist of economic activity, scores well on social capital and defends the founding principles in its actions, values, policies, measures, expectations and

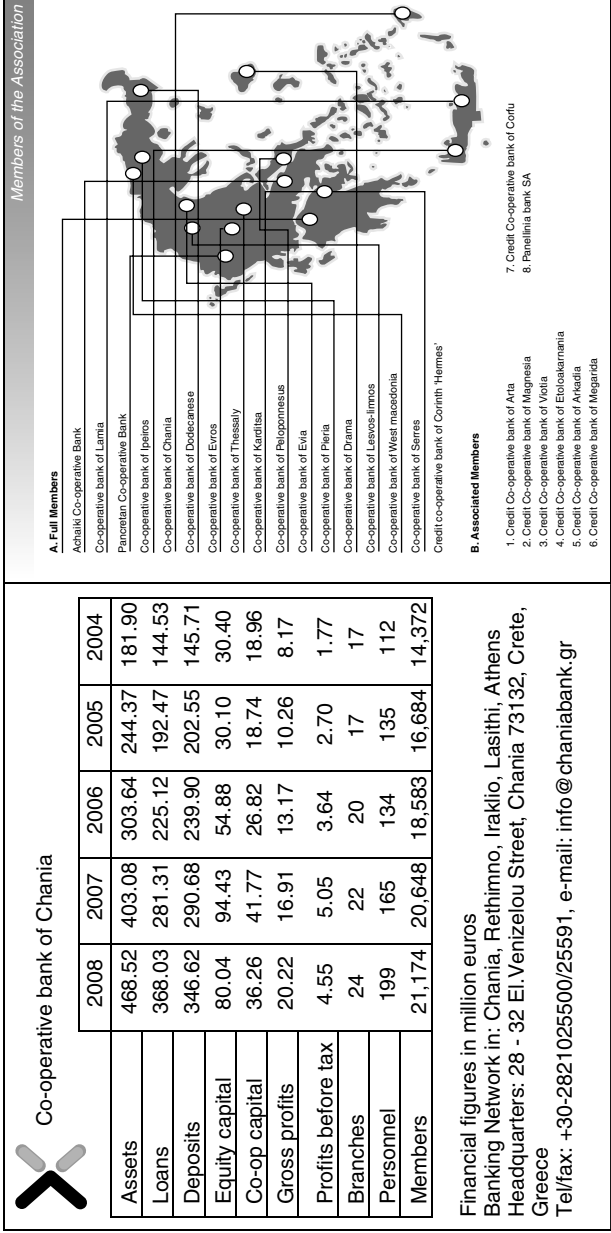
outcomes, indicating that healthy networks of families and friends play an essential role in local communities. In other words CBC is built upon integrity concerns threaded in a cohesive web of members that have made it resilient and less vulnerable than most of the industry.

### **Banking means participating in CBC, with society engaged**

Elinor Ostrom,<sup>4</sup> one of the 2009 Nobel laureates in economics, argues that humans have great capabilities and that when they are self-organized they are more effective than we might expect. Such a cooperative formula of polycentric self-organization is quite effective in Greece and the region of Crete; CBC has a proven record of banking efficiency, as shown on the left in Figure 7.1. CBC is one of the 16 cooperative banks covering the 13 regional authorities of the Greek territory, as shown on the right of the figure, in a network that consists of 181 banking branches.<sup>5</sup> CBC operates in the region of Crete and in Athens achieving remarkable figures as the only local-scope bank operating in Greece.

CBC has 21,000 customer-members starting from the founding core of just 62 members in 1993 who followed the vision of the pioneering dyad: Michael Marakakis – the current chairman and CEO – and Panayiotis Kostakis, who retired in 2005. It was a complete grassroots campaign, initiated by routine discussions and the demands of ordinary people, a bottom-up approach of energizing the person next door, as well as small entrepreneurs, to establish a bank that could promote a circular disposal of local resources: people of Chania buy shares and generate their (mutual) capital; lenders buy shares and get their credit facilities; money flows from Chania depositors to other local (regional) customers that participate in an open capital institution.<sup>6</sup> Thus, advantageous transactions that promote local exchange and interaction spread rapidly via word of mouth in connected local communities like Chania. Analogically to banking contagion,<sup>7</sup> dissemination of cooperation in the sense of ‘a friend of your friend may be a (founding) member, whose friend is also a member of CBC’ connects two-thirds of the economically active population in Chania with their own cooperative.

CBC operates under the supervision of Central Bank of Greece and is a relatively small bank with paradigmatic health and leading position in the region of Crete; a solvency ratio of 28 percent, far beyond the Greek national operational requirement of 10 percent for commercial banks and 12 percent for cooperative banks.<sup>8</sup> It is characteristic to say



*Figure 7.1* Scope and figures of CBC in Greece (Crete and Attica) and the distribution of cooperative banks in 13 Greek regions. Data extracted from CBC Annual reports (2004-2009). The distribution map is a courtesy of ESTE (available at <http://www.este.gr/en/index.html>, accessed on October 2009).



that National Bank of Greece<sup>9</sup> reports a solvency ratio of 15 percent. CBC retains all the guarantees for the average member and all investors in the bank's share capital, as well as institutional protection by the Greek Deposit and Investment Fund, as all the non-cooperative commercial banks. The small scale of 24 branches, 200 specialized personnel members, 40,000 deposit accounts, 8,000 credit accounts, 21,000 members, innovative technology, document management processes, and e-payment systems creates a comparative advantage. This is to say that CBC implements one-stop-shop policy, applies direct follow-up to customers within a two-day period, reduces the cycle of borrow-lend-payback directing to medium-term loans, is almost paperless (thanks to digitization of all incoming and outgoing paperwork), and implements an office self-organizer via IP-phone utilities. Each employee is responsible for several tens or hundreds of customers in his or her area and builds closeness with these customers. Thus, opportunity cost in operation is smaller than large-scale banks with CBC personnel as service centers. In terms of internal supervision, auditing is divided in reporting cycles, so compliance personnel and junior auditors generate their reports independently while having to respond to weekly auditing inquiries from the Central Bank of Greece and the Greek Capital Market Commission. CBC is a flexible, adaptive organization, with a complete chain of decision making at a local level, responsive to its members' needs, responsible in its lending policies, and sensitive in following-up credit requirements and the greater good for the local community of Chania, Crete, and southern Greece. All the parameters of doing business (from personnel recruitment and training to credit-facility evaluation, interest rates and spreads, and customized accounts) are analyzed in an ongoing process of interaction, under the maxims of cooperation and quality; casuistry is practiced when needed to resolve customer relationship issues; cases are personalized and personnel members are able to develop proposals outside the standardized banking products.<sup>10</sup> Pre-contract advising and detailed one-on-one interaction with customers is a common practice for all branches and all levels of managerial hierarchy, in favor of the customer/member. The customer is a member<sup>11</sup> with full access to the constitutional agreement, access to auditing reports, and a direct line of communication with the board members who live in the same community around the corner.

Furthermore, at the yearly general assembly members are encouraged to come and voice their opinion, challenge strategies and challenge managerial decisions with no middlemen; it is immediate democracy

on-site – with the option ‘not approve’– in banking governance and provides a clear message in corporate social responsibility standards. CBC has to keep its face in front of its constituents, from day-to-day operation to formal assemblies. It is characteristic to underline that, when there was a case of banking fraud at CBC in 2008, the CEO called the local media to disclose the case and reveal the policy measures undertaken to resolve the issue, assuming disciplinary action and litigation with the disgraced branch manager; ‘Incidents occur when banks operate, but we are monitoring operational risk on a day-to-day basis with a full disclosure strategy’, the CEO commented. It was a downside of closeness with a customer where the branch manager exploited such a connection, but the local community of customers showed their understanding and support for a loss that was under repair. CBC documented the case and presented it with auditing reports to the Central Bank of Greece and the general assembly for 2008. Also, the assembly applauded management for declaring a new policy of rotating branch managers among branches and positioning a network manager on random dates in each branch. Transparency and accountability are the keystones of CBC’s operation and the inevitable relation of the bank with its members who contributed the share capital. In the pace of its spirit of cooperation, CBC has managed to capture 15 percent of the whole market share in Chania, as well as half of it in the eastern part of Crete, competing with ten commercial banks of 150 banking branches on the island of 565,000 people.<sup>12</sup>

### **Living with integrity: Cretan *Philotimo*, the ethical core of CBC**

*Philotimo* is a value of personal honor and pride that promotes empathy for the ‘other’, as expressed through acts of generosity and sacrifice. Greeks since antiquity put emphasis on integrity (*akeraiotita*), today the foundation of *philotimo*.<sup>13</sup> Integrity originally reflected the public pressure to behave uprightly, a social norm. It would be unthinkable for someone without integrity – in terms of honesty, justice and truthfulness – to be admired. Emphasis on goodness is encapsulated in the ancient inscription ‘kalos k’ agathos’<sup>14</sup> on numerous Greek artifacts; it means, literally, ‘good and purely good’ in person and good as a social being. One is esoteric for personal improvement, the other extrovert to the quality of social relations. Integrity as a purpose and criterion of good life survived in modern times in Greece as the proverbial *philotimo*, with a teleological perspective but deontological roots. *Philotimo*

seems to gain the status of a collective conscience in modern Greece, where people no longer philosophize about it, or try to impose it on the masses, but take it for granted and assume its widespread existence.<sup>15</sup> That is the case of Crete, an insular community constructed by scattered individual households with prowess to defend themselves against enemies. It is a society with a radical shame culture with a ‘what we are and what we stand for’ lifeworld practice that also is represented in its ethical approach to banking.<sup>16</sup> The primary sanction that matters is ‘what people will say’.

CBC is a bank founded with humility by the people and governed by them and their directly elected executives; it operates for their greater good as a whole, consisting of pre-existing ties of homophily<sup>17</sup> that transmute to homopolar bonds among members of the community of Chania. The primary attributes of social entrepreneurship that boost stability and growth for CBC are (1) deep knowledge of local environment, people and their relations, (2) hands-on engagement with the economic and social life for employees and customers and (3) referral trust and solidarity, crucial for self-employed individuals and small-to-medium-sized enterprises living in Crete. At a community level, as living in affinitive local societies, members of CBC transform their cultural values to ethical – originally meaning *daily-expected* – traits when they decide to register, pay the ticket-share and start doing business.<sup>18</sup> This is an Aristotelian ideal that ‘*we are what we repeatedly do*’; ethos is a way of life diffused through the cooperative network fabric. The core value of Greek *philotimo* safeguards integrity and performance in Cretan society, as an enthymeme of a social added value. Greekness as identity,<sup>19</sup> manifested in Crete with *philotimo*, enriches transactional ethos with a social dimension that makes CBC ethical and a benefit dimension that makes it sustainable.

CBC in such a context, as the second largest cooperative bank in Greece, adopted the definition of the International Cooperative Alliance (ICA) for a cooperative: ‘an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise.’ Socially organized business finds an exemplary application in cooperative banking. The same notion seems to be the cultural foundation recognized with a Nobel Peace Prize for Muhammad Yunus for his founding of Grameen Bank.<sup>20</sup> Grameen, like CBC, is self-financed and makes a profit with a high repayment percentage, as the borrower maintains face to their own community, which guarantees normality and solvency in the bank’s operation. CBC lays out its cooperative

doctrine with seven internationally recognized principles that ICA<sup>21</sup> labels as *cooperative identity*:

- i) **Voluntary and open membership:** CBC is a voluntary organization, open to all persons able to use its services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.
- ii) **Democratic control by members:** CBC is a democratic organization controlled by its members, who actively participate in setting policies and making decisions. Men and women are able to serve as employees and elected representatives and have equal voting rights, following the principle of *one member, one vote* (L. 1667/86, March 8, 2010).
- iii) **Member economic participation:** Members of CBC contribute equitably to the capital of their cooperative and democratically control it; part of that capital is the common property of the cooperative. It is a non-publicly-traded company with a local scope and *open capital form*. Capital subscribed is a condition of membership. Members vote to choose an annual dividend or the appropriation of surplus in the form of deposit interest for all members and strategic philanthropic initiatives. Non-members are entitled to become customers, but their engagement is limited.
- iv) **Autonomy and independence:** CBC does not raise capital from external sources, as members commit to the *responsible sourcing and distribution of funds*. Participation in transactions and in common sphere debate maintains their cooperative autonomy, democratic control and accountability.
- v) **Education, training and information:** CBC provides education and training for its members, board members, managers and employees, so that they can contribute effectively to the development of the organization. Its outreach is to inform the general public about the nature and benefits of cooperation.
- vi) **Cooperation among cooperatives:** CBC serves its members most effectively by strengthening the cooperative movement; it is a pole that believes in social economy and promotes self-organization at a local, national and international level. DZ Bank, the central cooperative bank of Germany, was invited to participate in the Greek network following a proposal of CBC.
- vii) **Concern for the community:** While focusing on members' needs, CBC also works for community development through policies acceptable to its members. CBC is a reliable partner

for consultation, business ventures and synergies that connect different sectors. In several cases CBC is manufacturing consent for strategic decisions of the local *community of the people*. In a recent initiative, CBC donated a fully equipped fire truck to the voluntary fire-response team that oversees three rural counties of the prefecture of Chania. It was a socially beneficial return on investment, conveying the message of voluntary engagement.

This is a typical example of an amalgam of social and value capital supported by a banking network with connected members in the local community. Market share is not a goal but an inevitable evolution of togetherness in Chania.

### **Preparation and immunization against the crisis**

In October 2009, Mervyn King, the governor of Bank of England,<sup>22</sup> argued, 'It is in our collective interest to reduce the dependence of so many households and businesses on so few institutions that engage in so many risky activities.' For another time, diversification from pluralistic providers may help customers reduce risky-oriented decisions and the state to implement controls. This concept was instrumental for the broad cooperative movement in Greece (shown in Figure 7.1) and it is an optimization criterion for CBC. CBC believes that only investments that a bank can verify and self-manage are acceptable in its practice, and could not follow the securitization policies of large investment banks. Chairman and CEO Michael Marakakis explains that 'our [for CBC] very existence is justified by our goals. You cannot alienate the loan from the customer and the bank [but have a loan originate- to- hold]; otherwise you are creating a bubble of extraneous parameters that you are not capable to administer. It is a risk not acceptable in our principles and we exercise diligence to keep them. We operate as a complementary banking option focusing in small and medium size enterprises and individuals (self-employed or others) that cover 90 percent of the local labor and business market within society'. In 2009,<sup>23</sup> the solvency ratio – an indicator of robustness – was three times the minimum to operate. Also, the ratio of nonperforming to total loans was 1.95 percent, when the industry average was between 4.5 and 6 percent; protection from provisions from contingent liabilities was 150 percent beyond the nonperforming loans, in an industry average of 110–120 percent. And 90 percent of those nonperforming loans were secured under property

collateral, when the industry average was less than 50 percent. These operating standards served as antidotes for the crisis.

Furthermore, these reserves cater for CBC's liquidity; financially now is the best time for CBC to support the real economy. This level of liquidity allows CBC to support local entrepreneurship, keep the umbrella open under the tempest of the crisis. Also, CBC's ratio of deposits to loans is 94 percent, where as most Greek banks operate with a ratio of 130 percent. CBC is consistent in clarity – it is indicative to say a substantial percentage of time-deposit holders are renewing their deposits by phone and sign later, whereas in most other banks they are after deadlines and specific penalties in footnotes- and operational revenues with intermediary cost applicable only when paid to other providers; e.g. subscriptions and fees for credit/debit cards companies that are primary providers. Banking as usual in CBC reflects the actual determinants of cost and benefit: the spread between deposits and loans and personnel expenses. Marakakis explains in an interview<sup>24</sup>: 'We are expensive rate-wise as we had to keep out dignity against all our members. Mortgages at the rate of 3 percent are unrealistic, as the carrot to customers, when the interbank cost of capital is 7 percent and 8 percent. Phronesis and prudence is our principle. When paying 4 percent for our capital, our spread could be not less than 2 percent, so the cheapest loan would be 6 percent. Securitization is not an option, not even a resort for us. We know our customer and we want to keep it that way.' The financial meltdown of 2008–9 had as primary cause the *sub-prime mortgage domino*: sell mortgages (not only), assemble them in a pool as a fund, sell the pool-fund in consecutive steps 10–15 times (loans originate-to-distribute), with isolating the source (and the purpose) of the claim from the liable entity. This is an alienation of the borrower from the lender that CBC prevents. Thus, although interest rate is the primary source of revenue for CBC, about 15 percent of the loans are sold at an adjustable rate of 6.25 percent with monthly oversee depending on the volume of complementary services used.

Monitoring and contact, and close connection with local markets within communities, constitute the comparative advantage of cooperative banks, as Nikos Myrtakis,<sup>25</sup> president of ESTE, points out. CBC is a typical case consistent with the pioneering Raiffeisen Agricultural Banks Association<sup>26</sup> with considerable success. In 2007, after the successful capital increase, the board addressed the members visiting the new headquarters: 'for your trust as our members and stakeholders, who shared our vision for a lasting relation. Cultivating our roots in Chania, we embrace Crete, and we extend our message of cooperation

prioritizing you, the people.' Marakakis underlines that 'in 16 years, cooperative identity made the difference based on self-assistance, equity, solidarity and communal responsibility; with no deviation from our principles CBC evolved in competition by utilizing its size with flexibility. It was not a highway but a footpath coupled with humans as our capital.'

Unlike the expansion of Greek commercial banks in the Balkans and former Soviet bloc countries by investing 60 billion euros, with a significant loss due to currency depreciation against the euro, CBC progressed with deepening its ties in the Greek periphery. CBC, going in hand with other cooperatives, was the shelter of depositors, protecting its income with interest rates 1.5 percent greater than the commercial sector on average. In the first semester of 2009, CBC received an increase of 8 percent in deposits coming from the commercial sector, demonstrating confidence in the deep roots of CBC.

The Greek State Relief Program (SRP) embraced the banks as a medium to inject liquidity into the real economy and used 28 billion euros in the following ways: (1) government buying banking shares – 5 billion euros; (2) provision of state guarantee for long-term loans – 15 billion euros; (3) issuing of state bonds as collateral to lend – 8 billion euros. CBC, with the other members of ESTE, confirmed participation in the third phase only, using that option as a backup policy tool, still not activated. Credit expansion is feasible only when CBC's members are pumping their deposits. So, in the first six months of 2009, ESTE members have total assets of 4 billion euros, a 28 percent increase since 2007, a net worth of 500 million euros, deposits of 3.28 billion euros, and loans amounting to 3.1 billion euros and 200,000 members<sup>27</sup>; whereas conglomerates and commercial banking groups are tightening their credit facilities and re-evaluating their stock exchange and mutual funds portfolio. It is striking to see a press release that CBC sent out in the start of the summer season, a period of considerable seasonal income for its members: 'We have to be realistic. Our decisions are member-oriented and our Board guidelines dictate periodical stress testing and daily screening of our customers. In all cases where the global crisis is the problem we are going to refinance. We are stepping down to our customers to discuss, consult, advice and refinance. Synergy and symmetry are the corner stones and their longevity is our strategy'.

Foreclosures are not a priority but apply only in cases in which CBC's guarantees are at stake. A dynamic evaluation and adjustment of the collateral is preferred over collecting money, in order to support CBC's members who have a temporary shortage in their liquidity. CBC has

a functional hierarchy of 2–2.5 levels under the board of directors, with personnel members between the ages of 25 and 38, applying a personnel compensation that goes 5–10 percent above the collective labor agreement in the sector. Annual goals are strategically quantified, and bonuses are distributed not per person but by operating unit, only for profits exceeding a member's premium in customer deposit interest rate. CBC's criteria for bonuses cover share capital and membership increase, and yearly decisions are made to distribute a portion of total profits proportionally to all personnel members; no individual agreements apply. Thus, no personalized agreement of individual incentive but a sense of thriving through the collective drives CBC's employees. During all these years, there were times when CBC's personnel proposed not to get any year-end bonus but use the respective amount as reserves; still CBC holds a low employee turnover; *Homo Communicans* supersedes *Homo Economicus* in CBC.

### Lessons learned from an atypical case

The year 2009 was the first time since 1992 that 100 banks failed in the same year in the United States. The mission of CBC is redirected in the following board statement: 'This current crisis we live by creates an opportunity to show the very reason of existence of our bank, to step aside and support our thousands of members and the local communities in which we do business. In these emergency conditions, we support small business with a relief capital for their immediate and increased needs, keeping our guarantees. This will facilitate CBC's role as catalyst to protect our members from usury.'

In the tradition of their founders, CBC members lean toward ethical values of honesty, openness, social responsibility and caring for others. In ethical terms, CBC challenges *philotimo* of local communities and promotes it as a value incentive. CBC maintains a strong link with *local people* in a sustainable way.<sup>28</sup> That is why the board of directors is elected almost the same after 12 years of ballots with dithyrambic acceptance.

The key lesson that CBC provides is keeping trust; described as reflex, as a variable in interaction. Trust is also considered as a resource of social capital, power and social support. In cooperative banking, trust is the intangible connection that tightens concrete membership relationships; it involves a collective sense of belonging that CBC accomplishes. Key initiatives that proved invaluable during the crisis are the following (Table 7.1):



*Table 7.1* Personality engagement initiatives

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Know your customer	Customer is a member with a role and lasting relationship in the local community. So, interaction is preferable over transaction. And knowing your customer is an asset in turbulent times.
Recruiting	Meritocracy and transparency in personnel selection. CBC conducted 8 written contests in 10 years. Also, special care to redirect applications in other companies was taken after selection. CBC provided its services to populate other local businesses. Also, personnel members have their own life outside the bank. So, understanding is needed in their engagement to their duties.
Positioning in banking competition	CBC feels complementary in promoting small-scale business and self-organization in the local community. Thus, positioning itself in a community that markets recycling in capital makes it distinct. Real estate should be a separate activity where no interlocks are fruitful. Thus, CBC runs a separate estate developer 'Cretan Properties SA'.
Open doors	All members are entitled to address inquires at their closest branch, staff or manager, the CEO or the general assembly included.
Technology and innovation	The first Greek bank that installed IP phone and teleconference equipment in order to shrink decision making to a 1-day or 1-week basis. It is the first bank with an in-house operational Document Management System, in which all incoming and outgoing documents are digitized for workflow decision making and as a repository for members. When customers don't have a document in their files they come to the bank to get it. Also, technological applications are affecting CBC at vertical level, offering transparency, documentation and backtracking of all transactions with a dramatic reduction in paper cost.
One-stop shop	Personnel members are well trained to address customer issues, and all granting and approval functions are done automatically. In this sense, service personnel become personal contacts; every member knows that someone with 'a name and address' is taking care of his or her matters.
Solidarity & communal responsibility	Technological investment reduces all costs and environmental footprint. Thus, CBC takes time to listen, understand and respond to all applications and to resolve problematic situations. Also, it cultivates customer conscience to prevent tax evasion and money laundering.

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In such a context, business ventures somehow deal more with care and altruistic behavior, accountability, professionalism, symmetry in action and impact, and put in act the heart of survival as a *collective entity with a common destiny*. For CBC, apart from actions, emphasis on the human factor and commitment to integrity is documented in corporate messages and campaigns, as well as in the corporate statement (Table 7.2):

CBC encapsulates a back-to-basics approach that dictates, *'teach your company to feel small again* (as when it started)'; a notion that gains acceptance from the community and inspires personnel. That is what makes people pay attention to detail, work around the clock, stay involved when they are not in the office, and put effort into something that is worthwhile for their community. In the past months there has been a tendency for several banks to return to their 'economization'<sup>29</sup> that fueled the crisis. Frugality is an attribute of self-sufficiency, especially when people are connected with homopolar bonds of responsible sourcing and distribution of funds. In CBC, doing business is another side

Table 7.2 Corporate statements of CBC in campaigns

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**Main campaign messages**

1. Human capital is our capital.
2. Profit means to inspire optimism, security and confidence.
3. Humans are the cause, the means and the end of our actions.
4. We have to compete with the floating time with open minds.
5. Deposit means 'your work to have value'.
6. Financing is to 'put your back into it' in hard times.
7. Investment is ...to be trusted.
8. In a dynamic world...we don't follow others; we leave our mark.
9. Robustness and differentiation is in our people.
10. Optimism speaks with numbers: we take challenges as our power.

Integrity: a holistic concept of self-integration wholeness, intactness, and commitment

Consistency of actions, values, principles and expectations. Firm adherence to a code of moral values, commitments and keeping the self intact and uncorrupted.

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Source: *Stanford Encyclopedia of Philosophy* at <http://plato.stanford.edu/entries/integrity> (accessed on October 2009).

of the social networking coin; a Main Street bank that gives customers a word in how their money is managed – most importantly, by encouraging their input into the ongoing development of the bank's ethical policy. In CBC, *Homo Communicans* forwards *Homo Economicus* to *Homo Dictyous* (a connected member).

## Notes

1. Massimo Calabresi and Barbara Kiviat, 'Passbook Protector', *Time*, January 9, 2009.
2. An expression deriving from a holistic definition of prosperity to include both material wealth and quality of life in Legatum Prosperity Index (2009) available at [www.prosperity.com](http://www.prosperity.com), as of September 2009. In several cases communities have the ability to over-compensate for weak institutions.
3. Michael Herzfeld, *Poetics of Manhood* (Princeton, NJ: Princeton University Press, 1985). Also see G. Hofstede and G. J. Hofstede, *Culture and Organizations (Software of the Mind)* (New York: McGraw-Hill, 2005).
4. As documented on the Nobel Foundation website at [http://nobelprize.org/nobel\\_prizes/economics/laureates/2009/](http://nobelprize.org/nobel_prizes/economics/laureates/2009/) (accessed Oct. 2009).
5. The Association of Cooperative Banks of Greece (ESTE) reports 181 branches for the group of cooperative banks, in the first half of 2009 (available at <http://www.este.gr/en/index.html>, accessed Oct. 2009).
6. Legislation provisions for open capital, non-publicly-traded banks is described in Laws: 1667/1986, 3483/2006, 3601/2007, and 3606/2007. Also, the Central Bank of Greece in its capacity of the European Central Bank branch has the authority to publish regulatory acts like Governor's Acts 2258/2.11.93, 2413/9.7.97, 2420,12.9.97, 2471/10.4.01, 2587/2007, 2588/2007, 2589/2007, 2590/2007, 2591/2007, 2592/2007, 2593/2007, 2594/2007, 2595/2007, 2596/2007, 2577/2006, 2595/2007, and 2597/200 that ratify and explain the supervisory standards of Basel II Accord in the Greek legal framework.
7. It is a term used, sometimes with a negative connotation, in N. A. Christakis and J. H. Fowler, *Connected* (New York: Little, Brown and Company, 2009), a book on the surprising and catalytic power of social networks.
8. Data extracted from statistical bulletins (2008–9) from Central Bank of Greece, Association of Cooperative Banks, and NBG.
9. National Bank of Greece (NBG) is a leading commercial banking group in southeastern Europe and the dominant group in Greece. NBG was selected in 'The Global Dow,' a 150-stock index of the most innovative, vibrant and influential corporations from around the world at <http://www.djindexes.com/globaldow/> (accessed Sept. 2009). Only leading blue-chip stocks are included in the index. Its components, like those of 'The Dow', are selected by editors of Dow Jones.
10. Casuistry is the rule-deviant tolerance that deals with exceptional cases that may not fit in a generic policy framework. In this case the bank deals with people problems before dealing with account-efficiency, payback rate and

opportunity cost of lending. The theoretical approach, as a form of moral reasoning, is described in Albert R. Jonsen and Stephen Toulmin, *The Abuse of Casuistry* (Berkeley, CA: University of California Press, 1988).

11. CBC obtained a special license from the Central Bank of Greece to accept non-member transactions under the Law No 3601/2007. A plafond of 1502 shares/per capita has been decided in the latest amendment of L. 1667/1986, at the end of 2008. Further amended on March 8, 2010.
12. From estimates of the Regional Authority of Crete at [http://www.crete-region.com/en\\_contents.asp?id=87](http://www.crete-region.com/en_contents.asp?id=87) (accessed Sept. 2009).
13. John Psaropoulos explains the concept in his article 'From Homer to Coops', *Business File Quarterly Review* no. 74 (Dec. 2009).
14. A full explanation is offered in George A. Petrochilos, 'Kalokagathia: The Ethical Basis of Hellenic Political Economy and Its Influence from Plato to Ruskin and Sen', *History of Political Economy* 34, no. 3 (2002).
15. Several researchers document why in Greece, traditionally, *philotimo* is 'taken for granted': S. Hoban and G. Hoban G., 'Self-Esteem, Self-Efficacy and Self-Directed Learning: Attempting to Undo the Confusion', *International Journal of Self-directed Learning* 1, no. 2 (2004); G. Kostoulas (2008), *Philotimo and the Greek Manager* at <http://www.capital.gr/news.asp?Details=502016> (in Greek, accessed September 2009); G. A. Kourvetaris, 'Professional Self-Images and Political Perspectives in the Greek Military', *American Sociological Review* 36, no. 6 (1971): 1043–57; D. Koutsantoni, 'Relations of Power and Solidarity in Scientific Communities: A Cross-cultural Comparison of Politeness Strategies in the Writing of Native English Speaking and Greek Engineers', *Multilingua* 23 (2004): 111–43; V. Mavreas, P. Bebbington, and Geoff Der, 'The Structure and Validity of Acculturation: Analysis of an Acculturation Scale', *Social Psychiatry and Psychiatric Epidemiology*, no. 24 (1989): 233–40; H. C. Triandis, 'Culture and Conflict', *International Journal of Psychology* 35, no. 2 (2000): 145–52; G. Vassiliou and V. G. Vassiliou, 'Social Values as Psychodynamic Variables: Preliminary Explorations of the Semantics of *Philotimo*', *Acta Neurologica et Psychologica Hellemka*, no. 5 (1966): 121–35.
16. Brian Harvey, 'Ethical Banking: The Case of the Co-operative Bank', *Journal of Business Ethics* 14, no. 12 (1995): 1005–13.
17. M. McPherson, L. Smith-Lovin and J. M. Cook, 'Birds of a Feather: Homophily in Social Networks', *Annual Review of Sociology* 27 (2001): 415–44. Also see Kaduchin at <http://home.earthlink.net/~ckadushin/> (accessed Oct. 2009). The term 'homopolar' is taken from chemistry, in which it is contrasted to 'ionic' to denote mutually contributed electrons in a covalent bond.
18. Geert Hofstede provides a well-documented analysis of cultural aspects in business in several publications and on his website at <http://www.geert-hofstede.com/> (accessed Oct. 2009).
19. Managerial and behavioral aspects of *philotimo* are explained in the following publications: D. Bourantas and V. Papadakis, 'Greek Management', *International Studies of Management and Organization* 26, no. 3 (1996): 13–32; V. Skiftou (2005), *Within Social and Cultural Practices of Greek Society Subjects Negotiate a Series of Issues that Are Related to Family and the Complexities of It*, LSE Doctoral Conference; V. G. Vassiliou and G. Vassiliou, 'The Implicative Meaning of the Greek Concept of *Philotimo*', *Journal of Cross-Cultural Psychology* 4, no. 3 (1973): 326–41.

20. Muhammad Yunus, when he claimed the prize in 2006, said during the ceremony: 'Let us suppose an entrepreneur, instead of having a single source of motivation (such as maximizing profit), now has two sources of motivation, which are mutually exclusive, but equally compelling: maximization of profit and doing good to people and the world.' The second type of motivation drives CBC, while profit returns to its society at large.
21. ICA definitions, reports and principles are described in <http://www.ica.coop/coop/principles.html> (accessed Sept. 2009). The Co-operative Movement covers over 800 million members around the world. The United Nations estimated (1994) that the livelihood of nearly 3 billion people was made secure by cooperative businesses. ICA has undertaken three reviews of the Co-operative Principles, in 1937, 1966 and 1995.
22. From a speech in Edinburgh, available at <http://www.bankofengland.co.uk/publications/speeches/2009/speech406.pdf> (Oct. 2009). It is similar to Alan Greenspan's comment for breaking down banks: 'If they're too big to fail, they're too big' at <http://www.bloomberg.com/apps/news?pid=20601087&sid=aJ8HPmNUfchg> (accessed Oct. 2009).
23. Data derived from Central Bank of Greece Annual Report and ESTE reports (for 2008, 2009).
24. Interview with M. Georgakakis at [http://ixnilatontas.blogspot.com/2009/03/blog-post\\_04.html](http://ixnilatontas.blogspot.com/2009/03/blog-post_04.html) (accessed Oct. 2009).
25. Nikos Myrtakis, 'We Were Not Exposed', at [http://archive.enet.gr/online/online\\_text/c=114,dt=29.03.2009,id=97620628](http://archive.enet.gr/online/online_text/c=114,dt=29.03.2009,id=97620628) (accessed Oct. 2009).
26. See R. A. Yerburch, 'Agricultural Credit Banks', *Journal of the Royal Statistical Society* 59, no. 3. (Sept. 1896): 459–84.
27. Data available in ESTE reports at <http://www.este.gr/en/index.html> (accessed Oct. 2009).
28. An extensive explanation is offered in Alexopoulos Yiorgos C. (2006), *Financial Co-operatives and Rural Development in Greece*, PhD Dissertation, University of Leicester, Unit for Membership Based Organizations, Management Centre, UK.
29. As George Provopoulos, governor of the Bank of Greece, commented. See <http://www.enet.gr/?i=news.el.oikonomia&id=97433> (in Greek). Also see Paul Krugman, 'The Banks Are Not All Right', *NY Times* op-ed, October 18, 2009, <http://www.nytimes.com/2009/10/19/opinion/19krugman.html> (both accessed Oct. 2009).

# 8

## GLS Bank: Successfully Sustainable

*Eva Schneeweiss*

‘The way this small cooperative bank does banking should also be possible for other financial institutions,’ the newspaper *Süddeutsche Zeitung* demanded in August 2008. The *Ruhr Nachrichten* newspaper noted: ‘GLS Bank is growing and growing and growing.’ Whereas all signals in the financial markets from autumn 2008 onwards at the latest were set to insecurity and crisis, customer demand at GLS Bank in Germany rose by leaps and bounds. If in the equivalent period of the previous year the financial institution processed 2500 calls per week, that number rose to 5000–6000 after the start of the crisis.

In recent years, the bank has grown by 20 per cent, but in the crisis year 2008 it recorded total growth in the balance sheet of more than 27 per cent and thus crossed the billion Euros line for the first time in its history. Corresponding growth of 25 per cent was also recorded by GLS Bank in the field of loans and deposits. GLS Bank is continuing its successful course without interruption with growth of 37 per cent also in 2010.

So on what is this consistent success based? In Germany, a rethink is evident among investors. Instead of solely pursuing the aim of the highest return, investors are readjusting their objectives. Growing numbers of investors want to know the social and ecological effects of their investments in the real economy and have a say in how their money is used. There are good reasons for such a rethink.

First, the financial crisis has sharpened the awareness both of the effects which investments have and of the consequences of the decoupling of the financial sector from the real economy. Since the volume of financial losses and the large number of affected financial institutions worldwide has become known, since the rule ‘too big to fail’ proved to be incorrect, distrust within the banking sector is growing among

investors. Customers are questioning the hunt for the highest returns in which money is earned with money in a way ordinary people cannot understand anymore. They feel that they have not been properly informed, and they want to know where the banks are investing their money.

Second, increasing numbers of people see themselves being obliged to take personal responsibility. In the face of the challenges to society brought about by social problems and advancing climate change, people want to invest responsibly. The number of consumers of organic food, green electricity or clothing produced in an ecologically and socially responsible way is steadily growing. Such a 'Lifestyle of Health and Sustainability' (which has been termed LOHAS) also includes taking into account the sustainability criteria of financial investments. Investors see their investments as a lever to promote sustainable development of society. For some it also represents a political statement.

The current situation makes clear that long-term confidence of customers and investors in banks can exist only if they are given a real basis on which to assess banking products. This is possible only through a transparent way of working and enabling customers to make an informed decision, which takes social, environmental and financial aspects of the investment into account. In addition, it is clear that there is growing demand for socially, ecologically and economically sustainable investments. That is precisely the gap in the banking world which GLS Bank fills with its products.

## **The history of GLS bank**

GLS Bank was established in 1974, but its roots date back to the 1960s. The lawyer and anthroposophist Wilhelm Ernst Barkhoff was engaged at the time with others in promoting new forms of living and doing business. Their activities were focused on financing projects in agriculture, education and therapeutic education.

As early as 1961 the Gemeinnützige Treuhandstelle e.V. (today GLS Treuhand e.V.) was set up in Bochum, supporting community projects with donations and endowments. In 1967 the Gemeinnützige Kredit-Garantiegenossenschaft eG (GKG) was established as an investment bank for communal, agricultural and commercial businesses and projects. Then, in 1974, the GLS Gemeinschaftsbank eG (today GLS Bank) was established. Its focus was on financing ecological, social and cultural projects such as Waldorf schools,<sup>1</sup> Demeter farms<sup>2</sup> and housing projects, for example.

In early 2003, GLS Bank took over the business of Ökobank, which had gotten into difficulties. The takeover added two locations in Frankfurt and Freiburg and the GLS product range was expanded by current accounts, sustainable construction financing as well as social and ecological investment funds. In 2008, GLS Bank opened two new branches, in Berlin and Munich, giving it a presence in a total of seven locations in Germany (Bochum, Berlin, Frankfurt, Freiburg, Hamburg, Munich and Stuttgart).

## Transparency and sustainable use of resources

When GLS Bank was established in 1974 it was the world's first social and ecological full service bank. The aim of its business activities has ever been to contribute to the sustainable development of society. GLS Bank sees money as a means to make things happen in society. On that basis it focuses the whole of its business activity on services, which combine individual benefit for its customers with a social and ecological benefit for society. It addresses people who wish to produce non-material added value in addition to their financial added value and makes financing available in accordance with strict criteria exclusively to businesses and projects, which serve social objectives in the ecological, social and cultural field.

From the perspective of the economy, the function of banks consists of supplying the real economy with a medium of exchange and capital. GLS Bank focuses on precisely these core tasks – deposit and loan transactions. With banking services from current accounts through savings products and asset management to old-age pensions and financing, GLS Bank offers the most comprehensive range of sustainable banking products in Germany. Together with its currently 73,000 customers, the bank is at present putting into practice more than 6600 forward-looking enterprises and projects in regenerative energies, ecological agriculture, ecological building finance, natural food, independent schools and kindergartens, facilities for people with disabilities and housing projects.

This utilisation-oriented concept of GLS Bank includes comprehensive transparency unequalled in Germany as well as an open communication policy. The bank is transparent about the way it uses resources and informs customers about the enterprises and projects financed: it regularly publishes all new loans in its customer magazine, *Bankspiegel*, specifying the institution receiving the loan as well as the amount and purpose of the loan. In this way, investing customers can see at all times in which enterprises their money is being invested. In addition, GLS



Bank offers its customers – starting with opening a current account – the opportunity to decide the sector in which their money is to be invested. In this way, customers can support specific areas of society. This exemplary transparency does not stop at the publication of its own investments, either. Everyone can inspect GLS Bank's own investments on its website.

In order to separate the sustainable from the non-sustainable sectors, enterprises and business activities, GLS Bank works with rigorous positive and negative screening criteria. The 15 excluding criteria include, among others, nuclear energy, the arms industry and child labour. The bank refuses to work with enterprises which are tangent to these sectors because meeting the criteria is a prerequisite for a loan. This applies equally to the bank's own investments. In order to guarantee the highest quality and a consistent sustainable investment portfolio, GLS Bank has implemented a two-stage research process. To this end it works together with experienced rating agencies as a first step, which also includes ecological and social criteria in its company analyses alongside the economic ones. On the basis of the values suggested by the agency, the in-house GLS investment committee examines in detail which businesses can be included in the GLS investment portfolio. The committee consists of internal and external experts who meet several times per year and routinely monitor the investment portfolio.

In questions of transparency and the strict implementation of a sustainable banking strategy, the concept of GLS Bank sets standards. It provides investors with a sound basis on which to make decisions, and it makes GLS Bank's transactions verifiable and assessable. Furthermore, it offers a high degree of protection, something that is a central investment criterion specifically in times of crisis. Protection is also assured through GLS Bank's membership of the Volks- und Raiffeisenbanken's guarantee scheme, which guarantees all deposits to 100 per cent, as well as a business policy which strictly excludes speculative financial transactions.

With its 17,500 current members, GLS Bank is organised cooperatively and is committed to the idea of a joint and sustainable way of conducting its business. Every member has a right of codetermination and information. The bank maintains active communication with its members – for example, as part of the annual general meeting. Membership and codetermination, but also committed customers and staff, have made the bank into what it is today.

GLS Bank also includes GLS Treuhand e.V., which gives advice on foundations and endowments, as well as GLS Beteiligungs AG. The

latter provides young and sustainably managed companies with capital in the form of closed-end funds and participation rights.

### **Innovative banking products**

Throughout its history, GLS Bank has repeatedly focused on societal issues at an early stage. At its establishment in the mid-1970s it developed special financial instruments for social and communal projects. With the aid of so-called loan and gift communities, or guaranteed loans, it provided loans under particularly favourable terms by charging only a contribution to cover costs. This contains the costs of staff and materials, minimal interest and a small supplement to cover credit risk. This was possible because GLS Bank customers donated the offered interest wholly or partly when making their investment, combined with the instruction to GLS Bank to support civic commitment and community-oriented projects with the donated interest, such as independent schools or therapeutic education facilities. In the 37 years it has been in business, GLS Bank has enabled many thousands of projects and initiatives through this specific form of financing.

In the 1980s and 1990s, GLS Bank increasingly became concerned with ecological issues. In Germany it is among the vanguard in the financing of regenerative energies. Thus it set up the first wind-power fund in 1991. GLS Beteiligungs AG places and manages closed-end renewable energy funds to the present day.

In recent years, GLS Bank has also given innovative stimuli in the social field. The German Ministry of Labor and Social Affairs set up the Microcredit Fund in January 2010 to improve access to capital for start-ups and micro-businesses. The implementation is assigned to GLS Bank in order to establish in Germany a nation wide of microcredits. The concept – developed by GLS Bank – builds on collaboration with regional microfinance institutions that provide advice and support to start-ups. The program is highly effective and very successful.

### **Social stimuli**

To leverage its social impact, GLS Bank has built up a global network with associations, organisations and banks that are working in the same areas. It is in regular contact with them about current developments

and projects. Within these networks, but also through proactive press and public-relations work or participation in panel discussions and lectures, GLS Bank continues to stimulate social and political debate to support sustainable development of society.

As quality leader in the field of green banking in Germany, GLS Bank has also influenced other alternative banks in Europe. It is one of the founder members of the Global Alliance for Banking on Values, which was established in March 2009. GLS Bank's model as well as other member banks have been providing answers to demands for more transparency and the abandonment of purely speculative financial transactions in favour of financing activities within the real economy. As a result, the alliance, consisting of international sustainable banks, has set itself the target of together developing a socially, ecologically and economically sustainable alternative to the global crisis-ridden financial market. Alongside GLS Bank, the international alliance includes the BRAC Bank – part of the BRAC Group and the largest microfinance institution in the world, headquartered in Bangladesh – the Italian Banca Etica and Netherlands-based Triodos Bank. Together the banks, which all subscribe to the highest social and ecological values, have deposits of more than \$10 billion and look after more than 7 million customers in 20 countries.

As well as belonging to the Global Alliance for Banking on Values, GLS Bank is a member of the International Association of Investors in the Social Economy (INAISE). The association is a network of social and ecological financial institutions established in 1989. The objective of the association is the exchange of experience and information as well as to disseminate concepts of sustainable investment.

Furthermore, GLS Bank maintains active cooperation with more than 300 NGOs, with German federal ministries and agriculture ministries, higher education institutions and local politics. It supports the activities of the World Future Council, established in 2007, which actively works for sustainable and responsible action and sees itself as the voice of future generations.

## **Corporate sustainability**

Alongside its core business, the sustainability strategy of GLS Bank also comprises its in-house social and environmental standards. In 2010 approximately 60 per cent of all allocated loans went to social enterprises, projects and initiatives. The bank sees itself as a holistic social enterprise and has received several awards in recent years for its

staff-friendly corporate culture: in 2007, GLS Bank received the 'Top Job' prize for its human resources policy and staff development. This means that the bank belongs to the 12 best employers among German medium-sized businesses. In addition, it was awarded the 'Family-friendly Enterprise, North Rhine–Westphalia' (Familienfreundliches Unternehmen NRW) prize in 2008. The bank's mission statement sets out: 'Our work culture is marked by open and honest dealings with one another. We cultivate respectful dialogue in meaningfully structured functional hierarchies and a management style which takes its cue from a holistic image of the human being.'

GLS Bank currently employs around 273 staff, of whom 32 are trainees and 12 are people with serious disabilities. As a result of its growth, the bank employed more than 6 new staff in the course of 2010. The compatibility of family and work is a special concern of human resources policy. Almost 60 per cent of employees and 30 per cent of management are female. Each member of staff receives a child supplement of 220 euros per month per child, irrespective of their salary. Great emphasis is also placed on staff development. As a result, 416,000 euros were spent on training and advanced training in 2010.

The bank's salary structure was jointly developed by the board and staff. Salary consists of a basic salary as well as elements which take into account professional experience, function and social situation. Performance-based payments for staff in the form of bonuses are not included in the salary concept of the bank. GLS Bank thereby makes sure that no conflicts of interest arise and that advice is customer-oriented to the highest degree.

With regard to environmental and climate protection, GLS Bank achieves its greatest effect through the allocation of loans to ecological projects and businesses. In 2010 around 40 per cent of all loans went to the ecology sector. However, ecological sustainability also means the steady and continuous development and optimisation of the bank's operational ecology through minimising the consumption of natural resources and the generation of greenhouse gases. Since 2007, GLS Bank has undergone an annual independent certification process (Stop Climate Change). One part of the comprehensive obligations is to steadily improve the balance of CO<sub>2</sub> emissions and, building on that, reduce them further through innovation and investment. GLS Bank obtains green electricity in all its offices. In addition, a photovoltaic system has been installed on the roof of the head office building in Bochum. Staff routinely travel by rail for business trips. Furthermore, the bank provides company bicycles for its staff. With regard to office materials,

technology and reconstruction, attention is paid to environmental compatibility – in part involving external experts. Emissions which cannot be avoided despite these comprehensive measures are balanced by the bank through purchase of carbon credits, making it today a climate-neutral business.

GLS Bank has developed climate-protection products for private and business customers which enable their ‘ecological footprint’ to be calculated, makes reduction measures available and offers the balancing of unavoidable emissions.

### **Sustainability as success factor**

The concept of sustainability can no longer be ignored by business. The concept has entered the financial world and is growing in importance. As the example of GLS Bank shows, sustainability can be a source of competitive advantage. The bank’s model consists of meaningful, transparent and safe products, which also bear market interest. The case illustrates that the integration of sustainability into the banking business is not solely motivated by idealism and a strong will for social change. Social and ecological sustainability is evidently also the key to forward-looking economic development. And not just in banking – as the below-average credit defaults of GLS Bank compared to the industry average show. Sustainability, then, is also an economic success factor.

Undertaking banking business means taking economic as well as social and ecological responsibility. Through its social and ecological approach, GLS Bank provides answers to current issues many people are concerned about: the crises of poverty and climate change. With its products, customers have the opportunity to take responsibility and action towards a sustainable society. The raise in customers proves its strategy, especially in times of crisis. If the bank had about 62,000 customers in 2008, this has already risen to 100,000 in June 2011. And growth is continuing. GLS Bank clearly reflects the spirit of the times.

### **Notes**

1. Waldorf education (also known as Steiner or Steiner-Waldorf education) is a humanistic approach to pedagogy based upon the educational philosophy of the Austrian philosopher Rudolf Steiner, the founder of anthroposophy.
2. Demeter International is an accreditation body for biodynamic agriculture. Demeter farms are, accordingly, certified biodynamic agriculture farms.

# 9

## Industrial Credit and Investment Corporation of India (ICICI) Bank: The Emergent Bank of the Emerging Economies

*Radha R. Sharma and Philip Abraham*

In September 2008 the Reserve Bank of India issued a rare statement: 'The ICICI Bank and its subsidiary banks abroad are well capitalized'.<sup>1</sup> This statement epitomizes the confidence of India's central bank about India's largest private bank. Two days later, ICICI Bank reiterated to all its stakeholders that it possessed limited foreign exposure in the foreign market and was in good health. Healthy profits of 41 billion rupees, capital adequacy and a robust corporate governance framework led ICICI to this position while other Indian banks were focusing on the financial crisis in the United States. India's exposure to foreign market risks was limited, as was evident from only \$5 million exposure to Lehman Brothers by India's largest public sector bank, the State Bank of India, and its chairman was confident of recovering 60–70 per cent of that.<sup>2</sup>

This was the period when the global credit crisis was pushing the world towards recession. The crisis resulted from a vicious cycle of financial innovation, easy credit conditions, incorrect pricing of risk and lack of efficient forecasting. This crisis led to the fall of institutions, affecting nations and the global economy. During this turbulent time, some banks have not only survived but also thrived. This research presents a perspective and analysis of the Indian banking system, the environmental factors, macroeconomic policy and their impact on ICICI Bank, the largest private bank in India.

### **India: economic overview**

India is a federal democratic republic of 28 states and 7 centrally governed union territories. This pluralistic, multilingual and multiethnic country is the second most populous in the world and the seventh largest in terms of area. With a GDP of \$1 trillion, its economy is the

12th largest in market exchange rates and fourth largest in purchasing power. Services, industry and agriculture account for 55 per cent, 27 per cent and 18 per cent of GDP respectively.

India embarked on liberalization with market-oriented economic reforms that began in 1991. These included liberalized foreign investment and exchange regimes, industrial deregulation, significant reductions in tariffs and other trade barriers, reform and modernization of the financial sector, modifications in government monetary and fiscal policies to boost the economy, and safeguarding intellectual property rights. However, the *Economist* argued at the beginning of 1995, 'There are still too many constraints on the economy to allow it to function as efficiently as it could'.

## **Banking in India**

In order to gain insight into the functioning of ICICI Bank, readers need to know about banking in India in general. Banking in India originated in the early 18th century, and the General Bank of India came into existence in 1786. The oldest bank in India is the State Bank of India, established as 'the Bank of Bengal' in Calcutta in June 1806. By the 1900s, the market expanded with the establishment of other banks such as Punjab National Bank in 1895 in Lahore and Bank of India in 1906 in Mumbai – both of which were founded under private ownership. At the beginning of the 20th century, the Indian economy was passing through a relative period of stability. Around five decades had elapsed since India's first struggle for independence, and it had developed social, industrial and other infrastructure. Banking in India was controlled by the presidency banks, namely the Bank of Bombay, the Bank of Bengal and the Bank of Madras – which were later merged to form the Imperial Bank of India, which upon India's independence in 1947 was renamed the State Bank of India.

After independence the major steps to regulate banking included:

- In 1948, the Reserve Bank of India, India's central banking authority, was nationalized.
- In 1949, the Banking Regulation Act was enacted, which empowered the Reserve Bank of India (RBI) 'to regulate, control and inspect the banks in India'.
- The Banking Regulation Act also provided that no new bank or branch of an existing bank may be opened without a license from the RBI, and no two banks could have common directors.

However, despite these provisions, controls and regulations, banks in India (except the State Bank of India) continued to be owned and operated by private persons. This changed with the nationalization of major banks in India on 19 July 1969.

In the early 1990s the Indian government embarked on a policy of liberalization and gave licenses to a small number of private banks, which came to be known as New Generation tech-savvy banks, which included banks such as Global Trust Bank (the first of such new generation banks to be set up) which later amalgamated with Oriental Bank of Commerce, UTI Bank (now renamed Axis Bank), ICICI Bank and HDFC Bank. This move, along with the rapid growth in the Indian economy, kick-started the banking sector in India, which has seen rapid growth with strong contributions from all three kinds of banks: government banks, private banks and foreign banks. Currently, India has 88 scheduled commercial banks (SCBs), 28 public-sector banks (with the federal government holding a stake), 29 private banks (these do not have government stake; these may be publicly listed and traded on stock exchanges) and 31 foreign banks. These have a combined network of over 53,000 branches and 17,000 ATMs, with a predominance of public-sector banks, owning 75 per cent of banking assets.

### **The key differentiators: public policy and the consumer**

National economies are dependent on two phenomena: public policy and the consumer. Indian consumers are aspiring and drive the market. An efficient public Policy leads to healthy consumer behaviour. This is what differentiated India from the global economies in the economic crisis. In the United States, disposable household incomes were not growing, but wealth was; as a result spending was disproportionately increasing. Consequently, this led to percentage increase in the ratio of household debt to disposable income from 103 per cent in 2000 to 139 per cent in 2007.<sup>3</sup> Thus, US consumers were becoming resilient and spending more than they were earning. This pattern of consumption propelled global demand. With the sub-prime mortgage crisis and housing bubble burst, the US financial institutions went into liquidity crunch and failed to satisfy the US consumers. The world was dependent on US consumers to consume, and when they failed to consume as expected, the US economy slowly went into deep recession. Thus, the root cause of the economic crisis was the monetary policy of the US Federal Reserve in the Greenspan era followed by the growing global imbalances. Thus the financial crisis synchronized with the global recession.



However, in India, both a robust public policy and stable Indian consumers helped India to insulate itself from the crisis. Before the 2007 economic crisis, from 2000 to 2008 India registered unprecedented growth of 8.8 per cent in GDP while keeping inflation low. The key drivers of growth were state-friendly public policies, which initiated investments. India's macroeconomic policy tried to manage the three levers – growth, inflation and external balance. Due to an efficient external balance, it remained resilient to the external shock due to the global crisis. Unlike the Western world, India's domestic savings rate increased from 23.5 per cent in 2001–2 to 37.7 per cent in 2007–8<sup>4</sup> and hence investments also improved subsequently. Indian consumers as compared to their Western counterparts ensured that spending was done in line with their disposable income and kept the savings rate up. Thus, in the period of 1994–5, the rise in borrowings was 26 per cent of the rise of total assets and in 2008 the rise of borrowings was just 24 per cent of the assets. Thus, this depicts the stability in the entire spectrum of Indian consumption.<sup>5</sup>

### **Insulating the Indian banking system**

While trade, capital flows and deteriorating confidence were hitting the real economy, Indian banks started examining their financial reserve and found that most of them did not have any direct or indirect exposure to the financial crisis that hit the developing world. The few banks which were affected found the impact to be insignificant. With the Lehman phenomenon in September 2008, the Indian financial system started looking for liquidity. With mutual funds under pressure from their investors to sell, all eyes turned towards the central bank, the Reserve Bank of India (RBI), which came to the rescue in terms of money, motivation and credit growth. RBI ensured liquidity in the Indian financial system by a slew of measures that expanded the rupee's liquidity and foreign exchange liquidity. For decades, the role of India's central bank has been to advise, control and monitor the flow of credit without compromising with the credit quality. It is noteworthy that all the Indian banks are governed by the policies of RBI, which helped the Indian banks to insulate themselves from the financial crisis.

### **ICICI bank: an introduction**

The government of India established the Industrial Credit and Investment Corporation of India Limited (ICICI) in 1955 as a financial

institution in addition to the existing Industrial Financial Corporation of India (IFCI). The formation was also the result of initiatives of the World Bank. By mandate, ICICI was not a bank, it could not take retail deposits, and it was not required to comply with Indian banking requirements for liquid reserves. ICICI borrowed funds from many multilateral agencies (such as the World Bank), often at concessional rates, and utilized these to provide large corporate loans with the objective of financing large industrial projects. ICICI was also among the first Indian companies to raise funds from international markets. In 1956 ICICI declared its first dividend, of 3.5 per cent. In 1961, it obtained the first West German loan of 5 million Deutschmarks from KfW (Kreditanstalt fuer Wiederaufbau). In 1967, ICICI made its first debenture issue for 60 million rupees, which was oversubscribed. Besides, ICICI started setting up its regional offices for a wider spread. ICICI became a bank in 1994.

The mission of ICICI Bank has been:

- Maintain high standards of governance and ethics. ICICI believed in involving everyone in five pillars of organizational effectiveness: values, vision, rationality, integrity and truthfulness.
- Be the banker of choice for customers by delivering high-quality, world-class products and services.
- Play a proactive role in the full realization of India's potential.
- Expand the frontiers of the business globally.
- Maintain a healthy financial profile and diversify earnings across businesses and geographies.
- Contribute positively to the various countries and markets in which it operates.
- Create value for its stakeholders.

### **Management philosophy: emphasizing instrumental values**

To be *customer-centric* has been the overarching philosophy of ICICI Bank since its inception in 1994. M.V. Kamath, after taking over the reins of ICICI Ltd. in 1996, had a clear vision and mission for the Ltd. He had envisioned targeting the Indian middle-class with a slew of convenient, friendly banking strategies that would create a new level for services in banking, thus creating a niche for ICICI Bank in the minds of consumers. The visionary banker saw an opportunity in the retail banking space. ICICI's strategy and product offering recognized the changing demands of a growing middle-class.

Kamath's strategies revolved mainly around five platforms: Employees, Banking Technology, Banking Services, Values and Convenience. As

a pioneering private bank in India, ICICI had no models to emulate. The bank constantly created models all around the seven 'Ps' of services marketing and creating the quality dimensions of Reliability, Responsiveness, Empathy, Tangibles of highest standard thus improving the banking service levels in India. The basic management principles followed were decentralization and empowerment to take risks and learn from them, recruiting the right people for the right positions and encouragement of individual growth by rewards and recognition across levels. Above all, ICICI's operations were geared to provide outstanding value to the consumers through superior technology, low cost of access and convenience in various banking processes. ICICI Bank had all the capabilities in terms of resources or capital to expand organically. In line with its vision for growth ICICI vigorously started new branches all around the country and abroad. As Kamath put it: 'If we need a global size and scale in next 5–8 years.... We need to create a framework for growth – one route is consolidation, another is the organic growth and the third one could be opening the sector even further and let the global players come in.'

Kamath drew up aggressive plans for growth. In 1999, ICICI Ltd was listed on the New York Stock Exchange – a first for Indian financial institutions going the American Depositary Receipts (ADR) route. ICICI's ADRs debuted at \$14 on the NYSE, at a premium of more than 27 per cent over its issue price of \$11. Kamath was armed with strategies of acquisition as well. The same resulted in acquisitions such as ITC Classic Finance and Bank of Madhura. Also subsidiaries such as ICICI Personal Financial Services Ltd and ICICI Capital Services Ltd were brought under one roof.

ICICI Bank Ltd planned to embark on a two-pronged strategy of expansion: one, rapid penetration into the rural Indian market by unlocking the power of technology; two, a thrust for overseas expansion. Joint Managing Director at ICICI Bank, Lalita Gupte, envisioned ICICI among the top banks in the world. In its effort to reach new markets ICICI set up offices in New York and London in 2002. In 2003, it established subsidiaries in Canada and also set up a joint venture with Lloyds TSB in the United Kingdom. Offshore banking units were set up in Singapore and representative offices were set up in Dubai and Shanghai.<sup>6</sup> The bank's international presence has also enabled it to retain customers who would have otherwise turned to multinationals for their global financing needs.

Kamath had a vision to create an international banking experience in the country, which would provide complete financial services to different classes of customers. For the first time, the rural community

was included. With the use of technology, the bank started tapping into the micro-banking space in rural India, utilizing partnerships with multinational and local agricultural institutions. Kamath also introduced cross-selling in ICICI's banking system. He recognized the inconvenience faced by busy customers and brought in direct selling agents, who would reach customers easily, identify prospects and initiate dialogue. This not only helped ICICI deliver personalized banking facilities, but also changed the banking experience in India.

Kamath, explains the key facets of leadership for dealing with the challenges of changes: 'The future will belong to those who can operate with extreme agility in the face of very high levels of ambiguity'.<sup>7</sup>

### **The ICICI environment**

ICICI Bank is proud of its smart initiatives in the burgeoning financial sector of India and state-of-the-art banking infrastructure in its branches across India. The main strengths of ICICI Bank are the vast talent pool, complete product suite, large capital base, extensive customer relationship and strong brand franchise, technology-enabled distribution architecture and universal banking presence without losing sight of the socially less developed sector in rural India. Although ICICI Bank was mainly into retail banking, it expanded its horizons into other sectors like insurance, corporate banking and venture capital. In 2007 the bank was also one of the most valuable financial organizations in India when it raised \$5 billion in the largest-ever public offering in India. The total bids were worth more than \$25 billion, higher than the total FDI into India in 2006–7. The bids came not only from India but from all around the world.<sup>8</sup>

Kamath describes the impact of the Internet revolution in India: '[The] Internet has achieved "death of distance" and "death of time:"'. He knew that online banking would pay off and would address the convenience needs of a particular segment. However, in 1999, banks were faced with the threat of competition from telecom companies, media companies and any company with a large enough database and an Internet presence. This threat did not move any other bank, but Kamath knew that he had to take bold steps. This led to Internet banking for ICICI Bank, and it paid off.<sup>9</sup>

### **Work culture**

ICICI Bank's culture has been entrepreneurial in nature. The bank believes in building leaders from the existing pool of employees. The work culture is tech-savvy, non-hierarchical and empowerment based, where independent decision-making is the key to enable each employee to reach his or her potential. Coupled with this is a strong performance-management

system that has built a meritocracy where high-performing/high-potential individuals are duly rewarded. ICICI group companies to identified core talent who will act as entrepreneurs and build their own strong team. This system was a phenomenal success. ICICI also instituted a star system for the top 5 per cent of the bank's talent who received greater bonuses.<sup>10</sup> With this belief ICICI Bank became a breeding ground for a new generation of leaders such as V. Vaidyanathan, Sandeep Bakshi, Nachiket Mor, Chanda Kochhar, N.S. Kanan and Ramkumar. But with the bank's growing from 7000 employees in 2003 to 30,000 2009, this process needed structural change. That is a shift from a CEO-centric model to an institutionalized process of leadership development that has already evolved through six annual cycles. ICICI culture is performance driven and through 360-degree feedback is done for each employee, which is then shared with each individual. Further, transparency, openness, trust and sensitivity to others' needs, genuine care, celebrating leadership role models are key to ICICI culture.

### **ICICI bank: playing safe in economic slowdown**

In September 2008, shares plummeted by 15 per cent due to ICICI Bank's association with Lehman Brothers and Merrill Lynch through its UK subsidiary. Investors queued up in front of ATMs and bank counters to withdraw money. Morale was down, for both the bank and investors. The offices of the *Times of India* were flooded with calls from ICICI customers worried about their money. Kamath called off his visit to Europe and assured investors of adequate liquidity and described the rumours as 'baseless and malicious'. RBI, the central bank, also came to ICICI's rescue and assured the depositors that the bank had adequate liquidity and made arrangements to give the depositors the cash they required.<sup>11</sup> Within two weeks, people's fears had subsided.

But ICICI Bank was cautious to the downturns in the West. ICICI Bank, State Bank of India (SBI) and the Punjab National Bank (PNB) were some of the banks that had exposure to Lehman, Merrill Lynch and AIG bonds and derivatives. ICICI had invested around £57 million in Lehman bonds. Chandra Kochhar, Joint Managing Director and CFO of ICICI informed the media that ICICI's exposure was only less than 1 per cent of the UK subsidiary and 0.1 per cent of total ICICI assets. This implied that the board of ICICI was very much aware of the risk to which it was exposed.

The bank's capital adequacy ratio of 15.6 per cent is among the highest levels of capital adequacy in large Indian banks and much higher

than the regulatory requirement of 9.0 per cent. ICICI Bank made a profit after tax of 41.58 billion rupees (over \$850 million) in fiscal year 2008 and 30.14 billion rupees (\$619 million) in the first nine months of fiscal year 2009.

### **Paradigm shift at ICICI in the financial crisis**

Due to the financial crisis, ICICI Bank decided to play safe and to be extra cautious, evaluating risks in great detail. The board unanimously adopted the shift in policy from 'Growth and Performance Orientation' to 'Consolidation'. This shift in a slowing economy was justified. The bank in its new focus refused to look at buying units in India and abroad and also started evaluating its retail loan portfolio, which was shrinking from 65 per cent to 52 per cent. It also got rid of the entire \$700 million exposure to credit derivatives and other liabilities in foreign shores.

This shift was also evident when the bank's annual performance report in 2008 showed a dip of 22.49 per cent in ICICI CEO Kamath's performance bonus which corresponded to a dip in profit.<sup>12</sup> The bank had by then stopped hiring and had a look at realigning its organizational structure that sent clear signals to the stakeholders that the bank was adopting positive reforms due to pressure from the global environment.

### **Corporate governance at ICICI bank**

ICICI Bank has always been committed to the highest level of corporate governance and has derived its values from a system that integrates ethics, corporate integrity and best-in-class compliance practices. Transparency, fairness, disclosure and accountability have been central to the workings of the board of directors. Businesses within the same industry operate by standard means in many respects, but each is different in its management, goals for the future and perspective on the value of customers.

ICICI's Board consists of professionals who were groomed within the banks to take reins of the company. Kamath under his talent management system had encouraged the likes of Chanda D. Kochhar, MD & CEO, Sonjoy Chatterjee, Executive Director, Sandeep Bakshi, Deputy MD and others who know the bank's functioning inside out. Their expertise in the financial and banking domain is noteworthy. The board meets regularly at their Bandra Kurla Complex and reviews operations on a quarterly basis.

ICICI has embraced best practices in corporate governance, and the ICICI board functions as full board or through various

appointed committees like Audit Committee, Board of Governance and Remuneration Committee, Customer Service Committee, Credit Committee, Risk Committee, Share Committee, Grievance Committee and Fraud Monitoring Committee. These committees working under the guidelines protect the interest of all the stakeholders. Three areas are of particular relevance in the governance framework – risk management, executive compensations and corporate social responsibility.

- (1) **Risk Management at ICICI Bank:** Risk management is done at three levels at ICICI Bank: credit risk management, operational risk management and market risk management. Credit risk is managed by the Credit Risk Compliance and Audit Department (CRC & AD), which evaluates risk at the transaction level as well as in the portfolio context with a sectoral analysis and reviews each sector for better portfolio analysis. Market risk management is central to the risk management activities, as ICICI is exposed to varied risk like equity risk, interest rate risk, liquidity risk and exchange risk. The Market Risk Compliance and Audit Department evaluates, tests and approves market risk methodologies, which test all the new innovation in products that come from time to time. Operational risk is managed by the Audit Committee, which looks into adherence to policies and other aspects like proper documentation. Risk management is overseen directly by the CEO. All committees meet frequently to determine the risk versus reward.
- (2) **Executive Compensation at ICICI Bank:** Executive compensation in private and foreign banks in India is governed by a two-tier system. First, the compensation of board members is determined by the bank itself and at the second level, it has to be cleared by RBI's financial stability board. Remuneration of top executives of Indian private and foreign banks is cleared on a case-by-case basis by RBI. This system prevents any disparities in salary and protects the stakeholders' interests to a larger extent. The compensation of top management is cleared by the Board of Governance and the Remuneration Committee. The compensation includes performance bonuses and stock options. The CEO of the largest private bank in 2008 was paid around 16.2 million rupees against the net profit of over 40 billion rupees. Looking to the macro environment where the bank has also consolidated its operation, at the time of

writing the board has decided not to give any stock options and performance bonuses for the year 2008 and 2009.

- (3) **Corporate Social Responsibility (CSR):** CSR at ICICI Bank is about building strong and productive communities in which every individual has the means to live, the opportunity to learn, and the chance to give back. The company pursues a strong 'triple bottom line' policy, which is described as profits, people and presence. The Social Initiatives Group (SIG) of ICICI Bank Ltd works with a mission to build the capacities of the poorest of the poor to participate in the larger economy. The group identifies and supports initiatives designed to break the inter-generational cycle of poor health and nutrition to ensure essential early childhood education and schooling as well as access to basic financial services. Thus, by promoting early childhood health, catalysing universal elementary education and maximizing access to micro-financial services, ICICI Bank believes that it can build the capacities of India's poor to participate in larger socioeconomic processes and thereby spur the overall development of the country. It has introduced innovative farmer finance schemes propelling agribusiness and contributing indirectly to the Indian GDP. It has partnered with the government on various welfare schemes, which were not affected by the crisis.

As part of initiatives for inclusive growth ICICI created ICICI Foundation ([www.icicifoundation.org](http://www.icicifoundation.org)). ICICI Group's financial inclusion initiatives include microfinance initiatives, introduction of biometric cards, models like Business Correspondents, micro insurance and micro systematic investment plans. Disha Financial Counselling services are provided free to all in areas like financial education, credit counselling and debt management to consumers.

ICICI contributes around 1 per cent of its profits to ICICI Foundation's initiatives, which involves protecting the environment with its green initiatives. It believes that every small 'green' step today will go a long way towards building a greener future and that each one of us can work towards a better Earth.

Realizing the importance of education for a better life, ICICI Bank has pledged to educate a large number of children through the 'Read to Lead' initiative. Thus the policy and practices of ICICI Bank – educating schoolchildren on banking, innovating for rural India and enabling access to credit for around 3.5 million poor – provide ample evidence of being a responsible corporate citizen.



*Table 9.1* Comparison of management practices of foreign banks versus ICICI

<b>Characteristics of foreign banks impacted by the financial crisis</b>	<b>Characteristics of ICICI bank, India</b>
Focused on balance sheets.	Looked beyond balance sheets.
Were resistant to changes in the environment.	Was receptive to the context and the environment.
Decision-making at the core of the bank was based on a rational and primarily economic framework.	Decision-making at the core of the bank was based on rational, economic and the regulatory framework.
<b>Risk management</b>	
Overlooked internal controls and liquidity needs for growth.	Adhered to the internal controls and liquidity needs and justified growth.
Poor funnelling of relevant information on macro environment to the board. E.g., banks failed to pre-empt the liquidity crisis that swept the sector in 2007 by more exposure to derivatives & CDOs.	Efficient funnelling of relevant information to the board. Board decisions are taken under guidelines of RBI for bank as well as bank's overseas subsidiary. Thus, less exposure to high profit making derivatives and CDOs.
Liquidity norms were violated in the intent for higher risk over the intent of regulations.	Liquidity norms were observed and maintained around 5 per cent more liquidity than the stipulated norms. Intent of risk was not above the intent of regulations.
<b>Remuneration &amp; executive compensation</b>	
Remuneration to the employees as a whole was not aligned to the interest of the bank, culture, values, environment and long-term objectives.	Remuneration to the employees was based on the robust talent management system put in place which was aligned to the environment and long-term objectives of the bank.
Compensation was determined on the basis of revenues.	Compensation was determined on basis of cost of capital and profit.
Executive compensation solely determined by the banks. No stringent regulations by federal government.	Executive compensation was determined by the bank and regulated by the regulatory authority, RBI.
Top executives' salaries accounted for 4–6 per cent of total compensation with stock-related compensation at high levels leading to short-run herding behaviour. <sup>13</sup>	Salaries to top executives at ICICI accounted for approx. 70 per cent fixed with stock options which was additionally approved by the bank on a case-by-case basis. Performance bonus was approximately 27.11 per cent of total compensation in 2007 and was NIL for 2008 and 2009.
Parting payments to top executives; thus compensating for shareholding losses, if any	No parting payment to top executives at the bank.

Thus, core banking principles of values and ethics are the governing principles of ICICI, which are evident in the corporate governance of the bank. These have been compared with other banks in Table 9.1.

## **Conclusion**

When ICICI Bank was established more than five decades ago by Indian industrialists, the World Bank and the government of India, it was envisioned as the first Indian development bank. The story is about not just growth, but transformation: ICICI has evolved from a development bank to become a corporate and then a retail bank, meeting the needs of an aspiring population. The comparative analysis presented in the table above has brought out its differentiating characteristics which have enabled ICICI Bank to withstand the storm of the global financial crisis.

Finally, values and ethics providing a strong corporate governance framework, transformational and ethical leadership have helped the bank to emerge from the financial crisis. Thus, it is not only public policy and the consumer but also the successful corporate governance framework with humanistic principles which has made ICICI Bank a truly emergent bank in one of the largest emerging economies.

## **Notes**

1. 'India central bank supports ICICI Bank on its financial health', <http://www.nytimes.com/2008/09/30/business/worldbusiness/30iht-icici.1.16580531.html> (accessed Jan. 2010).
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# 10

## People's United Bank

*Anuj Gangahar*

### **Introduction**

Bridgeport, Connecticut, has few obvious claims to fame. It is the site of the first ever Subway restaurant, and there is some evidence for its being the birthplace of the Frisbee, but in the early winter of 2009 it is typical of many industrial towns in the United States during these times of economic pain.

A taxicab rank a few yards down the road from the main railway station is full of idle cabs – as potential passengers prefer the savings offered by public transport. A multi-storey car park housing the vehicles of fewer commuters than usual because of job losses that have spread from Wall Street stands across Bridgeport's main street. And unemployed, disaffected 20-somethings sit huddled around benches, blowing on their hands and shooting the breeze. But at the heart of this scene that, particularly on a cloudy day, can make for a depressing arrival in Bridgeport, sits arguably the biggest success story of the financial crisis.

Just across the road from the train station is the headquarters of People's United Bank, a 167-year-old institution that has been doling out lessons to many of its peers on how to successfully navigate a financial crisis. People's United is the largest regional banking organization headquartered in New England, with more than \$20 billion in assets and about 300 branches across Connecticut, Maine, Massachusetts, New Hampshire and Vermont and in Westchester County, New York. People's United provides consumer, commercial, insurance, retail investment and wealth management and trust services to personal and business customers.

The bank has been one of the clearest success stories of the financial crisis and is now one of the best-capitalized regional banking firms in

the country. It was and has remained insulated from many of the toxic products that cost many of its rivals so dearly, and its financial performance has been solid throughout the crisis, something that few of its peers can claim.

### **Secrets for success**

Samuel Hawley, who served as president and chief executive officer of People's United from 1956 to 1975, laid the foundations for the way in which the bank has managed to come through the most recent financial crisis so well. While in charge of the bank, he said: 'From inception, the purpose of the bank has been the encouragement of thrift, together with prudence in handling one's own personal finances – in order that the saver himself might benefit, and thereby the community in which he lives. The bank has continued to adhere to its philosophy that those things which improve prosperity and quality of life, will thereby benefit the [people] we serve.' These principles have been adhered to by his successors, and People's United's performance during the most recent financial crisis is an endorsement of those principles.

In its most recent quarterly financial statement, People's United posted net income of \$26.8 million, or \$0.08 per share, for the third quarter of 2009, up from \$25.3 million, or \$0.08 per share, for the second quarter of 2009, and down from the impressive \$46 million it posted in the third quarter of 2008 when many banks were feeling the pain of the financial crisis most keenly. Return on average tangible assets in the third quarter was 0.55 per cent and return on average tangible stockholders' equity was 3 per cent, compared to 0.53 per cent and 2.8 per cent respectively for the second quarter of 2009. At 30 September 2009, People's United Financial's tangible equity ratio stood at 18.6 per cent. For the second quarter of 2009, People's United posted net income of \$27.4 million, or \$0.08 per share, compared to \$26.7 million for the first quarter of 2009 and \$43.0 million, or \$0.13 per share, for the second quarter of 2008. Second-quarter 2009 earnings reflected margin pressure associated with the historically low interest-rate environment, the company's asset-sensitive balance sheet and security gains that served to offset an FDIC special assessment charge.

For the first quarter of 2009, People's United posted a 77 per cent jump in its first-quarter profit, but demonstrated that it was not completely immune from the recession as its results fell short of market estimates on margin pressure and a drop in net interest income. Apart from the higher margin pressure, the company's results were solid,

Anthony Polini, an analyst at Raymond James, told Reuters at the time. 'Their credit quality is probably in the top one percent in the nation. Their balance sheet is rock solid. They are just going to have these low levels of earnings until we get higher interest rates or they leverage their capital through acquisitions or putting on more assets,' Polini said.

Among the drivers of this performance over the most recent two quarters and over the course of the crisis more generally has been the continued loan growth across its lending business, demonstrating the fact that, unlike many of its peers, the bank did not suspend business, but continued to supply loans to families and individuals at a time of their greatest need in recent memory. The performance can also be attributed to a range of factors including the bank's high level of capitalization at the start of the crisis and liquidity that was among the healthiest in the business. Its credit quality was also superior to many institutions of similar size and character because the bank had never stretched the envelope in the bull years. Its roots as a conservative institution with community engagement as a key pillar remain intact.

In 1842, the bank's founding mission was to offer savings accounts to Bridgeport-area workers, and it was the first bank in western Connecticut to do so. Before this, only the wealthy had access to bank savings or loans. The founders launched the bank six years after the City of Bridgeport was chartered. They seemed to have understood at that juncture that in order to build a community, workers – not just large depositors – needed a safe place for their money.

People's United Bank, and its subsidiaries and divisions, provide financial support to non-profit organizations throughout New England, and People's United has a demonstrable heritage of volunteering. Its corporate literature states that the bank's heritage, its mission today and its plans for the 21st century are to continue what its founders set out to do – 'invest in the communities we serve.'

## **In charge of people's**

Philip Sherringham, the chief executive of People's United, is not a stereotypical US regional bank chief executive, having been educated in Paris, London and New York and having worked at a host of financial institutions.<sup>1</sup> As such, he brings a global executive's view to what could easily be seen as a primarily local job. Prior to joining People's United in 2003, Sherringham served as executive vice president and chief financial officer with United California Bank in Los Angeles. Previously, he was CFO at Citadel/Fidelity Federal Bank in Glendale, California, from

1991 to 1993, and before that he served as treasurer at Los Angeles-based CalFed Inc./California Federal Bank from 1989 to 1991. Sherringham has an undergraduate degree from Paris University and is a graduate of Hautes Etudes Commerciales in Paris. He completed the International Management Program offered in cooperation by New York University, the London Business School and Hautes Etudes Commerciales.

In terms of the success of his company, over the past two years of global economic crisis in particular, Sherringham points to a range of factors as key drivers. Not least among these are his own and management's perspective on life. 'A company fares well if management fares well. You have to ask how you look at the world philosophically and how we look at the business of banking. When I came here I tried to introduce specific common sense principles on how a regional bank should be run,' he says. He refers to the 'colossal failure of common sense' which is the primary cause of the current economic malaise. 'Bankers displayed a catastrophic lemming-like behavior.'

By this he means the sub-prime mortgage crisis had its roots in the tendency of bankers to try to blindly ape their peers, with no real regard for the long-term sense of the strategy. Bankers were offering loans to customers who could not afford to pay them back, and so other bankers did it too, causing the snowball effect which eventually led to a global recession.

### **A bank for the people by the people**

Part of what prevented People's United from plotting a course similar to that of its competitors, a course which has cost many of them so dearly, was Sherringham's own determination to think his own thoughts and go his own way. 'I have something of an independent nature. Where some see a herd, they immediately want to join it; I invariably see it as a red flag,' he says. This determination, he adds, starts with a realistic assessment of a company's strengths and weaknesses and a clear plan for what the company hopes to become. A keen focus on what defines the business of banking is vital.

'For us, the answer as to what defines banking definitely does not include managing a large securities portfolio. What possible value could we add managing equities or mortgage-backed securities? The answer is none, and so we got out of these soon after I arrived.' By doing this, the bank effectively ended running a securities portfolio while at the same time growing its loan portfolio. This may not seem like reinventing the wheel, but in 2003, when this took place, such action was certainly a

novel concept. 'People said we needed a securities portfolio for liquidity, but actually liquidity in many cases was false because it was based on borrowing. We had an unrelenting focus on what a bank should focus on.' Through its various subsidiaries, the bank offers brokerage, financial advisory services, investment management services and life insurance asset-based lending and insurance services.

## **Fruits of conversion**

People's was organized under the mutual holding company structure and went public in 1988 at a split-adjusted price of \$1.20 per share. In 2006, the bank changed to a federally chartered mutual holding company and a federal savings bank charter, providing significantly greater flexibility in opening new branches and expanding its businesses in all states. In April 2007, People's United Financial, the bank's parent company, completed the conversion from a mutual holding company structure to a fully publicly owned stock form holding company. As part of the conversion, the bank also established a \$60 million community foundation – the largest ever created – as the result of a second-step conversion. Following the completion of the conversion, the bank also officially changed its name to People's United Bank in June 2007.

The conversion to a wholly public company is at least in part responsible for the bank's seeming ability to navigate its way through the crisis so far with relative ease. Sherringham admits as much. 'I will say that sometimes the good guys get lucky, and in early '07 we went for a huge capital-raising. We benefited from that because when the hurricane winds started blowing, we had impregnable liquidity.'

However, he is quick to add that the fact the bank went public and bolstered its capital reserves with such fortuitous timing does not mean the bank's smooth course through the crisis can be attributed solely to luck. 'It was a deliberate plan on our part. How you survive anything like we have just been through (the crisis) is a function of how you are positioned at the start of the debacle. More capital is clearly better than less capital. We had and have 8–11 per cent tangible asset levels. So we could have been highly levered and borrowed heavily. But the fact is we weren't, and that stood us in good stead.'

## **Disbelief during crisis**

The equity market clearly believes that People's United has been doing something right. While the bank has not been brought to its knees by



the crisis like many of its peers, the significance of the past two years is not lost on the senior management at People's United. Sherringham recalls the disbelief he felt at several junctures during the crisis, as the news flowing out of some of the most famous and celebrated financial institutions became more and more shocking. And while he was surprised, he does not agree that there is any mystery about why so many could not survive the crisis.

'I do not subscribe to the oft-expressed view that many banks were caught in the perfect storm. This absolved them of responsibility. The fact is they were poorly equipped. The sub-prime crisis did not have to happen. If you offer homeownership to people who statistically have a demonstrable record of not paying you back, then something is wrong.'

### **Tough decisions taken early**

Tough decisions that affected the very essence of the bank's existence had to be taken at various steps in its history in order to prepare it to sail through this most recent crisis relatively unscathed. Perhaps the best example of this is that the bank had to effectively halt its mortgage lending business in 2006 when the real-estate market began to collapse. This was a decision that had a huge impact on long-serving members of staff and customers alike. But the decision had to be pushed through, because it was the best way for the bank to avoid the worst fallout of the crisis. And while the bank managed to completely steer clear of the sub-prime lending crisis in this way, it still had a thriving prime lending business. 'Spreads just dropped. And we stopped originating mortgages for our own portfolios. In hindsight it was a brilliant move because the real-estate market just started collapsing. It was tough because mortgage lending had been a key business for us for 150 years. The department, after some initial but futile resistance, restructured. We had to start the effort to find other buyers for those loans,' says Sherringham.

### **What defines success?**

This balance of the human cost of a tough decision against the business impact of not taking the decision is one of the key issues that chief executives who believe in the impact of humanism in business must confront every day. How far can you measure success solely by the share price of a public company? The post-crisis world is one in which

the benefits of concentrating on factors beyond pure performance for shareholders can be easier to justify.

One analyst said that because a vast array of previously seemingly impregnable businesses had been decimated by the crisis, strategic thought was turning to whether a return to pre-crisis ways is simply to ignore the lessons that should have been learned. 'I think you have to ask the question 'What is the benchmark for success?' And the fact is there is no one right answer to this. If you really believe in the impact of humanism in business, you have to be prepared to take some short-term pain and perhaps accept that you might have to put up with some poor quarterly earnings figures. But you have to make sure that the long-term success of a company – achieving its aims in areas such as its impact on the community and charitable giving – start to become as important as pure fiscal performance,' the analyst said.

This is something of a leap of faith, but as a recovery of sorts is underway, it seems that priorities in business, finance and beyond may be starting to shift subtly. Whether or not shareholders buy into this more 'touchy-feely' form of management remains to be seen. Such efforts may well turn out to be the idealism of those who believe, in the wake of the chastening effects of the crisis, that there must surely be a better way.

## **On the way to recovery**

Sherringham, speaking in November 2009, said the worst of the crisis was, in all likelihood, now a thing of the past but added that we are still some way short of complete recovery. 'Government intervention has halted the collapse of the system, but we are very far from a recovery worthy of its name. There are discouraged workers everywhere, and the consumer is obviously a major part of the US economy, and until they come back, the jury is out.' He also expressed some concern about the fact government intervention was needed in the first place, arguing that over time, government historically has proved to be less than the best allocator of capital in the world.

In spite of these misgivings about government intervention, Sherringham said that the crisis itself had not changed his outlook, only reinforced his determination to focus intensely on what he wants his bank to achieve – namely, shareholder value creation, profitability, employees who are rewarded both monetarily and in terms of professional and personal satisfaction, and a lasting and tangible impact on the wider community at a local level. As People's looks to the future,

the bank has been, and will continue to be, active in the M&A market as its puts the fact that it is now one of the best-capitalized banks in the United States to work for customers and shareholders alike.

### **Putting capital back to work**

In November 2009, the holding company for People's United announced a definitive agreement to acquire Financial Federal Corporation in a stock and cash transaction valued at approximately \$738 million. People's United expects the transaction to be significantly accretive to operating earnings in 2010 and to have an IRR greater than 20 per cent. Given Financial Federal's significant excess capital, the transaction is expected to have a slight positive impact on People's United's industry leading capital levels on a pro forma basis. The transaction is expected to close in the first quarter of 2010. Financial Federal is a leader in equipment financing and as such represents an interesting complement to People's existing business lines, particularly People's Capital and Leasing (PCLC), the bank's equipment-financing subsidiary. The transaction also generates meaningful earnings accretion without diluting the bank's capital ratios.

Sherringham noted: 'This transaction offers opportunities for People's United to grow our highly profitable equipment-financing business with established, experienced staff in new markets throughout the country. Our combined portfolio will rank us 13th among US bank-owned equipment-finance businesses, according to data from *Monitor*, an industry publication.' Paul Sinsheimer, chief executive officer of Financial Federal, said the deal substantially increased Financial Federal's growth potential by providing access to low-cost funding from People's United's deposits. 'The match in the credit cultures is another positive, as Financial Federal's underwriting philosophy echoes that of People's United, targeting secured lending (in which the lender is protected from losing money that they lend by some asset or other collateral), underwriting all transactions, focusing on the middle market, and tailoring products to customer needs.'

'We believe we are acquiring a very attractive franchise, especially given the ability to take market share in this dislocated market and with significant capital available for growth,' Sherringham added. 'In addition, we are excited about the opportunity to continue to participate more fully in a secular trend toward infrastructure upgrade in our country.' Such infrastructure benefits are typical of the way in which banks can turn their activities into socially important functions that

benefit the wider community – beyond their own staff and customers. The concept behind the Financial Federal and other potential acquisitions by People's United in the coming months is to grow without losing its focus on its core business.

Morgan Stanley analyst Ken Zerbe said in 2008 that the market was not crediting People's United for its \$2.5 billion of excess capital and a clean balance sheet, especially as many of its peers were experiencing significant credit problems. This excess capital is now being put to work through the Financial Federal deal, and further acquisitions are a possibility. In trying to maintain a focus on its core business of prudent lending, Sherringham points to the lessons to be learned from the experiences of Citigroup. 'They were a very impressive collection of businesses worldwide, but they essentially forgot their very low capital levels. They clearly lost track of it, and a sixth grader could have done the math that ensured they didn't get to that position.'

Commenting on his show *Mad Money* on CNBC on 24 November 2009, the ubiquitous Jim Cramer offered a glowing assessment of the deal and the bank: 'People's United will never be defeated. That rocks. That acquisition was brilliant. The yield is fine. This is the most conservative bank in America. It should be celebrated and not denigrated.'

## **Future prospects**

Sherringham said on the earnings call that accompanied the release of the bank's most recent financial results that the company believed its asset quality had held up remarkably well on both a relative and absolute basis through the recent recessionary cycle and that most of the bad news is substantially in the past. 'While we are well-positioned to benefit from future increases in interest rates given our asset-sensitivity, the current rate environment continues to pressure our net interest margin. Our strategic focus remains on expansion through opportunistic acquisitions even as we continue to pursue organic growth throughout our franchise. The strength of our capital and liquidity, asset quality and earnings, as well as the fact that our balance sheet remains funded almost entirely by deposits and stockholders' equity, continue to set us apart from most in the industry.'

## **Yardsticks beyond financials**

As well as financials that look encouraging for all who have a stake in the company, People's United appears to be succeeding using other

metrics too. In May this year, J. D. Power and Associates, the global marketing information services firm, ranked People's United Bank highest in customer satisfaction for the New England region in its influential annual Retail Banking Satisfaction Study. Sherringham said: 'We bring a concerted focus across the entire organization to consistently exceeding customer expectations. While our highest ranking from J. D. Power and Associates certainly is very gratifying, our greatest reward is clearly in being second-to-none in our customers' minds every day. It is for their support and loyalty that we are most grateful.' And while it managed to steer clear of the sub-prime mortgage debacle, People's United nonetheless has its roots in helping to provide local residents with affordable housing, and this is borne out by its current activities.

In addition to the bank's mortgage products, developed and sold through its residential lending department, it is also an active participant in state and federal programs that help low-and moderate-income households achieve the goal of homeownership. Mortgage calling officers are available to take mortgage loan applications from customers in suitable locations. A sales support team also provides training and seminars for banking personnel, real-estate agents and the public in the hope of fostering a more responsible system that will lead to safer homeownership.

From developing affordable mortgage programs to its own homebuyer counselling program – known as Unlocking the Possibilities of Home Ownership – People's United remains deeply involved in customer and community housing needs. A spokesman for the company said it carries out this commitment under its umbrella program, Building Foundations. This includes a community reinvestment loan pool, partnerships with Connecticut's central cities, hospitals and corporations, and the Connecticut Housing Finance Authority.

The bank also collaborates with non-profit organizations across the state, including non-profit loan funds, and groups such as the Mutual Housing of Southwestern Connecticut, Neighbourworks organizations across the state, Local Initiatives Support Corporation, and community development corporations. People's United also makes investments in organizations that have community development as their primary purpose.

The bank's development investment portfolio includes loan funds that finance small businesses and the development of affordable housing as well as low-income housing tax credit projects. And the bank also makes direct investments in the form of charitable contributions or grants to organizations that undertake community development or

affordable housing programs. According to the company's website, it 'continues to seek ways to meet the borrowing needs of business owners. Our community lending department enhances our commitment to improve local economics and support small businesses.' Some of this is borne out by the numbers. The total average commercial banking loan portfolio increased \$503 million in the most recent financial quarter, reflecting increases of \$465 million in average commercial real-estate loans and \$172 million in average equipment financing loans, partially offset by a \$134 million decrease in average commercial loans. At 30 September 2009, the shared national credits loan portfolio totalled \$614 million, compared to \$684 million at 31 December 2008.

People's United Financial is in the process of unwinding the shared national credits portfolio in an orderly manner over the next two to three years. Average residential mortgage loans decreased \$552 million compared to the year-ago quarter, reflecting People's United Financial's decision to sell essentially all of its newly originated residential mortgage loans. As a result, residential mortgage loan balances are expected to continue to decline until the company resumes adding such loans to its portfolio to an extent that more than offsets repayments. Average consumer loans increased \$193 million, including a \$190 million increase in average home equity loans.

In the third quarter of 2009, People's United Financial sold residential mortgage-backed securities with an amortized cost of \$308 million and subsequently reinvested the proceeds in residential mortgage-backed securities with substantially equivalent maturities and yields. This investment portfolio repositioning was undertaken to mitigate prepayment risk and generated \$4.8 million of security gains. Average funding liabilities totalled \$15.4 billion in the third quarter of 2009, an \$845 million increase compared to the year-ago quarter. Average deposits increased \$844 million, reflecting increases of \$85 million in average non-interest-bearing deposits, \$627 million in average savings and money market deposits, and \$132 million in average time deposits. Average deposits composed 98 per cent of average funding liabilities in both the third quarter of 2009 and the year-ago period.

People's continues to partner with government loan guarantee programs and make investments in non-profit organizations, such as the Community Economic Development Fund and the Grow Bridgeport Fund, to make it possible for small businesses to start up and expand. People's United offers the state's only revolving loan fund targeting purchase of 'assistive technology' for people who have physical handicaps. In looking beyond its share price performance and, like many of its

peers, becoming fully involved in its local community, People's United is becoming a force for good beyond simply providing good jobs for local people across the geographic areas in which it is active.

### **Partnering with the community**

A spokesman for People's United said that because the company believes that the communities it serves are among its greatest assets, it works with and invests in organizations that know the needs of these communities. 'Today, People's United's strong interest in community development is embodied in myriad partnerships and programs. Whether it's a health services development, a center for the arts, a downtown revitalization project or an affordable housing project, People's United leaders are there to provide the resources and support to rebuild, revitalize and renew neighborhoods.' Such renewal is being focused not only on the communities and problems of today but also on those who can carry on the legacy of humanistic and community-based management for future generations. People's United Bank recently received a leadership award from the Governor's Prevention Partnership, a non-profit serving Connecticut's youth.

The Bridgeport-based bank was recognized for a decade of individual and corporate leadership and support, particularly in the areas of mentoring and bullying prevention. The Governor's Prevention Partnership focuses on building a healthy future workforce through leadership in mentoring and prevention of violence, underage drinking and alcohol and drug abuse. So as Bridgeport tries to stage a lasting recovery, one of its most successful companies will be hard at work trying to put the experiences of the past, including lessons learned through a crisis successfully negotiated, to work for its employees, customers and wider community. This is the essence of how a bank can retain its focus on the business of banking while becoming a de facto force for good and renewal as the community and country rebuild.

### **Note**

1. Unless otherwise stated, all comments from Philip Sherringham are from an interview conducted by the author with Mr Sherringham on 24 November 2009. Financial results taken from quarterly company earnings releases and SEC filings.

# 11

## ShoreBank Corporation: Let's Change the World

*Fiona S. Wilson and James E. Post*

### **Introduction**

ShoreBank was a 'different bank' from inception. Over the course of 37 years, it became an example of how the market-based financial system can, under the right conditions, be deliberately and effectively used to create social change. Founded in 1973 by four idealistic business partners, ShoreBank became a model of responsible community investing and a symbol of the determination of a small band of progressive business leaders to change the world. ShoreBank has been an inspiration to several generations of socially conscious entrepreneurs, but the power of its vision never insulated the bank from the realities of the banking industry or the vagaries of the larger economy. Indeed, for most of ShoreBank's history, it struggled to be a progressive force for community investment amid the turbulence of a dynamic industry. ShoreBank's success was never guaranteed, but it succeeded for the majority of its 37 years through a combination of astute management, a compelling mission, and progressive business practices. The Great Recession of 2008–10, however, generated a tsunami of economic forces that swamped ShoreBank. Preserving the bank's mission, culture, and core values amid the greatest banking crisis since the Great Depression required both exceptional banking skills and a fierce determination by its stakeholders that ShoreBank survive as a force for community development in the new economy. In the summer of 2010, ShoreBank's struggle to survive in its original form came to an end. Its legacy, however, lives on, and it remains a story of vision and achievement.



## Founding: pioneering social capitalists

Ron Grzywinski had an unlikely start for a social entrepreneur. With early career years selling computers to banks for IBM, he eventually joined the Hyde Park Bank in Chicago as its president. During his tenure he created a successful and innovative urban development division, focused on a minority small-business loan program. He worked, and subsequently became friends with, three like-minded Chicago-based colleagues: Milton Davis, Jim Fletcher, and Mary Houghton.<sup>1</sup> Their backgrounds in community activism gave them an acute understanding of the radical, negative changes in economic prosperity happening in the inner city in the early 1970s. Urban decay was taking a terrible toll on neighborhoods and citizens, abetted by commercial practices such as redlining that served to keep credit out of many neighborhoods. According to Mary Houghton, the four friends realized that nonprofit organizations alone could simply not match the scale of the problem. Nonprofit economic development organizations were weakened because of their need to focus on day-to-day survival, with a heavy reliance on grants and other donations to implement their mission-related activities. At the same time, the 1970s in the United States were a decade of 'stagflation,' with high unemployment and inflation creating a hostile business environment in urban centers.

The four founders cared deeply about reversing the situation in the inner city, creating more economic prosperity for the mostly minority populations of those communities. As bankers by profession, they understood 'the credibility and the seriousness of a bank as an agent of change.' They started to envision a radical idea – a for-profit bank as a permanent local institution that could bring about social change.

Grzywinski reflects back to the beginning of their work in the late 1960s and says, 'We got here by saying to ourselves... that there is too much competition for [grant and philanthropic money for community development] and we're going to try to make it work with private sector money that we, to some extent, can control.' Inspired by this early idea, Grzywinski left Hyde Park Bank in 1969 to join the Adlai Stevenson Institute at the University of Chicago, where he could devote resources to developing the concept for a new kind of organization: a 'community development bank.' During the period when Grzywinski, Houghton, and others were working on their ideas, Congress passed the 1970 Amendments to the Bank Holding Company Act. The Federal Reserve, which regulates bank holding companies, issued a list of six permissible activities, which were 'all closely related to the business of

banking.’ As Grzywinski explains, the last of the six related to the fact that bank holding companies could invest in community development corporations if the primary purpose was community development for low- and moderate-income people.

As Mary Houghton explains, ‘that led us to expand our idea, from using a bank to using a bank *holding* company.’ The idea of a holding company could encompass both banking activities and other for-profit or nonprofit activities to complement the bank’s activities to bring about positive economic development in the community. The bank holding company concept was intended to be comprehensive in its approach to community renewal in inner-city minority neighborhoods. Grzywinski explains that the central idea was to create a for-profit vehicle that could be financially self-sustaining (as opposed to the many nonprofits they witnessed as being dependent for their survival on government and foundation grants) and create an organizational form that would serve as a home for related nonprofits.

The group ended up asking themselves a rhetorical question: if the Federal Reserve Board was willing to let bank holding companies *invest in* community-development corporations, might they actually allow a bank holding company to *be* a community-development corporation? As Grzywinski says, this was ‘our breakthrough thought...our intention was to test the idea and become operational.’ A year or so later, the Federal Reserve interpreted its own regulation to allow the team to forge ahead with what were, at the time, radical and innovative ideas about how community development could occur.

The team found a corporate vehicle in the South Shore National Bank, which was failing as economic conditions in its service area deteriorated. In 1972 the team started to raise funds to buy the bank. The group ultimately bought the bank with a \$2.25 million loan and \$800,000 of equity capital from a small group of private investors, two church bodies, and several foundations. The new bank officially began operating in August 1973 when the development corporation formed by Ron Grzywinski purchased the South Shore National Bank. Shortly after, Milton Davis and Mary Houghton joined the South Shore National Bank staff. Later, the bank was renamed ShoreBank, and the holding company was renamed ShoreBank Corporation.

In what the company’s website refers to as ‘those days of officially sanctioned discrimination on the basis of race and income,’ the vision for ShoreBank Corporation was to ‘demonstrate that a regulated [for-profit] bank could be instrumental in revitalizing the communities being avoided by other financial institutions.’ From the outset, the goal

was not just to aid community development in one small area, but to create a replicable model. The goal was to become a catalytic actor in the local community. As Houghton says, the group was ‘trying to proselytize for the model of a bank holding company that could do this kind of work at greater scale than a not-for-profit could.’ The intention, in Grzywinski’s terms, was to use ‘use all of the bank’s resources to bring about redevelopment’ in an ‘almost totally minority neighborhood [with] all of the symptoms of deterioration.’

The mission of community development was at the core of ShoreBank’s activities for 37 years. According to its 2007 annual report, ShoreBank Corporation measured ‘its success by the amount it invests to create economic prosperity and a healthy environment, as well as by its financial performance.’ The company was clear that, unlike most banks, its activities focused ‘on markets, communities, and individuals that have historically been economically underinvested.’ Central to this vision and mission was a basic belief in the right of individuals to prosper economically, and the role of individual economic prosperity in ultimate social change in terms of community development.

### **Model and approach 1973–2008: far from banking as usual**

Being a part of the mainstream banking system – operating a federally regulated bank with insured depositories – was central to the model, giving ShoreBank what Mary Houghton describes as ‘great credibility in a marketplace, and customers [who] believe that they’re going to be treated fairly when they walk in the door.’ At the same time, ShoreBank was markedly different from most traditional banks both in *what* it did and *how* it did it.

ShoreBank operated a basic model that converted market-rate deposits into development credits, to grow a business or refurbish or construct a building for housing, retail, or community organizations. But as Grzywinski noted in a 2008 interview, ‘what’s different in our case is that the focus is always on [making credits available to] those segments of the society that are not participating equally.’ In other words, the central focus of ShoreBank was to use the bank’s resources and funnel them, in a single-minded way, into loans for projects in low-income neighborhoods, which have traditionally been ignored by the mainstream banks.

Grzywinski explains the multiplier effect that comes from using a for-profit bank explicitly for community economic development in these terms: ‘One of the important things about a commercial bank is the

volume of lending that we're able to do.' One of the key differences between a commercial bank and a nonprofit focused on economic development is a bank's ability to leverage capital through deposits and interbank and other loans. This allowed ShoreBank to significantly amplify the impact of its shareholder equity. As Grzywinski explains, ShoreBank Corporation could make mission-related investments in any given year, which equated to approximately four times its capital, its annual ratio goal.

The concept of local focus was also a fundamental underpinning of the model and the corporation's theory of how change would occur. Over time, ShoreBank initiated banking operations in Arkansas, Cleveland, Detroit, and the Pacific Northwest. But in the early years, the bank focused narrowly on very specific neighborhoods in Chicago. As Houghton states, 'The first neighborhood of South Shore was the *only* named neighborhood as a priority for the first ten years.' She also notes, 'Our goal was to actually reverse the deterioration in the housing market and be a catalyst for appreciation in that market. If we hadn't [concentrated our efforts] but had just sort of dispersed our lending in a larger catchment area, we wouldn't have really changed the nature of a market... that principle has helped us to actually have a real impact over the years.'

The holding company, ShoreBank Corporation, accomplished its mission through a number of affiliated for-profit and nonprofit organizations that either supported local entrepreneurs with higher-risk debt and technical assistance services or advised banks or invested in similar banking institutions elsewhere. The idea of having affiliated nonprofits as part of the overall holding company, but separate from the for-profit bank, was central to the model. As Houghton explains, 'The vision is that both the bank and the not-for-profit are working in the same market: they work with different customers, they work with the same customers, sometimes they work together. But in general we have a variety of products or tools that are of use to entrepreneurs in our market.'

In more recent years, ShoreBank extended its model through its assistance to other 'mission-driven' organizations in other parts of the country and the world. The purpose of these extended activities was to be a catalyst for change and demonstrate a new model of how to provide banking services to the poor.

### **Action, not words: realizing the dream**

ShoreBank presented an example of a bank whose actions speak louder than words in terms of *how* it did what it did. Through deliberate and

intentional decisions, the bank's leaders reinforced their core social mission throughout their operations large and small.

For example, ShoreBank's core mission of community development strongly influenced its core lending operations. As Houghton explains, the message sent to loan officers was 'they should with every loan application ask if the loan is good for the long-term health of the community, and not just ask is it a profitable asset to the bank. And if the answer was that it was good for the long-term health of the community, then they were asked by us to go to extra lengths to find a way to structure the deal so that it was bankable, and that's a very different attitude towards how you screen credit [in a traditional bank.]' She was clear that this did not equate to ShoreBank being a 'lender of last of resort' because it still focused on finding the most successful entrepreneurs or investors in a community. But, she says, 'It does mean that you're urging them to go to the trouble of getting a credit enhancement from either the SBA or the state, or explore mildly unconventional forms of collateral, whatever it takes.' Houghton also explains that 'we were encouraging people to make loans which were small if they were good for the community, and we were not doing what other banks were doing which was essentially looking for the largest transactions for the most affluent customers.'

From inception up until 2010 ShoreBank stock was closely held by approximately 70 shareholders, made up of religious organizations, nonprofits, and community organizations, as well as insurance companies, banks and other corporations, and individuals. In 2008, Grzywinski explained how this deliberate choice in terms of capital and ownership structure meant that 'all the investors in ShoreBank to date have invested with the understanding that the primary purpose of their investment is to do development, and not maximize return on capital.'

Houghton explained there was a clear realization that some types of strategic decisions created a trade-off between mission and financial returns, but it was not a conflict: 'Our board has always been highly mission focused... there are not people on the board who pound on the table and say you can't do that because you're sacrificing a financial return. The board always wants to make the choice which is the mission choice. And the same thing is true in the management groups, nobody really argues for the conservative choice. There's just a supreme realization that one is making a tradeoff.' At the same time, Houghton says that the organization was clear that it had to survive in order to implement a mission, and so it was 'never making a tradeoff that has to do with really subnormal financial performance.' She characterizes the situation as one where there was an 'understanding at many points along the way that

we are preferring a moderate return to a maximum return because... the purpose of the place is to produce mission results.'

From its earliest vision, ShoreBank focused on providing innovative products which could address social issues in new and more effective ways. The website stated that innovation was one of the core values and '[W]e do not accept the world as it is – we recognize value where others may not. We create practical new tools that increase economic equity and produce a healthier environment.' Over the course of its first 35 years, some of ShoreBank's product and business expansion came from invitations from those who admired its work. These are essentially opportunities that ShoreBank evaluated for 'fit with mission' and responded to. Houghton explains situations in which the bank's leaders were invited to start banks in other regions of the country and how the decision to respond to the opportunity was in part based on their 'primary motivation... to make sure that this was seen as a replicable model.' One of the earliest ventures outside of Chicago was the establishment of a community-development bank in Arkansas at the invitation of the Winthrop Rockefeller Foundation and Governor Clinton because it was a chance to 'use the same business model but in a rural impoverished area.' Over the years, ShoreBank was also invited to become involved in international markets; rather than do so directly, it established a consulting company to advise local social entrepreneurs.

ShoreBank's nonprofit Center for Financial Services Innovation (CSFI) grew out of the entrepreneurial spirit of an employee who became interested in access to consumer banking services for the 'underbanked' and who 'saw an opportunity to push this agenda with the large banks of this country.' Again, Houghton describes the creation of CSFI as 'seizing an opportunity.' Although reactive, rather than proactive, Houghton was clear that the decision involved a clear understanding of several things. First, it provided a 'different form of advocating for the mission of ShoreBank in the larger financial sector... acting as a kind of a broker of knowledge amongst product managers in very large banks and technology companies in this country.' Second, she explains that 'the business benefit that it gives us [is] a fabulous window on innovation,' which she saw as beneficial because that kind of innovation is hard in the context of a small bank alone.

## **The first 35 years: a model in creating social impact**

The bank had to overcome many challenges, and success did not come quickly. According to the founders, figuring out how to run a break-even

or profitable operation took much of the first decade. Houghton explains that this was because of their desire to lower deposit minimums in order to make the bank available to all in the community regardless of socio-economic level. Because many accounts had low balances, it took time to figure out how these could be serviced profitably. As of the close of 2007, ShoreBank Corporation held \$2.4 billion in assets and achieved \$4.2 million in net income. At the end of 2008 Grzywinski described the bank as 'modestly profitable' and says, 'Over the last decade the consolidated performance has hovered around an 8 percent return on equity. For the decade ending in December 2008, net loan losses averaged 0.39 percent, just slightly higher than its national peer group of regulated commercial banks'.

Houghton explains that there are several factors that make it more difficult to earn a competitive return on capital when operating in an inner-city environment. In addition to the lower average deposit amounts, the retail banks have added expense with armed security guards. Their loan business also tends to have smaller average transaction sizes, and although the amount of work is the same, fees that are collected as a percentage of doing the loan are less than from loans made in upper-income markets. She concludes, 'All those things add together to lower the profit potential for doing business in a community like this.... Across the board in dealing with low-income populations, the income is lower and the expenses are higher in relationship to that income.'

At the same time, ShoreBank was proud of its overall impact in its first 35 years. ShoreBank Corporation was the country's first community-development bank holding company in 1973, and by the end of 2007 it was the nation's leading entity of its kind; its for-profit Chicago-based bank subsidiary was the largest certified Community Development Financial Institution (CDFI) in the United States.

True to its mission of community development, the company judged its success by the amount of mission-related investments it made; by the end of 2007, the company reported \$3.3 billion in cumulative mission investments since inception and financing of 52,000 affordable housing units. In the period 2004–7 the company reported that 70 percent of all loans and investments made by ShoreBank entities qualified under at least one type of 'mission-related' credit.

In discussing the achievements of which she was most proud at the end of 2008, Houghton pointed to the significant rehabilitation of properties the bank financed on the south side of Chicago. 'We have affected the real-estate markets significantly throughout the African American

community.' ShoreBank International also provided consulting services in over 60 countries to help replicate the model abroad. Houghton estimates that ShoreBank trained close to 4000 bankers around the world and adds that ShoreBank kept track of the outputs of the banks its people helped train. 'If the domestic operation is chugging out \$400 million a year in development loans, the international indirect business is chugging out a billion dollars a year,' Houghton says, referring to the significant amount of international community-development lending ShoreBank helped catalyze.

Houghton also talked about the replication of the model ShoreBank created. 'We really have pushed this model as a resilient, scaled way to get investment into urban and rural communities in this country and in other communities.' Indeed ShoreBank is widely credited with being the catalyst for significant legislative changes, and it is cited as the model for community-based economic development on which President Clinton based his Community Development Banking and Finance Institutions Act<sup>2</sup>, spawning a thriving industry of similar community-development banks and finance institutions.

Speaking in late 2008, Grzywinski perhaps best summarized the achievements of ShoreBank Corporation in its first 35 years: 'We have legitimized the use of a for-profit, privately owned regulated bank to convert insured bank deposits into development credit for the benefit of low- and moderate-income people especially minorities. So we have made it legitimate for ourselves and for others to use the nation's banking system to advance the cause of development...more broadly we have contributed to the work that others have done also to generally democratize the availability of private non-government credit to low-income and otherwise disadvantaged people. And we have done that in many parts of the world.'

## **ShoreBank in the great recession: 2008–10**

For all of its success, what happened to ShoreBank in 2008–10 underscores the fragility that any vision faces amid a tidal wave of economic events. In this section, we discuss how the Great Recession of 2008–10 affected ShoreBank and disrupted the community-development strategy the bank pursued for 35 years.

Even before the full scale of the collapse of the financial markets became apparent, ShoreBank felt the effects of excesses in the sub-prime mortgage market. Unlike the early days, when few financial institutions were interested in low-income communities, the financial markets



in the years leading up to 2008 were quite different. The sub-prime lenders brought new competition to ShoreBank, but this competition was entering its markets in ways that were making it hard for ShoreBank to compete. The now-familiar tale of predatory lending practices – weak or non-existent credit requirements, aggressive solicitation, and exaggerated marketing – reached ShoreBank’s major markets in Chicago, Detroit, and Cleveland. The bank had to respond to intense competitive pressure. At the same time, because of its continued desire to keep pushing the boundaries of its social mission, ShoreBank had launched a ‘Rescue Loan Program’ in 2007. This program refinanced mortgages at risk of default as a response to the wave of foreclosures in the Chicago neighborhoods and across the country that came as a result of the sub-prime crisis.

Meanwhile, the bank’s modest levels of financial returns were having an impact on its ability to attract growth capital. ShoreBank attempted to raise \$52 million in additional private equity in 2008 in order to support growth, but closed only approximately \$30 million. Houghton says it ‘proved to us that even if there hadn’t been a financial crisis it would have been hard to raise capital. There’s too small a pool of capital at the current level of return and the [mission- focused] strategy that we’re at.’

The bank continued lending to its customer base through the end of 2008, after many banks had pulled back in an effort to save capital. But by the close of 2008, ShoreBank Corporation reported a \$13 million net loss, compared to a \$4 million net income in 2007. This loss was primarily the result of a \$42 million provision for loan losses (compared to \$6.3 million in 2007) as the bank anticipated high levels of defaults on outstanding loans.<sup>3</sup> As the recession entered its second year, the regulatory environment also continued to evolve. The collapse of Lehman Brothers in September 2008 had been a stunning development, and virtually the entire financial services industry was reeling from the Treasury Department’s decision to rescue financial giant AIG with more than \$150 billion of capital. Coupled with the financial collapse of Fannie Mae and Freddie Mac, the housing market was in shambles and the home mortgage business was virtually halted. The debate leading up to the eventual passage of a \$750 billion bailout bill by Congress was dramatic and revealing – housing and financial services were both in desperate need of emergency assistance that could only partially be met by the Troubled Assets Relief Program (TARP).

The fallout from the financial crisis swept across the economy in 2009, creating the vicious circle of bad news: housing slowed,

construction ended, and unemployment skyrocketed to more than 750,000 new unemployed per month. Community banking suffered as local economies absorbed the impact of the crisis. Commercial and retail customers alike could not meet loan and mortgage payments, leading to defaults and forcing banks to foreclose or negotiate reduced payments (that affected the banks' cash flows).

By mid-2009, as the recession deepened, it became clear that ShoreBank's position was becoming unstable. As the bank's management responded to the economic crisis, they were notified that the federal regulatory bodies were raising questions about the loan portfolio. In July 2009 ShoreBank agreed to the issuance of a consent order with the FDIC and the Illinois Department of Financial and Professional Regulation because of concerns, including those about inadequate levels of capital protection for the kind and quality of assets held, inadequate earnings, and inadequate liquidity. Included in this 'cease and desist' order on the bank were requirements that ShoreBank increase the amount of its capital holdings, improve the quality of its assets, and develop a plan to improve earnings and liquidity – or face permanent closure.<sup>4</sup> In January 2010, ShoreBank Corporation also agreed to the issuance of a written agreement with the Federal Reserve Bank of Chicago, which included the need for prior approval before the declaration or payment of future dividends.<sup>5</sup>

One area of regulatory concern had been the depth and sophistication of the management team. The FDIC required banks to add seasoned loan officers and credit executives to their staffs in order to deal with the growing number of the foreclosures and problem loans, and ShoreBank hired a number of experienced executives to help address these issues. At ShoreBank, the personnel issues were more complicated, as both Grzywinski and Houghton had planned to retire in 2010. In May 2010 ShoreBank announced a new executive team, which they believed would address the challenges of the current banking environment and guide ShoreBank to fulfill its mission to underserved communities. The formation of the new executive team was consistent with the planned transition following the retirement of ShoreBank's remaining founders, Grzywinski and Houghton.<sup>6</sup>

At a time when many others their age were already retired, Houghton and Grzywinski were still hard at work. Even though they had actively been planning their retirement, the duo did not hesitate to do what they had spent 35 years doing: jump in to fight to maintain a market-based financial institution focused on community economic development. Grzywinski tells the story of raising new infusions of needed capital

for ShoreBank during 2009 and 2010 in metaphorical, almost biblical terms. As finding water is the eternal challenge in the desert, raising capital is the continuous challenge in modern-day banking. Rarely was it more challenging to raise capital than in 2009–10, when events seemed to be aligned against ShoreBank. ShoreBank's management had been in communication with its investors throughout the recession. Many remained supportive despite the worsening economic news. Over the years, the bank had been the beneficiary of 'patient capital' from a number of socially committed institutions that deeply valued its mission and accomplishments; these were not 'fair weather' friends, but the bank also needed new friends, with deep pockets, if it was to survive.

ShoreBank's senior management and board of directors engaged in the proverbial 'full court press' to meet regulators' concerns and capitalize the bank. The quest for capital led to potential investors both near and far. The bank retained the services of several consultants and advisors who added regulatory expertise to the management team. The media reported that ShoreBank engaged Promontory Financial, led by Eugene Ludwig, a former US Comptroller of the Currency. Ludwig was a former ShoreBank director and also a highly respected player in private equity.<sup>7</sup> The media also reported ShoreBank's engagement of David Vitale, a respected Chicago banker, to help lead its fundraising efforts. A ShoreBank spokesman was noted as stating, 'ShoreBank is moving forward in its efforts to raise capital... Assisted by well-respected Chicago banker and civic leader David Vitale and other experienced advisers, we are meeting with potential investors to achieve this objective as expeditiously as possible.'<sup>8</sup>

By the end of the first quarter of 2010, ShoreBank was still losing money, but its performance was better than it had forecast in late 2009. ShoreBank, the lead bank within ShoreBank Corporation, ended the quarter with improved liquidity. Total deposits had increased from 2009 levels, and the provision for loan losses for the quarter ended March 31, 2010 was heading in the right direction (\$15.0 million, compared to the \$71.1 million provision for the previous quarter, ended December 2009.<sup>9</sup>

The media reported on ShoreBank's talks with some of the largest banks in United States. As was noted regarding a significant infusion of capital, 'The potential rescue of ShoreBank by giant institutions that normally wouldn't concern themselves with a struggling community lender underscores the bank's wide renown for lending in neighborhoods other banks often shun, a reputation that gives it influence with national political leaders.'<sup>10</sup> By mid-May 2010, the media was reporting

that ShoreBank had been successful in raising as much as \$140 million in capital infusion, stating that the significant support was because ShoreBank was seen as 'a historically and symbolically important institution in the world of community development lending.'<sup>11</sup> The picture was looking brighter for ShoreBank.

At the same time, the media was also reporting that ShoreBank and its potential investors were waiting to find out if the bank would win an additional \$75 million from the US Treasury Department's Troubled Asset Relief (TARP) program, an amount (together with the private capital) suggested necessary to restore the bank to sound levels.<sup>12</sup> Unfortunately, by August 2010 it became clear that the possibility of TARP funds was, in fact, non-existent, effectively signaling the end of the long struggle to save the bank in its current form.

After a long quest to save a visionary institution, it was announced on August 20, 2010 that ShoreBank had been closed by the Illinois Department of Financial and Professional Regulation, which appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. It was also announced that the FDIC had entered into a 'purchase and assumption agreement' with the Urban Partnership Bank, a newly chartered institution, which assumed all of the deposits of ShoreBank.<sup>13</sup> According to a press release, the new bank was capitalized by a group of financial institutions, philanthropic organizations, and socially responsible individuals from Chicago and nationally, and the Urban Partnership Bank 'enters the market as "well-capitalized" with a Tier 1 leverage ratio of at least 8%, and has sufficient capital to meet pre-opening expenses, projected growth and overall capital needs.'<sup>14</sup> Operations of the bank in the Chicago area, Detroit, and Cleveland continued without interruption; depositors were fully protected, and customer relationships were expected to continue.

According to bank spokespersons, 'Urban Partnership Bank will provide access to financial services and support to distressed neighborhoods in order to help transform distressed neighborhoods into strong, stable communities.'<sup>15</sup> In this sense it is clear that the commitment to the original social mission of ShoreBank in terms of community economic development will seemingly endure in the new Urban Partnership Bank.

Mary Cahillane, chair of ShoreBank Corporation, was quoted as saying, 'This is an important positive outcome for these communities.'<sup>16</sup> She also stated, 'While our preference would have been to recapitalize and continue ShoreBank's Midwest bank, we are delighted that the communities that the bank served so well for so many years will have

access to a dedicated, high-quality, full-service community bank, led by a highly qualified management team.<sup>17</sup> Cahillane also said, 'We applaud Urban Partnership Bank's decision to apply to become a certified Community Development Financial Institution.'<sup>18</sup> George Surgeon, CEO of ShoreBank Corporation, was also quoted: 'ShoreBank's legacy lives on in the work of ShoreBank's subsidiaries and affiliated entities and in the broader community development finance field.'<sup>19</sup> He might have noted that the end of Shorebank's existence occurred almost 37 years to the day (August 20, 2010) that Shorebank commenced operations (August 23, 1973).

The core mission and strategy of the Midwest Bank of ShoreBank Corporation will likely remain under the new ownership structure, but the change in control will also bring demands for some changes in how the new bank operates. Only time will tell what these changes may be.

Separately, the signing of a stock purchase agreement for the acquisition of ShoreBank Corporation's Pacific Northwest subsidiary, ShoreBank Pacific, by OneCalifornia Bank was also announced.<sup>20</sup> OneCalifornia Bank shares a similar social mission to ShoreBank in that it 'strives to improve economic opportunity for low-income people by helping businesses create jobs and enhance their financial strength' and complements its banking activities with technical assistance and financial literacy programs supported by its nonprofit, OneCalifornia Foundation.<sup>21</sup> Again, it seems as if the original social mission will be supported and nurtured under this new ownership.

In terms of the broader holding company (ShoreBank Corporation), it seems likely that operations will wind down once the sale of ShoreBank Pacific is finalized. Although it seems that the other non-bank for profit and nonprofit affiliates can probably sustain themselves as independent entities, one of the uncertainties is the fate of these other entities that were part of the overall ShoreBank Corporation. It is not yet known if the independent entities will coalesce again in some new way.

## **Conclusion**

A number of critical lessons stand out from ShoreBank's experience. First, the bank's track record over its first 35 years convincingly showed that it is possible to meld a social vision with an economic concept and effectively tackle community-development problems. To be sure, the

bank encountered difficult challenges in Chicago, Cleveland, Detroit, and other markets, most especially in the great economic recession of 2008–10, but it also demonstrated that progress could be made.

Second, ShoreBank created models of banking services that remain relevant to the 21st-century challenges of community economic development, environmental sustainability, microfinance, and international commerce. Being a catalyst for change was at the heart of ShoreBank's mission for 37 years, and it was this core intention that drove its leaders to carefully design a model – from inception – that harnessed the power and credibility of the mainstream financial marketplace, but explicitly directed it for social change. In doing so, it created the conditions for the benefits – both economic and social – of the market-based system to be distributed equitably, and especially to those groups and communities that the mainstream market has often ignored.

Third, the social value of a progressive, humanistic approach to banking has not been lost in the Great Recession. In many ways, the singular focus on economic development for some of the country's most disadvantaged neighborhoods exacerbated the effects of the financial meltdown for ShoreBank. At the same time, the bank's core mission and track record of social impact appears to be precisely what led many mainstream financial institutions and investors to preserve the core social mission and approach of ShoreBank in the newly formed Urban Partnership Bank. Although ShoreBank will not continue, one result of the loss is that some of the country's largest financial and charitable institutions have invested large amounts of 'at risk' capital in the name of community economic development. The preservation of ShoreBank's original mission and operations under the Urban Partnership Bank by these institutions perhaps represents the largest commitment to mission-driven banking for low-income communities. It may set an important precedent for support of other types of community-development banking in the future.

The value of the ShoreBank business model, its knowledge about how to serve disadvantaged communities, and its reputation for progressive policy and practice are a form of social capital that will hopefully endure in the form of the new Urban Partnership Bank. The recession and a vicious political climate took their toll on ShoreBank and sealed its fate. But it seems that the commitment to 'change the world' lives on. Perhaps an editorial in the *Chicago Tribune* said it best when it said that ShoreBank was worth saving 'partly because if it didn't exist, it would need to be invented'.<sup>22</sup>

The final word on the contribution that ShoreBank made to social thought may have been offered by Ron Grzywinski when, in 2008, he offered this comment:

We really believe that the more some of these ideas are spread around that – in a variety of ways... the more others will begin to pick them up. And I think... [there is] a general sense that we have, ... that *the idea of a broader social usage of capital... [is] not an idea whose time has arrived, [but] it is certainly an idea which we think is on the right side of history.* (emphasis added)

## Acknowledgements

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# 12

## Triodos Bank – Mission-Driven Success Pays Off: From Dutch Infant Terrible to European Business Leader

*Frank Jan de Graaf*

### **Introduction**

The story of Triodos Bank over the last 20 years reads as a success story. It is also a story about how principles are guiding business. However, principles need a pragmatic approach in order to be successful. Over the past 30 years the bank's management has succeeded in balancing a clear focus to create value for society with the objectives of a financially sound company. This case will describe this development, focusing on a period of rapid growth from 1990 to 2009, in which the organization grew from a small entity to a serious bank.

This case<sup>1</sup> is structured as follows. I will start with describing how Triodos responded to the financial crisis. Then I will try to track down the reasons for Triodos's success. Hereby I will first focus on the bank's principles that have a strong humanistic, anthroposophical nature. These principles are embedded in the organization's structure and have implications for policies. The conclusion suggests that Triodos Bank can serve as an example for banks interested in a successful relationship between principles, governance and values.

### **Mission-driven success: how a crisis led to even more prosperity**

#### **2009 as international breakthrough**

'My money is doing well' was the slogan Triodos Bank came up with when the financial crisis occurred in 2007. The advertisement slogan was a response to the economic slowdown, but it emphasized that Triodos's clients knew where their money was invested.

Since the establishment of Triodos Bank in 1980, the company had tried to position itself as a humanistic alternative to other banks, wanting to demonstrate that saving, investing and lending could be combined with social and environmental progress. In 2009 the bank's chairman, Peter Blom, even stated that the social and environmental perspective was necessary to create sustainable banking for the long term. Triodos explained its approach to banking in a special book, called 'Het Nieuwe Bankieren, De Duurzame Oplossingen van bankier Peter Blom' (New Banking, Sustainable Solutions from banker Peter Blom).

In the book, written by a journalist, Peter Blom explains his perspective on the causes of the financial crisis and why the Triodos way might be conceived as a potential solution for international banking. Within this perspective, profit is mainly a means to the goal of sustainable development. Profit is necessary to meet the needs of one group of stakeholders – the shareholders and other investors – but the goal should be healthy sustainable development for everyone. Only when society, entrepreneurs and clients flourish can a bank also flourish.

The financial crisis made it possible for Triodos to become part of international mainstream banking. For example, in 2009 the *Financial Times* chose Triodos Bank as the most sustainable bank in the world. The bank was seen as a leader in reforming the sector. In the same year Triodos Bank, together with peers, founded the global Alliance for Banking on Values. This alliance would focus on promoting the principles behind sustainable banking in mainstream finance and aims to stimulate more research on putting these principles into practice. In general, the founders already agreed that (1) banks had to start working to fulfil specific needs of society (social impact investing), (2) a stakeholder approach was needed and (3) product development together with the client would be key principles.

### **The financial crisis and 30 years of prosperity**

It had taken Triodos 30 years to become a bank that was seen as a business leader by its mainstream competitors. Starting in 1980 as a small group of people with an idealistic plan, Triodos Bank had developed in the 1990s as an enfant terrible in Dutch banking. It was the first bank in various niche markets such as wind energy, bio-organic farming and sustainable investing. Becoming more and more self aware, it dared to promote itself with some irony. For example, since 2000 it has used in its publicity various social incidents. When ABN AMRO, the most prominent Dutch bank, was taken over by foreign banks, Triodos advertised with the slogan 'we are not for sale', illustrated by photos

in which the employees were standing in front of the bank carrying signboards with this slogan.

Besides linking to a growing awareness in society of sustainability issues such as climate change and organic farming, corporate communication needed to give more attention to the bank's healthy financial structure. Triodos Bank's solvability was solid because the bank had followed a conservative policy<sup>2</sup> and invested only in companies it really knew. One of Triodos's critical principles is that there needs to be a relationship between the money saver and the moneylender. They both need to have comparable principles, and the saver has to know where his or her money will be invested. Clear transparency in principles and products became even more critical.

Triodos's website stated in 2008, 'Triodos Bank has never invested in structured products, or complex financial constructions based on derivatives. Triodos Bank has always considered those products too abstract and too far removed from the real economy and the Triodos Bank's mission'. High growth objectives were kept during the financial crisis, contrary to many conventional banks that shrunk and had to be supported by governments. The bank expected to continue to growth of about 20 per cent a year. In September 2009 a new share offering was announced to finance these growth targets.

### **Growth is not a straight line**

Triodos Bank was founded in 1980. A group of businessmen and bankers concluded that there was a need for a bank that had a positive attitude to investments that were driven by social objectives. In their opinion, mainstream banks did not always recognize opportunities at the intersection of social objectives and a business case. Most men in this group of founders were related to the anthroposophical movement.<sup>3</sup>

In 1980 the group was able to acquire a banking license of the Dutch Central Bank (De Nederlandsche Bank). Between 1980 and 1990 slowly a small niche bank came into existence, focusing on savings and credit. It was a small group of idealistic people working in a network of people and companies with comparable ideas.

Triodos Bank's real growth began after 1990. In that year the organization had 19 employees and assets of just over 41 million euros. After 1990 the bank placed a strong focus on 'professionalism'. This implicated that more people with a background in banking were hired and that Triodos Bank focused on a bigger target group. Every individual and initiative that really went for positive social change would be relevant for Triodos. In 2003 the numbers had risen to 224 employees

Table 12.1 Key financial figures

<i>Amounts in millions of euros</i>	2008	2007	2006	2005	1990
Liability capital	204	200	124	120	–
Funds entrusted	2077	1617	1356	1072	350
Loans	1270	1019	854	665	290
Balance sheet total	2363	1885	1539	1222	410
Total income	73.7	59.2	45.9	36.6	12

and total assets of 962 million euros. Besides the Dutch office in Zeist, branches were opened in Brussels (Belgium, 1993), Bristol (United Kingdom, 1995) and Madrid (Spain, 2004). After 2004 the company grew even faster, and the current financial crisis even seems to have strengthened this development (see Table 12.1).

### The basis of Triodos's success: relating principles to structures and policies

Within this section I try to detect the basis of Triodos's success. I will develop the thesis that Triodos was able to flourish because it was principle-driven and successfully related these principles to policies. Also, the principles were safeguarded by a strict corporate governance policy that limited the formal influence of shareholders.

#### Clear business principles

The founders of Triodos Bank were very much aware that the bank's unique objectives should be protected. Therefore, until 1999, the Anthroposophical Movement and the Christian Community had a role in appointing members of management. *'leden van de directie werken vanuit de door Rudolf Steiner geïnitieerde geesteswetenschap, de anthroposofie'* The members of the executive board 'had to be inspired by the Rudolf Steiner spiritual science, the Anthroposophy'.<sup>4</sup> Additionally, in the statutes of the Foundation for the Administration of Triodos Bank Shares, anthroposophy had a role to play:

The appointment of board members is made by co-optation<sup>5</sup> and has to be approved by the board of the Association of Dutch Anthroposophical movement and the leadership of the Christian Community in the Netherlands.<sup>6</sup>

Due to the large growth of Triodos Bank and changes in its involvement with these organizations, the bank's formal relationship with these institutions changed in 1999. Now the preamble of Triodos Bank's statutes includes the following mention of anthroposophy:

The anthroposophical movement and the movement of religious renewal, the Christian Community, was the inspiration of the people who have created Triodos Bank. Triodos Bank – in complete freedom – is connected with the spiritual science initiated by Rudolf Steiner, the anthroposophy, which can be an important basis for the work of Triodos Bank.<sup>7</sup>

The preamble is not legally binding. In the note that explained the changes, it was stressed that these religious groups that were cofounders would still inspire the bank in its day-to-day business but that the bank was free in further developing its own ideas, in further developing to a 'a pioneer in sustainable banking'.

The social objective was stressed on various places in the statutes of 1999. Before 1999 was still the aim 'to encourage funding of projects which seek social innovation'.<sup>8</sup> In various annual reports and policy documents, social innovation was further specified (for example see below, Box 12.1):

The company intends to pursue the banking contributing to social reform, with the caveats that every man should be able to develop in freedom, equal rights and is responsible for the economic consequences of his actions for others and the earth.<sup>9</sup>

These articles should endorse the company's principles and were seen as translating the anthroposophical ideals into practice. Board members stressed that the changes in the statutes and the vanishing formal role of the anthroposophical movement should not be seen as replacing one principle with another. The founders of Triodos Bank had no intention to promote the anthroposophical movement. They wanted to promote humanistic banking, as we would call it now, driven by their religious and spiritual beliefs.

As described earlier, 1990 can be seen as a turning point in the history of Triodos. In its first ten years, the bank had proved that it could exist on its own. After 1990, a process of professionalisation led to a rapid growth. This growth was heavily related to the growing popularity of concepts such as triple P (people, planet, profit), corporate social

responsibility and sustainability. In accordance with these societal developments Triodos Bank formulated its mission (see Box 12.1).

*Box 12.1* The mission of Triodos Bank in 2002<sup>10</sup>

Triodos Bank is a pioneer in sustainable banking. Triodos Bank wants to contribute to the development of a humane society.

A society with respect for man, nature and culture.

Triodos Bank finances companies, institutions and projects with a value on social, environmental and cultural fields, being enabled by savers and investors who are in socially responsible business and innovative public affairs.

Triodos Bank in its action involves not only financial but also socio-economic, social and conceptual issues. This threefold approach is reflected in the name Triodos. 'Tri hodos' is Greek for 'threefold path'.

Triodos Bank will give meaning to social innovation as an independent, international financial institution.

Triodos Bank aims, in accordance with its social objective, to an optimal financial return.

## The implication of the principles: governance structure and policies

### Principles and the governance structure

The principles lead to action. Especially the stakeholder orientation was among the main reasons for the anti-takeover measures taken by the bank. The above objective of the bank should not be changed when a rich shareholder would take over all the shares by a hostile bid.

Triodos Bank is a limited company under Dutch law with an executive board, a supervisory board and, since 1998, a works council.<sup>11</sup> The bank is not listed and has anti-takeover measures to protect the specific principles and to ensure independence. The Foundation for the Administration of Triodos Bank Shares (SAAT) is critical in this construct. SAAT issues certificates of shares. Those certificates are held by 'shareholders', whereas SAAT holds the 'real shares'. SAAT issues new (certificates of) shares when necessary and is responsible for organising a market in which certificates of shares can be bought and sold.

Shareholders can own a maximum of 7.5 per cent of the capital, and less than 1 per cent of the influence at the shareholder meeting. The legal structure is designed so that large shareholders cannot have too much influence in a shareholder meeting.

Forty per cent of the (certificates of) shares are held by financial institutions and 14 (pension) funds. This structure protects not only

the bank's principles, but also its banking license. Given its small size, it would have been relatively easy to acquire, and with that to acquire a Dutch banking license.

The anti-takeover structure does not mean that the holders have no influence on policy. The board of SAAT offers voting right to the General Meeting of Shareholders. The SAAT board is appointed by co-optation, which means that existing members choose new members, but the annual meeting can give an opinion about members who are nominated. Furthermore, the bank's executive management and SAAT want to be accountable for their shareholders. The statutes also decide that shareholders get a minimum of dividend.

Everything was organised so that the bank can contribute to social change or social reform. To focus on this goal, shareholders accepted a limited dividend. A former member of the supervisory board mentioned that especially in the early years, return of investment was not an issue at all in shareholder meetings. People discussed only the relevance of new projects and what kind of criteria should be used to assess projects. After 1990, slowly these discussions became less prominent in shareholder meetings. The bank tried to develop other forums to keep these discussions going, knowing that it was critical in ensuring the long-term legitimacy of the organisation.

### **Principles and policies: not market-, but mission-driven**

Given the principles and mission of Triodos, interaction with stakeholders was critical when implementing these principles. The company tried to develop markets, for example in organic farming, by actively teaming up with key players and developing financial solutions for their problems. In the first years, the bank's small size and its employees' social backgrounds made this task easier. The bank was approachable and employed people out of the societal areas that were attached to the objectives of the bank.

Execution of the principles was also easier because most shareholders did not invest primarily for the return; they were motivated by the principles of the bank. Especially in the early years, they were more interested in participating in the decisions the bank made than in dividends. Often they knew of and were involved in the bank's projects.

Staff was involved in a similar way. The bank has implemented weekly company-wide meetings. In these meetings, current developments inside and outside the bank are discussed. The meetings give the staff and management the opportunity to align expectations. Furthermore,

there are monthly lunch seminars. These are used for discussing more general developments in society relevant to Triodos Bank.

Triodos also invites guests such as the director of an organic wholesaler or the representative of a certifying body for organic products.

Especially in its product development, Triodos is mission driven. For example, in the interest of helping avoid another nuclear disaster like Chernobyl, the bank decided to foster investments in wind energy. Also the principles of the company played a major role in the creation of the Biogronnd Fund. Land for farming was often difficult to obtain for organic farmers because it had been used extensively with industrial forms of agriculture. Because Triodos Bank wanted to meet anticipated needs of organic land, it made special investment mechanisms available for organic farming. In the development of such investment products Triodos continuously sought cooperation with others such as Delta Lloyd (a Dutch insurance company) or development organizations such as the Doen Foundation. Networking in a new, promising sector was the most important strategy. Often this meant that people with a background in that particular sector were recruited.

### **Principles and policies: remuneration**

The organization is and has been fundamentally opposed to bonus pay. People who need a bonus to motivate them do not fit the Triodos culture. The board is part of the normal wage structure. Before 2004, the highest salary was no more than five times the lowest salary. Because of the international growth, the ratio of lowest/highest salary changed to 1:7.7 in the Netherlands. In other countries this ratio is even lower because of smaller offices. All Dutch employees are in the same job-evaluation scheme that is known to everyone. The executives' salaries and the commissioners' remuneration are published in the annual report. The wage structure meant that people in senior positions at Triodos were paid considerably less than colleagues within other banks – in some cases, 20 to 30 per cent less. Executives motivated primarily by monetary considerations would clearly choose to work elsewhere.

### **Principles and policies: international expansion**

In the 1990s Triodos Bank slowly started to expand outside the Netherlands. In the beginning this was not the result of a preconceived plan, especially not in the United Kingdom and Belgium. The foreign branches emerged out of talks on several occasions, such as international conferences, in which Triodos staff met passionate people from other countries that were attracted by the mission of Triodos. These



people had a motivation to start a similar organization and asked for advice or assistance. In some cases they found out that a closer cooperation was desired. In most countries, it is easier to open a subsidiary of a foreign bank than to start a new bank.

In 1993 Triodos Bank took its first steps outside the Netherlands by opening an office in Belgium. In 1995 the bank took over a small organization in the United Kingdom. The Dutch banking license allowed the Belgian co-sponsors and the British organization to develop into a bank.

After these first two foreign subsidiaries, the bank developed a more proactive expansion strategy around 2000. It resulted in the establishment of a Spanish branch in 2005 and an office in Germany in 2007. This strategy was driven by the idea that Triodos's knowledge and approach could also make a difference outside the Netherlands. The international strategy was driven by the idea that it enabled more funding opportunities in the long run. By becoming international, the bank in turn became interesting for investors outside the Netherlands.

## **Concluding remarks**

For 30 years now, Triodos Bank has been driven by the principle to invest in 'social reform' or 'social innovation'. In the first instance, this objective implicated that the bank would invest in companies that have a specific social or environmental objective. The principle of 'social innovation' was never defined narrowly, which enabled the bank to act responsively to new developments. Currently (1) social impact investing, (2) stakeholder orientation and (3) developing products together with the client are the words in which the leading principles are formulated. The relationship between saver and lender – the saver knowing how his or her money is used and the lender knowing where the money comes from – became another key principle for Triodos.

This principle differed radically from the structured products that led to the financial crisis. Within these complex products, investors did not know in what they invested. Due to its principles, Triodos Bank has never invested in structured products and other derivatives, because such investments have no apparent relationship to developing a more sustainable economy.

## **Notes**

1. For this case an interview and e-mail exchanges have been held in 2009, together with desk research. Furthermore the case is based on a comparative study of Dutch banks between 1990 and 2003. In this study, published

in a recent article by De Graaf and Stoelhorst, the response of the banks was studied to the deregulation of the Dutch financial markets in the 1990s. This study focused on the relationship between the governance structure and how this structure influenced the policies of companies needed to adjust after the deregulation. See: F. J. de Graaf (2005), *De bestuursstructuur en de maatschappelijke verantwoordelijkheid van ondernemingen, de invloed van stakeholders en de deregulering van de Nederlandse financiële sector*, Eburon, Delft. This comparative study has been presented in: F. J. de Graaf and J. W. Stoelhorst (2009), *The Role of Governance in Corporate Social Responsibility, Lessons from Dutch Finance*, Business & Society (Accepted).

2. Because of its relatively small size, the bank had to meet higher solvency standards set by supervisory authorities. Smaller banks were seen as representing more risk. Looking back, small banks in the Netherlands did not need government support, whereas most big banks needed to be rescued by the government. With 18 per cent own capital (tier one) the bank was well above the regulatory requirements.
3. Anthroposophy is a spiritual philosophy based on the teachings of Austrian philosopher, social thinker, and esotericist Rudolf Steiner (1861–1925), which postulates the existence of an objective, intellectually comprehensible spiritual accessible to direct experience through inner development. Steiner advocated a form of ethical individualism, to which he later added a more explicitly spiritual component. He also applied his ideas to practical matters by founding Waldorf education, biodynamic agriculture and anthroposophical medicine.

The anthroposophical movement in the Netherlands is represented by two organizations: the Dutch Anthroposophical Society and the Christian Community, a religious movement inspired by the ideas of Rudolf Steiner. Nominees to Triodos had to be approved by both organizations.

4. Statutes Triodos Bank N.V., article 6, paragraph 2, translation by the author.
5. A new board member is chosen by the current members of the board.
6. Statutes of the Foundation for the Administration of Triodos Bank Shares, article 6, paragraph 4, translation by the author.
7. Statutes Triodos Bank N.V., preamble, translation by the author.
8. Article 2, paragraph 2c, translation by the author.
9. Article 2, paragraph 2c, translation by the author.
10. Triodos Bank 2002 Annual Report (translation by the author).
11. Works councils are a formal way of employee representation that is common in Northern European countries such as Germany, Scandinavian countries, and the Benelux. In the Netherlands, employees of medium-sized and large firms elect their representatives from among independent and/or union-related candidates for four-year terms. Dutch works councils have very specifically circumscribed legal rights that give them a formal role in decision-making processes that affect employee interests, see F. J. de Graaf and C. A. J. Herkströter, 'How Corporate Social Performance Is Institutionalised within the Governance Structure: The Dutch Corporate Governance Model', *Journal of Business Ethics*, 74, no. 2 (2007): 177–89. Depending on the nature of the issue at stake, this role varies from the right to be consulted to the right to block management decisions and refer them to court.

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# 13

## Wainwright Bank and Trust Case Study – Humanistic Management in Practice

*Christine Arena*

### **Introduction**

It's Election Day, 2008. America's stock index scores its worst performance in 21 years, with the Dow plummeting 2,400 points over a period of 1 month. A credit crisis that started by squeezing financial institutions such as Lehman Brothers, Merrill Lynch, Citibank, and Bank of America spills into the mainstream, hampering banks' ability to lend and consumers' ability to borrow. Meanwhile, a ripple effect spreads to the rest of the world economy, causing similar turmoil on stock markets from London to Hong Kong. Collective fears center on a looming global recession. With so much at stake, many corporate chiefs are understandably on edge today. And yet Robert Glassman, Founder and Co-chairman of the publicly traded Wainwright Bank & Trust Company, isn't fazed. And neither is his board. That's because, unlike other banks requiring massive federal bailouts in order to offset mistakes of the past, Wainwright's strong financials and unique management philosophy enable it to play up its strengths and better plan its future.

With over \$1 billion in assets, 40,000 accounts, and over half a million transactions per month, Wainwright is far from being the largest bank in the country. But its recent performance serves as an impressive contrast to a volatile industry plagued by a collapsed subprime market and diminished consumer confidence. According to Wainwright's third quarter 2008 results, average assets increased by \$87 million, or roughly 10 percent from the year before. Its average outstanding loan balances grew by about 15 percent, while residential real estate loans spiked an

impressive 31 percent. The Bank also saw nice growth in its commercial real estate and commercial loans. All this turmoil in the financial markets has continued to create opportunities for us to capture additional market share, especially in our residential real estate products,' Glassman explains. 'We are pleased that there continues to be a market for our products and approach.'

The 'approach' of which Glassman speaks is key. In fact, Wainwright sells the very same products that you can find at any bank – checking accounts, savings accounts, loans, and so on. That's not what drives the company's performance. It's *how* the company sells its products, how it conducts business overall, that sets it apart from its peers. For over two decades Wainwright Bank has been a step ahead of its industry with a socially progressive agenda and humanistic approach to management, both of which represent an ever important second bottom line to the company. 'One platform sustains the other,' Glassman explains. 'Our business success is fueled by the difference we make in our community.'

Wainwright's business approach is as atypical as its end results. To date the Bank has issued over \$700 million in loans to community development projects like affordable housing and HIV/AIDS services, and also has experienced virtually no defaults on those loans. Wainwright also has the highest level of customer loyalty and the lowest rate of employee turnover in its industry. Overall, the Bank doesn't look or behave as its Wall Street competitors do. Wainwright establishes a sense of openness and decency in all of its dealings, and its stakeholders and shareholders evidently love that.

## **Business as unusual**

To fully appreciate the extent to which Wainwright's humanistic management philosophy protects shareholder interests and sets the Bank apart from its peers, you have to first consider the current state of the market. In October, 2008 former Federal Reserve Chairman Alan Greenspan characterized the banking industry's troubles by saying: 'We are in the midst of a once-in-a-century credit tsunami.' He acknowledged he was 'shocked' when the system 'broke down,' but also predicted that the nation would emerge from the current credit crisis with a 'far sounder financial system.'<sup>1</sup>

Those comments irked House Representatives, including committee chairman Representative Henry Waxman, a Democrat from California, who chastised Greenspan, along with SEC chairman Christopher

Cox and former Treasury Secretary John Snow, for a lack of oversight. Waxman blamed the three for failing to prevent the credit crisis and for refusing to take responsibility for it. 'The list of regulatory mistakes and misjudgments is long and the cost to taxpayers and the economy is staggering,' he said. Greenspan responded by conceding that he 'made a mistake' in presuming that banks themselves were more capable than regulators of protecting their finances. But he also reiterated his support for the \$700 billion Wall Street bailout approved by Congress, which allows the US government to buy back bad mortgage investments from troubled lenders.<sup>2</sup> Theoretically the bailout is intended to thaw the credit freeze by freeing up capital, thereby allowing banks to offer new loans. But has it? And also, did it adequately address the underlying systemic issues that caused things to go awry in the first place? Wainwright's Glassman isn't so sure.

'The current meltdown is based on the extension of credit, but credit in itself isn't the problem,' he explains. 'The problem is how credit was passed from one party to the next with no ethical oversight under the veil of normal business activity.' Glassman uses the subprime debacle as an example: 'Each player along the way – from the originator, to the mortgage broker, who sold the mortgage to an investment bank, who then created a pool of mortgages for sale to investors, and ultimately the rating agencies who were supposed to protect the investors – had no continuing stake in the transaction and certainly no concern for the well being of the underlying homeowner.'

By contrast, Wainwright keeps a vested interest in all of its transactions. It has historically declined to repackage and resell its loans to third parties, and also provides customers with useful tools for building enduring financial success, thereby increasing customers' ability to repay the Bank. For instance, in 2001 Wainwright launched an online service for nonprofit clients called CommunityRoom.net, which, among other things, offers free hosted web pages and the ability to accept online donations. According to Glassman, over 200 of the Bank's 500 nonprofit clients have joined CommunityRoom.net and donations generated through this channel totaled \$1.1 million in 2007.

Wainwright prides itself on a string of similar products designed to promote financial stability among Bank clients and also serve worthy causes. Wainwright's Green Loan, launched in 1999, provides homeowners with a discounted home equity loan rate for energy-efficient home improvements. Its Equal Exchange CD provides a competitive interest rate while allowing deposits to act as collateral for lines of credit issued to Equal Exchange, a Fair Trade coffee merchant

providing third world farmers with a livable income. Overall, community development lending is a significant part of Wainwright's business strategy.

Currently over 50 percent of Wainwright's commercial loan portfolio is committed to financing projects such as homeless shelters, food banks, affordable and special needs housing, HIV/AIDS services, immigrant services, inner-city schools, community health centers, and breast cancer research, among others. 'The majority of our customers are aware their deposits help fund these loans,' says Glassman. 'We attract new customers because they want their money to support local community development, and once with us, become fiercely loyal.'

Customer loyalty is a great asset to any bank, especially in a largely undifferentiated industry with fungible products and services. In this respect, Wainwright does stand out. But what's perhaps even more noteworthy is the rate of repayment the Bank manages to achieve. Over the past 20 years Wainwright has invested \$700 million in community development loans, and not one has ever failed. 'Not a single client has entered into default,' says Glassman. That's not only atypical; it is radically unsettling to the banking world's prevailing mindset.

'The general assumption among most bankers is that community development loans are unprofitable, risky, and just another form of charity,' says Glassman. 'But nothing could be further from the truth. Our community development loans are not discounted and are market priced like any other commercial loan.' Indeed, it's not the product itself that makes the difference. It's *how* the product is structured and serviced. Rather than catering to pre-prescribed bank terms, Wainwright's loans are designed to meet the needs of individual borrowers. The Bank has found that allowing flexibility dramatically increases the probability that loans will be paid back. That's a key reason why Wainwright remains solvent and continues to grow.

At a time when many mortgage brokers have gone bust and most of the larger commercial banks have decreased or altogether halted lending activities due to problems with capital levels or deterioration in the quality of their loan portfolios, Wainwright remains well capitalized. It is still actively lending to small businesses and homebuyers. In fact, according to *American Banker*, one of the industry's most widely read daily news publications, Wainwright's home mortgage portfolio business experienced growth of 31.8 percent in 2007, making it one of the fastest growing community banks in the nation. 'Wainwright Bank is a powerful example of a bank that does well by doing good,' said David Longobardi, editor in chief of *American Banker*. 'It epitomizes how a

banking company can operate in support of a set of social or political principles, while also remaining profitable.<sup>3</sup>

As of January 2008 Wainwright's financials remain strong. The Bank ended the fourth quarter with a 5 percent increase in net income, from \$1.17 million in 2007 to \$1.23 million in 2008. For the year, the Bank's assets surged 15 percent to \$1.06 billion, while deposits increased 16 percent to \$717 million in 2008. Furthermore, Wainwright's net interest yield rose to 3.20 percent in the fourth quarter, compared with 2.97 percent for the same 3-month period in 2007. While Wainwright's solvency and growth earn it praise in local financial journals, wider communities also see the value of its double bottom line. Sustainablebusiness.com considers Wainwright to be one of the world's top 20 sustainable stocks. The Social Investment Forum sees it as one of America's top ten 'green' banking firms. And, among its community, Wainwright is portrayed as 'a bank that gives people strength,' 'a bank that keeps its promises,' and 'totally fearless when it comes to (its) beliefs.'<sup>4</sup>

People clearly love what Wainwright does differently, though the Bank does not pursue every market segment equally. Glassman and his colleagues realize that it does not matter whether all the public loves the company. What matters is that the *right* people love the company. Wainwright knows that it will never please everyone, so it does not attempt to waste its energy with fruitless efforts, for instance shamelessly pandering itself as everybody's 'favorite bank' or as the industry's 'best citizen.' To succeed in humanistic management is to remain wholly authentic and unpretentious, while also putting people's needs ahead of industry norms.

## Putting people first

Robert Glassman thinks more executives should forget about fluffy concepts like 'good values' or 'doing the right thing.' Instead, they should just listen more and respond better. That means closely examining what stakeholders' deepest needs are, and what issues are most worth fighting for. It also means taking opportune and substantive positions and backing the positions up in ways that are totally genuine, tangible, and financially productive. Wainwright does this really well.

The Bank takes a stand: 'One of the most unique aspects of our business, especially considering we're a publicly traded company, is our advocacy of social justice issues on behalf of our clients and employees,' says Glassman. 'Because of the progressive causes we champion and support in various ways, and the recognition we receive for that,



we've created a certain amount of what we call 'cultural capital'. And as controversial as some may be perceived, we're not afraid to stand up for these issues even if we stand alone.'

Wainwright has stood alone on multiple fronts, as the Civil Rights movement of the 1960s has been a major influence in the creation of the Bank's progressive social agenda. In 1996 Wainwright was the only publicly traded company in the United States to testify before Congress in support of the Employment Non-Discrimination Act, which would have outlawed discrimination against gays in the workplace. More recently the Bank stood in opposition to an anti-gay constitutional marriage amendment in Massachusetts, and has also been a signatory to social justice initiatives, including the endorsement of a living wage in Massachusetts.

Some wonder why a Bank would take such risky positions. Glassman explains: 'Over the years we have seen the same voices of intolerance arrayed against the civil rights movement, the women's movement, gay rights and the civil liberties of people with AIDS. For us, the rights of these groups are all connected threads that weave the fabric of a just society.'

Along these lines Wainwright translates the concept of humanistic management to a model of social inclusion that penetrates all levels of the organization. 'Employees, customers and communities have an equal place at the table alongside our stockholders,' explains Glassman. 'We believe each of these constituencies is best served when all are served.' As such, Wainwright has consciously created a corporate culture that stresses individuality and promotes equality. 'We have set up an atmosphere where our people don't have to conform to some corporate notion of what a bank should be,' says Glassman. 'They can be comfortable with who they are and feel free to express themselves.'

At Wainwright a 'free' work environment is one where all are provided with the same opportunities for professional advancement, regardless of race, color, religious creed, age, sex, marital or family status, sexual orientation, genetic information, ancestry, national origin, physical or mental handicap, membership in the United States Uniformed Services, or any other characteristic protected by law. That amounts to true diversity. According to Glassman, Wainwright's Board of Directors consists of nine outside members, two of whom are African American, two are female and one is openly lesbian. Among the Bank's 166 employees, 60 percent are women and 10 percent are openly gay, including two senior vice presidents. Minorities comprise over 30 percent of the total population of employees, while 22 languages are spoken at the Bank.

'There's also the recognition that employees have lives outside the bank,' says Glassman. In addition to providing 3 weeks' paid vacation and four sick days annually to all full-time employees, regardless of their position (the industry average for a teller trainee is 1 week's vacation), Wainwright provides free life insurance, generously subsidized health and dental coverage, health club membership, and public transportation reimbursement. And, recognizing a 401(K) plan will likely be the primary source of income for an employee in retirement years, all employees are automatically enrolled in the Bank's generous retirement savings plan and must opt out if they do not wish to participate. According to Glassman, only one employee has opted out to date, as the Bank annually matches 100 percent of the first 4 percent of an employee's salary saved, and 50 percent of the remaining amount saved up to the maximum allowed by law.

With all the benefits, liberality, and inclusion, who wouldn't want to work at Wainwright? Indeed, Glassman notes that such perks help keep the talent pool flowing and costs down. 'Since we're a small company with limited resources, employment candidates generally find us,' he says. 'While there is no formal requirement a job applicant must support the Bank's progressive social agenda to be employed, many enthusiastically do and in fact seek to work at Wainwright because of it.'

There are other benefits, too. Employee turnover is a key issue in the banking industry, as it can translate to a loss of valuable customer relationships. It is thus interesting to note that the United States banking industry's average annual voluntary employee turnover rate is estimated at nearly 23 percent, while the average cost of turnover is said to be roughly 25 percent of an employee's annual salary.<sup>5</sup> In light of this, Wainwright has managed to keep its turnover rate significantly lower than the industry average, with a 9 percent turnover rate in 2007. According to Glassman, the Bank credits its overall commitment to social responsibility and a double bottom line. 'This concept has become so embedded in the Bank's products and human resource practices that a clear and resonant brand image has emerged, one that is recognized and valued by employees and customers alike,' he says. 'Day to day decisions are made with the support or enhancement of the brand in mind.'

Wainwright's strong brand resonates in valuable ways – from affecting human resource policies to inspiring people to willingly contribute to the Bank's success. For instance, in 2006 Wainwright's facilities department unilaterally decided to install automatic light switches and low-wattage fluorescent bulbs throughout company headquarters, and

to completely switch to recycled products. Glassman notes that this was not a response to a mandate from senior management, but rather a voluntary, collaborative effort by motivated people who strongly support the bank's commitment to the environment. Another recent example is the Bank's response to an increase in customer requests suggesting the Bank offer electronic monthly statements to reduce paper and energy usage. The Bank is reportedly working on this capability and will soon be launching it.

Wainwright considers reciprocal relationships a key to success and a cause for innovation. For instance, when a customer closes a Wainwright checking account they receive a survey from the President and CEO asking why the account was closed. According to the Bank the response rate to the survey is consistently over 40 percent, with 97 percent of the responses favorable. Eighty-five percent of those who do respond indicate that they closed their account not because they are dissatisfied, but because they moved from the Boston area, while many express a wish that the Bank had a presence in their new home city.

### **Socially responsive companies**

If Wainwright's success story proves anything, it's that the vague and lofty notion of 'corporate social responsibility' is dead. The best, most successful firms do not concentrate on what it means to be perceived as socially responsible. Instead they focus on the simple notion of being *strategically responsive*. Rather than ignoring employee and customer feedback, strategically responsive companies listen and learn. As opposed to resisting or procrastinating, they rise to the occasion. Instead of struggling to comply with regulations, they use changes in the marketplace and the global climatic system, and among the needs of stakeholders, as a means of accelerating growth and performance. The world's most responsive companies do not worry as much about putting their values on paper as they do about producing actual, measurable *value* – socially, environmentally, and financially. At the end of the day, this is what matters most. This is the legacy that companies leave behind.

'Embracing a business model that considers social benefit as well as profit does not preclude the strength of either,' Glassman insists. 'The success of Wainwright Bank is proof of this.' Indeed, looking to the future, Glassman sees a clear trend toward what he calls 'conscious capitalism,' as more stakeholders (including shareholders) demand that corporations view their business through a wider lens and better

acknowledge and address their true impact. Ideally, says Glassman, ‘this [concept] will become so ubiquitous as to no longer be considered an alternative way of doing business. It will become the best way of doing business. It is plausible that companies who fail to recognize this will eventually cease to exist.’

The clear business trend toward greater strategic responsiveness – whether it is labeled ‘social responsibility,’ ‘humanistic management,’ or ‘conscious capitalism’ – will eventually affect every company, regardless of size or industry. Therefore it becomes increasingly important that current and future business leaders look to success stories of the past in order to make informed future decisions. In doing so, many will find a string of attributes that the greatest, most ‘humanistic’ companies tend to share. These five common threads are no random coincidence. They represent a higher order – a skill set and mindset not commonly taught in business schools, and yet increasingly necessary for enduring the constantly changing economic tides:

1. *Higher Purpose: Beyond making money for shareholders, what in the world is the company here to do?* Truly humanistic companies are purpose-driven, meaning that they have identified a core reason for being that enables them to succeed. Whatever their particular purpose is, it serves stakeholder interests and also drives most everything the company does, from the products it sells to the way it treats people and the planet. For instance, as demonstrated above, Wainwright Bank has a clear higher purpose, which is to ‘provide equality and financial empowerment.’ This purpose is relevant to stakeholders in that it helps to meet unmet socio-economic needs and also keeps the company competitive. Every product, service, and policy that Wainwright institutes – from flexible personal loans to green CDs and progressive outreach efforts – is an extension of its higher purpose. Therefore, the better Wainwright fulfills its higher purpose, the more value it generates overall.
2. *Relentless Innovation: Is ‘good enough’ ever enough?* In humanistic companies the answer is decidedly ‘no.’ That’s because humanistic companies are always raising the bar and constantly looking for new, enterprising ways of fulfilling their purpose. Such companies are never content to rest on their laurels. Glassman explains: ‘Despite all that we do, we don’t consider ourselves the perfect corporate citizen. There is still so much work to be done.’ Even as Wainwright succeeds by all the traditional measures, Glassman feels a little restless, as if he ought to be doing more. Therefore he and his management team are

always regrouping, rethinking and revising their strategic approach. This plays back to the old business adage that self-satisfaction and complacency invite competitive disadvantage, whereas healthy self-criticism allows continual advancement.

3. *Authenticity: How does a company foster unswerving love and devotion from its stakeholders?* Glassman insists the answer isn't expensive marketing gimmicks or even philanthropic efforts, but rather an authentic state of being: 'If we can't project an internal commitment to social justice, then we're not going to be perceived as credible externally,' he says. 'The sense of openness and decency toward our employees generates benefits for the customer and also a sense among our wider constituency that we are the real deal. We are exactly what we appear to be.' Humanistic companies like Wainwright don't have to fabricate elaborate means of conveying a certain image for themselves because that image is intrinsic. It is who they are and what they are. These companies remain true to their core, which is a key reason why the right people steadfastly support them.
4. *Intuition: How does a company best decide where to go next?* The most ingenious and humanistic firms do not follow tradition, remodel old models, mimic competitors' moves, or look to focus groups for answers or inspiration. Instead they liberally draw on a skill that is underutilized in the mainstream business world: *intuition*. The most significant business breakthroughs at Wainwright were based on a keen internal sense of what was right. As Glassman explains, he and his team 'just knew.' They just knew that many of the risks facing the banking industry could be easily mitigated through more transparent, responsive, and flexible products. They also knew that the goal of promoting equality and empowerment would be better served by taking an aggressive stand on controversial issues and also promoting an internal environment that rejected stringent management hierarchies and strict employee codes of conduct. On many occasions Glassman and his team have leapt into the void, proven to be unafraid of the unknown – and succeeded. When a leader's sense of intuition is strong, the possibility for what can be achieved is limitless.
5. *Collaboration: What's at the core of the fundamental shift in business?* If there is one attribute that best characterizes the humanistic leadership mindset, it's collaboration. People at truly collaborative organizations such as Wainwright are empowered and engaged. They co-labor successfully, reach agreement, resolve differences, and produce results that are the envy of the industry. Glassman and his team

use collaboration as an efficient means of engaging stakeholders and promoting innovation. As noted above, the company constantly listens and learns. It provides stakeholders with useful mechanisms for feedback and then uses the feedback to deepen relationships and beef up offerings. As Glassman proves, collaboration does not mean abdicating power, but rather sharing it. He knows that the more stakeholders are involved in ongoing decisions, the more buy-in and traction those decisions will ultimately gain.

Truly humanistic companies, or ‘High-Purpose Companies,’ thrive because without them society would be worse off. Since they are designed to help meet unmet human needs, they grow *invaluable* to people and *worthy* of success. That ultimately boils down to a new supply and demand model – one that honors a multitude of factors beyond just short-term economics. The businesses that do grow invaluable to people tend to do so because they stand for something greater than the products they sell or the money they generate for shareholders. They embody something that is meaningful, substantive and necessary, not frivolous or easily replicated. In such companies, the concept of a higher purpose is so integral to the fabric of the organization that, if you removed that thread, the company would start to unravel.<sup>6</sup> Indeed, the idea of ‘providing equality and financial empowerment’ has had such an effect on Wainwright’s people, products, process, and performance that without it Wainwright might be just another bank.

Theoretically, could Wainwright temporarily increase its stock price and maximize shareholder returns by cutting more corners and taking a less purposeful route? Possibly, yes! Although Wainwright has managed to strike an unprecedented balance between purpose and performance, there are certainly ways in which the company might improve margins by reducing its emphasis on ‘humanistic’ initiatives – for instance, cutting social outreach efforts or limiting employee benefits to levels commensurate with the industry average. But again, as mentioned above, moves like these could cause a steady erosion of the company’s core value proposition, which could in turn diminish the company’s market share. While humanistic management isn’t necessarily the most profitable short-term route, it does tend to mitigate certain risks and generate multiple long-term benefits for all stakeholders involved. Therefore this whole issue of whether or not to embrace humanistic management boils down to leadership, and tough decisions.

At a time when everyone seems to be talking ‘change’ and economic, social and environmental issues have reached crisis proportions,

Table 13.1 Humanistic management in the banking industry

Traditional model	Wainwright model
Single bottom line	Double bottom line
Serves shareholders	Serves stakeholders
High reward model (that is private equity)	Steady reward model
Hidden risk	Transparent methods
Lack of ethical oversight	Constant ethical oversight
Exclusive client base (favoring wealthy)	Inclusive client base (favoring social groups)
Product-centric	People-centric
Procedure orientation	Relationship orientation
Preset terms	Customized terms
Hierarchical structure	Collaborative culture
Emphasis on marketing	Emphasis on authenticity
High employee turnover: 28 percent	Low employee turnover: 9 percent
High customer default rates	Zero percent customer default rate
Reeling from market crisis	Seizing market opportunities

business leaders must face difficult questions. They must decide which management style is most needed for what lies ahead: Mandela-like leadership or Attila the Hun? They must think about what they're in the game in order to achieve: a quick turnaround with maximum returns, or a balanced approach with fair returns? And they must consider the importance of legacy. After all, as renowned author Jim Collins asks readers in his bestselling book, *Built to Last*: 'Why on earth would you settle for creating something mediocre that does little more than make money, when you can create something outstanding that makes a lasting contribution as well?' Humanistic management does present a challenge – hopefully one that's worth taking (Table 13.1).

## Notes

1. Testimony of Alan Greenspan before the House of Representatives Committee on Oversight and Government Reform, October 23, 2008.
2. Commentary of Alan Greenspan and Henry Waxman before the House of Representatives Committee on Oversight and Government Reform, October 23, 2008.
3. Press release, 'Wainwright Bank Co-Founder Named 2007 Community Banker of the Year,' November 30, 2007.
4. E. Jeanne Harnois, 'Bank official brings financial literacy to inner-city audience,' *Boston Banner*, Thursday, June 5, 2003; Trinity Creative Communications, 'A Bank that Keeps its Promise,' The Angle e-Newsletter,

May 2002 issue; Shawn Macomber, 'Branching Out in Green,' Brookline TAB, September 22, 2005 (<http://www.wainwrightbank.com/html/about/news/news/archive.html>) [all accessed October 11, 2010].

5. Statistics taken from 'The Cornerstone Report: Benchmarks and Best Practices for Mid-Size Banks,' Scottsdale: Cornerstone Advisors, September 2007, 1–4.
6. This description of High-Purpose Companies was derived from Christine Arena (2007). *The High-Purpose Company*. New York: Collins Business, 22–24.



# 14

## Investment Banks that Prospered

*Anuj Gangahar*

For those interested in the financial markets over the past two years, tales of woe have become commonplace. The events of the 'Great Recession' were profound, and they have changed the way we view the world of high finance. Firms that were previously thought of as impenetrable were proven to be anything but. Their ethics were called into question and often exposed as fundamentally flawed.

Executives who were previously viewed as our best and brightest saw their reputations ripped up and tossed to the winds. Fraud of unimaginable scale came to light, and the impact on ordinary investors was catastrophic. Amid all of the disbelief-engendering turmoil, it was easy to tar all in the world of finance with the same brush.

But the fact is that the theory of the survival of the fittest has rarely been so clearly demonstrated. Granted, those institutions that emerged as the fittest were perhaps not the ones that everyone expected. But as the acknowledged fabric of the markets disintegrated, if you looked closely you could see new franchises being built, new reputations being forged and certain firms proving through their resilience that they were, in actual fact, built of sterner stuff.

The explanation for how certain firms managed to survive while other, seemingly more solid firms foundered is not a simple one. There was no one right way to negotiate the crisis. Some survived by chance, some because they saw at least some of what was coming and adjusted their business models accordingly, some because they steered clear, by luck or by judgment, of the toxic assets that were at the heart of the perfect storm that engulfed the economies of the world. What it seems to boil down to, in the end, is risk management.

This ubiquitous term has come to encompass any number of factors that banks take into account when conducting their daily business.

Every firm of a certain size will tell you about its risk-management systems. These systems were clearly not uniform. Some firms were better at managing risk than others, and those that managed it best survived the crisis. Those that didn't must examine the reasons why. It will take years of soul searching and of honest self-criticism by those involved to ensure that should a similar set of circumstances occur again, the same wreckage does not result.

This chapter will seek to highlight some of the investment banks – a business in which so much of the wreckage was wrought – that managed to come through the financial crisis with flying colours. Few avoided the turmoil completely. The crisis was so all-encompassing and so based on interconnections between firms that nobody, it seems, was completely immune. But there are some clear cases of firms that shone. By no means an exhaustive list, or analysis of the winners, what follows is an attempt to highlight those investment banks that negotiated the crisis best and draw some conclusions about the common threads that bind them in terms of their strategies and decision making in the midst of an unprecedented crisis.

## **J.P. Morgan**

The House of Morgan is perhaps the most storied of the bulge bracket investment banks, and its performance through the crisis showed that hard-earned experience and determined conservatism often go a long way. Jamie Dimon, J.P. Morgan's chief executive, sealed his reputation during the crisis even as peers at other firms, who had long been viewed as at least his equals, fell by the wayside.

It is tempting to paint J.P. Morgan's impressive performance during the crisis as the fruits of one man's – Dimon's – vision. But those who know J.P. Morgan best suggest that this is missing the point. In actual fact J.P. Morgan succeeded because its management structure is relatively flat, bankers are encouraged to speak their minds and the politics that so often cripple similar firms do not seem to be nearly as damaging. It is also a naturally conservative institution – something it has in common with most of the banks dealt with in this chapter.

After the bank recently posted an impressive profit of \$3.3 billion for the fourth quarter of 2009,<sup>1</sup> Dimon, reflecting on the events of the previous year, said, 'Throughout this period of financial turbulence, our employees have never lost focus on what a bank should do – support and serve our 90 million customers and the communities in which we operate; deliver consumer-friendly products and policies; and continue

to lend. We extended nearly \$250 billion in new credit to consumers during the year, and for our corporate and municipal clients, either lent or assisted them in raising approximately \$1 trillion in loans, stocks or bonds. Lastly, I am very proud of our more than 200,000 employees around the world, from our programmers to our receptionists to our bankers. Through their tremendous efforts, we have been able to protect our company and keep it healthy and vibrant, while doing our part to support the global financial system and helping the countries where we do business.'

The bank's strong performance throughout the crisis is underlined by its full-year performance for 2009 and 2008 when it posted net income of \$11.7 billion, or \$2.26 per share, and \$5.6 billion, or \$1.35 per share, respectively. *International Financing Review*, an industry publication, voted the bank as its Bank of the Year in 2008. It also swept the board across a range of smaller categories. According to the publication, thanks to J.P. Morgan's belief in old-fashioned banking virtues, 'it is in a position to become the pre-eminent financial institution of the first half of the 21st century. It dodged most of the bullets of the financial crisis by a relentless focus on careful banking and has also built a global investment banking deal machine that is the envy of its rivals.'

Some have criticized J.P. Morgan over the past two years, even as some of its rivals crumbled, as having avoided the crisis by virtue simply of its staunch conservatism. The criticism went something along the lines of 'Okay, you didn't lose out dramatically, but you weren't really even in the game to start with, so your 'victory' is somewhat hollow.' Certainly the bank completely avoided some of the areas that have proven to be unmitigated disasters for others – such as sub-prime mortgages. But this was not because it could not be bothered to put in the spade-work or because it didn't have the staff or expertise to get its head around such products. Rather such products simply didn't fit in with its values. 'The thing that kept us from having sub-prime exposure was our requirement for return,' Bill Winters, co-CEO of JPM's investment bank told *IFR*. 'I'd love to say we saw the crisis coming – we didn't. But what we did see was that the industry's risk/return relationship had got out of whack.'

The bank had to endure a certain amount of pain along the way as it stuck to its guns. It saw almost 100 people leave to join Merrill Lynch's structured credit team in 2006 and 2007, and the accusations that the bank was missing out on several potential windfalls grew in frequency and volume. But it retained its discipline and a staunch belief in the ideals of its founder. In a crisis that was defined by the 'newness' of many

of the products at its centre, J.P. Morgan found a way to make old ideals and an old-fashioned approach work.

It was this return to and reliance on discipline that enabled the investment bank to avoid many of the problems that dragged down its rivals.

## **Canadian banks**

The survival of Canadian banks such as RBC, CIBC and Toronto Dominion through the crisis appears to have less to do with the banks themselves and more to do with the very fact that they were Canadian. The most important factor in their notable successes appears to be that, as a quick look at the Canadian financial system will tell you, there is less debt in Canada than in the United States. Homeowner liabilities are 20 per cent in assets. This is close to stable and has been since the late 1980s. Compare this to the United States, which has a 26 per cent asset liability, and Canada seems much more sustainable.

Mortgages in Canada are also more appealing than those in the United States. The sub-prime mortgage market is only about 1/20 of all the mortgages that have been taken out. In America, around 1/6 mortgages were sub-prime before the crisis – and about a quarter of the mortgages taken out between 2004 and 2006 were in the sub-prime category.

RBC offers perhaps the best example of the powerful financial performance of Canadian banks through the crisis. In 2009, the bank posted full-year profit of CAN\$3.9 billion. The previous year, when the crisis was at its height across the globe, the bank did even better, posting net income of CAN\$4.6 billion. Return on equity was 11.9 per cent in 2009 and 18.1 per cent in 2008. Diluted earnings per share in 2009 were \$2.57 and \$3.38 in 2008.

According to consultancy firm Deloitte, Canadian banks, while undoubtedly coping with the crisis better than their counterparts in the United States based on the more favourable legacy framework, have still been affected in three primary ways.

First, due to the global liquidity crisis, it now costs more for everyone to borrow – including banks. Banks facing significant write-offs, like those in the United States, suddenly find themselves hampered from raising the capital they need to meet margin calls and retain market confidence. This is partly why US banks saw their stock prices plummet. Although the effects for Canadian financial institutions are not as stark, higher borrowing fees raise the cost of doing business, putting negative pressure on profitability and making it harder to sustain growth.

Second, Canadian banks with exposure to US assets, or those with large operations in the United States, certainly saw their market valuations fall. At the same time, a lack of transparency into financial sector balance sheets makes it difficult for investors to determine which institutions have high – or low – risk profiles. The result? Valuations across the financial sector are in peril, even for institutions without significant US exposure. But despite the spillover from the US market into Canada's financial sector, domestic banks still boast certain strengths that shielded them from the worst and will continue to do so. For instance, banks in Canada tend to be better capitalized than their US counterparts and generally have lower risk profiles.

Third, the Canadian Bank Act requires lenders to take a more conservative approach to mortgage underwriting – a mandate that has helped to limit Canada's exposure to sub-prime debt. But along with financial institutions across the globe seeking to play a part in a post-recovery world, Canadian banks must take steps to understand their risks and mitigate them wherever possible. Domestic banks in Canada have recently been joining the global effort of reviewing their checks and balances and trying to identify potential areas of weakness.

According to Deloitte, much of this process of self-examination involves reviewing the financial stability of their counterparties to assess where exposures exist and conducting scenario testing and contingency planning to ensure they have appropriate response strategies to a range of potential outcomes. They are also updating existing policies to confirm that they apply independent valuation practices on an ongoing basis, assessing the strength and flexibility of their risk-management processes to ensure risk levels are consistent with tolerance levels. And as the backlash against fat cats continues, most companies have conducted a thorough review of executive compensation policies.

With a new accent on caution, some in the banking industry worry that the business as a whole will become too careful and that opportunities will go begging. And as Canadian lenders work to shore up their internal management practices, they should also be watching for external market opportunities. In addition to purchasing distressed US assets at bargain prices, Canadian banks are well-positioned to grow through acquisition as international institutions divest their Canadian subsidiaries. Similarly, Canadian companies doing business in the United States might now be more inclined to switch their banking relationships from US institutions to the relative safety of Canadian institutions, presenting a prime opportunity for banks to expand their market share. 'For domestic banks, current conditions can represent a once-in-a-lifetime

opportunity to grow by acquisition outside of Canada,' said Deloitte in a report. 'However, their ability to benefit will depend on whether they have sufficient flexibility built into their systems to support an intelligent and timely response.'

## **Banco Santander**

Perhaps the best indication of just how well Spanish bank Banco Santander did through the crisis is that when the crisis was wreaking much of its havoc and other banks were slipping, floundering and often completely imploding, it was quietly becoming the third-largest bank in the world in terms of profit and the seventh largest in stock-market capitalization. Further support for its outstanding performance came when the *Banker*, an influential industry publication, recently bestowed on Banco Santander the lofty title of 'World's Best Bank' for 2009. The magazine also named Santander as its Bank of the Year in Western Europe, Spain, the United Kingdom, Germany, Portugal and Puerto Rico, backing the view that Santander is now truly a global titan in banking. Indeed according to the editor of the *Banker*, 'without doubt, the international bank that has come through the crisis the best – and taken advantage of the opportunities that have arisen from it – is Santander.'

The bank seems to have arrived at a formula that combines an aggressive sales strategy with solid risk management and tight cost control – something it shares with banks such as J.P. Morgan and BNP Paribas. In essence, what sets all of them apart has been their ability to retain an almost basic approach to the business of banking. However, knowing that a back-to-basics emphasis works and actually putting it into practice are two different things, and in this regard, Santander has been particularly successful.

The bank's chairman, Emilio Botin, says, 'Now our challenge is to continue being the best bank in the world for our customers, employees and shareholders. We will strive to do it just as we have done for over a century and a half: with hard work, determination and ethics.'

Santander is the only Spanish bank to ever have received the Global Bank of the Year awards from the *Banker*. Santander was also named Best Bank in the World by the influential *Euromoney* magazine in 2008. In 2009, *Euromoney* named Santander Best Bank in Western Europe.

The year 2009 was the first that Santander has received the Bank of the Year award from the *Banker* in the United Kingdom and Germany. The award was based on the fact that 'Abbey's impressive 20 per cent

increase in net profits in 2008 was followed by even more staggering results for the first three quarters of this year.' It added more than 800,000 new accounts in 2009. It also added a share of more than 10 per cent in the UK mortgage, savings, bank accounts and branches. Abbey's profits surged by 30 per cent in the same period.

In Germany, where Santander is mainly present through Santander Consumer Bank, the magazine said, 'As much of the rest of Germany's banking sector struggled and sought government support, Santander Germany continued to introduce innovative products, grew assets by 39 per cent, and managed a staggering 35.6 per cent return on equity.'

In Spain, where the economy has been hard hit by the crisis, Grupo Santander's two main units in the country – the Santander branch network and Banesto – succeeded in generating significant, highly recurrent profits and closely managing its non-performing loans to keep them well below the sector's average. Banco Santander's scope is undeniably wide, but at its heart it is a retail and commercial bank, based in Spain, with offices all over the world.

At the end of 2008, Santander was the largest bank in the Eurozone by market capitalization and third in the world by profit. Founded in 1857, Santander had 1.271 trillion euros in managed funds at the end of 2008. Following the acquisition of Sovereign Bancorp in January 2009, Santander has 90 million customers, around 14,000 branches – more than any other international bank – and over 170,000 employees. It is the largest financial group in Spain and Latin America, with leading positions in the United Kingdom and Portugal and a broad presence in Europe through its Santander Consumer Finance arm. In the first half of 2009, Santander registered 4.519 billion euros in net attributable profit.

Now the acquisitive Spanish bank has its sights set on Asia. Santander set up a small Asia head office in Hong Kong in 2008 and now has around 120 staff in the region, based in offices in Australia, China, Japan and South Korea. At the moment, the bank's Asian team is mostly kept busy servicing cash and trade flows between Asia and Latin America, where the bank has a formidable network and client base. But its long-term ambitions are considerably grander than that.

Morgan Stanley analysts say, 'We regard Santander as an attractive proposition after the recent re-rating in the banking sector. While for many banks, investors are prepared to pay multiples on a look-through valuation as long term as 2011/12, we believe this is not the case for some high-quality franchises such as SAN.' Morgan Stanley's valuation for the shares assumes investors will continue to focus on long-term profitability for the sector, which remains an uncertainty.

'We believe the bank can start growing earnings again as soon as 2010. On our new forecasts (we are upgrading our EPS estimates for '09 and '10 by 13 per cent and 8 per cent respectively), which we believe are conservative on revenues and asset quality, the shares are trading at 8x P/E 11e and at 1.8x P/NAV 11e. These are not demanding multiples given the potential upside to earnings in an eventual macro recovery environment.' The analysts highlighted Santander's advantageous strategic positioning: 'A strong core capital ratio (we estimate 8 per cent as of end-10, 8.4 per cent using a conservative estimate for the Brazilian IPO), coupled with the ability to generate capital and a proven execution ability place the bank in an advantageous position to benefit from potential market opportunities.'

The main question for the bank remains the possible impact of regulatory risk, which may mean higher capital needs and hence reduce the bank's ability to re-leverage its capital ratios through M&A. In that event, though, the bank's strong capital situation still puts it in a relatively good position owing to low issuance risk.

## **BNP Paribas**

BNP Paribas knows risk when it sees it. The French-headquartered global bank has been built on the risk-management expertise that comes from a staff packed with some of the finest mathematical minds that a French education can produce. It sealed its own place in infamy by providing a convenient pillar to pin the start of the credit crisis on when it froze three funds on 9 August 2007. But that move, with the benefit of hindsight, was simply an early indication of the way in which the bank has prudently picked its way through the wreckage of the financial markets of the past two years.

BNPP is now the third-largest bank in Europe by market capitalization, behind HSBC and Banco Santander. As a group, it has not had an unprofitable quarter since the crisis began. In the third quarter of 2008, the most recent for which financial results were available, the group generated net profits (attributable to shareholders) of 1.3 billion euros (277 million euros from BNP Paribas Fortis), up 44.8 per cent compared to the same quarter the previous year, when the crisis was at its worst.

In its new scope, the group generated revenues of 10.7 billion euros, up 40 per cent compared to the third quarter 2008 (including a 308-million-euro negative impact from its own debt revaluation compared to a 123-million-euro positive impact in the third quarter 2008).



Operating expenses, at 6 billion euros, were up 30.2 per cent, and gross operating income, at 4.6 billion euros, grew 55.3 per cent.

For the first nine months of 2009, the group's revenues totalled 30.1 billion euros (up 33.8 per cent compared to the first nine months of 2008), and the net income attributable to equity holders was 4.5 billion euros, up 1.8 per cent compared to the same period a year earlier despite a doubling of the cost of risk. Its write-downs and loan losses have been relatively limited: only \$3.6 billion worth of sub-prime-backed debt and leveraged loans out of its \$1.8 trillion in assets (versus, say, Merrill Lynch's \$51.8 billion in write-downs with just half the asset base). BNPP now has an AA rating and is rated one of the top six banks in the world. The bank has managed to negotiate the crisis so well not least because of an enormous retail base.

While ambitious, the bank is staunchly conservative, and its dedicated risk managers are involved with the highest-level decisions. The mathematical rigor that runs through the very veins of the firm means that it was never in danger of being caught out, in the way that so many others were, by a lack of understanding of structured credit or equity products. The bank is well known for its expertise in derivatives, but as others piled into products that in many cases it became clear they did not understand, BNP Paribas continued with its rigorous strategy that gave it a lower return on equity during the boom times than some competitors but proved itself during the crisis. A key point in any bank's avoiding the worst effects of the crisis was not being involved in sub-prime-backed securities and other risky loans that got other banks in trouble.

By 2005, when the worst of the worst sub-prime loans were being issued and securitized at less conservative institutions, BNPP was just putting together a US mortgage-trading desk. And what complex sub-prime-backed debt it did buy was largely for clients, not its own benefit, so it hedged its positions well.

The bank is managed by CEO Baudouin Prot, who started working at BNP Paribas in the early 1980s when it was still state controlled, and Chairman Michel Peberau, who was chairman and CEO until 2006 and is widely regarded as one of the finest bankers of his generation. They have doubled the size of BNP Paribas in the last five years with successful acquisitions and transformed the bank into a European powerhouse. The bank argues that BNP Paribas's three-pillar model, based on retail banking, corporate and investment banking and investment solutions – including asset management and private banking – gives the group a far more solid base than rivals. The acquisition of the core of Fortis, the Belgian bank, has buttressed that position.

Besides acquiring Fortis, which gave it two further domestic markets of Luxembourg and Belgium, BNPP has made small deals this year, including nabbing Bank of America's prime brokerage unit after other suitors backed off as they concentrated instead on saving themselves. The bank adds that it 'will continue to be innovative and ambitious but also cautious.'

## **Conclusion**

So as the crisis raged, some remained relatively unscathed. The banks that prospered shared a common conservatism and a belief in, and rigorous practice of, risk management. They used this to show some famous Wall Street firms the way to handle their business during a recession of such magnitude. They did so using years of experience of previous crises, and all of them retained a keen focus on what was best for their clients and shareholders. They also stayed true to a long-term vision etched out long before the crisis. This belief in long-term shareholder value proved to be valuable for many, especially as market volatility made it all too easy to adjust business models that had been developed over years almost overnight. They did not give in to panic – a mood that was all too prevalent on trading floors and in boardrooms around the world. These banks have changed the pecking order in investment banks. They are the new pillars of the system. And that system has changed, probably in their favour. Although memories can be short, it seems unlikely that we will see a return any time soon to the high risk and reward approach to investment banking that has characterized the past 30 years. What we will probably have instead is a more boring, more chaste and more reliable system that treats its customers with respect while not forgetting the basic business of banking.

## **Note**

1. Financial performance for all banks taken from bank's own quarterly financial statements and SEC filings.

# 15

## Conclusion: Living Alternatives – Banking with Integrity

*Heiko Spitzbeck, Michael Pirson, and Claus Dierksmeier*

As history tells, our global society has yet to learn how to deal effectively with the recurring phenomenon of financial crises. Considering strict regulatory approaches, researchers concluded already in 2002 that ‘the endless cycle of boom-bust-regulation accomplishes little in the long run’ (Ribstein, 2002, p. 61). Reflective practitioners such as Howard Davies, the former chairman of the UK Financial Service Authority, agree that mechanical compliance did little to prevent problems.<sup>1</sup> There are two important questions to ask in this context: First, why did regulation not work? Second, what would be an alternative learning mechanism?

### **Why regulation did not work**

The general regulatory approach was to put new laws into place and expect people to behave accordingly – just like a cog in the machine. This represents a socio-technical approach to societal learning in which people are seen as variables in a legal incentive system. Also, no one but the government was asked to act. An important underlying assumption was that all other players just had to adapt to the new rules, which would solve the issues. It gives other actors in the system no responsibility, as all responsibility is delegated to the legal framework. The most fundamental rule to review here is the function of central banks as lenders of last resort. It provides a systemic airbag and encourages banks to take too much risk. Without any risk to financial results and individual bonuses, financial experts could return to business as usual without using the crisis to reflect on their own role in helping to assure the integrity of the whole financial system. ‘Innovation’ in the mainstream financial industry concentrated

on making high-margin profits while staying compliant and formally within the rules of the game.

As soon as the impacts of this most recent crisis fade in the public's consciousness, the more opportunistic parts of the financial system will again see regulation as nothing but a constraint to their profit margins. Slowly but surely they will return to lobbying against these legal constraints and arguing in favour of market liberalization. As the case of Glass-Steagall demonstrates, at some point in time they are bound to be successful, thus setting the stage for the next crisis as well as for subsequent waves of regulation.

It is paradigmatic for a post-crisis situation that the different players are blaming each other. The media was quick to start the hunt of the culprits. They started with bankers who were blamed for lending to customers who were not credit-worthy. Then followed the critique of the regulators who failed to provide necessary checks and balances. The clients were blamed for taking credits beyond their financial ability. The rating agencies were blamed for not recognizing the risks of MBS and for being paid by the institutions they should scrutinize. Business schools are blamed for educating bankers and managers with a mind-set characterized by short-termism and profit maximizing. However, as the crisis is systemic, there is no one culprit to be singled out. In other words, you could put different well-intentioned persons into the same position and the result would be similar. As long as the financial system is driven by the opportunistic hunt for profitability and bonuses, we will not prevent future crises. Neither can one simply regulate responsible behaviour.

We need responsible individuals who stay faithful to their principles even if others do not. They also understand the value of good laws that set a plain level field for the financial industry. However, neither good laws, nor good people alone will solve the issue of integrity, hence we need both. Humanistic principles provide the moral compass to judge the integrity of the people as well as the laws.<sup>2</sup> For that to happen, however, it is imperative that financial managers be not only trained to be technical experts but also educated so as to understand and respect the inherent sense of the rules of their industry.

People do not want to be put into a socio-technical straitjacket of regulation. Therefore they will make use of their freedom of choice if they are to follow the new rules. Often people choose to follow the letter, but not the spirit, of the law. How can they be expected to follow the spirit of the law if they have not been encouraged to reflect on why laws are in place? If they are encouraged to understand the value and reason of

the new rules, they might follow. If, however, rules are simply imposed, they might as well not.

### **Where are the ‘good’ people and organizations in the banking sector?**

In times of crisis, it is important to understand the power of alternative approaches to business in general, and in this case of the financial industry in particular. They are few and far between, but some financial services companies have made headlines of a different kind in the gloomy environment for the financial industry. Some banks saw a sharp rise in held savings, some mortgage companies could still afford to lend to prospective homeowners, and some others had little or no exposure to the financial market instruments that have caused billions of dollars in losses for most.

In this book we took a look at those companies from the financial services sector that stood surprisingly firm in these stormy times. In this conclusion we will present some common threads that have made them – in our view – less vulnerable than most in the industry.

After reading the book, an informed reader might ask why certain other banks that weathered the storm were not included as cases in this volume. In order to address this question, let us share the basics of how we identified financial institutions forming part of this work. We issued a call for cases on prominent e-mail discussion lists, inviting researchers around the globe to contribute to this project. Certain banks are not represented in this book due to the fact that no case study author volunteered to document their stories. If this situation changes in future, the Humanistic Management Network would be happy to publish a second book to complement the publication you are holding in your hands. A larger case pool might also lead us to qualify some of the conclusions we present here, as we are aware that we collected a very particular group of financial institutions.

An important selection criterion for cases in this book was the bank’s ‘immunity’ to the impacts of the financial crisis. With the exceptions of ShoreBank and Banca Prossima, all banks portrayed in this book have done well financially during the years 2007–10 and thus during the worst of the financial turmoil. And only three banks made use of government funding to weather the crisis. ICICI was backed by the government of India. Cooperative Bank of Chania applied for government funding but to date has not used the funds due to its financial health. Finally, BB&T used \$3.1 billion in TARP money, not so much to assure its survival but more to ‘spur growth in local communities.’

Table 15.1 Competitive advantages used by banks during the crisis

Competitive advantage	Examples
Increased market share by M&A	Banco Santander, ABN AMRO Real
Increased loan portfolio	People's United Bank, Wainwright Bank & Trust, Triodos Bank
Low exposure to bad debt	Banca Prossima, GLS Bank
Low employee turnover	Cooperative Bank of Chania, Wainwright Bank & Trust
Customer loyalty	Wainwright Bank & Trust

While others struggled with survival, some of our banks were able to extend market share by acquisitions; other institutions significantly grew in terms of loan portfolio and number of customers. Table 15.1 gives an overview of how the humanistic management practices of the banks portrayed in this book have helped them during the financial crisis of 2007–10.

### Towards a vaccine

The approach of looking at some of the winners of the financial crisis is comparable to developing a vaccine by asking, 'What made other banks resistant or immune to the crisis?' Following the considerations at the beginning of this book we were particularly interested in how these banks and financial institutions dealt with the threat of opportunistic behaviour on an organizational as well as on an individual level.

The diagnosis provided in the introduction was based on three observations regarding opportunistic behaviour: (1) increasing profitability by promoting the illusion that one can make money from money; (2) executive compensation schemes that incentivize opportunistic behaviour; and finally (3) lobbying for lax regulation based on considerations of competitiveness of financial service firms.

Following the same line of thought, we analyzed the management approaches of our case study sample firms.

### The relation to profitability

Banks involved in the financial crisis have been criticized for privatizing gains during good times and socializing losses in bad times. Their benchmark for success was the quarterly earnings report to shareholders. As Nobel laureate Joseph Stiglitz outlined, creating earnings based on market values is easier than creating value in the real economy. The banks in

this book take the burdensome real-economy approach and can therefore be considered to be humanistic higher-purpose companies.<sup>3</sup>

### **A mission geared towards societal value creation**

A leading indicator for recognizing in whose interest the bank acts has been given in the quote of People's United Bank CEO Philip Sherringham: 'I think you have to ask the question – what is the benchmark for success?' The mission statements of our cases position the banks to be of service of society (see Table 15.2 below).

The humanistic approach of these banks is codified in their mission statements answering the question 'Why do you exist and why does society need you?' A critical reader might suggest that other banks had or have similar visions but suffered from the impact of the financial crisis. The vision needs to be connected to the daily work of managers. Our case examples demonstrate a more human-oriented approach to management put into practice. In comparison to other banks, their mission provides real guidance, and they take great care to live up to it. How did they do that?

### **Sticking to clear business principles**

Derived from their mission, the banks aim to enhance real business and positively impact the their customers' quality of life as well as the communities in which they do business. Due to the banks' interest in improving the quality of life in society, they exhibit a very special relation to profitability. Some of the banks, such as Banca Prossima, purposefully adopt a 'low-profit model' to allow a fair distribution of profits. Similarly, Banca Popolare Etica distributes profits to all people that guaranteed its creation. CCML uses the profit it generates to fund the activities of its not-for-profit parent organization. The banks in this book distribute profits much more broadly than their mainstream competitors. Internal as well as external stakeholders feel that they are not abused to generate profits for shareholders.

This is not to say that profits are not important. Banks need a healthy financial basis upon which they can generate value for society. However, due to their particular relationship to profit, the banks in this book can be considered much more profit-satisfiers and not profit-maximizers. A good example for profit-satisfying or optimizing is BB&T. The bank's strategy to optimize returns has been based on providing excellent client service, ensuring the right employees are in place, and understanding that economic results are closely tied to the success of the communities in which the bank operates.

Table 15.2 Mission statements of portrayed banks

<b>Bank</b>	<b>Statement</b>
ABN AMRO Real	... contribute to the evolution of society.
Banca Popolare Etica	Credit, in all its forms, is a human right. For Banca Etica, these rights and processes are replaced by a logic centred on providing a service to civil society and, in particular, to its more disadvantaged members.
Banca Prossima	The company's purpose shall be the creation of social value.
BB&T	The bank's mission is: To make the world a better place by helping our clients achieve economic success and security creating a place where our employees can learn, grow and be fulfilled in their work making the communities in which we work better places to be
CCML	... mission to help create economically and environmentally healthy communities in which all people, especially those with low incomes, can reach their full potential.
Cooperative Bank of Chania	Philotimo – the love of honour, which motivates people to act in the benefit of others.
GLS Bank	The aim of the bank is to contribute to the sustainable development of society. GLS Bank sees money as a means to make things happen in society.
ICICI Bank	Play a proactive role in the full realization of India's potential.
J.P. Morgan	... support and serve our 90 million customers and the communities in which we operate.
People's United Bank	Invest in the communities we serve.
ShoreBank	ShoreBank invests in people and their communities to create economic equity and a healthy environment.
Triodos Bank	... to encourage funding of projects which seek social innovation. Triodos Bank wants to contribute to the development of a humane society.
Wainwright Bank & Trust	... become a catalyst for social change.



Even in the case of J.P. Morgan, Anuj Gangahar described how the bank's conservatism was faced with criticism, which he summarized as 'Okay, you didn't lose out dramatically, but you weren't really even in the game to start with, so your "victory" is somewhat hollow.' This critique applies to all of our cases. And all our cases would probably respond just as the author did for J.P. Morgan – it simply did not fit with the values. Along similar lines argued an analyst of People's United: 'If you really believe in the impact of humanism in business, you might have to put up with some poor quarterly earnings figures.' Due to their humanistic mission and their values, banks were never in the game of maximizing profits; they play a whole different game altogether. Their 'victory' is not expressed simply in financial earnings or losses. The victory of the case examples can be considered much more profound, as they avoided the social consequences of the financial crisis such as home eviction for their clients. This is their success and in turn helps them to create trust with current and especially with prospective clients – they are getting known for not letting their partners down as they stick to their principles (see Table 15.3). The same trust other banks lost because they regarded similar home evictions as an unavoidable consequence of business and basically as an externality, which is not measured in their balance sheets.

The collection of banks demonstrate that they take these principles seriously and that they are living their principles day in, day out. They are not prone to skip one of these principles to make a quick buck, as they know that the way they live their values defines their identity. They have never been called 'predatory lenders.'

### **Risk management**

Values such as prudence, responsiveness, empathy, and transparency are strongly linked to risk management. Flowing from the principles and values to invest in the real economy and to create benefits for clients and communities, the banks in this book adopted a serious approach to risk management. Wainwright gives credit only when the bank feels confident that it can help the client to pay back the loan. Instead of leaving the responsibility to pay back a loan with the client, Wainwright takes co-responsibility, helping clients who are struggling with their finances. Obviously, such an approach is more burdensome as it requires the banks to listen carefully to clients' needs, evaluating the projects they want to finance as well as their financial means. Engaging intensively with customers also makes sure that banks offer only products that their customers understand.

Table 15.3 Principles adopted by the portrayed banks

Principle(s)	Example(s)
Prudence	Wainwright gives credit only if the bank feels confident that it can help the client to repay the loans. Banks such as GLS did not engage in speculation, as it does not fit their values.
Relationship & Responsiveness	Triodos holds that there needs to be a connection between the saver and the moneylender. Savers need to know where their money is invested. Wainwright aims to listen more and respond better. That means closely examining stakeholders' deepest needs and the issues most worth fighting for. CCML tracks its success back to 'It's all about relationships.'
Honesty & Critical Loyalty	BB&T – in everyday decision-making at the bank, employees must say what they mean and mean what they say. GLS encourages an 'open and honest' dialogue across hierarchies. At J.P. Morgan, executives 'speak their mind.'
Transparency	GLS publishes all loans and their use.
Empathy	Triodos, GLS, and Wainwright practice High Engagement Banking, listening to their clients' needs, designing products in order to help their clients succeed. People's United holds that the saver needs to benefit and thereby the community in which he lives.
Integrity & Authenticity	BB&T stresses acting consistently with the principles of the organization. In Brazil, ABN AMRO Real engaged only with customers who shared the same principles, because otherwise these principles would be meaningless.

At the same time, sticking to such policies assures to avoid sub-prime lending.

Banks such as Santander, J.P. Morgan, and BNP Paribas simply did not engage in sub-prime lending because of their theme: don't engage if you can't calculate the risk. Their excellent risk-management skills prevented them from major exposure to the effects of the financial crisis. People's United is generally sceptical of lemming-like behaviour and encourages executives to think for themselves and to think long-term.

Surely all these approaches to risk management have helped the banks to have a low exposure to bad debt.

### **Corporate governance as stakeholder governance**

The principle of relationships also permeates corporate governance arrangements. Many of our cases have adopted a cooperative model (Banca Popolare Etica, Cooperative Bank of Chania, GLS) which favours a more democratic style of decision-making. Here the members actively participate in shaping the organization's policies and decisions.

However, more democratic forms of governance are also adopted by other cases. Triodos, for example, does not allow large shareholders to dominate the shareholder meetings. Shareholders can own a maximum of 7.5 per cent of the capital, and less than 1 per cent of influence in the shareholder meeting. To make this structure possible, Triodos is not listed publicly.

The banks also actively seek the value discussion with their stakeholders. CCML has set up both an independent board and an advisory board, which represents low-income communities. Banca Prossima also has an advisory board consisting of representatives of not-for-profit institutions, providing guidance on solidarity and development initiatives. Triodos held extensive deliberations with stakeholders, especially when developing new markets such as organic farming. Complimentary research (Spitzack and Hansen, 2010) also sees a new trend in which companies such as Unilever, Anglo Plantinum, Rabobank, Novo Nordisk, and The Cooperative Bank implement board structures in which stakeholders are granted a voice in corporate governance processes (see also Turnbull and Pirson, 2010). The innovative governance arrangements requiring engagement with stakeholders provide a solid frame of corporate decision-making which caters for the interest of all involved parties in the value creation process. More democratic forms of governance arrangements to confront financial crises had already been suggested by Galbraith (1975).

### **Executive compensation**

UK Chancellor Alistair Darling announced in 2008 that the government was limiting bonuses paid out to staff by the Royal Bank of Scotland (RBS). 'We want to see a cultural change where short-term bonuses are replaced with incentives for the long term,' he said.<sup>4</sup> He might be inspired by the compensation practices of the banks portrayed in this book.

Some banks cap the compensation in terms of the relationship of CEO to average worker pay. Banca Popolare Etica adopted a ratio of 6:1 while Triodos opted for a ratio of 7.7:1. Other banks, such as Banca Prossima and Cooperative Bank of Chania, implemented group-based performance systems. GLS and Triodos explicitly oppose individual bonus systems. Most banks take a long-term and mission-centred perspective to compensation, which is another mechanism guaranteeing that the bank lives up to its vision.

Even where individual bonuses are granted, executives acted in response to the economic climate. Facing the crisis, executives of BB&T opted for not accepting their bonuses despite excellent business results. They demonstrated moral acumen and showed that they were not motivated only by financial benefits.

What is common among most of the incentive systems is that they pay their executives significantly less than do their competitors. Triodos argues that executives who are motivated only by money shall work elsewhere, as they would not fit the culture of the bank. Similarly CCML would not hire somebody unless it was comfortable that the person had the commitment to the social mission. CCML's CEO, Charlie Spies, sees that his team 'first and foremost consider themselves as fiduciaries of the low-income community.' Just like professionals working in the not-for-profit sector, executives might feel compensated by a 'psychological income' – working for an institution which makes sense beyond profits.

Paying less to executives and to shareholders is another sign of living the principles and values of the banks. While profit sharing has traditionally been established based on share-ownership and hierarchical position, the banks here distribute their earnings much more equally among the different stakeholders and reinvest earnings in their social mission.

## Lobbying

Inspired by a vision to create value for people, the banks in this book continuously innovated by creating new markets and new products for the benefit of their stakeholders. This also involved taking a political stand, as the examples of several banks demonstrate (see Table 15.4 below). In the words of ShoreBank:

[W]e have legitimized the use of a for-profit, privately owned regulated bank to convert insured bank deposits into development

credit for the benefit of low- and moderate-income people especially minorities. So we have made it legitimate for ourselves and for others to use the nation's banking system to advance the cause of development...more broadly we have contributed to the work that others have done also to generally democratize the availability of private non-government credit to low-income and otherwise disadvantaged people.

The example of ShoreBank shows that there are banks taking responsibility to improve the system and legislation to benefit the people. The founders created a model which channels private finance to community development supported by government tax incentives. This is a system which does not confound means and ends. The means of finance is to improve the quality of life in communities. In order to distinguish this legitimate political discourse from more opportunistic forms, we call it *civic lobbying* – lobbying for the benefit of society.

Banks also lobby for their causes in the dealing with their partners. CCML is introducing social and environmental issues in the projects it finances and encourages its customers to take a more humanistic approach to management themselves. Central questions in credit

Table 15.4 Civic lobbying of some banks

Bank	Issue	Result
ABN AMRO Real	Microcredits	The Brazilian government invests in microcredit initiatives.
Wainwright	Gay communities	Support the government's Employment Non-Discrimination Act. 10% of the workforce are openly gay or lesbian.
ShoreBank	Community-based economic development	President Clinton's Community Development Banking and Finance Institutions Act
GLS	Sustainable development	Active member of the Global Alliance for Banking on Values
People's United	Mentoring and bullying prevention for youth	Entering the governor's Prevention Partnership to fight violence, underage drinking, and drug abuse.

approval are therefore ‘How does this project help society to become more sustainable (e.g. GLS Bank)? Is there any leverage for creating even more social or environmental value (e.g. CCML)?’

To lobby for more humanistic forms of banking, organizations such as Banca Popolare Etica, GLS, and Triodos are active members in the Global Alliance for Banking on Values. Members of the Global Alliance for Banking on Values are all banks whose central mission is investment in a society that values human development, social cohesion, and responsibility for the natural environment.<sup>5</sup> The alliance lobbies for a positive, viable alternative to the current financial system.

The lobbying activities of the portrayed banks demonstrate legitimate political participation in lawmaking processes. To confront the crisis, we are in need of sensible regulation for the global financial markets, and banks should have a say in that. Lobbyists, however, should be encouraged to argue in the interest of the general public and the taxpayers, who until today have always come to rescue struggling financial institutions. The civic lobbying activities of the banks above (Table 15.4) clearly show that they are done for the benefit of the stakeholders and can be defended publicly against any claim of opportunism. This observation can also serve as a test to separate opportunistic from civic lobbying activities.

## Supporting influences

We summarize the success of the banks in this book with banking with integrity, noting that some of our cases could count on external influences such as a strong internal market and sound legislation.

Compared to other banks, ICICI has a comparative advantage – a fast-growing internal market in one of the world’s most booming emerging markets. The same is true for ABN AMRO Real, bought in the meantime by Santander. Emerging economies such as India, China, and Brazil could buffer their losses in international markets with gains from the growth of internal markets – a phenomenon discussed as decoupling. This puts evidence to Stephan Schmidheiny’s (founder of the World Business Council for Sustainable Development) observation that ‘business cannot succeed in societies that fail.’<sup>6</sup> ICICI and ABN AMRO Real had the backing of a successful society, hedging them from the risks of the financial crisis. Banks which are successful in the long run understand that their business is intrinsically linked to the success of their customers and the society around them.

Another mediating factor was government regulation, which had a major impact in the case of ICICI in India as well as for Canadian banks. These markets were more prone to the crisis, as governments did not pull out safeguards as did the United States with the repeal of the Glass-Steagall Act. This underlines that we are not arguing for the abolishment of laws. Good laws and decent behavior mutually reinforce one another. Therefore, we do argue for complementing laws with better cultural forms of learning and management education. While, of course, the structural forms of societal learning such as banking laws and the incentive systems in the finance industry have to be improved, any revision of these factors alone will not be enough. If the vast majority of banks continue to be driven by an opportunistic culture, the market system rewards short-term quarterly earnings, and the purpose of the firm is seen as maximizing shareholder value, then no law and no structure will help to prevent a future crisis. Without a change of culture and a new mind-set, all structural adaptations will be only window dressing.

We argue, hence, that a new culture of integrity can emancipate financial actors to take on the responsibility inherent to their profession. Instead of putting bankers in legal straitjackets, we should rather educate them to make a responsible use of the managerial freedom that their jobs entail. It is thus not from the law but from the financial industry itself that the main response to outside criticism must proceed. This means, for instance, that society's question 'Why should we trust you?' can no longer be answered by the banks simply with 'Because we comply with regulation.' The foundations of trust have to be internal – stemming from the bank's own integrity. If a bank understands the ethics of integrity, it will also comply with the spirit of the law. Additionally it will proactively lobby for sound regulation, which in turn helps to create a level playing field. Without that, banking with integrity will always be seen as the exception and looked upon negatively in times of growth, as these financial institutions will not reach the same level of profitability as the more opportunistic financial service firms. Banks and bankers of integrity need to raise the bar of regulation for the financial industry as a whole, in order to better contribute to the needs of a rapidly changing global society and to the benefit of humans all across the planet.

Also bankers and other financial experts will no longer be able to divert responsibility to other players in the market. If they want to convince their now increasingly critical audience, they have to take responsibility for the systemic impacts of their own behaviour. They cannot

return to business as usual. They have to come up with a whole new approach to banking and finance.

### **Why should we trust your bank?**

The success during the latest financial crisis provides most of the banks portrayed here with a convincing answer to this question: You can trust us because we stand for – and have always been standing for – banking with integrity. Without these banks, society would be worse off. Such banks are clearly not following the economic logic of maximizing returns for shareholders. Banks in this volume have adopted a humanistic vision for banking – improving their communities' quality of life – in good times and in bad times. Therefore, they uphold their values, involve stakeholders in their governance systems, take a civic perspective when lobbying for regulation, exercise prudent risk management, and incentivize their staff not purely on financial terms.

Their example holds the potential of cultural learning.<sup>7</sup> Rahm Emanuel, President Obama's chief of staff, said in 2008, 'Let's not waste the crisis we have.'<sup>8</sup> We would waste it if we did not use it to reflect on the culture in the financial system, like we did in the financial crises we had before. Ultimately, the number of financial turbulences in the 21st century could prove the superiority of banking with integrity. The cases are not yet bulletproof evidence, but they provide some first indications. Just like a doctor standing in front of a new disease, we are not yet completely sure which treatment will cure the patient.<sup>9</sup>

Despite this precaution, one indicator of the success of cultural change and an alternative, more humanistic approach to banking is already visible today. This book contains some financial institutions which have done well under the financial crisis of 2007–10. The banks and financial institutions presented in this book all contain lessons to be learnt regarding banking with integrity. Each case demonstrates that the individual bank stayed faithful to its principles even when other banks were temporarily making more money. Due to their inherent trustworthiness and integrity, they attracted new customers and expanded their market share while others struggled for survival. The cases featured in our book exemplify professional finance and serve as inspiring examples on how banking with integrity can deliver enormous social benefits. Moreover, they accomplish the proof of concept: they demonstrate that banking with integrity brings financial returns as well.



## Notes

1. Quoted by Fr Christopher Jamison, the Abbot of Worth – lecture given on 11 November 2008, London, St. Alban The Martyr. Available at: <http://www.operationnoah.org/resources/religiousinspirations/changing-climate-spiritual-steps-sustainability> (accessed 21 Feb. 2009).
2. Dierksmeier, C. 2011. 'The Freedom-Responsibility Nexus in Management Philosophy and Business Ethics'. *Journal of Business Ethics* 101 (1), 263–83.
3. See Arena (2006) as well as her chapter on Wainwright in this volume.
4. See 'Chancellor sets RBS bonus limits', BBC News, 17 Feb. 2008.
5. See <http://www.gabv.org/> (accessed Aug. 2010).
6. See VIVA Trust and INCAE (2003): *Walking the Talk – Symposium on Entrepreneurship, Philanthropy and Development*, San Jose. n.p.
7. An ethical project put forward by the UK Financial Service Authority was initiated already in 2002. However, as the leadership changed, the institution went back to rule compliance. A short history of these activities is given by Fr Christopher Jamison, the Abbot of Worth – lecture given on 11 November 2008, London, St. Alban The Martyr. Available at: <http://www.operationnoah.org/resources/religiousinspirations/changing-climate-spiritual-steps-sustainability> (accessed 21 Feb. 2009).
8. Taken from Gwynn Dyer, 'Commentary – Never Waste a Crisis', *Athens News*, 24 Nov. 2008.
9. We might observe a similar situation as in the case of Peter and Waterman's book *In the Search for Excellence* (New York: Harper & Row, 1982). The authors revised the management practices of outstanding companies to identify what makes them excellent. Some of the portrayed companies, however, did not keep up with the high expectations regarding performance, casting doubt over the validity of the recommendations provided by the authors.

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# Index

- ABN AMRO REAL, 21–34
  - acquisition of, by Grupo Santander, 33–4
  - best practices and, 29–31, 33
  - business model of, 32–3
  - insolvency rate, 28–9
  - mission statement, 197
  - staff engagement at, 25–7
  - success of, 32–3
  - sustainability and, 23–5, 27–9
  - Sustainability Development Leadership program, 31–2
  - vision of, 21–3
- Acción Internacional, 29
- Allison, John A., 66, 70
- Amigo Real Project, 26–7
- authenticity, 178, 199
  
- Bagehot, Walter, 7
- Banca Popolare Etica, 36–47
  - corporate governance model, 46
  - distinctive dimensions of, 40–3
  - ethical and profitable banking by, 43–4, 46–7
  - executive compensation, 201
  - financial indicators, 44
  - mission statement, 197
  - structure of, 37–8
  - values and mission of, 38–40
- Banca Prossima, 48–63, 195
  - beliefs, choices, and actions by, 53–6
  - business model of, 49–50
  - employees of, 56–8
  - mission, 49, 197
  - remuneration policies, 58–60
  - social innovation by, 49–52
  - valuation model, 57–8
- Banco de Lavoura de Minas Gerais, 21–2
- Banco do Brazil, 34
- Banco Itaú, 27, 33–4
- Banco Real, 22
  
- Banco Santander, 187–9
- Bank & Society Lab, 50–1, 57
- bank failures, 4, 91, 101
- Banking Act, 13
- bank mergers, 33–4
- Bank of England, 7, 98
- bank of value concept, 22–4
- banks
  - alternative approaches to, 194–5
  - Canadian, 185–7
  - central, 7
  - commercial, 2, 13, 144–5
  - community, 64, 71–4, 91
  - competitiveness of, 14
  - investment, 13, 182–91
  - lending by, 11–12
  - lobbying by, 201–3
  - opportunistic behavior by, 10–18
  - regulations on, 12–15, 192–4
  - “too big to fail”, 107–8
- Barbosa, Fabio, 22, 34
- Barings crisis, 7, 9
- BB&T, *see* Branch Banking & Trust (BB&T)
- Bear Stearns, 5
- best practices, 29–31, 33
- Blair, Sheila, 91
- BNP Paribas, 189–91
- Botin, Emilio, 187
- BRAC Bank, 112
- Bradford & Bingley, 5
- Branch Banking & Trust (BB&T), 64–74, 195, 196
  - challenges facing, 72–3
  - conservative credit culture of, 70–1, 72
  - core values of, 67–9
  - cost-cutting by, 72
  - economic downturn and, 70–1
  - financial crisis and, 64–5, 66
  - mission statement, 197
  - ownership and leadership of, 67
  - restructuring by, 72–3

- Brazil, 22, 33–4  
 British Bank Charter Act, 7  
 business principles, 196–9
- Cahillane, Mary, 153–4  
 Canadian Bank Act, 186  
 Canadian banks, 185–7  
 casuistry, 94, 104n10  
 CEI Capital Management  
   LLC (CCML), 76–90  
   economic downturn and, 85–9  
   implementation of vision, 80–4  
   mission and model of, 79–80, 197  
   outcomes for, 84–5
- central banks, 7  
 circuit-breakers, 9  
 Citigroup, 13  
 civil society, 41, 46, 47  
 Clinton, Bill, 13  
 Coastal Enterprises Inc. (CEI), 77, 78,  
   80, 84  
 collaboration, 178–9  
 Collins, Jim, 180  
 commercial banks, 2, 13, 144–5  
 community banks/banking, 64,  
   71–4, 91  
 community development, 79–80,  
   140, 144, 146  
 Community Development Finance  
   Institution (CDFI) Fund, 79–80  
 community development lending,  
   71, 172  
 Community Reinvestment Act, 74n1  
 competitive advantages, 196  
 consumers, 117–18  
 consumer spending, 2, 4  
 cooperative banking, 91–2, 94, 96–8  
 Cooperative Bank of Chania,  
   91–106  
   ethical values of, 95–8, 101  
   financial crisis and, 98–101  
   governance, 94–5  
   lessons provided by, 101–4  
   mission statement, 197  
   personality engagement  
     initiatives, 102  
     society engagement and, 92–5  
 cooperative identity, 97–8  
 corporate governance, 200  
 corporate social responsibility, 24–5,  
   29, 53, 125, 175  
 corporate sustainability, 112–14  
 Cox, Christopher, 170–1  
 Crèche Project, 51  
 credit, 38  
   access to, 41  
   democratization of, 2  
   extension of, 171  
 credit-card debt, 16  
 credit cards, 2  
 credit crunch, 4  
 customer loyalty, 170, 172, 195
- Darling, Alistair, 200  
 Davies, Howard, 192  
 Davis, Milton, 142  
 debt burden, 6  
 democratization of credit, 2  
 deregulation, 12–15  
 Dimon, Jamie, 43, 183  
 distributive justice, 38  
 DryWash, 27–8  
 DSB, 91
- economic development, 79–80  
 economic growth, 3  
 electronic trading crisis, 8–9  
 Ellena, Guy, 32  
 Emanuel, Rahm, 205  
 empathy, 199  
 employees  
   Banca Prossima, 56–8  
   GLS Bank, 113  
   ICIC Bank, 121–2  
   respect for, 43  
   salaries of, compared with  
     executives, 43  
   Wainwright Bank and  
     Trust, 174–5  
 ethical banking, 43–4, 46, 53  
 Ethical Fund, 27  
 ethical products and services, 40–1  
 ethics  
   defined, 53  
   integrity and, 95–8, 101  
   profitability and, 43–4  
 Etica Sgr, 37  
 European Central Bank, 1–2

- executive compensation, 10, 15–18, 43, 200–1
  - Banca Prossima, 59
  - ICIC Bank, 124–5
- FEBRABAN, 22
- Federal Deposit Insurance Corporation (FDIC), 8, 66, 91, 153
- Federal Reserve (Fed), 1–2
- financial crises, 192
  - see also* global financial crisis (2008)
  - root cause of, 10–18
  - vaccine for, 196
- Financial Federal Corporation, 136–7
- financial industry
  - deregulation of, 12–15
  - innovation in, 192–4
  - problems in, 1–9
  - regulations on, 192–4
- financial institutions, opportunistic behavior by, 10–18
- Financial Institutions Reform, Recovery, and Enforcement Act, 8
- financial markets
  - bubbles in, 8
  - lack of trust in, 4
- Fletcher, Jim, 142
- flexible schedules, 43
- Floresta Real program, 24
- Germany, 107, 111
- Gianetti, Eduardo, 30
- Glassman, Robert, 169, 170, 173–5
- Glass-Steagall Act, 8, 13, 14, 193
- Global Alliance for Banking on Values, 112, 203
- global financial crisis (2008), 9, 91
  - Banca Prossima and, 60–1
  - BB&T and, 64–5, 66
  - community banks and, 64
  - Cooperative Bank of Chania and, 98–101
  - events underlying, 2–4
  - historic roots of, 6–9
  - ICIC Bank and, 123, 126
  - impact of, 4–6, 107–8, 182, 195
  - in India, 118
  - People's United Bank and, 133–6
  - root cause of, 10–18, 117
  - ShoreBank Corporation and, 149–54
  - Triodos Bank and, 158–60
  - Wainwright Bank and Trust and, 169
- Global Trust Bank, 117
- GLS Bank, 107–14
  - corporate culture of, 113
  - growth of, 107
  - innovative banking products of, 111
  - mission statement, 197
  - sustainability and, 109–14
  - transparency and, 109–11
- government bailouts, 4, 6, 66, 70
- Grameen Bank, 96
- Great Depression, 7–8, 13
- Great Recession, *see* global financial crisis (2008)
- Green, Stephen, 6, 16
- green banking, 112
- green management, 42–3
- Greenspan, Alan, 2, 14–15
- Grupo Santander, 33–4
- Grzywinski, Ron, 142–5, 151–2
- Gurría, Angel, 6
- Hadley, Thomas Jefferson, 65
- Hart, Stuart L., 30
- Hawley, Samuel, 130
- HBOS, 5
- HDFC Bank, 117
- Hippocratic Oath, 18
- Hohagen, Alexandre, 30
- honesty, 199
- Houghton, Mary, 142–4, 146, 148–9, 151
- household debt, 117
- house prices, 2–3
- housing market, 2–3
- humanistic management, 173–6, 179–80, 196, 205
- human persons, respect for, 43
- income gap, 16–17
- India
  - banking in, 116–18
  - economic overview, 115–16
  - financial crisis and, 118
  - public policy, 117–18

- Industrial Credit and Investment Corporation of India Bank (ICICI Bank), 115–28, 203–4  
 corporate governance, 123–7  
 economic downturn and, 122–3  
 executive compensation, 124–5  
 financial crisis and, 123, 126  
 management philosophy, 119–21  
 mission of, 119, 197  
 risk management at, 124  
 work culture, 121–2
- Industrial Financial Corporation of India (IFCI), 119
- innovation, 45, 49, 52, 57, 60, 102, 113, 115, 124, 147, 177–8, 192–4
- integrity, 95–8, 101, 199, 203–5
- interbank lending, 3–4
- International Association of Investors in the Social Economy (INAISE), 112
- International Code of Marketing, 40–1
- International Cooperative Alliance (ICA), 96
- Intesa Sanpaolo, 48–50, 55, 60–1  
 intuition, 178
- investment banks/banking, 13, 182–91
- Italy, 36, 44, 51–2, 53
- J.P. Morgan, 43, 183–5, 197, 198
- Kamath, M.V., 119–21
- Ki-Moon, Ban, 6
- King, Kelly, 64, 70
- King, Mervyn, 98
- Kostakis, Panayiotis, 93
- Lehman Brothers, 4, 5, 6, 15  
 lender of last resort, 7  
 lending standards, 4  
 Lighthouse Project, 71  
 loan and gift communities, 111  
 lobbying, 201–3  
 low-profit model, 54–5
- Ludwig, Eugene, 152
- MAG movement, 36–7
- Majolo, Jose Luiz, 22
- Marakakis, Michael, 93, 98–100
- market liberalization, 12–15
- means of exchange, money as, 11–12
- Merrill Lynch, 5
- micro-lending, 29
- Millennium Development Goals, 6
- mission statements, 196–8
- money  
 illusion of making money from, 11–12  
 as means of exchange, 11–12
- Morganti, Marco, 58
- mortgage-backed securities (MBS), 2–3, 13, 139
- mortgage lending, sub-prime, 2–3, 9, 13, 64, 117, 132, 149–50
- Myrtakis, Nikos, 99
- National Bank of Greece, 95, 104n9
- negative savings rate, 2
- negative screening, 40–1, 47n1
- New Deal, 8
- New Markets Tax Credit (NMTC) Program, 76, 78–90
- Niederhauer, Duncan, 16
- Northern Rock, 5
- opportunistic behavior, 10–18
- Ostrom, Elinor, 92
- Overend, Gurney & Co., 7, 9
- Payson, Mike, 79, 85
- pension funds, 4
- People's United Bank, 129–40  
 acquisition of Financial Federal Corporation by, 136–7  
 community development and, 140  
 financial crisis and, 133–4, 135–6  
 management of, 131–3  
 mission of, 131, 197  
 structure of, 133  
 success of, 129–31, 134–5, 137–40
- personal loans, 4
- pharmaceutical companies, 14
- Phillips, Ron, 77–8, 79
- philotimo*, 95–8, 101, 105n15, 105n19

- Pinto, Maria Luiza de Oliveira, 22, 23
- predatory lending, 2
- professions, 17–18
- profitability, 10, 11–12, 43–4, 195–8
- Promontory Financial, 152
- prudence, 199
- public policy, 117–18
- real estate foreclosures, 4–5
- regulations, 10, 192–4, 204
- remuneration policies  
*see also* executive compensation  
 Banca Prossima, 58–60  
 Triodos Bank, 165
- repayment of loans, 73–4
- Reserve Bank of India, 115
- Resolution Trust Corporation, 8
- responsiveness, 199
- retail banking, 4, 13
- risk management, 182–3, 198–200
- Roosevelt, Franklin D., 8
- Royal Bank of Scotland, 15, 200
- SA 8000 certification, 43
- savings and loans crisis, 8, 9
- savings rate, negative, 2
- Securities and Exchange Commission (SEC), 8
- Sherringham, Philip, 131–8, 196
- ShoreBank Corporation, 141–57, 195, 201–2  
 business model of, 144–5, 155  
 community development and, 144, 146  
 economic downturn and, 149–54  
 innovative banking products of, 147  
 management of, 151–2  
 mission statement, 197  
 social impacts of, 147–9
- Snow, John, 171
- social balance sheet, 41–2
- social enterprises, 52, 53, 57–8
- social entrepreneurs, 54, 57, 96
- social innovation, 49–52
- social progress, 47
- societal value creation, 196
- Società MAG, 36–7
- Solidarity and Development Committee, 58
- South Shore National Bank, 143
- Spies, Charles, 80–4, 201
- stakeholder engagement, 39, 41–2
- stakeholder governance, 200
- State Bank of India (SBI), 122
- Stiglitz, Joseph, 17, 195–6
- stock market crash, of 1929, 7–8, 9
- stock options, 17
- strategic responsiveness, 175–80
- sub-prime mortgage crisis, 2–3, 9, 13, 64, 117, 132, 149–50
- sustainability, 23–5, 27–9, 109–14
- Sustainability Development Leadership program, 31–2
- tax credits, 76, 78–9
- third sector, 41
- transparency, 38–9, 41–2, 109–11, 199
- Triodos Bank, 158–68  
 financial crisis and, 158–60  
 financials of, 161  
 governance structure of, 163–4  
 mission of, 163–5, 197  
 principles and policies of, 161–6  
 remuneration policies, 165
- triple bottom line, 53, 76
- Troubled Asset Relief Program (TARP), 66, 70, 150, 153, 195
- trust, 4, 101, 205
- unemployment, 4, 5–6
- United Bank of Switzerland (UBS), 15
- United States  
 household debt, 117  
 recession in, 117
- Urban Partnership Bank, 153–4
- US automakers, government bailout of, 4
- US housing marking, 2
- value creation, 196
- Wainwright Bank and Trust, 169–81  
 employees, 174–5  
 financial crisis and, 169

- Wainwright Bank and Trust –
  - continued*
  - financials of, 173
  - humanistic management approach
    - at, 173–6, 179–80
  - mission statement, 197
  - strategic responsiveness of, 175–80
  - success of, 169–70
- Wall Street crash, of 1929, 7–8, 9
- Waxman, Henry, 170–1
- Weems, Steve, 80, 83, 85
- welfare costs, 6
- Wells, Christopher, 28
- Yunus, Muhammed, 29, 96, 106n20