Responsible banking for sustainable development:

A theory of change

Introduction

Banks, amidst the global economic meltdown post 2008 crisis, have been looked upon the most reliable source of “compassionate capitalism” which aims to extend its hands towards those who need the financial inclusion for a sustained development.

This discussion upon a much sought after theory of change, which is now required for the social and economic upliftment as well as ensuring that the lost confidence rests again with the system.

In the modern capitalistic approach, where the global economy is a “market driven “mechanism, there has always been a debate between “pure profit motives” and the “social benefit motives”.

In the wake of the Global crisis of 2008, which had its origins in the banking system of the US.The fault was neither in the structure of the system nor in the fundamentals.The subprime crisis was the result of “unethical banking decisions”. The way the “stressed assets”were bundled together and sold as securitized products to the investors, which, with the busted loans (the underlying securities), made those institutional investors falter which were considered “ too big to fail”.

The problem did not start with securitization of potentially bad loans, but it had its roots in the immoral and unethical subprime lending to the housing sector of the economy.

The contagion effect worked, engulfing the whole global economy into a tryst of recession, pessimism and faltering institutions like Lehman Bros and even AIG.

One would argue that the main cause for the aforesaid crisis was “slippage of loans made to the housing sector” but was it really the one?

Wasn’t it evolution of the greed component in the banking system which, pursuing its full profit motive, led the banks to forget their goals of existence: responsibility and sustainability.

A trivial question arises: ***Is the banking system itself sustainable?***

When it comes to the recent scams (LIBOR and financial crisis of 2008) the following points are worthy to be mentioned:

- Is there any way to stop money laundering (money being routed illegally) through a banking system?
- Do the banks have "capital adequacy" as required by BASEL III norms?
- Are those innovative products like securitization, CDOs, CDSs sustainable and ethical in countries like India?
- Should banks be allowed to manipulate or decide prime interest rates such as LIBOR?
- Is technique of securitization and shadow banking the way?
- Is the rising level of NPAs especially in the PSU banks in India a real threat to the sustainability or just an overreaction?
- Shall the banks be allowed to become the victims of fresh slippages every year, mostly because of the sacred cows of the government-the agriculture and priority sector loans?

All these questions hover around the words like "*responsibility and sustainability"*

When these two words encounter banks or the entire banking system, the meaning of the word "Banking" changes.It makes a paradigm shift from pure profit motive towards social benefits by being responsible for its investments w.r.t. society and environment.

There has to be a development and acceptance of the fact that the profits of a bank, the impact of its investments on society and the environmental record of its clients are highly interdependent and correlated to each other.

This growing concern about ' environmental performance, manifested in lending and investments decisions, has begun to act as an additional driver of sustainability in the private sector. Companies have been given one more reason to pursue environmentally and socially sound solutions.

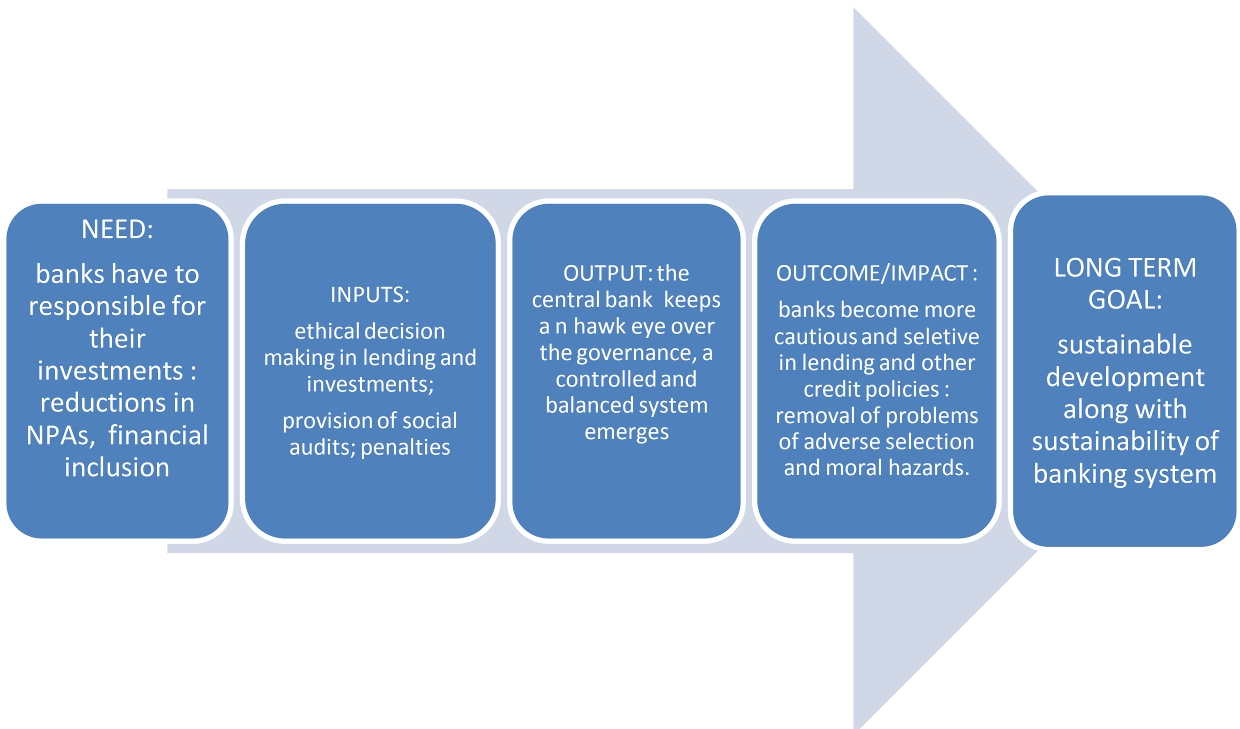
So has the *theory of change* has already started to be implemented or still in nascent stage?

Here is the desired theory of change described in the flow diagram.

Figure 1

The Logical Framework shown above must be developed into a model and should be implemented to the core of the system.

The banks especially in countries like ours have to create a differentiated proposition in the



cluttered financial services market-space by institutionalizing 'sustainability' as a key ingredient in all internal and external processes.

The sustainability zone for a bank:

The banking system should operate in a 'Sustainability Zone' where wider economic, environmental and social objectives have to be met by supporting new emerging businesses that not only promote financial growth but also enhance social causes across a range of the common man base and the stakeholders, thus constituting the economic pyramid as a whole. To this end, they have to offer innovative financial solutions to address a wide spectrum of issues regarding sustainable livelihoods, public health, education & education.

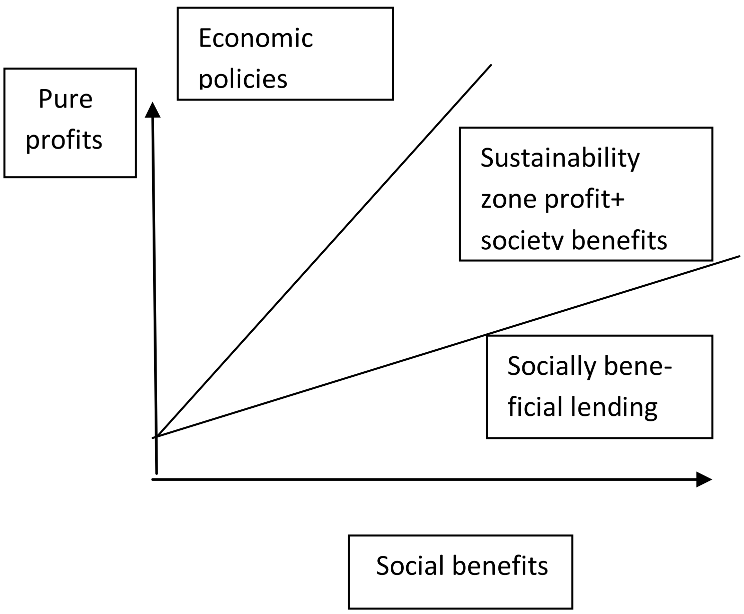


Figure 2

The responsibility can be put into thought by thought leadership and a specific strategy and it can be converted into action by integrating the following business verticals of a bank:

- Microfinance (transition from micro credit to microfinance thereby inching towards financial inclusion)
- Sustainable investment banking (sustainable underwriting)
- Agri-rural banking (managing priority sector lending)
- Social banking (Social networks and building up of social capital)

For banks to emerge out as *sustainable champions,* they will have to develop a central theme focusing on :

- Introducing sustainability in agricultural sector and priority sector lending and banking mechanism
- Promoting economic participation and diversity

- Insulating themselves from all types of systematic and idiosyncratic risks

It is widely agreed that a financially included population is a major asset to the nation and such a society benefits enormously from a socially responsible banking system. India has to be highly endowed with a deeply penetrated bank branch network with policies such as to allow the banking find its roots in the remotest corners of the country which can deliver agricultural credit along with other financial services especially at the farmers' doorsteps.

Strong internal decisions which have to be sound ethically and commitment to socially responsible banking combined with proper and transparent voluntary disclosures to such values and ethics as embedded in the social responsibility statements shall go a long way in building an equitable, socially responsible, sustainable country.