

Ethical Finance

Finance for Positive Change

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We can only build a world based on solidarity if wealth is shared equally and used for sustainable development

The perspective

The concept of ethical banking entered the public arena after the onset of the 2008 global financial crisis, with the ample erosion of customers' confidence into commercial banks' financial behavior providing a backdrop. Investors and customers turned to a reliable, more transparent and simple banking alternative—not mainly driven by profit maximization—represented by so-called green, social, ethical or sustainable banks. Ethical banking has recently witnessed a proliferation due to specificities of its business model: Investments mainly in projects which bring societal value added from an educational, cultural, environmental, and/or social perspective; and public commitment towards reconciling economic and financial profitability with active concern for human rights and the environment.

What is ethical finance:

Finance is neither good nor bad. It is a tool to achieve an end, which can be speculative (causing negative externalities) or it can be more collective and supportive of the general well-being of the many (in which case it will cause positive externalities). The problem is that today 'Finance' has lost its core role, as a means to support and promote economic activities and has invaded the social and democratic spheres.



Ethical finance is the offering of financial services with focus on principles of fairness, objectivity and transparency. Ethical finance, the one that really is, is defined by its purpose: to whom will money be loaned, and, what will it serve? Ethical finance is a term used to describe those kinds of finances which apart from focusing on financial return, also give importance to environmental, social and governance factor commonly known as ESG factors. Thus, ethical finance can be understood as a tool that seeks to maximize the positive externalities. Ethical finance is aimed at developing a fair and equitable relationship between humanity and environment. This reflects an increasing recognition of the importance and value attributed by investors, both institutional and retail, to delivering measurable positive environmental and social impact on a sustainable basis.

It is also difficult to find a real definition distinguishing exactly what it is that sets an ethical bank apart from a conventional bank. Ethical banks are regulated by the same authorities as traditional banks and have to abide by

the same rules. While there are differences between ethical banks, they do share a common set of principles, the most prominent being transparency and social, civic and environmental aims of the projects they finance.

An ethical bank, also known as a social, alternative, civic, or sustainable bank, is a bank concerned with the social and environmental impacts of its investments and loans. Ethical Finance or ethically orientated finance begins by asking questions and gaining answers about the consequences of economic actions; with particular reference to productive or financial consequences that effect human life, communal good and the natural environment in terms of human and economic development. Beginning with such questions, ethically orientated finance distinguishes itself from traditional finance by initiating research into new ways of living economic situations. It offers a commitment to assigning a human, social, environmental and collective evaluation of money. Savings are invested following precise socially and environmentally responsible criteria, thus financing activities promoting human, social and environmental aspects and evaluating projects with two-fold criteria: economic and social.

Market Development

Ethical or socially responsible investment is a complex and ever - evolving concept. It has a long history but there has been a paradigm shift in its focus. It has evolved from an ethical movement in the 1960s and 70s, where religious and charitable trusts and organizations avoided investment in companies manufacturing tobacco, alcohol, arms and ammunitions, etc. to a mainstream financial strategy in the 1990s, where individual and institutional investors use environmental, social and governance or ESG criteria to screen projects for investment purposes. Since the concept evolved independently, at different time periods in different nations around the globe, it has been the subject of different terms and viewpoints; and no universal terminology and definition seemed to prevail over the years.

Ethical finance and investment is growing momentum, globally and nationally, at an exceptional pace. Previously, it was principally the remit of specialist finance providers and investors supporting enterprises with an environmental or social purpose, now it has morphed into the mainstream with an ever-increasing recognition of the importance and value of taking ESG factors and values into account. It has been estimated by the Global Ethical Finance Forum that there are over \$27 trillion worth of assets under management globally on an ethical basis. This reflects a huge and growing market, with more retail and professional investors recognizing that ESG factors have a material role to play in determining risk and reward.

RAISON D'ETRE

Ethical finance has brought in the new benchmark of externality. Any investment has to be evaluated on risk factor and profit along with externality. In other words, any financing or investment will not only be assessed in economic terms but also on what impact it has on society and the environment. This benchmark strengthens the financial model and make it more sustainable.

The role of an ethical bank is to work for the common good and ensure the right to receive credit through a banking activity consisting in raising funds and reallocating them in the form of credits for cultural, social and

environmental projects. Through their activity, ethical banks promote social inclusion, sustainable development, development of social economy and social entrepreneurship. Ethical banks also help raising public awareness on the role of money and the failure of the economy based on short-term approaches and profit as the only objective.

Values promoted by Ethical Finance

Initially ethical finance used to focus on the negative controls, viz. imposing restrictions on the investment and finance in sectors such as weapons, nuclear, animal testing, alcohol and so on. But of late, the core idea has shifted on the positive impact of ethical finance. A list of key values identified by European Federation of Ethical and Alternative Banks (FEBEA) in 2012 for the ethical finance criteria are as follows:



Origin of money: Ethical financial institution does not accept dirty money. Any source of money which is illegal, speculative and coming from highly polluting activity are termed as dirty money.

Destination of money: Ethical financial institution performs lending activity which is poised towards creating positive societal and environmental impacts. It is done by lending to the weaker section of the society, low income earners and by promoting social integration and employment in the disadvantaged areas.

Criteria and values for the use of money: Ethical financial institution maintains transparency in disbursing of loans. There is a systematic flow of information between ethical financial institution and its customers.

Objective of the ethical financial institution: The objective of ethical financial institution is not to seek only profit; though minimal profit is required for sustaining the institution. Most part of the profit are reinvested in the social cause or objective of the financial institution.

Challenges of Ethical finance:

The first and foremost challenge is that there is no structured methodology through which it can be identified that finance is ethical or sustainable or not. Thus, there arises risk of attracting investment on ethical terminology, but the sole motive of investment may not be exactly ethical financing.

There is a possible class conflict for corporate managers, investors, charities and finance providers who want to adhere to ethical finance. They face potential conflicts from their corporate duties and their commitment to comply with the ethical finance.

The ever-increasing demand for investment responsibility is a fertile ground for the development of ethical financial products. Nevertheless, it currently covers less than 2% of financial assets. Indeed, despite the fact that these subjects find an increasingly favorable echo in a large part of the population, speeches have difficulty in taking action. Ultimately, saving and investment behavior remains very traditional.

The financial illiteracy of the large chunk of population is also a key the obstacle which prevents ethical banking to become broadly recognized as a new banking approach.

Conclusion

Ethical finance is a fairly broad term. It is considered one of several forms of alternative finance. It is a term that encompasses any financial system that embraces environmentally and socially conscious practices. The key to ethical finance is deciding on a common set of principles and sticking to them no matter what. Maximizing long-term economic value creation, addressing real needs, while considering all costs (including negative externalities) and stakeholders, all this if done right can make the world we live in more sustainable. Ethical finance institutions should ensure that their governance systems are capable of holding those in charge accountable for fulfilling the institution's ethical commitments. To sum up , once the right governance systems are in place, there is no doubt that the three key grounds- moderation, human dignity and common good upon which the ethical financial institutions are founded can significantly help re-establish the missing traditional foundations of the financial business namely responsibility, prudence, trust and honesty

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