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The Embeddedness of Ethical Banking in the UK

A thesis submitted to The University of Manchester for the degree
of

Doctor of Philosophy

In the Faculty of Humanities

2013

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People, Management and Innovation Division

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Abstract

University of Manchester
Daniel Tischer, PhD

The Embeddedness of Ethical Banking in the UK 2012

Following the financial crisis that began in 2007, various groups and individuals demanded an ecologically diverse banking sector to help spread risk in the banking industry and to more effectively cater to customer needs. To date, however, measures to change retail banking have been limited to modest structural and incentive adjustments to boost competition and modify the banking culture which prompts an investigation about the nature of the ethical banking sector and its ability to grow and thrive.

The lack of progress in reforming banking in the UK raises questions of whether and how we could encourage and sustain ethical, social and non-profit alternatives to current high street banks. Because prior academic research in ethical has been limited, the research aims to fill gaps with regards to understanding the network established between ethical banks their business models and to identify the type of intervention needed to promote ethical banking as an alternative to established mainstream retail banking.

The research presented in this thesis investigates how the ethical banking sector is embedded in the UK financial services industry and draws out political-economic dynamics that facilitate as well as hinder the development of the sector. To this end, the thesis develops a conceptual framework that draws on literatures on industrial districts and embeddedness. The thesis also models and analyses the ethical banking network using social network analysis, before developing an understanding of ethical banks' business models and how the sector is organised within the banking industry. Data on the banks' relationships with other organisations were gathered through questionnaires, and interviews were conducted with respondent firms to explore ethical banking as a sector from the perspective of ethical banks themselves. In addition, company, industry and legislative publications have been analysed to add context and validate findings.

At the broadest level, the results draw a picture of ethical banking as a diverse but disorganised subsector which is dominated by two players and lacks prospects to develop into an alternative banking sector that could compete with the full banking services offered by high street competition. Only if the sector manages to reorganise itself internally with support from external players could it form a more coherent and centralised subsector with a clear and shared understanding as to what its ambitions are. Thus the research highlights the potential of ethical banking which is expanding rapidly, but, at the same time, the research also raises the difficulties in developing ethical banking as a sector which retains its distinctiveness from high street banks.

In sum, the research findings are in line with current ambitions to develop and promote a more diverse and sustainable UK banking industry: ethical banks should receive more attention from policy makers as they are a set of diverse actors that has grown significantly since the beginning of the financial crisis and, could if strengthened, contribute to developing a stronger retail banking sector more responsive to customer needs. Government efforts to reorganise banking should include developing ethical banking as an alternative to Plc retail banks which would change competition by increasing consumer choice instead of creating yet more large scale banks.

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List of Abbreviations (in order of appearance)

| | |
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| ICB | Independent Commission on Banking |
| PPI | Payment Protection Insurance |
| SME | Small and Medium-sized Enterprises |
| US | United States |
| UK | United Kingdom |
| LIBOR | London Interbank Offered Rate |
| SNA | Social Network Analysis |
| ROCE | Return on Capital Employed |
| TBTF | Too Big to Fail |
| CSR | Corporate Social Responsibility |
| NGO | Non-Governmental Organisations |
| SEC | Securities and Exchange Commission |
| PR | Public Relations |
| MNC | Multinational Corporation |
| GABV | Global Alliance of Banking on Values |
| FEBEA | European Federation of Ethical and Alternative Banks |
| INAISE | International Association of Investors in the Social Economy |
| C/I | Cost Income Ratio |
| RoA | Return on Assets |
| GM | Genetically Modified (Food) |
| BBA | British Bankers Association |
| ECB | European Central Bank |
| GDP | Gross Domestic Product |
| IMF | International Monetary Fund |
| BSA | Building Societies Association |
| WOCCU | World Council of Credit Unions |
| PCA | Personal Current Accounts |
| ABCUL | Association of British Credit Unions Ltd |
| M&A | Mergers and Acquisitions |
| FSA | Financial Services Authority |
| OFT | Office of Fair Trading |
| OECD | Organisation for Economic Co-operation and Development |
| DE | Germany |
| BVR | Central Organisation of the Cooperative Banking Group (Germany) |
| DZ | DZ Bank Group |
| DGRV | German Cooperative and Raiffeisen Confederation |
| BoE | Bank of England |
| BS | Building Society |
| CU | Credit Union |
| CEO | Chief Executive Officer |
| EACB | European Association of Cooperative Banks |
| ISA | Individual Savings Account |
| Plc | Public limited company |

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| SRI | Socially Responsible Investment |
| FOS | Financial Ombudsman Services |
| SA | Savings Account |
| MA | Mortgage Account |
| APR | Annual Percentage Rate |
| PIBS | Permanent Interest Bearing Shares |
| AGM | Annual General Meeting |
| BSMA | Building Societies Members Association |
| UKCU | UK Credit Unions (independent trade association) |
| ACE | ACE Credit Union Services |
| PLADS | Permanent Loss Absorbing Deferred Shares |
| FCA | Financial Conduct Authority |

Chapter 1: Introduction

The Financial Crisis of 2007-10 and its continuing effects on national economies challenge common conceptions of the role of finance and banking in an economy which has created an almost universal public demand for banking reform. Yet, the overwhelming response is a demand for policies that are aimed at restricting and regulating bank activities, and, indeed, political and economic elites have been charged with an inability to reform the banking industry effectively (Engelen et al. 2011). For example, both John Vickers and John Kay are content that their specific reforms of the banking sector can fix the instable and uncompetitive banking sector in the UK. However, in reality it is unlikely that either ring-fencing (ICB 2011a) or the break up of banks (Kay 2012a) will have the desired effects, especially as banks are engaged in the policy making process and have considerable influence over the influence reform process and content of reform.

The disagreement about how to reform banking between various interest groups complicates and delays the policy making process and weakens results. The ICB's call for ring-fencing has provoked a large debate about its feasibility and cost to the economy even before implementation, resulting in concessions given to the big international banks (Bischoff 2012; Bisseker 2011; Mathewson 2011; Peston 2011). Similarly, the proposed break up of the big five high street banks which have a UK market share of 85% (The Treasury Committee 2011) as demanded by Kay (Kay 2012a) has been debated by professionals, politicians and regulators (Treanor 2012b) without going further than that. The public generally accept that the current banking system has failed at various levels and apart from the initial government bailout of banks, little progress has been made (CRESC 2009). Yet the costs of this intervention in the failing markets to the taxpayer is not yet

clear (Guardian 2011). However, numerous more recent examples of improper and illicit business conduct of retail banks exist, and they come with a significant price tag for UK consumers and businesses. Banks have been found to have mis-sold PPI insurance to private customers and interest rates swaps to SMEs which they now have to compensate for to the tune of over £11bn, which reflects the damage caused to their customers (Harris 2012; Thompson and Masters 2012). High street banks also repeatedly missed SME lending targets set by the government as condition for providing extra liquidity to banks (Treanor 2012a). HSBC, once named “Best Ethical Bank” in 2007 (HSBC 2007), has been found guilty of money laundering (BBC 2012). Moreover, large internationally acclaimed banks have systematically defrauded customers by rigging the LIBOR rate, demonstrating that the current approach to banking is fundamentally dysfunctional across the sector. Thus, it is not surprising that 60% of respondents to a recent YouGov-poll stated that they distrust UK high street banks and a further 45% think that they are incompetent (Gardiner 2012). The US Financial Trust Index confirms those findings but highlights that US Americans are more than twice as likely to trust credit unions (63%, up 5 to March 2012) and local banks (55%, up 4) compared with national banks (23%, down 2%) (Sapienza and Zingales 2012). Dissatisfied customers increasingly consider switching to alternative banks like Nationwide or the Co-operative, who saw a 60% increase in applications for current account openings as highlighted by Peter Marks (Treanor 2012c), yet further regulatory and capital problems are cited as interfering with the shake-up of retail banking (Peston 2012). Overall the Move your Money movement estimates that over 500,000 bank customers have switched accounts from high street banks to ethical alternatives which represents at least a temporary boost to ethical banking (Move your Money 2012; Orr 2012).

Still the proposed solutions are limited and ignore less conventional and politically undesirable, yet often straightforward debates and explanations for the failure of the banking system. These include ownership structures, firm concentration and regulatory capture through the financial elites represent by the City of London Corporation as well as and considerable donations by financial intermediaries to political parties (Mathiason and Newman 2012). In addition, high street banks and more controversial financial actors receive the majority of attention, yet alternative forms of financial intermediaries such as ethical banks are largely ignored and not promoted significantly because of the lack of market share and little systemic risk posed. Nonetheless, the analysis of the ethical banking sector in the UK and the structural and regulatory problems faced by the actors involved also contributes to the larger discussion of the failure of the banking system more generally. Thus, investigating the role not-for-profit banks play in the UK banking sector is as good a starting point as any.

The emerging questions are broadly linked to three steps:

Why have ethical banks not benefitted more from the financial crisis and the public disaffection with big banks?

What does the ethical banking sector look like in terms of its structure, attitudes towards banking and how is this linked to the business models of the ethical banks?

What conditions can be created to encourage the positive development of ethical banks and the sector.

This study is linked to the discussion of the need for a more diverse banking sector. Various studies (E.g.: Erturk et al. 2012; Michie 2010; Nissan and Spratt 2009) have discussed the benefits of an ecologically diverse banking sector in spreading risk and catering customer

needs and it is this latter point of view which poses the question of whether and how we could encourage and sustain ethical, social and non-profit alternatives to current high street banks. In the context of this thesis, ethical banks are conceptualised as not-for-profit stakeholder banks with more or less strongly pronounced motivations to use banking to create a positive social and environmental impact as well as fulfilling their economic role. The boundaries are fuzzy and the idea of ethical banks should be viewed as a spectrum rather than a dichotomy as it is difficult to establish exactly when a bank changes from being ethical to being non-ethical.

Compared to banking generally, ethical banking has received relatively little attention in the media and policy papers. In particular small and specialist ethical banks are largely unacknowledged by the public and by the political process and coverage is often limited to the largest ethical banks. Moreover, most discussion to date has been around the themes of competition and systemic risks in the banking context, with little differentiation between ethical banks and high street banks business models. This leads to the ignoring of the specific communities ethical banks are often interconnected with and their more risk-adverse business models. As a result, regulatory efforts are focused on creating an institutional environment that eradicates cooperation between actors within an industry. Above all, the financial sector has succumbed to the ideas of market efficiency, and by introducing competition policies and industry self-regulation, state-regulation and political interference have been increasingly withdrawing from supervising economic activity (Engelen et al. 2011).

The emphasis on competition as the defining aspect of an industry is illustrated by economic approaches to analysing industry or sector composition such as Panzar & Rosse's H-statistic, the Herfindahl Index or contestability as highlighted by Claessens and Leaven (2004). However, the usefulness of competition in regulating a sector is limited and can indeed lead to socially undesirable outcomes (Boyd and De Nicolo 2005). Indeed, relationships between firms, especially those highly dependent on markets, deserve more attention because of the fact that the economist's premise of the individual firm has been repeatedly refuted, for example by the systemic shocks in the financial markets responsible for the crisis and not least by the recent LIBOR scandal.

This thesis then takes a different view altogether and goes beyond conventional concepts. It assumes that fixing the dilapidated banking system requires a multidimensional approach including structural, cultural and technical considerations as demanded by Erturk et al (2012). Moreover, banking is viewed as an intermediary activity with the function of transforming bank deposits into loans rooted in local, regional or national contexts. To accommodate the two assumptions, an alternative, more inclusive and sociologically informed, approach to research the business models of ethical banks and the embeddedness of the ethical banking sector in the UK socio-political landscape has been chosen. The relational aspects of sectoral and industrial organisation and how ethical banks interact within this environment (which are conventionally dismissed by individual firm autonomy and the importance of competition) are of central interest to the study.

Before analysing the organisation of the ethical banking sector, the business models of ethical banks themselves have been analysed with the view to integrate those findings in

the later discussion of the sectoral characteristics. Yet, instead of adopting a conventional concept of business as a profit maximising entity, Froud et al's (2009) discussion of business models in public, not-for-profit firms has been used to investigate economic as well as socio-political and cultural aspects of a firm's organisation and operations. The industry element of the research is framed by three distinct, yet complementary theories: Embeddedness, Social Network Analysis and Industrial Districts. Granovetter (1985) developed a concept of embeddedness that argues that both under- and over-socialised efforts (e.g. economics and sociology) are insufficient in explaining the interconnectedness of the social and the economic. By doing so, he introduced network analysis as a middle ground between the two extremes and clearly illustrates the relationship between the two. The industrial district, seeks to explain the organisation of sectors in terms of their social connectivity and embeddedness. Despite the intra-industry focus of district relationships, the approach is useful in connecting the individual firm to the industry and thus adds to the research. Even with the criticisms that the individual concepts have faced for being too empirically informed, too strongly linked to a distinct discipline or too fuzzy, their combination should increase the robustness of the findings by mediating the limitations of the individual concepts.

Moreover, there are logical connections between industrial district and embeddedness, particularly with regards to the relational character with which the concepts explain industrial activity (Staber 2001b). Rather than viewing firms as atomistic agents that operate according to market principles, both literatures highlight the complex interactions between economic actors and their environment as defined by politics, culture and cognition (Zukin and DiMaggio 1990; Powell and Smith-Doerr 1994). The embeddedness of industrial districts in cultural and institutional spheres further develops the concept as a

socio-cultural phenomenon alongside its economic implications. Granovetter's concept of embeddedness largely reflects key characteristics of industrial district theory as highlighted by Harrison (1992), who considers trust relationships central to Granovetter's argument to also be key to the district's collective industry organisation. Thus, there is a clear link to the collective action described by the industrial district literature in as much as both are governed by trust principles facilitated by repeated interactions between parties, which in turn "promotes re-contracting and the sharing of common support services [...which] is a particularly concrete expression of embedding" (Harrison 1992: 477-478). Overall, this investigation of ethical banking sector is based on six features that have emerged from the industrial district and embeddedness literatures: *sectoral cultural identity; complementary services; connectivity and exchange; competition; trade association; and industry regulation and legislation.*

The research project employs both quantitative and qualitative research tools in a mixed methods approach. Although linking embeddedness and social network analysis (SNA) has been criticised it marks the first step in this research project, followed by interviews and a secondary data analysis of company, industry and legislative publications. By using SNA at the beginning of the research, interviews can target industry relationships between the various actors more effectively than it would be the case if relationships between banks are just assumed. Particularly the considerable differences between ethical banks with regards to their size and business model are reflected in the results of the SNA and highlight some specific patterns of interaction that are of importance for the discussion of the state of the ethical banking sector. Moreover, the SNA highlights dominant actors and brokers in the network which is useful in relating the structural findings to a more sociological discussion.

The interviews and secondary data analysis serve two purposes. The first aim is to contextualise the findings of the social network analysis both with the business models and the industry setting in mind. It answers questions about the context of specific relationships and the roles played by various actors of interest to enhance knowledge about this specific network. The second step goes further and gathers data that informs on the nature and politics of ethical banking, specifically the relationships between ethical banks and actors external to the ethical banking district, *id est* government agencies and for profit banks.

Overall, the research aims to contribute to a variety of academic interests. The most obvious is the contribution to the literature of alternative models of banking which are significantly less researched than the commercial banking sector. The findings highlight the dynamics and heterogeneity of the sector by explaining the disfunctionality of the current approaches of regulation; this allows proposals to be outlined for more regulation and more cooperation between ethical banks and commercial banks. The research also illustrates how social network analysis can benefit the analysis of sectors and industries, whilst at the same time pointing out the various problems faced in the process. Despite issues with missing data and the variation in understanding the content of a relationship by respondents, having a set of empirically informed results is helpful in identifying key actors and influencers in the network. This approach is to be preferred to the often assumed nature of sectoral organisation or the economics perspective on industries explained by competitiveness, concentration and contestability. Moreover, the research's combination of embeddedness theory, social network analysis and industrial districts operationalises an alternative way of analysing sectors which do not conform to the economic idea of a sector

and whose complex relationships may require a more nuanced analysis as proposed by Rayner et al (2001).

Overview of the Thesis

Chapter 2 explores the existing literatures on ethical banking, business ethics and ethics in a wider sense to conceptualise ethical banks at firm level. It justifies the fuzzy approach taken with respect to conceptual boundaries and the variety of organisations investigated. Following, the chapter introduces stakeholder theory (Freeman 1984) and connects it with more current discussion of business models, particularly with regards to public and not-for-profit alternatives to the shareholder value business model.

Contemporary approaches to the analysis of industries and sectors are discussed in chapter 3. It begins with a review of conventional tools to determine industries and sectors before criticising those as too narrowly focused on mainstream economics. Following this debate, the chapter will demonstrate the connections between embeddedness, social network and industrial district theory before framing this research's approach focusing more on relational and socio-political aspects of an industry. It proposes six dimensions that reflect the research interest of embeddedness and industrial districts by considering both internal and external aspects of the industry set-up.

Chapter 4 introduces the three-step methodology consisting of social network analysis, interviews and secondary data analysis. It explains why a mixed method approach is useful in exploring structural aspects and examining socio-political facets of the ethical banking

sector. Whilst overwhelmingly pragmatic in nature, the chapter will also discuss how the simultaneous collection and analysis of data has informed later cycles in the research. It outlines the research process and highlights how problems faced have been dealt with. Moreover, it highlights how the triangulation of data benefits this research by stimulating a critical engagement with sometimes contradictory evidence.

The results of the social network analysis are reported and discussed in chapter 5. The primary purpose of the chapter is the discovery of the network structures underlying ethical banking in the UK via social network analysis. The descriptive analysis explains the various network analysis tools used and discusses the results of each analysis within its context. The chapter will then identify and outline the key issues emerging for ethical banks and the sector which are then developed in the following chapters.

Chapter 6 features the in-depth discussion of the ethical bank business models and focuses on the issues of cost recovery mechanism, how visible the banks' subscription to ethics is in their business operation and the various stakeholders involved. This knowledge gained on the ecology of finance is fundamental to the following discussion of the industry dimensions. Moreover, the various models employed and ownership structures present contribute to the discussions about the legislative and regulatory challenges faced by the sector.

Having developed a structural and firm-level understanding of the ethical banking sector, Chapter 7 employs the six dimension framework to developed in chapter 3 to uncover whether the ethical banking sector indeed constitutes a sector, or whether it is a mere

collection of marginalised actors with similar aims. It treats the industrial district literature as an analogy with the intent to highlight discrepancies between the literature and the ethical banking reality. Although the chapter does not produce a definite answer to the question of whether the sector exists, the pro and contra argument highlights a variety of issues that are relevant for policy makers; thus the chapter's conclusion directly informs policy recommendation made in the next chapter.

In order to formulate a set of policies that promote ethical banking as a sector, chapter 8 draws on the previous discussion and summarises key issues that emerged that can be target through a set of policy recommendations. Because of the disfunctionality of the UK sector, the research uses both the responses given by interviews as well as the more researched and more successful European alternative systems of banking, especially the German cooperative banking system to highlight the potential of the recommended policies.

Finally, the conclusion will summarise the main features of the study and highlight key findings. It will answer the key question and highlight why ethical banks have failed to benefit more from the financial crisis. In doing so it emphasis the connections across the various methods used and theories employed across the chapters.

Chapter 2: Ethical Bank Business Models

International banking conglomerates have failed at various levels and continue to not only strain public resources, but appear unable to provide the most basic services to retail customers (Enrich et al. 2012; The Socialist 2012). Thus it is unsurprising that the current business models are increasingly questioned, particularly in the banking industry in which they have driven corporate excesses and risk taking unsustainably (Engelen et al. 2011). As a result, business practices and corporate structures are under more scrutiny from academics and cooperative and mutual business structures are becoming increasingly supported by politics. The public also acts on news of repeated mis-selling, system break downs and adversity to customer service, by moving money to high street bank alternatives. Thus, a new consensus has emerged about a greater need for variety in business models and economic activity in the banking industry.

This chapter has a dual purpose. The first is to critically explore how and why current business models and business ethics are increasingly informed by the shareholder value narrative. As a result, this study replaces business ethics with normative ethics and introduces these elements to the concept of business model. The second purpose is to explore the concept of the business model and how it could be used in the ethical bank context, thereby accepting the different approaches to ethical banking yet producing comparable findings across ethical banks.

To address these two issues, the first part will debate the profit-motive at the core of current business thinking and how this links corporations to the social environment they engage with. Following, the chapter will discuss two well debated examples of business

ethics, Corporate Social Responsibility and Philanthrocapitalism, to show how they are aligned with the corporate focus on maximising returns for owners. The argument then turns towards investigating Kant's, Aristotle's and Mill's normative ethics to establish a suitable alternative to business ethics, proposing that ethical firms should focus on the motivation, conduct and outcome of their business activity. The chapter then introduces the stakeholder model as a suitable alternative to the dominant principles of shareholder value which promotes a more inclusive view that looks beyond financial returns and focuses more strongly on the impact of ethics and stakeholder interests on the business model.

Profits for Owners

“...[T]here is one and only one social responsibility of business -- to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.”

(Friedman 1970: 54)

Friedman's (1970) claim that the only social responsibility of a business is to increase profits has moved from a 3000 word spread in the *New York Times*, to become one of the most influential principles driving business and management studies (Robe 2012). Yet he does by no means present a new argument but summarises the key libertarian ideas of individual freedom in a society with a small government, one that has been argued since the emergence of the tradition in the late 18th century *free-thinkers* Belsham and Locke. His ideas draws heavily on Smith's *Wealth of Nations* (Sen 1993) who “considered justice, so understood, to be the necessary foundation of society” (Viner 1991). As a result, business

activity is only restricted by the demand for its operations to be legal and need no further consider impact on society and environment. Friedman too asserts that business has no responsibility to interfere with, or consider its impact on the environment or society unless it supports profit growth (1970). It is this demand for increasing profit which has a significant impact on business studies generally and business ethics specifically. Linked to Friedman's idea that maximising profit for owners is the goal of business, *Value Based Management* (or shareholder value [SHV]) emerged in the 1980's and is continuously developed by economists like Jensen and Meckling (1976), Fama (1980) and Rappaport (1998)¹. It essentially aligns management principles with shareholder demands (Bratton 2002) and in doing so aims to create shareholder wealth by maximising the market value of a firm (Jensen 2001).

Maximising shareholder value has been argued to ultimately and most effectively benefit the whole society through the "trickle down effect" (Aghion and Bolton 1997: 151). However, Bratton (2002) argues that the maximisation of firm value has the opposite effect and the financial benefits are raked in by the top 10 percent (Hillman and Keim 2001). Instead, negative effects are borne by the rest of society whose job security is subject to rationalisation process (Williams 2000). More evidence emerges in the form of the Tax Justice Network's recent estimation that wealth does not trickle down but moves offshore to the tune of US\$21 trillion to avoid taxation (Henry 2012). Lazonick and O'Sullivan (2000) similarly argue that the pursuit of a maximised return for shareholders often triggers a divestment strategy and makes financial reporting and the managing of financial results on a quarterly basis strategically important which can have a dramatic impact on the long-term viability and future performance of the firm. This focus on financial returns by

¹ First edition published in 1986

empowered shareholders and managers alike is exemplified in Rappaport's (1998) estimation that returns on capital employed (ROCE) should be between 10-12 % regardless of sector, even if this did turn out unachievable in many cases (Froud et al. 2006). Still, the investors' obsession with short-term performance targets (Bratton, 2002) led to substantial changes in corporate governance and reshaped and expanded entire industries such as the consultancies sector (Froud et al. 2000).

Shareholder Value also served as an answer to the ever growing corporation in 1960s America and the associated administrative inefficiencies (Lazonick and O'Sullivan 2000: 15). The poor performance of corporations in the 1970s particularly in an increasingly competitive international environment led to the development of agency theory, which allowed firms to be disciplined through market mechanisms such as mergers and acquisitions, with firm performance increasingly judged by financial results. Employee pension provisions were "outsourced" from firm level to pension funds, making the role of institutional investors more significant and expanding the funds available cash for investments in the market (Lazonick and O'Sullivan 2000; Williams 2000). This drove the financialisation of the economy as argued by Erturk et al (2008) and Williams (2000), with the negative effects on society apparent in the 2000s – a reduction in real wages in the US and a shift of wealth distribution to the higher income groups.

Despite early resistance by management, shareholder value quickly became accepted as the norm when it comes to ensuring shareholder ownership rights in listed companies, not least because of the financial benefits for the corporate elites attached to them (Bratton, 2002). But linking SHV and stock market performance is complicated as it divorces the

actual corporate performance from the returns received by shareholders. Bull markets can lead to the overvaluation of poorly performing firms, thus pleasing shareholders. On the other hand bear markets can have a negative impact on share prices and therefore reduce shareholder value in depressed markets without acknowledging good corporate performance. Notably, the lack of confidence in the markets displayed during the burst of the dot-com bubble, 9/11 and the financial crisis illustrate these relationships, or lack thereof, between stock and corporate performance (Froud et al. 2006). However, instead of moving away from shareholder value, share price and earnings mechanisms have developed to reduce the impact of cyclical decline on both shareholder and management wealth (Bergstresser and Philippon 2004). Moreover, associated cost reduction programmes and restructuring are likely to impact negatively on other stakeholders through job losses and reduced tax receipts on a communal level.

Shareholder value impacts significantly on corporate behaviour and targets and, as argued by Lazonick and O'Sullivan (2000) and Froud et al (2006), forces corporations to save costs and maximise profits in short-term horizons by abandoning social goals of the firm in the long-term. The risks of short-term losses are limited for the shareholders to the sum invested whilst society are likely to have to bail out failing firms if they are system relevant, as in the case of big banks. This problem has been discussed by scholars as early as Smith (1759 [2009: 438f]) who asserts that limited liability drives risk and reduces commitment to corporate governance; two points that have commonly been argued to have partial responsibility for the creation of market conditions that led to the financial crisis. It is obvious that Friedman's position of divorcing business activity from its impact on society beyond of what is legally required is untenable (Robe 2012). Indeed, Le Menestrel (2002) argues that Friedman's pursuit of economic interests promotes the idea that profit is as

important as other social needs ultimately suggesting that “profit is ethical” ignoring the conditions under which the profits have been generated and for what purpose they are being used.

The rise of shareholder value also had a significant impact on how banks operate. Firstly, markets became more liquid which, in combination with the industry deregulation beginning in the 1970s, enabled banks to enter new markets and expand their functions from intermediation to providing financial services more broadly. This expansion of banks into international financial conglomerates with diversified ownership was driven by increasing demands for returns on equity which resulted in an increasing risk appetite and the entering of derivatives and proprietary trading markets. Whilst customers benefit from a number of innovations and the availability of easy credit, the big banks increasingly moved away from being providers of the banking utility and used private customers as a source of both interest and increasingly non-interest/fee income (CRESC 2009). The decline of prudence and the increasing risk appetite of banks culminated in near bankruptcies and bail outs of some major banks. The move away from their traditional business models and the risks taken on by banks has produced casino banks whose interests are ethically questionable at least and arguments list generally both the high compensation levels of bankers and the TBTF / moral hazard arguments. This highlights a need for more prudence in retail banking which is purely served in the current system driven by high demands for return on equity. The separation of retail banking from investment banking, or ring-fencing are two approaches discussed by regulators, yet although they mitigate the risk for savers and requirements for future public bail-outs (Froud et al. 2011; ICB 2011a), they do not question the underlying principles of banking.

Current Concepts of Profit and Social Objectives of the Firm

The dominance of shareholder value had considerable influence on the development of business ethics. The neglect of morality in the study of economics, which as a field has been most influential in shaping business studies in the past 30 years, has resulted in a narrow, impoverished version of economic theory that concerns itself mostly with abstract models that replaced societies' complexity and altruism with the concept of the rational and self-interest *homo economicus* (Solomon 1992). Removing, or distancing, people and society from business is particularly precarious in the field of business ethics and early attempts to replace the focus on the economic man with an appreciation for society more generally led to the view of business ethics as a "set of impositions and constraints [and] obstacles to business behaviour" (Solomon 1992: 330). The engagement with ethics in the context of business is markedly dominated by economic interest. Thus it seems justifiable and strikingly accurate that an entire book containing only empty pages has been published on business ethics (Boatright 2008). "Business ethics" is not just one phenomenon that can be defined and explained in one specific manner.

The development of modern business ethics as a field is largely a response to increasing public concerns about environmental damage and the rise of the multinational corporation in the post-war USA (De George 2010). The emergence of the "social responsibility" of a firm in the 1970s created academic interest that led to the emergence of business ethics which was, according to De George (2010) initially badly received by business scholars and philosophers as it conceptualised a firm's social responsibility as being an *ethical* problem which added a more critical level to the investigation. Yet the degree to which researchers are critical of business practices and aims varies considerably as discussed by Lewis (1985).

Despite his criticism of codes, standards, rules and principles, he suggests that business ethics are defined “broad[ly] enough to cover the field of management in a sense as full as most managers might conceive of it” (1985: 382). Moreover, the discussion of business ethics is largely linked to large, publicly traded firms which ignores a substantial number of economic actors: “the central questions of business ethics tend to be unabashedly aimed at the directors and employees of those few thousand or so companies that rule so much of commercial life around the world” (Solomon 1991: 359).

The following section will discuss two prominent approaches to business ethics, *Corporate Social Responsibility (CSR)* and *Philanthrocapitalism*, and highlight how they reflect the commercial interests of owners.

CSR

The CSR literature represents business ethics concepts that originate in business schools and are therefore strongly aligned to strategic, management and value creation principles of the firm. Its purpose is to equip businesses with tools that help them to solve problems and gain competitive advantage. CSR developed largely in the post-war era (Carroll, 1999) although social responsibility had emerged in the 1930s. Carroll (1999) cites Bowen’s (1953) book “Social Responsibilities of the Businessman” which he regards as a response to the rise of the modern corporation and its impact on social life. Its development in the post-war period coincides with the growth of business schools and the multinational corporation (Rosett 1982). Although, or because, business ethics are more accepted by today’s business and has developed into a vibrant academic field (De George 2010), it has increasingly lost its critical tone by seeking conversation with and acceptance from business. As a result, business ethics are often seen to be “specious gloss” (Owen and Swift

2001: 5) and “greenwashing” (Bruno 1997). Moreover, the tendency to justify ethical considerations by linking them to firm profitability has a long history (Aupperle et al. 1985).

Trevino and Weaver (1994) distinguish between a normative approach and an empirical approach to business ethics. They highlight the intellectual divergence between both fields and conclude that a stronger normative influence in business ethics is required as empirically informed business ethics are overly concerned with the solving of business problems and largely neglect the fairness and justice demanded by normative ethics. This idea questions engagement between shareholders and stakeholders more fundamentally.

However, the centrality of pro-business thinking in the domain of CSR remains a concern and is particularly visible in practitioner literature such as the Harvard Business Review.

Porter and Kramer (2006) propose that CSR can also add value to the business in the long-term. For them, CSR is increasingly important to strategic management and as such is not merely a PR and marketing tool used by business to deflect criticism, but is much more integral to a firm’s long-term success. However, Porter and Kramer fail to introduce other stakeholders to the equation and see CSR to be of benefit only if it helps to increase a company’s competitiveness: “Each company can identify the particular set of societal problems that it is best equipped to help resolve and from which it can gain the greatest competitive benefit” (2006: 15). Thus, despite their claim that CSR should not be used as a PR and marketing tool, they see value creation to be the underlying principle of the CSR activity, which means that social and environmental considerations will be evaluated with respect to their impact on firm profit. Still, Carroll (1999) optimistically points out that CSR can help to strategically engage with public concerns. In his earlier work (1979; 1991) Carroll demands that CSR must recognise additional ethical responsibilities that are not demanded by the firm’s pursuit of profits and its legal responsibilities. Moreover, he

defines a set of discretionary activities that are required from corporate citizens such as philanthropic contributions, support for drug addicts and the unemployed, and support for workers such as day-care (Carroll 1979). Notwithstanding the intended benefit to society of his ideas, CSR can be linked to masking the negative impact of a specific business activity.

Business often sees CSR as conflicting with the economic function of the firm to achieve profits. Most prominently, Friedman (1970) argued that CSR is a typical agency problem that is used by managers to further their private agendas at the cost of the business owners. More recently and in support of Friedman, Besley and Ghatak (2007) modelled CSR contribution to the firm and found there to be little evidence that CSR is of benefit and that it is only a “niche.” Social actors and NGOs on the other hand criticise the use of CSR to redirect the public interest away from ethical issues emerging from the corporation’s core activities and the use of CSR campaigns to market a business’s moral contributions to society (Brønn and Vrioni 2001).

The theoretical inconsistency of the usefulness of CSR is also evident in more practical investigations. Indeed, the use of CSR appears limited to those occurrences in which it benefits overall value creation (Deny and Green 1989; Porter and Kramer 2006; Trevino and Nelson 2010). Moreover, Johnson (1971: 54) critically notes that “social responsibility states that business carry out social programs to add profits to their organization”. However, the impact of business activity on individuals, groups and organisations other than shareholders, is often left largely un-discussed (Carroll 1991). Yet, the true contribution of CSR to profitability is not conclusive either (see Aupperle et al. 1985; Barnett and Salomon 2006; McWilliams and Siegel 2001); indeed, Vogel (2005: 164) asserts that the only reason why CSR is benefitting performance is because the true costs of introducing CSR are mostly modest. Hence, overall, the criticism that CSR is being used

overly for publicity and marketing purposes to drive profit with little interest in contributing to ethics and a social end seems justified. Still, despite this criticism, the real problem with CSR is linked to the limited impact it has on firm behaviour in the first place.

Philanthrocapitalism

Philanthropy has a much longer tradition and its origins date back to Aristotle and other Greek philosophers. The concept in itself describes the “love of humanity” and as such is not directly associated with businesses but with the good human life (Bremner 1960). Money is viewed as a means to an end, or a facilitator in purchasing goods to increase general happiness and well-being, not an end in itself. However, the concept is still linked to the private non-profit sector as it describes the exchange of private capital with “*quasi*” public hands (Salamon and Anheier 1997).

Philanthropic activity presupposes an unfair and non-egalitarian distribution of wealth for it to be redistributed through charity. Philanthropy seeks a private resource allocation based on the amassment of private wealth and a minimisation of state activity, including welfare and taxation. Thus the philanthropic principal is dependent on the inequalities created by current day capitalism to which shareholder value maximisation has contributed. Also, the activities by which the wealth is amassed must be judged as to whether any resulting action can actually be considered philanthropic. Bremner (1988: 42) argues that in the 19th century, philanthropy developed to mask the means by which wealth was amassed: “Thus early Americans began to voice suspicion that philanthropy was a device used by the rich to atone for their way of acquiring wealth.” Consequently, a wealth derived from business activities that negatively impact on the happiness of people, for example in case of poor

working conditions, unfair pay and working hours, lack of security and dependency on the arbitrariness of the employer, even if redistributed in an egalitarian and just manner, may be difficultly thought of as philanthropic. Such form of philanthropy can be considered a self-interested activity which does not fulfil the philanthropic ideal but rather resembles atonement. In this light Bremner's (1988: 3) claim that "*whatever motives* animate individual philanthropists, the purpose of philanthropy itself is to promote the welfare, happiness, and culture of mankind" (emphasis added) can be objected to. Philanthropy must be a selfless act rather than a selfish act which naturally limits what we may consider to be philanthropic. For example, as Porter and Kramer (2002) point out, Phillip Morris has spent US\$ 75 million on charity in 1999, followed by US\$ 100 million on promoting that charitable contribution, which rightly received cynical remarks. Only philanthropic activity that is motivated by selflessness must be considered as ethical and charity that is motivated by financial gains, atonement or otherwise self-interested would subsequently be unethical.

Philanthropy also receives considerable criticism for being donor-centric. Donors like Bill Gates and Warren Buffett are given considerable attention while the impact on recipients such as charities remains often unexamined (Karnofsky, 2009). The philanthropic donor has complete control over how to donate his or her money (Bremner 1988: 2). Philanthropists can decide how and where to allocate their money which creates a variety of issues in relation to transparency, accountability and legitimacy: "The principle of individual equity holds that individuals maintain the rights over their own property" (Steuerle 2002: 3).

The linkage between corporations and philanthropic activity appears to be growing stronger. Since the emergence of corporate philanthropy in the post war period, the mindset of corporations towards philanthropy has changed considerably. In the beginning, it is widely assumed that corporations voluntarily engaged in philanthropic activity for various reasons, which was followed by increasing public demand for corporate charity that required corporations to engage in activities that did not increase profitability (Varadarajan and Menon, 1988). However, Edwards (2010) argues that particularly the linking of philanthropy and capitalism is likely to act in a way that is politically and socially unacceptable. He (2008, 2010) claims that the true interest of philanthrocapitalism is the creation of value, not social well-being. Evidence for this claim can be found in "*The Birth of Philanthrocapitalism*" (*Economist*, 2006) which describes the shift from a system of social welfare organised and legitimised through governments to a market based system in the hands of philanthrocapitalists which is becoming more prominent:

"The need for philanthropy to become more like the for-profit capital markets is a common theme among the new philanthropists, especially those who have made their fortune in finance."

Philanthrocapitalism is polarising opinions even further than traditional philanthropy does. Edwards (2010, in Kremer 2009) argues that there is a general lack of critical debate and understanding of the impact of philanthrocapitalism on the structure of social welfare and the democratic distribution of resources. Philanthrocapitalists on the other hand argue that current for-profit business principles help to reduce the inefficiencies found in current philanthropic organisations (Bishop & Green, 2008; *The Economist*, 2006).

The discussion has shown that the concepts discussed in business ethics are closely linked to the principles of profit making in businesses. Yet neither CSR nor philanthrocapitalism put ethics at the core of the business. Instead, it is clear that under philanthrocapitalism, the love of humans only extends as far as it is commercially viable and CSR is equally only adopted by businesses when it sustains or increases the flow of profit. Moreover, in both cases it seems that gaining competitive advantage through either is at the forefront of the business ethics debate (Porter & Kramer, 2008). Logically, a more socially and environmental focus of the business is thus sidetracked.

Normative Ethics: Motivation, Conduct and Outcome

The discussion of CSR and philanthrocapitalism has shown to be intrinsically dependent on capitalist structures and thus focused on increasing profits and shareholder value in one form or another, for example by generating good-will, privatising social welfare or simply through charitable contributions towards specific projects to create positive corporate PR to increase sales. Because of this apparent dependence of business ethics on firm profitability it seems appropriate to introduce another, more fundamental way of looking at ethics in business. The following section constructs a different type of business ethics which guides firm activity more fundamentally by viewing ethics at the core of the business. This approach incorporates a more complete view on ethics that is informed by normative ethics and considers various aspects of a firm: deontology is linked to *motivation*, virtue ethics informs the *conduct* and utilitarianism enlightens the *outcome*. The chapter highlights that business ethics are not comparable to the more general moral obligations expressed by Kant, the virtuous behaviour introduced by Aristotle and the maximisation of

well-being proposed by Mill. The diverse ideas about ethics discussed in moral philosophy develop a more complete view of ethics integrated in a single framework.

First and foremost, the link between profit and business ethics must be reassessed. Yet this does not mean that a business can be uneconomical as it needs to recover its cost and be at least marginally profitable to be sustainable in the long-run. However, recovering cost and aiming to achieve excessive profit margins imply two very different ideas about what firms are for. The view taken here is that ethical businesses cannot simply focus on their profitability but must be motivated by achieving goals that are not financial introducing “motivation” as an integral part of the ethical business model.

At this point, it seems appropriate to revisit Kant's deontological ethics. For Kant, the motivation behind actions is the key to judging actions as ethically good or bad. Guidance is given in form of a set of universal rules which comprise basic principles that inform our morality: it is wrong to kill, to steal, to lie and to break promises. Kant refers to those universal rules as *categorical imperative* which states that one should “act in such a way that you can also will that the maxim of your action should become universal law”(Guyer 1998).

Thus, the motivation behind a business is crucial to its moral “character” with wide-ranging impact on the business model. When applying Kantian morality to business it is essential to look at the intentions behind the subscription to ethical conduct by economic actors. For one, moral guidelines could be imposed by law or further the self-interest of the firm by enabling it to access specific markets, but at the same time they could originate in the good

intention the “business” aims to fulfil. The distinction may easiest be seen in comparing businesses that seek profit-maximisation to those that operate on a non-for-profit basis. A business that seeks to maximise its profits and acts in accordance with an industry code of conduct and within the legal framework is not to be considered ethical as it has a natural disregard for moral behaviour that is not demanded by an external legislator² (Smith 1776).

Those firms are likely to only consider ethics when it suits their purposes and benefits the firm’s profitability which is visible in business ethics: CSR and philanthrocapitalism are primarily motivated by financial returns (Porter and Kramer 2006). Equally, the introduction of ethics by a firm, solely to enable them to enter new markets or to adapt to a change of public sentiment, is also motivated by the potential for profit in a new market. For example, retail investment banks entering the market for Social Responsible Investment have been described as offering services that are qualitatively different to investment funds run for churches and charities (Sparkes 2001; Sparkes and Cowton 2004). On the other hand, firms that are motivated by having a positive impact on society and the environment, without the explicit demand for higher economic returns, are potentially ethical. The choice to benefit society will impact on their business model and it will guide their business activity according to normative rules that are specific to the business’s goals but at the same time accepted by society in the sense of Kant’s categorical imperative (Kant 2002: 31 ff).

Importantly, Kant demands those rules cannot be enforced as laws or heavily imposed codes of conduct as that would destroy the motivation to act morally good and simply

² Although often enough one finds that businesses act in conflict with legislation in search for greater profit. For specific examples on law-breaking unethical conduct refer to Boatright (2002).

make it a rule-obeying act (Kant 1785 (2004): 17). For those rules to become morally meaningful, they have to be self-legislated, and instead of referring to the commonly understood legislation, it prescribes to the idea that “basic moral requirements are laws we legislate to ourselves as rational persons with autonomy” (Hill 2000 : 28). Anscombe (1958: 2) rejects this idea as in her view a “concept of legislation requires superior power in the legislator”, however Anscombe fails to acknowledge that Kant’s self-legislation does not aim to be superior to the law. Kant suggests that imposing legislation cannot make our motivations be considered morally, whereas our choosing to obey them can make such action morally good (Denis 2005). Hence, Kant’s *categorical imperatives* must not be understood as imposed commands (Hill 2000). This highlights the difference between firms that impose rules which are understood internally and by society to be morally right, and firms that only follow the rule of law.

Thus, the second principle that needs to be considered with regards to ethics is that of business conduct. Ethical conduct is based on modern interpretations of Kantian deontological and Aristotelian virtue ethics. For Aristotle, ethics are related to achieving an individual state of excellence and happiness. The way business is conducted will therefore influence the action of the individual and collective as proposed by Solomon (1992). He proposes that the achieving of excellence is dependent on the community the individual habituates, an issue that has previously been raised by Hegel (1821 [2001]: §187).

Solomon's Aristotelian approach to business ethics argues that business and employee morals are interrelated in the sense that a firm partly defines the individual through job roles and description and that business morals are informed by the communities they are engaged in (1992: 320). Yet, this also suggests that the firm’s employees also influence the business as they are part of the community. Moreover, it seems that firm ethics are also

informed by the employees' behaviour as a corporation is at least partly defined by its employees. It is therefore in the interest of the ethical firm to control and guide the behaviour of its employees.

Salomon (1992) acknowledges established corporate governance procedures, but he suggests that the cultivation of character through community engagement is equally important. There are two fundamental differences in the use of ethics in firms. In many for-profit businesses, ethics are eliminated by strong community structures and fostering of relations. Granovetter (1995) argues that corporate action is more generally embedded in social networks, not only within organisations but also between them. As a result, the business network a corporation is engaging in should be investigated. Wall Street and the City of London are networks that specifically undermine employee ethics to further firm profits; this has been considered by many to create the reckless behaviour which contributed to the financial crisis (Bebchuk et al. 2009; Chakraborty 2010; Ho 2009; Lewis 2010; Schmidt 2010). Moreover, codes of ethics introduced by firms to instil ethical behaviour have little meaning in practice (Schwartz 2002). Indeed, Lewis (1985: 381) points out that code of ethics are introduced to "prevent unethical behaviour", not to introduce ethical behaviour. Moreover, as mentioned above, ethical behaviour cannot be enforced but must be chosen by the individual. It seems therefore that codes of ethics are often used as a corporate governance tool or, if published and advertised, a marketing tool. Goldman Sachs, after settling a fraud charge with the SEC, overhauled its corporate governance principles and work ethics. It pledges commitment to clients, reforms and transparency, but those pledges are unlikely to impact greatly on the business activities and appeared more self-serving than interested in actually changing their business practices (Guerrera 2011).

So far the discussion has shown that the motivation and conduct of businesses as well as employees are important when considering the ethicalness of a business. However, in the same way that measuring the outcome of a business activity alone is not sufficient in judging a businesses ethical performance, the focus on only motivation and conduct cannot be either. A business activity that results in unethical outcomes must be considered unethical despite the fact that it may be motivated by the best of intentions and has been conducted without causing harm to individuals, communities and society directly and indirectly.

One way of assessing the ethicalness of an outcome is by adopting Mill's (1863) principle of utility maximisation. His view ignores intent and solely focuses on the outcome of an activity in which, the more good consequences an act produces, the more ethical it is considered to be. This is a principle similar to that of *pleasure* in Aristotle's writings (Kraut 2012). However, one important problem of the utilitarian tradition lies not in its concept, but in the interpretation thereof. Mill's utilitarianism is conceptually close to the economic norm of *wealth maximisation* as pointed out by Posner (1979). The tradition of economists to remove anything remotely human from their model has created an interpretation of the *greatest happiness principle* that is overwhelmingly concerned with monetary gains whilst it ignores other principles such as well being and friendship: "wealth is the value in dollars or dollar equivalents" (Posner 1979: 222). The simplification ignores the redistributive flavour of utilitarianism and its focus on a variety of factors. In light of this, Sen and Williams propose the need for a change of focus in utilitarian thought, one that embodies commonly supported rules and institutions that could help utilitarianism to shake of its economic dominance (1982). A major problem in applying Mill's concept to real life

situations is the complex interaction of a multitude of human and organisational actors that may be affected by the outcome; a point frequently raised by stakeholder theorists.

Freeman (1984 [2010]) argues in his seminal work that despite the simplicity of identifying stakeholders, the management of those relations and interactions is a complicated task.

Whilst investigating “who and what really counts” in stakeholder models, Mitchell et al. (1997: 853) expose a range of problems related to legitimacy of the claim, stakeholder power and urgency of the claim. They point out that for-profits frequently manage their stakeholders according to stakeholder power, and that in those cases unethical behaviour and self-interest are displayed. This follows that non-profits are more likely to consider a variety of attributes as they are not driven by principles of power and self-interest in the same way for-profits are. Thus, their engagement with stakeholders is more genuine and reintroduces the idea that a business must keep a wide array of social benefits in mind that can ultimately have a positive impact on society and environment.

Despite the criticism, the idea behind Mill’s utilitarianism is still a useful one to this study, particularly when excesses are constrained by rules. A variety of consequentialist theories driven by Anscombe’s (1958) influential *Modern Moral Philosophy* have emerged, of which rule-consequentialism is of particular interest to this discussion. It aims to combine some of Kant’s deontological ideas, particularly the notion of universal moral rules, and Mill’s idea of promoting the most beneficial consequences of the action. Berkeley suggested very early that the maximisation of any utility must be judged within an existing body of rules: “The rule is framed with respect to the good of mankind...” (1712: Section 31). Therefore, moral rules should guide utilitarian action according to the principles envisaged by society. At the same time those rules should include the ideas of equality, fairness and justice (Rawls, 1971 [2005]).

For those purposes, Rawls's (1971 [2005]) proposes two principles of justice: equal basic liberties (rights) and the arrangement of social and economic welfare in a way that provides for all parts of society and not only the elite: "justice generally requires that basic social goods – liberty and opportunity, income and wealth, and the bases of self-respect – be equally distributed" (1971, p. 62). The provision of wealth and happiness to all members is an important step as it qualifies the greatest happiness principle whilst at the same time distinguishes rule-consequentialism from the economic tradition of wealth maximisation. Thus, in a rule-consequentialist sense, the principle of wealth maximisation is immoral, as it only benefits a group of individuals, one which is often already privileged. Hooker (1999) proposes that justice and fairness both contribute to the promotion of overall happiness. The *law of diminishing utility of material resources* illustrates why happiness is maximised through the redistribution of wealth rather than the amassment thereof in a small group. The law proposes that the increase of happiness achieved with each unit of a resource, declines the more a person owns of that resource (Hooker 1999). For that reason, the redistribution of profits to those who have least, the *disadvantaged* (Rawls 1971 [2005]), follows the fairness principle and is morally good. Rule-consequentialism helps to redefine the utilitarian idea of utility maximisation in a less economic way. The demanded fairness and justice are more socially acceptable. Utility maximisation is achieved based on a set of "fairly general rules whose acceptance by (more or less) everyone would have the best consequences" (Hooker 1990: 70). Those rules must be concerned not only with the overall wealth created, but particularly the distribution of that wealth in an egalitarian manner, based on fairness and rights (Hooker 1999). Yet, Posner (1979) maintains that the economist alternative is equally just and fair as it allocates wealth based on contribution and that it furthers altruism, empathy and benevolence. However, as increasingly large parts of the population in industrialised countries live below the poverty line and are increasingly dependent on charity, it seems unreasonable to maintain that the current

system of allocating profits according to the contribution made functions adequately. Indeed, Posner himself shows that there is no fair allocation principle maintained in the economist model: "... the wealthier people will be those who have the higher marginal products, whether because they work harder, or are smarter or luckier, or for whatever reason" (1979: 135).

Nonetheless, the justice debate ignited by Rawls does itself suffer from some controversy, particularly in regards to the grounding of his theory in atomism. The view that individual liberal values override that of society has sparked a critical response from the communitarian school that argues that viewing individual freedom entirely divorced from the culture and society they are embedded in which is ultimately untenable. Sandel (1984) emphasises that Rawls discussion criticises both Utilitarianism, for taking society to be one single person, and liberalism, for the unjust distribution of fortune. In doing so, Rawls (1971 [2005]) removes society and people's belonging embedded in specific communities. Sandel (1984: 90) however argues that it is impossible to clip the individual-society bridge without causing harm to the moral foundations people live by "as members of this family or community or nation or people, as bearers of that history, as citizen of this republic." Equally, MacIntyre (1978) and Taylor (1985) hold the view that both morality and political judgement are to be made in reference to human beliefs, practices and institutions. The criticisms are thus directed towards Rawls's *Original Position* which holds that human are to imagine themselves "in the position of free and equal persons who jointly agree upon and commit themselves to principles of social and political justice" (Freeman 2012). Particularly within Rawls's *Original Position's* hypothetical *Veil of Ignorance* people are being deprived of their social embeddedness, which refers to the knowledge and relationships held by those people, society more generally and their history. However, the

communitarian school, rather than dismissing Rawls' (1971 [2005]) *Theory of Justice* gives opportunity for improvement to the idea as shown by Gutman (1985: 190). She holds that the communitarian contribution "combines community with a commitment to basic liberal values [...]," thus reintroducing the community aspects to the considerations of individual freedom.

Despite the criticism of Rawls, the communitarian contribution emphasises and strengthens the ideal of equality, justice and fairness. Moreover, this work shows that Friedman is wrong in liberating businesses entirely from considering the impact on the various communities the firm interacts in. Businesses, especially in seeking corporate status and request treatment equal to that of human members of society must consider how their business models impact on various stakeholders and cannot only focus on their profitability. This supports Sandel's (1984) proposition that nations might regulate business in order to restrict capital mobility and disruptive changes to industry (Gutmann, 1985). Gutmann argues that this would not infringe Rawls' liberal basis, but would instead prohibit a "disruption of local communities" which in itself "is an important contribution of communitarianism to liberalism" (1985: 190).

Thus a more fundamental analysis of ethics applied to the business context shows that current business ethics are insufficiently inclusive to judge an ethical performance.

Friedman's claim that a business must only focus on making and increasing profits to be socially responsible ignores the impact such activity has on society and as a result both, the CSR and the philanthrocapitalist approach to business ethics are to be dismissed.

Particularly the rationalisation of businesses driven by shareholder value is deeply unethical

as it is motivated purely by increasing profits for a few people whilst other parties are knowingly disadvantaged. Business is conducted in ways that neglect the negative impact on society for example, job losses, pollution and resource hoarding. The combined use of deontological, virtue and utilitarian ethics allows a more nuanced interrogation of the ethical character of businesses that reflects on different aspects of the firm. The approach does not aim to declare a business unethical because it may have deficiencies in some area. To the contrary, it is used to develop a scaled judgement about ethicalness that reflects the degree to which the firms act ethically more appropriately. Nowadays a large number of profit maximising firms use CSR to communicate some idea about their ethical use of resources or support for specific communities, however, this says little about the procedures by which the firm conducts its business and how the outcome reflects the impact on society and environment. To more realistically reflect an organisation's ethicalness, all three aspects need to be considered. Combining motivation, conduct and outcome (MCO) in a scheme reflects the ideas that the three discussions on ethics are complementary and not opposed to one another.

The Advantages of the Stakeholder Model for Managing Social Impact of the Firm

So far, the analysis has shown that current business ethics are too focused on business principles and profits whilst ethical motivation, conduct and outcome are often ranked lower. The relationship between shareholder value creation and a firm's participation in social issues through CSR and other mechanism are to be seen "as a transactional investment easily copied by competitors" (Hillman and Keim 2001: 135) and thus is of little long-term benefit to a firm's strategy. Instead, they argue that a more in-depth

engagement between firms and key stakeholders is more likely to benefit a firm's long-term viability and success (ibid: 136). The current focus of firms as profit maximising agents with a sole responsibility to their shareholders may only consider social issues when required to do so because of negative PR; yet, such engagement may not create the same long-term value that results from managing stakeholder interests.

As suggested by Carroll (1979) ethical businesses have to consider at least three components when measuring their performance: economic responsibilities to shareholders and customers, legal responsibility to rules and legislations and ethical responsibility to society. This has often been taken to be in hierarchical order, so that profits are implied as more important than social goals; however, as shown above, profits and legal responsibilities have eliminated much of the social attachment of business activity. Thus, the ethical instance has been increasingly infiltrated by economic considerations. Part of the problem, is how to measure ethically good performance (see for example Porter & Kramer 2002). Whereas the economic performance can be easily measured in terms of profits, cost and productivity ratios and legal responsibility is defined by law, measuring social performance is more complicated. As a result different approaches have been developed.

One model that shows potential in facilitating the demands for a more qualitative review of business impacts as part of its ethical judgement is the *stakeholder approach* driven by Freeman (1984) and refined since by Donaldson and Preston (1995), Mitchell et al. (1997) and in Carroll and Buchholtz's *Business and Society* (2011). The central idea behind the model is that business should facilitate the needs and demands of various stakeholders in a

balanced way; thus it lifts the focus on shareholders and gives more power to other interest groups such as employees, suppliers, communities and customers. The model offers a relatively complex, yet structured form of analysis that allows the integration of the demand for ethical motivation, conduct and outcome described earlier. Donaldson and Preston's (1995: 68f) article compares types of relationships in the stakeholder model with the more traditional input-output model and conclude that relationships and interactions between parties are much more complex and of managerial importance (Preston 1995: 87). Moreover, they highlight that the dominance of shareholder interest is "morally untenable" (Preston 1995: 88).

Yet more crucially, the identification of who may be considered a stakeholder has raised considerable concerns as suitably discussed by Mitchell et al (1997: 854) who argue for shareholders to be grouped according to their level of *influence* on the firm, the *legitimacy* of their relationship with the firm and the *urgency* of their claims which results in the emergence of two different views on stakeholder groups, the *narrow* and *broad* view. The narrow view focuses only on those interest groups that are of direct importance to corporate survival, but the broad view is more inclusive and incorporates the idea that modern corporations can effectively be impacted by, and have an impact on a more diverse range of actors (Mitchell et al 1997: 857). Defining who and what constitutes a stakeholder is further influenced by different institutional settings found in different countries (Carroll and Buchholtz 2011: 399f). The *Varieties of Capitalism* literature offers an insight into the different traditions of economic organisation across nations and how those differences impact on corporate behaviour (Amable 2003; Hall and Soskice 2001; Whitley 2007). One institution that has received considerable attention because of its ability to influence business activity is the German co-determination law which describes workers rights and

ability to participate in management decisions and the resulting employer-employee commitment (FitzRoy and Kraft 1993). Although strictly speaking the enforced integration of German employees in managerial decision making does not credit the business to be ethical as it is required by the law, it has a profound impact on the business models of German companies even though some of its strengths have been eroded by shareholder interests (Roth 2010).

Other national contexts, such as the Anglo-American countries, tend to empower shareholders over other stakeholders (*Economist* 1992: 52). The stakeholder that is most likely to suffer in cases in which ideologies favour one or few stakeholders – mostly, shareholder, managers and suppliers – is often the workforce as it represents the biggest controllable cost (Froud et al. 2000). Proponents of shareholder value have strategically eroded social welfare systems by driving a neo-liberal agenda (Dore 2000). The retreat of the state and the empowerment of market structures through increasing liberalisation of business activity led to the decline of social democratic and corporatist models of business organisation and have created an institutional design that removes stakeholders that are not integral to the firm strategy from being considered (Williams 2000). This institutional design has systematically favoured contractual and ownership rights of shareholders and suppliers. Moreover, agency theory has empowered management and directors to shape the future of the corporation according to the demands of the owners by linking corporate performance to executive compensation (Bebchuk and Fried 2003). However, as Jackson and Höpner (2001) and Vitols (2003) note, with changing national institutional environments, the overall impact of shareholder value principles is constrained, sometimes considerably, and stakeholder systems emerge *augmented*.

The diversified interests of stakeholder firms are highlighted by the triple bottom line concept which considers social, ecological and economic criteria when assessing corporate success (Eklington 1998). It signals an increasing interest in the impact corporate action has on communities, employees, customers and other stakeholders from management, investors and civil society groups and proposes that social and economic criteria should be measured and accounted for in the same way financial performance is (Norman and MacDonald 2004). The commitment to this principle however, similarly to other ethical principles, has been described as a “good old-fashioned single bottom line plus vague commitments to social and environmental concerns” (Eklington 2004: 256), thus reflecting above concerns in which the profit principle suppresses social and environmental goals. The decline in the variety of stakeholders considered in firms’ strategic decision making is most visible in shareholder owned corporations. Although shareholder value principles have increased their grip on national and indeed international business thinking, some types of organisations seem less indoctrinated by it than others (Thomsen and Pedersen 2000). These authors point out that the financialization of corporate aims and strategy is not a universal development and that non-market owned firms tend to be driven by more risk-averse and long-term oriented strategies. Particularly mutually owned organisations appear less inclined to follow governance structures informed by agency theory and shareholder value as highlighted by Spear (2004). Mutuals have no distinct set of owners which means that external pressures to maximise profits are reduced and more effort is given to the negotiation and reduction of the impact mutuals have on business partners, customers and the community. Moreover, democratic member participation in mutual organisations illustrates a broader stakeholder approach to corporate governance although low election turnouts could undermine member impact (Spear 2004).

The discussion so far has developed an argument that views current business concepts as dominated by shareholder interest in which corporate strategy is continuously adjusted to maximise short-term profits. Attempts to introduce business ethics and the managing of stakeholder interests have equally been hijacked by the corporate elites to access new markets and drive economic performance. As a result, a concept of an ethical firm has been developed that uses arguments from moral philosophy to inform its central business principles. When considering the motivation, conduct and outcome of the ethical firm, a more inclusive engagement with stakeholders is promoted. The stakeholder approach defined by Freeman (1984) and subsequently developed academically is considered to strengthen stakeholders input in corporate strategy. The final part of this chapter will consider the implications for ethical firm business models, specifically the ethical banks which are the subject of this investigation.

Towards an Ethical Bank Business Model

Although “business model” is a useful concept commonly used in everyday situations, its terminology is confusing (Zott et al. 2010: 1023). Froud et al (2009: 254) link this to the little agreement as to what exactly a business model is, what it consists of and how it should be used in the business context. Others (Chesbrough and Rosenbloom 2002: 533; Zott et al. 2010: 1020) go further and suggest that academic investigations take advantage of the relatively weak and wide-ranging ideas about the concept and thus directly contribute to the lack of a clear definition. Whilst this could be viewed as a weakness of the concept it offers ample room to create a model that sufficiently fits the type of organisation in the specific context investigated. Overwhelmingly, business models have been thought of as part of the profit maximising corporation and entrepreneurs and is

aligned strongly with the idea of value creation (Johnson et al. 2008; Zott et al. 2010); however Froud et al (2009) have highlighted its usefulness in investigating public sector organisations which are likely to feature different structures and aim to fulfil largely different goals to those of privately owned companies. Moreover, Foster et al (2009) applied the idea of business models to the US non-profit sector and highlighted some of the complexities and problems that arise from running organisations without clearly defined quantifiable business goals such as profit margins or return on investment. Although neither private, non-profit or public organisations' business models fully incorporate the principles and ideas behind ethical banking, they highlight the adaptability of the concept reflecting the differences in ownership, strategy and behaviour making the business model concept useful to the investigation of ethical banking.

Froud et al's (2009) idea of a business model features two dimensions: *cost recovery* and *stakeholder expectations*. The choice to use their relatively open dualist idea of a business model has been made to ensure that it is flexible enough to deal with the considerable variety of conceptual ideas behind ethical banks. At the same time their concept of a business model is sufficiently removed from the idea of the "shareholder value/profit maximising" economic approaches that dominate business and management studies. This is crucial with regards to the idea of a business model having a direct influence on performance. Zott et al (2010) highlight a number of studies (Afuah and Tucci 2001; Patzelt et al. 2008; Zott and Amit 2008) that link business models to firm performance and value creation. Froud et al's (2009: 255) make a further distinction between performance focused on shareholder value in privately held firms and value for money in public sector organisations.

This study will adopt Froud et al's (2009) business model concept as it permits both the comparison of profit-focused high street banks with not-profit-maximising ethical banks, and the comparison of the different forms of ethical banks existent in terms of ownership ranging from mutual-cooperative ownership structures to those owned by charities or depository receipt holders. Moreover, in contrast to the firm level analysis with clearly defined boundaries, the investigation of ethical banks through a business model approach focuses not only on the firm itself but also on the interaction of the firm with a variety of stakeholders (Zott et al. 2010) within different institutional, cultural and regulatory settings. Although such comparison is considered more important in comparing organisations across national backgrounds as emphasised by the *Varieties of Capitalism* literature (Amable 2003; Crouch and Marquand 1993; Hall and Soskice 2001; Zysman 1996), it remains helpful in understanding the different cultural ideas behind ethical banks. Particularly, the different sets of stakeholders that engage with ethical banks and the variety of outcomes that are aimed to be achieved demand the integration of cultural and institutional factors in the analysis (Froud et al. 2009). Additionally, these aspects link to the embeddedness literature that emphasises the importance culture, politics and cognition play alongside the economic factors in understanding an organisation within its environment (Zukin and DiMaggio 1990) which will be discussed in more depth in chapter 3.

To date, "ethical bank" and "ethical banking" have not been clearly defined or even much discussed in academic literature. Yet, non-academic discussions of ethical banking raise the issues of sustainability, transparency and social and environmental goals as being important features of ethical banks. De Clerk, co-founder of Triodos and the *Global Alliance for Banking on Values* asserts (2009: 209) that ethical banks have "ethical and sustainable

developments at the core of their mission, ambitions and practices.” In practise membership criteria and definitions of ethical banking appear to differ substantially depending on the specific focus of the associations. GABV³ (2012a) requires members to be independent and focused on retail banking, a balance sheet larger than \$50 million and “committed to social banking and the triple bottom line”, thus openly stating commercial elements. Yet, GABV (2012b) also state the need to have a “*positive*” impact whilst also demanding transparency, community involvement, long-term sustainability and a organisational culture that reflects the aforementioned principles. FEBEA (2012) similarly issues a set of *positive* criteria – “role of an ethical bank”, “origin of money”, “destination of money”, “criteria and values for the use of money” and “conditions for bank management” – in which it describes what ethical banks are and how they should operate. INAISE (2012) the third large European association defines its membership as investing: “in undertakings of an ethical, ecological, cultural, collective and self-managing nature, across cultures and genders, including fair access to finance, sustainable support of the developing world, and in favour of the social economy generally.”

Although ethical banking is not legally defined it appears that industry practitioners largely agree on key characteristics, yet there are “substantial differences in the business models” of ethical banks in Europe (Carboni 2011: 6). Overall, the difference between the three main European ethical bank associations are relatively limited, thus it seems puzzling as to why it needs three representatives to cover a relatively small section of banking especially since membership is often overlapping (Weber and Remer 2012). The various, but largely similar approaches, could however be one of the reasons for the confusion in defining

3 GABV – Global Alliance for Banking on Values, FEBEA – European Federation of Ethical and Alternative Banks and Financiers, INAISE – The International Association of Investors in the Social Economy

ethical banking. Thus, it is essential that principles are clearly stated as in the summary provided by Carboni (2011) focusing on financial inclusion; transparency; provision of finance for socially and financially sustainable activities; mutual and cooperative ownership is preferred to market ownership and lending on trust basis⁴. Overall there is considerable ambiguity as to what ethical banks should be which could enable high street banks to capture the market as has previously occurred in the SRI market (Sparkes and Cowton 2004). If this were to happen again, it could affect ethical banks negatively as it would undermine their ability to grow in future (Carboni 2011: 34; Weber and Remer 2012).

The cost recovery dimension is quintessential to any firm's longevity. A key element of the sustainable firm, whatever type of ownership, is their ability to recover costs (Froud et al. 2009). However, whilst it is accepted that a business must create a surplus to be sustainable, the extent of the surplus and how this is to be achieved differ significantly across organisations. With regards to this, public organisations objectives of balancing the books are very different to the process of profit maximisation that is dominant in privately held firms (Friedman 1970; Rappaport 1998). Similarly, the importance of cost recovery and profit making in ethical banking is expected to differ significantly amongst the organisations with those driving for growth and market share expected to be more focused on profit making than those with clearly formulated social value goals.

Although it cannot substitute cost recovery and profitability, an additional prominent feature of ethical banks is the creation of *social value*. Whilst value creation has been heavily standardised across industries partly because of the cognitive acceptance of

⁴ This is particularly important in supporting social businesses and start ups who are often declined credit in mainstream banks

financial measures as superior in judging firm performance in an increasingly financialised world (Dess and Robinson 1984; Erturk et al. 2008; Fligstein 1990), a recent report by Demos (Wood and Leighton 2010) highlights the difficulties in standardising social value measures. Because of these complexities, the concept is not used to benchmark the “goodness” and robustness of the ethics to create a single number. Instead, it uses snapshots to highlight the different approaches taken by ethical banks to create social value.

Froud et al’s (2009) concept of business model used in this thesis has been adapted to incorporate ethics. This will support the demarcation of ethical bank business models from those of plc banks and highlight the different approaches taken by ethical banks themselves as ethics may be at the heart of the ethical bank, or they may feature more as an add-on to a relatively commercial business model. Furthermore, the inclusion of the banks’ ethical features in the analysis is seen as a crucial element in explaining why ethical banks operate in dissimilar ways whilst aiming to achieve similar goals. The stakeholder dimension of the business model concept is crucial to understand the ambitions of ethical banks. The embeddedness of firms in a set of relationships has a major impact on how a business is run and what products and services are offered (Leadbeater and Christie 1999). Froud et al (2009) highlight the influence key stakeholders can have on a variety of measures, for example share price and value for money. They argue that organisations must be seen to act with credibility to protect the specific stakeholder interest. The answer to the question who the stakeholders are and what they demand of the business differs from organisation to organisation, but as suggested above shareholders tend to hold more power compared with other stakeholders (Brickley et al. 2004; Jensen and Meckling 1976; Lazonick and O’Sullivan 2000; Rappaport 1998) and have considerably more influence on

firm strategy and performance than for example the electorate and government have in public organisations. Yet in most cases, ownership structures in ethical banks eliminate the shareholder as a stakeholder because of their mutual status. Alternatively, they may limit the impact shareholders have on the business by setting limits to depository receipts held per person and the voting rights associated with each depository receipt holder to one vote per person. Froud et al (2009) propose that the absence of shareholders has an impact on governance, nonetheless, they argued that performance is measured by tools that are similar to those used in shareholder companies. Hence, stakeholders in ethical banks may, albeit for differing reasons, be interested in relatively commercialised ratios such as cost/income or return on assets. The literature (Froud et al. 2009: 256; Wood and Leighton 2010) points towards the increasing impact financial management narratives have on organisations even though their commitment is not financial but linked to the provision of services. This is an understandable requirement in public organisations to limit the costs of mismanagement impacting on service provision to the population, and equally, ethical and social organisations must manage costs effectively and be economically viable in the long-term. However, the influence of strong profit and cost-control narratives can also have negative implications for business and leave ethically oriented business without a clear mandate.

Whilst cost control is important for some stakeholders, other actors are likely to have different interests in an ethical bank (Goulet and Frank 2002). For example, a bank customer like an organic farm has specific expectations of how the bank conducts its business and with who. The farm may choose the bank depending on whether it invests in or deals with producers of genetically modified vegetable and caged hens. Such specific stakeholder demands are unlikely to be considered by commercial banks who would argue that their investments and lending practices are neutral as highlighted by De Clerk (2009). An ethical bank focused on lending to the organic market can however not ignore this kind

of stakeholder interest. Similarly a bank that supports a specific charitable aim (fighting homelessness) may run into reputational difficulties if it attempts to repossess houses where owners have not kept up mortgage payments. As a result of this, stakeholders in ethical banks are likely to be different to those of their Plc counterparts, with a more pronounced interest in how the organisation fulfils its social aims. As a consequence, the management and the impact on the business model of ethical banks are likely to be more varied too and because it lies in their interest to do so, stakeholders probably consider not only the financial performance but have a keen interest in the commitment an ethical bank makes to “bring about change in individuals and society” (Drucker 1990: 3). The central question that arises from dealing with non-shareholder stakeholders is therefore the extent to which stakeholders can take over the control mechanisms that are similar to those of shareholders in plcs.

Conclusion

Banks and other financial intermediaries have become increasingly powerful actors in the economies of developed nations, not only because of their function but also because of the financial interest of the economic and political elites to extract large amounts of profit from the real economy to then reinvest them profitably. This process of financialisation (Epstein 2005; Krippner 2005) has been argued to have considerable impact on everyday life and corporate management (Froud et al. 2006; Martin 2002). Subsequently, the chapter developed a new approach to business ethics which considers the ethicalness of a firm’s motivation, conduct and outcome, thus placing ethics at the core of the business. By also considering a variety of stakeholders other than shareholders, this approach reflects a broader view on the role both ethics and stakeholders play in a firm. The chapter then

proposed a business model framework that reflects Froud et al's (2009) cost recovery and stakeholder interest functions, but crucially adds an ethical component.

Ethical banks should feature a motivation to predominantly advance social and environmental aims; a conduct that reflects the interest of customers and not self-interest; and a positive outcome and limited, yet equally distributed, or retained profits to develop future lending capabilities. Instead of empowering managers and shareholders to govern the firm and share firm-profits, the stakeholder business model approach takes a broader yet flexible approach. It considers the different ideas behind ethical banks, including how they recover costs and how strongly ethics command business conduct. The model also recognises the potential for multiple stakeholders to be involved in the ethical banks' governance process which appears particularly useful as ownership structures are more diverse and non-representative of those found in commercial banking. The next chapter will examine the banking industry in the UK, specifically the relationships between ethical and mainstream banks. Following this, the chapter will discuss the industrial district literature and why it is useful to the investigation of ethical banking.

Chapter 3: Ethical Banking and the UK Banking Industry

Ethical banks are unlike profit maximising, commercial banks, as discussed in the previous chapter and ultimately do things differently. It is, therefore, reasonable to assume that their structural organisation and political and cultural integration in UK banking is equally dissimilar to that of high street banks. Nonetheless, ethical banking cannot be seen as separate from UK banking. It is embedded in national systems of regulation and the national socio-political context, both of which have to be considered when analysing ethical banking.

This chapter sets up the framework to study ethical banking as a sector in its own right and as a sub-sector of the banking industry. To begin with, the chapter will examine the banking industry in the UK and briefly summarise its development and current features. Next, more conventional approaches used to analyse industries will be criticised as being dominated by mainstream economics. The argument will then propose that an approach recognising *embeddedness* theory is a more suitable starting point as it features social interactions as well as political-economic attributes. Embeddedness as a core concept informs different varieties of embeddedness which the study will operationalise in two different ways. The chapter commences with the analysis of the political and cultural-cognitive integration of banks featured in an approach that features six dimensions informed by the industrial district literature. Finally, the chapter argues for structural embeddedness to be analysed via social network analysis.

Ethical Banking: A Small and Peculiar Sector

Talking about banking often conjures the image of a well-dressed, powerful and internationally mobile elite running the world's largest financial conglomerates. However, talking about an ethical banking sector challenges such images as it refers to non-Plc alternatives embedded in specific regions or communities. In order to understand ethical banking, this section begins with describing past developments in the sector before discussing current ethical banking structures. Throughout, emphasis is being placed on highlighting British exceptionalism and how this has led to the UK ethical banking sector being smaller and more peculiar than its European counterparts. The discussion features building societies which represent the largest and most institutionally mature segment of ethical banking, as well as niche ethical⁵ and credit unions.

Following the 1986 Big Bang, the financial services industry in the UK has expanded dramatically as highlighted in Figure 3.1. UK banking sector assets as a percentage of GDP are considerably higher than in other European markets, topping 600%, nearly twice as high as Germany. However, assets held by the main high street banks⁶ only explain about 50% of the assets held by the financial system; £4.2tn (BBA 2012a) of approximately £8.9tn (ECB 2012)⁷, thus suggesting that the financial services industry in the UK as a whole is substantially larger than domestic high street banking activities. Whilst both figures show the importance of finance generally, and banking more specifically, to the UK economy, they say relatively little about ethical banking. Indeed, not even the large ethical banking institutions are included in the BBA figures for *main* high street banks, although assets held

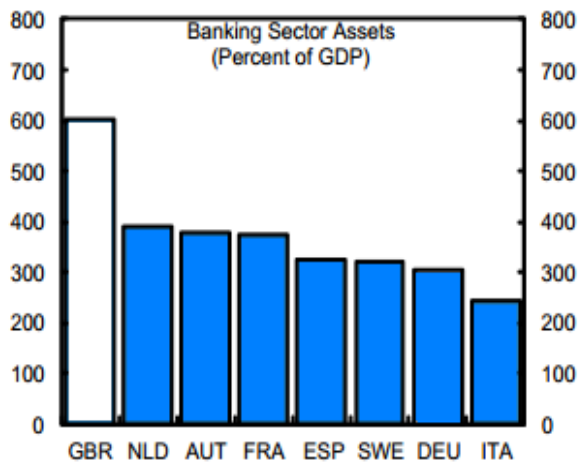
⁵ 'Niche ethical^s' includes the Co-operative Bank, Triodos Bank, CAF Bank, Unity Trust Bank, Islamic Bank of Britain, Reliance Bank, Airdrie Savings Bank, Charity Bank, Kingdom Bank and Methodist Chapel Aid

⁶ As used by the BBA includes Santander UK, LBG, Barclays. HSBC, RBS and Northern Rock only

⁷ ECB figure is €11,142bn (times approximate exchange rate 0.80 equals £8.913bn)

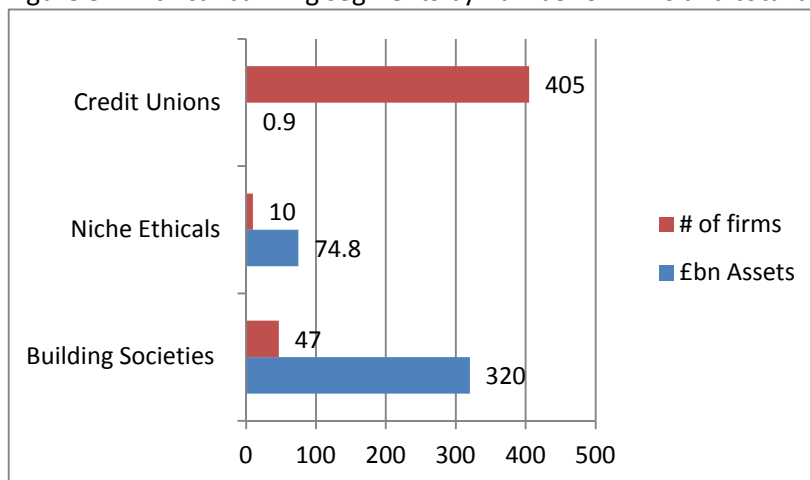
are considerably higher for both the Co-operative Bank and Nationwide compared to Northern Rock which is included. This signals one of the key issues for debate in this research, which is the apparent lack of visibility of ethical bank alternatives in mainstream political and economic debate. Thus, it is unsurprising that ethical banking in the UK has received very little attention in main stream media and political debates until after the financial crisis, and still, current debates have limited impact on the sector as a whole.

Figure 3.1: Banking sector assets as % of GDP



(Source: Deutsche Bundesbank, (IMF 2011))

Figure 3.2: Ethical banking segments by number of firms and total assets 2010 figures



(Source: BSA, company websites and WOCCU)

Yet, by some measures, ethical banking is not a significant sector. The number of firms (n≈450) in the ethical banking sector is more than twice the number of all BBA members

(n=200), which also includes some ethical banks as well as many international and private banks (BBA 2012b). Moreover, assets held by ethical banks represent about 10% of the UK banking sector - approximately £400bn (Figure 3.2) against the £4.2bn held by main high street banks (BBA 2012a). Nonetheless, ethical banks are underrepresented in main stream banking debates. Part of the reasons for this is highlighted in Figure 3.2; ethical bank segments differ significantly both in terms of the number of firms and total assets. This is linked to a different set of activities that the various firms engage in and the goals they pursue more widely. Overall, the circa 450 ethical bank organisations appear to conjure the idea of ethical banking as being substantial and ecologically diverse; however, doing so ignores the fact that building societies in particular have diminished in size and influence over the past two decades.

Demutualisation and Consolidation of Building Societies

Some of these significant changes are summarised in Table 3.1, illustrating that building societies have suffered substantial losses in market share throughout the 1990s as highlighted in the drop in branches and assets after the passing of the Building Societies Act 1986, making it possible for societies to demutualise. It is important to note that the transformation into Plc banks was politically legitimated and driven by pro-market attitudes of managers following the 1986 Big Bang (Cook et al. 2002; Klimecki and Willmott 2009). Moreover, Cook et al (2002: 44) argue that changes to the institutional framework have left building societies intentionally unstable and thus encouraged conversion. The accumulation of large reserves following a decade of high profit margins (Boxall and Gallagher 1997) has also attracted “carpetbaggers” who also pushed for conversion to gain windfall profits (Cook et al. 2002). As a result of demutualisation, the remaining building societies have become increasingly marginalised as economic actors, and in their ability to

influence politics and regulation through lobbying. Indeed, demutualisation strengthened high street banks' market share and political influence, not only because of their conversion but ultimately because most converted societies were soon taken over by larger competitors.

Table 3.1 Historic development of building society number, assets and branches, selected dates

| Year | Number of societies | Number of Branches | Total assets £m | % change in assets |
|---------------|----------------------------|---------------------------|------------------------|---------------------------|
| 1986 | 151 | 6954 | 140,603 | |
| 1996* | 77 | 4613 | 318,392 | 127% |
| 1996** | 72 | 2571 | 124,869 | -61% |
| 2006 | 60 | 2105 | 294,419 | 136% |
| 2007 | 59 | 2016 | 330,272 | 12% |
| 2008 | 55 | 1916 | 358,956 | 9% |
| 2009 | 52 | 1685 | 331,274 | -8% |
| 2010 | 49 | 1652 | 309,451 | -7% |

* Includes societies demutualised by 31/12/97, ** Excludes societies demutualised by 31/12/97 (Source: BSA 2012b)

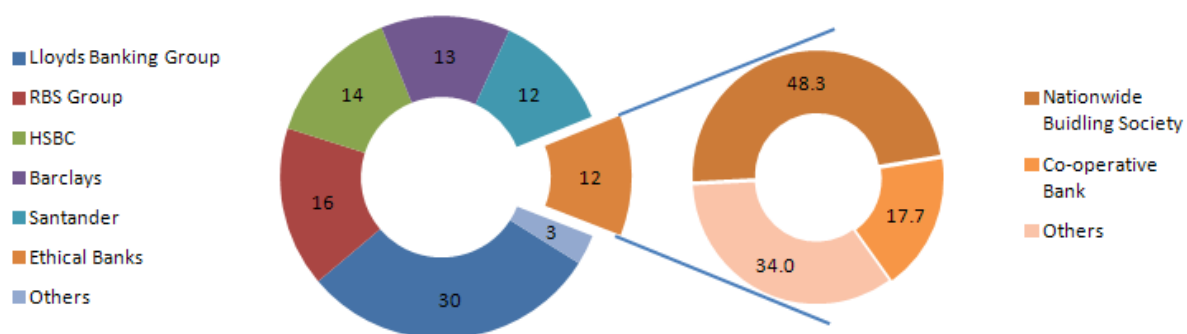
Since 1996, building societies have succeeded in raising deposits to pre-demutualisation levels by 2007; and have generally been less affected by the financial crisis because of the restrictions regarding risk taking imposed on them (Table 3.1, S&P 2012). Although this expansion of assets seems encouraging, the sector has continued to shrink and consolidated into 47 organisations in 2011 with 25% fewer branches, compared to 2006. Moreover, since the establishment of the Ecology Building Society, no building societies have been established in over 30 years. This seconds the idea that restoring building societies influence is impossible within the current legislative and regulatory framework, and under market conditions emerging after wide-ranging changes to the financial services and banking industry, following the passing of the Financial Services Act 1986 and Building Societies Act of 1986 (BSA 2012d; Leadbeater and Christie 1999; Michie and Llewellyn 2010). Additionally, an almost Darwinian idea of the extinction of building societies could

be considered as a precursor of niche-oriented ethical banks, epitomised by the niche focus on “green” or “environmental” mortgage products offered by the Ecology Building Society. Resulting from this brief discussion, it is evident that despite the recovery in total assets, the sector has diminished in size and cohesion. At the same time, Nationwide Building Society has nearly tripled in size to assets totalling £191,397m which represents 60% of the building society segment and 50% of the ethical banking sector as a whole. This massive increase is interesting as it raises question about the source of this expansion partially explained by consolidation, but also indicating changes to the business model and pointing towards increased commercial activities. Nonetheless, the figures clearly show that the building society segment as well as the ethical banking sector as a whole is dominated by one organisation. Alternatively it raises a question about the role of Nationwide and specifically about its ability to influence the agenda of the sectoral development both internally through the BSA, and externally with regulators.

Two Dominant Firms

The conversion of building societies into Plcs in the 1990s has had a significant long-term impact on the remaining societies. Overall, the formerly well-established and diverse sector has been increasingly weakened and concentrated over the past two decades by internal consolidation and demutualisation.

Figure 3.3 Ethical bank market share as % of industry total and disaggregated market shares of the segment



(Source: Treasury 2011 and company reports)

The dominance of Nationwide is only challenged by one other ethical bank, the Co-operative Bank. In recent years, the Co-operative Bank has also expanded significantly through the merger with Britannia Building Society and acquisition of 600 branches previously owned by Lloyds. Total assets held by the bank topped £70bn in 2010/11 (up from £12bn in 2006) and are likely to increase further as a result of the expansion and customer demand, despite the proposed sell of its “Life and Savings” business (The Co-operative Bank 2012b). Whilst, the overall increase of the ethical bank market share from 8% to 12 % (2007-10; estimated to increase to 16% after 2012) of the PCA market⁸ (Figure 3.3, Treasury 2011) is communicated as the dawn of an ethical alternative to high street bank domination, it also has significant impact on ethical banking more widely. Together, the Nationwide and Co-operative Bank dominate the ethical banking sector with assets totalling 66% (Figure 3.3) which suggests that they have a considerable influence over lobbying for legislative change. The domination of ethical banking by the two firms is comparable to the strangle-hold power of the BBC and Sky over British media which raises the image of both as 800-pound Gorillas crushing would-be competition. This consolidation of power may also drive further industry consolidation, particularly amongst building societies with potentially considerable negative impact on the ecology of ethical banking.

⁸ The Co-operative Bank’s market share of the personal current account (PCA) market will increase from 3 to 7 following the take-over of the 632 Lloyd branches (Trotman, 2012)

Moreover, the focus on two dominant firms also raises question about the commercialisation of these firms, and to what extent the two firms are indeed different from high street banks.

As a result, other forms of ethical banks are marginalised in UK retail banking. The limited development of credit unions is particularly striking in the UK, in particular when set in contrast with what has happened in other national retail bank markets, especially across Anglo-Saxon countries, and even India. Table 3.2 shows that on two key measures, credit union assets, as percentage of total bank assets and penetration in the UK, are significantly lower compared to other countries⁹. Moreover, compared with the cooperative bank systems of Germany and the Netherlands, it shows that the market position of ethical banks, especially credit unions, is much weaker. Particular regulatory restrictions, and a weaker link between communities and voluntarily run credit unions, are often cited as reasons for the sector's lack of development (Goth et al. 2006; Lyonette 2012). Yet whilst recent developments have been positive, particularly in terms of members (ABCUL 2012a), O'Connell suggests that prior to the 2008 crisis, they "have strikingly failed to become widely established despite strong government support, leaving the sub-prime sector vulnerable to doorstep money lenders" promoting industry consolidation into "more entrepreneurial credit unions" (2005). Others argue that the recent growth of credit unions is unsustainable and indeed dangerous, as such growth increasingly attracts sub-prime lending which threatens the ability of credit unions to recover loans (TFN 2012). It is needless to say that until very recently, credit unions in the UK have been marginal actors only, and their relatively recent increase in popularity appears to be unsustainable because of capital and sub-prime risks and the unsophisticated products and operations run by

⁹ The penetration figure for India is low because of the general lack of access to banking facilities.

credit unions, largely dependent on volunteers to offer competitive rates to their customers. Yet, despite future growth ambitions and a potential consolidation of credit unions into larger, interregional or even national unions, both market penetration rates (2.4%) and assets held by credit unions in the UK, are, and are likely to remain, an insignificant player in retail banking.

Table 3.2: Size of credit union sector in selected countries, 2011 data

| | total credit union assets (TCUA) in US\$bn* | total bank assets (TBA) in US\$bn | TCUA as of TBA in % | Members in 1000's | penetration** |
|-----------------------|--|--|----------------------------|--------------------------|----------------------|
| Australia | 84 | 2,727 | 3.080% | 4,504 | 30.60% |
| Canada | 270 | 3,355 | 8.048% | 10,605 | 45.50% |
| India | 52 | 1,219 | 4.266% | 20,000 | 2.60% |
| Ireland | 17.4 | 1,495 | 1.164% | 3,070 | 72.20% |
| United Kingdom | 1.4 | 13,965 | 0.010% | 983 | 2.40% |
| United States | 982 | 12,639 | 7.770% | 93,933 | 44.90% |
| Germany* | 913 | 7,995 | 11.420% | 17,000 | 40.48% |
| Netherlands* | 915 | 3,547 | 25.796% | 1,800 | 23.54% |

(Source: WOCCU 2012, data for total bank assets from Austrade 2011, ECB 2012, FDIC 2011, PWC 2012 & Reserve Bank of India 2011)

* for comparison only (Co-operative Banks), BVR 2012, ECB 2012 & Rabobank 2012

x calculated by members / economically active population

Exchange rates from local currency to US\$ as of 28 August 2012

Niche ethicals, as suggested by their name, are generally involved in niche markets with very specific customer foci and aim to support specific industries (for example green and social enterprises), charities or communities. The segment appears more dynamic than credit unions and building societies, evidenced by the establishment of new niche ethicals in recent years – for example, Unity Trust Bank (1984), Charity Bank (2002) and Islamic Bank of Britain (2005). However, the entrance of new players is largely complicated by the high concentration of retail banking market share in the “Big 5” as highlighted by the Treasury (2011) and the unwillingness of the government to change this situation. Only recently, and as a result of repeated failings of the large high street banks, has the government accepted that more competition is needed, which led to the entrance of Virgin Money and the

growth of both Nationwide (through consolidation) and the Co-operative Bank (through M&A of Britannia and Lloyds branches). Yet, whilst some players might benefit significantly, the niche nature of their business specialism generally restricts smaller actors' competitive involvement in retail banking. Moreover, the lack of a distinct trade association is likely to hinder a collective engagement with policy makers, which could impact negatively on the kind of regulation that is introduced.

Overall, the ethical banking sector exhibits a variety of features that are important to this investigation. First, the sector's market share is relatively small in comparison to other European systems of non-Plc banks. Secondly, and more importantly, it appears that developments of the sector are driven by the idea of "becoming more competitive" by consolidating, as well as creating two champions of ethical banking that can effectively compete with high street banks, by featuring a branch network, thus resembling a non-plc alternative. Thirdly, however, as the majority of ethical banks appear less taken by those main stream ideas of where ethical banking needs to go and remain both small and niche oriented, which seems to create two different trajectories within the industry. Fourthly, market entrance is limited unless new entrants limit operations to a niche market that might be unattractive to large, established banks, because of the kind of specialist information that is required to accurately assess market risks.

The Financial Crisis as an Opportunity for Change?

The financial crisis of 2007-2010 has been, both in the UK (Froud et al. 2010; Hodson and Mabbett 2009; HM Treasury 2010b) and abroad (Barr 2012; Taylor 2009; Wissenschaftlicher Beirat beim Bundesministerium für Wirtschaft und Technologie 2010),

heralded as an opportunity to reform the inequalities produced by the financialisation of the economy and the banking industry (Erturk et al. 2008). Yet, Froud et al (2012) and Kay (2012a) amongst others have highlighted that little actual reform has materialised, and that the pre-crisis structures and narratives have changed little (Treasury 2011). Whilst this debate is important, the mainstream economic ideas that inform reform agendas have substantial impact on the ethical banking sector. A key example of this is the call for breaking-up international finance conglomerates to reduce risk and cost of bank failures, as well as to increase competition, which is increasingly encouraged by former protagonists of big banks: Sanford Weill (Browning and Benoit 2012), Sheila Blair (Kavoussi 2012), Terry Smith (Aldrick 2012) and John Kay (2012a). Yet, it seems unlikely that large banks will be broken up in the UK considering the lobbying activity of both the FSA and the City of London Corporation (Mathiason and Newman 2012; Newman 2012). Even the proposed alternative “ring-fencing” suggested by the ICB, which already represents a major concession to large UK banks, has been weakened in the policy making process. Instead of breaking up oligopolies, a series of take-overs has increased the market share of the 5 largest personal current account providers in the UK from 79 to 85 per cent (Table 3.3). Even considering the selling of Lloyds’ branches to the Co-operative Bank as demanded by the EU in response to the government bail-out, it is unclear whether this will have any fundamental impact on UK retail banking. Moreover, it is entirely unclear in what ways the creation of two “champions” of ethical banks (Co-operative Bank and Nationwide) as an alternative to high street banks will impact on ethical banking as a whole. So far, reforms have insufficiently dealt with the issues of competition and entry barriers as highlighted in the ninth Treasury report (2011) and positive developments in ethical bank apart from these champions appear largely linked to niche organisations like Triodos bank who have received attention from the media, such as the *Guardian’s* ethical banking feature.

Table 3.3: Personal Current Account (PCA) market shares pre- and post-financial crisis, by number of customers

| PCA Provider | June 2007 market Share (%) | March 2010 market Share (%) |
|--|----------------------------|-----------------------------|
| Lloyds TSB } Lloyds Banking | 19 | 30 |
| Halifax Bank of Scotland } Group | 14 | |
| RBS Group | 17 | 16 |
| HSBC (Including First Direct) | 14 | 14 |
| Barclays | 15 | 13 |
| Abbey } Santander | 6 | 12 |
| Alliance and Leicester | 3 | |
| Nationwide Building Society | 5 | 7 |
| Co-operative Bank | Data unavailable | 3 |
| National Australia Group Europe (Clydesdale Bank & Yorkshire Bank) | 3 | 2 |
| Others | 4 | 3 |

(Source: OFT, Review of barriers to entry, expansion and exit in retail banking (Table 3.2, in Treasury 2011: 13))

The aim of breaking up of big banks is to increase competition in retail banking. However, existing literatures on competition, especially with regard to its impact on stability and concentration, is inconclusive about the benefits and problems attached to competition in banking, as highlighted by the OECD (2010: 333) policy roundtable on banking:

“There are two opposite views: one (competition - fragility view) is that competition is bad for stability as it induces financial intermediaries to take more risk. Another view (competition - stability view) argues that the less intense the competition, the higher the risk taken by borrowers. However, there is no real distinction between competition and concentration in this literature.”

Yet, the debate also has negative effects on organisations like ethical banks that are less able to compete with the larger actors per se, as they have little or no market power (OECD 2010: 335) because of their very small market share, limited resources and access to back office functions such as clearing. This practical exclusion from competition means that efforts to increase competitiveness of the sector could very well drive consolidation and

increase commercial orientation in ethical banks. Yet post-crisis reforms can have more visible and direct negative impact. Attempts to increase banking sector stability by adjusting capital ratios upwards has been a particular problems for ethical banks, as they cannot easily generate equity by issue of shares (Norton Rose 2011) and instead have to shrink their balance sheet and retain more profit, which overall reduces their ability to compete with high street bank providers even further. Indeed, the reduction in assets held by building societies illustrated in Table 3.1 may reflect this problem.

However, it appears that not all is doom and gloom in ethical banking. Customer satisfaction scores are approximately 50% higher in challenger banks¹⁰ compared to the Big 5 (Table 3.4; Treasury 2011), supporting claims by challenger banks and the BBA that they are more customer-focused (BSA 2011c; Flowers 2010; Virgin Money 2012). Yet, the Treasury (2011) report also cites *Which?*, stating that because of the dominance over the high street and overall apparent reluctance of customers to switch bank accounts, the Big 5 emerge “‘as clear winners of the financial crisis’. The conclusion they drew was that a poor quality service for customers is irrelevant to the growth of significant market power, a clear sign that normal competition is failing”.

Table 3.4: Customer satisfaction scores for UK retail banks 2008-2010 (Source: Treasury 2011)

| | 2008 | 2009 | 2010 |
|---------------------|------|------|------|
| BIG 5 | 57% | 57% | 53% |
| Challengers* | 83% | 85% | 81% |

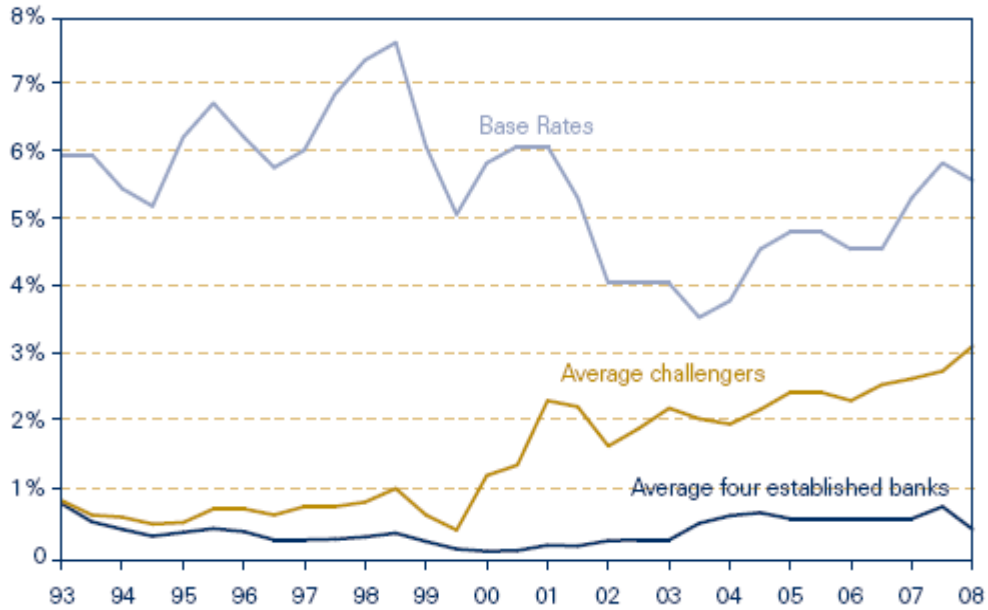
*includes: 2008-10 – Nationwide, Smile & Co-operative Bank; 2010 – Virgin One & First Trust; (Source: Treasury 2011)

¹⁰ “challenger banks” before 2008 are defined by the OFT (2008: 113) as “Banks which are not one of the traditional established four banks of Lloyds, RBSG, Barclays and HSBC Group” (including Co-operative Bank, HBOS, NAB, Alliance and Leister, Abbey, Nationwide and smaller banks); after 2008, “challengers” are Nationwide, Smile, Co-operative Bank before adding Virgin One and First Trust in 2010 (Treasury 2011: 20) (First Direct, Cahoot and Intelligent Finance have been excluded as they are brands of high street banks)

The point made by *Which?* reflects the Office of Fair Trading's (2008) argument that competition in the retail banking sector is dysfunctional, not only because of market entry barriers, but particularly because bank "customers' low levels of switching" between banks which has been repeatedly highlighted by government agencies as giving little incentive to banks to compete effectively for new customers (Cruickshank 2000; ICB 2011a; OFT 2008; Treasury Select Committee 2009). Indeed, even attempts by challenger banks to gain new customers by offering considerably more competitive rates on savings and lending products did not lead to significant changes in market shares (see Fig. 3.4 and 3.5).

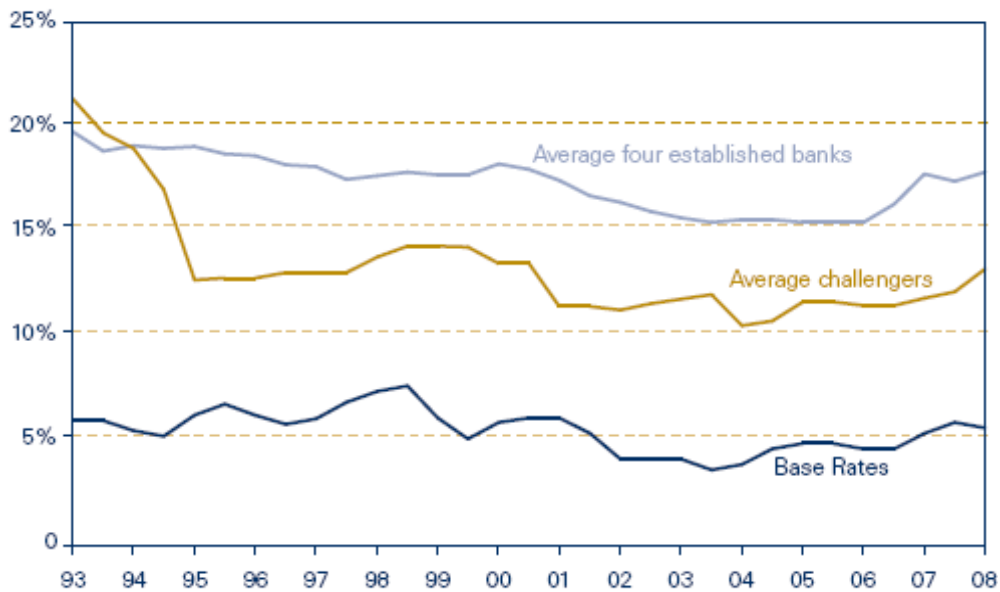
However, despite the recent failures of high street banks to treat customers fairly (FSA 2008; Kay 2012b), and clear evidence that bank customers are increasingly dissatisfied with banking and the handling of the crisis in the UK (*Which?* 2012) as well as the US (Sapienza and Zingales 2012). The Co-operative Bank's, Virgin Money's and "Move your Money" campaigns (Orr 2012) to create awareness are only slowly progressing. However, whilst the Co-operative Bank published a 60% increase of interest in their current accounts (Treanor 2012c) and it is estimated that half a million customers have moved their money from high street banks (*Move your Money* 2012), the big 5 retail banks are unlikely to fail to protect their interests in the long run unless government and regulators show an interest in introducing change (Kay 2012b). Therefore, although this is a big moment for ethical banks, the extent of change has been, and is likely to remain, limited because of customer inertia, switching costs and limited number of alternatives to high street banks.

Figure 3.4: Deposit interest rates, 1993-2008



(Source: OFT, 2008)

Figure 3.5: overdraft interest rates, 1993-2008



(Source: OFT, 2008)

What does Ethical Banking Look Like Elsewhere?

Some observers might consider the weakness of ethical banking in the UK as an indicator of the strength of the private banking system in place. They might argue that after all, if customers were really that unsatisfied with the current systems of high street banks, both in terms of services and rates offered, they would, in protest, switch accounts to building

societies. However, this pro-market explanation ignores that other European countries have developed an institutional environment that enables alternative banking systems to flourish. The comparison between the UK and German banking systems is one of the most documented and often quoted of different approaches to banking as it reflects the ideal types of capitalism discussed in the variety of capitalism literature (Hall and Soskice 2001; Whitley 2007). It is therefore, of little surprise to see that, from the outset, country level indicators for those banking systems are indeed very unlike each other. Both Table 3.5 and Table 3.6 illustrate huge variations in the number of credit institutions and assets distributed across different sized credit institutions which leads to different results in the concentration of banks.

Table 3.5: Country-level indicators: consolidated banking data reporting population

| | DE | | UK | |
|--|----------|----------|----------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Number of credit institutions | | | | |
| <i>Stand-alone credit institutions</i> | 1,700 | 1,709 | 166 | 173 |
| <i>Banking groups</i> | 37 | 40 | 11 | 8 |
| <i>Credit institutions</i> | 1,737 | 1,749 | 177 | 181 |
| Domestic credit institutions | 1,655 | 1,666 | 91 | 91 |
| Foreign-controlled subsidiaries and branches | 82 | 83 | 86 | 90 |
| Total assets of credit institutions in the sample (EUR billions) | | | | |
| <i>Domestic credit institutions</i> | 7,576.91 | 7,517.46 | 7,687.82 | 7,165.52 |
| of which: | | | | |
| Large | 4,378.21 | 4,482.39 | 7,405.18 | 6,899.11 |
| Medium-sized | 2,466.54 | 2,315.05 | 247.76 | 236.64 |
| Small | 732.16 | 720.03 | 34.87 | 29.76 |
| <i>Foreign-controlled subsidiaries and branches</i> | 418.76 | 379.3 | 3,454.82 | 3,021.91 |

(Source: ECB 2012)

Table 3.6: Concentration analysis: % of total domestic bank assets held by top 2, 5 and 10 banks, by domicile

| | Germany (no. banks = 575) | | | UK (no. banks = 84) | | |
|-------------|---------------------------|-------------|--------------|---------------------|-------------|--------------|
| | Top 2 banks | Top 5 banks | Top 10 banks | Top 2 banks | Top 5 banks | Top 10 banks |
| 2009 | 45.58 | 65.85 | 79.8 | 57.48 | 91.78 | 97.18 |
| 2008 | 46.7 | 68.41 | 82.77 | 70.17 | 90.1 | 96.86 |
| 2007 | 45.04 | 67.9 | 81.49 | 67.28 | 87.87 | 95.72 |
| 2006 | 43.42 | 65.81 | 78.81 | 66.52 | 89.2 | 95.77 |
| 2005 | n.a | n.a | n.a | 71.34 | 95.75 | 97.79 |

The UK has relatively few banks (credit institutions) and the top 10 hold about 97% of bank assets. Additionally, foreign controlled subsidiaries also hold a significant share of assets illustrating the international attractiveness of the UK finance industry. The German system on the other hand, is characterised by a large number of credit institutions – ten times the number of UK institutions – which hold a similar amount of assets. Yet, whilst both banking systems are of a similar size, German small and medium sized banks control approximately 40% of assets¹¹ which results in smaller concentration figures. The data tells two different trajectories. The first supports the earlier analysis of UK ethical banking as being marginalised by high street banks in a financial system that, as a whole, is open to international capital markets. The second, contrasting story in Germany reflects government interventionism in the banking system, safeguarding the existing three pillar structure, and a well-established market for small and medium-sized banks. Table 3.6 adds to this picture by illustrating the overall importance of German non-private banks as employers. Although the efficiency of this structural set-up has long been debated by both German and international academics and regulators (Altunbaş et al. 2001; Bikker 1999; Brunner et al. 2004; Hau and Thum 2009; Ifo 2005; Lang and Welzel 1996), Table 3.7 indicates that assets held by saving and cooperative banks appear more stable in time of

¹¹ $[(732 + 2,467)/7577=42.2\%]$; calculated using figures from table 3.5: (sum of assets held by small and medium sized institutions) divided by assets held by domestic credit institutions.

crisis compared with private banks¹². Moreover, cooperatively owned banks appear to be more successful, as they have increased their aggregate assets by 3.22% from 2008 to 2011, which reflects Lang and Welzel's (1996) assessment of small cooperative banks developing more productively.

Table 3.7: German Three Pillar System (various figures)

| | Assets in € bn | | | | No of Banks | Branches | Employees |
|---|----------------|-------|-------|-------|-------------|----------|-----------|
| | 2011 | 2010 | 2009 | 2008 | 2011 | 2011 | 2011 |
| 1 Saving banks | 2,568 | 2,601 | 2,583 | 2,685 | 600 | 20,470 | 360,300 |
| 2 Cooperative Banks ¹ | 1,058 | 1,020 | 1,017 | 1,025 | 1,121 | 12,229 | 158,250 |
| 3 Private Banks ² | 3,448 | 3,621 | 3,068 | 4,127 | 300 | 11,126 | 178,731 |

¹including BVR, DZ and WGZ bank, 3 cooperative mortgage banks & Schwäbisch Hall;

²only contains Deutsche Bank, Commerzbank, Bayerische Hypo- und Vereinsbank, Hypo Real Estate (Source: DSGV, BVR, DB, CB, HVB, HRE)

Yet the relative success of German ethical banking is not only a result of the corporate form and behaviour, but also in the institutional support enshrined in the federal 1972

Cooperative Law and the principles of the social market economy (Mestmäcker; Reichelt 2010). The emergent network is best summarised as containing organisations that are

legally integrated and largely decentralised (Fonteyne 2007), yet this description ignores

the importance of central institutions like the "*Sicherungseinrichtung*"¹³, R+V –Versicherung and cooperative building societies, as well as the BVR and DZ Bank (Ayadi et al. 2010: 31).

Moreover, it is important to note that whilst the most common measures for concentration (HH-Index and C5 ratio) indicate a highly competitive banking market in Germany,

cooperative banks themselves are usually not in direct competition with one another

(Ayadi et al. 2010:38). This has considerable impact, not only on the market share of the cooperative sector as a whole, but also for concentration levels within, as the market for mergers and acquisitions is limited (Table 3.8). Despite continuous consolidation within

¹² The reduction in saving banks assets is explained by the decline of assets in Landesbanken

¹³ Cooperative guarantee system covering deposit insurance and assures cooperative banks against failure

both systems, the British ethical banking sector is visibly more concentrated. The largest German ethical bank exhibits a market share in the cooperative banking sector of less than 4%, compared with the UK Nationwide's market share of almost 50%. Moreover, the differences between ethical bank assets are larger in the UK sample showing, the Co-operative Bank as being a quarter, and Yorkshire Building Society as less than a fifth of the size of Nationwide. The second and third placed German ethical banks, on the other hand, are approximately a third and a quarter of the size of the largest German ethical bank. Additionally, branches held by the individual organisations are generally smaller in the German sample, reflecting the regional or specialist focus of ethical banks, which limits competition between cooperative banks after the establishment of the DGRV in 1972 (DGRV 2012). UK ethical banks, on the other hand increasingly operate on a national basis and compete in geographic areas following significant consolidation and pro-competitive policies (HM Treasury 2012a).

Table 3.8: Comparison of Ethical bank organisation by size & branch (2011/2012 figures)

| | | | Assets in £/€ mio | % of Sector total | Branches |
|---|---------------|----------------------|-------------------|-------------------|----------|
| UK | 1 | Nationwide | 194,988.00 | 48.75 | 800 |
| | 2 | Co-operative Bank | 48,955.60 | 12.24 | 342 |
| | 3 | Yorkshire | 33,177.00 | 8.29 | 178 |
| | 50 | Century | 24.70 | 0.01 | 1 |
| DE | 1 | apoBank | 38,535.05 | 3.64 | 54 |
| | 2 | SB Baden-Württemberg | 12,282.40 | 1.16 | 42 |
| | 3 | Berliner Volksbank | 9,674.21 | 0.91 | 155 |
| | 1136 | Struvenhütten | 14.04 | 0.00 | 1 |
| Difference between 1 & 2 (3); and 1 & smallest organisation by assets | | | | | |
| UK | 2 as % of 1: | | 25.11 | DE 2 as % of 1: | 31.87 |
| | 3 as % of 1 | | 17.01 | 3 as % of 1: | 25.10 |
| | 50 as % of 1: | | 0.01 | 1136 as % of 1: | 0.04 |

(Source: BSA, Co-operative Group, BVR)

The brief comparison between the German and British banking systems illustrates how different institutional settings and, therein approaches to bank regulation, can produce different structures of ethical banking sectors that are unlike one another. What is

particularly striking is that despite considerable interests to reorganise the German structure to improve efficiency and profitability (Center for Financial Studies 2006), the three pillar system receives considerable support from a variety of institutions, not least the federal BVR which is, often in conjunction with the DSGV, particularly vocal in reform debates, both at national and European level (BVR et al. 2012). The UK ethical bank associations, on the other hand, (primarily the BSA), are considerably weaker compared to their private interest organisation counterpart, the BBA. Moreover, as illustrated in the responses given to the interim report of the Independent Commission on Banking (ICB 2011b), larger UK ethical banks appear to respond to regulatory enquiries on an individual basis, as well as under BSA leadership, which can potentially weaken their position if the individual responses vary significantly from the BSA's position. Additionally, the UK government in effect promotes for-profit motivations in the ethical banking sector, especially through economies of scales, and aims to reduce the restrictions imposed on the type of products that can be traded (HM Treasury 2012a). Yet, considering the decline of ethical banking in the UK over the past two decades, it appears unlikely that a continuation of the current free-market based regulatory agenda will reverse this story and create a thriving ethical banking sector in the UK. Indeed, further consolidation and commercialisation of ethical banking will potentially further strengthen the position of the Co-operative Bank and Nationwide, whilst also marginalising other ethical banks which may increasingly focus on niche markets. The next section will argue that the current engagement with ethical banking is inappropriate and, subsequently, a new approach to research this sector will be developed.

Towards an Embedded View of Ethical Banking

So far, the discussion has highlighted that ethical banking appears to be weaker in the UK, compared to some of its European counterparts. The following discussion will pick up on the importance of *competition* in UK banking before introducing a different type of analysis that replaces some of the economic ideas with a more sociologically informed idea of industry organisation.

Established approaches to the investigation of industries and financial services are overwhelmingly aligned to neo-liberal ideas of industry organisation, as individual actors competing in markets using similar products (Bureau of Labour Statistics 2008). Within neoliberalism, the individual firm's boundaries are defined as a strict barrier that separates intra-firm cooperation from inter-firm competition (Barney 1991). As a result, regulatory efforts are focused on creating an institutional environment that eradicates cooperation between actors within an industry. The financial sector has, above all, succumbed to the ideas of market efficiency and by introducing competition policies and industry self-regulation, state regulators and political interference have been increasingly withdrawing from supervising economic activity (Engelen et al. 2011).

As already shown above, UK enquiries into competition in retail banking unanimously agree that current policy approaches based on mainstream economics are failing. The emphasis on competition as the defining aspect of an industry is illustrated by economic approaches to analysing industry or sector composition such as Panzar & Rosse's H-statistic, the Herfindahl Index or contestability as highlighted by Claessens and Leaven (2004). Yet, Claessens and Leaven (2004) are cautious in over-interpreting the benefits of the individual

approaches and indeed the OECD suggest that “[t]here is no consensus on the best variable for measuring market structure in banking” (2010: 19). Moreover, they propose that those factors “neglect important features of the financial sector such as *asymmetric information* and *networks* that may affect competition significantly” (OECD 2010: 21, emphasis added). Those two features are easily marked as critical in the context of this investigation. The dominance of high street banks and the information supremacy of large, international banks suggest that ethical banks might be constrained in access to market information. Moreover, this limited access to information could be further reinforced by the network(s) ethical banks engage with. Indeed, if ethical banks intentionally try to limit connections with high finance, they might themselves reduce their ability to compete effectively with other banks. Thus the network aspect must be considered in analysing the industrial organisation of the banking industry. Overall, it seems that the usefulness of competition in regulating a sector is limited and can even lead to socially undesirable outcomes (Boyd and De Nicolo 2005). Banking is dominated by few players and evidence supports a call for a break up of the market; still, policy makers and regulatory bodies resist the demand for regulation, citing unwillingness to jeopardise the “international” competitiveness of London’s financial services sector. Whilst it is not necessarily clear from current research how this impacts on ethical banks’ development potential, it certainly suggests that research into ethical banking must not be based on mainstream economic models, but include a more sociologically and politically informed debate.

The OECD (2010: 9) report on “competition, concentration and stability in the banking sector” offers a comprehensive review of mainstream economic approaches used by antitrust authorities. Two often neglected features, information asymmetry and networks, are identified in the report which are of interest when developing a framework that

attempts to (re-)embed banking in society. The concept of embeddedness goes back to Polanyi's (1944 [1957]) *Great Transformation*, in which he proposes that economic activity is embedded in society and not, as argued by economists, a disconnected system of self-adjusting markets governed by supply and demand. He describes a double-movement in which an increasing dis-embeddedness of economic activity will be followed by attempts driven by popular interest to re-embed the economy (Block 2001). Polanyi's concept represents an outright critique of contemporary capitalism which lifts society from being dominated by market forces, to a position in which the markets themselves are "subordinated to politics, religion, and social relations" (Block 2001). Whilst it is debatable how successful this re-embedding of the economy is, the double-movement represents an intriguing starting point for the study of ethical banking, in which ethical banking could be regarded as a response to the increasing dis-embeddedness of retail banks and their consistent failure to provide the services demanded by their customers. A more ethical banking sector, one that is focused on the customers, social and environmental goals and reduces the profit motive in importance, is indeed of increasing popularity and particularly the most recent failures of high street banks, whether they are linked to technical problems, the mis-selling of products or the rigging of LIBOR, have shown an increase in account opening in ethical banks (Move your Money 2012).

Yet whilst Polanyi's concepts offer a suitably critical starting point, it is important to note that the more recent debates surrounding embeddedness are linked to the seminal work of Granovetter (1985), who developed a concept of embeddedness that specifically aims to combine both the undersocialised (economic) and oversocialised (sociology) approaches to researching economic activity. His approach introduces social network analysis (SNA) as a middle ground between the two extremes. Yet his work has been criticised for putting too

much emphasis on their relational structure: “social relations are fundamental to ‘market processes’” (1985: 500). Furthermore, in introducing SNA as a concept and method, he undermined Polanyi’s intention to explicitly “undermine incipient disciplinary boundaries by portraying social processes in terms of a fluid mixing of ‘economic’ and ‘non-economic’ factors” (Krippner et al. 2004). Lie (1997: 351) seconds Krippner’s critique and argues that Granovetter’s approach “neglects non-social and structural factors, such as culture, technology, and even macroeconomic forces.” Responding to this critique, Granovetter (in Krippner et al. 2004) has acknowledged that although SNA is particularly well suited to connect the micro and macro aspects of embeddedness, the results must be considered within “the larger setting in which social networks operate”.

Zukin and DiMaggio developed a concept that deals with some of the criticisms expressed above and theorises economic embeddedness in a more structured way within the spheres of structure, politics, culture and cognition (1990). Here, a central argument is Polanyi’s original notion that social action, particularly economic activity, is to be considered within its social and normative context; and not separated from it. The structural sphere is defined through Granovetter’s social network approach as “the contextualisation of economic exchange in patterns of ongoing interpersonal relations” (Zukin and DiMaggio 1990: 18). Because of its methodological simplicity, and ability to discuss personal relationships within the overall network structures, social network analysis dominates this particular kind of embeddedness as highlighted by Dequesh (2003) and Biggart (in Krippner et al. 2004). Zukin and DiMaggio characterise political embeddedness as the process “in which economic institutions and decisions are shaped by a struggle for power that involves economic actors and nonmarket institutions” (1990: 20). This form of embeddedness incorporates both the legal framework of the state and the inequalities of power situated in the classes within an

economy and affected by economic activity. Cultural embeddedness emphasises the “role of shared collective understandings in shaping economic strategies and goals” (1990: 17) and finally, cognitive embeddedness reflects the limitations of “human and corporate actors” to reason economic rationality as featured in neoliberal economic theory (15-16). Although Zukin and DiMaggio (1990) differentiate between cultural and cognitive aspects, they are, because of their interrelatedness, best considered as one sphere as argued by both Scott (2008) and Dequesh (2003).

The lack of prior research for the embeddedness of alternative banking in the financial services sector of the UK specifically supports the use of social network analysis in this context. Besides the more social relationships between banks, business relationships are considered to be constrained by competitive aspects as argued by Kay (2003). Still, while commercial banks are generally well researched, using mainstream economic approaches that confirm competitive behaviour (Berger et al. 2009; Bikker and Groeneveld 2000; Bolt and Humphrey 2008; ICB 2011a), the structure and inter-relatedness of ethical banking is barely understood. This poses the question about what kind of relationships exist, and what structures are being formed within the financial services network between ethical banks and the various actors, including high-street banks, regulators and the many other organisations who provide financial services.

Social network research is particularly well suited to investigate those structural links between individuals, by focusing on the meso-level of industry organisation and seeking to find out what ties communicate about firm behaviour on a grander scale (Freeman 2004). Moreover, Emirbayer and Goodwin (1994) propose that network analysis is ideally placed to investigate social networks of people as well as organisations, particularly within strong subcultures of larger systems; this is supported by Granovetter (1985: 500) who notes that

“social relations are fundamental to ‘market processes’”, again drawing on the relationship with the more general embeddedness theory.

Social network analysis can benefit the analysis of ethical banking in the UK significantly as it collects empirical evidence of their industry organisation. The analysis of relationships between ethical banks and their network partners will highlight whether ethical banks are more likely to interact with other ethical banks or non-ethical banks. Moreover, it will either confirm or disconfirm if the various types of ethical banks are connected in ways that are similar to their peers. In turn, this either validates the categories “building societies” and “credit unions”, or supports a different view of ethical banking as being more niche oriented. The findings will also illustrate power relations within the network by highlighting dominant actors and dependencies which are discussed in more detail in chapter 5.

The relational nature of ethical banking illustrated through social network analysis and embeddedness is also linked to subcultures. Although there is no single definition of subcultures, its academic usage is linked to the idea that society is not a uniform abstract concept that can be discussed on national level, but mostly heterogeneous in character, and that various subcultures co-exist (Fine and Kleinman 1979). These authors assert that subcultures tend to centre on a common set of beliefs, norms and behaviours of specific groups that interact with other subcultures through interlocking networks (1979: 18). This interaction, according to Young (1974: 161) is reasoned in the necessity for cultures to adapt to newly emerging situations and problems by forming subcultures or elective communities. Gelder (2007) suggests that narratives play a particular role in defining subcultures, as its structural parameters are not only dependent on geography, but also on

a shared understanding of values and similar goals. Emirbayer and Goodwin (1994: 1419) suggest that groups of actors with strong collective identities are likely to produce subcultures, particularly under conditions in which they are relatively isolated from the rest of the network, but illustrate considerable commonalities. Brint (2001: 15) cautions that high levels of interaction are most likely to feature in geographically close subcultures; nonetheless, he advises that subcultural groups can also exhibit significant support structures for group members that eliminate the deficiency of elective subcultures that are not defined by local proximity. It thus seems feasible to argue that, in trying to achieve those goals, ethical banks would predominately interact with other similar-minded banks and third sector organisations. It is therefore reasonable to suggest that ethical banking qualifies as a subculture of banking in general, through its shared understanding of what services are being offered, for what purposes. Nevertheless, potential interactions with more commercial banks and financial services could have a negative impact on the formation of a uniform culture.

Both classical and more modern conceptualisations of embeddedness highlight that social and economic action should be investigated in recognition of one another, and that particularly the cultural and political surroundings can have significant impact on firm behaviour and interest. This concept suits the research interest of this thesis particularly well, as it recognises that an ethically informed business will be subject to both the ability of internal and external stakeholders to recognise, apply and follow the cognitive-cultural limits set, and the political debate that distinguishes between ethical banks' business models, ownerships structures and risk and that of global financial conglomerates and other financial services industries such as hedge funds. The differences between ethical bank business models are substantial, and because of the non-competitive and non-profit

focus of some of the institutions, it seems logical to use a framework that reflects this specific way of doing business in ethical banking. The different cultural and political understandings of ethical banking, if they indeed exist, would then suggest that ethical banking is to be viewed as a separate sector or a sub-system of the financial services industry with boundaries defined by those differences, as conceptualised in the *industrial district* literature. This literature questions the idea of competition as the dominant driver behind economic success and promotes cooperative arrangements within industrial districts that are dominated by small firms (Piore and Sabel 1984: 39). Thus, the concept does not only help to frame the study through its approach to analysing the industry, it also breaks with the neoclassical demand for competition, which will be particularly useful in examining ethical banking. Although competition is still viewed as a vital factor driving entrepreneurial behaviour, product and process innovation (Piore and Sabel 1984), interaction between firms is seen as an essential feature in creating sector identity (Dei Ottati 1994; Harrison 1992; Staber and Morrison 2000: 9). According to Porter (2000: 21, 32) collective activities are considered “pro-competitive” in the sense that it creates competitive advantage against “external economies.” Indeed, in his discussion of *industrial clusters*, Porter points out that “a cluster is a system of interconnected firms and institutions whose whole is more than the sum of part” (2000: 21), highlighting the positive impact of personal relationships, and individual and institutional networks.

There are logical connections between industrial district and embeddedness, particularly with regards to the relational character, with which the concepts explain industrial activity (Staber 2001b). Rather than viewing firms as atomistic agents that operate according to market principles, both literatures highlight the complex interactions between economic actors and their environment as defined by politics, culture and cognition (Powell and Smith-Doerr 1994). The embeddedness of industrial districts in cultural and institutional spheres further develops the concept as a socio-cultural phenomenon alongside its

economic implications. Granovetter's concept of embeddedness largely reflects key characteristics of industrial district theory as highlighted by Harrison (1992) who considers trust relationships central to Granovetter's argument to also be key to the district's collective industry organisation. Thus, there is a clear relationship to the collective action described by the industrial district literature, in as much as both are governed by trust principles facilitated by repeated interactions between parties, which, in turn, "promotes re-contracting and the sharing of common support services [...which] is a particularly concrete expression of embedding" (Harrison 1992: 477-478).

Yet, Markusen points out that the boundaries for investigation are inappropriately set in industrial district literature, and exclude actors and institutions outside of the industrial district (1999: 878). She argues that the *new industrial district* must be extended to an approach of embeddedness that does not exclude externalities, such as state government, national regulation and competition of vastly bigger actors. Staber similarly emphasises the required presence of regulatory agencies and interest association in empirical investigation of industrial districts (2001a: 331). Moreover, Porter agrees that competitive advantage is as much linked to externalities as it is linked to the firm itself, and therefore it changes the role of companies, government and institutions in promoting competitiveness (2000: 16, 29). Zukin and DiMaggio's (1990) fourth kind of economic embeddedness, political embeddedness, also helps to overcome this key restriction of the industrial district concept by emphasising the struggle for power, as well as the impact of political values and institutions on the behaviour of economic actors. Additionally, Markusen questions the relevance of the local as "[i]n reality, sticky places are complex products of multiple forces" (1996: 309). It features heavily in the more traditional discussions of the industrial district as the concentration of firms in a specific region linked to the availability of "physical

conditions” and markets (1890 [2009]: 223). The local proximity has been argued to facilitate personal relationships and ties with the community, which, in turn, foster trust and information flows within industrial districts (Harrison 1992; Porter 2000). Porter views *industrial clusters* as “geographic concentrations of interconnected companies” (2000: 15), however he relaxes the requirement of geographic proximity by highlighting that clusters can exist at “several geographic levels” seconding Markusen’s critique(1996). Additionally, he notes that cultural and institutional proximity are equally relevant in shaping the development of the industrial district (Porter 2000: 32). Indeed, it is the “repeated interaction and informality of contracts” between members of the cluster that is important in shaping the cluster (2000: 25), and whilst he links that to “living and working in a geographic area,” advances in communication, technology and transport have significantly impacted on the organisation of both human life and economic activity, particularly remote access and the ability to travel longer distances quickly (Castells 2009).

Consequently, it appears that the ethical banking sector characteristics can be investigated by utilising a framework that is informed by the industrial district literature and recognises relationships between actors. Such a district-informed framework would assume that a collectively organised ethical banking sector would enable the banks to compete more effectively with high street banks. The investigation of ethical banking will make use of six features¹⁴ that are discussed within industrial district and embeddedness literatures: sectoral cultural identity, complementary services, connectivity and exchange, competition, trade association, and industry regulation and legislation. They have been derived from main industrial district literatures and aim to combine both the classical understanding of

¹⁴ Using 6 dimensions may not cover every aspect, but they are expected to yield significant information to judge embeddedness of ethical banks within the district boundaries and with actors and institutions external to the district

the district as hypothesised in Markusen (1996), and the critiques that have been offered by a variety of researchers, with regards to the wider integration of districts in the regional and national political, economic and regulatory systems.

Six Dimensions of Embeddedness

The six dimensions are derived from Markusen's (1996) typology of industrial districts. The various characteristics highlighted by Markusen have been summarised as three dimensions, cultural identity, complementary services, and connectivity and exchange to reflect specific aspects that summarise a number of features of the internal organisation of the sector. The aim is to identify the attitudes of ethical banks towards the sector, the organisation of the product markets and associated offerings, and interactions between the various types of ethical banks, such as product and information exchanges and collaboration. The remaining categories, competition, trade association, and industry regulation and legislation, are introduced to investigate the embeddedness of ethical banks with actors that are external to the sector; thus the relationships between the ethical bank sector, and the wider financial services, aiming to highlight dynamics and power relations more widely, with the intention to inform the embeddedness of ethical banks in the national regulatory, political and economic systems.

Cultural identity and cultural assimilation are themes identifiable in most, if not all discussions of industrial districts (Harrison 1992). Porter (2000) highlights the importance of formal and informal cultural norms in forming and policing the sector, and, similarly, Markusen (1996) and Sforzi (2002) argue that the relatively stable environment allows cultural norms and values to develop according to a shared understanding of "...work, consumption, saving, [and] attitudes to uncertainty..." (Sforzi 2002: 442). Whilst much of

this is attributed to the localised character of engagement, it seems entirely feasible to suggest that ethical banking in the UK should have developed a shared understanding of the activity and what it aims to achieve. In particular, strong competitive forces and a relative isolation from non-ethical banks external to the district should intensify the formation of a collective culture, or subculture, as highlighted by Emirbayer and Goodwin (1994: 1419). Ethical banks should have a shared understanding of banking as a utility that is linked to positive social outcomes, such as the provision of mortgages, social value creation and access to banking services more generally.

This variety of potential products implies a certain *complementarity of products and services* across ethical banks. Even products that are often standardised are being adapted to promote specific causes, for example a mortgage product that reduces the interest rate payable according to the energy-savings of the new or modernised house, loans to non-profit business and social organisations, or savings products that ensure that deposits are only lent to, or invested in, organisations, firms and individuals that are not linked to arms trading, human rights violation, or environmental pollution etc. Thus the specialisation seen in ethical banks' product and service choice is similar to that identified within industrial districts (Piore and Sabel 1984; Staber 2001a). On the other hand, it is important to recognise more recent developments in ethical banking towards a more universal approach to banking taken by most building societies, a few niche ethicals and some larger credit unions. The aim to benefit from economies of scope by offering complimentary services and products themselves, could lead to ethical banks increasingly internalising processes and thus restricting the need to cooperate.

Interaction between actors is another item featured in industrial districts. Albino et al (1998), Harrison (1992) and Porter (2000) highlight the importance of repeated interaction to foster trust between actors and produce collective outcomes that are long-term oriented. Markusen (1996) also argues that interaction between members of an industrial district extends to supplier / buyer relationships facilitated by long-term relations between firms, limited connection to firms external to the district. Whilst much of the interaction between firms was linked to the proximate production of goods in Markusen's account, high levels of interaction between ethical banks seems entirely plausible, as they are not as dependent on tangible products, and can communicate and *exchange* products effectively via the internet, phone or post. The repeated intra-district interaction of firms and the trust relationships emerging are taken to increase knowledge and resource exchange (Enright 2004), and create labour pools internal to the district (Markusen 1996). The exchange of knowledge, resources and labour is linked to the competitiveness of the district by promoting the specialisation of the workforce and product and process innovation (Porter 2000). Yet, Dei Ottati (1994: 464) argues that the success of the division of labour within an industrial district is dependent on the coordination between firms and thus the quality of exchange through formal and informal channels (Newlands 2003). The limited number and size of firms present in ethical banking and the focus on achieving social benefits instead of economic returns should only facilitate both the formal and informal exchange of resources and information through trade unions and industry representatives, as well as personal contacts. Movement of labour between ethical banks also seems feasible, because of the relative specialisation of the workforce¹⁵ within a similar regulatory environment and relative short distances of ethical banks' branches and headquarter locations, particularly across England. Moreover, specific requirements on resources and employees to be aligned with the ethical requirements and cultural identity should impact on what kind of external

¹⁵ Employees dealing with compliance and regulation and technical matters should be able to move easily across firms

firms ethical banks would buy from and employees would work for. Similarly, if ethical banks managed to instil a specific ethically rooted cultural identity in employees, competition for labour with firms outside ethical banking should also be restricted as workers should find the move to a “work hard, play hard” environment undesirable. Intra-district competition for labour is highlighted by Markusen: “Workers are committed to the district rather than to the firm” (1996: 299) Thus, it seems adequate to suggest that competition is linked to less destructive forms of competition, such as product market and business model competition, which should encourage both process and product innovation (Porter 2000).

The industrial district literature establishes that collaboration between district firms restricts *competition* internally, but creates competitive advantages externally (Porter 2000). Dei Ottati (1994: 473) highlights that price competition is generally limited due to the destructive consequences for the sector, and that instead, intra-district competition is more likely to feature competition with regards to new technologies, products, resources and organisational forms. Moreover, she (1994: 477) argues that whilst competitive forces and innovation will interrupt the stability of the industrial district, the maintenance of a dynamic equilibrium allows the reproduction of the district by integrating the product and process advancements. Within banking, competition is often discussed in the context of product intransparency and switching costs (ICB 2011a), or the ability of new competitors to enter the market (Claessens and Laeven 2004). Economies of scale are limited as the market for interest rates is relatively competitive and savings are transformed into owner profits instead of customer benefits. Within ethical banking, economies of scale are limited because of the relatively small size of the organisations, endorsing Lazerson and Lorenzoni’s (1999) argument about economies of scale being relatively less important than,

for example, economies of time and moral considerations. Advances in consumer technologies are available to most ethical banks, and even small credit unions offer online and telephone banking. Moreover, ethical banks' reliance on a market for resources is limited as they use customer deposits to fund their lending.

While informal organisation linked to repeated personal contacts and specific cultural taboos may suffice to govern and police some districts, a more formal attitude towards "supporting, policing and spreading" the industrial district is necessary (Dei Ottati 1994: 466). *Trade associations* are important in providing education and technical support, as well as facilitating the exchange of information and conducting research (Porter 2000: 17). Porter (2000: 30) highlights that the collective organisation of a district in trade association is of benefit as a group of firms organised that way "can command higher attention and have greater influence [...and] create a vehicle for cost sharing." Still, trade associations are often excluded as a distinguishing feature of industrial districts as it is the case in Markusen's (1996) typology. Yet, she (1996: 301) notes that specifically industrial districts make use of collective associations of firms to network and problem solve, which is related to the strong personal nature of relationship building. Although it is not a central feature of industrial districts, it could be a vital feature in ethical banking. As ethical banking is viewed not as a separate entity, but as a subset of the banking industry more generally, it seems crucial to take Markusen's notion that trade associations are "embedded in external relationships" (1996: 309), to explain interaction between ethical banking and the wider financial services industry. Both the BSA and ABCUL¹⁶ appear to support their members by providing education, technical information and represent them nationally to regulatory and legislative inquiries.

¹⁶ Building Societies Association and Association of British Credit Unions Limited

Industry regulation and legislation is the final point considered here. Markusen (1996: 301) promotes the role of government as being “central in regulating and promoting” industrial districts. Yet, while Porter largely agrees, he also highlights a potential drawback in terms of regulation, creating “unnecessary inefficiencies” (2000: 26). Thus, he stresses, that government policies which inflict costs without being beneficial, should be abolished. Therefore the role of government and regulation can be positive and negative. Newlands (2003: 529ff.) applauds recent shifts in macro-level policy that accommodates some cooperation; nonetheless, the dominance of competition policy is still premised in the atomisation of firms, and deregulation and individual firms are giving maximum freedom to act in their interest. The destructive impact that such economic behaviour can have on competitors and society more broadly has been largely ignored, or justified by the need to increase profits. In the UK, ethical banks are regulated differently to high street banks; however, they are more restricted in conducting their business. While some people may suggest that the restrictions impact negatively on ethical banks, the more prudent approach to banking taken on by ethical banks as a result also allowed them to manoeuvre through the financial crisis more successfully than their high street counterparts (Goff 2012). The effect that changes to legislation and regulation have on ethical banks is certainly crucial in explaining how the district functions.

The hypothesised and, rather idealist district features identified by Markusen (1996), Porter (2000) and others describe a situation in which, if exhibited by ethical banks, the sector should be successful – banks should interact successfully and organise collectively to gain competitive advantage over high street competition. Whilst this conceptualisation suggests an ideal set of characteristics that would support the view of ethical banking as a distinct sector, it is equally useful to examine alternative views or arguments.

Conclusion and Implications

The chapter has described the financial services industry in the UK and introduced the theoretical framework used to analyse ethical banking embeddedness. The existing empirical investigation of the banking sector highlights the dominance of mainstream economic thinking that is apparent in how the industry is run and regulated. These neoliberal ideas also govern the analysis of finance which has been argued to be of little use to investigating ethical banking, as alternative banking organisations are not necessarily interested in competitive and opportunistic behaviour, or the commercial aspects of profit maximising firm, but seek to create social value in a more cooperative setting.

In response to the critique offered to the mainstream economic approaches to industry analysis, the chapter considers an alternative approach to conceptualising industries based on a more sociological view of industry embeddedness. Having highlighted why using structural and non-structural embeddedness tools are useful in analysing ethical banking, the research will draw on the industrial districts literature and the parallels that can be found in the relational character of both embeddedness and industrial districts. From these literatures, the research draws the idea that a successful and dynamic sector is distinguished by a number of features which can be empirically measured. These six dimensions of ethical bank organisation are developed from both the more general embeddedness theory and the empirically informed industrial district literature: *sectoral cultural identity, complementary services, connectivity and exchange, competition, trade association, and industry regulation and legislation*. They highlight characteristics that illustrate the organisation of ethical banks as a subgroup, whilst also recognising criticism voiced by introducing external aspects of industry organisation to embed the industry more

widely in the socio-political realm. The emphasis on firm interactions is investigated through social network analysis that adds to both the internal and external dimensions of ethical banking.

Viewing ethical banking as a sub-sector of the UK banking sector has an analytical element and potential to inform policy-making. Viewing ethical banking as a subsector allows the internal connections and coherence (or otherwise) to be highlighted. Moreover, as highlighted by Cashore et al's (2001) case study of the forestry industry, sub-sectors have been largely ignored in policy making. Although the forestry industry and ethical banking are clearly different, this argument emphasises the relationships between the sector and the sub-sector, or, in this case, studies relationships between ethical banking and banking in general. With regards to the politics involved, a coherent ethical bank sector would have a more public profile, and thus potentially more political and lobbying influence, as illustrated by the German system of cooperative banks.

The framework has the benefit that the combination of industrial district and embeddedness, allows the shortcomings of the individual concepts to be reduced. The industrial district's inward focus is extended by the political and cultural aspects of the more general embeddedness theory, which itself benefits from the more focused boundaries of the district. The network analysis (which is introduced and discussed in detail in the next chapter) is suitably equipped to investigate the relational setup of the district, which has previously been largely ignored in the discussion of industrial districts. It also visualises and analyses the relationships between the political and commercial institutions

and ethical banks. At the same time, it benefits from the context of the discussion which addresses the absence of political and social aspects in social network analysis.

The implication of the discussion is that the understanding of ethical banking in a mainstream setting is unlikely to be fruitful. The economist's idea of an industry defined by a large number of firms creating a competitive market has been highly influential in politics and regulation. Yet, it ignores the fact that firms may not only be interested in competing with one another in a Darwinian-type battle, but also in cooperation to achieve specific aims. The picture drawn earlier of ethical banking in the UK as a small and diminishing sector, highlights a scenario in which a more cooperative industrial activity, and the development of institutions governing the sector, might be productive in strengthening the sector, as can be seen in Germany. In particular, the small scale of ethical banks, their product offering and the organisation of the sector in its current form suggest that macroeconomic ideas about competition and concentration measures are unsuitable to describe the nature of ethical banking. Barriers to entry and the lack of institutional support do, furthermore, demand a different type of investigation to capture the social aspects of ethical banking more successfully.

By focusing on the relationships between ethical banks, particularly with regards to collaboration and cooperation, the framework developed in this chapter implies an altogether different idea about the ethical banking sector as a cultural space that is defined by a shared understanding of banking in a non-economic domain. Ethical banks understand their economic activity within a specific socio-cultural setting, whether linked to social, environmental or other related issues, which impacts on their business behaviour.

Moreover, as described in chapter 2, their profit ambitions are restricted, as ethical banks are often owned by their customers which instils a long-term focus of day-to-day operations and limits high-risk volume trading that creates unsustainable short-term profits. This more prudent approach to banking is linked to a more basic understanding of banking as a utility and not a value-creating industry in its own right. As a result of those differences, the sector is understood to be more supportive and less competitive in nature, which has significant impact on the goals of the ethical banks that operate within this sector. and implies that a different engagement with politics and the regulator is needed to support the sector in the long-term.

The following chapter will introduce the research questions and discuss how both quantitative and qualitative methods together will answer those questions. It will emphasise that the exploration of ethical bank organisation in the UK is particularly well served by a pragmatic use of methods to inform this empirical and practise relevant study.

Chapter 4: Methodology

The chapters 2 and 3 have introduced ethical banks as an alternative to profit maximising retail banks that dominate the UK banking sector. However, despite favourable market developments and a shift in society's attitude towards banking, ethical banking has failed to advance its market share and does not appear to compete effectively with the incumbents.

This chapter outlines the research design through a multi-method research strategy based on social network analysis, interviews and secondary data analysis employed in this study. Neither method itself can sufficiently capture structure and behaviour, but these combined methodologies, allows for a more complete analysis of the embeddedness of ethical banking (Greene et al. 1989). After a discussion of the aims and research questions, the following parts will both interrogate the usefulness and highlight the benefits of the SNA analysis whilst offering a comprehensive review of how it has been used in this study. The chapter will critically reflect on problems that emerged from the social network analysis, both related to the data itself as well as its interpretation. The third section will explain how interviews have been used in this research strategy by outlining designates sample selections and the kinds of issues that were explored in the interviews. Lastly, the chapter will highlight the use of secondary data.

Research Design

The previous chapters have shown how ethical banks differ from mainstream retail banks by being less focused on achieving economic profit but aiming to achieve non-economic returns that have benefit to their customers and the wider community. As a result, mainstream economic approaches to investigating industries appear to be less useful. The need of economic approaches to quantify firm success as, for example, profits or return on assets or equity, as well as the use of economic models to analyse competition, contestability and concentration of the banking sector (see Beck et al. 2006; Claessens and Laeven 2004) are challenged by the interest of ethical banks to achieve non-financial, social and environmental targets that have a “positive impact” on peoples’ lives. The analysis of ethical banks in this study rejects such a positivist research agenda favoured by economists and introduces elements of qualitative research to investigate, for example, the relationships between actors and the nature of competition. Beckert (2003: 783) proposes that instead of following the well-established research paradigms linked to quantitative (positivism) and qualitative research (constructivism, interpretivism) approaches, a more pragmatic research agenda may be more suitably used in this study:

“The introduction of pragmatism helps to understand how economic structures and action are intertwined, how cooperation is achieved, and how changes in products and processes have a basis in the creativity of action”

Similarly, Johnson and Onwuegbuzie (2004: 18) endorse pragmatism as “a middle ground between philosophical dogmatism and scepticism [...] to find a workable solution”. In addition, findings of this study were not expected to be generalised as it specifically discusses ethical banking within the UK structures. This pluralist approach benefits from combining a range of “different, even conflicting, theories and perspectives” in a mixed

methods approach (Johnson and Onwuegbuezie 2004: 18). This study used both quantitative social network analysis and qualitative open ended, semi-structured interviews to discuss the ethical banking industry from various perspectives. Additionally, the study used a number of empirical secondary data sources drawing largely on information that is publicly available, such as annual company, industry and government reports and statistics in addition to media coverage to add information and context to the narrative of the research, as well as to validate claims made by interviewees.

Aims and Questions

As suggested in the previous chapter there is little empirical evidence to help evaluate the extent of the embeddedness of alternative banking in the (national) financial services sector of the UK. Relationships between the various banks are often derived from membership of the various national representations of different types of banks – Building Societies Association, British Bankers' Association, Association of British Credit Unions and UK Credit Unions. This poses further questions: "What other relationships exist?" and "Do ethical banks cooperate or compete with one another?" Moreover, it asks about the kind of structures that exist within the financial services network between ethical banks and the various actors including high-street banks, regulators and the many other organisations who provide financial services.

One key starting point for such investigation can be found in subcultural theory. Although there is no single definition of subcultures, its academic usage is linked to the idea that society is not a uniform, abstract concept that can be discussed on national level, but is mostly heterogeneous in character, with various subcultures existing alongside each other

(Fine and Kleinman 1979: 18). These authors assert that subcultures tend to centre around a common set of beliefs, norms and behaviours of specific groups that interact with other subcultures through interlocking networks (Fine and Kleinman 1979: 18). This interaction, according to Young (1974: 161) is reasoned in the necessity for cultures to adapt to newly emerging situations and problems by forming subcultures or elective communities.

Gelder (2007) suggests that narratives play a particular role in defining subcultures, as its structural parameters are not only dependent on geography but also on a shared understanding of values and similar goals. Shipilov (2006) suggests that similar positions in networks can be related to organisations sharing similar ideas about innovation, market share and profitability. Emirbayer and Goodwin (1994: 1419) similarly propose that groups of actors with strong collective identities are likely to produce subcultures, particularly under conditions in which they are relatively isolated from the rest of the network but illustrate considerable internal commonalities. Thus it seems reasonable to view the ethical banking industry as a subculture of the financial services industry as ethical banks are mostly owned by their members and customers and as a result have to consider a number of different stakeholders. This means that their goals are more focused on promoting sustainability and stability, support of social, religious and environmental causes, or support for communities rather than on profit maximisation.

Brint (2001: 15) cautions that high levels of interaction are most likely to feature in geographically close subcultures; nonetheless, he advises that subcultural groups can also exhibit significant support structures for group members that eliminate the deficiency of elective subcultures that are not defined by local proximity. Therefore it seems feasible to argue that in trying to achieve those goals, ethical banks might predominately interact with other similar-minded banks and third sector organisations. It is of obvious interest to see

whether ethical banking qualifies as a subculture of banking in general through its uniform understanding of what services are being offered and for what purposes. Nonetheless, ethical banks might be equally over-dependent on the oligopolistic high-street banks and thus kept from developing subcultures.

In doing so, this research aims to understand whether the marginal role played by ethical banks in the UK banking sector has created sub-cultures within the ethical banking industry by utilising exploratory social network analysis. This has been followed by interviews with respondents both to demonstrate the validity of these findings and to develop a greater understanding of the processes and dynamics that are in place. Additionally, the research used various types of secondary data published in companies' annual reports, industry reports and government reviews, providing a balanced analysis of the financial data to interrogate claims made by interviewees about the different models, and to give insights into the sector.

The four main research questions examine how the ethical banking sector is embedded in the UK financial services industry and draws out political-economic dynamics that facilitate as well as hinder the development of the sector. The first three questions are further developed by means of supplementary sub-questions. The first question investigates the structure underlying the ethical banking network:

Research Question 1:

What are the network structures underlying the ethical banking sector in the UK and how do they impact on competition and strategic alliances between ethical banks and the other financial services organisations?

What are the key structural features of the network with regard to the groupings of ethical banks, their connectedness within ethical bank networks and their interconnectedness with other financial institutions?

Which organisations are the key players and what are their characteristics?

What attributes shape the connectedness of ethical banks?

Following the analysis of the sectoral structures, the research follows up on some of the themes emerging from the initial findings relating to their business model and sector dynamics such as competition and cooperation between the various firms investigated.

Research Question 2:

How does the ethical approach of the banks translate into bank objectives and performance?

What are the different strategies ethical banks use to recover costs?

How important are ethics to different types of ethical banks – are they visible in the organisation and running of the business or an add-on to differentiate from competition?

Who are the stakeholders and to what extent do they impact on the operation of the ethical bank?

Research Question 3:

How is the ethical banking sector organised internally, and what is the role of external agents?

Do ethical banks recognise the existence of an ethical banking sector?

Do ethical banks collaborate and organise their interests collectively?

How do external factors affect the ethical banking sector?

Lastly, the research aims to highlight some potential interventions to the problems the sector will face in relation to its development potential uncovered in earlier chapters.

Research Question 4:

What conditions can be created within the sector by internal adjustments and external changes to regulation to support the development of a self-sufficient ethical banking sector?

Research Strategy and Mixed-Methods research

The use of multiple methods in this research draws on debate between academics (see Krippner et al 2004)¹⁷ which highlights the complexities in researching embeddedness, particularly, the need to move away from only analysing the structure through network analysis. Krippner (2004: 111-113) highlights the difficulty in combining both the social and the structural aspects of the market without introducing a hierarchy that separates society and economy. Biggart (2004: 120) notes that whilst the structural aspects of embeddedness have been researched consistently within a quantitative research environment, other (more qualitative) aspects such as political, cognitive and cultural insights have been largely ignored. Similarly, Granovetter (2004: 114) notes that: “you can’t just analyse social networks, you also have to analyse institutions and culture and politics and all of the micro and macro elements, of which the “meso-level” of social

¹⁷ At the Polanyi Symposium held in 2002 prominent scholars (Greta Krippner, Mark Granovetter, Fred Block and Nicole Biggart etc) debated ‘Embeddedness’ and pointed out some of the problems that emerged in previous research.

networks is in the middle?" Although this highlights only a small proportion of the issues debated, it indicates that analysing embeddedness requires the researcher to look at both structural as well as socio-cultural aspects of embeddedness, necessitating the use of both qualitative and quantitative research methods. What now follows is a more elaborate description and justification of the research strategy used in this study.

This research adopts a mixed-method approach to cover the structural as well as social aspects of embeddedness based on the notion that employing qualitative and quantitative methods "fit together the insights provided by qualitative and quantitative research [...to] answer important research questions" (Johnson and Onwuegbuzie 2004: 16). However, it is not assumed that the findings will necessarily complement one another as implied by theories of "triangulation" and "multiplism" (Greene et al. 1989: 256): "In many cases the goal of mixing is not to search for corroboration but rather to expand one's understanding" (Onwuegbuzie and Leech 2004).

This pragmatic approach to research has received criticisms (see discussion in Creswell and Tashakkori 2007; Giddings and Grant 2007), but Howe (1988: 10 & 15) proposes that mixed-methods as an approach to research is "what works" instead of sticking to "the tyranny of methodological dogma." Following his call to end the debate of "qualitative versus quantitative" (ibid 1988: 15), the research uses both qualitative and quantitative methods which resembles a classic case of mixed method research (Tashakkori and Creswell 2007: 4). Although the findings of the social network analysis informed the interview guide to some extent, the interviews also raised questions that are unrelated to the network analysis. Overall, the mixed method approach adds "in-sights and understanding that might

be missed when only a single method is use[d...and] produce[s] more complete knowledge necessary to inform theory and practice[...]" (Johnson and Onwuegbuezie 2004: 21).

The strengths and weaknesses of mixed methods designs have been widely discussed in the literature (Greene et al. 1989; Creswell and Tashakkori 2007; Giddings and Grant 2007; Johnson and Onwuegbuezie 2004). The approach to mixed methods used in this study can be described as a sequential mixed methods approach as discussed by Ivankova et al (2006), which implies research is done in consecutive phases. In this study, the initial quantitative network analysis is, once analysed, followed by a qualitative interview stage which further investigated some of the findings but also raised unrelated issues. The approach is considered beneficial for single researchers as it is easy to implement and the researcher can concentrate on one method at a time (Ivankova et al. 2006). Although there was some overlap between the final collection of questionnaire data¹⁸ and interviews being conducted, individual interviews have always been scheduled following the questionnaire stage.

The research has three main components which are reflected in the thesis structure. The first is linked to the identification of the ethical banking sector's structural character through social network analysis as detailed below. Following this, on from this, qualitative elite interviews were conducted to gather an in-depth understanding of the business models that feature within ethical banking. These were focused towards the dynamics within the sector with regard to competitive practices, and to give an "insight" view on how the ethical banks themselves engage with the idea of an ethical banking sector. At that

¹⁸ The delay is mainly linked to one important ethical bank that took a longer than expected time to fill in the questionnaire

point, the thesis also introduces secondary data, mainly derived from company reports and industry papers, to explore emerging arguments further. The final section of the PhD uses findings from the previous chapters to challenge current government policies that affect ethical banking, as well as to outline and discuss policy recommendations which are informed by this research.

Phase I: Social Network Analysis

The first part of the research used social network analysis to analyse the connections between ethical banks and other financial and non-financial organisations. Social network theory and analytical tools have developed considerably over the past decades; even so, it is by no means a new concept and has indeed a long history of academic use, most notably in French and German sociology of the late 19th and early 20th century by Durkheim, Tönnies, Weber and Simmel to investigate the complex patterns of labour and production (Scott 1988: 110). Social network analysis has emerged as a key technique in organisational studies investigating network structures within (Cross et al. 2002; Krackhardt and Brass 1994) and between organisations (Gulati and Gargiulo 1999; Uzzi 1996) as it developed its own theoretical basis, methods and tools for analysis (Freeman 2004; Marsden 2005). In business and management studies specifically, social network analysis has been used to investigate informal organisational networks (Cross et al. 2002; Tishy et al. 1979) information and resource exchange (Haythornthwaite 1996) and interlocking directorates (Mizrushi 1996), and is generally of increasing popularity across disciplines as argued by Borgatti et al (2009), Carrington et al (2005: 2) and Freeman (2004: 167). Within the banking industry, its use has so far been very limited and the most notable examples are Uzzi's (1999) study on the relationship between banks, customers and the cost of lending and Bearden et al's unpublished study of bank centrality in corporate networks (1975, see discussion in Scott (1988: 118)). More recent investigations such as by Iori et al (2008) focus

on the connectedness of the banking industry by investigating borrower-lending relationships in Italy's overnight-money market. However, the relationship between ethical banks and the financial services sector has not been addressed. Thus, despite previous use of social network analysis within the field, this network research has a distinct exploratory character.

Besides its increasing popularity, there is ample evidence for the usefulness of social network analysis in representing the importance of actors within a specific network by acknowledging the importance of ties and structure (Borgatti et al. 2009). Fundamentally, Wassermann and Faust (1994: 4) distinguish network analysis from other fields of social studies in four major ways:

- actors and their actions are viewed as interdependent rather than independent, autonomous units;
- relational ties (linkages) between actors are channels for transfer or "flow" of resources (either material or nonmaterial);
- network models focusing on individuals view the network structural environment as providing opportunities for or constraints on individual action; and
- network models conceptualise structure (social economic, political and so forth) as lasting patterns of relations among actors.

Further, Borgatti et al (Borgatti et al. 2009) and Wellman (1983) note that despite its strong methodological basis, social network analysis is not merely descriptive but can illuminate the consequences of the relations between actors by, for example, investigating the transmission of goods between two nodes in which the varying properties of network relations will be accompanied by differences in outcomes. This suggests that the different

relations between various ethical banks and the banking industry and the positions taken by ethical banks will have an impact on their business operations.

Much of social research is focused on the investigation of the individual actor, whether it is the firm, community or person, or an amalgamation of these various elements. However, such analysis tends to ignore the social influence that organisations have on each other when interacting in networks that both occur naturally or are created on the basis of some communality. Thus social network research is motivated by the structural links existent between individuals: *id est* it investigates the meso level of organisation, and seeks to find out what those ties communicate about behaviour on a grander scale (Freeman 2004).

Emirbayer and Goodwin (1994) propose that network analysis is ideally placed to investigate social networks of people as well as organisations, particularly within strong subcultures of larger systems, which is supported by Granovetter (1985) who notes that “social relations are fundamental to ‘market processes’”. The notion of cliques and homophily of organisations (Granovetter 1973; McPherson et al. 2001) – the trend towards interconnectedness between similar organisations – seems an appropriate theoretical basis for the investigation of subcultures in the banking industry. The strength of such subcultures can be identified through the coherence of networks:

“...relatively strong, dense, and relatively isolated social networks facilitate the development of uniform “subcultures” and strong collective identities...”

(Emirbayer and Goodwin 1994).

Empirical research has also shown that the likelihood of an alliance shaping between two actors also increases the more indirect alliances those two actors share before engaging with one another (Gulati and Gargiulo 1999).

The use of social network analysis in this study was intended to develop an understanding of the ways in which ethical banks are connected. It aimed to answer questions about the patterns of engagement and the influence of particular actors. However, as the explanatory power of this method is limited¹⁹, interview based research was used in a second stage to investigate the network patterns discovered through qualitative data, as described in the latter half of this chapter.

The social network analysis is based on two main steps, the data gathering itself and its later analysis through social network software UCInet. Network analysis is largely based on two types of data, *whole* network data or *egocentric* data. Whereas it is ideal to use whole network data in comparative analysis in which the actors resemble bounded social collectives (Marsden 2005), defining the exact network boundaries, as well as the generation of the data on full networks, doing so in empirical investigations is often problematic (Hanneman and Riddle 2005). The data collected in this study is *egocentric* network data and is based on the self-informed networks emerging from individual actors, but at the same time, the degree of overlap between actors is known, anticipated and used to construct a whole network based on individual responses as the whole network could not be reached. As suggested by Marsden this method is valuable “to explain differences across actors in social position” (1990: 438). At the same time, the use of egocentric network data allowed some inferences to be made about the network as a whole

¹⁹ Limitations are discussed later in this chapter

(Hanneman & Riddle 2005; Marsden 2005). Hanneman and Riddle further point out that even in cases which investigate egocentric networks without further information on the egos' alters²⁰, general and specific knowledge about the network and in this case the UK banking industry will enable the development of an understanding of the differences actors play within a social structure (2005). Redefining the actors as "generalised social positions" (Marsden 1988: 58, in reference to Laumann (1973)) – here by organisational type – helped to form more generalised views on the structural network itself although it cannot provide much insight into the overall density of the actors (Hanneman & Riddle 2005).

Data Discovery / Gathering

Data about the relationship ethical banks have with other banks has been gathered through questionnaires which are an extensively used tool in social network analysis, especially whenever archival records are non-existent (Marsden 2005). The questionnaire was designed to be easily accessible for the respondent as the data gathered is self-reported and therefore a complicated questionnaire design could impact negatively on both the respondent's ability to understand the questionnaire as well as his or her willingness to respond. The nature of the population – senior managers and directors as representatives of the ethical banking organisations they are employed by – made this an important consideration for various reasons as discussed below. Although it would have been beneficial to include questions that generate knowledge about how alters are connected to the population, neither cognitive social structure nor ego-network approaches could be applied in this study. Doing so would have complicated the data gathering process considerably for the respondents and the knowledge of relationships between the actors would have been unmanageable and too time consuming. Hence, it has

²⁰ Alters are actors to which the ego node is connected to

been decided that questionnaires should measure an ego's connections only as discussed by Hanneman and Riddle (2005) to minimise the time it takes respondents to fill in the questionnaire. The data gathered on the respondents' connections within the financial services network is meaningful and provides information about local structure or "neighbourhoods" which are of particular interest to this study (Hanneman & Riddle 2005).

Population

One major consideration is linked to the boundary setting and the decision of who should be a respondent. As mentioned above, ideally whole-network data would be available; however, the discussion has shown that egocentric network data is suitable for many types of social network analysis. A second important consideration is the nature of the subject as well as the timing of the investigation. The UK financial services industry, described as non-transparent and highly competitive, may be hard to convince about the usefulness of this research. Even the ethical banking sub-sector may have felt uncomfortable in participating in a questionnaire that aimed to examine the connections created between actors in the banking industry. However, it was felt that because of their ethical credentials, ethical bank organisations are more easily approachable and more likely to have an interest in the planned research.

In an attempt to deal with those concerns, the questionnaires were issued to a pilot group of banks that fit into the category of ethical banks according to the definition presented in Chapter 2: mostly mutually owned organisations or those aligned to specific regional, environmental or religious interests and organisations, or those that actively support charitable organisations. Initially questionnaires (see Appendix A) were sent out to a cross-section of the ethical banking sector reflecting the different forms of ownership, business

model and customer base. The questionnaire was sent out via mail to 30 institutions, including the 10 largest building societies by assets, the 10 largest credit unions and the 10 niche ethical, as characterised by their business models. After the initial request, non-respondents have been contacted via email and telephone to encourage their participation. This first round has yielded a response rate of 57%. The respondents can be summarised as follows²¹: five building societies, seven credit unions and six niche ethical.

A second round of data gathering was directed at all credit unions and building societies in the UK as well as the non-respondent institutions of the initial research (see Table 4.1). Within the niche ethical group, 70% of the identified population of niche ethical based on the BoE's Monetary Financial Institutions publications of 2 June 2010 (Bank of England 2010) have responded. Particular emphasis has been placed on receiving responses from building societies to uncover whether the indicated clustering of this group is indeed significant. As a result, of the 48 independent building societies 17 responded after being contacted by letter, email and telephone to encourage responses. Although reasonable efforts have been made to gather more data within the credit union sector, only 19 responses could be collected of a total of circa 300 credit unions contacted via email – therefore, credit unions without email addresses published were not included in the 300. This low response rate resulted in a considerable amount of missing data which must be accounted for when analysing the network data, in addition to the missing building society and niche ethical cases impact on the analysis of the network as a whole. However, the extent of the responses collected reflect a pattern that illustrates the disconnectedness of the sector within and across the financial services more broadly. This response rate is in line with what one would expect to find in a sector dominated by smallest scale, community based financial institutions that are marginalised through adverse market

²¹ Please refer to Table 4.1 for more details

conditions within the wider financial services sector as illustrated by the New Economics Foundation's *Ecology of Finance report* (Nissan and Spratt 2009). Thus, the data collected reflects the relative disconnectedness of credit unions. Additionally, because the research design anticipated a relatively high level of missing data it focuses on ego-networks and employs a mixed-method approach that uses interview data to supplement the SNA findings.

Table 4.1: Listing of final population by type.

| Building Societies | Credit Unions | Niche Ethicals |
|-------------------------------------|-----------------------------|--|
| Ambitious BS 1 ²² | City CU 1 ²³ | Niche Ethical 1 ²⁴ |
| Ambitious BS 2 | City CU 2 | Niche Ethical 2 |
| Ambitious BS 3 | Regional CU 1 ²⁵ | Niche Ethical 3 |
| Regional BS 1 ²⁶ | Regional CU 2 | Niche Ethical 4 |
| Regional BS 2 | Regional CU 3 | Niche Ethical 5 |
| Regional BS 3 | Regional CU 4 | Niche Ethical 6 |
| Regional BS 4 | Regional CU 5 | National Niche Ethical 1 ²⁷ |
| Regional BS 5 | Regional CU 6 | |
| Regional BS 6 | Regional CU 7 | |
| Regional BS 7 | Regional CU 8 | |
| Regional BS 8 | Regional CU 9 | |
| Regional BS 9 | Regional CU 10 | |
| Regional BS 10 | Regional CU 11 | |
| Regional BS 11 | Regional CU 12 | |
| Regional BS 12 | Employee CU 1 ²⁸ | |
| National BS 1 ²⁹ | Employee CU 2 | |
| National BS 2 | Employee CU 3 | |
| | Employee CU 4 | |
| | Employee CU 5 | |

²² Ambitious BS include building societies who either have recently been involved in substantial M&A or follow different business models compared to the sector as a whole, *id est* employees and environmental foci

²³ City CU are based in a specific metropolitan area and often emerged from council credit unions

²⁴ Niche Ethicals' business models differ significantly as discussed previously and should therefore not be seen as a commonality as such

²⁵ Regional CU are credit unions that cover specific communities, generally on a smaller scale than Regional BS do

²⁶ Regional BS focus on specific regions, but are not active across all areas of the UK

²⁷ Whilst some of the niche ethicals might cover all of the UK, this specific niche ethical's business model is focus on expanding its reach nationally through branches and IT

²⁸ Employee CU's members are members of a specific industry, for example health, police and transport

²⁹ National BS have brick and mortar branches across England, Wales and Scotland and are expected to expand those further

Design

The questionnaires have been designed to allow the strength of the relationship between ethical banks to be rated following a three scale Likert scale, ranging from “weak” or “arm’s length” relationships to “embedded”, “strong” or “cooperative” relationships. The ties presented by Granovetter (1973) are essential in formulating the embeddedness theory and are frequently referred to as “arm’s length” and “embedded” (Powell 1990; Uzzi 1996). Hirschman (1982: 1473) suitably describes the former as functioning “without any prolonged human or social contact between parties.” The definition suggests weak ties to be strongly represented within strong market economies and through short-term oriented contractual agreements between a multitude of intermediaries and based on widely publicly available information. In critique, Weber (1948 (2001)) eloquently describes this form of relationship as one that knows “nothing of ‘honor’” and Waldenberger (2002) seconds this by describing them as “ruthless.” Nonetheless, the apparent benefits of arm’s length relationships has been discussed within the fields of job-seeking [as complimentary to flexible labour markets (Granovetter 1973)] and network expansion by offering highest returns on investments (Burt 1992). On the other hand, the usefulness of embedded relationships has not yet been subject to systematic academic investigation, however, “social attachments ... [are suggested to] ... create unique value” and to support cooperation efforts (Uzzi 1999: 483) – mainly through the transfer of specific, not publicly available knowledge and resources.

Thus, in this questionnaire (see Appendix A), relationships were operationalised as arms’ length and cooperative to avoid confusing the respondents by use of academic language. Nonetheless, despite their usage in academic work, the relationship experienced by an organisation may not fit in either category which is why the Likert value 2 represents a

relationship that may feature both some cooperative aspects and contractual relations with a limited exchange of knowledge and restricted sharing of resources. If they have no relationship, the value of the relationship is zero. Such opinion variables (Dillman 2000) inform the reader about how respondents feel about something, in this case the strength of the relationship between their bank and other institutions within the financial services sector. Thus, the values one, two and three represent a range of characteristics of the relationship, which, although not ideal, allowed the respondent to give a more informed response compared to a dichotomous variable, *id est* having or not-having a relationship with the specific organisation which could be explored in subsequent interviews. By exploring networks, this part of the research strategy did not aim to explain the aforementioned relationships above which have been indicated through definition of the relationships above. However, the analysis of the network through UCINET explained in the next section will identify network characteristics and point towards some conclusive evidence.

As many of the analysis tools required binary data to be used, the ordinal data collected can easily be turned into binary data, in which case a 0 is used to illustrate no relationship and 1 one is used for any of the existent relationships. In fact, some of the questionnaire data indicated a variation in awareness of the strength of relationships particularly between smaller and larger institutions. As a result, the majority of the analysis was based on the converted binary data. Furthermore, connections sent by an ego were treated as a connection whether they are reciprocated or not. Because of the lack of naturally reciprocated ties from non-responding alters this is an essential step. Although this is not an ideal situation, the impact of this is accounted for when analysing the network data by only examining reciprocity between the respondent organisations. Basing the existence of a

relationship on reciprocity would mean that many connections would have to be ignored, not least those to the national institutions and high street banks. The difference between in and out degree, *id est* the number of ties sent compared to those received, also helps to assess the cognitive positions of the larger institutions that do not reciprocate connections sent by, often smaller, ethical banking organisations. The latter point is reasoned in the fact that the subject of analysis is the embeddedness of ethical banking organisations from the perspective of those institutions, that is, the study investigated egocentric networks based only on the ego itself.

The large number of organisations in the financial services industry in the UK required the questionnaire to be split into five sections. The first section lists the 105 UK banks listed in the BoE's "Monetary Financial Institutions" publication of June 2 2010. This initial list has been extended by a section that allows the respondent to enter additional financial services organisation and credit unions manually. The listing of credit unions seemed unadvisable due to the high number of credit unions in the UK (n= 485, FSA 2009) and their relatively low expected connectedness. Further the questionnaire features two sections that request additional information on relations with national and international institutions guarding, representing and regulating the financial services sector and other organisations the respondents are connected to. The final section of the questionnaire has asked the respondent to rank their relations according to the importance of the actors they engage with enhancing the strength of the given relationship.

In addition to the data generated in the questionnaire, an attribute file has been created that contains information on whether actors are respondents or non-respondents, and the

type the organisational belongs to. Further attributes cover the location of ethical banks' headquarters and the operational focus as well as the size of the organisation (see Table 4.2). Underlying these categories are certain assumptions regarding the geography, size and interests of the respondents. The attribute *headquarter location* was used to explore whether certain business models are more likely to be found in certain geographic environments. Furthermore, the *organisational type* attribute enabled the data to be grouped and analysed specifically which is important to a variety of network analysis tools including the "E-I Index" and "Structural Holes".

Table 4.2: Attribute categories for the egocentric network's egos and alters

| Survey Results | Organisational Type | Headquarter Location | Organisational Focus | Size of the Organisation |
|----------------|--------------------------|----------------------|----------------------|--------------------------|
| yes | Niche Ethical | London | Regional | Small |
| no | Building Society | England | National | Medium |
| | Credit Union | Wales | Employee | Large |
| | High-Street | Scotland | Other | N/A |
| | Bank | Other | | |
| | Other Financial Services | | | |
| | Other | | | |

Data Analysis

Following the data gathering, the completed questionnaires have been inputted into Excel to form a matrix containing the 43 questionnaire respondents (ego) and a further 149 organisations that have been identified in the respondents questionnaires as being connected to at least one respondent organisation . The data has been analysed via UCINET and its illustration software Netdraw. UCINET has been chosen because it offers a comprehensive package for the data analysis of small and medium sized networks. Within the following section, the different social network tools that have been used to analyse the ethical banking network are being discussed according to the following three sub-questions of Research Question 1.

Sub-question 1: What are the key structural features of the network with regard to the groupings of ethical banks, their connectedness within ethical bank networks and their interconnectedness with other financial institutions?

To begin with, the data analysed descriptively identifies the network composition of each group. Both the mean and median values have been calculated to illustrate the average size of the groups. Standard deviation scores are used to show differences of connectivity within groups as well as between all respondent actors. Standard deviation is furthermore calculated as percentage of the mean. This enables the comparison of the group deviation between the groups to indicate robustness or the groupings. The idea is that similar organisations should be connected similarly. Therefore, high percentage differences of standard deviation within groups would suggest that the actors belonging to the groups are dissimilar. Skewness has been assessed to provide information about the distribution of organisations according to their connectedness. Attribute data has also been enlisted and analysed to highlight basic network characteristics. The network has been visualised to give first insights into the network structure such as group clustering and highly connected actors.

The analysis used a variety of measures to analyse basic network characteristics as well as group scores. Particular emphasis was placed on the structure of the groups by organisational type and the nature of their connectedness computed by the E-I Index, which is a measure of homophily. Homophilic tendencies support the idea that subcultures are being formed within the ethical banking sector. These illustrate the potential for social capital to develop. Group reciprocity scores for the respondent network are calculated as reciprocated relationships between actors and have strong potential to facilitate the formal and informal exchange of information and resources. It also indicates if certain groupings of

organisations have different understandings of their connectedness, because of differences in size, or other strategic concerns. Other measures such as density and centrality scores have also been calculated but are likely to suffer from missing empirical data which means they may be of little contribution in analysing the network. Analysing the structural equivalence of the ego structures emphasised similarities across actors with regard to their structural behaviour. Again it has provided information about network characteristics on group level as well as questioning the assumptions of similarities of engagement with other actors.

Sub-question 2: Which organisations are the key players and what are their characteristics?

This section of the analysis focuses on the ego network and the importance of actors both in terms of size and centrality, as well as their position within the network. It first looks at standard measures that disclose the size and density of the ego networks as well as the number of components the ego is connected to. Few and weak connections would suggest that the egos have relatively less access to and control over network resources. Reference is made to group level to see if the individual characteristics are replicated at a higher level. Hub and Authority values are investigated to highlight the different function of actors within the network. Authorities receive a high number of good quality relationships and can be seen as knowledge or organizational authority within a domain that act as definitive sources of information (Kleinberg 1999). Hubs on the other hand connect to authorities and thus this measure highlights the importance of actors in the network with regards to communication and flow of resources. Further brokerage scores and structural holes highlight which roles are being played by the respondent egos based on their connectivity. This analysis aims to point towards egos that are particularly important in connecting

respondent actors whilst identifying actors that may benefit from competitive advantages based on their structural position and the access to various sources of information.

Sub-question 3: What attributes impact on the connectedness of ethical banks?

To answer this question, Pearson R correlation coefficients have been calculated for a number of variables. Of particular interest here was the relationship between attributes such as organisational type, location and organisational size, and network parameters such as network size, density and brokerage, to reveal whether connectedness is a predominately a result of size or if other factors are of influence.

Limitation and Problems of the Social Network Analysis

As with other forms of academic investigation, the employment of network analysis as a tool is subject to a variety of limitations and problems. Previous use of social network analysis in researching connections between banks is limited and based on lending relationships between banks (interbank lending market) or between banks and specific business customers (Iori et al. 2008; Uzzi 1996; Uzzi 1999). This study however aims to unearth the relations between ethical banks as a subculture of the financial services industry and focuses on both arms' length and cooperative relationships. Thus existing questionnaire designs are ill fitted and a new unproven design needed to be created taking into account Uzzi's (1996; 1999) distinction between arms' length and cooperative relationships.

Firstly, questionnaire data for each organisation is based on responses of one or two individuals working within the ethical banking organisation, which could be considered

inadequate as the knowledge held about the connectedness of the organisation he or she represents may be incomplete. By requesting senior management and directors to fill out the questionnaire, this potential problem has been limited; however it has at the same time introduced strategic considerations that should be recognized. Senior management may be reluctant to acknowledge some relationships due to the nature of such relationship and their possible misunderstanding of what the research is about. Consequently, they may have only given an account of those relationships that fit into their understanding of ethical banking. Furthermore, the respondents may blur relationships between the banks and private relationships with bankers in other banks. As a precaution, the questionnaire underlined that it is the bank-bank relationship that is being investigated, not private linkages with other banks.

A second, interrelated issue is to do with non-reciprocated relationships. As mentioned above, some organisations may, for strategic reasons, ignore relationships, whilst others may just forget about them. As a result the data may show significant levels of non-reciprocity. To reflect this, even if relationships are not reciprocated, the relationship is considered existent whenever the network analysis uses non-directed data. Additionally, the strong differences in organisational size may create different understandings of what it means to be related. Thus particularly small credit unions' relationships with large actors such as National BS 1 and National Niche Ethical 1 may not be reciprocated as those institutions may not recognise those relationships as being of any importance. A further point is related to the qualification of relationships as arms' length and full cooperation. Again asymmetric understandings of the exacting content of those categories between different types of actors are likely to change the understanding. That is why in most types of analysis data has been dichotomised to reduce the impact of such misunderstandings.

A third source of limitations and problems for the analysis is the considerable lack of data. Network analysts mostly work with whole network data or ego-centric networks adding information on alters; however, the ego-centric (only) network approach utilised in this study has been highlighted by Hanneman and Riddle (2005) as equally tenable. Notwithstanding these issues and without repeating what has been said earlier in this chapter, the application of network analysis in this study is focused on identifying relationships within the network and pointing out the actors of particular importance, whether that may be due to size, representativeness or because of its usual connectivity. The study provides empirical evidence that adds to the mostly theoretically informed discussion of the intra-industry organisation of the ethical banking sector within the financial services sector. Given the support for the empirical evidence that has been gathered through subsequent interviews, the network analysis has contributed to the understanding of the organisation of the sector as a whole and unearthed contentious issues within the industry that require further investigation. Thus it is reasonable to assert that findings will not only be informative of the sectors investigated, but also add to interdisciplinary approaches of research that focuses on mixed-method research.

Phase II Interviews

The qualitative second phase had two objectives. Firstly, focusing on exploring the findings of the social network analysis in context; secondly, it has moved the discussion away from a purely structural debate and introduces cognitive, cultural and political elements to thicken the concept of ethical banking as a sector.

Data Gathering, Sample and Approach

The interviews were designed for two purposes. In order to explore the character of the ego-networks in-depth, the first section of the interview needed to respond directly to the findings of the social network analysis and thus be adapted for each interview. Whilst this may appear to gather information that is very different across the sample because of the different size, location and focus of the individual ethical banks, the questions had the aim both to discuss specific relationships between the ego and its alter, and to ask more generic questions. For example, interviewees were asked about the relationship between the ego and a specific type of organisations – high street banks, building societies or niche ethical. Despite adaptations of the stated questions, the questions were semi-structured and sufficiently open-ended to yield specific, pre-determined results. This approach ensured that the themes discussed with interviewees were broadly similar whilst also allowing for a degree of freedom in adapting the questions if and when required to follow up on interesting and unusual motives.

Naturally, the link between interviews and previously completed questionnaires is relevant to the sampling strategy for the interview phase as it limits the number of potential respondents to those that have filled in the questionnaire. To start with, requests for interviews were sent out to all questionnaire respondents to limit bias and generate a maximum number of positive responses. Whilst this yielded eight interviews, based on the initial analysis of the social network data from Phase 1, it was felt that some organisations that had not originally agreed to be interviewed would be essential to explaining the network. Subsequently, some organisations were contacted again and an additional five interviews were conducted as a result. This increase in sample size was valuable because, the literature review indicated that they may be particularly important actors in the ethical

banking network because of their size. Interviews were expected to last between 30 minutes and one hour; it was felt that the respondents, mostly CEOs, would object to longer time requirements because of their tight schedules.

One interview was conducted within each organisation. However, by targeting CEOs or non executive directors as interviewees it was believed that the information gathered gives a reasonably good view of the organisational perspective on the topics discussed.

Nonetheless, and particularly in larger ethical banks, respondents were at times unable to answer specific questions but they referred to publically available documents such as “The Vision for Mutual Lenders and Deposit Takers,” “The Mutuals Yearbook” and the report of the Commission on Big Society “Powerful People, Responsible Society.”

Interviews were semi-structured and the questions were open-ended. The interview guide was based on five topics formulated as a question with up to 5 sub questions within each theme. One of these topics was directly linked to the content of the relationships identified in the questionnaires; while others discussed ethical banking as a sector, the ambitions of the firm, developments within the financial markets in recent history and the changes needed to promote the sector in future. The interview questions provided a structure rather than a rigid template which allowed for adaptation to specific issues that emerge throughout the interview to be made to reflect the exploratory intent of this research (Appendix B). A basic interview guide highlighting the main themes to be discussed was sent to the interviewees prior to the appointments. Respondents had the opportunity to review and correct the transcribed interviews.

Analysis

The analysis was guided by Creswell's (2011) five step guide to analysing qualitative data – preliminary exploration of the data, coding of data, developing of codes into themes, linking of themes and constructing a narrative. Overall, 13 interviews have been conducted out of the 43 respondents in Phase I. Niche ethical banks have been most responsive to the invitation and subsequently five interviews have been carried out highlighting the distinct approaches to ethical banking taken by these banks. At the same time, by interviewing half the population of niche ethical banks identified in the UK, it was felt that the themes identified will be reasonably representative for niche ethical banks in the UK in general. Additionally five building societies have been interviewed. Altogether, this represents 30% of the questionnaire respondents and 10% of the entire population of building societies in the UK. The number of organisations interviewed is considered sufficiently large to illustrate the key issues of the sector. Finally, three credit unions have been interviewed which represents 16.5% of the questionnaire respondents but only around 1% of the entire credit union population in the UK. Whilst this has an obvious impact on the findings, it gives a perspective on the diversity within the credit union movement, also allowing an extension of the analysis and a connection to the social network analysis.

Following the analytic scheme discussed by Creswell (2011) and the more structured template analysis proposed by King (2007) 12 themes have emerged which have subsequently been partitioned into three groups: the first group of themes provides information about different business models employed by ethical banks with regard to their ambitions, stakeholder base and measures for success amongst other things; other themes centre around the ethical banking sector's identity and trajectory, related to their self-recognition of the sector, aspects of competition and regulation as well as external

recognition of their sector; and the final theme looks specifically at internal and external efforts to change the sector.

The interviews both follow up on the questionnaire findings and facilitate engagement with some of the issues emerging from the literature review. Well-known weaknesses such as non-generalisability, the time-consumption of the data gathering and analysis, the potential influence of the researcher's bias and the unwillingness of participants to answer questions accurately and completely (Boyce and Neale 2006; Johnson and Onwuegbuezie 2004) were considered before conducting the interviews and have been dealt with where possible. For example, to limit time spent on conducting and analysing data important interview partners were identified and contacted early in the research process. Also, from the outset, the research did not aim to produce generalisable findings but to investigate a specific subsector of banking.

Use of Secondary Data, Validity and Credibility

The use of secondary data to support primary research is widely accepted as a powerful technique to verify findings and counterbalance biases in investigations, for example through triangulation (Greene et al. 1989). However, the methods used in this study are applied to gather additional, sometimes conflicting data to create a rich narrative of the embeddedness of ethical banking in the broader UK banking industry.

Much of the data was taken from published audited company reports; however, the accounts also contain large amounts of narrative, descriptive text which feature "a complex

arsenal of communication tools [...] that engage the reader as a co-maker of a story” (Stanton and Stanton 2002). Judd and Tims (1991) highlight the function of corporate reports as marketing tools to customers. Thus the non-financial information disclosed is likely to be motivated by the company’s concern to represent itself in a specific light rather than being a true reflection of how things work in reality. Company reports are also likely to offer similar information to that gathered through interviews as the CEOs’ have a substantial knowledge of the narrative of and arguments made in annual reports. Because the sources are linked to each other and share the same position, data used from annual reports to support claims made by interviewees were not triangulating data, but supported arguments and added further information.

Nonetheless, the marketing efforts and the specific sections in annual reports on customer focus and how organisations present themselves as different from high street banks can be used alongside the interview data. Other secondary data sources were used to interrogate the validity of statements made in the interviews. In particular, official government papers linked to regulation and reform agendas and industry and academic reports that investigate specific themes discussed have been used to add additional data and context to follow up on claims made by interviewees.

The use of mixed-methods, particularly a combination of quantitative and qualitative techniques, is often argued to enhance validity through cross-examining or triangulating the findings (Jick 1979); yet this was not the case in this study. Because of its sequential research design and exploratory nature, the interview phase built on the findings of the earlier network analysis stage. Whilst this may include some aspects of triangulation by

following up on earlier findings, the research has not been set up in such a way. Still, the different methods and resources used to gather and analyse data enhance the internal validity of the study by reducing the biases of the methods and help to overcome their respective weaknesses. As intended in the initial setup of this research, all efforts have been made to maximise sample size but because the study is industry-specific the findings are very specific to ethical banking in the UK and cannot be generalised (Stuart et al. 2002). In principle, findings may be transferable to similar settings of ethical bank embeddedness (Onwuegbuzie and Johnson 2006); however, the distinct features of UK banking is relatively dissimilar to other European and Anglo-Saxon banking systems, thus transferring findings may be non recommendable. Research reliability and credibility have been accounted for at various stages of the research (Morse et al. 2002) by standardising the questionnaire measurements, and ensuring that interviews reflect a variety of opinions. Still, to further enhance the credibility of this exploratory research the study could be repeated with the aim of receiving more responses to the questionnaire and to interview other actors; however, because its findings are specific to the UK context and may also be affected by the timing of the research towards the end of the financial crisis and high levels of insecurity in the financial services industry at the time.

Conclusion

The chapter detailed the mixed-method approach used to gather and analyse data and to addressing the research questions. It described the samples and procedures that generated data and how data is analysed. The chapter also illustrated the connections between Phase I and Phase II of the research with Phase II building on the knowledge generated through

the social network analysis before critically engaging with the findings and creating a more in-depth account.

The findings of the study and the discussion thereof are discussed in the following chapters.

Chapter 5 will discuss the results of the network analysis and answer research question 1.

Ethical bank business models are discussed in chapter 6 in answer to research question 2

which is followed by the discussion of the ethical banking sector in chapter 7 answering

research question 3. Policy recommendations, as suggested by research question 4 are

given in chapter 8.

Chapter 5: Network Empirics: Ethical Banking Relatedness in the UK

The chapter investigates the social networks of ethical banking organisations in the UK and links to the theoretical discussion of the importance of social networks within this highly interconnected industry. Chapter 3 has discussed the connections between embeddedness and industrial districts whilst chapter 4 outlined how and why social network analysis is a useful technique to investigate aspects of ethical bank embeddedness. The empirical data gathered and investigated here complements previous arguments whilst also unearthing new problems requiring further investigation. The chapter focuses on answering research question 1 linked to the structural set-up of the sector

What are the network structures underlying the ethical banking sector in the UK and how do they impact on competition and strategic alliances between ethical banks and the other financial services organisations?

- a) What are the key structural features of the network with regards to the groupings of ethical banks, their connectedness within ethical bank networks and their interconnectedness with other financial institutions?
- b) Which organisations are the key players and what are their characteristics?
- c) What attributes impact on the connectedness of ethical banks?

This chapter first presents the data and delivers a descriptive analysis, before contextually discussing specific problems and emerging themes. The primary purpose of the chapter is the discovery of the network structures underlying ethical banking in the UK via social network analysis. The following descriptive analysis explains the various network analysis tools used and discusses the results of each analysis within its context. The chapter will

identify and outline the key issues emerging for ethical banks and the sector which are then developed in the following chapters. The results from the empirical investigation are assessed as to what impact they have on competition and strategic alliances between ethical banks and the other financial services organisations.

Network Data Analysis

The descriptive analysis discusses a variety of different social network analysis tools. First however, it briefly considers basic measures of the data set, including mean, median and standard deviation which give an initial overview of the dataset and distribution. They indicate both the average relationships responding ethical banks have and the variance thereof. This is followed by a brief description of the attribute data that has been used alongside the network data gathered through the questionnaire. The attribute data is important for the analysis of the network structures and is similar to variables in standard statistical analysis. In this study, the affiliation attribute “type” is important as it enables the legal structures of the organisations to be considered.

The social network analysis starts with standard measures such as *Density* of the whole network and *Freeman Degree Centrality* as mean degree for groups. Density indicates how many relationships out of the maximum possible are present. Freeman Degree Centrality informs about the number of connections an actor holds. It highlights the relative importance of an actor in the network based on its in-degree centrality. The analysis then zooms in on measures such as *Size* and *Density* of the egonetwork and *Weak Components* to further highlight similarities and differences across the actors with regard to the individual organisation’s number of direct connections and density, as well as the number

of weak components in each ego-network. The *E-I Index* goes further and informs about the social fabric of the network by considering the connections made to organisations of the same type and those of different organisational type. *Reciprocity* values, both at individual and group level further highlight collaboration between the various actors. The analysis then shifts towards more sociologically informed tools such as *Hubs and Authorities* (Kleinberg 1999), *Brokerage Scores* (Gould and Fernandez 1989), and *Structural Holes* (Burt 1992) suggesting that respondents have different functions within the network with regard to knowledge transfer, cooperative practices and opportunism. The last part of the analysis looks at structural equivalence and correlations between various attributes and some of the analytic findings. The typology of ethical banks used in this study is scrutinised by testing for structural equivalence, which identifies if actors have a similar profile of connectivity. Furthermore, structurally equivalent nodes are considered to have similar attitudes, behaviours and performance; thus it informs us about the similarity of the social environments of the organisations.

Overall, the analysis will provide insights into the network structure both in terms of the individual nodes' roles in the network and the three types of ethical banks investigated. As there is no template as to which of the many available measures should be used, emphasis has been placed on proven standard measures that are relative robust when analysing datasets with high levels of missing data as discussed in the methodology.

Basic measures

The network is based on 43 egos³⁰ who represent individual banks and have been asked to give information on the relationships they hold with other financial and non-financial organisations, *id est* their ego-network. Ethical banking organisations have been grouped according to legal status as a credit union or building society. Organisations that do not fit those strict legal requirements have been grouped together under the type “niche ethicals” and as indicated in the term *niche* they differ considerably in their business models and approaches to day-to-day business, strategy and markets. Nonetheless, as discussed in Chapter 2, niche ethicals have common interests that tend to link social and environmental concerns with business needs whilst giving serious consideration to the impact their operations have on various stakeholders.

Analysis of the survey results shows that the average size of the ego networks is 27.7 nodes, which means that the average ethical bank is connected to nearly 28 organisations; however there is considerable variation in the mean values for the types of organisation investigated, as highlighted in Table 5.1. Building societies are the most connected group of ethical banks and standard deviation as a percentage of the mean (SD) (21.2%) is relatively low compared to both niche ethicals and credit unions. Niche ethicals are on average well connected; however, the number of connections can vary largely between different organisations. Credit unions are the least networked organisations in the sample, averaging less than eight connections whilst the S.D. is, as percentage of the mean, relatively high as few credit unions are considerably more connected than the median. The size of the networks has implications for the analysis but reflect broadly what has been expected:

³⁰Egos are focal nodes (in this case respondents) that are connected to other egos and alters

larger organisations are more connected. The range of ego network size (3 to 72) also impacts on standard deviation across the groups with raw values between 3.3 and 12.0; however, as percentage of the mean per type of organisation, S.D. is more similar (21.2% to 51.7%) compared to total network standard deviation as percentage of mean (80%). Apart from the respondent nodes ego-networks, the wider network adds 148 nodes that represent actors that are passive in the network and do not send ties. Extending investigations for mean and S.D. to the 191x191 network lowers both considerably (10.4 and 15.4) because of the lack of networks originating in the non-respondent actors. They are either non-respondent ethical banking organisations, other financial services, high street banks or other organisations.

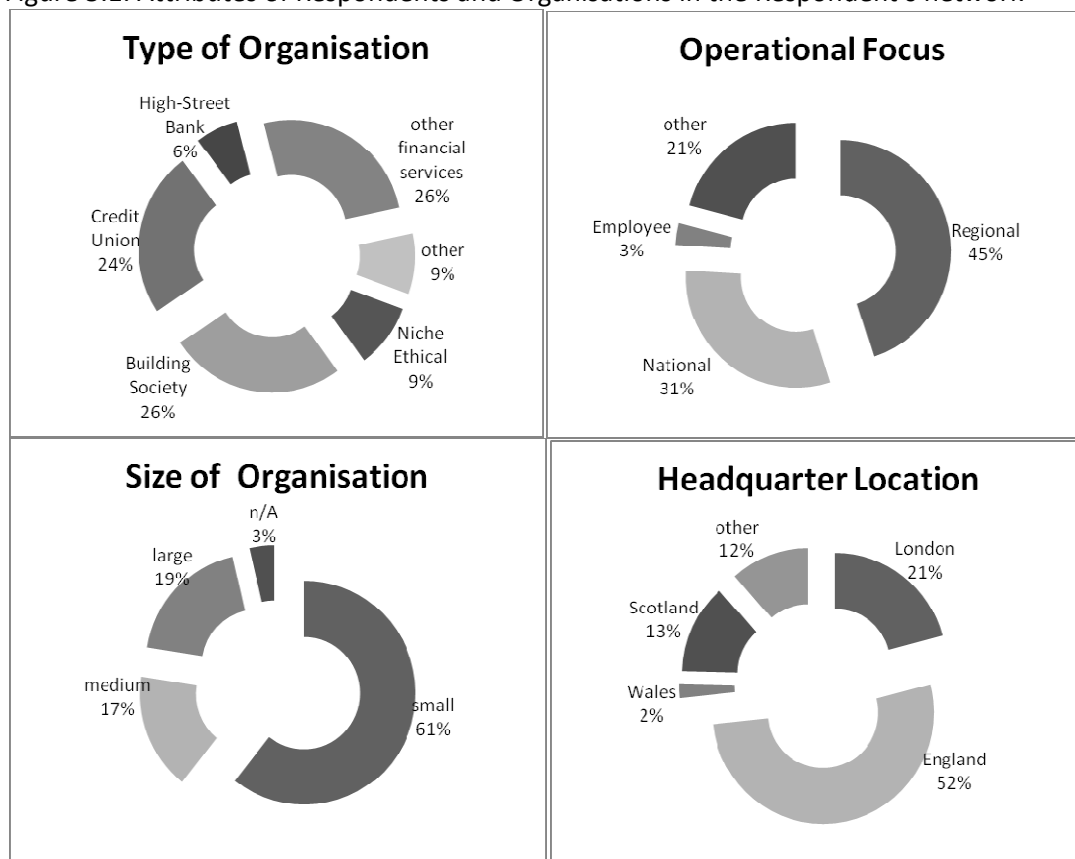
As highlighted in the methodology chapter, the data set has a number of limitations, particularly in relation to missing data which can impact on the analysis. As a consequence two networks emerged in the analysis – the first network considers all 191 actors, including egos and alters. The second only considers part of the network - that is only the connection between responding organisations. To avoid confusion, the chapter will highlight which network is being analysed. Thus a focus on the respondent network only will be marked by reference to the 43 actors times 43 actor matrix as “43 network” whilst the entire network including non-respondent actors is being referred to as the “191 network.”

Table 5.1: Mean Degree of egos by type of organisation and total (43 network)

| | Niche Ethicals | Building Societies | Credit Unions | Total |
|--------------------------|-----------------------|---------------------------|----------------------|--------------|
| Mean Degree | 23.3 | 51.9 | 7.7 | 27.7 |
| Median Degree | 21 | 53 | 8 | 18 |
| S.D. | 12.04 | 11.00 | 3.31 | 22.17 |
| S.D. as % of Mean | 51.7 | 21.2 | 42.8 | 80.0 |
| Skew | 1.71 | -0.19 | 0.95 | 0.49 |

The attribute data in Figure 5.1 shows that the network consists of the 43 respondents plus 148 alters which have been named by one or more respondent egos. The attributes show that the network is very diverse, in terms of type of the organisation, headquarters, operational focus and size. The sometimes extreme variation in the number of occurrences of attributes, such as headquarters in Wales (n=4) compared to organisations headquartered in England excluding London (n=100), must be considered in the discussion. In this study, London has been separated from England as London's City has distinctly different characteristics compared to the rest of England, for example the lack of building societies headquartered in London and a generally much more concentrated financial services industry (Ertürk et al. 2011).

Figure 5.1: Attributes of Respondents and Organisations in the Respondent's network³¹



³¹ Size is classified by assets held by the organisation: small ≤ £0.5 billion; medium ≤ £5 billion and large > £5 billion

Network and Group Measures

Overall, the network *Density* for the 191 network is very low at 0.03 which means that only 3% of theoretically possible relationships exist between the actors. This indicates that interaction is generally low; however, missing data strongly impacts on this measure. At this point a comparison to other studies is not possible as the few network studies of the banking industry that exist focus on different kinds of relationships such as interbank lending and the population differs. Moreover, the configuration of the network based on 43 ego networks means that the 148 alters have no out-degree which impacts significantly on overall density figures. However, looking at the respondent network only, considerably higher levels of interaction are evident at 16%. Thus, whilst missing data has some influence on the existing relationships between ethical banks compared to those theoretically possible, it seems that the sector appears fragmented and only partly connected. The network centralisation is 32.75%; however out-degree (34.01%) centrality is nearly twice as high as in-degree (19.72%)³² centrality. The considerable difference between in- and out-degree indicates that the respondent networks' central position is overestimated as it sends out more ties than it receives. Vice versa in-degree centrality may be underestimated because of missing data of the whole network. Further, the indicator shows that building societies are the best connected actors, followed by the niche ethicals. Credit unions are considerably less connected which is an expected result, considering their restricted personnel and financial resources as highlighted by Mutuo (2010). Building societies receives fewer ties than they send out. On first glance this suggests that they overestimate their connectedness. Yet, the high reciprocity of relationships between building societies suggests that the in-degree would increase if all building societies had participated in the research. Niche ethicals have a relatively low in-degree measure,

³² Out-degree centrality is the number of ties node sends to other nodes in the networks whilst in-degree centrality is the number of ties it receives.

supporting the hypothesis that they are niche operators with little central organisation as a sector because of the differences of their business models with few relations to traditional mutuals such as building societies and credit unions.

Table 5.2: In-degree and out degree centrality for two key nodes (43 network)

| | National Niche Ethical 1 | National BS 1 |
|-------------------|---------------------------------|----------------------|
| in-degree | 33 | 19 |
| out-degree | 1 | 3 |

Both the National Niche Ethical 1 and National BS 1 seem to underestimate their interconnectedness with ethical banking institutions as their in-degrees in the respondent networks are considerably higher than their out-degrees (Table 5.2). Krackhardt (1992: 223) argues that this signals the perceived importance of an actor for a specific network. Whilst his example discusses individuals within one firm it seems entirely feasible that the high in-degrees of those organisations mentioned in this study also indicate a high level of experience and know-how and thus are attractive network partners for other ethical banks. This idea is supported in Johnson and Orbach's (2002) paper on ego-biases, however, they also acknowledge that it may be a more unconscious process. National BS 1 considers itself to be linked to three respondent organisations whilst 19 egos stated connections with National BS 1. In case of the National Niche Ethical 1 the results are even more extreme with 33 out of 43 identifying the bank as a partner whilst the bank only recognises one of those relationships. The high in-degree centrality of the National Niche Ethical 1 and National BS 1 suggest that both are regarded as central actors within the ethical banking network. On the other hand it suggests that neither recognises their position within the network which could have implications on their business activities, that is their competitive behaviour and strategic development, as well as the sector's potential for future development and competitive forces.

Social Fabric of the Ego-Networks

The next part presents basic *ego network measures* of the 191 network and the findings for the E-I index and reciprocity. *Size*, which identifies the total number of actors the ego is directly connected to, has found that building societies are the most connected respondents. Yet interestingly, despite being the largest, National BS 1 is considerably less connected than smaller building societies. However this could be linked to the frequency of ties between building societies indicative of a relatively active subsector rather than a sign of the importance of the actors. This view is supported by relatively high size values for non-respondent building societies. National Niche Ethical 1 has a network (n=48) that is substantially bigger than that of other niche ethical banks such as Niche Ethical 6 (27), Niche Ethical 2 (23) and the Niche Ethical 4 (21). Credit unions have generally smaller ego networks (n=3 to 16). Further actors with reasonable network size are the FSA, BSA and BoE, which brings to light their important position in the network as they are non-respondents and as such have not sent any ties. For example all respondents are connected to the FSA, arguably the most important actor in the UK financial services industry as it regulates firm activities in the sector.

Ego network *density* of the 191 network is highest for Building societies (12.5-39% [26.9%³³]) underlining the relative high connectedness of building societies followed by niche ethical banks (11.5-21% [7.5%]). Niche Ethical 4 is an outlier at 5.95% which may be a result of its particular religious focus and the general disconnectedness of its network from other ethical banks shown by the in-degree of 0. Credit union values for density are between 0 and 33% and highly influenced by the limited connectedness overall, yet at group level, credit unions are only sparsely connected with a density of 2.2%. Moreover,

³³ Group level aggregates

whereas group level densities increase significantly in the 43 network for both building societies and niche ethicals (81.3% and 31.0%) they decrease for credit unions to 1.5% which suggests that very little interaction exist between the respondent credit unions³⁴.

The weak component measure (*PWeakC*) highlights how many disconnected components will result if the ego is removed; however the results are affected by the lack of data and should therefore be considered as outline indicators. Compared to a generally low percentage of weak components in the building society group of respondents (<10%), Ambitious BS 2 has a large *PWeakC* (15%) which can be explained through its alternative approach as a building society. The niche ethicals' values show a higher variety in the percentage if weak components ranging from 4.17% (National Niche Ethical 1) to 52.38% (Niche Ethical 4), which supports the idea that they are interacting with a variety of actors different to their competitors based on their niche business models. The low *pWeakC* of the National Niche Ethical 1 in particular suggest that it is connected to central actors and affirms the claim made about the National Niche Ethical 1's central position within the network. Credit unions show high levels of weak components which suggests that most actors in their ego network are marginalised.

Table 5.3: Group Level E-I Index

| | Internal | External | Total | E-I |
|----------------------------------|-----------------|-----------------|--------------|------------|
| Ethical Banks⁶ | 1424 | 284 | 1708 | -.667 |
| Niche Ethicals | 40 | 155 | 195 | .590 |
| Building Societies | 1086 | 217 | 1303 | -.667 |
| Credit Unions | 90 | 102 | 192 | .063 |
| High Street Banks | 0 | 131 | 131 | 1 |
| Other Financial Services | 0 | 151 | 151 | 1 |
| Others | 0 | 20 | 20 | 1 |

³⁴ The reduction from 2.2% to 1.5% is linked to the removal of the trade associations as they are non respondent actors.

The *E-I index*³⁵ investigates whether a group of nodes is more likely to be connected to members of the group or to actors external to the group. Running the E-I index on ethical banks³⁶ against other financial organisations within the 191 network, including high-street and investment banks and their associations, illustrates that ethical banks are much more likely to be connected to other ethical banks (Group level E-I index -.667; $p < .05$).

Diaggregating the ethical bank group into its component, the results are more varied (see Table 5.3). Building societies are particularly strongly connected to other building societies (-.667) confirming the networks preferences, however niche ethicals are more heterophilic (.590) with many of their connections being to organisations and institutions of a different type. Credit unions show little relation to any particular group and the E-I index of .063 suggests that there is a balance between relations to organisations of the same type and to different organisations. Moreover, both niche ethical and building societies are connected to high street banks whereas some credit unions are not.

The E-I Index at individual level confirms group findings, particularly the homophilic tendencies of building societies. However, both National BS 1 and Ambitious BS 2 show weaker homophilic tendencies (-.056; -.167) compared with other societies, which is linked to their multiple connections to a variety of actors outside the building society group. However, both figures normalise when looking at both organisations E-I index using the ethical bank category (-.389; -.583), which suggests that they are more likely to be connected to credit unions and niche ethicals than are other building societies. Similarly, niche ethicals tend to interact with other organisational types; nonetheless both Niche

³⁵ The E-I index informs us about the social fabric of the network by partitioning the network by an attribute, in this case type, to calculate the relations that are to different organisations (external) minus the ones to the same type of organisations (internal)

³⁶ This is an aggregated category which includes building societies, credit unions and niche ethicals

Ethical 2 and Niche Ethical 3 are less heterophilic than the others, which could be linked to their niche focus. Interestingly, National Niche Ethical 1's heterophilic tendency at group level (.750) turns into homophily (-.583) when considering ethical banking against other actors. This suggests that the actor is connected across the ethical banking network and less niche-oriented.

Running the E-I index on location of headquarters shows that overall ethical banks do not connect to organisations based on their geography. Those headquartered in London and Wales behave in a highly heterophilic way (.893 & .854), *id est* they are connected to organisations that are based elsewhere. Those based in England show some degree of homophily (-.441) whereas Scottish ethical banks tend to connect more to organisations outside Scotland as compared to other Scottish banks. The results must be taken with extreme caution, despite being significant at $p < .05$, due to the large differences in the numbers in each category – London (40), England (101), Wales (4), Scotland (25) and other (21) – as they are likely to overemphasise the results. For example the fact that Regional BS 10 is connected to all three of the organisations headquartered in Wales is ignored in its E-I index as it is connected to 63 organisations headquartered elsewhere. Similarly, the high values for England suggest that English companies are more likely to be connected to other English organisations; however, based on the data it is hard to establish whether the results are skewed towards England because of the overall number of organisations headquartered in England in the first place. Thus despite being statistically significant, the results of the analysis of the headquarter location has to be taken cautiously and findings not overemphasised.

Table 5.4: Between-group reciprocities (43 network)

| | Niche Ethicals | Building Societies | Credit Unions |
|---------------------------|-----------------------|---------------------------|----------------------|
| Niche Ethicals | 30% | 33% | 0% |
| Building Societies | 15% | 67% | 0% |
| Credit Unions | 0% | 0% | 0% |

Some of the homophilic tendencies observed by the E-I index are also visible when analysing reciprocity between respondents (Table 5.4). As non-respondents cannot reciprocate data, the analysis is based on the 43 network. Results underline a relative mutual understanding of relationships between building societies; however, National BS 1 reciprocates ties only at a rate of 10%. In contrast, National BS 2 reciprocates over 90% of its relationships. National BS 1 sends links to only 3 ethical banks, whereas National BS2 sends considerably more ties, particularly to building societies. Niche ethical highlight once again a non-uniform behaviour with values between 0.5 and 0.0, *id est* 50% of the Niche Ethical 3's ties are reciprocal whilst both Niche Ethical 1 and the Niche Ethical 4 have no reciprocal ties with other respondent organisations. Similarly, National Niche Ethical 1 is only reciprocally linked to 3% of the respondent network, again because of the limited ties sent to ethical banks. Lastly, credit unions show no reciprocity in their ties which suggests that they are either relatively autonomous, or that any ties which they do send are either no considered to merit reciprocation by receiving organisations, or simply go unnoted by them.

Functions of Actors within the Network

Table 5.5: Range of Hub and Authority values for selected types of organisation within the network³⁷

| | Hubs | Authorities |
|--------------------------------|-------------------------------|-------------------------------|
| Building Societies | .036 National BS 1 | .191 Regional BS 7 |
| | .495 Regional BS 3 | .294 National BS 2 |
| Niche Ethicals | .005 National Niche Ethical 1 | .000 Niche Ethical 4 |
| | .045 Niche Ethical 6 | .262 National Niche Ethical 1 |
| Credit Unions | .000 various | .000 most |
| | .056 Regional CU 7 | .002 Regional CU 5 |
| High Street Banks* | | .026 Santander |
| | | .139 Barclays |
| National Organisations* | | .127 BBA |
| | | .253 BSA |
| | | .302 FSA |

*derived from the 191 actor network

Hubs and Authority scores (see Table 5.5) support the idea that actors have different functions within the network. Authorities receive a high number of good quality relationships and can be seen as knowledge or organizational authority within a domain that acts as a definitive source of information (Kleinberg 1999). Consequently the measure provides insights into the social status of actors, mainly egos, within the network with regard to knowledge exchange. The difficulty for respondents to assess the strength of the relationships may impact on the analysis; nonetheless the results are in line with findings from other measures in this paper. Building societies are strong hubs (up to .495) as they point to good authorities, whilst at the same time having some authority themselves. However, larger building societies such as National BS 1, National BS 2 and Ambitious BS 1 have authority (.278, .294 and .276) whilst being relatively weaker hubs (.036, .167 and .093) which is an indication of their relative importance to the ethical bank network. Niche ethicals have low hub and authority scores which underlines the idea that they engage with a variety of actors that are linked to their specific niche market but which are not

³⁷ This analysis uses the valued data as it should reflect the respondents view on what actors they see as important.

considered a good hub or authority by other respondents. However, National Niche Ethical 1 has a strong authority score confirming previous findings about it being seen as an important actor. Credit unions have weak hub scores indicating that they are connected to few good authorities, or in other words, pointing towards a peripheral position within the network. This claim is helped by the non-existence of authority scores which suggests that they are not perceived to be of central importance to the network. High street banks³⁸ have some authority in the network (.089 to .139). It is important to note that these values cannot be directly compared to the 43 network, however, they indicate the relative importance commercial banks are considered to have, which is likely to be linked to their dominant position in the UK banking sector more generally. Within the 191 network, National Niche Ethical 1 and the National BS 1 both have authority scores of around .140 which is comparable to high street banks, suggesting that the latter are considered as important and central to the network as are the ethical clearing bank alternatives. Nonetheless, most authority in the network is exhibited by the FSA (.302), BSA (.253), BoE (.244) and BBA (.127) highlighting the importance of both national regulators and trade associations. The lower authority scores of the ABCUL at .032 is explained by the fact that credit unions as organisations that are linked to ABCUL are not considered good hubs. Making direct assumption about the authority exhibited by the ABCUL however may be misleading.

Brokerage Scores examine the roles played by an actor who lies on a direct path between two actors (Bellotti 2009) as expressed in Gould and Fernandez's (1989) influential paper which assign the following roles:

³⁸ This figure includes Santander, which has considerably less authority at .026

| | |
|------------------------|---|
| <i>Coordinator:</i> | a, b and c belong to the same group. |
| <i>Consultant:</i> | a and c belong to the same group, while b belongs to a different one. |
| <i>Representative:</i> | a and b belong to the same group, while c belongs to a different one. |
| <i>Gatekeeper:</i> | b and c belong to the same group, while a belongs to a different one. |
| <i>Liaison:</i> | all the actors belong to different groups. |

These 5 distinct kinds of brokers – each representing “an exhaustive and exclusive partition of any actor’s total raw brokerage score” (ibid, p. 101) – relate to specific flows of information and or resources within a network and are statistically allocated so as to give specific actors “intuitive, ideal-typical brokerage role[s]” (ibid, p. 123).

The scores derived from the data on the ethical sector indicate that across the respondent network, building societies hold most brokerage positions, followed by niche ethicals. Credit unions’ brokerage scores are very small. On average the scores assign more than two roles to each building society (2.3) and almost as many (1.9) to niche ethicals but only 0.2 to each credit union. Table 5.6 illustrates that overall the most popular roles of the respondents within the network are that of the coordinator and representative, *id est* that organisations broker mostly between organisations of the same group or sharing a connection with an organisation within its network. The dominance of those roles is broadly similar in the larger 191 network. Although doing so adds cases to the less represented roles, particularly liaison (from 3 to 11), this is explained by the introduction of high street banks, regulators and trade associations which are central actors but of a different type. The fact that cases are also added to the coordinator and representative roles (23 & 24) supports the previous findings. The coordinating function within the building societies is high as they are relatively densely connected, whilst the building societies representative functions may be linked to connections held with niche ethicals. Ethical banks on the other hand are most numerous in gate keeping, *id est* in controlling

access to their networks for organisations of different types. Few credit unions seem to represent other credit unions.

Table 5.6: Brokerage scores by role for each organisation and in total

| | Niche Ethicals | Building Societies | Credit Unions | Total |
|-----------------------|----------------|--------------------|---------------|-------|
| Coordinator | 3 | 16 | 0 | 19 |
| Gatekeeper | 4 | 6 | 0 | 10 |
| Representative | 3 | 13 | 3 | 19 |
| Consultant | 2 | 2 | 0 | 4 |
| Liaison | 1 | 2 | 0 | 3 |

The relative brokerage scores show that building societies Niche Ethical 2 and Niche Ethical 3 play the role of coordinator more than expected; whilst the National Niche Ethical 1 is less coordinating than one would expect to occur by chance. On the other hand, the National Niche Ethical 1 and Niche Ethical 6 both gate keep more than expected by chance alone. Representative tasks are unexpectedly high in Niche Ethical 5 and the CUs (4.41) and to a lesser degree for Niche Ethical 3 and Ambitious BS 2. The role of consultant and liaison are both underrepresented compared to what one would expect to find in the network. This suggests that overall respondents are confined to broker in networks with the same organisational type or represent its group to organisations not part of the group. On the other hand, ethical banks tend not to consult between two ethical banks from a different group and are unlikely to liaise between actors of different organisational types. Looking at some ego networks of interest we can identify that National Niche Ethical 1 is particularly active in gate keeping between both building societies and credit unions and other niche ethicals, Ambitious BS 2 represents other building societies to niche ethicals and that National BS 2 is the typical coordinator within the building societies subculture.

Structural holes focus on the gaps in the social structures investigated through the connections between internally denser groups. Burt (1992) argues that actors who span the

holes are advantaged as they have access to more information than others. More recently Burt suggests that within organisations brokerage is needed at individual level whilst closure is required at group level (2005). The existence of a structural hole is not to say that the actors belonging to the networks on either side do not know about each other, but means that they decide for whatever reason not to entertain relationships with the other side. People are therefore “focused on their own activities such that they do not attend to the activities of people in the other group” (Burt 2002). Vlies and Maas (2009) hold that Burt’s structural holes add to the social capital literature that naturally focuses on closure as proposed by Coleman and thus focus on the density of networks which is taken to be a condition for the emergence of social capital linked to norms and expectations.

Table 5.7: Choice of Structural Holes Measure for Selected Nodes

| | Degree | EffSize | Efficiency | Constraint |
|---------------------------------|---------------|----------------|-------------------|-------------------|
| Niche Ethical 3 | 6.000 | 3.944 | 0.657 | 0.530 |
| National Niche Ethical 1 | 33.000 | 28.632 | 0.868 | 0.091 |
| Niche Ethical 4 | 3.000 | 1.000 | 0.333 | 0.926 |
| Regional BS 2 | 16.000 | 3.593 | 0.225 | 0.243 |
| Ambitious BS 2 | 19.000 | 9.217 | 0.485 | 0.198 |
| National BS 1 | 20.000 | 9.636 | 0.482 | 0.194 |
| City CU 2 | 2.000 | 2.000 | 1.000 | 0.500 |
| Employee CU 1 | 0.000 | 1.000 | | |
| Regional CU 11 | 4.000 | 3.000 | 0.750 | 0.535 |

The selection taken from the 43 network data in Table 5.7 shows that building societies have many redundant ties. That means that building societies can reach other actors by using a variety of links within the network. Thus despite generally high connectedness, building societies are not effectively connected with an *effective size (EffSize)* that is considerably lower than degree. National BS 1, Ambitious BS 2 and Regional BS 12 are more effective than other building societies with approximately 50% of ties being effective

compared to 30%. The credit unions effective size is similar to or the same as degree and as such, appears highly affected by the few connections made. Niche ethicals have some redundant ties, which could be influenced by the low degree of connections within the respondent network; however, National Niche Ethical 1 has a high degree and high Effsize (33 & 28.63) indicating ample potential to span over the holes and connect the denser structures. Likewise, *efficiency scores* normalise effective size by the actual size of the ego network, *id est* it shows the proportion of non-redundant ties and indicates total impact of the ego in the network. Building societies' efficiency is constrained by the relative high number of redundant ties indicating the closure of the network but limiting their position to take advantage of structural holes. Credit unions show high variations in their efficiency values which is again affected by their low degree. National Niche Ethical 1 exhibits high efficiency which indicates that it is in a strong position to take advantage of structural holes. Except for one, niche ethicals are more efficient than their building society counterparts suggesting that the relationships engaged in by niche ethicals are chosen for specific purposes and not because of a sense of belonging to a specific subculture, as appears to be the case for building societies.

The measure *Constraint* indicates the extent to which an ego is connected to actors that are already connected to each other. Being connected to many already connected organisations means that organisations can constrain the ego's behaviour (*freedom to act*) (Hanneman and Riddle 2005). They (2005) argue that the measure raises issues about the kind of relationships an organisation has proposing that many relationships to interrelated actors can "lose freedom of action rather than gain it". The high constraint for credit unions (.5-1) and niche ethicals (.446-.926) suggests that freedom of action is limited for those actors. This is linked to the non-redundancy of relationships coupled with a relative small

degree leading to high constraints and limiting activity. The National Niche Ethical 1 is the least constrained actor (.091) in the network suggesting a high level of freedom to act. Building societies have higher constraints to act than National Niche Ethical 1 which is linked to the high level of closure of their network and relative high levels of redundancy, as closed networks can in certain circumstances restrict freedom (Hanneman & Riddle 2005).

Overall, the descriptive statistics presented in this section provide an outline of the different roles egos play in the network with regard to their centrality, measured in terms of people considering them to be knowledge authorities, their roles in distributing information and other resources across the network and their ability to connect across specific groupings of organisations. It indicated that larger organisations tend to be considered authorities within the networks while small and medium sized organisations tend to be more concerned with the distribution of information received from authorities. The dominance of roles that are coordinative, representative and linked to gate-keeping signals that a subculture “building societies” exists that coordinates between its members and represents members to other types of organisations whilst, relatively speaking, niche ethicals tend to control access to their specific networks. The investigation of structural holes supports this as it highlights that niche ethicals, with the exception of one larger member, are constrained by their relatively specific connections, whilst building societies can choose from a wide range of options when interacting with the network. For various reasons, often because of their size, credit unions have little role to play in the network as indicated by the non reciprocity of relationships and the low degree centrality.

Testing Equivalence and Correlation

Following the investigation of structural holes and other structural characteristics of the networks, CONCOR standard *structural equivalence* (SE) highlights nodes that have common linkages to other nodes in the network. It indicates whether the grouping by type in niche ethicals, building societies and credit unions are reasonable groups according to their structural equivalence, *id est* are the nodes within the groups connected in similar ways? The idea behind testing for structural equivalence is that it is important to see which organisations are connected in similar ways, and whether the different categories of ethical banks (building societies, credit unions and niche ethicals) are comparable to one another. Borgatti highlights that structurally equivalent actors are likely to have similar “attitudes, behaviours or performance” (2012).

The SE confirms the groups and illustrates that the groups are largely structurally equivalent. The sample of respondent actors from the large network suggests that building societies are structurally equivalent except for the National BS 1 and Ambitious BS 1 which are structurally similar to Niche Ethical 5. Allowing for some variation, other niche ethicals and credit unions confirm their groupings. The structural equivalence analysis of the respondent 43 network split four times and considering transposition has an R-squared of .808, which suggests that the model fits the data well and explains 80.8% of the variance. The analysis of the entire 191 node network produces an R-squared value of .296 which is a much worse fit of the model and only explains 29.6% of the network variance. This dramatic decline of R-squared in the larger network is expected as non-respondents have no out degree; their network activity is therefore underestimated meaning they are not suitable to be tested for structural equivalence.

The standard analysis (Figure 5.2) enforces the splits into structurally equivalent groups statistically without interaction of the researcher and confirms some of the earlier findings and the overall groupings reasonably well. Building societies' relationship structures are relatively similar, *id est* they are similarly connected to certain types of actors. The Ambitious BS 2, Ambitious BS 1 and National BS 1, as well as Regional BS 7 and Regional BS 12 are structurally different which is consistent with the National BS 1's and Ambitious BS 1's limited out-degree, Ambitious BS 2's connectedness with niche ethicals and the limited connectivity of Regional BS 7 and 12 with the sector. Further it confirms some similarity between niche ethicals, particularly the group containing Niche Ethical 6, Niche Ethical 2 and Niche Ethical 3, and to a slightly less degree the National Niche Ethical 1. National Niche Ethical 1 is grouped separately because of the different connections represented in the in- and out-degree although the others mentioned are commonly connected to few building societies, National Niche Ethical 1 and the Ambitious BS 2 and to each other. Most of the credit unions form a single structurally equivalent group based on similarly low levels of connectivity. They show some structural equivalence based on their low connectivity, thus the smaller groupings are explained by having more connections. These findings support ones discussed earlier in this chapter that highlight relative component weakness in credit unions and relatively large variation across the niche ethicals grouping in terms of size and connectedness with particular reference to Niche Ethical 1 and 4. Also building societies are relatively dense whereas the structures containing credit unions tend to be of very low density.

Figure 5.2: Structural Equivalence of ethical banks

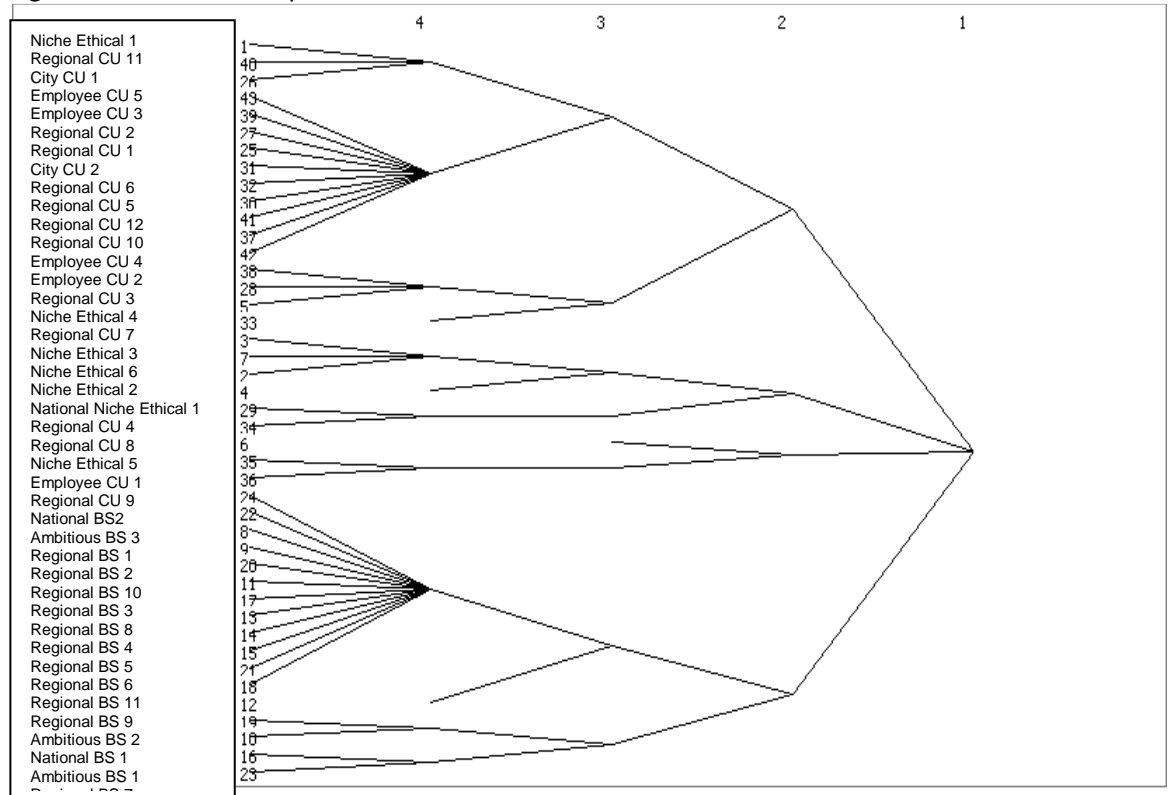


Table 5.8 provides a matrix of the correlation coefficients for a variety of variables, both individual attributes of organisations and network metrics. This table illustrates that building societies are highly positively correlated with network size, broker function, organisational size and main component³⁹ and, as expected, is correlated with density. Credit unions on the other hand are highly negatively correlated to the same variables. Niche ethicals, in contrast, are only positively correlated with the variable “national” which suggests that business models of niche ethicals cover national parameters and are not constrained by regional boundaries as is the case with credit unions and most building societies. Additionally, the positive correlation between niche ethicals and “other” supports the idea that those organisations follow more diverse business models that are neither based on employment nor geographical status. Credit unions are positively

³⁹ The main component consists of 23 actors – all building societies and niche ethicals except the Niche Ethical 4. It is labeled ‘component’ in the table.

correlated with Scotland and are the only variable that is linked to “employment” based business models. Furthermore, positive relationships between network size, density and the size of the organisation suggest the possibility that network participation may be dependent on size. Moreover, it seems that brokerage functions are also correlated with size and that brokerage increases alongside organisational size.

Table 5.8: Pearson R correlation coefficients between variables

| | Size | Density | pWeak Comp | Broker | Niche Ethical | Build Society | Credit Union | London | England | Wales | Scotland | Regional | National | Employee | Other | OrgSize | Component |
|------------------|---------|---------|------------|---------|---------------|---------------|--------------|--------|---------|--------|----------|----------|----------|----------|-------|---------|-----------|
| Size | 1.000 | .332* | .853** | .961** | -.089 | .891** | -.811** | -.104 | .250 | .340* | -.425** | .149 | .058 | -.267 | -.005 | .549** | .822** |
| Density | .332* | 1.000 | .769** | .231 | -.160 | .566** | -.438** | .059 | .137 | .040 | -.198 | -.159 | .167 | .077 | -.104 | .497** | .496** |
| pWeakComp | -.116 | -.725** | 1.000 | -.057 | .176 | -.295 | .159 | -.133 | .148 | -.152 | -.032 | -.006 | .031 | -.134 | .249 | -.338* | -.283 |
| Broker | .961** | .231 | -.604** | 1.000 | -.154 | .811** | -.684** | -.110 | .179 | .385* | -.366* | .204 | -.052 | -.203 | -.045 | .417** | .704** |
| Niche Ethical | -.089 | -.160 | -.093 | -.154 | 1.000 | -.357* | -.392** | .350* | -.030 | -.097 | -.049 | -.470** | .599** | -.178 | .350* | -.022 | .285 |
| Building Society | .891** | .566** | -.688** | .811** | -.357* | 1.000 | -.719** | -.125 | .256 | .273 | -.387* | .193 | -.020 | -.188 | -.125 | .595** | .754** |
| Credit Union | -.811** | -.438** | .747** | -.684** | -.392** | -.719** | 1.000 | -.137 | -.230 | -.197 | .417** | .160 | -.425** | .317* | -.137 | -.570** | -.954** |
| London | -.104 | .059 | -.112 | -.110 | .350* | -.125 | -.137 | 1.000 | -.263 | -.034 | -.074 | -.211 | .323* | -.062 | -.024 | -.099 | .144 |
| England | .250 | .137 | -.087 | .179 | -.030 | .256 | -.230 | -.263 | 1.000 | -.377* | -.815** | -.205 | .143 | .082 | .090 | .155 | .201 |
| Wales | .340* | .040 | -.207 | .385* | -.097 | .273 | -.197 | -.034 | -.377* | 1.000 | -.106 | .162 | -.106 | -.089 | -.034 | .315* | .206 |
| Scotland | -.425** | -.198 | .253 | -.366* | -.049 | -.387* | .417** | -.074 | -.815** | -.106 | 1.000 | .225 | -.229 | -.020 | -.074 | -.306* | -.393** |
| Regional | .149 | -.159 | .007 | .204 | -.470** | .193 | .160 | -.211 | -.205 | .162 | .225 | 1.000 | -.653** | -.550** | -.211 | -.136 | -.096 |
| National | .058 | .167 | -.197 | -.052 | .599** | -.020 | -.425** | .323* | .143 | -.106 | -.229 | -.653** | 1.000 | -.193 | -.074 | .434** | .326* |
| Employee | -.267 | .077 | .203 | -.203 | -.178 | -.188 | .317* | -.062 | .082 | -.089 | -.020 | -.550** | -.193 | 1.000 | -.062 | -.258 | -.297 |
| Other | -.005 | -.104 | .021 | -.045 | .350* | -.125 | -.137 | -.024 | .090 | -.034 | -.074 | -.211 | -.074 | -.062 | 1.000 | -.099 | .144 |
| OrgSize | .549** | .497** | -.534** | .417** | -.022 | .595** | -.570** | -.099 | .155 | .315* | -.306* | -.136 | .434** | -.258 | -.099 | 1.000 | .597** |
| Component | .822** | .496** | -.792** | .704** | .285 | .754** | -.954** | .144 | .201 | .206 | -.393** | -.096 | .326* | -.297 | .144 | .597** | 1.000 |

Discussion of Findings

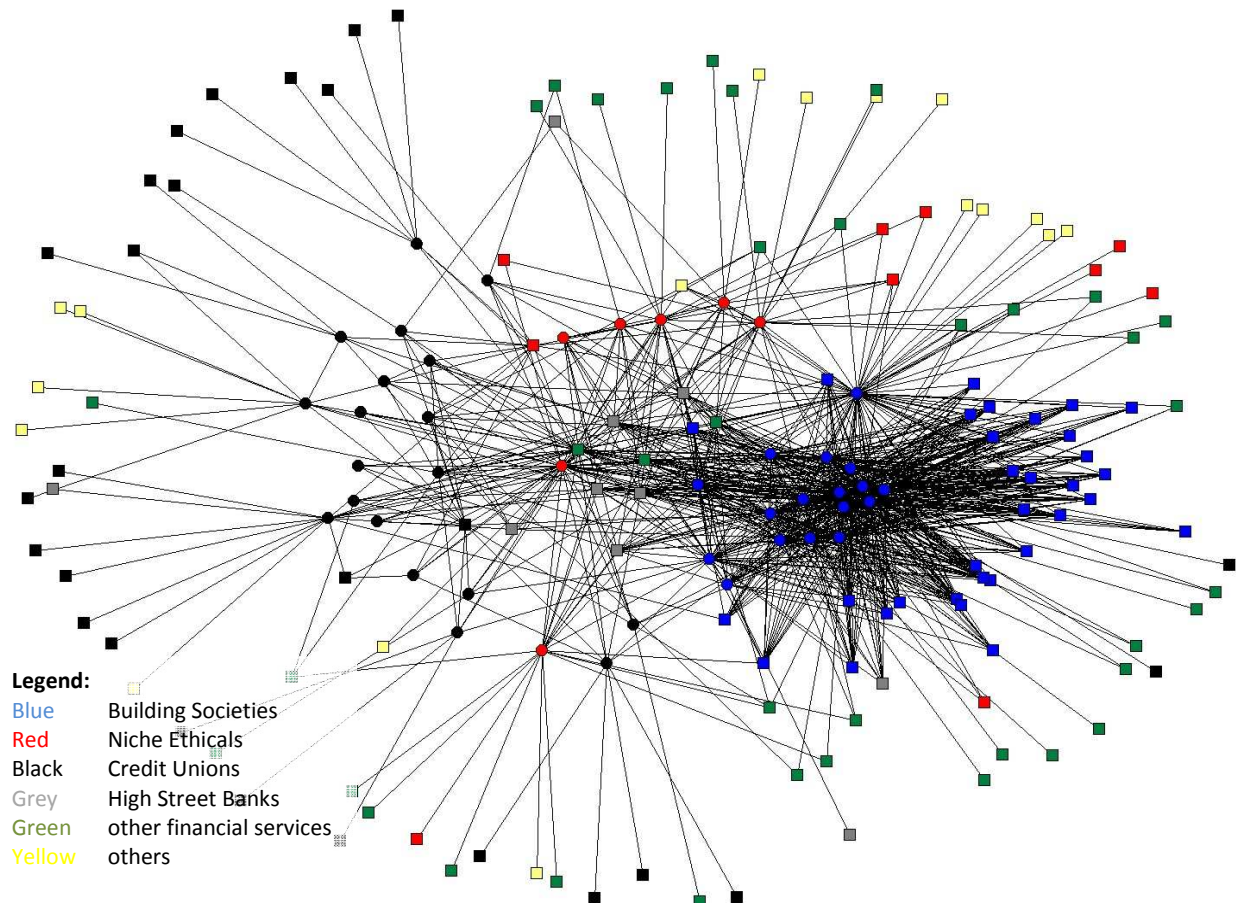
The first part of this chapter has described the structural parameters of the ethical banking sector in the UK empirically. The descriptive analysis has confirmed the typology of ethical banking as consisting of building societies, credit unions and niche ethicals with relatively strong links to national representatives and regulatory bodies as well as high street banks. It has further shown that the patterns of interaction between the respondents vary according to organisational type and size with credit unions being on the whole least connected and niche ethical showing a more individual behaviour and connectivity. Building societies on the other hand seem to have created a relatively strong subculture in which coordination and representation are two very active roles played. The descriptive analysis has also shown that the larger actors in particular have taken on more prominent roles within the network in terms of brokering information and resources between people whilst also spanning across the network and acting as authorities.

The discussion of the network findings has been structured as follows. The first section presents the findings of the network as a whole with particular emphasis on the relationships between ethical banking network and other financial and non-financial actors within the network. The second part adopts a district view to examine the relationships between ethical banks. At this point, the discussion will focus on group level measures instead of discussing the role of individual actors. Lastly, the role of individual ethical banks will be discussed reflecting the findings of their structural analysis to inform the discussion of the business models in Chapter 6. Consistent with the exploratory character of this study and the analysis of new, original relational data, as opposed to conventional survey metrics, the conclusions drawn from this analysis necessitate a degree of speculation, albeit in line with existing empirical knowledge of the sector and its operations.

Network Embeddedness of Ethical Banks

Overall, the network investigated is reasonably large, yet incomplete, which is worth noting as adding additional nodes could have a significant impact on the structure. Still, since those are actors, believed to be the most important, are present in the network, it is expected that the findings represent the structure of the ethical banking network from the perspective of ethical banks reasonably well.

Sociogram 5.1: Ethical banking network illustrating respondents (circles), non-respondents (squares) & type of organisations (coloured)



The Sociogram 5.1 illustrates the basic network structure for the ethical bank network which indicates the central position of high street banks (grey squares), the BBA and regulators (the three green squares in the centre). It also shows a clustering of building societies which shares

considerable connection with central actors including National Niche Ethical 1 and the BSA. Other financial services (green) and other actors (yellow), such as investment banks and third sector organisations, are connected to only one or two ethical banks. This suggests that their role in the network is linked to the business interests of the individual ethical bank rather than being an important network feature. To recap, the network features 191 actors which, apart from ethical banks, stem from a variety of sectors: government, financial services and the third sector. This in itself is an interesting finding as it proposes that ethical banking is reasonably well connected to mainstream banks and institutions and not a disconnected sub-sector. Although it is hard to differentiate between the kinds of relationships between the various groups, it seems reasonable to assume that links with government sponsored organisations are both legislative and lobbying ties. Links with financial services could be related to product and money market access and third sector ties are likely to be more related to ethical banks' customers. Even though findings for density suggest very little relatedness across the 191 network, this seems linked to the response rate. Indeed, the analysis highlighted two important findings.

The first of these findings highlights the dominant position of large high street banks, regulators and trade associations. The data for both the size and authorities measures⁴⁰ illustrate how important those actors are to the ethical banking network. The associated knowledge and organisational authority indicate significant influence over the ethical banking sector. Regulators are of obvious importance because of their function, but in light of this, changes in the regulatory procedures could significantly impact on the ethical banks' ability to operate effectively and sustainably. Moreover, the relationships between ethical banks and high street banks is of major concern as it mirrors the excessive power vested in those banks as highlighted in numerous recent reviews of the financial services industry (Bailey 2011; FSA 2010; HM Treasury 2009; ICB 2011a; Michie and Llewellyn 2010; Office of Fair Trading 2008). If these links are indeed related to the access to product and money markets, both through clearing and investments, than this could have a major impact on the ethical

⁴⁰ Part of the ego network measures and Kleinberg's (1999) Hubs and Authorities

banks' ethical orientation linked to commercial pressures. The findings for trade associations also point towards a position of central importance for the network. The BBA as the trade organisation for the financial services industry has half the authority score of the BSA, but nonetheless suggest that ethical banks choose to be represented by the more commercially oriented BBA. This signals an interesting dynamic towards a potential commercialisation within ethical banking as fewer ethical banks are connected to the BBA.

The dominance of some non ethical bank actors may come as a surprise; however, it reflects the oligopolistic structures of the banking industry more generally. Whilst this may be taken to suggest that ethical banking will be increasingly absorbed into commercial structures, it is important to point out that despite the connections to commercial actors, ethical banks as a whole are more likely to be connected to other ethical banks as indicated by the E-I index (-.667). This finding could be interpreted in numerous ways. It could either propose that ethical banks are more interested in being connected to other ethical banks, which would suggest that many of the relationships are required to get access to the market and treasury. On the other hand, it could reflect a political motivation of the research subjects to overstate their connectedness to other ethical banks thinking that this would reflect positively on their degree of ethicalness. However, because of its consideration of external versus internal relationships, the analysis allows no conclusion to be drawn about the attitude of ethical banks towards the connections to high street banks. Yet, it seems reasonable to suggest from the data that if alternative access to clearing and investment markets existed provided by an ethical bank, ethical banks would probably connect to this actor as it reflects the homophily tendencies of the E-I index.

A District View on Ethical Banks' Structure

As suggested in chapter 3, although the district literature often refers to network analysis theoretically (Giuliani 2011), it is not common practice. Indeed, only selective, basic SNA tools have been used to analyse the industrial district, for example centrality (Reid et al. 2008) and closeness and betweenness (Capó-Vicedo et al. 2012). The analysis of ethical banks within the context of the industrial district provides this section with a focus on the relationships between ethical banks and substructures of ethical banking. The district is characterised by a considerable variety of actors. Network size ranges from 7.7 (credit unions) to 51.9 (building societies) connections which is reflected in the group densities ranging from 2.2% to 26.9% respectively. They are located across Britain, or operate locally or regionally; they are also of different sizes. All this suggests that their business models are likely to differ significantly, a claim that will be analysed in depth in chapter 6. However, despite those differences, the district appears to be reasonably well connected with 16% of the potential relationships existing in the network (compared to 3% in the 191 network). Nonetheless, within the district differences between the types of ethical banks are prominent throughout the analysis. Before discussing the relationships between the various forms of ethical banks, the next section will summarise and discuss the findings within the ethical banking groups.

Relationships within Ethical Bank Subgroups

Building societies are likely to be reciprocally connected to other building societies (E-I index -.667, reciprocity = 67%). Smaller societies tend to distribute information and resources across the network whilst the larger societies have a certain, but not complete, authority over the kind of knowledge and resources shared. In this respect, coordination between building societies is a relatively common feature facilitated by what appears to be a dependence of smaller hubs on larger authorities, including the Building Societies Association. Although this may at first appear reasonable, smaller

societies may increasingly consider their business principles to be dominated by large societies and the BSA, which could trigger significant repercussions for the group's ability to organise and communicate internally. However, building societies are also likely to represent each other when dealing with other ethical banks and diffuse "knowledge of the own group to another group" (Kirkels and Duysters 2010). Societies may also control access to their group of building societies through gate keeping, but this occurs less often. Frequent interactions between societies enables them to easily contact one another but at the same time, this leads to network closure which restricts societies' ability to connect to actors outside the group. This ultimately limits the building societies' ability to benefit from structural holes and connect to other ethical banks.

Diverse niche ethicals have been grouped in this residual category as they are legally different to both credit unions and building societies, thus it would be reasonable to expect that they have little in common with these other organisations. The E-I index reports that niche ethicals are more likely to connect to organisations that are not niche ethicals, however, whilst on paper this indicates heterophily, this outcome is highly affected by the limited number of organisations classed niche ethical (n=18⁴¹). Indeed, within the 43 network, group density for niche ethicals increases from 7.5% to 31% which is a significant improvement linked to a more balanced distribution to the type of organisations in the network and a reduction in the possible number of ties. The quality of the connections of niche ethicals within the network however differs notably as expressed by the difference in the weak component measure. This proposes that some niche ethicals are more engaged in the network than others, particularly with regard to central actors, suggesting a variation in the ranking of the organisation. Yet, this does not lead to the same two tier structures visible in building societies hubs and authorities scores. Indeed niche ethicals are altogether weak hubs, which means they do not share information systematically. This effect may be explained by the niche focus

⁴¹ This is equivalent to less than 10% of the organisations in the 191 network, and increases to 16.2%.

of those organisations which make information more specific than in the case for the building societies. Moreover, only one niche ethical is considered an authority in the network as it received connections from each respondent group; yet, this says little about its impact on other niche ethicals. Further adding to the blurry picture of interaction between niche ethicals, the roles played by them in the network appear more diverse and the structural hole measures say little about the niche ethical group except pointing out the special position of one actor. However, the results for structural equivalence show that their relationships patterns are similar in approximately half the cases.

The analysis has shown that credit unions are relatively poorly connected with one another and the Sociogram 5.1 shows that most of their relationships are with large banks, trade associations, the FSA and Unity Trust Bank. However, considering the limited resources held by most credit unions⁴² the findings can be justified; it seems unreasonable to expect small voluntarily run credit unions to be able to establish complex network connections and more importantly, invest time and money to sustain those in the long-term on a grand scale. The structural hole measures further indicate that credit unions may have difficulty in connecting to new actors.

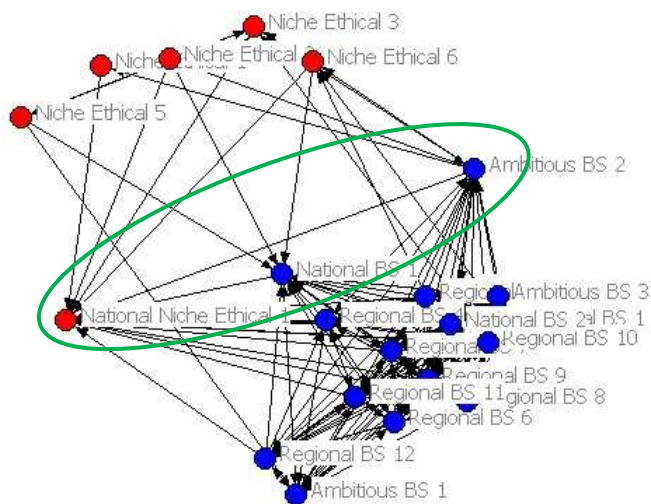
Relationships between Ethical Banks

Overall, interactions between ethical banks is relatively limited and often linked to a few actors. Moreover, the shared connections with the FSA, BoE, trade organisations, particularly the BSA and BBA, and high street banks are unlikely to encourage any interaction between ethical banks as they are either legally required or technically required so that ethical banks can access clearing and treasury. Nonetheless, it seems that some building societies and niche ethicals are more engaged

⁴² Credit unions are often community focused, relatively small and have few employees, many of whom work voluntarily

(Sociogram 5.2). Whilst this could be interpreted as a breaking down of the categorical divisions, it seems more reasonable to suggest that interaction is linked to the specific niches of the ethical banks and the unusual role of the building societies involved. However, it appears that National BS 1 and Ambitious BS 2 are particularly engaged in representing the building society subgroup and gate keeping which results in the reduction of their ability to coordinate more strongly. National Niche Ethical 1 on the other hand can more freely connect to actors across the network as explained by Burt's structural holes and is therefore more likely to act opportunistically instead of trying to encourage more relationships to be formed across the sector. This idea is strengthened as National Niche Ethical potentially hampers relationship building by gate keeping between various types of ethical banks in the 43 network and liaising between credit union and high street banks.

Sociogram 5.2: Ethical banks bridging between groups



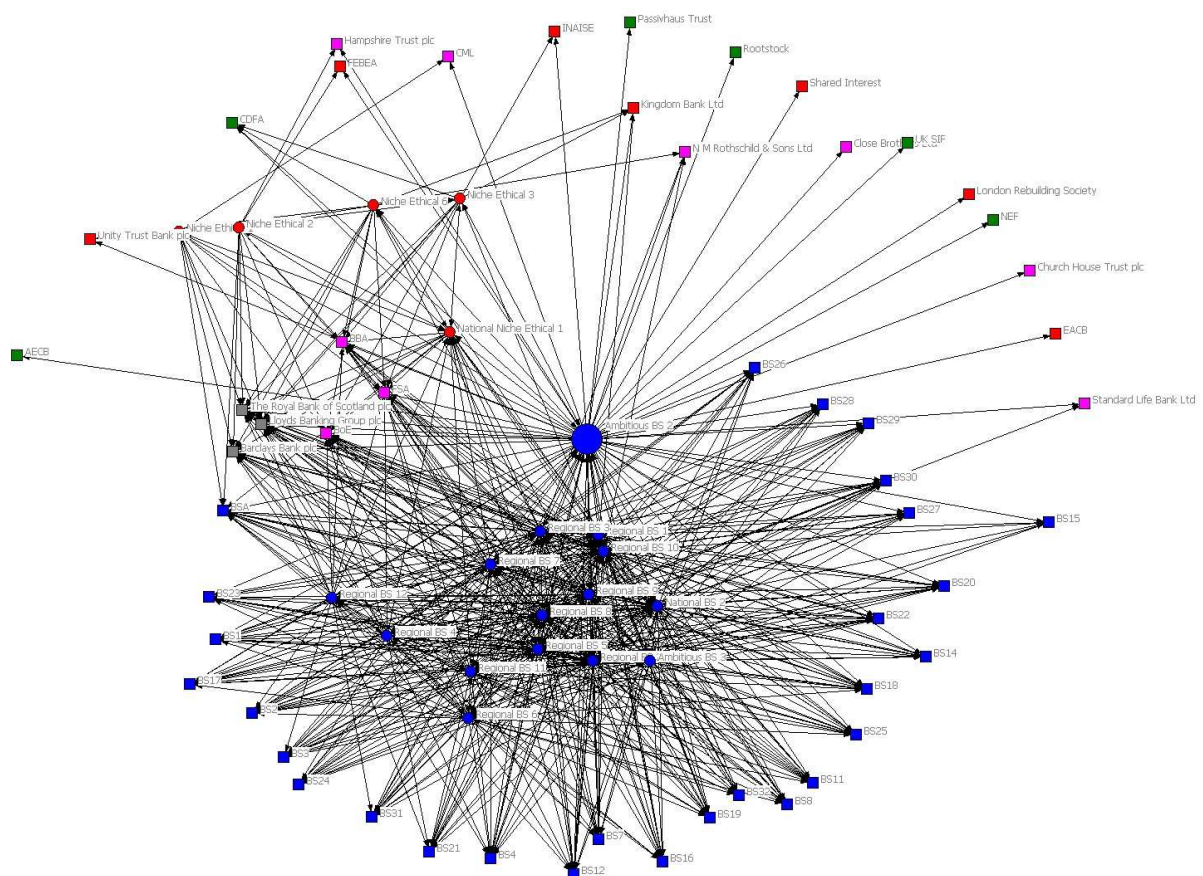
Individual Ethical Banks with Peculiar Network Positions

Three of the respondent ethical banks stand out as they behave differently to their peers. Both National Niche Ethical 1 and National BS 1 are considered the most central ethical banks based on

their in-degree centrality. Yet, the substantially lower values for their out-degree indicate that they do not identify the same relationships. The two banks, incidentally the biggest representatives of UK ethical banks, send significantly fewer ties to ethical banks than they receive (Table 5.5). By only recognising one connection, National Niche Ethical 1 is particularly poor in recognising its position considering its important position as seen from the perspective of other ethical banks. However, National BS 1 does not fare much better by only recognising 3 connections. Whilst there are potentially a variety of explanations, two seem more likely than others. One is to do with the ability of individuals to accurately report a relationship between their organisation and others. This could have led to both the misrepresentation of ties from both ethical banks' respondents, but also the overestimation of ties reported by respondents from other organisations. Representing ties accurately maybe particularly difficult in larger organisations as a variety of connections may exist that are unknown to the respondent. A second potential explanation can be found in previous research. Johnson and Orbach's (2002) work on cognitive biases in politics and Kumbasar et al's (1994) earlier work on biases in social perception have shown that actors may underestimate their centrality. Whilst this study does not directly investigate the cognitive perceptions as Johnson and Orbach (2002) did, it appears that National Niche Ethical 1 and National BS 1 underestimate their relationships with the ethical sector. Although it would have been ideal at this point to cross-reference the initial responses by resending the questionnaire to other senior managers of National Niche Ethical 1 and National BS 1 it is not focus of this study. Moreover, because of the very slow response time in filling in the questionnaire, a second data gathering could have seriously delayed the research project. Instead, the idea that large national ethical banks do not consider themselves to engage actively with the ethical banking sector as indicated by their very low reciprocity has been investigated in the interview instead and will be discussed in chapter 7 in greater detail.

The third ethical bank, Ambitious BS 2, exhibits a set of relationships that is less confined to the building society sector. Sociogram 5.3 illustrates how Ambitious BS 2 connects to a variety of actors outside the building societies' group which are not banks, providing essential services or regulation. Many of those actors are either linked to niche ethicals, for example FEBEA, INAISE and EACB, and provide an international support network that represents the interests of those niche ethicals. Other connections are more specifically linked to ecological building practices. Considering the society's focus on supporting a sustainable built environment, specific relationships like this would be expected to connect to customers and follow industry developments. However, this finding is also important as it marks a building society that focuses on a niche market and as a result bridges the gap between niche ethicals and other societies.

Sociogram 5.3: Ambitious BS 3 as bridge between building societies & other ethical banks



Conclusion

On the whole, the social network analysis has generated a mixed set of results. Findings reveal the structural parameters of the ethical banking network in the UK. It has been a useful tool in illustrating connections between ethical banks and the wider financial services industry as well as giving some ideas about clusters. However, it should be stressed that missing data and different understandings of what constitutes a relationship in this network must be considered.

The findings discussed here highlight the central role of non-ethical actors in the network. Whilst it is unsurprising that both the FSA and BoE have been identified as key actors as they play a fundamental role in the financial services sector, the relatively central role of high street banks and the BBA are less expected. The prominence of these highly commercial actors raises questions about the impact this may have on the ethical banks' ability to refrain from adapting to commercial, profit oriented practices as well as about the dominance of high street banks in the UK retail market more generally. Secondly, the research indicates that the ethical banking sector is not uniform and various substructures are visible across the sector. Building societies are particularly densely and homogeneously connected which supports the idea of them being organised as a subsector. Such a view is supported by the functions of its members as they tend to coordinate internally and represent each other to external actors. Niche ethical banks' connections appear more closely a function of the niche market they are active in, for example a niche ethical focusing on the charity sector would be visibly connected to actors that are relevant in gaining access to and knowledge about customers and other relevant actors. Ambitious BS 2 seems equally focused on connecting to a niche market which reflects its own niche position within the building society sector. Credit unions on the other hand are only of peripheral importance to the network and connected to very few players, usually the FSA, a trade association and a clearing bank and the Unity Trust Bank.

The social network analysis has established a picture of the network structures which helps to inform the more qualitative parts of this research. Overall, the findings give a more nuanced view of the various relationships found within the ethical banking sector than would be possible without it. The relationships, clusters and roles identified within the network are of particular interest to the discussion of ethical banking embeddedness and with regard to the industrial district theme.

The following two chapters will further investigate these issues by raising the findings in the interviews. Chapter 6 will pick up on findings that might be relevant in the discussion of ethical bank business models. The connections between ethical banks and for-profit banks could indicate an increase in commercial activities undertaken by some ethical banks. Moreover, it seems that niche ethical banks' connections reflect their business model in the sense that many of their connections are with organisations that are linked to the niche market. This requires further exploration as virtually all of the new ethical banks, ignoring credit unions, belong to this category. However, the social network results are more important to the discussion of the industrial district in Chapter 7. The interviews provide further information on the connections between the various actors and identify what type of products and knowledge are shared between the actors. Moreover, the interviews will raise questions about the role of central actors identified by raising the issue of competition with high street banks as well as the role trade associations have in organising the sector.

Chapter 6: Empirical Investigation of Ethical Bank Business Models

The previous chapters have described ethical banking in a number of different ways. Chapter 2 views ethical banks as organisations that increase the diversity of business models in a banking industry dominated by Plc banks, yet ethical banks themselves are considered to have broadly similar interests (social and environmental aims) and ownership structures (mutually owned or similar, but not Plc); therefore ethical bank business models are expected to reflect those similarities by being relatively similar. Chapter 3 discussed ethical banks as belonging to specific legally defined categories, either building societies or credit unions. Their engagement in relatively similar activities would suggest that they use similar business models within those categories. However, Chapter 5 indicates that ethical banks' relationships with the sector are more dissimilar as considered before. By taking this dissimilarity to be indicative of different business models, ethical banks business models might be expected to be even more diverse.

This chapter will examine the extent to which business models differ based on three dimensions. The investigation will use various types of evidence including interview data and financial analysis as well as the analysis of non-financial data to answer Research Question 2:

How does the ethical approach of the banks translate into bank objectives and performance?

- a) *What are the different strategies ethical banks use to recover costs?*
- b) *How important are ethics to different types of ethical banks – are they visible in the organisation and running of the business or an add-on to differentiate from competition?*
- c) *Who are the stakeholders and to what extent do they impact on the running of the ethical bank?*

The chapter is split in three parts that follow the ethical banks business model framework proposed in Chapter 2. The chapter will begin by investigating how ethical banks recover their costs, before examining how ethics feature in the business model. It will assess if ethics are an integral part of the business model or more of an add-on as part of the bank's marketing. The third section will discuss the role stakeholders have in ethical banks and if stakeholders can replace the control functions of shareholders in plc banks. Finally, the chapter will summarise the findings by highlighting four generic approaches.

Cost Recovery in Ethical Banks

The requirement for firms to recover costs is a feature that all firms have, no matter what type of ownership (Froud et al. 2009). Froud et al. (2009) suggest that the mechanisms behind and the extent to which cost recovery is adopted and extended into excess profitability varies substantially according to firm and ownership. But at the same time cost recovery is at the heart of a firm's economic viability. Therefore, the cost recovery function must be present and capable of being investigated in ethical banks. The investigation reported in this chapter will first discuss ethical banks within their topography before drawing on the findings in a more general format.

Credit Unions

Credit unions are historically limited in their ability to generate income and thus recover their cost. The Treasury (1999) defines their primary purpose to be to "encourage their members to save regularly and enable them to borrow at lower interest rates." The strict legal framework imposed on credit unions dates back to the Credit Union Act of 1979 and establishes them as thrift institutions

which restrict their ability to charge interest on lending and pay dividends on their savings (Ward and McKillop 2005: 481). The restrictions imposed on credit unions mean that they have fewer opportunities to generate income compared to banks. Basic features include taking deposits from and lending money to members and invest access funds in investments such as gilts and currencies. Interviewees acknowledge the restriction imposed on them and highlight the impact on their ability to cover overheads and create enough surplus profit to pay dividends to members⁴³. After 2002 credit unions were regulated by the FSA and re-categorised as Version 1 and Version 2 (V2) credit unions which gives larger V2 credit unions permission to extend their services basic savings account to ancillary services including interest bearing current accounts, mortgages and larger loans (McKillop and Wilson 2008). As a result, current accounts are increasingly used by larger unions⁴⁴ to attract and retain members by offering more comprehensive services (ABCUL 2012b).

However, the financial crisis of 2007-2010 has shown that credit unions' income generating potential remained weak overall, even for diversified V2 credit unions. Particularly, "the collapse of interest rates has had a major impact [15%] on income as it covered the overheads" as suggested by Regional CU 4. This is problematic as it coincides with a rising demand for ISAs (Employee CU 5) that offered competitive interest rates but more importantly they were considered safe deposits because of the FSA's deposit insurance. However, as noted by Employee CU 5, falling interest margins made it increasingly difficult to cover future interest payments although unions that diversified into offering current accounts, mortgages and insurance were less affected (Employee CU 5, City CU 2). Credit unions also note that the falling demand for loans over the period deepened the problems of generating income for the credit union as the interest spread is higher for lending money compared to safe investments through its treasury function. City CU 2 however notes that the diversification

⁴³ Until recently, credit unions were not allowed to offer interest bearing accounts and paid dividends to members based on their profits that replaced monthly interest payments.

⁴⁴ Two of the interviewed credit unions offer current accounts

into various bank products including mortgages and strict cost saving measures enabled it to continue to be profitable despite increasing provisions for bad loans. The Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011 (LRO) introduced in 2012 further relaxes some key restrictions and allows credit unions to expand their customer base from private individuals under a common bond to businesses and social enterprises⁴⁵ (FSA 2012a). The reform retains some features to safeguard member interests, such as a maximum rate of interest on borrowing of 2% a month (APR 26.8%) (ABCUL 2012c), whilst at the same time making credit unions more attractive for savers by scrapping the 8% cap on annual dividend payments⁴⁶. This more recent set of changes has been particularly welcomed by the larger City CU 2 as it grants it and other V2's access to products and services that enable them to diversify lending and the associated risks.

Overall, credit unions' mechanisms to generate income differ significantly. Regional CU 4 describes its model as a traditional credit union that is embedded in its region and offers a personalised service to its members. Closely aligned to the thrift concept of banking, the credit union enables members to deposit funds easily whilst making it 'marginally difficult' to withdraw funds. Employee CU 5 on the other hand has indicated that it benefits from over 90% of its members depositing savings through payroll deduction which enables the credit union to relatively accurately forecast money flows and budget accordingly. Additionally, circa 25% of its members use the unions' credit account facilities and 'quite a lot' (Employee CU 5 interviewee) of them use it as full banking service. City CU 2 increasingly moves away from providing personal services justified in a footfall from only 1.6% despite its proximity to the main shopping area. Subsequently, the union has created multiple channels to engage with customers (telephone and online banking) (City CU 2 interviewee) and thus

⁴⁵ Membership and loans to businesses and social enterprises are capped to 10% of members and loans are also limited to 10%. Up to 25% of shares can be held by those organisations.

⁴⁶ The 8% cap remains in place when a credit union is closed (unless specified otherwise by Treasury order)

moves closer towards becoming a ‘faceless’ financial services provider mimicking smaller building societies.

Income generation has been identified by the interviewees as an important part of their business model; however, because of the restrictions on generating income, cost reduction has equally been identified as a key measure to balance the books: “either [you] look at getting a mortgage permission, including with a mortgage advisor, but that is expensive, or you look at reducing costs and that is what we are doing” (Regional CU 4). Larger credit unions with full-time staff may cut cost more directly in human resources and certain expenditure items. For smaller credit unions, cutting costs is more difficult as they are often operated on a voluntary basis.

Building Societies

The relationship between customer and building society is relatively similar to that in credit unions. The societies traditionally take deposits from members and finance property purchases. Restrictions on societies’ lending and funding impact on their ability to compete and grow as funding rules require 50% of funds to originate from members shares. External sources of funding are restricted to subordinated debt and PIBS (permanent interest bearing shares). As a result, long-term growth is restricted by advances in customer deposits and reserves. Equally, restrictions on lending require that 75% of loans must be secured on residential property, owner-occupied or let (BSA 2009) which limits loans extended to private and commercial customers and has impacts on the product mix of building societies. Therefore building societies’ ability to generate income is largely linked to the health of the mortgage market (Cohen 2012).

Table 6.1: Overview of services offered by the 47 building societies

| | current accounts | Mort- gages | savings | ISAs | insura nce | Share- dealing | Financial planning | loans | credit cards |
|-----------------|---------------------|----------------|---------|------|---------------|-------------------|-----------------------|-------|-----------------|
| Top 5 | 5 | 5 | 5 | 5 | 5 | 3 | 5 | 1 | 2 |
| Top 6-20 | 1 | 15 | 15 | 15 | 13 | 0 | 12 | 0 | 0 |

| | | | | | | | | | |
|-----------------|---|----|----|----|----|---|----|---|---|
| other 27 | 0 | 27 | 27 | 27 | 13 | 0 | 9 | 0 | 0 |
| all | 6 | 47 | 47 | 47 | 31 | 3 | 26 | 1 | 2 |

(own calculations, Source: Company accounts and Websites)

Despite the restrictions on loans secured on residential property building societies diversified into new products and services as a result of changes to regulation. This development is summed up in Table 6.1 and three different approaches income generation can be identified. The first is the traditional building society which retains its focus on mortgage lending. The second and largest group of building societies has diversified into basic fee-originating insurance and financial planning products. Finally, six large building societies offer full-banking services –current accounts, mortgages, savings, insurance, investments, loans and credit cards. This indicates that building societies make different product choices and as a result income generation can differ significantly. Societies also increasingly generate fee income (Golding 2010) mirroring developments in the banking sector more generally (DeYoung and Roland 2001: 81). Overall, 31 building societies sell third party insurance products and 26 are active in financial planning which generate commission and fee income (Table 6.1). The review of the product mix indicates increasing competition between building societies for market share, mainly through diversification of the product mix with large societies increasingly entering and thus competing with high street banks. Three building societies stand out further by dealing shares, two by providing credit cards and one by offering loans not secured against residential property indicating future trends in the product mix of societies.

The five interviewed building societies' income stream will now be examined further (Table 6.2). The data shows that whilst loans fully secured on residential property remains the key source of income, commercial societies such as National BS 1 and Regional BS 1 and 10 generate approximately 5% of their income from fees and commissions. In retail banks, the rise of fee income is explained by high levels of competition and continuous demands to increase profitability (Erturk and Solari 2007) however it has also shown to destabilise earnings (Smith et al. 2003). Looking at interest receivables

as disclosed in the annual accounts divided by overall income⁴⁷, they decrease from 99% in Regional BS 3 to 92% in Regional BS 10.

Table 6.2: 2010 Income streams of interviewed building societies in % of total income before any cost

| | Regional BS 1 | Regional BS 3 | Regional BS 10 | Ambitious BS 2 | National BS 1 |
|--|------------------|------------------|-------------------|-------------------|------------------|
| Interest receivables and similar income | | | | | |
| on loans fully secured on residential property | 79.36 | 86.06 | 79.46 | 77.10 | 64.94 |
| on other loans | 15.75 | 8.51 | 9.56 | 15.50 | 21.74 |
| on debt securities | 1.05 | 4.32 | 5.04 | 3.68 | 19.97 |
| on other liquid assets | 1.37 | 2.31 | 0.73 | 7.48 | 0.89 |
| Fee and commission income | | | | | |
| Insurance and related financial products | | | 2.71 | | 5.67 |
| Mortgage related fees | | | 1.46 | | 0.53 |
| Estate agency | | | 2.11 | | |
| Valuation fees | 0.76 | | | | |
| other fees and commission | | | 1.42 | 0.47 | 0.76 |
| Other income | | | | | 0.00 |
| Rental income | 0.72 | | | | 0.11 |
| Dividend income from shares in subsidiaries | | 0.13 | | | |
| Profits on investments | | | 2.71 | 1.94 | |
| Gains from derivatives and hedge accounting | | | 0.09 | | 0.64 |
| Fee income as % of total income | 0.76 | 0.00 | 7.71 | 0.47 | 6.96 |
| Other income as % of total income | 0.72 | 0.13 | 2.80 | 1.94 | 0.76 |
| Interest receivables as % of total income | 93.79 | 99.09 | 91.65 | 98.04 | 94.35 |

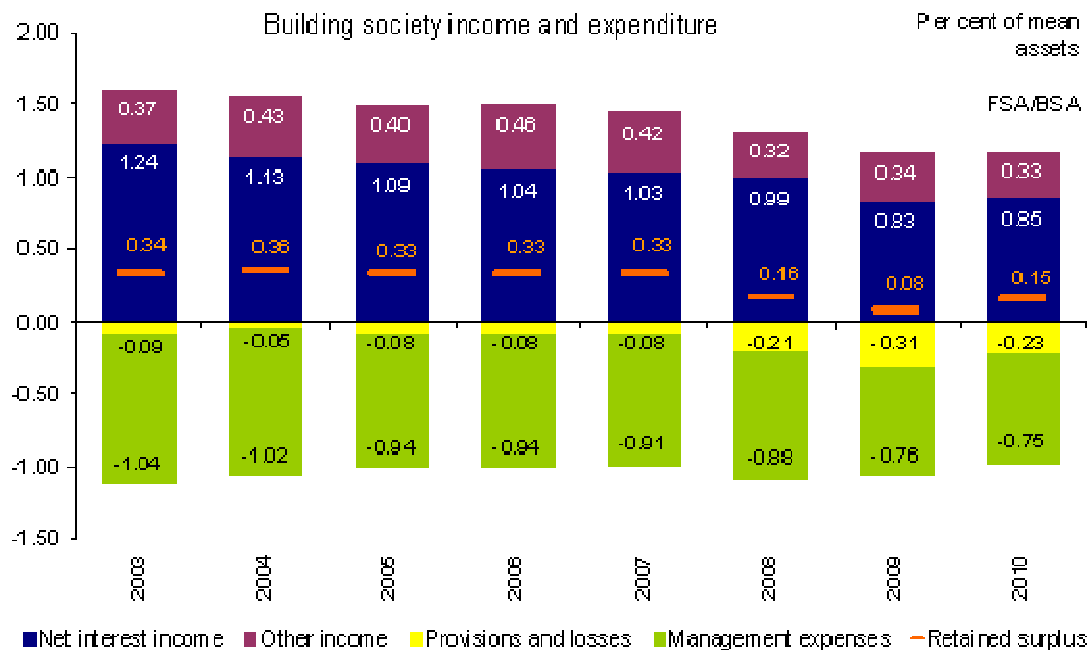
(own calculations, data from company annual reports)

Figure 6.1 illustrates the tendency of fee-income becoming increasingly relevant to building societies income streams. *Other income*, which includes fee income, has remained relatively stable between 2003 and 2010 between 0.32% and 0.46% of mean assets and peaked before the financial crisis at the high of the mortgage market. Over the same period, net interest income of assets decreased by 32% from 1.24% to 0.85 % of mean assets whilst other income only declined by 11%. Furthermore, net interest income seems to decline gradually, even in strong market conditions, whereas other

⁴⁷ Overall income is calculated as total income before interest payable and similar charges, fees and commission payable and net expenses on (derivative) financial instruments.

income seems to be a more resilient source of revenue. Figure 6.1 also shows that building societies continue to reduce their cost basis as expressed in the decline of management expenses from 1.04 in 2003 to 0.75 in 2010 which enables societies to absorb a rise in loss provisions and to remain profitable.

Figure 6.1: Building society income and expenditure



(exhibit taken from BSA 2011a)

Overall it seems that building societies adapt considerably different mechanisms to recover costs. Some appear more commercialised and offer full banking services to rival high street banks, most however limit their operations to mortgages and associated services. Restrictions to have most assets secured against residential property imposed on building societies largely retain the importance of the mortgage business amongst the societies. Instead of finding new and more exotic sources of incomes, many societies seem to adjust their cost management in tough market conditions.

Niche Ethicals

The review of building societies has demonstrated diverse cost recovery strategies despite the legal restrictions imposed which raises questions about the diversity of niche ethical banks as they are less stringently regulated. A niche market is created by a firm that cannot compete or avoids competition with other firms for a limited number of resources (Chase and Leibold 2003: 14), by creating services that are “tailored to the specific requirements of a niche market” (Osterwalder and Pigneur 2009: 21). Morris et al (2005) highlight the relationship between niche and entrepreneur and Swedberg et al (1987) cite a study by Barth (1963) that explains an entrepreneur’s focus on the *niche* market through *resource* availability, *restrictions* and *social costs*. Niche ethical banks are thus ethical banks that focus on a specific market instead of competing in standardised product markets. Oligopolistic dominance from high street banks and the established, yet marginal alternative banking sector consisting of building societies and credit unions leave little room for other actors which explains the emergence of niche ethical banks in the UK (BSA 2012d). De Clerk (2009: 7) on the other hand proposes that niche ethical banks emerged out of a recognition for a need for banks to focus on social and development issues and to improve the “quality of life including care for the environment.” The exploitation of the niche is dependent on access to specific resources, people and networks (Swedberg et al. 1987) which in turn will restrict the entrepreneur’s / niche ethical banks behaviour as there is a constant requirement for assessing the impact of an activity on social costs (Barth 1963).

However, the niche focus of ethical banks does not necessarily mean that they have exclusive access to a niche market as highlighted in Table 6.3. Whilst building societies tend to offer more advanced services with added size, niche ethical banks are generally more focused and concentrate on offering specific services that helps them to fulfil their mission. Niche Ethical Banks 1 and 5 offer retail banking services to specific communities, yet they largely refrain from cross-selling to boost their profits unless they are demanded by customers and in line with their mission as highlighted by interviewees

from both banks. Niche Ethical 3 however has the principle activity of transforming deposits into loans to charities whereas Niche Ethical 5's focus on providing loans to social and green enterprises means that the product range extends into investment banking. Still, depositors only have basic savings and investment products whereas current account facilities, personal loans and mortgages are not offered. National Niche Ethical 1 competes with high street banks and offers similar products and services. Its retail focus is also reflected in a substantial branch network.

The financial data shows that niche ethicals recover their costs effectively and especially more recent entrants have expanded significantly during the financial crisis. However, Niche Ethical 1 just about covers costs and Niche Ethical 5, historically profitable (RoA in 2009 is 0.84%), saw its operating income halve in 2010 as interest receivables declined by two-thirds. This indicates a similar dependence on interest rate spreads as seen in credit unions as their limited product range reduce income potential and asset growth. The other niche ethicals examined are financially more successful with RoAs between 0.32% and 0.44%. Yet, cost income ratios have increased for all but Niche Ethical 3 which has turned to profitability in 2011 and reduced C/I to 84% (137% in 2005). The increase in National Niche Ethical 1's cost income ratio is linked to the ongoing expansion via M&A activities which creates short term inefficiencies but offers long-term opportunities to rationalise costs (Haynes and Thompson 1999). Leverage ratios and management expense ratios vary across the niche ethicals and support the view that their cost recovery approaches differ considerably.

Table 6.3: Overview on non-financial & financial data and services offered

| | Niche Ethical 1 | Niche Ethical 3 | Niche Ethical 5 | Niche Ethical 6 | National Niche Ethical 1 |
|---------------------------|---|---|--|---|---|
| Non-Financials | | | | | |
| What is the niche market? | Provision of bank services to and for the local population and SMEs | Financing of charities and social organisations (SO) & enterprises (SE) | Offers competitive personal banking based on Christian values to further Christian charity | Provision of savings (private and SME) and loan opportunities to SME to further SE & Green Enterprises (GE) | Provision of full banking services to and for customers |
| coverage | regional | UK wide but limited to charities, SO & SE | UK wide but linked to the Salvation Army | UK and Europe, sector specific | UK coverage |
| branch network / offices | small branch network | no branch, incl in offices | no branch, incl in head office | no branch, incl in offices | sizeable branch network (expanding) |
| internet / phone banking | multichannel as support | phone banking is central | internet / phone banking central | internet / phone banking central | multi channel approach |
| owned by | Trust | Foundations (ord. and preference shares), a bank (preference shares) and subordinated loans | Trust | Trust & Depository Receipt Holders | Member organisations and customers |
| business banking | yes, SME | limited | yes, SME | yes | yes |
| services offered | | | | | |
| current accounts | x | | x | | x |
| savings | x | x | x | x | x |
| mortgages | x | | x | only commercial | x |
| loans | x | x | x | only commercial | x |
| credit cards | | | | | x |
| insurance | | | | | x |
| investments | | | | x | x |
| capital raising | | | | x | |

| offshore Banking | | | | | | x |
|---|--------|-----------|--------|---------|-----------|---|
| Financials | | | | | | |
| Size | small | small | small | medium | large | |
| Growth 2007-2010 | 12.06% | 61.31% | 5.13% | 117.66% | 248.30% | |
| Profit/assets 2011* | 0.18% | 0.44% | 0.09% | 0.41% | 0.32% | |
| Cost/ Income | 91.40% | 129.59%** | 69.70% | 75.90% | 71.67%*** | |
| Change in C/I 2007-2010 | | 52.98% | | -0.59% | -12.87% | |
| Man Ex / Mean Assets 2010 | 3.12% | 4.41% | 0.81% | 2.23% | 1.25% | |
| Leverage Ratio 2010 (Reserves, Sub debt) | 8.68 | 5.62 | 9.64 | 25.39 | 20.99 | |

* building societies profit/mean assets were 0.18 in 2011, 0.37 in 2008 and 0.36 in 2006 with peer group 3 (0.25, 0.44 & 0.42) consistently beating both peer group 1 (0.08, 0.32 & 0.33) and peer group 2 (0.22, 0.34 & 0.34)

Triodos figure is an estimate based on half year figures

** first profit made in 2011, so considerable improvement made

*** post merger

(own calculations, Source: Company accounts)

Discussion

In Plc banks, profitability is the key performance measure and its distribution is clearly and hierarchically managed by investors interests (Berle and Means 1993; Jensen and Meckling 1976): by implication, investments are made under the condition that they improve the ability to earn excess profits in future (Coase 1937). However, although profitability is an essential part of a firms long-term sustainability, the maximisation of shareholder value is increasingly considered to be unsustainable (Froud et al. 2009; Lazonick and O'Sullivan 2000) and to have a negative impact on people and planet (Chomsky 1999; Elkington 1998).

Ethical banks do not have shareholders which means that the demands for profits changes (Froud et al. 2009) as dividend payouts are limited or benefit customers directly. Theoretically, the mutual ownership of most ethical banks aligns owner interests with those of customers. The *margin advantage* of the mutual firm gives a competitive advantage to mutually organised banks according to Llewellyn (1996: 60) as the lack of external capital reduces the cost of capital raising. The demand for ever increasing profits are negotiated by the interest of members to receive good rates and long-term stability. However, the investigation of cost-recovery mechanisms in ethical banks has shown that mutuality is only one factor in this equation. The diverse strategies employed by the different firms indicate that ethical banks increasingly compete for market share by either choosing a focused niche approach or by offering similar products to market leaders but attempting to undercut their cost or differentiate themselves as classically illustrated in Porter's *Generic Strategies (1980)*. The member ownership also has higher demands for stability and security attached to it which limits risk taking and enabled most ethical banks not to require government support in the recent financial crisis.

Because of the impact that shareholder value ideology has on business elites, some interviewees⁴⁸ have suggested that ethical banks are considered to be less sustainable or less sophisticated when compared to high street banks as they do not focus on profitability. However, when reviewing profit to asset ratios of high street and ethical banks, it appears that overall profit making is not that different. Although ranges for both niche ethical (.09% to .44%) and building societies⁴⁹ (-1.23 to .83%; average is .18%) reflect different performances, UK high street banks' net profits to assets ratios are equally diverse [HSBC .7% (2011); Barclays .24% (2011); RBS 1.13% (2011; .41% in 2007⁵⁰) & Lloyds -.27 (2011; .295% in 2009)]. The performances of Plc banks appear however superior as they target high returns by minimising equity invested and increase risk taking which has led to the collapse of Plc banks during the financial crisis (Elliott et al. 2012; Engelen et al. 2010).

Part of the financial success of ethical banks can be explained by the rise of non-interest income which balanced the decline of income made from interest spreads indicated in Table 6.2 and Figure 6.1. The increase reproduces developments in the banking industry more generally and niche ethical generate substantial income through fees and commission. National Niche Ethical 1 for example generates 11.1% of overall income from non-interest income which is twice the amount of National BS 1 of 5%. Niche Ethical 6 has non-interest income amounting to 25.5% of overall income largely generated by management fees from its investment activities. The rise of non-interest income has received considerable attention and while it is acknowledged to stabilise profitability and income, it has also been shown to increase risk-taking as income is not risk-adjusted (Stiroh 2004). Lepetit et al (2008) go further and suggest that whilst expansion of non-interest income increases risk levels compared to more traditional intermediation, it is more risk inducing for small

⁴⁸ National Niche Ethical 1, National BS 1 and Ambitious BS 2

⁴⁹ Taken from KPMG Building Societies Database 2011

⁵⁰ Calculation based on profit in the most recent year

banks compared to larger competitors which raises concerns about the potential effects this may have on ethical banking in future.

Overall the review of cost recovery mechanisms used by ethical banks is diverse. Some move into new product and services to offer a more complete product range with which they compete against retail banks; others are increasingly focused on niche markets and adjust their product mix accordingly. Although they differ in the extent to which they make excess earning, they are largely profitable and recover their cost; however, as other banks they are dependent on interest spreads for their income and fee income which largely depend on externalities.

Ethics at the Core: Social Value Creation in Ethical Banking

In addition to cost recovery which is discussed by Froud et al (2009), Chapter 2 also raised the issue of how ethics are integrated in the business model which is raised by De Clerk (2009). He suggests that ethical banks feature “ethical and sustainable developments at the core of their mission, ambitions and practices” (2009: 209) which raises further questions about how else ethical banks use ethics in their business models.

Aims: Do Organisations Have a Clear Mandate of What They Want to Achieve?

Ethical banks employ a variety of cost recovery approaches as part of their business model and their aims are similarly diverse but can be grouped in three categories: 1) social value creation with specific focus to environmental sustainability and charities, 2) member focus, and 3) a compelling alternative to high street banks.

Organisations that fit into group one are Niche Ethical 3 and 6, and Ambitious BS 2 as they appear to have clearly defined missions that focus on the creation of social value. Niche Ethical 3 is focused on providing funding for charities and other social value organisations who address social problems. It is doing so by encouraging social organisations to be more transparent and by assessing the impact of investments. Niche Ethical 6 follows the triple bottom line principle of people, planet and profit and aims to have an active positive impact on society, environment and culture. It is doing so by transforming customer savings to fund lending to social and environmental businesses organisations as well as managing investments in *SRI*s⁵¹. Ambitious BS 2 specifically focuses on the built environment and supports and promotes sustainable communities and ecological building practices. Despite the different markets, the three ethical banks' aims have clearly defined goals that aim to create a positive change. Their aims are specific enough to enable impact assessment through different measurements such as loans extended to charitable, social and green organisations, mortgages underwritten to fund environmentally sustainable private and commercial buildings and investments in and support of domestic and commercial renewable energy projects. While they recognise the need for growth and profitability to be sustainable, they see both as a means to an end, *id est* to fulfil their mission (De Clerk 2009: 7f) as two of the CEOs interviewed highlight:

“We want to have the right members with the right impact, not customer acquisitions as other organisations do. We need members to join us because they agree with what we do. We don't have growth targets, and yet we had record lending numbers last year,”

“[...] to fulfil our developmental banking role, do we need to be any bigger? There is no point in being big for the sake of being big”

⁵¹ Socially Responsible Investments refers to a type of investment that excludes investments if they are found to have a negative impact on society and environment, or promotes investments if they are found to have particular positive impact on society. They are distinct to ethical banking as they aim to influence firm behaviour directly through the provision of capital (De Clerk, 2009: 5f)

Member-focused ethical banks have less defined missions which date back to the building societies movement and the credit union movement of the 19th century. They aimed to provide mortgages for home buyers and savings accounts at a time when many communities were excluded from finance (Bevilacqua 2012). This group consists largely of credit unions and building societies⁵², as well as Niche Ethical 1 and Niche Ethical 3. Products and services offered have developed in post war industrialised societies but their focus on members has remained relatively similar (Oliver Wyman 2008):

“Credit Unions are member-owned democratic organisation [... and] the Board and senior management will ensure that the credit union provides an efficient and relevant service to members [...] plus a commitments to upholding the values of the Objects and Social Goals of the credit union...”

(ABCUL 2012d)

Building societies are equally keen to showcase their interest in, and fair treatment of members. They also highlight their investment in the local communities through charitable donations. Similarly Niche Ethical 1 points towards its founding principle of providing local workers with saving opportunities and highlights its interest in providing banking services to SMEs to benefit their communities. Niche Ethical 3 on the other hand specifies that its key objective is linked to its owner and largest customer whilst providing efficient and personal services in accordance to its Christian values to its customers. Regional BS 1 also follows a different approach, which whilst being relatively commercial in character, it focuses specifically on customers whose mortgage application has been rejected by mainstream lenders. They “look for interesting cases for lending and productise those” if it is economically viable to do so.

⁵² City CU 2, Regional CU 4, Employee CU 5, Regional BS 1, Regional BS 3, Regional BS 10

The commercial character is more pronounced in the third category which includes ethical banks that view themselves as alternatives to high street banks including National BS 1 and National Niche Ethical 1. They pride themselves in being different to high street banks by highlighting their values and principles⁵³, customer focus and profit share, low costs and a risk adverse investment strategy. However, while retail banks are very similar indeed, the alternatives benefit from supporting community development and environmental causes. Ethical banks in this group have clearly defined interests in expanding their market share. They acknowledge that they are in direct competition with high street banks: “We would see the main banks as our competitors, not other building societies” and consider a larger ethical banking sector to be critical to making a positive impact on banking as highlighted by National Niche Ethical 1 executive:

“ [We are] ethical and take ethical banking main stream. [... Other ethical banks cannot] provide wider ranges of services and compete effectively”

Products, Services and Behaviour: Focused on Mission, or Focused on Competition?

Well formulated mission statements, aims and goals enable ethical banks to embody ethics and merge them into a corporate entity (Balmer et al. 2007). They have been linked positively to corporate financial performance (Pearce and David 1987); however, Galbreath (1989: 114) recognises the need for products and services to be aligned with the mission. Hence, products traded by ethical banks must be ethical as specified by the mission.

Some ethical banks are more vocal about their ethics, yet in doing so, they risk disappointing customers and members more if they fail to fulfil their promises. The high risk of losing custom could however have a positive impact on product and services choices to be chosen more carefully

⁵³ Values and principles are often attached to negative lists and restrictions of what business they can do and whom they can have as a customer or invest in.

considering the potential impact on their overall business. Ambitious BS 2 has channelled its ecological focus into products that benefit mortgage customers directly⁵⁴ if they built or renovate property to eco-standards. Savings products are also ethically oriented, transparent⁵⁵ and offer a guaranteed minimum interest of 1% and specialist mortgage products aimed at organic and social organisations, housing associations and cooperatives reflect the social and environmental interests of the ethical bank. Niche Ethical 6's product choice is reflected in its ambition to connect savers and social entrepreneurs and organisations. Although reliant on support from savers and investors, the savings products offered may be less interest rate competitive. However, the bank details all loans and mortgages and attracts investors that are keen to invest in socially sustainable investments but are cautious about doing so with non-transparent high street banks. Its investment products also generate funding for projects that might be considered not commercially viable elsewhere, thus advancing the social enterprise sector within the UK. Niche Ethical 3 follows a similar approach and offers saving accounts to customers interested in financing charities and social organisation. Transparency is again key to its approach as reflected in the listing of all borrowers as well as all investors with a stake in the company. They compete with other banks by being transparent and offer specialist products, but they lack interest rate competitiveness. One executive (Niche Ethical 6) highlights that "...UK savers are much more rate sensitive..." compared to their European counterparts; nonetheless, their positive organic growth rates throughout the financial crises⁵⁶ suggests that there is a sizeable market interested in their alternative ethical concepts. To strengthen transparency and open dialogue, the banks actively encourage savers and borrowers to meet on annual or more specific events which can be an advantage over more anonymous approaches by high street banks.

⁵⁴ The mortgage products offer discounts to members that increase with every energy rating achieved.

⁵⁵ Banks with bad track records, such as irresponsible lending, are excluded from counterparty transactions.

⁵⁶ 27.8% for Ambitious BS 2, 61.3% for Niche Ethical 3 and 117.7% for Niche Ethical 6.

The *Vision for Mutual Lenders and Deposit Takers* outlines that “mutuals exist to help people to buy their homes and to build their savings. [...] based on mutuals’ long-term relationship with their customers as owners” (BSA 2011c: 3). The products offered should reflect this mission and focus on long-term relationships and indeed, the summary of building society products in Table 6.1 highlights that most societies retain the focus on offering savings and mortgage products with 2/3s offering home insurance to provided further services to members. Historically, building societies were cheaper than high street banks in providing loans and offered higher interests on deposits⁵⁷ and operate on lower net interest margins. Overall satisfaction levels seem higher whilst FOS complaints are considerable lower compared to commercial banks⁵⁸ (BSA 2011c: 20-21). Mostly larger building societies have diversified into current accounts, credit cards and financial planning and services appear more similar to those offered by high street banks as suggested by De Clerk (2009). However, it is important to not romanticise the historic role of societies but to consider current market conditions and demands. The products offered reflect a prudent and long-term oriented strategy at building societies as portrayed in their missions, yet they lack the specificity of earlier discussed examples. Developments are similar in both larger credit unions investigated and Niche Ethical 1 and 5. Credit unions have pushed for restrictions on services, products and the common bond to be lifted through parliamentary intervention⁵⁹. The changes can increase competition between larger credit unions and smaller building societies as services offered by either group are less distinct and the common bond is weakened. Smaller credit unions may chose to retain their links to local communities and continue to offer only basic products. Niche Ethicals 1 and 5 on the other hand are restricted by ownership. Niche Ethical 1’s trustees have a clear mandate to look after customers and offer their support on a voluntary basis. The bank services⁶⁰ focus on core bank products and are

⁵⁷ Since 2009 high street banks have reversed this by competing more strongly for customers.

⁵⁸ Additionally, complaints upheld are 22% for building societies (52% for banks).

⁵⁹ Legislative Reform (Industrial & Provident Societies and Credit Unions) Order 2011 (from here on LRO 2011).

⁶⁰ Niche Ethical 1 offers a variety of savings and mortgage products, current accounts and personal loans.

offered to locals and local SMEs on a not-for-profit basis. Services offered by Niche Ethical 5 are influenced by Christian values but the bank fulfils its mission to provide efficient services within the framework set by its charity owner as indicated by an executive: “ [W]ithin our target we want to be seen as a very good bank.”

So far, ethical banks have aligned their product choices with their missions and aims, but large ethical banks that see themselves as alternatives to high street banks should find this more difficult. They compete directly with commercial banks which means they potentially risk adopting practices and procedures that appear to be more efficient, profitable and competitive but at the same time can severely undermine their ethics. For example, whilst it was seen as a profitable endeavour by high street banks, the mis-selling of payment protection insurance (PPI) by ethical banks is a breach of the trust relationship, yet more recent growth at National Niche Ethical suggests that customers still consider the bank an ethical alternative. The ethical credentials of both National BS 1 and National Niche Ethical 1 are still reasonably well rooted in the organisations’ procedures despite being less focused on customers and creating social value. Their members are more satisfied (Table 2.3) and complaints as percentage of overall complaints are below their market share, both including and excluding PPI claims (Table 6.4).

Table 6.4: Analysis of customer complaints for large ethical banks and high street banks

| Bank | Complaints* | PPI | Market share PCA** | market share PCA/SA/MA | %complaints of overall complaints | %complaints excl PPI*** | Source of complaints |
|-----------|-------------|-------|--------------------|------------------------|-----------------------------------|-------------------------|----------------------|
| Lloyds | 20310 | 11585 | 30 | 25.00 | 36.60 | 32.11 | B&C + PPI |
| RBS | 6500 | 1837 | 16 | 13.00 | 11.71 | 17.16 | B&C + PPI |
| HSBC | 6190 | 4371 | 14 | 11.00 | 11.15 | 6.69 | PPI (+B&C) |
| Barclays | 12273 | 7196 | 13 | 11.00 | 22.12 | 18.68 | PPI + B&C |
| Santander | 6200 | 1040 | 12 | 14.00 | 11.17 | 18.99 | B&C |
| Nat BS 1 | 2513 | 1778 | 7 | 8.00 | 4.53 | 2.70 | PPI |
| Nat NE 1 | 974 | 243 | 3 | 3.00 | 1.76 | 2.69 | PPI + B&C |
| Nat BS 2 | 456 | 243 | 1.15 | 1.38 | 0.82 | 0.78 | PPI |
| New BS | 76 | 27 | 0.2 | 0.27 | 0.14 | 0.18 | |

(own calculations, data source: Ombudsman and OFT Report 1282)

Still, both organisations are in danger of becoming too much like high street banks. Their mission is to serve their members guided by investment principles and codes of practice, but members also want a one-stop solution to their personal finances (Treasury 2011) which means that large ethical banks adopt full banking solutions of high street banks. National BS1 focuses on providing good customer services only, but National Niche Ethical 1 has a more stringent ethical policy that sets out lending practices and financial inclusion policies to provide basic bank accounts to those who are rejected from high street banks. Thus, although their ethical stance is less explicitly oriented towards creating positive change and developing society, they offer an alternative to high street banks by being more focused on financial inclusion and customer needs.

Table 6.5: Selected ethical consumer scores for banks

| 0-5 | 5.5-10 | 10.5-15 | 15.5-20 |
|-----------------|--------------------------|----------------|-----------------|
| Barclays | National Niche Ethical 1 | | Ambitious BS 2 |
| HSBC | Northern Rock | Ambitious BS 1 | Niche Ethical 3 |
| Lloyds | Virgin Money | National BS 1 | Niche Ethical 6 |
| RBS | National BS 2 | | |
| | | Regional BS 10 | |
| | | Regional BS 12 | |

(Source: *Ethical Consumer* 2012)

The different approaches of ethical banks' product choice are reflected in the selected saving accounts' ratings by the *Ethical Consumer* (Table 6.5). It shows that ethical banks are perceived as more ethical than high street banks, yet the differences amongst ethical banks are considerable. National Niche Ethical 1 is rated low because of its owner's activities but the *Ethical Consumer* notes that the "relatively low scores... is more than compensated for by their sector-leading approach" (*Ethical Consumer* 2012: 13). Overall, it seems reasonable to suggest that ethical banks' missions restrict product choices and retain focus on member interests; yet, the degree to which this is the case can differ significantly.

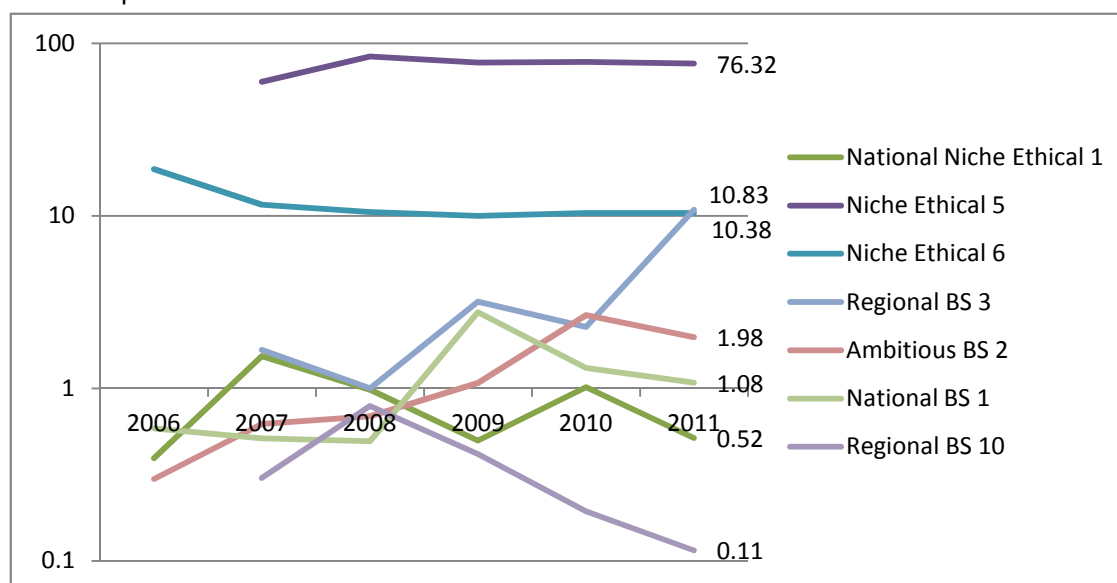
Profits: How Do Profits Support the Mission and How are They Distributed/Reinvested?

We know from what has been discussed so far that ethical banks differ in their approaches to cost recovery and product choices thus it is not surprising to see that the use of profits is similarly different. One interviewee suggested that his bank is “not interested in profitability for profitability’s sake” but they use it to build capital reserves instead (Niche Ethical 1) whilst another interviewee (Regional BS 10) found that “giving members a dividend” to be the justification for making profits. Interviewees from Employee CU 5 and City CU 2 similarly noted that profits are paid out as dividends⁶¹. However, the use of dividend here is not comparable to dividends being paid out to investors as they are limited to customers who also own the ethical bank and remain in the community. Other ethical banks consider charitable donations as a contribution to their ethicalness; however, the analysis of charitable donations (Figure 6.2) paints a more varied picture. Niche Ethical 5 is the most generous donor, but it is required by statute to donate at least 75% of its profits to its owner charity. Niche Ethical 6 appears to have charitable donations adjusted at circa 10% which is considerable higher than other ethical banks. Building societies⁶² and National Niche Ethical 1 show little interest in charitable donation. Whilst the interviewees did not raise this issue, one of the reasons behind the lack of donations is that it is not part of the mission and member focus of mutuals. Moreover, because donations are frequently used by commercial actors and sold as part of their CSR activity, this may discourage ethical banks from an overt role as donor in an attempt to distance themselves from mainstream CSR programmes.

⁶¹ Credit unions were, until the LRO 2011 passed, unable to pay interest and therefore used dividends paid out from profits to pay interest on savings.

⁶² Regional BS3’s increase in charitable donation is largely linked to reduced profitability in 2011 whilst donations were kept stable,

Figure 6.2: Charitable donations as % of profit at year end by ethical banks as disclosed in their annual reports.



(own calculations, Source: Company accounts)

Interviewees mentioned repeatedly (National BS 1, Niche Ethical 1, Regional BS 3 and 10) that profits are the main source of capital available for future growth. Most societies are dependent on reserves built from profits as they do not use subordinated debt or PIBS⁶³ to raise capital (see Table 6.6). An executive of Regional BS 1 confirms this: “Profits are used to build new capital. We are not paying out profits to members.” Some niche ethical banks also reinvest most profits into building up capital reserves, for example Niche Ethical 1 is investing all but a circa 10% charge for the pension scheme into its reserves and National Niche Ethical 1’s reserves are made up to 80% from retained earnings. Using profits to shore up capital ratios is in the members’ interest as it represents the ethical banks’ prudent and risk-averse approaches to banking that makes them more resilient in turbulent market conditions as well as funding future expansion whilst remaining independent from outside control. Although a common feature of plc banks, both credit unions and some niche ethical banks pay dividends. As mentioned earlier, member owned credit unions use dividends to cover the interest payments to a maximum of 8% APR⁶⁴ (McKillop and Ferguson 1998), thus in effect the

⁶³ Permanent Interest Bearing shares

⁶⁴ Under the LRO 2011, the limitation has been removed FSA (2012)

dividends are the interest paid on savings. Further, Niche Ethical 6 pays out between 50-70% of its profits to its owner, a trust, who in turn compensates the depository receipt holders who have no voting rights and therefore no decision rights and control over the banks strategy safeguarding the bank's social and environmental interests.

Table 6.6: Capital funding sources⁶⁵ of 48 UK building societies

| Reserves | #⁶⁶ | Subordinated Debt | # | PIBS | # |
|--------------------|-----------------------|--------------------------|----------|-------------|----------|
| < £25 mio | 22 | < £5 mio | 4 | < £50 mio | 4 |
| £25 mio - £100 mio | 14 | £5 mio - £50 mio | 5 | > £50 mio | 6 |
| > £ 100 mio | 12 | > £50 mio | 7 | | |

(Source: KPMG Building Societies Database 2011)

Overall, profit distribution in ethical banks is more variable than in Plcs controlled by shareholder interests. Ethical bank profits are mostly retained and added to reserves, or donated; however, the few cases that see profits distributed to depository receipt holders, have significant control mechanisms in place to reject shareholder demands for higher returns. Profits are therefore important to the banks future ability to develop and to absorb shocks.

Size: Can Big be Ethical?

The question about whether big organisations can be ethical is complex and has emerged predominantly from the interviews. Within this discussion two opposing views on ethical banking emerge. The first idea centres on ethical banking as providers of niche services. Such view accepts that the overall market share and impact will be limited and because it targets specific markets, it may remain largely unknown to the public. In the second view, larger ethical banks describe a need for ethical banking to take a bigger market share to drive retail banks into adopting more ethical services themselves to change the culture altogether towards becoming a customer focused utility.

⁶⁵ All PIBS holders also hold subordinated debt.

⁶⁶ How many building societies have tapped into what type of capital funding sources to borrow what amounts?

Having discussed social value creating ethical banks above, the question that will be discussed here is not only relevant for large ethical banks themselves, but connected to the growth-oriented economy they operate in. Size and growth are key ideas that, supported by government and economic elites, shape and guide economic policy and firm behaviour. Whilst some attempts have been made in investigating the relationship between firm size and ethicalness of the firm (Murphy et al. 1992; Orlitzky 2001; Spence 2002; Stanwick and Stanwick 1998) they fail to distinguish adequately between ethics and issues of corporate social responsibility (CSR) and the related corporate social performance. Thus it is entirely plausible that firm size positively influences corporate social performance; however, may be linked to the formalisation of ethical principles through CSR and similar techniques which is more likely to be feature in larger firms (Adams et al. 2001: 209). This relationship between size and ethics is important as it is questioned particularly by smaller ethical banks. Broadly speaking, they are concerned about the formalisation of organisational procedures in large firms (Hall et al. 1967) and changes this may have for employees to be able to accommodate individual decision.

Niche ethical banks were particularly vocal in this discussion and have argued that ethical banking is niche and can “relate to many things. There are social, religious and charitable aspects” (Niche Ethical 5 executive). Whilst executives from Niche Ethical 3 and Ambitious BS 2 agree, they explicitly argue that size is detrimental to ethical banks’ ability to sustain their ethical stance:

“The best example is Credit Agricole. As they grew the economies of scales, growing up market with your customers, they completely lost touch with their grass roots. Are they still an Ethical Bank? Probably not! The Co-operative Bank found it had secondary housing in its books. [...] There are things that are very ethical about the Co-op [...] but I think people think of them more as a responsible commercial bank rather than an ethical bank.”

(Niche Ethical 3 executive)

“[The Co-op is] much larger in size and the question is how big can you get before you can’t integrate these values properly?”

(Ambitious BS 2)

If ethical banks are restricted to niche markets, larger diversified banks are excluded from the community by smaller, more focused ethical banks. Both larger ethical banks interviewed for this study recognise that they are different to the smaller banks’ approaches but they are keen to grow further as they aim to be an alternative to high street banks. National BS 1 and National Niche Ethical 1 exploit their connection with ethical banking to market their ethical views to potential customers: “Customers like the idea of ethics in banks, the membership ideas as well as their social engagement” (National Niche Ethical 1). Their prudent business practices and customer oriented policies have created bank business models that are competitive, sustainable and risk-adverse and add to the ecology of banking by giving customers the opportunity to bank more ethically compared to high street banks. More importantly, they offer full banking services whereas small ethical banks often focus on few products. However, the public seems also concerned about ethical banks claims to behave ethically and focus on customers. A 2012 Mintel study (2012) highlights that 60% of respondent Britons consider “green and ethical ‘talk’ by finance [as] a PR stunt” suggesting that customers are disoriented and confused about the products and services offered by banks. Nonetheless, Clark (2012) highlights that both the Co-operative Bank and Nationwide were the only banks “more trusted than distrusted by those consumers most interested in the idea of ethical financial services.” Thus whilst there are obvious concerns, the public differentiates between commercial and large ethical banks and people consider ethical banks to be more ethical.

Overall, the discussion has shown that two guiding ideas exist about the importance and value of ethics to their business. The first views ethical banks as an alternative to high street banks. Although

they operate in a relatively commercial way, they are more focused on customer needs compared to high street banks. Therefore, although it is clear that large ethical banks are not as ethical as smaller organisations, they are more ethical than high street banks. The second view shows views ethical banking as niche. Whilst the niche approach enables ethical banks to achieve their social and environmental targets, and to communicate this more clearly and transparently, it ignores customers' interest accessing full banking services provided by one bank. Other ethical banks, including building societies and credit unions do not promote a particular set of ethics, but because they are focused on their members they tend to be more ethical compared to high street banks who tricked their customers into buying products and services that were not required or disclosed.

Stakeholder Engagement or Board Hegemony – Can Stakeholders Replace Shareholders

Analysing stakeholders is equally important to understand the variety of business models, whether in the context of for-profit firms, or in this case, a diverse group of ethical banks. Froud et al (2009) highlight that constant changes to business principles, particularly the dominance of Anglo-American corporate governance, continuously redefines “the constellations of key stakeholders whose demands and expectations in turn influence the structure and goals of the business model” which has repercussions for private and public businesses. Ethical banks lack both shareholders⁶⁷ and the public scrutiny of public sector organisations. Indeed, they seem very different and unusual. When compared to public and private firms, they are less clear about their stakeholders and how important they are. Although they are commonly owned by members they can be run by anyone from volunteer to former city banker. They differ hugely in size from neighbourhood savings clubs

⁶⁷ The few cases that have shareholders are owned in trust, through a foundation or are a wholly owned subsidiary of a cooperative or charitable organisation; depository receipt holders, PIBS holders or preference shareholders, whilst possibly receiving a dividend, have no direct influence on governance issues within the firm.

with easily identifiable key stakeholders to national organisations with a more diverse set of stakeholders.

This chapter aims to identify stakeholders in ethical bank and although it seems more appropriate and customary to investigate stakeholders on a firm level, this discussion will do the opposite and discuss the role of distinct stakeholders across ethical banks and if and how they impact on business models. Identifying key stakeholders of a group of ethical banks with such diverse characteristics and ambitions is problematic. Still, a number of key stakeholders can be observed across the sample: members & customers, employees, communities, investors & creditors, government, owners and competitors. In private companies stakeholders often have very distinct tasks and rights within the firm setting. Shareholders, as the owners of the business impact on corporate governance and expect dividends in return for their investments; competitors influence each other and adapt to business models. Workers are in many cases treated as a cost factor and often bear the brunt of corporate change and customers increasingly struggle to compare and contrast an ever increasing range of products and services as companies become less transparent. Ethical banks however should display a different set of priorities and pay more attention to non-owner stakeholder including workers by providing them with stable and reasonably remunerated jobs, they should be more focused on customer service, interact with members and work more closely with the communities they operate in.

Who are the Owners? The Missing Principle

One of the attractions of shareholder owned companies is that ownership rights are clearly negotiated and implemented according to Jensen and Meckling's (1976) and Fama's (1980) *Principle-Agent Theory*, which has repercussions for business goals and product choices of the firm (Froud et

al. 2009: 255). Yet shareholder ownership is unusual in ethical banks which raises questions about how ownership impacts on their business activities in an analogous way to Froud et al's (2009) discussion of the public firm. The ethical banks investigated are generally held in trust, owned by a foundation or member-owned. Ethical banks held in trust or owned by a foundation tend to have clear guidelines of the supervisory process. Trusts can be set up to benefit either particular people or for charitable purpose, but not for non-charitable purposes. Doing so requires a clear statement of intention to both define the subject, (in this case full ownership of ethical bank x) and beneficiaries (people living in specific community). Charitable Trusts are irrevocable, not-for profit and must benefit the public (Edwards and Stockwall 2007: 204-212). Relationships between the board of trustees and managers are relatively similar to the relationship observed in private firms between managers and the supervisory board. The supervisory function entrusted in trustees ensures that business decisions are in the interest of the trust, a function that is comparable to the board of directors in a private firm and the board of governors in a public firm.

Yet, although governance structures appear relatively straightforward in entrusted ethical banks, they are less clearly formulated in other ethical banks. Most ethical banks are member-owned, yet the rights of the member owner and his or her impact on governance are less clearly defined. The BSA generally sees the lack of shareholders as a benefit and highlights the benefits of member-ownership as it is on par with customer interests (BSA 2010: 5), assuming that members have similar influence in corporate decisions than shareholders have. However, the *Building Society Members Association* (BSMA 2012a) highlights a variety of problems in member owned organisations such as excessive director compensation and charges⁶⁸ that are clearly not in the interest of members. They also charge building societies to actively influence voting procedures by providing ballots that offer a

⁶⁸ The BSMA (2012) highlights early redemption charges and mortgage fees as being unreasonable and ignore the purpose of building societies as defined by the BSA: "This means building societies are solely focussed on delivering the *best services and products* to their members." (emphasis added) (BSA 2012).

“fast vote” box that assigns the member’s voting rights to the chairman of the board which is inconceivable in a private firm. The lack of ownership control over management is problematic and linked to changes in the recognition of the distinct relationship between building society management and members. Permanent building societies treat members more like customers and not like owners (Regional BS 1 executive):

“They [members] certainly do not understand mutuality as such. They do not put a stake in the society. They do not feel they own it; they are effectively customers.”

As a result, a power vacuum emerges and the control mechanisms like the democratic participation of members that was meant to promote member interests ceased to function effectively and indeed was captured by directors to strengthen their control over the future direction of the building societies.

Democratic Participation: Are Members Integrated in the Governance Process?

One of the key arguments for the mutual form of organisation is that the lack of outside investors facilitates an environment in which the mutually owned organisation can wholly concentrate on satisfying members needs. However this theoretical underpinning of the mutual ideas suffers significant problems in practise. The original bond of early societies, for example to provide people with homes, has been eradicated in modern building societies and customers and members are considered the same. However, Table 6.7 clearly indicates that customers are little interested to take on the more active role of a member as indicated by the low AGM turnout. Reasons for this vary and whilst some customers may consider their mutual as yet another “provider of bank-like products” (Ambitious BS 2 executive), Leadbeater and Christie (1999) argue that member participation is limited because of the largely symbolic rights they are given without having any actual “power to sanction” business developments and directors (Froud et al 2009).

Table 6.7: building society AGM voting results

| Turnout and voting at building society AGMs (averages) | | |
|--|-------------|-------------|
| | 2011 | 2010 |
| AGM Turnout | 14.4 | 14.2 |
| Approve annual accounts | 98.9 | 98.8 |
| Reappoint auditors | 97.4 | 97.4 |
| Approve directors' remuneration | 92.2 | 92.3 |
| Election of directors | 96.4 | 96.1 |

(Source: BSA 2011b)

Shareholders are widely recognised as controlling their business's future development and safeguarding their own financial and power interests (Boatright 2002); yet the ability of members to influence boards and managers of mutuals is highly restricted as pointed out by Leadbeater and Christie (1999) and Spear (2004): "managers in [...] co-operatives and mutuals have more power than in similar private sector organisations [... while] the market for external control is weaker" (Spear 2004: 55). Members of mutuals only seem to be able to vote on very basic issues as highlighted in Table 6.7 which allow little direct influence to be taken on the strategic direction of the mutual. Yet more importantly, the voting scheme appears to have lost its democratic principles. The BSA highlights that members "can appoint a proxy to attend and vote on" their behalf (2012e: 3) which could be argued to encourage members to vote by making the process more simple. However, the suggestion that "most members choose the Chairman to be their proxy" (2012e: 3) questions the process by transferring voting rights to the Chairman of the Board which is supposed to be controlled through the member voting process. Table 6.7 illustrates very high approval rates for the various motions, which the BSMA (2012b) points out is linked to building societies encouraging members to tick boxes labelled "Quick Vote" or "Fast Track" which means that members automatically votes for the motions:

“Several societies have introduced a “quick vote” option to their AGM voting form to make it easier for members. Here the member has to cross just one box, and the Board will be appointed to vote on the member’s behalf. “

(BSA 2010: 19)

Thus, the supposedly democratically member run building society is in effect less controlled by its owners than a plc bank, and furthermore directors and executives are barely accountable for their actions.

One of the key trends that can be observed in building societies is the increase in executive pay similar to developments in high street banks: At Nationwide, CEO pay has increased from £838,000 in 2003 to £1,884,000 in 2011 and Non-executive remuneration has nearly doubled from a total of £456,000 to £840,000 over the same period. Yet the justification for this rise, namely the ‘market rate’ that needs to be paid to secure top talent to manage complex derivatives and risks, is largely irrelevant for building societies. Moreover, it is doubtful that members are overly enthusiastic about this at times when the public, politicians and shareholders alike propose curbs on bankers pay. Indeed, executive pay is a *hot* topic for building society members interested in participating in the societies’ politics and numerous articles exist on news websites (Gower 2011; Walne and Womack 2011). What is equally striking is that building societies do not disclose how many votes are cast by proxy and therefore given to the Chairman. Instead high approval rates are celebrated as a sign that members approve the societies’ work (BSA 2010: 18). However, it may also be speculated that building societies try to keep overall voter turnout high by encouraging members with little interest in the society to vote by proxy to dilute more troublesome members’ voice of disagreement.

Democratic participation in cooperatives is equally limited and was between 1 and 5 % in the UK and declining with size of the organisation (Spear 2004: 39-41). Nonetheless, Spear (2004) indicates that

changes which eased the voting process have increased member participation. The interests of the Co-operative Group's members are for example represented at group level through regional constituents, including a Methodist minister, a plasterer and a nurse elected (FT 2012), to the board of directors. Whilst the impact of those on the day to day activity and operational procedures is limited, members appear more integrated in governance processes compared to building societies. Additionally, the values and principles committees are run by members and influence the Co-operative Group's ethical values and principles. Yet, Wilkinson and Balmer (1996: 30) suggest that the Co-operative Bank is less interested in the ideals of the Co-operative Movement but interested in distancing itself from being considered a generic bank. The recent demand to change the board composition at group level by the FSA (FT 2012) suggest that the group is willing to undermine its principles to gain a larger stake in the banking market which is unlikely to benefit the members' influence in group decision making.

Other ethical banks, such as credit unions have similar rights to building societies, but because of their mostly voluntary nature, small size and link to local communities, member influence is higher. However, in larger credit unions, issues seem remarkably similar to those evident in building societies as the relationship between members and union is less intense. City CU 2 had a turnout at the AGM of 0.35% and its executive generally acknowledges that: "There are some that won't get involved and we are happy with that. There are some that will get involved strongly and we know that." However, the executive also realises that the relationship with its member has changed because of the size of the organisation and they can no longer offer the community feel of small neighbourhood credit unions: "We have people coming in that want to chat and we do that, but this is more for smaller credit unions." Democratic participation is not really a feature of niche ethical banks. Whilst they are operating for specific communities, they do not have membership structures that encourage the involvement of customers directly at organisational level. However, considering

the limited impact members have in supposedly democratic ownership structures, the lack thereof should not be equated with unethical behaviour on behalf of niche ethical banks.

Overall it appears that members have relatively little influence over the developments in larger ethical banks and are largely unable to sanction the management for poor performance. As a result, managers, particularly in building societies are empowered and have considerable control over product choices and business goals.

Government Complacency and the Gold Standard

Whilst for most businesses, especially the financial services industry, a relaxation or even minimization of government policy as promoted by liberalism and market fundamentalism is admirable, the relaxation of regulations and government disinterest in mutuals has contributed to the marginalisation of ethical banking. Stephens (2001), Cook et al (2002) and Llewellyn (1996) agree that demutualisation of building societies has had serious negative impacts on the mutual sector as a whole. Not only has it encouraged competition in the mortgage market historically dominated by building societies (Stephens 2001) it also showcases government complacency in supporting mutuals to safeguard diverse forms of ownership (Marshall et al. 2003). Successive changes⁶⁹ to the acts that legislate ethical banks have eroded a system that limits competition between the various types and replaced it with a system of highly competitive Plc banks:

“... [M]utual forms of governance are simply being washed away within what’s happening. The capital requirements become an acceptance and the equity led plc model is gold standard, and the rest is inferior and weak”.

(Ambitious BS 2)

⁶⁹ Building Societies Act, Credit Union Act and the LRO 2012 (see above)

Almost all interviewees have suggested that government regulation through the FSA does not sufficiently differentiate between high-risk, internationally connected high street banks and risk-adverse, geographically restricted ethical banks. They argue that “prudently run businesses need less regulation” (National Niche Ethical 1). Regional BS 1 and 3 and Niche Ethical 5 further suggest that the FSA ignores the need for ethical banks to be regulated in a different way to large banks which hold large stakes in risky derivatives markets. Whilst some provisions are being made for building societies and credit unions, ethical banks are generally being regulated like normal banks, thus the ethical banks resources are strained by the “increasing regulatory burden on smaller institutions [and] dealing with the range and complexity of changing regulation” (Niche Ethical 1) and that the “... significant cost of regulation [makes it] very difficult for new social banks to develop because of that” (Niche Ethical 3). Overall, it seems that the government and regulators lack ambition to regulate ethical banks according to the risk they pose and enforce unreasonable and irrelevant regulatory burden on ethical banks.

Competitor Influence

Ethical banks are also affected by competitor in at least two ways. The first links to the danger of ethical banks adapting products and processes similar to those found in commercial retail banks which could jeopardise ethical banks attempts to be considered as a different, kinder type of bank (Regional BS 1). The second threat to ethical banks comes from the commercial banks’ interest to enter niche markets previously occupied by niche ethical banks.

The adoption of new products can have a negative impact on how ethical banks are perceived. The mis-selling of payment protection insurance for example has exposed how large ethical banks act a similar way to high street banks and adapt procedures without considering the potentially negative

impact sufficiently. After all, ethical banks pride themselves on customer services and thus the mis-selling of products, whether this happened knowingly or not, can have negative impact on the ability to run a successful ethical bank in future. However, not all new products and services are necessarily against customer interests: there is scope for online banking and telephone banking as they improve access for customers. However, the subsequent closure of branches⁷⁰ (BSA 2012b) or changes to the business plan which replace the opening of new branches with an extension of online services as indicated by the executives of City CU 2, Niche Ethical 6 and Regional BS 10, may be negatively perceived by some customers. Yet more crucially the adaption of services such as wealth management (Michie 2010: 22), PPI and other for-profit originated products have moved mutuals away as indicated by Ambitious BS 2: “[They] talk like banks and that culminates in the change of legislation which allowed them to act more like banks with the results that the sector has been weakened.” This view is seconded by Leadbeater and Christie (1999: 22):

“In the case of large finance services providers, this common denominator might be simply the price and quality of service. But this can leave the service offered by a mutual looking indistinguishable from that provided by a private sector company.”

Before the crisis hit, high street banks were keen to establish themselves in the social, green and environmental banking niches occupied by various niche ethicals and Ambitious BS 2; however, the interviews suggest that banks that entered the market did so half-heartedly but quickly “retreated from the market” (Ambitious BS 2 and Niche Ethical 3) because they lack the “advantage of knowing the sector” (Niche Ethical 6). It seems that despite the growth of social and green enterprises (Northampton University 2012) ethical banks are able to compete with commercial interests because of the knowledge and relationships they created in the past (Ambitious BS 2, Niche Ethical 6). However, the forceful expansion of the mortgage market by retail banks after 1984 has changed the nature of the mortgage market significantly which culminated in the financial crisis (HM Treasury

⁷⁰ Branches reduced from 2126 in 2001 (post Bradford and Bingley demutualisation) to 1916 in 2008 (prior to Britannia and Kent Reliance demutualisation).

2012a). Despite large retail banks “cutting their exposure to mortgages”, which benefits building societies and other ethical banks (Cohen 2012), building societies have changed significantly and irreversibly in the meantime (ambitious BS 2). Some of these changes are visible in the language used as highlighted by Redman et al (1997: 103) language used by building societies changed from “surplus” to “profit” and “member” to “customers”. How much changes impact on the individual ethical banks differs considerably, it seems evident that ethical banks are influenced by competition impacting on product choices as well as cultural aspects, such as cross-selling, excessive executive pay demands and a lack of customer relation building (Salazar 2009: 315-317).

Conclusion

The chapter has examined the business models of ethical banks in the based on discussion in Chapter 2. The features evaluated reveal various aspects of ethical banks' business models including how financially sustainable they are, how ethics impact on product choice and business goals and how stakeholders are integrated in the process. The key features of various categories of ethical banks that emerged from the analysis are summarised in Table 6.8 and in the following paragraphs.

Table 6.8: Overview of Ethical Bank business models features

| | Large Ethical Banks ¹ | other Building Societies | S+E Niche Ethicals ² | small Ethical Banks ³ |
|------------------------------|----------------------------------|--------------------------|---------------------------------|----------------------------------|
| <u>Cost Recovery</u> | | | | |
| Services offered | + | 0 | - | 0 |
| PCA | + | - | - | 0 |
| Credit Card | + | - | - | - |
| Lending to Business | + | 0 | + | - |
| Local/Community involvement | - | 0 | + | + |
| Fee income generated | + | 0 | + | - |
| Profitability | + | - | 0 | 0 |
| <u>Ethics</u> | | | | |
| Specific aim/mission | - | - | + | 0 |
| Ethical products/services | - | - | + | 0 |
| Ethical Consumer Scores | higher than retail banks | | + | + |
| <u>Stakeholders</u> | | | | |
| Mutual ownership | 0 | 0 | 0 | + |
| Member Engagement | - | 0 | + | 0 |
| Supported by Regulation/Govt | + | - | - | 0 |
| Competition for market | + | + | - | - |

+ = feature - = not a feature 0 = limited

¹ includes 5 largest BS and National Niche Ethical 1

² Ambitious BS 2, Niche Ethicals 3 & 6

³ includes Niche Ethicals 1,2,4 & 5

Large ethical banks commonly offer full banking services to personal customers and business accounts. A substantial % of their income is fee income and profitability is a key matrix by which these ethical banks measure their success. The commercially focused operations of large ethical banks on the other hand appear to negatively influence their community involvement and both the

mission and product choices lack a distinct ethical interest. However, the ethics scores awarded to them by the Ethical Consumer are substantially higher than for commercial retail banks. Although they are largely mutually owned, the effect of this is limited and member engagement is weak, which suggests that managers and directors have considerable influence and control over the future direction of large ethical banks. They generally benefit from earlier deregulation, which allows them to diversify into new product markets and access derivatives to hedge their exposures. However, at the same time, large ethical banks operate in highly competitive markets and compete largely with the large retail banks and increasing online providers of banking services.

Other building societies offer a more limited selection of products and lending to business is more restricted, however, they engage more closely with the local communities in their primary regional markets. Fee income and profit margins are of lesser importance supporting the view of them as following a more traditional building societies business model. Their aims and product choices focus on providing basic bank services to their region yet they largely lack a specific focus, nonetheless they also receive higher consumer scores suggesting that they offer more customer focused services as retail banks. They are owned mutually, yet again because members have limited influence over developments within the societies it seems that the main benefit of this is attached to prudent product choices and a long-term strategy. The changes to regulations that allowed large ethical banks to compete more effectively with commercial banks are of lesser benefit to smaller building societies as they fuelled competition in the mortgage market which is their core business and as they lack efficiencies or scale and size they are less able to compete with high street banks for price.

Niche ethical focus on specific social and environmental goals offer limited products and services and tend not to be active in personal current accounts and credit cards. Their business models is

connected to intermediation, specifically between savers and the charity, social or environmental enterprise. These specialist ethical banks may also generate considerable fee and commission income as part of their loan and investment business. Profits are important to those organisations primarily to grow their business and compensate depository receipt holders for their contribution to capital. They are closely interconnected with their markets, which gives them superior knowledge over the industry and reduces competitive pressures as the barriers to entry for the niche markets are relatively high and may not be financially attractive for commercial banks. The products offered are specifically tailored to the niche markets they engage with and products are transparent and ethical as highlighted in the highest Ethical Consumer scores. Although these niche ethical banks are not necessarily mutually owned, they promote both depositing and borrowing customers to get together through various events which strengthens the community.

Finally, small ethical banks' product choices vary significantly but tend to be basic in nature, for example savings account, some basic current account and few mortgages. Some small ethical banks offer loans to SMEs and social businesses but the extent is restricted, for example credit unions are only allowed to lend up to a maximum of 10%. Because of their specific local focus they tend to be very active in specific communities, especially in providing access to finance. They may generate some fee income but this can vary as well as profitability. Their products are not particularly ethical, but because they are relatively simple organisations and often mutually owned, members are generally treated more fairly as in building societies which is also highlighted by the positive ethics score. The recent LRO has reduced restriction on credit unions but the effects of this are yet to be seen, yet other small ethical banks are negatively affected by increasing levels of post-crisis regulation. Competition is limited by the local specificity of operations and customers.

Overall, it has been shown that the ethical banking sector is ecologically diverse. The various business models differ on all three dimensions of business model discussed here. Some of the findings also respond to results from the social network analysis in the previous chapter:

The difference in low out-degree and high in-degree connections with other ethical banks discovered in large ethical banks corresponds with their business model focused on competing with high street banks.

Small ethical banks' poor connectedness corresponds to their regional focus and simple organisational form.

Niche ethical banks are focused on their specific markets which is visible in a restricted number of connections to organisations with similar goals.

More importantly, the findings have significant implications for the industry analysis in the next chapter and the policy recommendations later on. Chapter 2's theoretical discussion of ethical banks as sharing largely similar interests has not led to the development of a cohesive subgroup. Instead, the analysis of ethical banks' business models highlights divergent interests which are more likely to lead to clusters emerging instead of an industry wide connections.

Chapter 7: Ethical Banking as Industrial District: Identity and Trajectory

So far the analysis of ethical banks' structural network and business models present a potentially confusing and sometimes contradictory set of findings. As set out in Chapters 2 and 3, ethical banking is in theory demarcated from commercial banking activities through a distinct focus on creating a positive social or environmental impact that suppresses profit ambitions and provides less complex and more transparent products and services. The findings from the network and business model analysis however, suggest that boundaries between ethical banking and commercial banking are more blurred: commercial banks appear to have authority in ethical banking and some ethical banks are increasingly interested in competing with commercial banks. Ethical banks have been shown to employ diverse business models, supporting the previous idea of competition but at the same time they favour cooperative-type relationships with other ethical banks as indicated by the questionnaire data and network findings.

Research Question 3, which will be answered in this chapter, is one about how these disjointed ideas about ethical banks impact on the coherence and organisation of ethical banking as a sector:

How do industry characteristics of ethical banks impact on connectivity and competitive behaviour and what does this mean for development prospects of the ethical banking sector?

- a) Do ethical banks recognise the existence of an ethical banking sector?*
- b) Do ethical banks collaborate and organise their interests collectively?*
- c) How do external factors affect the ethical banking sector?*

Six Dimensions of Interaction and Embeddedness in Ethical Banking District

The approach taken to answer these questions is different to previous investigation of the finance industry informed by the economic ideas of *concentration* and *competition* analysis (see Beck et al. 2006; Bikker and Groeneveld 2000; Claessens and Laeven 2004; OECD 2010). It uses an altogether more socially focused approach rooted in the concept of industrial district and a modern approach to Polanyi's notion of embeddedness. The district literature itself offers an ideal type of concept hypothesised by Markusen (1996) that explains how conventionally uncompetitive industries dominated by small firms can succeed against large scale competitors by organising internally as a sector in which these firms cooperate with each other and minimise transaction cost through complex interactions informed by largely implicit codes of behaviour (Dei Ottati 1994; Harrison 1992; Porter 2000). Embeddedness explains the interconnections between the institutions governing the socio-economic realms and introduces politics and cognition (Zukin and DiMaggio 1990). These concepts are useful as they enable the interactions, behaviours and ambitions of ethical banks to be identified. These can then be used to contextualise previously confused findings according to six specific dimensions: cultural identity, complimentary services, connectivity and exchange, competition, trade association and industry regulation and legislation. The dimensions derive from the district literature and are a check list of relevant behaviours and interactions which can be examined in ethical banking. The approach yields valuable results by comparing the network of ethical banks investigated in the UK with the empirically informed, yet somewhat idealistic, industrial district literature.

The use of the industrial district is not so much as a frame for analysis as it is a provocative metaphor: the industrial district resembles both an analogy and a disanalogy in this investigation of ethical banking in the UK. This idea of using analogies and disanalogies is taken from Erturk et al (2012) who depart from Michel Serres's (1995) idea of *multiplicity*, or *multiple* knowledge to develop

a multidisciplinary enquiry. They consider it to be “necessarily experimental” (Erturk et al 2012: 5) as it works well in distinct contexts but may be less useful in other circumstances. Nonetheless, it seems logical to associate this form of enquiry with complex phenomena that are ill-explained by confined disciplinary approaches such as a purely economic investigation of industry and thus requiring a more flexible multidisciplinary form of analysis. Their investigation of the complexities of the European debt and financial crisis evokes the analogy of a plane crash that has been caused by the adaptation of a technically complex system. Similarly, they argue that finance has been affected by major and minor design changes which ultimately led to the collapse of the financial systems but also further fragmented the sector’s and experts’ ability to handle the crash.

This analysis uses the image of the industrial district which romanticises the collective organisation of small firms through humane, almost family-like sharing of resources, interaction and collaboration to minimise transaction costs and effectively compete with highly complex, impersonal and competitive multinationals. In the context of UK banking, the analogy shows that if organised in similar fashion to the industrial district, small ethical banks should be successful in gaining a competitive advantage over more complex and established high street banks and subsequently gain market share and thrive as a sector. In contrast, an ethical banking sector that resists this type of organisation and operates opportunistically is unlikely to succeed against highly competitive retail banks. This forms the disanalogy of the industrial district metaphor. In principle, both analogy and disanalogy appear equally useful in forming a view of a sector of ethical banking and making sense of the data that emerged from the previous chapters.

The chapter systematically investigates ethical banking according to the six dimensions identified above. It features two levels of analysis: the first is the *intra-district* level which describes

relationships within the sector; the second offers a more macro perspective of its *embeddedness* in the wider social, political and economic institutions. Therefore, following the discussion of the sector's cultural identity, complimentary services and connectivity and exchange, that are largely linked to ethical banks themselves, the focus will shift towards competition, trade associations and industry regulation and legislation. Following this initial investigation, the chapter will discuss the disanalogy and highlight specific issues that have emerged from the discussion, such as the missing of central institutions.

Sectoral Cultural Identity

This section will establish whether ethical banks share a cultural identity which is an important and widely acknowledged feature of the industrial district (Dei Ottati 1994; Harrison 1992; Piore and Sabel 1984; Sforzi 2002). Particular emphasis is placed on the idea of districts as stable communities that encourage a shared and strong cultural understanding legitimising collective action (Staber 2001a). However, Lazerson and Lorenzoni (1999) argue that this might be limited to the Italian industrial district citing the diverse origins of people working in the industrial district of Silicon Valley.

At first glance, ethical banking appears to be culturally uniform. Ethical banks' aims to provide banking services that benefit customers and provide social value on a not-for profit basis however, give the impression that a subculture has emerged. The diversity of bank business interests indicated in the previous chapter highlights the problems faced in creating a relatively uniform culture in which banks do not feel as they are compromising their ideals. Indeed, when asked about the nature of an ethical banking sector in the UK, ethical banks neither agreed on whether it does in fact exist,

nor what form it might take. The larger and more commercialised banks (National BS 1, Regional BS 1 & 10, National Niche Ethical 1) did not identify ethical banks as sharing a culture:

“Ethicalness is most often linked to niches and distinct ethical ideas are only matched by a few players at a time. Ethical ideas are linked to very personal interests so can mean very different things.”

(National Niche Ethical 1)

Relatedly, ethical banks that are less commercialised and more skewed towards creating social value appear to consider such a sector to be existent. At the same time however, they provided evidence that redefines the sector’s borders:

“That doesn’t mean to say it doesn’t exist but I think, because in the description you gave is all embracing, is why it doesn’t quite fit the definition. Two bits are missing from that are: the focus on people [...and that ethical banks] are rooted completely in the real economy.”

(Niche Ethical 3)

As a result, only a few players are included within such a definition, which poses a problem for sector efficiency and effectiveness: “Any banking network works better if there is a number of participants in it...” (Ambitious BS 2). Their idea of a network is generally limited to ethical banks that are focused on creating social value and / or focus on specific goals, such as the environment and local communities. In this light, the executives of Niche Ethical 3 and 6, and Ambitious BS 2 identified the ethical banking network as containing themselves and other socially focused organisation such as Niche Ethical 2, Shared Interest Society, INAISE and Global Alliance for Banking on Values; as well as

National Niche Ethical 1⁷¹. This finding is in line with the results of the Markov Clustering Algorithm that identified a similar cluster in chapter 5⁷².

More commercially oriented ethical banks treat banking as a spectrum ranging from very ethical (Niche Ethical 5 & 6, Ambitious BS 2, CUs) to highly commercial (Santander, Barclays) and locate BS towards the middle of the spectrum describing them as “personal and flexible” and “nicer than banks but not really ethical” (Regional BS 1). The problems such views create for the organisation of the sector is evident in the controversy arising from granting mutual firms ethical status. Whilst Regional BS 3 argues that mutuality is a good basis on which to bind the sector, it has reservations about its coherence. The Ambitious BS 2 executive goes further and suggests that:

“There is an assumption that any mutual is ethical... [but] by their statutes they can’t be involved in lending into other jurisdiction and so therefore they wont do it... They can’t do it so they are okay. But they are not concerned with positive impact.”

Clearly, the sector, if it exists, is fragmented. Despite the differences in recognising the sector however, smaller ethical banks appear to operate more closely with each other than larger ones (Regional CU 4, Regional BS 3). This links back to the arguments that larger ethical banks appear to act more independently of the sector and are not recognised by smaller ethical banks as belonging to the sector. National BS 1 showed that large ethical banks do not view themselves as part of the sector despite recognising its existence. Moreover, evidence for sectoral divergence can be found in the increasing niche character illustrated by the type of new organisations formed. Table 7.1 highlights that whilst building societies are declining in number, both due to M&A and demutualisation, niche ethicals are growing in number. This suggests that ethical banking becomes

⁷¹ The belonging of National Niche Ethical 1 was a little more contested because of its increasingly commercially oriented activities.

⁷² Although Ambitious BS 2 did not belong to the cluster because of its multiple connections to building societies

increasingly specialised. Credit union assets also seem to be growing strongly⁷³, however, the number of credit unions is contracting which implies both an increase in M&A activity as well as organisation failure. Moreover, the increasing M&A activity in societies and unions are not identifiable in the niche ethical sector, suggesting that organisations' growth is generated by developing markets instead of increasing concentration.

Table 7.1: Ethical Bank Historical developments

| | Building Societies* | | Credit Unions** | | Niche Ethicals ⁷⁴ |
|-------------|---------------------|--------------------|-----------------|--------------------|------------------------------|
| | No | Assets in £million | No | Assets in £million | No |
| 1960 | 726 | 3,166.00 | 0 | | 5 |
| 1982 | 206 | 73,033.00 | 73 | | 6 |
| 1996 | 72 | 318,392.00 | | | 9 |
| 1998 | 71 | 156,014.00 | 660 | ~100 | 10 |
| 2007 | 59 | 330,272.00 | 504 | 548 | 14 |
| 2010 | 49 | 309,451.00 | 485 | ~750 | 13 |

(Source: *BSA (2012b) (last BS established in 1980); ** McKillop et al (2002), ABCUL (2012a))

In spite of the evidence it is difficult to decide whether a cultural identity is shared amongst ethical banks or not. It appears that smaller ethical banks are more likely to recognise some cultural similarity; yet, at the same time they exclude larger and more commercial ethical banks, promoting the idea that ethical banking is culturally fragmented. However, it seems appropriate, therefore, to ask how strong this shared cultural identity must be in order to facilitate the formation of a sector. Lazerson and Lorenzoni (1999) question the need for a unanimous cultural understanding between district members⁷⁵ based on their critique of Saxenian's (1994) investigation of the Silicon Valley. Porter (2000: 32) suggests that cultural proximity enables clusters to function more effectively, but he does not make a requirement for them to be cultural uniform. In any case, the evidence suggests that ethical banks are indeed culturally proximate rather than sharing a distinct culture. It might be

⁷³ According to ABCUL (2012) assets of the sector increased to circa £875 million in 2011 with the number of unions declining to 405.

⁷⁴ Chronology of the establishment of niche ethical banks: (established by) 1960: Cooperative Bank, Reliance Bank, Aidrie Savings Bank, Methodist Chapel Aid, LV; 1982 CAF; 1996 Unity Trust Bank, Triodos Bank, Shared Interest Society; 1998 Rootstock; 2007 Charity Bank, IBB, Kingdom Bank, London Rebuilding Society; Exit of LV Bank in 2007.

⁷⁵ Cultural uniformity is traditionally emphasised in the industrial district literature; see for example Markusen (1996); Albino et al (1998).

interpreted that ethical banks have more in common with other ethical banks as they are more similar to commercial banks as suggested in chapter 6. Yet they also have different visions as to what the future of ethical banking looks like.

Complementary Services

This section examines the product mix of ethical banks to understand the degree to which ethical banks complement each other or offer substitute products. It will also examine product sharing and competitive efforts within the ethical banking industry.

For Porter (2000) complementarities are central to the effective functioning of industrial clusters. Like others (Dei Ottati 1996; Harrison 1992; Storper and Scott 1995), Porter (2000) suggests that cooperation between cluster firms can increase buyer satisfaction. He proposes that the mutual dependence between cluster firms “creates internal pressures for improvement” and can “reduce perceived buying risk” by offering buyers the choice to choose from multiple sources (2000). By connecting with other intra-district firms, especially “suppliers, channels and downstream industries” (Porter 2000), firms are able to improve cost and time efficiencies (Harrison, 1992). However, Becchetti and Rossi (2000: 66) suggest that complementary services are limited to situation in which the benefit from being cooperatively organised outweighs the costs of increasing competition.

Ethical banks are constantly increasing their product offerings. As indicated before, larger building societies and National Niche Ethical 1 increasingly offer comprehensive commercial banking services. Thus from the outset, the potential for complementarities amongst ethical banks appear relatively

limited. Indeed, a review of building society insurance underwriters has shown that most products are underwritten by international insurance companies such as RSA, Heath Lambert, L&G and Aviva, as well as insurance brokers, yet barely any society uses LV or the Cooperative Insurance. Thus, even in cases where complementary services are being offered by ethical banks, they are not sold by district firms. An executive of National BS 1 indicated commercial and practical reasons for this:

“We also use other insurance products, for example from RBS and earn commission for doing so. Our investment and protection are manufactured by L&G with similar arrangement and there are a number of those in place... We are a major distributor of investment and insurance products so need major companies who can cope with the volumes of business”

This said, smaller ethical banking organisations such as Scottish Building Society, Chorley Building Society and the ABCUL have entered partnerships with Scottish Friendly (2007) who further entered a distribution deal with Royal London. This lack of complementary products being sold amongst ethical banks could be argued to be a logical result of decades of competition policies aimed to organise the industries individually. Credit unions however, appear to share more products: regional CU 4 highlights ALTO cards provided by Unity Trust Bank and City CU 2 and Employee CU 5 state the credit accounts and platform provided by the Co-operative Bank. At the same time they recognise that the Co-operative Bank is increasingly commercially focused as it stopped providing free banking for credit unions. A membership in ABCUL requires credit unions to purchase CUNA Mutual Insurance; however, smaller credit unions complain about the affordability of such insurance and threaten to leave the trade association (Employee CU 5).

Overall, niche ethical banks appear more confident in offering complementary products and services from other firms. While it appears that niche ethical banks operate in the interests of their customers, an

executive of Ambitious BS2 has stated that it refers customers in need of a current account to the Co-operative Bank and would, therefore, like to be able to be more flexible: “Currently we can only recommend the Co-op, but with Triodos doing [current accounts], we could offer them a choice.” This highlights a less competitive, more collaborative attitude towards organising ethical banking which is feasible if banks are focused on niches and aim to achieve similar goals but use different strategies which is linked to their product offering. Moreover, Niche Ethical 6 argues that competition between ethical banks impacts negatively on their ability to work together more closely to move the many “shared agendas” forward. The executive of Niche Ethical 3 further proposes that whilst there is a considerable amount of overlap of products offered, only the Co-operative Banking Group offers “a full service banking solution.” Thus, even if ethical banks wanted to share complementary products, the choice would be very limited, provided that the Co-operative Bank is interested in sharing its services in the first place.

The recent and, most probably, continuing consolidation of ethical banks⁷⁶ is likely to increase the rift between ethical banks that are interested in complementarity and those that increasingly compete with one another in providing services. Some larger ethical banks have ambitions to strengthen their own market position as indicated by the Britannia/Co-operative merger and the 12 mergers of building societies since 2007. This is also reflected in the expanding product portfolio, increasing competitive behaviour and weakening cooperation as indicated by a Niche Ethical 3 executive. As a result they are increasingly unwilling and unable to enter into long-term product sharing and distribution. However, the research has also identified some efforts by ethical banks to share complementary products and two specific clusters have been discussed. The first describes the increasingly disintegrating collaboration between credit unions, the Co-operative Bank and CUNA Mutual as commercial interests of the latter two led to free services to support the credit union

⁷⁶ See Table 6.1

sector being abandoned. The second cluster contains the more focused niche ethical and develops more positively. This is at least partially linked to the limited product offering and the specific sectoral alignment of the niche itself⁷⁷ which make it both necessary and feasible for niche ethical to share services with and recommend products of similar organisations as they do not compete directly.

Connectivity and Exchange

This section will examine relationships of ethical banks and in doing so discuss and contextualise earlier findings from the network analysis. The first part will look at the interaction between intra-district firms as repeated interactions between district firms have been argued to have a positive influence on trust relationships and future cooperation (Albino et al.; Harrison 1992; Markusen 1996). The second part will investigate the relationships between ethical bank connectedness and resource exchange discussed in Enright (2004) and zoom in on the specific issue of the intra-district labour market which has been raised as an important feature of the industrial district by Dei Ottati (1994) and Markusen (1996).

With regards to intra-district relationships, the social network analysis in chapter 5 has illustrated that ethical banks are generally more connected to other ethical banks as compared to other financial services organisations (Ethical bank Group Level E-I Index = -.667, $p < .05$). However, interview data highlights that most relationships between building societies are superficial and linked to BSA membership (Ambitious BS 2): relationships between niche ethical are focused on

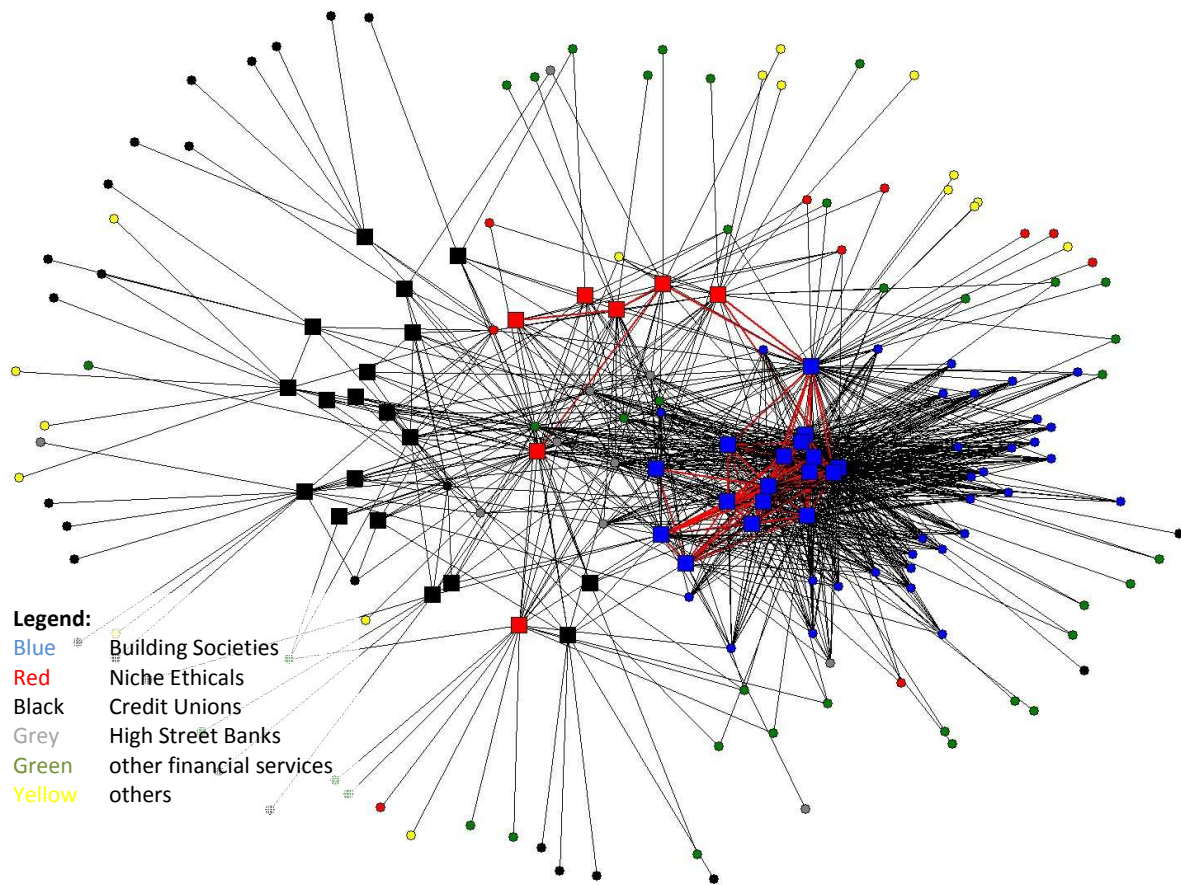
⁷⁷ Focus on green and social businesses, charities, green mortgages

their niche markets (Niche Ethical 6), and credit union interactions are facilitated through ABCUL (Regional CU 4)⁷⁸.

The E-I index and the reciprocity of relationships visible in Sociogram 7.1 illustrates that some niche ethicals and most respondent building societies consider themselves to be connected which is, at least in the context of building societies, a contradiction to the rising competitiveness amongst societies which would suggest less competition as highlighted in the interview data: “We don’t have any direct connections with their staff... [except] with smaller [societies]” (Ambitious BS 2) and “[o]ne of the things building societies have been appalling at is getting together and work together – without merging” (Regional BS 1). There seems to be consensus among building societies that interactions are commonly limited to relatively superficial tasks, such as lobbying activities and market activities, and are largely facilitated by the BSA. Moreover, executives interviewed in both National BS 1 and Ambitious BS 2 agree that there is virtually no contact between large and small societies. It has been suggested that it is this lack of relationships and cooperation that led to the failure of medium sized BSs and their subsequent merger with large societies (Regional BS 3). Nevertheless, it would be a mistake to interpret that the results of the E-I Index, which indicate homophily are incorrect. Two points can be raised. The first is linked to the fact that indeed most building societies considered themselves directly connected to others. This suggests that despite the different understandings and trajectories among societies, they consider their mutual ownership to be a connecting factor. Secondly, the smaller societies interviewed report recognising considerably more activity amongst societies that are less commercially focused. The connections can be on an ad hoc basis, for example, the executive of the Ambitious BS 2 executive notes that “[t]here is still a lot of day to day cooperation. The smaller once and [we] are much more connected.”

⁷⁸ Note: The BSA and ABCUL are discussed under trade association below

Sociogram 7.1: Ethical banking network illustrating respondents (squares), non-respondents (circles) & type of organisations (coloured); reciprocity (red connections)



Niche ethicals show a slight tendency to connect to external actors according to their group E-I Index of $<.25$. This tendency is linked to there being fewer organisations to be connected to and the lack of institutions catering specifically for niche ethicals, resulting in their connections to organisations that are dissimilar, such as the BBA. Moreover, the specific business models and aims of the niche ethical have an impact on its connectivity. For example, Niche Ethical 6 has various connections to investment companies as it offers investment services to its clients and Niche Ethical 2, 3 and 5 are connected to charities and social organisations (see chapter 5 for details). Thus, the connections made externally support the specific aims of the company as illustrated by Niche Ethical 6 executive: “There is a different relationship with [Ambitious BS 2] as it is more in line of what we are trying to do”. He also identifies a “lot of interaction... It is a bit like the building societies. They are working together, but ... there is also quite a lot of competition” (Niche Ethical 6). Credit unions appear to face similar problems. The City CU 2 executive interviewed has identified other local credit unions to

be the main competitors and thus limiting interaction between those parties. However, there is clear evidence that credit unions group together to sources software collectively, possibly because they recognise their weak position due to their size. This interaction is organised in regional chapters thus reflecting the overall local ambitions of credit unions. The largest 10-15 credit unions, the “spearhead group” further interacts in meetings that discuss more general issues like future collaborations and legislation (Employee CU 5).

Following this trend, it seems that resources and knowledge exchanges are more likely to be a feature in smaller organisation which is driven by repeated interactions and constraints in connecting to larger, less ethical and more competitive ethical banks. Two types of exchange have been identified from the literature and the interview data: information and resource exchange, and labour movement.

The exchange of information and the sharing of resource within credit unions and building societies is partly organised by their trade association. This will be discussed in more detail later. Both groups of ethical banks have identified scenarios in which they exchange both information and resources, such as contract drafts and knowledge specific to their industries: “We are happy to share information amongst smaller societies... as long as it isn’t just in one direction” (Regional BS 1). Moreover, within the credit union sector, exchanges appear to be common place as identified by an executive of Employee CU 5:

“We talk to lots of other CU, in fact I have one here who want to have a chat. So we always get request. There is a lot of interaction between us. People will phone about and ask about who we are using for IT and so on, and we will share that information. CUs are renowned for borrowing each other’s loan agreements and application forms

and just changing the names accordingly. We all do that and you don't get that in other financial backgrounds. And that's all part of helping each other out and saving money."

This statement encapsulates the idea of the industrial district in that it highlights the notion that credit unions cooperate not only for their own benefit, but to enhance the competitiveness of the sector more generally by sharing cost and potentially increasing customer services. The interaction between smaller building societies identified before appear limited to largely informal conversations and knowledge exchange. Yet apart from the resource exchange at trade association level, building societies have not identified the exchange of, or the communal use of, technology and computer systems elsewhere. Mutual One⁷⁹ however, exemplifies how the potential of sharing services could be organised amongst building societies. Having the clear objective of "enhancing the competitiveness of Mutual organisations" (Mutual One 2012) by initially providing internal auditing to the owning societies, they have now extended into compliance and various insurance products for societies themselves⁸⁰, as well as organising conferences and seminars for a range of societies. In line with the industrial district ideas, they offer advice on collective procurement of insurance which is used by nineteen societies saving them up to 30% compared to the individual rate.

Niche ethical banks have not highlighted any exchange of resources as such apart from informal conversations, yet two of the niche ethical banks (Niche Ethical 3 & 6) and Ambitious BS 2 interviewed have highlighted their engagement with the Institute of Social Banking in Germany which provides teaching and research for ethical banks focussing on creating social value. Although this does not directly encompass the exchange of knowledge and resources discussed by the ID literature, it highlights that niche ethical banks establish network functions on European, potentially international, scale, to support their interests within an institutional environment which, leading up to the financial

⁷⁹ Mutual One is a service provider established by eight building societies and offers audit, compliance, procurement and education services to building societies.

⁸⁰ Compliance services, corporate insurance and collective mortgage indemnity guarantee & private medical insurance

crisis moved increasingly towards competition based policies. Another interesting finding is that large ethical banks have not indicated any ambition to share resources and knowledge with their smaller competitors which again supports the idea of them as more commercially focused alternatives to high street banks instead of ethical banks.

The internal labour market advocated by the ID literature is present in a limited way at executive level but how far this extends into lower skill jobs is hard to estimate and data is not readily available. The lack of geographic proximity observed in the Italian Industrial District or Silicon Valley is not a feature of the ethical banking market and people switching jobs between firms are likely to have to either travel for work or re-locate which may be unreasonable to expect for low skilled employees and middle management. Yet this does not mean that people within the sector do not move between ethical banks, particularly in senior and executive positions. Three interviewees have worked for other ethical banks or the third sector before joining their current firm (Niche Ethical 3, Regional BS 3, City CU 2). Whilst this is an encouraging sign of intra-sector exchange and engagement, labour in-migration appears to be significantly more common based on the interview data as identified by eight of the interviewees (Niche Ethical 1, 5, 6; National Niche Ethical 1; Regional BS 1, 10, National BS 1, Regional CU 4). Nonetheless, the review of building societies and niche ethical boards (Table 7.2) illustrates that at board level, most directors appear to in-migrate from for profit finance and other businesses. Only two board members in building societies come from within the ethical banking sector (representing 22.43% in total), whilst this is only true for 10.78% board members in niche ethical boards. Yet within building societies, 48.72% of boards feature more than a quarter of directors from within the ethical banking sector. Moreover, 24 of 39 CEOs have worked for building societies most of their life, and moreover, 14 of those have moved up the ranks within one society.

Table 7.2: Origin of building societies₁ and niche ethical₂ directors (n₁=39 & n₂=5)

| | leaders from within the sector | | origin of board members | | boards with >25% internal directors | average % of board internal |
|----------------------------------|-------------------------------------|---------------|-------------------------|----------------|-------------------------------------|-----------------------------|
| | CEO (internal riser ⁸¹) | chairman | internal | external | | |
| building societies | 24 62% | (14) (58%) | 1 | 1.96 22.43% | 6.54 77.57% | 19 48.72% |
| niche ethical₂ | 1 20% | 0 | 0.92 10.78% | 7.58 89.22% | 1 20.00% | 10.78% |

(Source: Company Reports)

The data illustrates two major dynamics within specifically the building society sector⁸². Firstly, building societies show weak signs of an internal labour market for executive positions; however 62% of CEOs from within the ethical banking sector learn and stay with the same company for a large part of their working life. Thus loyalty to the district firms is high, but it is limited to the specific organisation and does not supersede the firm level to create sector-wide loyalty structures as suggested in the literature. The second finding is a relatively strong in-migration of executives from finance plcs and other professional backgrounds, for example lawyers and chartered accountants. Whilst this dynamic is almost certainly imposed on ethical banks by industry best practice and enforced by the regulators (Walker 2009), it raises questions about the impact this transfer of interest has on the niche ethical's ability to sustain their ethical position and interests albeit potential amalgamation of business models and interests. Particularly the in-migration of senior banking officials from UK high street banks may have contributed towards the increasing commercial focus of some UK building societies and the "fat-cat" director remuneration controversy widely discussed in the media.

This section highlights a number of findings regarding interaction and resource exchange. The relationships between building societies are weaker than indicated by the network analysis and indeed larger societies' interaction with the sector is limited to trade association activity and

⁸¹ Internal riser refers to CEO has spend the majority of their career in one society or have been with one society expressed as % of leaders from within the sector

⁸² Data for credit unions is not available

lobbying. Smaller societies on the other hand appear increasingly interested to interact and share resources as indicated by the emergence of Mutual One as a mutually own provider of centralised services for support and to create efficiencies of scope. There is also evidence to suggest that building societies exchange expertise through an internal labour market at executive level although most stay loyal to one society. Credit unions appear more ready to exchange knowledge and services and are dependent on external back office infrastructures. Because small credit unions are very simple organisations and focus on very small communities, interaction and sharing are more developed in larger unions. Niche ethical banks focus their operations around specific niche markets which limits the usefulness of interaction and collaboration with other niche ethical banks, particularly if they focus on different product markets. Moreover, the section has shown that the largest ethical banks investigated in their categories (City CU 2; National BS 1 & National Niche Ethical 1) limit their interaction to a bare minimum and act more strongly on their own behalf. They also restrict access to their resources and knowledge for smaller ethical banks highlighting again that they are not overly keen on advancing the sector but focused on their own success.

Competition

This section investigates the competitive environment of ethical banks. In an environment that is regulated in such a way as to provide highly competitive markets, the extent to which internal and external competition impacts on ethical banks' ability to succeed is fundamentally linked to the ability of the sector's to thrive and develop. The literature suggests that within districts competition is limited by a high degree of cooperation and the division of labour across firms is seen chiefly to drive product and process innovation which will again be shared across the sector for the benefit of district firms (Dei Ottati 1994; Lazerson and Lorenzoni 1999). This, enables the district to compete against the large corporations (Porter 2000). Thus, internal competition is controlled by formal and informal governance processes established by the district and firm specialization. External

competitiveness however is not achieved by individual firms, but is negotiated by the collective action of intra-district firms against MNC competition. Before discussing the nature of competition in detail, it is important to highlight that all interviewees praised competition as being essential to the functioning of the economy. Yet, they stress the importance of competition being based on a level playing field provided by non-preferential policies that regulate the market for banking.

Overall, it appears that competition has increased, particularly between the large actors and the smaller ones. Small credit unions are competing with larger ones who, in turn compete with small building societies and niche ethical banks and so on: “The big boys versus the small ones” (Regional BS 10) and “We can’t compete with big competitors, they will always beat us on price.” (Regional BS 1). In this way, the largest ethical banks would be competing with the next largest actors, high street banks as indicated by one interviewee

“So from a competitive perspective [...] we are looking at it we look at Santander, Natwest, RBS and Lloyds as opposed to looking to looking at the BS sector. And also the product offering is fully focused on retail financial services but is far more like what you expect to see in a bank compared to a small BS.”

(National BS 1)

The effects of this competition are particularly well illustrated in the building societies sector. Table 7.3 shows that, especially in the past decade, concentration of assets increased in the top five societies driven by a jump of assets held by the largest society⁸³. Indeed, the largest society in 2010 controls nearly the same share of assets controlled by the “largest 5” societies a decade before. This has obvious implications for the sector: domination by one sole actor is likely to result in public perceptions and policy ambitions to be linked to one organisation rather than the sector as a whole.

⁸³ Indeed, if the largest society is removed from the ‘largest 5’ category the % Change is negative 11.3

This is surprising as the ideals and frameworks currently in place support and are focused on creating a competitive environment modelled on market efficiency; yet the dominance of one firm suggests that competition is only recognised in the context of the largest ethical banks and high street banks. Smaller societies on the other hand could find it increasingly difficult to focus attention on their interests and may be subject to further consolidation as the environment they operate in appears to be increasingly unsustainable. Thus it seems that current competition policy has a negative impact on the district whilst it benefits one, or few ethical banks.

Table 7.3: Degree of concentration in building societies

| Year | Share of total assets of the largest 20 societies | | | | | |
|-------------------------|---|--------------|-------------|------------|-------------|------------|
| | Largest | Largest 5 | Next 5 | Largest 10 | Next 10 | Largest 20 |
| 1995¹ | | 67.0 | 18.7 | 85.7 | 9.3 | 95.0 |
| 1996² | | 67.8 | 13.4 | 81.2 | 11.5 | 92.7 |
| 2000 | 36.0 | 68.6 | 13.8 | 82.5 | 11.1 | 93.6 |
| 2005 | 45.5 | 70.1 | 13.8 | 83.9 | 10.5 | 94.4 |
| 2010 | 65.4 | 86.3 | 8.1 | 94.4 | 3.3 | 97.7 |
| % Change '00-'10 | +29.6 | +18.3 | -5.7 | | -7.8 | |

1 Includes societies demutualised by 31/12/97

2 Excludes societies demutualised by 31/12/97

(Source: BSA, FSA and Nationwide)

The competition exhibited by ethical banks, however, is related to the wider financial services industry. Firstly, with regards to competition, ethical banks are frustrated about the regulatory environment they are currently operating in as “the increasing weight of the regulatory burden on smaller institutions becomes quite a strain and a cost to actually be able to deal with it effectively” (Niche Ethical 1). Regional CU 4 voiced that legislative changes have introduced competition to the credit union sector by revoking the former demarcation of unions. Moreover, Regional BS 3 and 10 complained about an “unlevel playing field” as distorting competition, indicating the influence government policy and regulation can have on the ability of a district to form and function effectively.

Secondly, various interviewees commented that competition from commercial actors has weakened as a result of the financial crisis, especially on the lending side; competition on deposit taking however remains very high, and may have even increased, because of its commoditised nature compared to specialist mortgage products (Regional BS 1). Further, this interviewee suggested that its focus on unusual mortgage products and their subsequent productisation⁸⁴ (Feller et al. 2008) allows the society to compete because of the “disappearance of some players, especially foreign banks”, which probably have to focus on their core business and home market. Similarly, Niche Ethical 3, 6 and Ambitious BS 2 reported that their specific niche focus enables them to have entire markets to themselves as the high street competition has either retrieved itself or is out-pricing itself. Moreover, offering niche products for specific markets also reduce information asymmetries between the lender and the borrower which allows niche ethical specifically to lend to customers that would be rejected by the computerised systems of main stream banks:

“There is little competition for what we do in terms of our focus on the environment. When attempts were made in terms of green products, it falls down on two fronts. They don’t have relationships with the ‘green’ community they are serving and their staffs don’t buy into it. They don’t know how to present the product to the customers. They don’t understand. As soon as you ask a question that goes into detail they won’t be able to answer you. You would have thought that an organisation with much more capital would come along and would make a serious attempt in gaining momentum and those that were thinking about it retreated from it in the FC.”

(Ambitious BS 2)

This highlights one of the key issues about size raised in the previous chapter. The extent to which a niche focus can prevent competition however, is not quite clear. The interviewee from Niche Ethical

⁸⁴ Refers to the process of turning a custom product (for one or few customers) into a standardized product for the wider market

6 proposed that they “get a lot of competition from other banks, but [they] have the advantage of knowing the sector.” Nonetheless, Niche Ethical 3 offers a more compromising view:

“I think on the lending side which is why we exist, most of the clearing banks have retreated from the market place and others are pricing themselves out of the market place. Whilst there is competition, we believe there is plenty of space in the market.”

Thirdly, as raised by a Regional CU 4 interviewee, it is important to recognise that most of the more traditional building societies and credit unions were not set up for market competition, with the resulting effect that they are less equipped do so: “the reality is that is pretty difficult for CUs to compete because of the lack of information that is necessary for real competition”. Building societies face equal problems as they emerged from a similarly geographically demarcated quasi-monopolistic market in the 1980s in which there was virtually no competition with high street banks: “In the 70s the BSA set the interest rates for everybody, so it was a cartel that once a month the CEOs would meet and set the rate for everyone in the country” (Regional BS 3).

Overall, competition appears to be severely distorted internally and externally. It appears that ethical banks either adapt to commercial services or seek protection from competition by focusing on a specific niche. Although larger commercially oriented ethical banks have suggested that by offering an alternative yet competitive offering to high street banks are able to expand the sector, the findings here suggest that this behaviour introduces competition to the sector and cannibalises other ethical banks regional market. This has the result that actors that do not conform to the commercial orientation are marginalised and thus cannot actively shape and develop the ethical banking sector in the UK in their own initiative. Hence the commercial focus is detrimental to the sectors ability to organise internally.

Trade Associations

The following examination of ethical banks business associations is essential to understand the districts collective activity and has been discussed widely, but not in the context of ethical banking. Authors highlight the potential role of trade associations in helping to establish networks with individual firms and to “solve problems of cycles and overcapacity and to respond to new demands for flexibility” (Markusen, 1996: 300) and to represent firms externally (Porter, 2000). Thus, with regards to the collective activity being associated with increasing competitiveness (Porter, 2000: 16), trade associations are pivotal to the success of a district. Yet, by categorising districts, Markusen (1996) points out that this associational context is confined to the Italian variety: other types of districts have weak or no trade associations. On first glance, the ethical banking sector’s two major trade associations, the Building Societies Association (BSA) and the Association for British Credit Unions Limited (ABCUL), appear to “provide shared infrastructure-management, training, marketing, technical or financial help, i.e., mechanisms for risk sharing and stabilization” (Markusen, 1996: 298) as proposed on both organisations websites. Yet, interviews have shown a rather more varied view of trade associations.

Overall, interviewees have credited the BSA for its lobbying activities, the information provided to members and being good value for money (Regional BS 1 & 4, Ambitious BS 2). However, when compared with other trade associations, such as the German BVR⁸⁵, the ability of the BSA in providing support as indicated by Markusen (1996) appears to be very limited. Indeed, a quick comparison with the services offered shows that the BVR’s is considerably more central to the functioning of the German cooperative banking sector and offers a range of services alongside the *Sicherungseinrichtung*, providing deposit insurance and assures the existence of cooperative banks,

⁸⁵ Bundesverband der Deutschen Volksbanken und Raiffeisenbanken – the national representative for German cooperative banks.

and the *Pruefungsverband*, which provides auditing for all members (Ayadi et al. 2010; BVR 2012a). Collective marketing, which is highly centralised through the BVR in Germany, is contested by some building societies who suggest that it is not feasible as it undermines the individual efforts from societies to market themselves in a competitive environment (Regional BS 1 & 4). Still, the interviewee of Regional BS 10 suggests that a more centralised industry could improve chances for future success of the sector. The interviewee highlights that particularly the education of the public about the benefit of mutuals, a service already provided by the BVR in Germany (BVR 2011), could have positive impact on the sectors potential for future development.

One of the key issues that undermine a more functional set up of the BSA is the dominance of the interest of the Nationwide associated with the different business models identified in the previous chapter: “We are down to [47] societies and one represents over 50% of the movement and inevitably everything gets skewed to that view” (Ambitious BS 2) and “whilst it is only 48 societies, the different scales and aspirations make it difficult to speak with one voice” (Regional BS 3). As a result, themes that divide the sector according to their commercial and social interest such as the substance of the housing stock in general are left uncovered at large formal events such as the BSA’s annual conference (Ambitious BS 2). Obviously all those issues have considerable implications for the lobbying activities of the BSA, as indicated by the more recent changes to the Building Societies ACT which reduces the restrictions on the business models and therefore increases competition which benefits mostly the large societies. Moreover, large societies also lobby separately to the BSA (Regional BS 1) with the result that their view is considerably more represented than that of their smaller competitors. Yet, whilst criticising the current set up, the interviewee from Regional BS1 suggests that a separate body representing small societies within the BSA could balance interests. Moreover, the opening up of the BSA to mutually owned ethical banks is seen as a positive sign as it could raise the voice of the sector with regards to lobbying altogether.

The problems in representing diverse member interests are not only confined to building societies but clearly visible amongst credit unions. The ABCUL suffers from the many different ideas credit unions have about the role they play as providers of basic banking services, and thus also had different views on what the future direction of the sector should look like (City CU2 & Regional CU 4). McKillop et al (2010: 6) argue that the easing of regulatory restrictions is “perhaps premature given the development of the movement” and that the focus on growth is not in tune with the existence of credit unions in the first place, an argument seconded by Niche Ethical 1. More importantly however, ABCUL seems to have ambitions that only poorly reflect the interest of its members and “seems to think it is the UK credit union and owns all the other” (City CU 2). Thus, larger societies use their own initiative in responding to proposed changes to regulation and legislation as indicated by City CU 2. Interviewees also cited that the forced purchase of insurance through CUNA Mutual as part of the ABCUL membership was seen negatively by many and deemed too expensive to sustain (Regional CU 4 & Employee CU 5).

This non-satisfactory performance of UK ethical bank trade associations has led to the emergence of a variety of alternative organisations that represent building societies and credit unions, and / or provide services that enable collective action in procurement, training and auditing services. This development can be seen as being advantageous by promoting competitiveness but also problematic as it may indicate a potential break up of credit unions and building societies thus weakening the sectors ability to lobby and develop successfully in the UK. The problem identified mirrors Porter’s view on trade associations:

“Individual companies can independently influence cluster development, but the importance of externalities and public goods means that informal networks and formal trade associations, consortia, and other collective bodies often are necessary and appropriate.”

Porter, 2000: 30)

Having identified the problems faced by the sector's trade associations, it is of little surprise that niche ethical banks have suggested that they are more interested in having a specialist trade association that represents their ambition to create social value. Niche Ethicals 3 and 6, and Ambitious BS 2, which all focus on creating social value appear to have considerable interests in alternative trade associations such as INAISE, FEBEA and Global Alliance for Banking on Values as they link in with the banks' niche business model. Moreover, Niche Ethical 3 calls for changes to the way it is represented in the UK and how ethical banking is viewed more generally within the banking industry:

“The BBA needs to have an ethical banking group; we need to have business schools that teach ethical finance as a form or part of their investment module. It is not about ‘this is the best way to do it’ – if you talk about the range of activity you can’t deny this market place does exist just because you can’t agree with it. I think there are some fundamental issues with regards to engaging with finance. “

Whether it is feasible for the BBA to have an ethical banking group that can legitimately, independently, and, most importantly, effectively, push the view of niche ethical banks is an interesting question in itself, but nonetheless, it seems entirely appropriate to question the focus on the currently adopted doctrine of competition and commercial activity as the basis for banking services.

The discussion highlights that trade organisations are not central actors with a clearly agreed upon function as can be identified in commercial business associations such as the BBA. The more traditional associations (BSA, ABCUL) appear to disregard the interests of less influential member organisations. As a result, alternative associations (Mutual One, UKCU, ACI) emerge that offer a collaborative environment that benefits particularly smaller organisations. Niche ethical banks' trade associations are internationally organised which enables them to exchange ideas and collaborate with similar organisations but at the same time it weakens their influence on national policies significantly.

Industry Regulation and Legislation

Lastly, the impact of government policies is to be examined as it defines the markets in which ethical banks can be active and the kind of behaviour banks, both commercial and ethical, can and do engage in. The role of government institutions has been recognised as impacting on industrial clusters success and development prospects (Porter, 2000: 26); yet Staber (2001) highlights that government agencies are not central to the research agenda of networks, nor are they omnipresent in the discussion of industrial districts. Markusen (1996: 309) strongly criticises this lack of interest in the government institutions as the firms are embedded in external relationships including those with government agencies and she complains about the limited research into this area (1999: 880). However, the quality of regulation, that is the fit of district interest and the regulation governing it, is crucial to limit inefficiencies (Porter, 2000: 26). In this light, and because districts are in direct competition with MNCs, it is unlikely that they would be keen to see deregulation to continue as they are unlikely to benefit from it.

One of the main issues noted by virtually all interviewees is rooted in the regulatory system. Interviewees were dissatisfied with the current regulatory system as it fails to recognise the differences in their business models compared to high street banks. Thus, the regulation in place creates inefficiencies partly as a response to the financial crisis, but also because the regulators appear to be unwilling to understand the nature of and risk involved in ethical banking: “Consider what we are doing. So when the guidelines arrive we are not all put in the same draw” (Niche Ethical 5). By demanding that both risk (National BS 1, National Niche Ethical 1) and culture (Regional BS 10, Niche Ethical 1) are considered when making decision about the type of regulation and the accompanied paper work, ethical banks effectively request the regulatory authorities to pay more, not less, attention to their business. This demand for qualitative regulation reduces the inefficiencies linked to filling out non-applicable paper work drastically (Regional BS 2) and therefore enables

ethical banks to use human resources more effectively elsewhere. This is linked closely to the simplicity and relative transparency of their business operation as compared to internationally interconnected banks (National BS 1, Niche Ethical 6).

It is important to recognise that both credit unions and building societies operate within a highly restricted environment. They are not allowed to do what commercial banks, including niche ethicals, can do as assets have to be secured against property and funding must be largely drawn from deposits. This means that access to the wholesale markets is limited, and they cannot operate internationally. Niche ethicals on the other hand are regulated in the same way as banks: while they must pay for the cost of excessive regulation, they can at least act relatively freely in theory. Thus, it appears that building societies are penalised twice: the restrictions imposed on them, as well as having to compete with banks that are not restricted and can use cross-subsidies to compete in specific product markets, such as current-accounts (Niche Ethical 6). Thus, from this point of view it appears understandable that building societies, at least the ones competing with high street banks, are pushing for deregulation to be able to do so more effectively (Regional BS 10).

Ethical banks also have signalled capital requirements to be a key problem for two reasons. Firstly, as a result of the financial crisis capital requirements have been raised following a new Basel III standard. Secondly, and more importantly, ethical banks do not usually have the ability to raise capital quickly by raising the equity stake in the business. This is because they may not have external shareholders and, instead, raise capital incrementally through retained profits providing potential for slow annual growth (Ambitious BS 2, National BS 1, Niche Ethical 1). The issue of capital raising opportunities is currently being debated and current PIBSs are likely to be replaced with PLADSs (National BS 1; Regional BS 10). Nonetheless, the cost of raising capital and reserves may in the short

term undermine their ability to serve the demand for credit which is boosted by a lack of lending from commercial banks (Masters and Jenkins 2012). In any case, it seems unreasonable to make ethical banks pay for the collapse of the international financial market by imposing higher restrictions on them and charging them via the Financial Services Compensation Scheme (as indicated by Ambitious BS 2).

Yet, the role of government further undermines the ability of ethical banks to compete with external actors as already highlighted above. The bail outs provided to high street banks are viewed by most of the interviewees as creating a system characterised by a form of unfair competition that prefers high street banks. However, “a level playing field doesn’t mean ‘let us throw some money at BS’. It means stop throwing money at everybody else. I think that would help” (Regional BS 3). Moreover, the government has largely ignored initial calls for the break up of the large dominating high street banks that could have reduced the entrance barriers for ethical banks to compete more effectively whilst at the same time providing a more stable banking system. Instead, they set up lengthy commissions to delay decisions being made and avert considerable changes to the UK banking sector (Engelen et al. 2011).

This section has shown how ethical banks’ ability to act is constrained by legislation and that the cost of regulation is disproportionate to the risk they pose to depositors. Moreover, whilst enabling ethical banks to develop new markets and diversify their operations, deregulation efforts have also increased competitive pressures as ethical banks operate increasingly in similar, less regionally defined markets.

The Industrial District as 'Dis'analogy

Having highlighted how the ethical banking industry is organised within a system informed by the industrial district and embeddedness literatures, it is also of interest to note specifically how the failure of the district analogy highlights key issues relating to the ethical banking sector. First, it is obvious that using the industrial district as an analogy is ambitious and from the outset it seems unrealistic to expect that ethical banking will conform to the key criteria of the concept. Yet it is exactly in the breakdown of the analogy where its value can be found. The industrial district's origin in understanding the organisation of small firm manufacturing processes is difficult to translate directly into the non-tangible services offered by banks. Yet on the other hand, the more recent ideas about district configurations enhancing the chances to successfully compete with external, often large scale competitors seem suitably transferable as ethical banking also needs to compete with dominant players.

As the relationships of the industrial district are the benchmark, it is suggested that failing to establish similar relationships and behaviour will result in the failure of ethical banking. This highlights areas for improvement that would enhance interaction and cooperation between ethical banks and facilitate an increased exchange of resources and knowledge. The absence of geographic proximity, external and technical interventions in the ways ethical banks are connected and the inability and disinterest of experts within the sector to respond as a community to developments in the market are issues that require further attention.

The absence of geographic proximity within ethical banking exacerbates their current situation, mainly because the sector lacks a central organising agent. First, because banking is different to manufacturing industries and largely based on the provision of service to people, geographic

proximity is theoretically not an issue for the formation of a coherent sector. Ethical banks can be successfully independent from the location of their headquarters as communication and transport systems enable quick exchanges of resources and knowledge even to remote areas. Instead, the lack of a central agent that organises interaction between the different types of ethical banks appears to contribute to the disfunctionality of the sector as suggested in above discussion. None of the actors currently representing and coordinating ethical banks have the legitimacy and capabilities to develop a more comprehensive offering and are unlikely to be granted this in light of the vast differences displayed by the various actors. They have also not developed an internal understanding of why the sector needs to be substantially different to commercial banks to justify its limitations in offering services and competitive rates. The result of all this is an increasing weakening of the sectors' ability to organise and act collectively underlined by the increasingly divergent commercial and niche focus of its members.

The second point proposes that continuous external and technical interventions in the way ethical banks organise themselves will result in the break down of existing relationships. Similar to the context of the financial crisis argued by Erturk et al (2012: 33), ethical banking has experienced a variety of reform ambitions that resulted in the shrinkage of the sector by assets driven by externally induced demutualisation of building societies which also increased competition outside of ethical banking, for example by increasing the PLC's market share in mortgage products w. Moreover, new ideas about efficiencies, such as economies of scale and scope have reduced the number of firms present in the sector and significantly increased concentration within ethical banks by promoting mergers and acquisitions, the result of which is the dominance of the Co-operative Bank and Nationwide. By increasing competition between ethical banks, regulators have propelled a divergence of interests because existing markets are increasingly competitive which encourages niche activities. Lastly, the approach to regulation is poorly aligned to the sectors needs and largely

ignores the different risk profiles of member organisations compared to high street banks. Thus ethical banks' inability to act coherently and collectively may be interpreted as being caused by the reconfiguration of the sector's properties due to continuous changes in to their environment.

The lack of shared interests between the involved parties in supporting ethical banks, as well as their cognitive ability to recognise the underlying problems faced (Erturk et al 2012: 34f.) also contributes the disfunctionality of the ethical banking sector. Clearly, the dominance of neoliberal thinking in UK business has created a significant bias in the education of bankers, both through public higher education and private industry educational facilities, leading to an increased absorption of so-called ethical banking into more commercially oriented banking activities, particularly by the larger ethical banks in this study. The use of standardised performance measures like profit and liquidity ratios blurs the boundaries between ethical and commercial banking and signifies the growing importance for ethical banks to be seen as commercially successful and sustainable by customers, regulators and investors alike. In addition, the arrival of commercial financial expertise at board level may further push at least parts of the sector towards adopting industry norms and practices of commercial banks. Yet, the FSA is equally to blame for some of these developments by demanding a specific expertise to be present at board level (FT 2012). In sum, the points draw attention to an unfavourable concentration of commercial thinking in the sector driven by both economic elites as directors of ethical banks and the industry-education system that implicitly questions the usefulness of ethical banks as not conforming to a system that seeks to add value, and to share it amongst elites, above anything else.

Conclusions

Analysing ethical banking as a distinct sector implies that it is organised differently to other parts of the financial services industry. Because of its ability to link socio-political, cultural, economic and

network aspects of a sector, the concept of industrial districts and embeddedness theory have been used to guide the industry analysis in this chapter. The literature promotes a district as “... geographic concentrations of interconnected companies, specialized suppliers, service providers, firms in related industries, and associated institutions [...] in a particular field that compete but also cooperate” (Porter, 2000: 16); thus, findings are expected to reference those issues if ethical banking is organised as a district.

Although the analysis was unable to generate a straightforward answer to the question of whether ethical banks share a uniform cultural identity, the evidence suggests that they are proximate enough to have a common understanding of the problems faced by the industry. Yet, the expansion of their businesses through increasing commercialisation chosen by some ethical banks is distinctly different to the niche focus of others, thus indicating divergence of member firms. Services are seldom shared between larger competitive actors and external services such as insurance products are being bought by external for profit agents. Older provisions of complementary services such as between the Co-operative Banks and credit unions appear to have weakened. Connections highlight inward looking building societies and externally-oriented niche ethical which are linked to exchange of resources and information. Traditional trade associations that organise building societies and credit unions activities are questioned by member organisations as to whether or not they serve the needs of smaller organisations or act out of self-interest and as a result alternative providers. Facilitators of collective product procurement have emerged more recently. Niche ethical appear more focused on the organisations with which they collaborate and, because of the focus on specific goals, they tend to connect internationally to organisations with similar goals. Labour exchange is limited to director level showcasing internal movements of CEOs and inward movement from the wider financial services and legal professions at non-executive director level.

Overall levels of competition have increased, particularly between ethical banks, driven by the expansion of services and geographic trading areas. The effects of this can be seen in an increasing niche focus of smaller ethical banks. More specialised markets are increasingly ignored by mainstream banks, and, the drift between more niche focus and more commercialisation is likely to increase in future. Both the more traditional trade associations fail to provide for smaller members, because of larger members dominating the agenda and because of paternalistic attitudes towards their members. New representative trade organisations are demanded by smaller ethical banks to support their interests, including one specifically aimed at representing the interests of niche ethical banks whose goal is to create social value. The specialisation of niche ethical banks drives them to equally specialised trade associations with mostly international and European membership. With regards to industry regulation and legislation, ethical banks have unanimously complained about the wrong kind of regulation they are subjected to. Smaller banks also highlighted problems regarding the dissolution of protective legislation to provide an environment for competition and growth which undermines the ethos of ethical banking. Moreover, government intervention in bailing out high street banks is considered to have created an unlevel playing field benefitting the dominant players.

This chapter has highlighted that following the analysis of ethical banking according to the six criteria investigated, ethical banks fail to meet the industrial district criteria and appear relatively disembedded as a network. Collective action is weakened by what appears to be a political and economic front against ethical banking with regulators failing to provide a suitable institutional environment and high street competition. Despite there being a similar culture shared between ethical banks, the future trajectories appear to go into sharply different directions. Size and commercial interests eat into the distinctiveness of some organisations whilst others consider the preservation of their ethical and social focus to be the key to their success. This results in various

intra-district initiatives that might enhance the different ideas about the future development of the sector by organisations on either side. On the other hand, the features discussed above have implications for policy-making in supporting the ideas that underlie the sector as well as protecting the sector from being co-opted by commercial competition.

Chapter 8: Policy-making for an Ethical Banking Sector

One of the aims of the study is to investigate ethical banking as a subsector within the banking industry. In doing so, the study investigated the extent to which the various types of ethical banks are collectively organised and collaborate on important issues. Moreover, the availability of support structures through trade associations has been examined to understand the organisation of ethical banks. Overall, the findings point towards a sector that on the whole is poorly organised and lacks a collectively shared identity to support the various firms and to represent the sector's interests. The lack of central organisations that facilitate sharing of resources, communication between ethical banks and collective arrangements to represent the interests of all, particularly smaller, ethical banks has also been identified to prevent a strong ethical banking sector from emerging. Based on the findings, this chapter proposes the radical reorganisation of ethical banking to provide a subsector that is self-sufficient, rather than being dependent on services and access provided by large retail competition. In doing so, the chapter answers the fourth research question:

What conditions can be created by internal adjustments as well as external changes to regulation and the wider business environment to develop ethical banking as a self-sufficient subsector?

The chapter begins by discussing the possibility and need for ethical banking to be regulated as a subsector. It then summarises key findings from the empirical investigation of ethical banking both at firm and subsector level, followed by a brief discussion of possible alternatives to organise UK ethical banks based on conceptual and empirical accounts. The second half of the chapter discusses policy recommendations and their implications.

The Possibility of Policy-making at Subsector Level

The subsector is intellectually similar to the industrial district, which represents a group of firms that organise in a manner that is distinct from the wider industry in which they operate as discussed in Chapter 7. They collaborate and share resource to compete with external competition from the industry.

Rayner et al (2001) argue that the subsectors are of importance to policy-making for a number of reasons including their ability to resist and support change at sector level. More importantly they highlight that because of the “blurred boundaries and overlapping responsibilities” (p. 320) policy-making traditionally views industries as being characterised via a generally accepted “set of rules and norms”. In doing so, policy-makers potentially neglect the diversity of firm business models and ambitions and focus instead on the dominant players in the market. The preference of policy makers to deal with the largest organisations within a sector appears logical as after all, those organisations hold most market share, and in the case of banking, are system-relevant. Moreover, large organisations have more resources to spend on consulting and lobbying policy makers on complex issues (Patton and Sawicki 1993), thus making it attractive for policy makers to deal with those. In the case of banking, policy-making appears to be strongly skewed towards the interests of large retail banks whose aim is to ensure that their market share and ability to generate profits are not undermined by changes to sector policies (Hutton 2012). These lobbying efforts of large UK retail banks have been highly effective. At the beginning of his enquiry, Vickers voiced the possibility of splitting up the largest UK banks (Treanor 2011), which was turned into a non-structural separation of services “ring-fencing” in the final recommendations of the Vickers enquiry (ICB 2011a). A few months on, George Osborne attempted to further water down the impact of reform on large retail banks (Guthrie 2012; Hutton 2012; Treanor 2012d).

As a result, the significant demand for reforms in UK retail banking has resulted in remarkably little change to how banks are organised and operate, and the relationships between banks and their various individual and collective stakeholders still appear to principally serve the self-interest of the banks. The current reform ambitions in retail banking are largely linked to two generic ideas that propose quarantining retail banking from investment banking and increasing of competition in the market which is intended to produce a safer retail banking sector focused on customer needs. Yet whilst this may or may not produce the expected outcomes, it supports the idea that policy-making is little concerned with subsectors like ethical banking.

Indeed, both reform proposals, the structural separation of retail banking from investment banking proposed by Vickers (ICB 2011a) and John Kay's (2011) proposal to transform retail banking in narrow banking to meet consumer needs, offer some improvement to how retail banking is conducted presently; however, both accounts fail to acknowledge the existence of other types of banks that offer possibilities for change. Vickers' proposal is about reducing risk for future bank failure but it does offer remarkably little in terms of changes to the type of bank that provides retail banking services and the concentration of market share in few national chains. In fact, Vickers' report is actually not concerned with competition at retail bank level but instead focuses on "maintaining the UK's strength as a pre-eminent centre for banking and finance" (ICB 2011a: 7), and the few provisions to change retail banking should be considered adjustments rather than changes to how retail banking functions. The established retail banking sector illustrates that the self-interested nature is not questioned in principle and that customer needs are second ranked. Moreover, the divestiture of some branches by Lloyds and RBS is enforced by the EU in return for UK government bail-out and is not initiated by the UK government to reduce switching costs for consumers. Thus current proposals to increase transparency and shorten account transfer periods, as well as the establishment of the FCA offer little tangibles for consumers.

Kay (2011) on the other hand argues that restructuring retail banking to create a system of narrow banking will improve competition and consumer choice by reducing the power traders and investment bankers currently possess to structure retail banking operations. Kay holds large retail banks to account for being self-interested as they “promote the services the wholesale divisions of the same institution want to sell” (2011: 227) which is evident in the mis-selling of PPI and interest rate swaps. He further suggests that the current set-up is widely accepted to be the most efficient way to organise retail banking; however, he concludes that this is not the case because of the role banks played in creating of the current financial crisis. Restructuring retail banking in a narrow way introduces a different mentality that takes consumer needs into account and thus “demands that suppliers meet these needs with good products at low prices” which is essentially what being a retailer is all about, whether supermarket, clothes outlet or, in this case, narrow retail banks. In viewing it as a single sector rather than a sector with distinctive subsectors, Kay fails to acknowledge the possibilities of more radically restructuring banking by encouraging alternatives to mainstream retail banks.

In contrast, the discussion of policy reform in this chapter is focused on the subsector of ethical banking which, whilst being part of the retail banking sector, offers a variety of business models that differ from large retail banks in the outcomes they produce. So far the research has shown that, despite their similarities, ethical banks have failed to establish a self-sufficient sector that can act on its own behalf and influence the policy debate at higher level. Thus, this chapter explores the different possibilities to strengthen the sector in ways that instil subsector thinking.

Key findings

The empirical discussion of ethical banking in the study has produced some interesting findings that are relevant to develop an understanding of how the sector is organised. But at the same time, the findings point towards the failure of current government policy to provide a suitable environment to encourage and sustain ethical banking as an alternative to the dominant high street banks. Together, the findings open up a discussion of what a new, sector-specific and more engaged industrial policy might look like.

Competition and Complementarity

Relationships between ethical banks have been a key focus of this study and have been investigated both quantitatively as well as qualitatively. The quantitative investigation has found that ethical banks are more likely to be related to other ethical banks compared with other financial firms, as indicated by the negative E-I index (-.667). Whilst this draws a picture of ethical banks as having an interest in sustaining subsector relationships, it ignores the various conflicts between ethical banks themselves that have been uncovered in the interview process, particularly between small and specialised ethical banks and larger, more commercialised ethical banks: “We can’t compete with big competitors, they will always beat us on price” (Regional BS 1). Indeed, a closer look into the type of relationship that occur shows that building societies considered themselves to be connected to other societies because of their joint membership in the BSA, yet when asked about collaboration interviewees accepted that the exchange of resources and knowledge is limited. Niche ethical banks on the other hand appear more selective and their relationships are largely aligned to the specific niche markets they engage in and the relationships are characterised by cooperative arrangements within those networks.

The relationships between ethical banks reflect complementary and competitive arrangements within the sector. Building societies have historically collaborated on issues such as interest rate charges recommended by the *Council of the Associations*, but since the beginning of the 1980s, when deregulation occurred, competition between societies increased significantly (Boleat 1986). Further changes to policy in the 1980s and the demutualisation in the 1990s increased competitive pressure between societies and introduced external competition in mortgages as retail banks entered the market. Because building societies have historically been limited to mortgage dealing, the introduction of competition quickly led to industry consolidation and the abandoning of the established sectoral organisation and collective engagement which developed previously. Moreover, the ability of building societies to enter new product markets has been constrained by market access issues such as branch networks and a lack of expert knowledge in small societies. This has reproduced relatively similar business models with the exception of larger societies which offer services more similar to high street banks (see Chapter 6 for details). As a result the relationships between building societies have dissolved into shared membership but offer little room for collaboration as larger societies are little more than competitors: “[Competition] is more about the national players and building societies” (Regional BS 10).

Niche ethical banks on the other hand connect with organisations for a more specific purpose. Their relations tend to be more focused on the specific niche markets they engage in, which means that direct competition with other ethical banks is limited. Moreover, their business models tend to focus on specific products: societies that operate in the same market offer complementary products rather than competing products, enabling them to cooperate with one another and recommend customers to other niche ethical banks⁸⁶. The complementary product offering enables them to engage in

⁸⁶ To illustrate this, Ecology Building Society offers savings and mortgage products only to develop the sustainable housing stock whereas Triodos largely focuses on providing financing to business and organisations.

specific collaborative and cooperative relationships and therefore provide a more successful offering in the niche market which may be greater than the sum of its parts. The visibility of those niche ethical banks also means that competition from large ethical banks is potentially reduced as they lack the specific resources to enter and develop relationships with the niche market developed by the more focused competitors⁸⁷.

Dependence on Big Banks

The social network analysis in particular has pointed towards the authority of high street banks in the network alongside national trade associations and regulators. The centrality of organisations such as the FSA and the BoE⁸⁸, as well as the BAA and BSA⁸⁹ was expected; however, ethical banks were unhappy about the dependence on treasury and clearing service provided by high street banks as indicated by Niche Ethical 6:

“We don’t like it. [...]he reasons we don’t invest with many banks is things like investments in the Three Gorges Dam or dealing with corrupt regimes, arms trade; there are many more heinous things but we have to put the money somewhere.”

Essentially high street banks provide treasury and clearing services to ethical banks as ethical banks have no means to do so themselves. Although both Nationwide and the Co-operative Bank having clearing facilities, the interviewees confirmed that they effectively retreated from offering the services to other ethical banks, specifically credit unions, by increasing their prices and making it more cost effective for ethical banks to use Barclays, RBS or NatWest. Moreover, it seems that

⁸⁷ For example, the Co-operative Bank offers both green mortgages and SME financing to green/social organisations but their ethical policy is less focused which may alienate customers for example its financing of the expansion of Manchester Airport (Robbie, Gillett Manchester Mule Coop Bank;s refinancing of Manchester Airport.

⁸⁸ Banks and other financial services companies are linked to the FSA (and often the BoE) as they are regulated through those regulatory organisations.

⁸⁹ BSA and BAA are the largest trade associations for banks and building societies so they will have a significant membership from the investigated population.

neither Nationwide nor Co-operative Banks are interested in offering more services to other ethical banks as volumes are relatively low (Regional BS 10, Regional CU 4). What this essentially means is that ethical banks are dependent on the generosity of high street banks to offer reasonable rates that will allow ethical banks to make returns on their investments into the markets (treasury) and to finance their settling of commitments (clearing) in an increasingly market based banking system.

Trade Associations

A third finding mirrors a demand, particularly from smaller ethical banks, to make changes to the way the industry is currently represented. Some interviewees highlight that the BSA is strongly aligned with the interests of larger building societies and ignores the interests of smaller societies:

“We are down to 48 societies and one represents over 50% of the movement and inevitably everything gets skewed to that view.” (Ambitious BS 2)

“ABCUL has a role to play in terms of lobbying and that sort of things but we are all independent and we are not quite clear on the ABCUL’s end goals.” (City CU 2)

This view is confirmed by the Co-operative Bank recently joining the BSA as a member (BSA 2012a), further concentrating the power of few large actors which are more commercially oriented than smaller building societies as indicated in the business model analysis in chapter 6. Moreover, smaller building societies have highlighted in the interviewees that they are interested in centralising some procurement processes, for example a joint purchase of insurance premiums to reduce costs:

“The only thing missing is a society for small building societies. Maybe they could share treasury, HR or similar and make a difference [...in sharing] services slightly easier and more likely. We would be marginally more cost effective, productive and resilient.” (Regional BS 1)

Mutual One, a mutually owned company has been established to provide services to smaller building societies reflecting that interest. Overall, the ABCUL appears contested as the leading trade association for credit unions, and alternatives groups (UKCU, ACE) have emerged to promote a different future for credit unions as regional and community-based lenders.

Niche ethical banks are organised internationally more than nationally with three major European and international networks concentrating on representing the interests of specific types of niche ethical banks. However, it is important to note that although those representatives might be able to further the presence and visibility of the sector, both to policy makers and potential customers, their influence on policy making at national level, for example in the UK, is likely to be limited. Hence it is of little surprise that British niche ethical banks are interested in having a specific group set up within the structures of the BBA to reflect their interests.

Current Regulatory Practices

The way in which ethical banking is regulated and legislated has a significant impact on how the sector is organised more generally, thus it is important to summarise the impacts of current regulations that affect ethical banks, both general approaches to policy making and more specific regulation that is focused on ethical banks.

The deregulation following the Big Bang in 1986 had a substantial impact on public policy making; specifically the dominance of policies created to enhance competition has changed the way the banking industry functions. The most prominent changes to legislation that affected, and still affects building societies is the ability for societies to demutualise which led to a significant drop in market

share for building societies in the 1990s. This made it harder for societies to compete collectively against retail bank competition, whilst simultaneously giving publicly owned companies significant market shares in the mortgage industry that had historically been dominated by building societies. It also relaxed restrictions on the types of products that are being sold through building societies which led to some building societies replicating services offered through retail banks, thus increasing competition between societies and for profit banks. Overall, commercial interests have been argued in Chapter 7 to have become more prominent over the past decade. Similarly, the Co-operative Bank has adopted a variety of products and services, including the early adaptation of 24 hour telephone banking, credit cards and the online-only bank “smile”(The Co-operative Bank 2012a), that are offered by retail bank competitors which has been encouraged by changes to legislation. These changes have significantly altered the relationship between ethical banks and retail banks.

On the other hand, the deregulatory actions have negatively affected the ability of smaller building societies to focus predominantly on mortgage lending as competition in this market has increased significantly. Furthermore, both UK and international regulators undermine the ability of building societies to remain competitive by increasing capital requirements despite a risk-adverse business model (HM Treasury 2010a; Norton Rose 2011). This is particularly problematic as building societies appear to have to pay the price for the reckless business large retail banks have conducted which, although briefly subjected to tough capital rules beyond Basel III, have recently benefitted from a relaxation of rules in an attempt to boost lending (Masters and Jenkins 2012). Moreover, enhancing competition between building societies by making it more appealing for societies to operate over larger geographical areas, also has potential negative effects on smaller societies as they have to compete with more efficient and well resourced organisations that can market themselves in similar ways. All of this makes it more difficult for small societies to differentiate their services. However, the increased competition in retail banking has helped to create niche actors outside the building

society sector that focus on specific customers and communities to evade competitive pressures from retail and larger ethical banks.

Despite the various benefits attached to niche ethical banks providing finance for social and green business development and charities (see Ethical Consumer 2012 for more detail), as well as their generally more prudent business models, the changes are barely reflected in government policy and regulation:

“It is an issue for us, to have to carry the same rules of regulation as Citibank and Barclays which doesn’t make a lot of sense as our risk profile is completely different[...] The regulators say they regulate banks they don’t regulate the ethics of banking. I can understand that but I think they need to understand that there are different models.”

(Niche Ethical 3)

Indeed, instead of promoting ethical alternatives, the government and retail banks together appear to push out established niche ethical banks through the “Big Society Bank” initiative which provides finance for community and social projects to organisations that are often excluded by high street providers. Both smaller building societies and niche ethical banks have voiced a demand for more appropriate regulation that recognises the differences in business models, and the potential risks posed to consumers compared to large commercial retail banks.

Overall, the research highlights a number of concerns voiced by ethical banks. Resolving these issues however is unlikely to be met by changing one specific aspect of regulatory practices, instead it may require a number of policy approaches to suit the specific needs of the ethical banking sector and a more hands-on government intervention to provide an environment in which ethical banks can develop sustainably and expand their market share. The following section will introduce alternative

concepts of regulating the ethical banking sector. The first idea draws on Rayner et al's (2001) approach to regulation that emphasises the importance of understanding sector-subsector relationships to provide a more suitable set of policy recommendations and to dissolve the conflict between top-down and bottom-up approaches to organise an industry. The second approach to regulation utilises examples of regulating cooperative banking activity in other European contexts to showcase well-established subsectors of banking established in Germany and the Netherlands.

Alternative Ways for Sector and Firm

The following discussion of two alternative ways to policy making and organising industries is crucial at this point, as it introduces and discusses an empirical and a conceptual account of how ethical banking can be regulated and organised in a different way.

Privileging the Subsector in Policy-making

One aim of this study was to investigate ethical banking as a subsector of UK retail banking. This idea is rooted in the different ideas about banking that have been introduced in chapter 2. The sector can be divided in three parts: publicly-owned banks with shareholder value driven business models, mutually or cooperatively owned ethical banks that aim to be profitable but customer focused, and niche ethical banks that are not driven by profit maximisation, but aim to generate social and environment value by working with a variety of stakeholders. Chapter 3 follows up on this distinction by introducing the industrial district concept which implies that ethical banks need to organise collectively to be able to compete with the much larger retail banks. In doing so ethical banks restrict competition within the sector while also increasing collaboration and connections between district members. Chapter 4 supports this idea of ethical banking as a subsector of banking

through sub-cultural theory, according to which it was argued that actors with similar interests are likely to group together and support one another, especially if there are considerable differences between the group and the environment they are embedded in.

This idea of ethical banking as a subsector of the banking sector is not only important in terms of informing the ways that data have been collected and analysed in this study, but is also relevant to formulating subsector specific policy and regulatory approaches as proposed by Rayner et al (2001) that recognise that ethical banks are different in comparison to large retail banks. UK industry policy and regulation draws on mainstream economic ideas about competition and efficient resource allocation via markets. This idea remains dominant, as illustrated by the Financial Conduct Authority's "competition objective and competition duty" (FSA 2011; FSA 2012b: 16), despite the problems caused during the financial crisis. Both the OFT and the ICB consider the approach to be ineffective for a number of reasons (ICB 2011a; OFT 2010). More importantly, however, it is not only the ineffectiveness that is cause for concern, but the effects competition has on ethical banking, particularly its ability to compete with large rivals, discussed in chapter 7 and summarised above. The failure of sectoral policy approaches at subsector level justifies a demand for a more nuanced approach to policy making that at least recognises the specific needs of this subsector.

The relationships between the sector and its subsectors differ and subsectors can overlap or be distinct from one another. Thus, it is an empirical question whether networks exist at both levels, as highlighted by Rayner et al (2001: 322), and the findings of the empirical research will impact on how policy-making may be structured. Their analysis of the Canadian Forestry industry highlights how policy-making has increasingly become a matter of "specialized subsectors dealing with specific aspects and implications". Despite a significant overlap in subsector membership, "interests in each

subsector was often significantly different” (2001: 324) and some subsectors had more influence over policy changes than others. If we apply this idea to the findings of this study and consider large retail banks to make up one subsector and ethical banks to belong to another subsector of the UK banking industry, we can see that, whilst there is some overlap between the two⁹⁰, retail banks have a considerably larger impact on policy-making than ethical banks. This could be the case for various reasons including the dominant market share of retail banks and because retail banks match the “basic rules and norms” set out by the sector (2001: 320). On the other hand, the authors point out that subsectors in the Canadian Forestry industry have created specific policy goals accompanied by tools to achieve those goals, which, according to Rayner et al (2001) balances the forces. However, the interviews have shown that the forces in the UK banking sector are not balanced at all, as large commercial retail banks have significantly more power and voice to influence policy change than small ethical banks. The effects of this poor representation of ethical bank interest in policy making has been described in the previous chapters and they generally draw a picture of decline in the diversity of business models and connectivity in the more traditional credit unions and building societies subsectors and the emergence of a new, niche focused subsector.

Nonetheless, what this discussion reflects is the importance of recognising the different needs of specific subsectors to sustain their ability to offer alternative banking services. More importantly however, it makes a case for sector-specific policies and regulations demanded by interviewees which recognise the differences between a stakeholder and shareholder business model.

⁹⁰ Larger ethical banks compete with large retail banks and replicate some of their business model characteristics and product market features

Organising Subsectors in Germany and the Netherlands

The importance and benefit of having sector-specific policies is clearly visible in the relative successes of the cooperative banking sectors in Germany and the Netherlands. Of course, many of the distinct aspects of how these subsectors are organised can be related back to historic developments but nonetheless, contemporary policies can have a significant impact on the sector, as illustrated by the demutualisation of large parts of the building society sector in the 1990's in the UK.

One of the key features of the German banking system is the three-pillar structure⁹¹, which structurally separates the cooperative banking sector from savings banks and commercial banks (Ayadi et al. 2010). The cooperative banking sector is organised as a *Verbund*, which refers to the networked set up of the sector. The connections between organisations are based on equal standing and rights of the independent cooperative banks rather than organised hierarchically, and competition between the various banks is restricted to specific regions. More importantly however, the network features a number of central institutions that provide a variety of services to their member banks including insurance, mortgage, leasing and credit products. But because of the structural partitions, German cooperative banks have developed central banks for clearing and treasury purposes, most importantly the DZ-Bank (Ayadi et al. 2010). As a result, cooperative banks in Germany are relatively independent from the retail outlets of large commercial banks, and because products are provided by what can be described as intra-district organisations and not by external agents, the content and distribution of the products and services is relatively similar.

⁹¹ For more information, please refer back to the discussion in Chapter 2

Table 8.1: Comparison between largest and smallest organisations⁹²

| | | UK | | Germany | | |
|---|----------------------|-------------------|----------|--------------------------|-------------------|----------|
| | | Assets in £mio | Branches | | Assets in €mio | Branches |
| 1* | Nationwide | 191,397 | 800 | apoBank | 39,100 | 54 |
| 2 | Co-operative Bank | 46,431 | 342 | SB Baden- Württemberg | 11,754 | 42 |
| 3 | Yorkshire | 22,722 | 178 | Berliner Volksbank | 9,230 | 155 |
| 20 | Furness | 842 | 1 | Bank Bistum Essen | 4,226 | 1 |
| 50 | Century | 23 | 1 | Struvenhütten | 13 | 1 |
| Difference between 1 & 2 (3); and 1 & smallest organisation by assets | | | | | | |
| | 2 as % of 1: | 24.25 | | 2 as % of 1: | 30.06 | |
| | 3 as % of 1 | 11.87 | | 3 as % of 1: | 23.61 | |
| | 20 as % of 1: | 0.43 | | 20 as % of 1: | 10.81 | |
| | 50 as % of 1: | 0.01 | | 1136 as % of 1: | 0.04 | |

*position within national network according to size
(Source: BSA, The Co-operative Group, BVR)

The centralised cooperative sector in Germany also guides developments within the sector such as the consolidation of cooperative banks. As a result, German cooperative banks are less dominated by few organisations as is the case in the UK. Table 8.1 compares the size of mutual and cooperative banks in the UK and Germany. In the UK, the smallest building society is only 0.01% the size of the Nationwide and assets held by societies fall quickly when compared to the largest mutual. In Germany however, where there are many more cooperative banks, the difference between the largest and the smallest cooperative banks is still substantial but smaller than in the UK. Moreover, assets held decline more slowly and the 20th largest institution is only a tenth the size (or 10%) of the largest. Overall, it seems that the German system is not dominated by one specific ethical bank which is a result of organising banks regionally or by specific niches.

While the structure of the German banking sector is not perfect, it has evidently created a third system of banks that exists alongside private and savings banks. The German system of cooperative

⁹² Excludes credit unions

banks manages to integrate most of its members' banks product and service needs, and whilst this creates dependencies, the member banks can chose to procure services elsewhere. Indeed, many of the functions of this central organ already exist in one form or another in the UK; yet the fragmentation of the industry may limit access to it for different types of ethical banks, reducing the savings potential from economies of scope and scale that the central organ could potentially realise.

The Dutch system of cooperative banks was modelled on the German system but is different in some important ways. For example, two central banks emerged in the late 19th century so that cooperative banks could benefit from economies of scale (Groeneveld and Sjauw-Koen-Fa 2009) and merged in the 1970s to form Rabobank. Although it too is made up from member banks owning the central bank, the functions and power of Rabobank Nederland exceed the level of influence held by the DZ Bank; thus, the system of cooperative banks is more centralised than the German equivalent.

Otherwise, the systems are similar in that the Dutch cooperative's central bank owns specialised subsidiaries and is active in wholesale banking whereas member banks are limited to retail banking (Ayadi et al. 2010).

Rabobank Nederland's establishment was driven by the need to realise the economies of scale that have been identified by interviewees as lacking in UK ethical banking. The emergence of Mutual One⁹³ providing economies of scale in specific areas, such as insurance for the bank, appears to be similar, yet ownerships structures and the dependence on its members means that the services provided are far from those provided by Rabobank. Thus, it provides an alternative way of organising ethical banking in the UK horizontally through collaboration and cooperation by extending services provided to all members via a mutually owned and empowered central actor.

⁹³ A mutually owned service provider to building societies to enhance competition – www.mutual-one.co.uk

Overall, both the conceptual and empirical ideas illustrate that subsector specific approaches to policy-making appear to be successful in both sustaining the sector and advancing the interests of the specific subsectors. Privileging the subsector suggests that it is effective to identify subsectors and their specific interests and to recognise those when making policy, both at sector as well as subsector level. Rayner et al (2001) also observe a fragmentation of the sector into subsectors that may or may not share interests, which is relevant as it benefits the understanding of the relationships between sector and subsectors in the UK banking industry. Crucially, the limited overlapping interests of ethical banks and retail banks suggest that policy-making must reflect those differences, which has been shown to be successful in both the German and the Dutch cooperative banking sector. Thus, it appears important to consider the sector/subsector relationships when promoting changes to how ethical banking is organised and regulated. The next section will use the idea of providing more specific policies for ethical banks as a subsector of the banking industry as it discusses and recommends specific policy initiatives to support the sectors development.

Policy Recommendations

The research so far has highlighted that ethical banking appears to receive little attention from policy makers and that approaches to regulate ethical banking are driven by mainstream economic ideals instead of recognising the differences between ethical banks and large retail banks. This section explores a number of policy objectives that aim to reorganise ethical banking so it can operate more collectively and more independently from for-profit finance. The first point looks at introducing a new approach to policy making that recognises ethical banks as different to high street banks, both in how they operate, by minimising risk and increasing transparency, and with regards to the bank's culture focused on consumers' needs. Following this, the proposed reorganisation of

retail banking aimed to provide an environment that is less dominated by few, large actors is outlined. The third point details how ethical banking itself can be reorganised by strengthening its institutions, as highlighted in the German and Dutch examples, and by organising horizontally in specific areas with limited geographical overlap to restrict competition between ethical banks. Next, the possibility of integrating niche ethical banks in a more centralised ethical banking sector in the UK is discussed. Lastly, ideas to align ethical banks' interests to form a more coherent sector are outlined, including education and training programmes designed specifically for the sector.

Policy-making for a Subsector

The most agreed upon finding from interviews is the lack of suitable regulation for ethical banks. Interviewees argued that by being regulated just like normal banks, the regulators ignore their different objectives and working cultures and there are regulatory limits to services offered (HM Treasury 2010a). Instead of being rewarded for a more prudent approach to banking and for a culture that generally does not encourage mis-selling but rather promotes fairness and transparency, ethical banks have to comply with a standardised approach to regulation that is expensive and time-consuming. This can be especially problematic for smaller ethical banks, as noted by Niche Ethical 1:

Where the impact of the crisis had greatest effect is with regulation and the increasing weight of the regulatory burden on smaller institutions like us and dealing with the range and complexity of changing regulation." (Niche Ethical 1)

Instead, regulators should provide ethical banks with a more focused approach to regulation that does not only focus on competitive aspects of the industry but actually reflects the risk posed by specific organisations. The collapse of small ethical banks with assets seldom reaching above £10 billion will not have the same impact on the stability of the financial system as the collapse of

large retail banks with assets of £1trillion or more. Yet the likelihood of collapse is limited in the first place because of more restrictive regulation that should be recognised by the regulators and result in lower capital requirements. Moreover, the special relationship between customers and owners of ethical banks should be considered by regulators as it can have a significant impact on the corporate culture of ethical banks. Smaller ethical banks are particularly affected by the mismatch of regulation with the nature of their business and they are not necessarily interested in competing directly with large retail banks when they lack the resources and incentives to do so. Their members do not demand growth and ever increasing returns but rather a stable and reasonable interest rate paid on savings, providing the ethical bank with a motivation to act prudently. Moreover, the relationship between customer/member and the organisation is built on trust and long-term interests which should limit the extent to which self-interested behaviour such as mis-selling and excessive charges will occur. Similarly, the relationship between niche ethical banks and their niche markets appears to restrict the type of products and investments the organisations offer because of the specific interests of their markets in the environment, local community or charities.

Thus, a new approach to regulation for ethical banks should reflect both the cultural differences and the actual risk posed by smaller scale ethical banks. Because of a more prudent and risk-averse approach to banking, ethical banks should benefit from a reduced capital adequacy ratio instead of having to increase their capital alongside large retail banks. This is particularly important as ethical banks cannot raise capital with the ease of publically traded banks and as a result, ethical banks are forced to increase their capital ratio, hindering their ability to respond to demands for financing in their region or niche markets. Furthermore, the information provided by ethical banks to the regulator and the paper work associated with it should be appropriate and reflect the size and complexity of the organisation. Ethical banks that limit themselves to basic intermediation should

not be asked to fill out the same complicated and long forms that are filled out by retail banks with significant exposure to financial markets and derivatives.

There also is a strong case for taking the organisational culture of ethical banks into account when deciding how to regulate them. For example, targets set in commercial banks increase risk-taking and reduce incentives to be diligent. However, ethical banks have less incentive to maximize short-term sales as they are more focused on building a long-term relationship with customers. In order to succeed, ethical banks attempt to build a relationship on trust and transparency, a situation well illustrated by the depositor/borrower engagement events organized by niche ethical banks. However, claims by mutuals to be run by and for members should be substantiated more strongly by giving members more say in the running of their building society. The current election system in place seems unfit to give members a voice and in actual fact has been argued to look after the interests of directors (BSMA 2012a). Membership involvement could be extended to give members a say on important operational and strategic issues. For this to be feasible, members should be elected to director level to create a German style system of co-determination (Streeck 1997) that balances member interests and director interests. Such interests appear to have diverged from each other during the consolidation of the industry since the wave of demutualization in the 1990s leading to the growth of individual societies and limiting the member impact.

Reorganising Banking

Reports from the OFT, ICB and Treasury agree that retail banking fails to be competitive in the UK and that entry and exit barriers are too high (ICB 2011a; OFT 2010; Treasury 2011). Ineffective competition is linked to high switching costs, limited branch networks and weak brands of new challenger banks. Moreover, large retail banks in the UK are highly concentrated and during the

financial crisis, have become more so. At the same time, large retail banks have been acting in socially undesirable ways that include: risking private savings in complex casino banking which led to their initial bail-out during the financial crisis; mis-selling insurance and hedging products to both private consumers and SMEs; and by rigging the LIBOR rate (Weatley quoted in Wilson 2012). They also continued their self-interest in banking and undermined attempts to change regulation and industry practise (Hutton 2012). Because of the undue power large retail banks appear to have in the market place and at the political level, as highlighted in Froud et al. (2011), large high street banks should be broken up and limited to only capture a certain percentage of the market share as previously enforced in the US by the Glass-Steagall Act.

A question that requires considerable thought is how to break up banks. Simply splitting investment and retail banking is unlikely to suffice in creating effective competition in UK retail banking as it ignores a more fundamental questioning of shareholder value in retail banks and challenger banks. They have been positioned as alternative, yet by becoming more mainstream they are likely to leave consumers with little real choice, especially those seeking more “ethical” banking services. Yet other options are unconventional and are likely to meet considerable resistance from UK economic and political elites. However, it is important to consider both the split up of large retail banks into regional entities and a system of private banks that operate nationally but are restricted in the services they provide. For example, it could be made more onerous for retail banks to operate a mortgage division, justified by previous misconduct, thus preventing them from using their scale as a competitive advantage. This would also encourage consumers to shop around more and switch providers of financial services more regularly.

A system of regional banks would have a clear advantage in that it reduces individual market share and at the same time promotes the development of regions outside Greater London by having headquarters based in other parts of the UK. This could stimulate local developments and have a positive impact on the economy more generally by promoting financing initiatives in less successful UK regions, rather than focusing activities in London. Benefits may also include increasing employment and tax receipts in the regions. The services offered by regional private retail banks would compete with one another as well as building societies and credit unions. Overall, the systems could be organised in a way that allows people to more easily transfer their accounts from bank to bank should they move into a different region. Regular commuters can access their bank accounts through the extensive LINK network already in place. Moreover, because online banking is becoming ever more popular (UK Payments Administration 2010), regional retail banks can compete nationally for online customers, which could serve as a suitable tool to maintain effective competition. Maintaining a system of nationally operative private banks could also be feasible if they are restricted to providing only specific services like current accounts and SME financing whilst other product categories, for example mortgage lending and insurance products are not available through those banks. Thus, it would provide incentives for consumers to shop around rather than using products provided by their current account provider. The system would create more choice for consumers and as a result be effective in retaining a competitive market as retail banks would again compete with one another as well as offering consumers the choice to opt for regional building societies. However, this concept has less positive impact on the regions in terms of employment and the regional integration as it is likely that the concentration of UK banks headquartered in London will remain. It also seems feasible to combine both ideas to create a system of regional and national private retail banks that compete with one another. For example, Barclays and HSBC could remain nationally operating whilst the part-nationalised RBS and LBG could be split up regionally. In this scenario competition would be strong between regional and national retail banks which would create benefits for consumers.

Large national chains of ethical banks could equally be broken up into organisations that operate in specific regions or focus on niche markets in an attempt to reverse the industry consolidation in recent years and reduce the ability of a smaller number of players to dominate the policy debate in the ethical banking subsector. Moreover, breaking up large building societies into regional actors could have positive effects on collaboration between building societies. Yet at the same time, the provision of online services will ensure that ethical banks remain competitive and provide efficient and cost-effective retail banking services because of direct competition from other market participants. Additionally, the re-regionalisation of ethical banks, or the focus on niche markets respectively, should contribute positively to the relationships between an ethical bank and its customers, as it helps to clearly define goals and conduct guidelines that can be assessed more easily by the communities and thus action can be taken more readily. The need to split up large banks and ethical banks, however, is a prerequisite for the reorganisation of ethical banking more generally into a horizontally integrated and more independent sector.

Horizontal Integration for Ethical Banks

The significant changes to the organisation of the banking industry proposed above should, however, be accompanied by further changes to how ethical banking is organised. One key element that emerges from the regionalisation and niche-focus of ethical banks is the need for stronger horizontal organisation. Because ethical banks are smaller scale and thus cover smaller regions or niche markets when compared to the larger private retail banks, they need to balance the market power of private retail banks by integrating horizontally. Ethical banks lack the back office efficiency of private retail banks and more importantly they are dependent on clearing and treasury services provided to them by those private retail banks. Horizontal integration would enable the sector, or its

central bank as in the case of Rabobank Nederland, to set rules and thus control the developments within the sector as set out by Ayadi et al (2010: 81). To balance the power given to the central bank to regulate and supervise member organisations, ethical banks would own and as such, can influence their central bank through elections and specific committees run by member banks.

There is a strong case for promoting the horizontal integration of ethical banks based on either the German or the Dutch systems established in the cooperative banking sector. This is because once the larger national ethical banks including Nationwide, Yorkshire and Coventry Building Societies, and possibly the Co-operative Bank have been split into regional societies, they would be significantly smaller and may lack the ability to compete with larger private banks. The organisation of ethical banks horizontally is likely to increase their collective power to compete with private retail competition on regional level by bundling services. In turn, this would make them more cost efficient, as well as possibly enabling members to use other ethical banks facilities for basic banking services. Alongside the providing economies of scale and scope to the sector, Fonteyne (2007) promotes the ability of integrated networks to provide mutual support mechanisms. Ethical banks might reject any top-down pressure to integrate into a national network, but because of the success of organising cooperative banks in this way across Europe, doing so appears to be justifiable. Moreover, Fonteyne (2007) and Ayadi et al (2010) highlight trends of increasing integration and decision-making through central institutions. This often creates a two-level cooperative system of member banks owning the central organisation which in turn owns a number of mutual services providers discussed in the next section.

Centralisation of Services and Clearing

Hierarchical integration of ethical banks in the UK could replicate the various ways of organising cooperative banking in European countries. Instead of establishing entirely new organisations and

systems, the central organisation can recycle existing systems and reorganise them. Rather than creating a new clearing system, the central bank of a horizontally integrated ethical banking sector could fall back on the one that was originally created by the Nationwide and when broken up into regional societies could serve as clearing house for ethical banks in the UK and be mutually owned. Similarly, the various trade associations could, once reorganised and aligned with the interests of a horizontally integrated ethical banking industry, continue their lobbying activity whilst teaching/training and marketing functions would be bundled in this organisation as well. Moreover, the centralised services offered through Mutual One should also be reorganised and integrated in the new organisation to offer support to members. Particularly the auditing and compliance services, as they replicate the auditing association (*genossenschaftlicher Prüfungsverband*) offered to German cooperative banks. The central procurement of insurance products by mutual banks, whilst initially useful, may be replaced by the establishment of a mutually insurance provider owned by the integrated network of ethical banks in the UK.

The establishment of mutually owned providers of services to ethical banks is equally as important as recycling existing structures, particularly in terms of warranting the independence of the sector long-term. Again, the German cooperative sector has a number of different products provided by directly owned subsidiaries including investment and insurance products, leasing and other credit products, mortgage products and a private bank (BVR 2012c). Cooperative banks also own customer services companies, a media outlet and firms that provide the IT and payments infrastructure to the cooperative sector. Some of the organisation may already exist, for example, Royal London is a large mutual provider of insurance products and CUNA Mutual provides both insurance and financial services to mutuals, and can theoretically be incorporated into a horizontally integrated ethical banking sector. Others might have to be established over time and in this way, ethical banks can increase or limit the centralisation of the ethical bank sector.

Niche Ethicals as Specialised Ethical Banks

Integrating mutually owned organisations, such as the building societies, horizontally in a centralised mutual/cooperative banking sector is relatively straight forward as they are owned by members and not by external investors. However, niche ethical banks are often owned privately or held in trust, which makes integrating them more difficult unless they chose to join the horizontally organised sector as member or associate member. The benefits of integrating niche ethical banks would be shared as ethical banks could sell the niche ethical banks' specific products through branch networks when and if appropriate, thus extending their product offering, and in return niche ethical banks would benefit from the economies of scales and services provided by the network. Yet there is also a danger for niche ethical banks of being closely associated with organisations that do not necessarily share their specific goals, which could alienate their customers, members and owners. The German niche ethical banks (GLS Bank, Ethikbank and Bank fuer Sozialwirtschaft) are members of the German cooperative banking sector. Yet, because many British niche ethical banks are not owned mutually, they may find it difficult to join a mutually organised ethical banking sector because of their form of ownership. Similarly, the German Umweltbank is not a member of either the Association of German Banks (*Bundesverband deutscher Banken*) nor the BVR (*Bundesverband der Deutschen Volksbanken und Raiffeisenbanken*) and operates largely independently.

It is important to note that currently most niche ethical banks are members of the BBA. Whilst this might be reasoned by the fact that they are excluded from membership in the BSA as they are not cooperatively or mutually owned, it also raises questions about their willingness to change their current affiliation. The interviews have highlighted that they are interested in establishing a working group for similar organisation within the BBA. Moreover, interviewees have distanced themselves from mutual owned organisations because they consider them to be too similar to normal banks.

Although this questions their membership in the BBA, it is a pragmatic decision to have some representation in the UK. Because of their specific focus, niche ethical banks are able to operate within the current regulatory and environmental framework and possibly benefit from scandals at larger banks as customers might consider them to be the only real alternative. Additionally, niche ethical banks appear interested in forging international alliances and networks to voice their ideas about banking and to develop institutions supporting their goals, such as the Institute for Social Banking. Thus, it is questionable whether or not niche ethical banks will engage with a mutual/cooperative ethical banking sector in the UK. Instead, they may remain loosely affiliated to either private or mutual national banking associations and strengthen their international networks.

Aligning Industry Culture and Education

The proposed changes to the industry organisation and the regulatory environment highlight the need for changes in the training and education of staff both at managerial level and in customer facing positions. The formation of skills and expertise in employees should follow a relatively standardised protocol throughout the sector and channels to facilitate staff development should, and could, be centralised. Both the BVR and Rabobank Nederland have established sector internal training and skills programmes to educate employees in a way that strengthens the cooperative ideas about banking, thus promoting a more prudent, sustainable and customer focused banking culture. Thus, a centralised provision of education and training which is similar to the one established between German cooperative banks, does not only serve the spread of technical and regulatory knowledge throughout the sector, but could also strengthen the cultural bond of ethical banks by promoting similar ideas about banking as proposed by Germany's BVR career slogan: "To achieve more together" (BVR 2012b).

Current training efforts in UK ethical banking are ad-hoc organised training courses provided by the ABCUL, Mutual One, BSA and UKCU, or directly by larger employees, and are offered to existing staff. However, many graduate positions are filled with students from business schools and economic backgrounds, thus, the pre-existing ideas about banking might create cultural misunderstandings. An ethical banking sector could offer both apprenticeships and part-time degree courses with partner universities focused on cooperative retail banking, similar to those offered by the International School of Finance in London that are aimed at private banks and their staff. Instead of offering mainstream financial perspectives on banking and the importance of trading and markets, a similar organisation for ethical banks should particularly focus on banking as provider of financing to the real economy and real people. Establishing institutions that can provide education and training to a mutual banking sector in the UK is relatively straight forward as indicated by the establishment of the Institute for Social Banking in Bochum which provides training and study opportunities to employees of niche ethical banks and existing initiatives in the UK.

Implications

The chapter has explored a number of ideas that promote a more centralised ethical banking sector. The changes are radical compared to the mainstream ideas of ring-fencing and increased competition and thus, the proposals are likely to face resistance from political and economic elites as well as ethical banks themselves. However, to support the sector and grow a market for ethical banks outside its current niches, UK ethical banks and regulators should learn from European contemporaries and re-organise ethical banking to provide consumers with a more diverse and competitive retail banking environment. Government should provide expertise and financial support to create institutions that support the ethical banking sector. After the initial set-up, the organisations' ownership could be transferred to ethical banks themselves and be owned mutually

on a one-member-one-vote organisation which is in line with the government's commitment "to foster diversity in financial services, promote mutuals and create a more competitive banking industry" (HM Treasury 2012b; Mutuo 2011).

The initial resistance to more substantive reforms in retail banking is weakening amidst the LIBOR and mis-selling scandals and prominent figures within finance accept that it is not enough to make adjustments to how retail banking is conducted in the UK. Andrew Haldane, for example, argues that the *Occupy* movement was right in its radical analysis of the causes of the crisis (Kuchler and Jones 2012) and he now suggests that it is possibly best to break up large retail banks despite the earlier agreement on ring-fencing (Elliot 2012). Similarly, Mervyn King has repeatedly voiced concerns about banks offering both retail and investment services and favours the breakup instead of ring-fencing investments (2012). Moreover, in its *roadmap* to turn the FSA into the FCA, the FSA also claims to take a more proactive role in regulating retail bank conduct in future and introduces new tools to intervene in the markets, such as by banning products that have no consumer benefits or restricting financial promotions (2012b).

Despite the anticipated resistance in the UK, the success of organising cooperative banks in a more centralised fashion in other European countries creates a case for promoting ethical banking in the UK to increase the diversity of banks and consumer choice. The current competition-based system means that small ethical banks cannot compete effectively; nor are they able to operate independently from private retail banks. The sector-driven consolidation and government interests to turn the Co-operative Bank and Nationwide into national retail banks are ineffective because in doing so, these "alternatives" become more mainstream leaving little real choice for consumers, especially those seeking more ethical options. Even if retail banks survive the reform ambitions in

their current form, it is imperative to strengthen and to centralise products, services and back-office functions of ethical banks to promote an alternative sector that can challenge national retail banks. Government and regulators have the opportunity to promote a different kind of banking that is demanded by parts of society and other stakeholders of banking by supporting changes to regulation that recognise the different ambitions and business models of ethical banks that result in more prudent firm behaviour. Reducing the regulatory burden for ethical banks would send signals to the markets that risk-averse and customer focused business conduct is recognised and rewarded by the government, acting as an incentive for new ethical and social businesses and banks to be established. It is also fully consistent with the ambition of the incumbent UK government to cut red-tape for small and medium sized businesses as reaffirmed by Michael Fallon, UK Business Minister (Hurley 2012).

Overall, the proposed changes to the ethical sub sector are representative of an approach to organise and regulate ethical banking, providing an environment which promotes banking for customer needs as a real alternative to the retail mainstream. The recommended changes may at first appear to be overwhelmingly against large retail banks; however, they have long-term benefits attached to consumers, taxpayers, ethical banks and private retail banks by increasing consumer choice.

Chapter 9: Conclusions

The research presented in the preceding chapters of this thesis explores the ethical banking sector in the UK using social network analysis, business model analysis and sector analysis informed by the concept of industrial district.

The work was motivated by what appeared to be a disinterest on the part of political and economic elites to support an alternative form of banking sector. Various actors within and outside the banking sector including Andrew Haldane, (Director for financial stability at the Bank of England), the *MoveYourMoney* campaign and the *Occupy* movement, have demanded a different kind of banking based on the need to build a stronger retail bank sector that features more competition and more focus on customer needs. However, to date measures to change retail banking have been limited to modest structural and incentive adjustments to boost competition and modify the banking culture.

This final chapter outlines the conceptual context, summarises key findings, contributions and limitations of the research and discusses areas for future research.

Conceptual context

The research set out to explore ethical banking and has developed an understanding of ethical banks' business models, their motivations and ambitions, the organisation of the subsector and how that interacts with mainstream banking, the regulatory framework and its reform. The study has also sought to identify the type of intervention needed to promote ethical banking as an alternative to established mainstream retail banking. Overall, the theoretical framework reflects the lack of

previous theorisation and research in the field of ethical banking, which is to do with a lack of interest from policy makers, academics and other stakeholders prior to the financial crisis. As an inevitable result, ethical banking was not considered as a suitable alternative to high street retail banking in the post-crisis reviews of UK banking.

The study sought to answer four questions about:

What are the network structures underlying the ethical banking sector in the UK and how do they impact on competition and strategic alliances between ethical banks and the other financial services organisations?

How does the ethical approach of the banks translate into bank objectives and performance?

How is the ethical banking sector organised internally, and what is the role of external agents?

What conditions can be created within the sector by internal adjustments and external changes to regulation to support the development of a self-sufficient ethical banking sector?

The temporal context is important: the research for this PhD was conducted and written up in the post-financial crisis period in which a number of debates about how to reform banking arose. The period also presented an unprecedented opportunity because hitherto the banking sector was not widely seen as problematic. After 2008 people agreed that some kind of change is needed, but most of the solutions put forward identified ring-fencing, narrow banking and increased competition in retail banking as adequate and implementable solutions. The net result therefore was very limited change to banking operations. Yet, ethical banks have been largely ignored by policy makers as a possible alternative way of restructuring banking except in two cases in which the government promotes ethical banks to expand into national chains of retail banks to shakeup of high street banking, as endorsed by George Osborne: "The sale of hundreds of Lloyds branches to the Co-

operative creates a new challenger bank and promotes mutuals" (Treanor 2012c). However, it can be argued that these expansions into national chains create more of the same, rather than a different kind of banks. What is obvious is that there has been very little empirical research on the UK ethical banking subsector and thus there are few established arguments and ready-to-go policy ideas to promote ethical banking.

Ethical banks present an alternative way of thinking about banking which is motivated by, and conducted in ways that create social value. Within this study, ethical banking includes credit unions, building societies and niche ethical⁹⁴ which tend to be more integrated in local communities, connected to real economies and/or focused on customer service; thus, ethical banks are considered distinctly different to banks that are focused on shareholder value and ignore other stakeholder interests. The notion of ethical banking as a sector follows naturally on from these differences by proposing that the sector is, or needs to be structurally and culturally separated from mainstream banking to create a bond, or shared understanding of what it is aiming for.

The study represented a challenge as it investigates the idea of ethical banking as a sector which does not formally exist empirically and is not recognised in policy terms or by industry associations. The originality of the aim is visible in the appropriately creative combination of methods used to interrogate the idea of an ethical banking sector in the UK, because mainstream economic ideas that inform current policy making in banking seldom acknowledge issues other than competition and concentration. Instead, the study assumed that the relationships between ethical banks and a more collectively organised sector are important elements of the organisation of a subsector which can provide ethical banks with an environment that successfully enables them to collaborate, and thus

⁹⁴ Niche ethical banks include more specialised ethical banks such as Triodos Bank, Charity Bank and the Co-operative Bank

develop into a sector that represents a more attractive alternative to mainstream retail banking. To examine the ethical banking sector, the research design features a number of steps that focus on specific aspects of the sector, including: ethical bank business models; the analysis of the ethical banks' networks and their connections to mainstream banking; and how the sector is internally organised and influenced by external actors.

Summary of Findings

The social network analysis in Chapter 5 drew an insightful picture of ethical banking as a sector based on a network structure informed by connections between actors. According to the findings, ethical banks are more likely to engage with other ethical banks; yet, whilst this promotes the idea of ethical banking as a subsector of mainstream banks, the number and strength of connections differ considerably. At firm level, the statistical analysis showed that larger ethical banks hold influential positions within the network and are more connected, whilst the opposite is the case for small ethical banks. The networks of niche ethical banks differ as they feature connections to a variety of non-financial organisations such as charities, environmental and social organisations, which suggests them to be of importance to niche ethical banks' ability to achieve their aim. Most ethical banks are connected to two large national ethical banks, but the connection is seldom reciprocated. Moreover, ethical banks are also connected to important central actors in the form of regulators and high street banks, signalling dependence on public and private mainstream institutions and infrastructure, which violates the idea of the sector being separated from mainstream banking.

In answer to research question one, the ethical banking network appears to be dominated by a cluster of densely connected building societies, yet connections are relatively sparse elsewhere, or more focused in the case of niche ethical banks. Credit unions are poorly connected to other ethical banks

whereas there is some interaction between niche ethical banks and building societies. Moreover, the central position of two large ethical banks raises issues as to what kind of power and influence they have over other ethical banks and the sector. This emerging question is particularly important as large ethical banks do not reciprocate the connections, a finding which could be linked to their lack of interest in other ethical banks and thus in the sector. The search for organisations that are central within the network highlighted mainstream banks as holding authority, supporting claims that big UK retail banks dominate the market and access to it for potential future competitors, which is highly relevant for the discussion of future policies.

The business model analysis in chapter 6 developed a firm level understanding of ethical banks and demonstrated significant variation in how firms recover cost and engage with stakeholders. For smaller ethical banks, recovering costs is important in the sense that they need to create a surplus in order to be financially sustainable and additional profits are used predominantly to finance moderate organic growth. Stakeholder engagement in those banks is more developed compared to larger ethical banks and niche ethical banks developed strategies that enable depositors and borrowers to meet at events to ensure that the customers can identify with the achievements of small ethical banks. Ethics are shown to be of declining importance in larger ethical banks that adopt practices and service that are more similar to mainstream retail banks. Moreover, the inclusion of stakeholder management of large ethical banks is less pronounced and stakeholders' impact is mostly limited to voting rights that have little impact on the day to day operations of the banks. Thus profitability becomes a more important measure of success which marginalises the idea of a positive impact on the community.

The chapter has examined business models as set out in the second research question and overall it can be said that ethical banks are diverse actors that used different business models to achieve a diverse set of aims. Whilst smaller ethical banks appear more closely linked to customers and specific niche markets, such as charities, social and environmental organisations and businesses, and thus represent an alternative to mainstream retail banks, large ethical banks are more similar to established retail banks, and their growth in recent years is likely to make them even more similar. The findings are relevant to policy-making for an ethical banking sector as they underline the way that mainstream strategies of growth and consolidation affect ethical banks negatively as they appear to replace the aim to benefit community stakeholders with the aim to improve financial results.

Chapter 7 synthesised structural and business model findings and built on those findings to examine ethical banking as a subsector informed by the industrial district literature. The findings identified key issues within ethical banking starting with different ambitions of the firms, which again highlighted the idea that ethical banks cannot be large or mainstream as they lose their ethical identity. The lack of central structures, limited exchange of resources and information, and too little complementarity between ethical banks all highlight key deficiencies in the ethical banking sector, which together explain the dominance of mainstream retail banks as providers of information, services and products to ethical banks. Yet, smaller ethical banks showed an interest in developing a more centralised system aimed at sharing resources and procurement of products and services required. The research also highlighted that trade associations are poorly equipped, both in terms of resources and intellectually, to provide a central hub for ethical banks to exchange ideas and organise interest as they are dominated by two large ethical banks which operate in similar ways to mainstream retail banks. Government preference has been to grow the sector by consolidation to produce large actors that can compete with plc banks. At the same time government has shown

little interest in or ability to provide ethical banks with a regulatory framework that acknowledges their different interests, further undermining the sector's ability to organise effectively and retain its distinctive identity.

The third research question was aimed at gathering further information on the internal organisation of ethical banks and the impact external actors have on the ethical banking sector. Results show that ethical banks do not identify with a sector, particularly not if large national chains of ethical banks are included. Whilst the sector is disorganised due to a lack of a central actor, smaller ethical banks have stepped up efforts to collaborate more widely whilst large ethical banks appear to be more focused on growth and access to the high street which is a result of government policy and trade association interest in growing the sector. Overall, the research has highlighted that the different ideas about retail banking held by ethical banks lack support from the sector such as common interests and ambitions, trade associations coordinating activity, centralised back office structures and market access through non-mainstream firms. Equally external stakeholders fail to provide incentives to encourage the development of ethical banking.

The policies recommended in Chapter 8 target the weaknesses identified and adapt successful examples of ethical banking organised as a subsector that exist in other European states. The chapter outlines a set of policies that could provide ethical banks with an environment that supports the development of an independent ethical banking sector in the UK, as set out in research question four. A key condition for the success of ethical banking is market access which necessitates structural changes in the banking industry including splitting-up ethical banks and a German style separation between for-profit and cooperative type banking to establish a system of regulation that can more suitably identify and manage risk and conduct. In addition, by offering ethical banks access to the markets, back office functions and educational and training facilities via one or two central actors which are mutually owned through ethical banks, the sector could develop more independently

from mainstream banks and regain market share in the UK, thus establishing a sustainable and customer oriented alternative to high street banks.

Contribution

The contributions of this thesis cover both theoretical and empirical aspects, as well as policy relevance. As suggested in the title, the main contribution of the study is made by developing knowledge of ethical banking, both at the level of the firm and the sector. Other contributions are made in connection to the use of social network analysis as a theory and method in researching industry organisation. Network analysis is largely applied to people within or between organisations, but not often used to model the network of an industry, or a subsector thereof. Moreover, the intellectual connections between social network analysis and industrial district analysis that are often discussed theoretically (see O'Donnell et al. 2001; or Staber 2001b) or refers to specific exchanges of knowledge in a more positivist type research (Boschma and ter Wal 2007). In this study, social network analysis is used to explore the kind of network is created between ethical banks. This is different to other approaches as its population and thus network size was not pre-defined by the district but encouraged connections with the banking and finance sector to be considered.

Ethical Banks at Firm Level

The research has significantly enhanced understanding of ethical banks by analysing their business activity empirically using an adapted version of Froud et al's (2009) concept of business model which is based on two "basic requirements of financial viability and stakeholder credibility" (Bowman et al. 2012) and introduces a third criteria, *ethics*, that is particularly relevant to the study

of ethical banks to compare and contrast different ideas about ethics. With regard to business model, the research showcased the ability of the concept to be adapted to a number of industries and its ability to capture the ethical dimension of business alongside financial and stakeholder issues. Thus, the business model concept is responsive and can capture peculiar attributes of specific industries which underlines the success of Froud et al's (2009) conceptualisation of the business model in generic terms. By adapting and extending the original concept, the investigation did not only find that cost recovery and stakeholder engagement strategies differ, it also highlights the different ideas about and uses of ethics at firm level by investigating ethics displayed by the banks' aims and missions, their product and service choice, and ethical consumer scores. Results showed that larger ethical banks offer more products and generate more profits, but at the same time are less clear about their ethical intentions. On the other hand, niche ethical banks define specific social and environmental aims and select products in ways that enable them to achieve those goals.

Ethical banks than are not one "thing" – they offer a diverse range of different types of business models that offer consumers choice in the extent to which they want to subscribe to ethical banking. This results in a spectrum of ethical banks ranging from what can be described as member-owned mainstream banks for which ethics is often little more than marketing, to specialist niche organisation whose business model is built around achieving pre-defined social, charitable and ethical outcomes. In this sense, the business model research illustrates issues regarding consumer choice in ethical banking which is essential about compromising between mainstream and niche ethical banks. Mainstream banks offer full-banking services but lack a "true" ethical approach to banking whilst niche ethical offer fewer products that are more ethical. Thus the research highlights that most ethical banks are not a real alternative to high street banks as they are too narrowly focused on specific products and services, and thus fail to offer full banking services which inconveniences potential customers as they would have to shop around to cover the various product

and service needs they have become accustomed to. Vice versa, large ethical banks offer full banking services, but they become increasingly more similar to mainstream providers of retail banking services. This also means that they offer no real alternative, in turn raising an important question about the potential to establish a more ethical high street bank that offers full banking services.

Ethical Banks as a Sector

Within the research objective of establishing ethical banking as a sector, the industrial district concept has served as a useful starting point as it focuses on the internal organisation of a distinct subsector. The industrial district in its modern form idealises collectively organised industries featuring narrowly specialised SMEs with well established channels to exchange resources and information within its boundaries and a shared cultural understanding. Whilst being a useful concept to begin with, it has been extended to take relationships with important external actors, including competitors, regulators and governments into account as demanded by Markusen (1999). Using a framework that is rooted in the industrial district, made it possible to not only examine the organisation of an ethical banking sector, but also to what extent attitudes towards banking, ethics and ambitions are shared between ethical banks. Contrary to mainstream economic investigations that use concentration and competitiveness measures to assess the banking sector and to allow for comparison between similar sectors or across a range of sectors, this approach highlights problems that are more specific to the ethical banking sector in the UK which eliminates the requirement to contrast and compare findings.

The findings reflect the importance of using an approach that examines the internal organisation as well as the interaction with external stakeholders. Results show that the ethical banking sector lacks central actors that are able to coordinate sector activity and offer support to the diverse types of ethical banks. Additionally, it has been shown that ethical banks do not necessarily share the same

ideas about how ethical banking should be defined and what kind of developments are required to strengthen the sector. In particular, larger ethical banks with lesser focus on ethics show little interest in supporting smaller ethical banks; this divides the sector and has implications for the ability of ethical banks to create institutions, similar to those found in the Netherland and Germany, which can provide ethical banks with a more collaborative environment and offer support structures.

The inclusion of external actors in the network analysis has also highlighted particular issues such as the dependence of ethical banks on treasury and market access provided by high street banks which links directly to the previous point. Ethical banks do not have access to an independent provider of treasury and clearing services and because of this the Big 5 retail banks have significant market power and control market access which could affect ethical banks. Moreover, the two ethical banks with clearing facilities have grown considerably in size on the back of government support and as a result are increasingly less interested in supporting ethical banks by offering them access to clearing, treasury and back office functions. These findings are illustrative of the problems faced by ethical banks to operate independently from the UK banking sector and thus highlight potential future problems that require attention from government regulators. The cooperative banking sector in Europe, with direct access to treasury and clearing through mutually owned central organisations, has significantly higher market shares and are therefore able to compete with private retail banks more effectively. Thus, in order to grow ethical banking into becoming a true alternative to high street banks which repeatedly failed customers, ethical banks need to have access to independent provision of clearing and treasury. Moreover, the investigation of ethical banking as a sector has drawn attention to the problematic role of government agencies and regulators in supporting ethical banking as an alternative to high street banks by for example making ethical banks pay for the failure of large retail banks through increases in the FSCS levy and the increased regulatory burden.

Overall, the investigation of ethical banking as a subsector of the UK banking industry highlights the problems faced by ethical banks, both regarding the lack of internal organisation as well as the role played by other stakeholders. Moreover, it highlights the need to view the subsector as heterogeneous and internally conflicted which requires policy making to be more flexible than is feasible at present because of the rigidity of the current regulatory and legislative framework.

Network Analysis of Sectors and the Industrial District

The use of social network analysis to analyse ethical banking in the UK contributes to the use of network analysis as a method and theory in research industries. At its most basic level the research has shown that network analysis can be a useful tool in understanding network structures of industry sectors by investigating relationships between banks. Many previous attempts to investigate corporate networks were based on interlocking directorships, but the relationships examined in this study are based on self-informed ties between ethical banks which yielded a number of interesting results, particularly when combining network findings with interview data.

At sector level the social network analysis highlighted the dependence of ethical banks on mainstream banks, both through high in-degree and authority values for high street banks. Because of these findings, questions on the relationships between ethical banks and high street banks have been asked in the later interview stages to uncover more detail about the content of the relationships. Thus, it is fair to say that the network analysis has raised issues that could have otherwise been left un-researched. Moreover, the sector level relationship has highlighted that ethical banks that are similar are connected in similar ways. The statistical analysis of the networks also showed that organisational size and network size are correlated, which suggest that larger

ethical banks are not only likely to be more connected than smaller ethical banks, which can provide them with more opportunities in exchanging resources and knowledge, but also seen as central players within the sector based on high in-degree figures. This finding is particularly interesting as large ethical banks only considered themselves to be connected to a few ethical banks. This suggests that large ethical banks do not consider themselves to be as involved in an ethical banking sector as smaller organisations consider them to be. Therefore, recent efforts by the government to expand and consolidate ethical banks to create large retail chains, particularly the Co-operative Bank and Nationwide, to create a more competitive UK retail banking sector are likely to have negative impact on ethical banks' ability to network and exchange resources effectively, as established by interviews.

Moreover, the social network analysis has drawn up a useful empirically informed view on ethical banking as ethical banks tend to be more likely to be connected to other ethical banks as indicated by a negative value from the E-I Index (-.667) as well as structural equivalence. This finding illustrates that ethical banks show an interest to organise with and connect to organisations that are similar to them; thus, establishing a mutually owned, not-for-profit provider of clearing, treasury and other services should be accepted as a supreme alternative to being dependent on high street banks. Additionally, as discussed in chapters 7 and 8, such a provider would act as a central focal point for ethical banks which could have a positive impact on intra-sector connectivity in the sector by improving intra-sector collaboration and resource and knowledge exchange.

Findings also highlight that ethical banks, particularly Niche Ethical 2, 3 and 6 and Ambitious BS 2, which are more focused on creating social value in specific areas, are connected in different ways compared to the more traditional building societies and credit unions, despite their different underlying business models focused on mortgages, savings accounts or SME lending. Their focus on

social and environmental aims is reflected in their connections and highlights the importance to be part of the niche market and develop expert knowledge of and connect to the networks to succeed as lender within those markets. This explains why high street banks that are unwilling to invest considerable resources have generally failed to establish themselves in those niche markets. However, this need to gather specific knowledge about and focus on niche markets also raises questions about the ability of ethical banks to expand services to provide customers with full banking services without losing their ethical focus. Both the Co-operative Bank and Nationwide appear to have become increasingly mainstream by attempting to grow into alternatives to high street banks on a national scale which is illustrated by their involvement in the PPI scandal and revoking services from disadvantaged communities by shutting out bankrupt customers. It must be feasible to establish national services that more keeps more focused on social value creation, caps on pay ratios, local lending goals and redistribution of proceeds regionally.

Contributing to Policy-Making

In addition to the empirical and theoretical contributions, the study also provides valuable information to those interested in and responsible for the development of UK retail banking. By setting out a range of policies that are specific to the nature of the ethical banking subsector, it adds to the more general ideas of how to control retail banking in the UK that are currently debated by regulators and the government such as ring-fencing and narrow banking. The study specifically outlines how an alternative system of retail banks that is accounting for the needs of various stakeholders may coexist alongside mainstream retail banks by providing ethical banks with institutions that allows them to operate more independently. Moreover, the relationships forged between ethical banks and their stakeholders have been shown to restrict misconduct and increase customer satisfaction. This has implications for how mainstream retail banks conduct their business,

as it can provide them with incentives to focus more specifically on customer needs and to prevent future cases of mis-selling to customers.

Limitations

Whilst this study has produced interesting findings that answer the research questions, it does, however, have limitations that need to be discussed and reflected on. The lack of available and reliable data that could be analysed through social network analysis meant data needed to be gathered specifically for this study which created potential limitations of both measurements of relationships and access to the population. Additionally, because the data gathered is self-reported and cannot always be validated via other secondary sources the research findings are potentially biased. Further risk of bias arises because the research has been conducted by one researcher only. Moreover, the specific research approach taken in this study utilising both the industrial district and social network analysis have introduced further ambiguities which whilst being a necessary step, may have a potential impact on research findings.

The discussion of limitations of the research is common practise and doing so at this point should not be understood as an admission that the study is seriously flawed. Instead, it provides the reader with an overview of decisions made during the research project that were necessary because of the aim of researching how ethical banking is organised with respect to the relationships between ethical banks. Furthermore, the following paragraphs explain the steps taken to reduce the risk of bias at different stages such as sample selection and interviews.

The sample chosen in this research includes a variety of actors for whom ethics may be more or less important, including building societies, credit unions and more specialist niche ethical banks. Doing so was a necessary step for three reasons. First, the research aimed to understand ethical banking as a sector that is different to mainstream retail banking. Because this alternative sector's assets are mostly held by building societies, and credit unions are small but numerous, both were included alongside other more obvious cases such as Triodos and Charity Bank. Secondly, European alternatives to private retail banks are cooperatively organised as national sectors containing up to 1200 independent firms; thus it was decided that building societies and credit unions should be included in the sample. Third, the ethical banking network was constructed from ego-networks which means that having more cases increases the robustness of the findings.

The use of social network analysis required the collection of data on the ties between ethical banks and with the UK banking sector, which is not readily available. Moreover, there is no blueprint of how to best collect network data on relationships between organisations and the most common practise, the use of interlocking directorships, was not a feasible options as many of the organisations investigated do not publish information on directors which are readily available for Plc firms, or indeed do not have directors in the same sense in case of credit unions. The questionnaire constructed included a number of sections that gathered data, yet the measurements of the relationship that aimed to distinguish between arm's-length and cooperative relationships has yielded data that clearly showed different understandings of what those types of relationships refer to. As a result the categories have been collapsed to simply regard relationships between organisations to be existent or non-existent. The number of responses (43) may appear a limited result; however, respondents include major ethical banks and good variety of small- and medium-sized ethical banks that have been identified as being potentially important to the ethical banking network in the initial review. Credit unions were least likely to respond ($N_R=19$), which arguably has

to do with their small size and limited resources, but because they have the largest population ($N_0=300$) of any type of ethical bank, it has significant impact on the response rate. However, the findings from credit unions that are in the sample, match early formed expectations about the possibility of credit unions to connect to other organisations: their lack of resources and the absence of the necessity to connect to multiple agents because a considerable proportion of credit unions are run on a voluntary basis and only concerned with small communities in specific local areas. Contrasting problems also arose from getting access to large ethical banks as it is more difficult to identify key people within those organisations who are able to identify the relationships held with other ethical banks, and are willing to act as a spokesperson for their company. Despite these problems, one person in each of the two largest ethical banks have participated in the research and while the accuracy of the network data may have improved by having more than one person filling in the questionnaire, it was impossible to get more key personnel to participate. However, despite these potential limitations, the social network analysis has produced significant results that have been validated by secondary data analysis and interview data.

Limitations of using interviews are both linked to interviewer and interviewee biases. To limit their impact, interview claims have been validated against other sources, such as industry and government reports, and an interview guide was produced and made available to the interviewee prior to the interview taking place to structure the interviews. The research has chosen specific firms for interview because of findings from the social network analysis and the importance of the organisation to the sector in terms of size and visibility. Thus the sample is non random but includes 13 actors that were considered essential in providing diverse views on the industry. Experts in trade associations, regulators and high street competition were also contacted regarding their availability for interview; however, they declined the invitations, which is regrettable as it would have added a different angle to the issues gathered as relevant to ethical banks.

Last but not least, the theories that contributed to framing the research have been criticised on various levels. Yet it was felt that the idea of ethical banking as a subsector of UK banking is best researched by utilising the industrial district concept and social network analysis. The concept of the district has been extended to include other banks because these organisations have a significant impact on the organisation of the district as argued by Markusen (1999). As suggested by Emirbayer and Goodwin (1994), basic social network analysis has limited explanatory power which is particularly relevant here because of the missing data in the ethical banking network. However, the study was set up to control for this and network findings are used in this study as being predominantly exploratory findings. Interview and secondary data is used to put network findings into context and for explanatory purposes.

In light of these limitations, efforts have been made to minimise their potential impact on the robustness of findings. Thus, the research was designed to enable potential problems to be identified and dealt with early on in the research, which meant that the research could balance the downsides associated with employing particular theories and methods.

Conclusions

The aim of the thesis was to develop an understanding of ethical banking in the UK and whether and how it is politically, economically and culturally embedded in UK banking. To pursue this aim, the study attempted to model and analyse the ethical banking network using social network analysis and the business models of ethical banks to examine whether an ethical banking sector exists in the UK and to understand the kind of problems faced by such (putative) sector. Data on the banks' relationships with other organisations were gathered through questionnaire and interviews were

conducted with respondent firms to explore ethical banking as a sector from the perspective of ethical banks themselves.

Overall, the results of this thesis produced a number of interesting findings that contribute to a better understanding of ethical banking in the UK. At the broadest level, the results draw a picture of ethical banking as a disorganised subsector which is dominated by two players and lacking prospects to develop into an alternative banking sector that could compete with the full banking services offered by high street competition. Only if the sector manages to reorganise itself internally with support from external players could it form a more coherent and centralised subsector with a clear and shared understanding as to what its ambitions are. Thus the research highlights the potential of ethical banking which is expanding rapidly, but, at the same time, the research also raises the difficulties in developing ethical banking as a sector which retains its distinctiveness from high street banks.

In summary, the research findings are in line with current ambitions to develop and promote a more diverse and sustainable UK banking industry: ethical banks should receive more attention from policy makers as they are a set of diverse actors that has grown significantly since the beginning of the financial crisis in 2007 and, moreover could if strengthened, contribute to developing a stronger retail banking sector more responsive to customer needs. Government efforts to reorganise banking should include developing ethical banking as an alternative to Plc retail banks which would change competition by increasing consumer choice instead of creating yet more, large scale banks that offer more of the same.

Future research in banking and ethical banking can build on the findings of this study. Whilst building societies and credit unions have received some academic interest and some basic research is conducted by their trade associations, niche ethical banks have generally been little researched. This lack of research may be a result of the few ethical banks that are active in specific geographic areas and their focus on niche markets. Therefore, there is incentive and opportunity to research niche ethical banks within an international context by examining how they are organised in networks that are based on the ambitions of these organisations to have a positive impact on specific communities that are not limited geographically, but rather represent social movements. Alternatively, future research into retail banking conduct could make use of the various bank-customer relationships formed by ethical banks. Considering the shifting interest of regulators from light-touch to a more hands-on style of regulations which is set to be introduced with the replacement of the FSA with the Financial Conduct Authority, it is proposed that conduct and bank-customer relationships will receive more attention from the regulators. Thus, retail banks may find it useful to consider ways in which to imitate some of the stakeholder engagement tools used by ethical banks. Lastly, whilst social network analysis has received significant attention in recent years, it would be beneficial to compare the results of the network analysis to other ethical banking sectors elsewhere. Studying the relationships between UK ethical banks based on different types of data to compare the findings offers further opportunity to add to the empirical knowledge gathered on ethical banking in the UK but also provides social network analysts with an opportunity to examine the effect using different types of data can have on the network findings.

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Appendix A – Questionnaire

| <i>Introduction</i> | | | | | | | | | |
|--|--|--|--|--|--|--|--|--|--|
| <p>This questionnaire aims to map relationships formed between ethical banks and other financial institutions, businesses and social organisations. Although personal relationships are important in networking, this study focuses on those relationships formed between businesses.</p> | | | | | | | | | |
| <p>The person completing this questionnaire should have an overview over all or most of the business relationships that exist between their own organisation and other financial services organisations and should be able to judge the strength of those according to the rating described below. The participant is likely to hold a senior position within the firm. If you feel that it would also be helpful if one of your colleagues completed this survey, in order to give a fuller picture of all the relevant business networks, then please ask a colleague to complete and return this questionnaire too. All information provided will be kept confidential.</p> | | | | | | | | | |
| <p>Section a)</p> <p>The first part of the questionnaire lists UK banks in a variety of categories: High Street Banks, Building Societies, Alternative Banks and Other Banks. The classification of banks is used to make the questionnaire more accessible</p> | | | | | | | | | |
| <p>The columns on the right side of the page, next to this list of banks, provide a range of options, of which you are asked to select the one that offers the most appropriate answer in each case. The first two options ('Don't know' and 'No relationship') are straightforward and require no further explanation; nonetheless, it is important that you distinguish between the two options as accurately as possible. For the purposes of this study, not knowing an organisation is different to not having a relationship with an organisation.</p> | | | | | | | | | |
| <p>If there is a relationship between your organisation and any of the banks in the list, you are asked to select one of the options suggested in the scale from 1 to 3. This 3 point scale is intended to measure the strength of the relationship. "1" resembles a weak, or occasional relationship that is often of contractual nature. "2" resembles relationships that are of medium strength. Those may show signs of collaboration or occur relative frequent. The "3" indicates close, continuous cooperation between many members of the organisation including the sharing of resources and knowledge on regular basis.</p> | | | | | | | | | |
| <p>Section b), Section c) & Section d)</p> <p>The following sections ask for additional relationships that your organisation has with partners such as credit unions, industry organisations, government institutions (for example specific municipalities), religious institutions and Non-governmental Organisations (NGOs).</p> | | | | | | | | | |
| <p>If you have more organisations you would like to enter then rows, please feel free to enter them in section b). Section c) is UK-specific and section d) is interested in any associations outside the UK. The organisations entered are institutions that could potentially have relationships with your organisation. The blank rows are there for you to fill in the names of any other organisations that you have relationships with. You do not have to fill in all rows.</p> | | | | | | | | | |
| <p>Section e)</p> <p>In this short and final section, you are asked to list the partners you are most strongly connected with. Whilst doing so, please keep in mind that the strength does not necessarily reflect the financial value of the relationship, but should reflect the extent of collaboration between you and the partner organisation and the degree to which both organisations use each others knowledge and resources.</p> | | | | | | | | | |
| <p><i>Thank you very much for your cooperation!</i></p> | | | | | | | | | |

| | | | | | | | | | | | |
|-------------------|---|--------------------------|--------------------------|---|--------------------------|--------------------------|--|--|--|--|--|
| | | | | | | | | | | | |
| | Name of the Organisation: | | | | | | | | | | |
| | Your role within the Organisation: | | | | | | | | | | |
| Section a) | Please indicate which banks your organisation is connected to. | | | | | | | | | | |
| | High Street Banks | Don't Know It | No Relations | Strength of relationship arms-length full cooperation | | | | | | | |
| | | | | 1 | 2 | 3 | | | | | |
| | 1 Barclays Bank plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 2 Bradford and Bingley plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 3 HSBC plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 4 Ulster Bank Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 5 The Royal Bank of Scotland plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 6 Lloyds Banking Group plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 7 National Westminster Bank plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 8 Northern Rock plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 9 Sainsbury's Bank plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 10 Tesco Personal Finance Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | | | | | | | | | | | |
| | Building Societies | Don't Know It | No Relations | Strength of relationship arms-length full cooperation | | | | | | | |
| | <i>Top 5</i> | | | 1 | 2 | 3 | | | | | |
| | 11 Coventry Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 12 Leeds Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 13 Nationwide Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 14 Skipton Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 15 Yorkshire Building Society incl. Chelsea | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | <i>Top 6-20</i> | | | | | | | | | | |
| | 16 Cambridge Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 17 Cumberland Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 18 Furness Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 19 Kent Reliance Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 20 Leek Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | | | | | | | | | | | |
| | 21 Manchester Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 22 National Counties Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 23 Newcastle Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 24 Nottingham Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 25 Norwich and Peterborough Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 26 Principality Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 27 Progressive Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 28 Saffron Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 29 Stroud and Swindon Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |
| | 30 West Bromwich Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | | | | | |

| | | <i>Top 20-50</i> | | | | | | |
|----|---|--------------------------|--------------------------|---|--------------------------|--------------------------|--------------------------|--------------------------|
| 31 | Bath Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 32 | Beverly Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 33 | Buckinghamshire Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 34 | Century Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 35 | Chorley & District Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 36 | City of Derry Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 37 | Darlington Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 38 | Dudley Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 39 | Earl Shilton Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 40 | Ecology Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 41 | Hanley Economic Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 42 | Harpenden Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 43 | Hinckley & Rugby Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 44 | Holmesdale Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 45 | Ipswich Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 46 | Loughborough Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 47 | Mansfield Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 48 | Market Harborough Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 49 | Marsden Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 50 | Melton Mowbray Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 51 | Monmouthshire Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 52 | Newbury Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 53 | Penrith Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 54 | Scottish Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 55 | Shephed Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 56 | Stafford Railway Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 57 | Swansea Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 58 | Teachers Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 59 | Tipton and Coseley Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 60 | Vernon Building Society | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 61 | Chesham Building Society (part of Skipton) | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 62 | Dunfermline Building Society (part of Nationwide) | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| | Alternative Banks | Don't Know It | No Relations | Strength of relationship arms-length full cooperation | | | | |
| | | | | 1 | 2 | 3 | | |
| 63 | Alliance Trust Savings Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 64 | CAF Bank Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 65 | European Islamic Investmen Bank plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 66 | Islamic Bank of Britain plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 67 | Kingdom Bank Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 68 | Liverpool Victoria Banking Services Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 69 | Methodist Chapel Aid Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 70 | Reliance Bank Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 71 | The Charity Bank Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 72 | The Co-operative Bank plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 73 | Triodos Bank | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

| | Other Banks | Don't Know It | No Relations | Strength of relationship | | |
|-------------------|--|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| | | | | arms-length | full cooperation | |
| | | | | 1 | 2 | 3 |
| 74 | Adam & Company plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 75 | Airdrie Savings Bank | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 76 | Aldermore Bank plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 77 | AMC Bank Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 78 | Arbuthnot Latham & Co Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 79 | C Hoare & Co | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 80 | Church House Trust plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 81 | Close Brothers Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 82 | Consolidated Credits Bank Ltd † | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 83 | Coutts & Co | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 84 | Crown Agents Bank Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 85 | DBS Bridge Bank Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 86 | Fairbairn Private Bank (IOM) Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 87 | Hampshire Trust plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 88 | Harrods Bank Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 89 | HFC Bank plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 90 | Investec Bank plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 91 | Julian Hodge Bank Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 92 | Marks and Spencer Financial Services plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 93 | Metro Bank Plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 94 | N M Rothschild & Sons Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 95 | Rathbone Investment Management Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 96 | Schroder & Co Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 97 | Scottish Widows Bank plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 98 | Secure Trust Bank plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 99 | Smith & Williamson Investment | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 100 | Southsea Mortgage & Investment Co Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 101 | Standard Chartered Bank | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 102 | Standard Life Bank Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 103 | The Hardware Federation Finance Co Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 104 | Unity Trust Bank plc | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 105 | Vanquis Bank Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 106 | Weatherbys Bank Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Section b) | Does your organisation engage with any Credit Unions or other financial insitutions not listed above? | | | Strength of relationship | | |
| | | | | arms-length | full cooperation | |
| | | | | 1 | 2 | 3 |
| 1 | | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 2 | | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 3 | | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 4 | | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 5 | | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 6 | | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 7 | | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 8 | | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 9 | | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 10 | | | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

| Section c) Are there any other UK Institutions your Organisation engages with on a regular basis (i.e. Government Institutions, FSA, ABCUL, Civil Society)? | | | | | | |
|--|--|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| | | Don't Know It | No Relations | Strength of relationship | | |
| | | | | arms-length | full cooperation | |
| | | | | ← 1 | 2 | 3 → |
| 1 | ABCUL - Association of British Credit Unions Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 2 | FSA - Financial Services Authority | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 3 | BoE - Bank of England | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 4 | BSA - Building Societies Association | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 5 | BBA - British Bankers' Association | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 6 | UKCU - UKCreditUnions Ltd | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 7 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 8 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 9 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 10 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 11 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 12 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 13 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 14 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 15 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 16 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 17 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 18 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 19 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 20 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

| Section d) Are there any Institutions outside the UK your Organisation engages with on a regular basis (i.e. European Cooperatives, Associations, Global Insitutions)? | | | | | | |
|---|---|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| | | Don't Know It | No Relations | Strength of relationship | | |
| | | | | arms-length | full cooperation | |
| | | | | ← 1 | 2 | 3 → |
| 1 | EACB - European Association of Cooperative Banks | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 2 | EBA - Euro Banking Association | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 3 | EBF - European Banking Federation | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 4 | FEBEA - European Federation of Ethical and Alternative Banks | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 5 | INAISE - International Association of Investors in the Social Economy | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 6 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 7 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 8 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 9 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 10 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 11 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 12 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 13 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 14 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 15 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 16 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 17 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 18 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| 19 | | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

| Section e) Who does your organisation perceive to be the most important actor within your network? | | | | | | |
|---|--|--|--|--|--|--|
| List the top 3(5) organisations | | | | | | |
| 1 | | | | | | |
| 2 | | | | | | |
| 3 | | | | | | |
| 4 | | | | | | |
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Appendix B – Interview Guide

1. The research investigates ethical banking as a sector that is motivated by advancing social and environmental aims and pursuing various non shareholder value/ non-profit maximising approaches; conducting its business based on a restriction of risk taking, prudence and an increased interest in satisfying the customers need; and distributes profits amongst a broad customer base (through dividends, reduced loan rates, increased interest rates), the wider community (donations) and the retaining of some profits to shore up capital ratios to further future growth and reduce risk.
 - a. Do you think that there is such sector within the UK banking industry? What does the sector look like in terms of size, coherence and success?
 - b. Do you see yourself as part of such a sector and, if so, where do you fit in?
 - c. What are the firm's objectives and how do you measure performance/ success?
 - d. In what way does your ethical focus and related policies benefit your business? I.e. do they benefit marketing strategies and competitive practice? To what extent do they provide limitations on what you can do and how you can operate?
 - e. In the grand scheme of the British financial services industry, is it fair to say that ethical alternatives are either a niche model – that has very limited impact overall because of its small size – or an exception – as some (Nationwide, Co-op) operate similar to high street banks without the aspects of shareholder value?

2. What are the ambitions for the firm?
 - a. How do you see the future of the firm in terms of size of the operations and geographical coverage or do you consider an alternative to growth to be a valuable strategy?
 - b. Do you consider your business model to be well equipped to deal with financial market dynamics? How so?
 - c. How has the financial crisis and regulatory response impacted on your business in terms of opportunities created and threats emerging?
 - d. How do you feel about the increasing consolidation in the big 5 banks and do you consider yourself to be a 'challenger' to those banks?

3. Have you seen changes in the type of organizations you are dealing with in recent years, both within the ethical banking sector and other financial and non-financial firms?
 - a. How has competition impacted on your banks development in recent years?

- b. What is your view on competition as an effective tool to manage sector developments?
 - c. Have developments in the 2000s helped your business or hindered its effective competition with the big four?
 - d. What impact did government and regulators have on the banking sector when dealing with the crisis.
 - e. Do those changes impact on your bank's performance? In what way?
4. In the questionnaire you filled in prior to the interview, your bank is said to have a strong relationship with x, y and z.
- a. Could you please give a little more detail concerning that relationship?
 - b. Why is this relationship stronger than xyz?
 - c. Why haven't other banks been chosen to provide you with those services?
 - d. Who does your bank consider as your main competition?
5. The preliminary analysis of the SNA data has indicated that the sector is troubled by a lack of development prospects. Two business models are dominant: "niche" (too small to make a difference) & "exception" (absence of shareholder value but little other difference)
- a. Do you see any potential for internal or external intervention to help the sector develop? To what extent and how can the sector help itself?
 - b. What do you think should be changed to help you and other alternative and ethically run banks to succeed in this environment? What are the obstacles? What are the prospects of positive change?
 - c. Do you think it would help to have a central non-profit clearing system, provided by the government, a government owned bank or a mutualised post office?
 - d. Could a more protected mutual banking sector support your development?
 - e. Would it help to restrict competition amongst ethical banks to enable them to compete more effectively with high street banks?
 - f. Are there countries where ethical banking is stronger? Why is that the case?