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# Corporate Social Responsibility in the Banking Sector

**SUMMARY:** As countries of the world used large amounts of public funds to manage the 2008 financial crisis, public debt has risen to a critical level in many of them. Due to the drop in real economy, several countries faced unemployment and economic fallback that are still unresolved to this day. After the crisis, many were concerned how to restore the confidence in financial institutions and how banks can better contribute to sustainable social and economic growth. This paper discusses corporate social responsibility (CSR), an attitude putting ethical norms in the spotlight. The CSR pyramid distinguishes various layers of responsibilities. The first at the bottom is economic responsibility, serving as the foundation for the pyramid, however, companies also need to comply with legal norms. Ethical responsibility is the obligation to conduct in a fair way and to do the right thing. After the crisis, central banks in many countries became responsible for sustaining financial stability. To this end, central banks have developed their own corporate social responsibility strategies. This activity is studied from the view of how CSR can contribute to financial stability.

**KEYWORDS:** corporate social responsibility, bank, public awareness, financial stability, business ethics

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## THE ACTORS OF FINANCIAL MARKETS AND THEIR SYSTEM OF RELATIONS

According to traditional economics, the highest efficiency of economic welfare is achieved by reaching the Pareto-optimum. This desirable state of the economy can be basically achieved through a pure and restriction-free market. Deviations from the equilibrium can be remedied by improving market operations. In such a world, relations between economic actors can be established and maintained by market coordination only; ethical and bureaucratic coordination is strictly separated and undesirable. Crises lead to purer and more efficient markets. In our opinion, such views tend to ignore the true operation of society and the economy, as well

as the consequences of economic volatility, which undermine society and cause long-term economic setbacks.

Since the 2008 crisis stems from the financial sector, we set out to explore, within the financial domain, the possibilities of increasing ethical coordination in public awareness and thus better fulfilling social expectations. We must note that in our view, the enforcement of ethical aspects does not contradict market interests either on a macro or a micro-economic level. Economic welfare, however, may be increased alongside such values which are considered by traditional economics as externalities.

Looking back at economic history, the seeds of economic activities sprouted from the exchange and lending of money, which was later expanded by deposit transactions. Transactions were regulated by ethical norms

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for centuries, especially as far as lending was concerned. With the increasing prevalence of market economy, these ethical rules have all but disappeared in Europe and in countries that have embarked upon the development of market economy. (Fekete – Tatay, 2013) In the 19th and 20th centuries, the turmoil of the financial system caused the states to assume a role in the regulation of financial institutions. During the history of the financial institutional system, ethical, market and bureaucratic coordination was present to a varying degree in the relations of financial operators. The last quarter of the 20th century was characterised by the dominance of market coordination. This development is indicated by the deregulation and liberalisation of financial markets. The expansion of financial processes beyond borders is not a new phenomenon, however, the proliferation of cross-border transactions and the standardisation of the rules of these transactions are the results of the changes seen in recent decades. This process is generally referred to as financial globalisation. New technologies and methods, introduced to financial markets and supported by liberalisation, have generated an unprecedented level of financial innovation. The image of financial markets has been reshaped by these new instruments, solutions, transactions and institutional forms.

The number of people affected by the activities of financial organisations tends to be very large, since not only owners and employees, but also those using their services are linked to a given institution for years or decades. Using their services is not a one-off act or a system of relations that can be easily dissolved, but a long-term commitment. External stakeholders “co-exist” with financial institutions for decades through their long-term investments or loans. The financial management of a given organisation directly influences their present or future, as their investments can be de-

revaluated, their income can change and their debt service may be modified. (Sági, 2012)

The global economy of the 1990s saw a significant increase in the importance of financial organisation activities. At the same time, these institutions have acted as a relay for the global proliferation of the crises. Moreover, their transactions and instruments themselves have become the reasons for the crises and contributed to deepening their impact. (Bessler – Kurmann, 2013) The crises in Latin America highlighted the phenomenon of financial markets acting as channels that convey these crises. The crisis in East Asia has shown how a region’s economic problems can be deepened or caused by financial institutions. The collapse of Barings Bank in 1994 and the crash of LTCM (Long Term Capital Management) in 1998 drew attention to the risks of innovative products and transactions. Tensions that have been lurking deep under the surface have become clearly visible with the outbreak of the crisis in 2008.

The crisis that erupted at the epicentre of the financial markets, namely the financial markets of the USA, deeply affected most of the developed world. It was not confined to the boundaries of the financial markets, also causing a recession in real economy, as well as social problems. Several avenues have been explored as to how to remedy the crisis and avoid similar events happening in the future. The key areas of these analyses included reviews on the financial literacy of households, the assessment of financial sector regulations and the implementation of self-regulation in the financial sector. The latter again concerns the possible involvement of ethical coordination. Ethical aspects remain to be present in particular areas, with the attention towards them increasing as a result of the crisis. An example of such ethical restraints, applied to financial activities in a special way, is the Islamic way of financing. Banks jointly assume

risks with their clients, they do not place extreme burdens on borrowers that would contradict the principles of Islam and depositors do not expect an interest on their deposits. (Bajkó – Varga, 2013)

In developed market economies, financial institutions, searching for a way out, started to focus more on corporate social responsibility. Even their financial statements pay attention to the social, economic and environmental impacts of their operations. In essence, a bank's stable financial position, increasing economic performance, ethical and transparent activities and responsible financial services ensure its predictable and reliable operation, which also enables it to acknowledge and serve the interests of society to a larger degree.

In the financial sector, besides the short-term internal business interests of companies, social, environmental and human rights objectives are gaining a dominant and increasing role. An interesting example for the latter can be accessed on the website of OTP's Fáy András Foundation ([www.otpfayalapitvany.hu/galeria/tipus/videogaleria/video/414](http://www.otpfayalapitvany.hu/galeria/tipus/videogaleria/video/414)). Open Society Archives preserves documents from various countries that serve as evidence of the violation of human rights, which are also used in litigation.

## THE GENERAL INTERPRETATION OF CSR IN THE BANKING SECTOR

There is no universally accepted definition of Corporate Social Responsibility (CSR). It is described as an instrument, a concept or even a business model that requires companies to apply a radical change in attitude. The latter assumes a paradigm shift in business, according to which there is more to a company than return on investment and maximisation of profit. It is also a community of people, which operates in a social and natural environment,

the environmental and social impacts of which must be considered (Szegedi, 2014).

One of the best known and most widely accepted definition of CSR is by *Carroll*, who says that corporate social responsibility encompasses the economic, legal, ethical, and discretionary (philanthropic) expectations that society has of organisations. The CSR pyramid (*see Chart 1*) distinguishes various layers of responsibilities. The foundation is economic responsibility. At the same time, however, companies also need to comply with legal norms. Ethical responsibility equals the obligation to conduct in a fair way and to do the right thing, going beyond mere compliance with rules. It can also mean discretionary or philanthropic responsibility (Carroll, 1991).

The banking sector responded relatively late to the challenges of CSR. First it considered environmental, then social issues (Viganò – Nicolai, 2009). CSR as an instrument of the business sector serves to increase and legitimise the sector's economic performance and also appears as the embodiment of the fundamental principles of business ethics (Scholtens, 2006). The 2008 financial crisis drew attention to the necessity of CSR in this sector also, increasing the need for trust, as well as accountability and transparency that lead to it. Besides the role of an intermediary which channels savings into investments, traditionally considered as the main social function of financial institutions, besides efficient allocation and risk management, the need for ethical and responsible conduct has led to financial and investment processes pointing beyond the protection of the legitimate interests of depositors and owners (Tzu-Kuan Chiu, 2013).

Banks' stakeholders include the owners, borrowers, depositors, managers, employees and regulators. Compared to many other sectors, a key characteristic of the banking sector is that it affects a large number and a great variety of people. This results in considerably



Source: Authors' own editing based on Carroll, 1991.

more complex information asymmetry. Another feature of the system is that in order to ensure the stability of the banking sector, it is characterised by much stricter regulation (Yamak et al., 2005). Since the banking sector differs from other economic sectors, its CSR practices are also different. Here there is more emphasis on responsibility in the areas of bank lending, investment and asset management operations, where combating bribery and money laundering are particularly important issues, being the key elements of anti-corruption efforts, which is a crucial part of the banks' CSR activities (Viganò– Nicolai, 2009).

Although banks have smaller direct impact on the environment, their indirect environ-

mental and social responsibility may increase if they grant credit to companies which pollute the environment, produce unsafe products or violate human rights (Idowu – Filho, 2009). This way banks act as mediators of sorts, which may cause significant damages. (Thompson – Cowton, 2004). The indirect impact may arise not only in relation to the users of banking services, but also the suppliers. As the management element of the responsible supplier chain, integrating environmental and social aspects into supplier policies has been adopted to finances as well.

Applying Carroll's CSR model to the financial sector, the levels of responsibility in terms of the banks are the following (Carroll, 1991):

① *Economic responsibility.* This is the traditional reason for having banks, in other words to increase the owners' welfare, ensure profitability and growth. One of the means of this is financial innovation. Since individual and corporate financial interests are constantly changing, banks create new opportunities for risk management and the effective mediation of resources. This involves developing new products, redefining the existing ones and creating new channels. Interaction with stakeholders has a crucial role in determining these new products (Decker – Sale, 2009).

② *Legal responsibility.* Regulation is determined by statutes, and its aim is to minimise risk and ensure safety and confidence in the financial system. In practice, statutes are supplemented by the compliance with the guidance of various supervisory bodies and trade associations, which is signified by the compliance function (Decker – Sale, 2009). Such statutes include Recommendation No. 11/2006 or 6/2013 (III.11) of the Hungarian Financial Supervisory Authority in Hungary; Compliance and the Compliance function in banks, the Guidelines on Internal Governance (GL 44, September 2011) or the Guidelines on Certain Aspects of the MiFID compliance function requirements in the European Union; and the Foreign Account Tax Compliance Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010) or the UK Bribery Act, 2010 (Wieland, 2013) at an international level.

③ *Ethical responsibility.* Ethical norms can be interpreted through individual conscience and the expectations of external stakeholders. The motto of the London Stock Exchange „My word is my bond” embodies the basic ethical principles of honesty and sincerity, which together with trust, are traditionally linked to the financial sector (Decker – Sale, 2009). The codes of ethics that embody voluntary constraints also include the basic principles of

integrity, fair conduct, respect and transparency in the financial sector. The ethical values and expectations of stakeholders are most apparent in the stakeholder dialogue, which puts communicative ethics into practice. Decker and Sale (2009) draw attention to the fact that the compliance approach, which is aimed at compliance with statutes, often does not favour the establishment of ethical business practices and business culture.

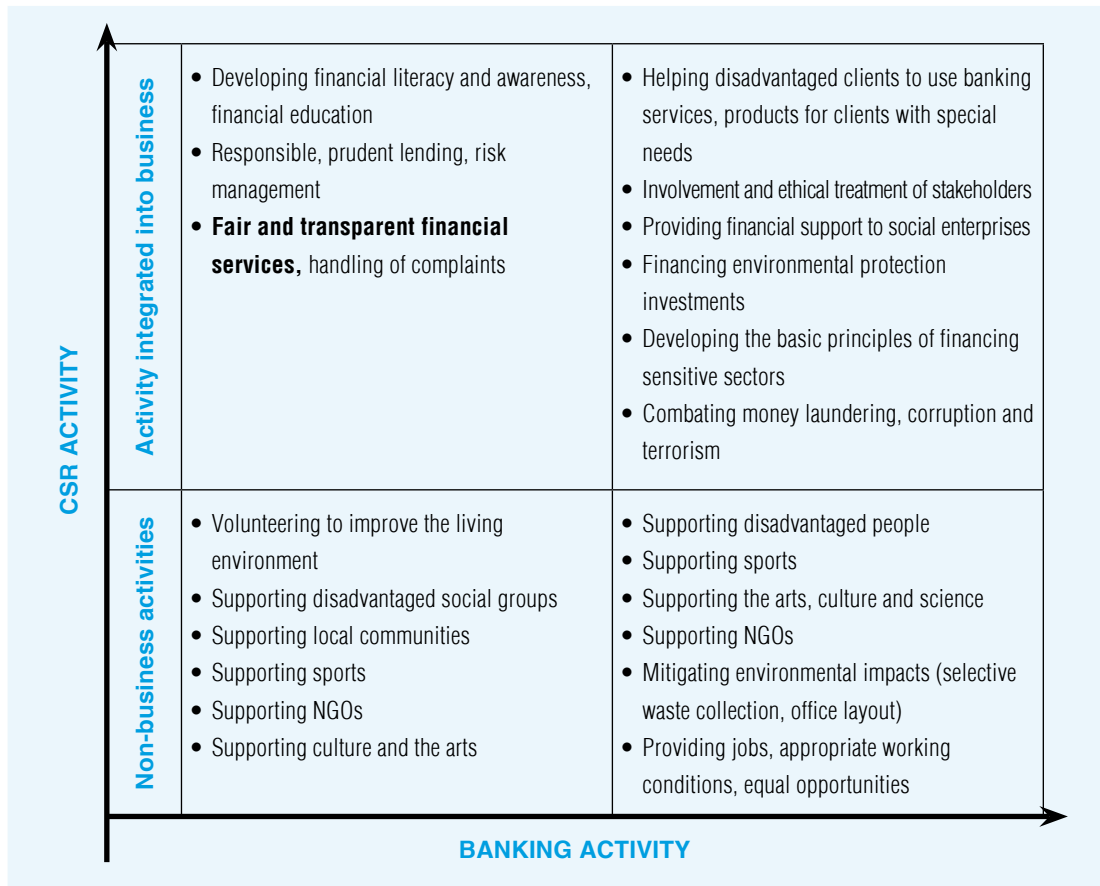
④ *Discretionary (philanthropic) responsibility.* It cannot be interpreted through external expectations; it is a voluntary activity, however, it has become common practice among banks, contributing to the better reputation of the financial sector (Decker – Sale, 2009).

In the years following the crisis, there was an apparent shift in social expectations towards the general domains of CSR in the banking sector and its preferences. There is a need for the endorsement of social expectations in CSR that are more directly linked to the bank's business activities and clientele. (Lentner, 2011)

As far as stakeholders are concerned, the key expectations of clients include secure products and appropriate information provision. Employees want a safe workplace that is free from discrimination, and the respect of human dignity, while competitors expect fair competition. Banks not only need to watch the direct environmental impacts of their own operations, but also the impacts of their lending activities (Thompson and Cowton, 2004).

From a social aspect, there has been a new development in recent years, namely helping the poor. One example is the micro-loan programme through low-income banking (Tzu-Kuan Chiu, 2013). The backdrop to this is the UN's Principles for Responsible Investment, which stresses the importance of „inclusive finance” for vulnerable groups which otherwise could not afford financial products and services (PRIs 2011).

**THE CSR MAP OF BANKS**



Source: authors' own editing

Chart 2 shows banking activities and CSR activities in relation to the typical CSR areas of the banking sector. Banking activity is interpreted in terms of the balance sheet total and the number of branches, while CSR activity shows whether the bank integrates CSR initiatives into its business activities or just applies the philanthropic aspect. The following CSR map is based on information available on the websites of Hungarian commercial banks.

In our opinion, the CSR approach can be expanded to other areas. During decision making, benefits and damages could be considered, which are yielded or caused by that particular

decision outside of a given organisation and not influencing their profit in the short-term. For example, faulty product development causing system-level failures may destroy the savings of certain household groups. The basic principles could be laid down in voluntary codes of ethics that go beyond the statutes in order to keep to the right directions. There should be more stress on guaranteeing compliance with the Codes Of Ethics in banking organisations. In the previous example of Islamic banking, the implementation of Islamic principles is checked by a separate supervisory board. The enforcement of ethical principles

is guaranteed on the level of individual contracts.

There are an increasing number of people who think that business decision-making must not only consider profit maximisation, but businesses should also voluntarily contribute to solving social issues, since it is not their economic interest, but their moral responsibility (Barclift, 2012). CSR needs to apply a value-oriented approach that becomes an integral part of the banks' everyday operations and is incorporated into the organisational culture.

The global survey of the CFA Institute (2013) collected the opinions of 6783 respondents from 22 countries. 56 per cent identified a continuing lack of ethical culture within financial firms as the major factor contributing to the current lack of trust in the finance industry. Two-thirds of respondents said that a culture of ethics and integrity within firms needed to be reestablished, since the primary problems were not the physical failures of the market or government actions, but the culture of firms within the financial industry. However, it is not enough to come up with basic ethical principles; they should also be implemented: "Ethics is an ongoing project to help restore trust in the financial industry. We need to improve financial professionals' sense of self control, construct related culture for the whole industry and set a serious penalty system for any illegal and unethical activities." (CFA Institute, 2013, page 9).

## INTRODUCING CSR IN CENTRAL BANK ACTIVITIES

The mitigation of the impacts of the 2008 financial crisis consumed vast amounts of public funds. A considerable amount of public funds were required to manage the crisis immediately and then soften its consequences. Bank bailout

packages, economic recovery measures and the management of unemployment were all strains on state budgets. This led to rising public debt in many countries. As a result of these severe consequences, the role of central banks in financial stability has been reconsidered in several countries. (National Bank of Hungary, 2013) The central bank's role in maintaining financial stability has also been redefined in countries like the United States. Another example is the European Central Bank. (Naményi, 2012) Financial sustainability and stability functions can generally be interpreted as parts of CSR and they can be implemented by using the tools provided by CSR.

Becoming aware of their social responsibilities, central banks have established their CSR strategies and activities. Traditional CSR areas, such as equal opportunities and environmental protection have also been incorporated into these strategies. An important role is given to information provision and improving financial literacy through education. Through education and the provision of information, central banks now focus on enhancing the financial awareness of people who use financial services and highlight the importance of reducing information asymmetry. Examples for applying such methods are the Fed (Chicago Fed, 2012) or the National Bank of Hungary.

Apart from regulatory tools, central banks also have the option of transforming processes by influencing expectations, opinions and mindsets. We must not forget that taking out loans and using investment or other financial services always entails uncertainties in the decision-making of economic actors. Central banks which pursue active communication can shift these decisions in the right directions by utilising the psychological components behind the decision-making process. Herd mentality and the importance of expert opinions may be used to prompt economic actors to pursue proper conduct. (Sunstein – Thaler,

2012) Linking the development of financial literacy and the intensification of financial education with active communication could become key areas of the central banks' CSR. To this end, the various channels and forms of communication with stakeholders must be established.

In Hungary, the National Bank has developed its corporate social responsibility strategy (MNB, 2008), which has been undergoing significant changes since 2013. Connecting macro- and micro-prudential supervisory activities in a wider sense allows new tools to gain ground in order to promote sustainable and secure economic and social development. An important change in the monetary policy

of Hungary's central bank is that the objectives, previously set by the EU laws and regulations, such as achieving and maintaining price stability, have by today morphed from objectives into tools for the common good. In addition to the task of the National Bank of Hungary to maintain price stability, further important elements include financial stability and the support of economic policy. The National Bank of Hungary can use this triple mandate to serve the common good more efficiently, in other words, help society and companies operating in the administrative territory of Hungary. The MNB's entire scope of activities has therefore been subjected to its complex corporate social responsibility.

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