

Briefing Paper

The Social Purpose of Banks

Since Lord Turner criticised the banks for engaging in ‘socially useless activity’ there has been much said about what the social purpose of banks is, and whether it is being fulfilled. There has also been considerable confusion about what it means for banks to have a social purpose, and whether it makes sense to say that they do.

To have a purpose is to further a particular goal. Roughly speaking, then, we can say that to have a social purpose is to pursue a goal in the interests of society. The ways in which the banking system promotes the interests of society are not mysterious. For example, [the Future of Banking Commission](#), established by consumer group ‘Which?’, highlighted three: the facilitation of payments, co-ordination that brings savers and borrowers together, and the management of risk.

Criticism of the banking sector has focused particularly on risky investment banking activity, such as trading in derivatives, which jeopardised the banks’ ability to perform these core functions. This activity was undertaken with different purposes in mind. One such further purpose, we might think, was the generation of returns for bank shareholders. However, given the riskiness of these activities over the medium to long term, critics have concluded that the main purpose being pursued was the maximisation of short term bonus payments to bank directors and employees.

How should we decide which of these purposes takes precedence? Agency theory says that bank directors and employees should prioritise the goals of their principals: the shareholders (although in an ideal world, incentive structures would ensure their interests coincided). This is because shareholders own the business. But why should banks promote society's interests?

The simple answer is that they have an obligation to do so. This idea of an obligation that business owes to society finds perhaps its clearest recent expression in the idea of a societal 'license to operate'.

It is a mistake to think of banks only as associations of private individuals engaged in market activity. Banks are institutions with multiple stakeholder groups that are embedded in the institutional framework of society and that benefit from this position, not least in the form of an implicit state guarantee against the failure of their core business functions. Society also depends on the ongoing ability of banks to provide these functions.

When society licenses a private association to hold a privileged institutional position, it is fully entitled to demand the promotion of certain interests as a condition of that license. In the case of banks this requires, at least, a robust and conscientious provision of their core functions in manner that is not exploitative.

This defence of the idea that banks have a social purpose may not seem particularly groundbreaking. However, its implications are significant. A banking culture that sees the maximisation of remuneration for bankers as the primary goal, with regulation as an obstacle to be overcome in pursuit of this goal, is deeply maladjusted.

It is only by respecting their obligations to society by promoting its interests in certain core ways that banks are justified in operating, and profiting, at all.

James Dempsey

Research Fellow

Centre for the Study of Global Ethics

Department of Philosophy

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