The UK's stab at corporate responsibility

Does a consciously ethical approach to business preclude success? One might surmise as much from the recent collapse of Co-op Bank. But the real cause of business failure is just a bad sense of business.

Until this summer, the UK's mutually owned Co-operative Bank was a poster child for those who believe that a socially responsible approach to business is the only way forward.

Underpinned by a strong set of ethics that ensured its deposits would not be invested in weapons or environmentally damaging projects, the "Co-op" had signed up hundreds of thousands of new customers over the past decade, many of them attracted by the bank's ethical principles.

But in May, after posting a £257 million loss and withdrawing from a deal to buy 630 branches from Lloyds Bank, the Co-op's debt rating was downgraded to junk status. And in June the bank disclosed that it had a £1.5 billion hole in its finances, caused partly by the takeover of another mutual, the Britannia Building Society, which had a large portfolio of bad loans.

By August the Co-op had revealed the largest loss in its history (£559m) and had begun emergency talks aimed at averting complete collapse. Much to the dismay of many of its 4.7 million customers, in October it fell into the arms of a group of US hedge funds, which offered a bail out in return for 70% ownership. Survival was assured, but at the expense of the Co-op's mutual status and with the company's reputation in tatters.

What, then, does the Co-op Bank's failure say about the notion – much bandied about in recent years – that companies with a strong grounding in ethical and social responsibility are more likely to have a sustainable future than those that do not?

The first thing to note is that a commitment to corporate responsibility and good ethics has clearly done nothing to prevent calamity at the Co-op Bank. But the second point to make is that neither have its ethical policies, in themselves, had anything to do with the bank's poor fortunes. By common consent the Co-op's main problems have stemmed from inadequate management, injudicious pursuit of growth through acquisitions and mergers, and a lack of oversight from a board whose now-disgraced chairman, Paul Flowers, had little, if any, experience in banking.

"Essentially the Co-op's troubles have come down to poor governance and bad management," says Michael Littlechild, chief executive of GoodCorporation, a firm that helps businesses assess their ethical and corporate responsibility performance. "The bank has reaped some benefits from its ethical stance, including by gaining new customers – we ourselves moved our account to them because of their policies in that area. But when it comes down to it, those benefits don't compensate for poor management.

"If a business doesn't have a strong ethics policy, then it runs the risk that it will get into trouble on a number of fronts – environmental disasters, customer mis-selling, or problems with corruption, for example. So the absence of an ethics program is a reasonable indicator that a company is not well managed. But the converse is not true; you can't say that if a business is doing its ethics well that it is therefore well managed; it has to get everything else right too. What the Co-op Bank's difficulties have illustrated is that a company with good ethical credentials can still get into a mess if it's badly managed in other ways."

Paul Burke, a senior partner at Carnstone Partners, a management consultancy that specializes in corporate responsibility and sustainability, says there may be collateral damage for ethics enthusiasts from the Co-op debacle, but argues it would be wrong to draw the conclusion that corporate responsibility is a busted flush.

"There's no doubt that the Co-op's problems have, to an extent, damaged the idea that corporate responsibility is the way to go," he says. "But there were specific circumstances at the Co-op, and while the bank has made a mess of things, there are still plenty of examples of British companies – such as John Lewis and Nationwide – that are acting in a reasonably responsible manner and appear to be well run and thriving."

Burke, who was the first head of social accountability at Co-operative Insurance, the Co-op Bank's sister organization, points out that the Co-op Group, the Co-op Bank's parent, had a board composed of individuals who were elected by members and, including the chairman, had little inside knowledge of banking. "At least with an unelected PLC board there's a greater degree of scrutiny of directors, because shareholders want to know what's going on," he says. "But once you were elected to the board at the Co-op Group [from which the Co-op Bank's chairman was appointed] you could pretty well stay there for the duration."

He also notes the irony that while the bank was, ultimately, owned by the Co-op Group's members and therefore theoretically free from the tyranny of the markets, it still became obsessed with growth and adopted an outlook that was just as aggressive as any PLC.

"It didn't have shareholders jumping up and down, but the Co-op Group as a whole wanted to revive the idea of mutuality. So the bank didn't grow the business organically; it tried to thrive through acquisitions and mergers, and it ended up expanding beyond its competency. In the end it was just as susceptible to the vicissitudes of the market and to poor management decisions as any other business. The shame was that it was trying to compete head on with the PLCs."

The Co-op Bank, then, has shown us that corporate responsibility makes no difference at all if a company is headed for the rocks. While an ethical outlook may provide certain benefits, a socially responsible company is just as capable of meeting a nasty end as any other business beset by poor management and distracted by greed.

The idea of corporate responsibility is as valid as it has ever been. But what the Co-op Bank fiasco reminds us is that the most valuable and overriding social responsibility of any company is to stay in financial good health.