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HBR CASE STUDY AND COMMENTARY

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by Christopher Marquis and Juan Almandoz

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Expert commentary by Ken LaRoe and John Replogle

Case Study

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The Experts

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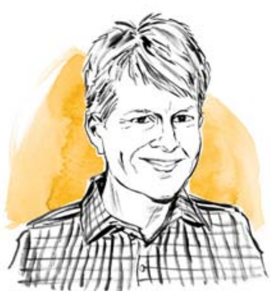

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ILLUSTRATION: BRETT AFFRUNTI

HBR's fictionalized case studies present dilemmas faced by leaders in real companies and offer solutions from experts. This one is based on the HBS Case Study "First Green Bank: Bringing Bloom to Desert Landscapes" (case no. 9-413-073), by Christopher Marquis and Juan Almandoz. It is available at **HBR.org**.

As the founder and president of a new ethical bank focused on environmental sustainability, Jay McGuane realized that he and his board needed to set guidelines about which loans to approve and which to reject on "values" grounds—and fast. In his eagerness to get the business started, he'd put the issue off. But now the bank was facing two problematic requests: one from a company involved in fracking, the other from a gun maker.

Without clear ethics rules, Jay worried that his already divided directors would fall into bitter squabbling, leading to resignations, negative media attention, and a flight of investors.

Ethical banking had seemed so benign when Jay had decided to enter the industry. Now it seemed like a hornet's nest.

A Green Vision

Jay didn't need this job. At age 50, he had years of entrepreneurship behind him. He had founded a bank in Maryland, expanded it to six branches and $400 million in assets, and sold it for a substantial profit. While looking for his next project, he happened to see the movie *An Inconvenient Truth* and decided, during the sleepless night afterward, to build something meaningful out of his concern for the environment, his love of his native Colorado, and his knowledge of banking. The result was Rocky Mountain Green Bank, a company with a mission to promote environmental stewardship.

He established himself in Colorado Springs and assembled a board of directors: Four successful entrepreneurs, a lawyer, an ex-mayor of the city, a former executive in the Maryland bank, a doctor who was a school friend and sometime hunting partner, and an evangelical (and ardently environmentalist) leader of a megachurch Jay attended occasionally.

To drive home its mission, the board hired a famous architect to make the bank's headquarters an environmental showcase, with prototype solar-power windows, a set of wind turbines, and a butterfly roof that channeled rain and meltwater into underground cisterns.

Articles and TV segments about the building and about Jay, the returned native son and environmental crusader, helped attract local depositors and small borrowers, who'd grown disenchanted with the big national and global banks. Deposits grew at a healthy rate, but to succeed financially, the bank needed to make big loans to a few strong companies. So far, that hadn't happened.

Moreover, the values-based approach was proving harder to implement than Jay had anticipated. Rifts among the directors had started to appear. The first sign of conflict came up in a discussion of what Jay thought was a nonissue: a gym for employees.

"Oh, come on," Neitha Wellman said, shaking her head. "Are you going to have a personal trainer on-site, too?"

"Actually, yes," Jay said. "Two afternoons a week."

She rolled her eyes. "Since when does a gym or a personal trainer have anything to do with being green?"

An avid fly fisher and former bouldering champion, Neitha considered herself a pragmatic environmentalist, and she detested the idea of the "nanny state." She actively campaigned for Libertarian candidates—in fact, she had been at a rally at a mall when a shooter had gone after a Congressional candidate and the people waiting to shake his hand. A picture of her giving CPR to a wounded child, who later died, had been all over the internet, though she refused to discuss the incident.

Two other board members agreed with her about the gym, so Jay had scaled back those plans.

Twin Debates

Neitha had been the one to solicit the first problematic loan application. She'd been talking to the head of a Colorado engineering company that developed pumping systems used in hydraulic fracturing—fracking—and wanted to expand into making the polymers, emulsions, and surfactants the industry relies on. These materials, the executive said, would be significantly less toxic than those currently in use. Though ambivalent about fracking in general, Neitha had recommended that the executive approach Rocky Mountain Green Bank.

But on hearing about the opportunity, Neitha's fellow directors were divided. One side touted the economic and employment benefits of fracking, while the other insisted that the risks outweighed any good that could come from it. The 300-million-year-old sedimentary rock under the Denver Basin in eastern Colorado contained one of the country's largest gas deposits, and a number of local engineering firms were working on solutions for drilling, injecting, and waste disposal. It was a growth industry, but warnings from experts about the risks of groundwater contamination and seismic instability seemed to increase every day.

"Look, let's not get worked up about a loan application we haven't even received," Jay said, trying to lower the temperature in the room. "But when we are approached by a company like this one, we have to be ready. We need to be talking about how to make loans that reflect our mission."

Jay promised that he would research the guidelines other ethical companies used to make values-based decisions, solicit opinions from each director individually, and come back to the group with a proposal.

The next day, he visited the board member he knew best, Fred Keeler, a gastroenterologist. "I'm a believer in the precautionary principle," he told Jay. "It's the idea that in order to act, all you need is partial evidence—not proof." Bans on smoking in public areas were a perfect example, he said: Many of them went into effect before the dangers of secondhand smoke had been proved.

So if it looks bad, it *is* bad, Jay thought ruefully. Hoping for a more nuanced perspective, Jay went next to the pastor, the Reverend Clyde Dahlberg, who, to Jay's surprise, advocated a completely evidence-based approach: "Make two columns, one for adverse environmental impacts, one for the positives," he said matter-of-factly. "Figure out a way to quantify the effects, then do the math." Simple.

In some ways, it was just the type of loan the bank needed: Field Force was a solid performer, a growing source of local jobs, and a good corporate citizen.

It was while wrapping up his meeting with Clyde that Jay received an e-mail from the bank's chief loan officer. "Wow—3 million dollars," he blurted out.

"What's this?" Clyde asked. Jay wished he hadn't said anything: The e-mail was about an official application from Field Force, a large, local firm that had been talking informally with Jay about a multimillion-dollar loan to expand its business. In some ways, it was just the type of loan the bank needed: Field Force was a solid performer, a growing source of local jobs, and a good corporate citizen.

"A gun manufacturer?" Clyde asked in horror.

"A military contractor," Jay said.

"A gun manufacturer," Clyde repeated. "In the state of Colorado? After Columbine and Aurora and Arapahoe High School? You'd better not do anything on that without a board decision. I'd put it on the agenda for next week's meeting if I were you."

Changing the Subject

Jay didn't share the aversion that some of his directors felt toward guns, and it seemed to him that weapons had nothing to do with environmentalism. But Clyde was right about the necessity of a board discussion, so he notified the directors about the Field Force application and planned his strategy for the meeting.

"As you all know," he said to the group a few days later, "I got into this business because I was excited by the environmental mission. And I think you all felt the same."

Heads nodded.

"But," he continued, "the regulators made it very clear that we were to be a profit-making bank first and a green bank second. To get our charter, we had to demonstrate that our mission wouldn't add significant costs or impose significant limits on our banking operations, that we wouldn't let the mission wag the dog. I remember telling them that even if we *wanted* to lend only to businesses aligned with our environmental mission, we couldn't—we'd go broke in a month.

"I'm not always happy with this situation," he added. "I didn't get into this just to run another bank, but I accept it as the price to play."

Mark Lerman, Jay's former employee from the Maryland bank, provided a few facts and figures to support Jay's point: "Green" loans—to green-certified builders and consultants, as well as landscapers, farms, nurseries, organic-food companies, and solar-energy firms—constituted only 7% of the bank's total; deposits from green businesses and from customers drawn by the bank's mission accounted for just 1.8%, the data showed.

"Probably our biggest impact on sustainability comes not through the loans we make," Jay said, "but through media coverage of our mission. By being a successful green bank—with an emphasis on 'successful'—we pave the way for more capital to flow to green causes.

"As I said last week, I think we need to create a decision-making framework so that we don't have to reinvent the wheel every time a loan application falls into what some of us might see as an ethically gray area. I've made a little progress on that front by talking to Fred and Clyde here—"

Clyde interrupted him. "With all due respect, Jay, we have one of those applications on the table. It's from Field Force."

Apparently, Clyde had recruited several other directors to his position, and together they had drafted a statement categorically rejecting business from gun makers.

Clyde began to read aloud: "Point number one: The economic considerations…" The statement compared gun makers with tobacco companies, arguing that their stocks would quickly lose value as the public became more concerned about violence. The statement cited Cerberus Capital Management's unsuccessful attempts to shed its investment in the company that made the weapon used in the 2012 Newtown elementary-school shooting. Under pressure from investors, Cerberus had finally allowed clients to sell their individual stakes.

Jay was irritated. "No one would ever advocate that our military do without weapons," he said. "And as long as there's demand from the Pentagon, Field Force's stock will be fine."

Clyde put down the statement and looked at Jay. "Rocky Mountain Green Bank is supposed to be founded on ethical principles," he said. "What is 'green' if not an ethical principle? That's why we're part of the Global Alliance for Banking on Values. Last time I looked, it wasn't the 'Global Alliance for Banking on *Selected* Values.' What would other alliance members think about our lending to a gun maker?

"You say that our main impact is through media coverage," he continued. "What will the media say if we lend to Field Force? That certainly trumps our fancy LEED-certified office building. A loan to a gun manufacturer would announce to the world that we really have no principles and that the green thing is just a marketing gimmick. If that happens, I'll have to leave this board."

Lukas Hoenig, a board member who was the founder of a chain of environmentally friendly dry-cleaning businesses, cut in. "Let's be real here," he said to Clyde. "We're a green bank, but when did we become the bank for the entire liberal agenda? Selling weapons to our military is not only legal, it's laudable. And we need the business."

"There's nothing unethical about making or selling arms that are purchased and used properly," Jay added. "I'm a gun owner myself, and so is Fred."

Looking for support, Jay turned to Neitha. She looked at him for moment and then said softly, "Jessica Belford was killed by a lightweight cartridge from an FF286."

It took Jay a few seconds to figure out what she was talking about: the girl on the ground at the mall, a weapon from Field Force.

"Sure, they sell to the military," Neitha said. "But you can buy the FF286 at gun shows. That's what makes it one of Field Force's most profitable products. Our bank's mission is sustainability. How can we have a sustainable society where military-grade guns are being used to kill children? How can we, in good conscience, do business with that company?"

"It's a no-brainer," Clyde said. "Jay was talking about establishing guidelines for decisions. I'm all in favor of weighing the pros and cons—let's do that when we discuss the shale gas loan. But when it comes to guns, there's only one guideline we should follow." He turned to Fred Keeler. "It's like the Hippocratic Oath, right? First, do no harm. Or how about this: Do no *evil*."

It was Fred who had advocated saying no to a loan if there was mere indication of harm, but now he looked conflicted. He loved his gun collection, from the flintlocks to the Uzis, as Jay well knew. Fred asked, of no one and everyone, "But what is 'harm'? What is 'evil'?"

Q Should Rocky Mountain Green Bank deny a loan to a gun manufacturer?

See commentaries on the next page.

The Experts Respond

Ken LaRoe is the chairman and CEO of First Green Bank.

IT'S TRUE that gun proliferation isn't an environmental issue. But having joined the Global Alliance for Banking on Values and staked its claim as an "ethical" bank, Rocky Mountain Green Bank has to do more than simply promote "green" causes. A loan to Field Force would suggest that the bank's position is indeed just a marketing gimmick. Instead of saying yes, the bank should affirm its commitment to a broader set of values.

That's what we've done at First Green Bank. While we emphasize environmental sustainability, our mission statement refers to "social responsibility"—a much broader concept. As a result, our loan decisions can be quite challenging.

When the issue of guns first came up, we wrestled with it. (This fictionalized case is loosely based on our experience.) Like Field Force, the manufacturer that wanted a loan from us was (and still is) a well-run company with great financial fundamentals. About half of our senior loan committee considered it a terrific prospect and believed we should approve the application. The other half—myself included—thought that the company's output of semiautomatics and ammunition for those types of firearms was ethically repugnant.

In the end, we were saved by circumstance: Another bank grabbed the business by offering the manufacturer a loan at a much lower rate.

It's OK that some sectors are off the table for us, because that's what being an ethical bank is all about.

When our bank was very small, ad hoc decision making was fine. But as we've grown, we've seen the value, as Jay McGuane does, of having a set of guidelines to which everyone can refer. We explicitly decided, for example, that we're not going to lend to companies in the extractive industries or to gun manufacturers.

In some cases, this doesn't have a big impact on our bottom line; in others, there are definite economic consequences. Florida, where we're based, has a good amount of mining, and a new pipeline for fracked gas is being considered. But it's OK that some sectors are off the table for us, because that's what being an ethical bank is all about. We make trade-offs on the basis of our mission to do the right thing for the environment, our people, our community, and our shareholders.

We realize, too, that it's important to build flexibility into our guidelines. We might, for example, consider lending to a company that manufactures only high-end shotguns used exclusively for trapshooting.

Real estate is another sector that prompts serious debate. As the central Florida market heats up, we expect lots of requests for loans to support the kind of slash-and-burn development that hurts the state's delicate ecosystems and contributes to sprawl. If we flatly say no, we'll be rejecting a steady stream of revenue, and other banks will support the projects.

Our hope is instead to say yes to developers willing to make their projects more environmentally responsible. We'd like to help them find the right architects, teach them to use solar and other sustainable technologies and practices, and influence their thinking for the future.

Rocky Mountain Green Bank should consider saying yes to companies that are receptive to guidance and assistance on sustainability and other ethical issues. But if the loan requests come from corporations that are clearly set in their ways, then saying no is the only option.

WHAT WOULD YOU DO?

SOME ADVICE FROM THE HBR.ORG COMMUNITY

ROCKY MOUNTAIN Green Bank should do whatever its shareholders want it to do. "Ethical" is in the eye of the beholder, so there is no objective standard to apply to the question of which potential customers are mission-appropriate. The challenge is to find out what shareholders want.

Gary Phillips, *CEO, Republic Finance, LLC*

THE BANK should be able to succeed by operating only in the industries it deems ethical. There are many segments this bank could lend to that would not disrupt the green vision. Choosing to focus on fewer industries will increase credit risk, but with proper management and oversight, the risk can be managed.

Justin Evenden, *credit union director*

ROCKY MOUNTAIN Green Bank should accept business from a firearms manufacturer. The real question for an "ethical" bank in Colorado is whether it should accept deposits from, and provide services to, a marijuana retailer.

Kenneth Mitchell, *software engineer*

John Replogle is the president and CEO of Seventh Generation.

THE RESPONSE to Field Force's loan request should be obvious. Jay McGuane founded Rocky Mountain Green Bank on ethical principles and enrolled it in the Global Alliance for Banking on Values. His intention to create a bank that's a positive, progressive force in society is crystal clear. Given all that, he has no business even wondering whether to lend to a maker of semiautomatic weapons that find their way to the street. Yet he's stuck. Why the disconnect?

Two reasons. The first is that he has shortcomings as a leader. In his hurry to get the bank up and running, he missed a crucial step: He didn't clearly define the company's purpose. He didn't articulate his vision and principles. Every company needs to know its reason for being in business, and his doesn't.

This leadership gap is evident in Jay's interactions with the directors. He bounces questions off them, trying to weave a path between opposing sides. That's not what a leader does. And he allows himself to be dominated by the regulators' requirements. The legal stipulation that Rocky Mountain Green Bank be a profit-making organization first and a green bank second doesn't mean that Jay always needs to choose profits over people. Once he starts doing that, he'll find that he can rationalize any decision. He'll destroy what was supposed to have been the core purpose of the organization. He would have been better off establishing his bank as a "B corporation": an entity that focuses on social and environmental performance, accountability, and transparency as well as profit. Several states, including Colorado, have passed legislation allowing companies to choose that designation.

The second reason for the disconnect is that Jay built the wrong board. His directors are divided over ethical issues. That's a huge handicap for a values-based organization. The board is supposed to be the company's North Star, looking beyond short-term needs and providing unified guidance on strategic issues.

So his next moves should be first to clearly define his company's purpose and principles and then to reboot the board. In my view, the more explicit the purpose and principles, the better. Companies with clear guiding principles tend to stay out of trouble. Look at the value of Johnson & Johnson's credo during the Tylenol-poisoning crisis in 1982. The company had explicitly determined that it would prioritize the needs and well-being of the people it serves, so it decided to do a recall, despite the cost. The decision protected the company's reputation, brand, and business.

Over time, the bank's vagueness about where it stands on ethical issues will erode its relationship with customers.

Jay can then use the purpose and principles to recraft the board. Half of the directors need to go. In his search for replacements, he should establish selection criteria and seek the help of a corporate recruiter who truly understands his goals. Jay shouldn't rely on friends and acquaintances this time around—that's not the way to build a professional board.

In the long run, the lack of clear principles is going to hurt Rocky Mountain Green Bank. We live in a transparent world. Consumers are looking at companies' principles and values and voting on them with their wallets. Over time, the bank's vagueness about where it stands on ethical issues will erode its relationship with customers. Jay's idealism will be for nothing, and his bank will become a story of good intentions gone bad.

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