

Ethics And Morality In Finance

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ABSTRACT

Recent financial crises have attracted significant debate in the media about the ethical and moral issues that ought to have been considered by the stakeholders involved in the market. This discussion has gained further traction in the aftermath of the global financial crisis of 2007-08. One of the factors that are being considered is based on the argument that the market is as good as its participants. If the market participants behave in a moral and ethical manner, the market outcomes are expected to be in the best interest of the society. This study reviews literature in the area of ethics and morality in business in general, and in finance, in particular. The researchers also looked at the emphasis academicians and market participants gave to ethics and morality in finance. Based on the research, the authors concluded that the issue of ethics and morality has been tested in the area of marketing and to a certain extent in accounting ; whereas ethics and morality research has been largely ignored in finance and economics research. Origins of the words ethics and morality from religion and theology may have been a cause for academia in the field of finance and economics to shy away from identifying ethical and moral considerations in the practice of finance and economics.

Keywords: Business Ethics, Ethics in Finance, Ethics after Crisis

JEL Classification: G02 ,M10, M14

INTRODUCTION

Ethics relate to the moral issues and right and wrong behaviour in daily life and at the workplace. It deals with the moral duties and obligations so that the actions performed at the workplace and in daily life are truthful and just. The recent financial crisis has sparked discussions around the ethical and moral issues surrounding economic activity in the modern times. The Global Financial Crisis (GFC) of 2007-08 has added further traction to this discussion. A large section of the academia supports the argument that unethical behaviour from market participants significantly contributed to the crises. Thus, the argument that market is as good as the participants has gained more acceptance. In this eve of after-crisis recovery and with the looming threat of a new alluring crisis, it is essential to revisit the major views on ethics and morality in finance.

OBJECTIVES OF THE STUDY

This paper reviews literature in the area of ethics and morality in business in general and then narrows down to an examination of studies on ethics and morality in finance. The researchers believe that the issue of ethics in finance and financial market participants is of immense significance in this post-crisis era. A closer examination into the ethical aspects of the recent GFC (Global Financial Crisis) could shed immense light on what ought to be done to prevent the financial world from crumbling again. Based on this aspect, the researchers examined various studies that have been conducted in ethics in business in general, and ethics in finance, in particular.

METHODOLOGY

This paper aims to provide a comprehensive review of literature in the field of ethics and morality in business and finance. In order to understand an overall structure of literature on ethics and morality in business in general and finance, in particular, the researchers followed a two-step approach. First, they classified the topics that should be examined in their analysis. Second, they conducted an extensive search by using selected databases.

The researchers identified that related to ethics in finance and financial market participants were two widely published areas - ethics in business and ethics in accounting. Issues of unethical behaviour among financial market participants are, to a certain extent, related to business ethics or accounting ethics. In the second step, the researchers undertook an extensive search of literature using various databases such as Ebsco Host and Scopus. They examined

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various literature covering the period from 1949 - 2011, thus covering an extensive period of time. The review of literature is presented in the next section.

REVIEW OF LITERATURE

The authors undertook an extensive review of literature that has been recorded on the issue of ethics and morality in economic and financial activities. This section presents a detailed review of literature relating to the significance of ethics and morality in business, accounting and finance.

❖ **The Evolution of Ethics:** The concept of ethics in daily life and at work involves issues such as punctuality, abiding by rules and regulations, being polite and loyal and so on (Sifah, 2009; Chismar, 2001). Ethics form a major part in the science of philosophy and is deeply rooted in theology. Most of the religious beliefs today have profound ethical implications built within themselves (Keljo and Christenson, 2003; Dhand, 2002; Akpinar, 2010). Buddhism embraces principles of loving kindness, compassion, equanimity and abstinence from killing, stealing or lying. Ethical principles of compassion and kindness, loyalty and truthfulness and refraining from various temptations are found woven into Hindu beliefs also. Christian ethics emphasize the significance of love, mercy and forgiveness and virtuousness in thoughts and actions. Islam also appeals to the followers to command the good and forbid the evil, kindness, compassion, avoidance of wastefulness, adultery and dishonesty are some of the ethical principles set out. It can be noticed that all the religions have common ethical principles implied within them, although there are differences in the degree and nature of these beliefs (Parboteeah, Hoegl and Cullen, 2008). Various religious scriptures underline the significance of these principles as the Bible providing the Ten Commandments that are a broad basis of codified ethical rules, the Quran and the Bhagavad-Gita/ epics detailing on Dharma, all state the broad outlines of moral behaviour.

Ethics have been defined and explored by scholars as early as Aristotle, and there exist various definitions of ethics. Ethics were defined by Beauchamp and Bowie (1983) as the inquiry into the theories of what is good and evil and into what is right and wrong, and thus is the inquiry into what we ought and ought not to do. The term ethics and morality are often used interchangeably, and Tsalikis and Fritzsche (1989) suggested that while this usage is acceptable, it would be more accurate to use the terms - morals and morality to denote the actual conduct and the terms - ethics and ethical as referring to the study of moral conduct.

Everyday ethics involve traits like sincerity, truthfulness, reverence, compassion and punctuality. Punctuality is one of the important ethical principles that are often overlooked by many, and its significance in ethics arises from the fact that being punctual implies respect for time and work and regard for other persons' time. These principles of morality assist in refining a person's character and behaviour towards himself and towards the society. Apart from these principles that influence the domestic lives, the workplace demands certain specific ethical behaviour. Ethics at the workplace include being punctual and regular, loyalty and confidentiality and truthfulness. Adherence to these ethical and moral principles at the workplace is highly significant for the smooth, efficient and transparent functioning of a work unit. Workplace ethics essentially spring from ethics of daily life and it is the behavioural patterns of the workers that render a workplace either efficient or chaotic.

The significance of workplace ethics arises from the fact that violations of workplace ethical principles have caused great chaos and financial scandals in the past. The 1970s and 1980s witnessed bribery scandals and defence industry scandals followed by the collapse of the dot-com bubble (Brenkert, 2010). The economic world was shocked again by the accounting scandals involving Enron, WorldCom and recently in India, involving Satyam. The recent financial crisis of 2006-07 and its damaging effects around the globe have increased academic attention on ethics in financial activities. Based on the existing literature, this paper examines the role of ethics in business and accounting in general and ethics and morality in finance, in particular, emphasizing the need for more research on ethics in finance.

ETHICS IN BUSINESS

Business ethics is the normative branch that provides ethical guidance to individuals and organizations in business regarding the way in which day to day business is conducted and its impact on the society. The past four decades have witnessed a great number of scandals and corporate meltdowns and has rendered increased attention on the significance of business ethics. The concept of Corporate Social Responsibility - which broadly denotes the firms'

obligations to the society, has also gained greater acclaim among companies, governments and the society in the last four decades. The discussion on ethics in business can be traced back to ancient scriptures across nations. Ciulla (2010) described the writings of Ptah-hotep, an ancient Egyptian sage on work ethics and the moral entails of money and power. Aristotle detailed the problems associated with profit making and social responsibilities, and Nielsen (2010) stated that Aristotle can be interpreted as suggesting that the purpose of business activity is to create wealth in a way that makes the manager a better person and the world a better place to live in. Economic activity in markets greatly depends on moral standards like transparency and confidence, and the market is considered to be as good as its participants.

Blommestein (2006) stated that markets survive because of widespread adherence to moral traditions and behaviour. He also suggested that abstract morality (which deals with honesty, responsibilities, private property, etc.) results from ethical evolution, and is essential for the development of markets in general, and financial markets, in particular. The presence of high ethical standards in the people in a firm or market will eventually lead to a smooth and transparent functioning of that unit. Unethical behaviour from either the buyers or the sellers in a market will cause unproductive and inefficient swings in the market and hence, ethical behaviour from all parties is tantamount to the effectiveness of the market place (Fullerton, Kerch and Dodge, 1996).

Tsalikis (2010) recognized the significance of ethics in business by stating, “while it has long been recognized that firms which behave more ethically do better economically, it is becoming increasingly clear that economies that manifest greater integrity in business may do better as well.” Several approaches have been suggested for attaining high ethical standards in business, which includes the adoption of codes of ethics, government regulation and corporate models of ethical behaviour (Tsalikis and Fritzsche, 1989; Ma, 2009; Murphy, 2009; Ciulla, 2011). Kaur and Kaur (2011) examined the significance of 'whistle blowing' in business ethics. They concluded that whistle blowing has a very significant impact on the organization and the stakeholders, as it often contributes to improvements in internal control systems and in providing solutions to organizational problems. In the recent years, an increasing number of companies have chosen to adopt codes of ethical conduct and there are various professional codes of conduct in place for accountants, doctors, lawyers and financial intermediaries.

Ganguly (2010) noted that a number of people automatically think of ethics a system that provides guidance based on a set of principles or rules, which help us in determining what is right or wrong. Ganguly added that even though there is a good deal of truth in this perception, it needs to be viewed in a broader context.

The area of advertising ethics has also received significant research interest in the recent years. Cunningham (1999) defined advertising ethics as what is right or good in the conduct of advertising function and concerns with questions of what ought to be done, and not merely what legally must be done. Bishop (1949) is one of the earliest works on advertising ethics, and he described various moral indictments posed by advertising. Spence and Van Heereken (2005) concluded that the pervasiveness and unrestricted proliferation of advertising that threatens to engulf all aspects of our private and public domains remains the biggest ethical problem of advertising. Drumwright and Murphy (2009) indicated that the temptations, risks and rewards of unethical behaviour in the advertising business are increasing, as hence, the industry and academia need to become more proactive in dealing with ethical problems and in setting norms.

The significance of business ethics was underlined with the creation of the Business Ethics Index (BEI) in 2004. BEI was constructed to systematically monitor the consumer perceptions of business ethical behaviour and it is based on the synthesis of two major consumer sentiment indices:

- 1)** University of Michigan's ICS (Index of Consumer Sentiment) and ;
- 2)** the Conference Board Consumer Confident Index (CBCCI) (Tsalikis and Seaton, 2006).

BEI is constructed by incorporating four measurements of consumer ethical perceptions - personal/past, vicarious/past, personal/future and vicarious/future. The BEI questionnaire comprises of four questions that were constructed to analyze the consumers' own experiences, consumers' conception of ethical behaviour of business based on the opinion of others and media, consumers' future expectations and evaluation of consumers' past experiences. These questions are scored on a single five-point or three-point Likert-type scale. Tsalikis (2011) found that the BEI 2009 results showed higher disappointment among consumers on business ethical behaviour and that the consumers' disapproval of business performance before and during the crisis has led to increased direct criticism of managerial behaviour.

Donleavy (2007) examined two major business theories- the Integrated Social Contract Theory and the Care Theory providing a comparison and contrast of the two. The ISCT is based on minimal interference from state and free market, and it puts forth that entrepreneurs and individual firms enter into agreements with each other, which are made in a moral free space. No external regulation or interference is ethically justified other than necessary enforcement of hyper-norms (agreed ethical constraints on contractual freedom). The Care Theory suggests that the foundation for morality and ethics should be based on care instead of justice. Donleavy (2007) emphasized on the need for developing a new framework to examine business ethics by incorporating the classical ethical principles of the Integrated Social Contract Theory and the Care Theory such that the ethical gap in ISCT be fixed by Care Theory. The emergence of China as an economic superpower in the last century has attracted academic interest in the Chinese style of management and conduct of business. The concept of Confucian ethics and self-regulation was examined by Woods and Lamond (2011). Self regulation involves regulating one's behaviour in order to achieve refinement in character and self-cultivation. They examined six key Confucian virtues in the context of self-regulation in management - benevolence, righteousness, ritual propriety, wisdom, trustworthiness and filial piety. They also identified seven Confucian principles, including the principles of social harmony, acting ethically according to rules and complementary reciprocity that are needed to attain self-regulation in management. This concept of self-regulation is an important aspect in business ethics as the firms and its managements are greatly responsible to maintain ethical standards within themselves. Chandel, Kumar and Kant (2009) stated that one cannot be ethical in the long-run by being unethical in the short-run. They emphasized on the significance of leaders with strong character whose governance will bring about better corporate governance.

ETHICS IN ACCOUNTING

Accounting literature has consistently dealt with ethical issues and need for adherence to ethics. This issue may have gained significant importance in this area because of the clearly defined framework in terms of accounting standards. Ethics in accounting is highly significant for organizations and the society itself who rely on the services provided by accounting professionals. Scandals involving Enron, WorldCom, Microsoft and Satyam have shown the extent of potential losses that fraudulent accounting could result in. The misinterpretation of earnings reports and manipulation of loss figures of the company by the executives at Enron finally culminated into the bankruptcy of Enron and billions of dollars in loss to the investors. The WorldCom scandal involved similar cover-up of accumulated losses over the years, and the company went into bankruptcy in 2002. These cases emphasize the significance of high ethical standards required of accounting professionals in the modern economy. Singh and Kant (2010) emphasized on the need for effective, transparent and timely communication to the stakeholders regarding the financial and other quantitative information about the organization through an appropriate medium.

The models of ethical behaviour and development proposed by Kohlberg (1958) and Rest (1986, 1999) have formed the basis for most of the studies on accounting ethics. Kohlberg's Cognitive Moral Development model proposed that increased ethical development will bring about higher ethical behaviour. Rest developed on Kohlberg's model and put forth a four-component model of ethical decision-making process consisting of ethical sensitivity, ethical judgement, ethical intention and ethical behaviour. Thorne (2000) examined the differences in ethical development and behaviour based on a model of prescriptive and deliberative reasoning. Thorne studied accounting students at an undergraduate level and noticed that they used more principled considerations in analyzing the ideal judgement on an ethical dilemma related to an accounting issue as opposed to their actual intentions. Ponemon (1992) discussed the selection-socialisation process in an accounting firm and found that there existed ethical socialization, whereby those who progressed to higher positions within the firm tend to possess lower and more homogenous levels of ethical reasoning. McPhail and Walters (2009) examined how the accounting functions are influenced by ethical principles inside a society and detailed the role of public interest, independence and codes of professional conduct on accounting professionals. Wong-On-Wing and Lui (2007) studied the extent to which Americans and Chinese differ in their causal judgment about fraudulent behaviour and found that the Chinese were more sensitive to situational factors and are less likely to attribute fraudulent behaviour. Such cultural differences in levels of ethical standards have resulted in increased attention to the management styles and regulation patterns of culturally segregated economies.

The significance of imparting ethics in accounting education has been emphasized greatly in the recent years (Leob, 1971 ; Armstrong, Ketz and Owsen, 2003 ; Cavalière, Mulvaney and Swerdlow, 2010 ; Stanga and Turpen, 1991 ;

Kutluk and Ersoy, 2010). Fisher, Swanson and Schmidt (2007) stated that the effectiveness of ethics CPE (Continuing Professional Education) is limited if the accounting graduates do not obtain a foundation in ethics and if accountants lack a solid, consistent background in ethics from a well developed core curriculum, then CPE educators are restricted in what they can achieve in a two to four hour course. Bebeau (2002), Trevino and Nelson (2004), Williams and Elson (2010) and Kannaiah and Kumar (2009) emphasized on the need for ethics education for accountants. Understanding of ethical considerations in students has been found to have a strong correlation with ethical practices in professional judgements exercised - as current students are future professionals.

ETHICS IN FINANCE

Financial activity around markets and economies are shaped by extensive rules and regulations as opposed to the common perception that there are no ethics in finance. Very high levels of ethical standards and professionalism are expected from the participants of financial market activities in order to ensure efficient and transparent functioning of the system. This general misconception of lack of ethical and moral principles in finance may be primarily due to the fact that ethics and morality have their origins in religion and theology, and finance is considered distinctly segregated from these areas. Blommestein (2006) indicates that the modern theories of financial contracts examine ethical issues as morally neutral incentive problems only and hence, these models cannot be used to analyze the relationship between a wide range of moral problems and financial markets. He also stated that one important reason why economics and finance have ignored ethical concepts is that they are very hard to incorporate into the prevailing mathematically tractable formal models. He concluded that while there is a need for developing financial models based on rational self-interest, it is also necessary to provide explanations on the key role of moral standards in the evolution of more efficient and complete financial markets.

Sifah (2009) stated that ethical dilemmas and ethical violations in finance can be attributed to an inconsistency in the modern financial economic theory and the widespread use of principal-agent models. The underlying assumption of rational individuals aiming to maximize their own interests and the condition that an agent can act on behalf of another person have been identified as inconsistent with each other and present an ethical dilemma. Sen (1986) suggested that instead of the assumption of strong rationality, economic models should incorporate ethical considerations through alterations to self-interested behaviour at various degrees.

The ethical issues that the finance theory has explained are limited to phenomena such as adverse selection and moral hazard, whereas a great deal needs to be researched. The problem of moral hazard within financial institutions was explained by Nielson (2008). Moral hazard is the phenomenon where the person/persons in a scenario act carelessly/indifferently because they are confident of an external bailout. Nielson indicated that several top managers and executives of financial institutions with huge corporate debt crises were allowed to retire with major financial benefits and also that the problem of moral hazard has been increased through various central bank bailouts. He stated that:

“If we cannot avoid subsidizing, bailing out and recapitalizing the financial institutions to some extent at the expense of the ordinary people, at a minimum, we need better and stronger enforcement and regulation to protect against the recurring, exponentially negative effects of large, sub - prime and often over-leveraging bubbles and bailouts” (page 315).

The author points out fraudulent financial dealings, influence peddling and corruption in governments, unauthorized transactions and insider trading as some of the major ethical violations in finance. Such violations and ethical problems are being regulated by various legislations and codes of conduct. However, these measures have not prevented the occurrence of unethical actions of participants in financial activities. Islamic Finance is a relatively new area in finance, which is proposed as having greater ethical implications inbuilt in the system. Walsh (2007) examined the ethical implications of Islamic finance and pointed out that the social implications of a business transaction are also taken into consideration and hence serves the greater community interests. Examining the levels of ethical and moral standards of financial market executives during the financial crisis is an important aspect (Camiciottoli, 2011 ; Watkins, 2011). Adhering to ethical standards is of great significance, particularly during an economic downturn. Fleming and Schwarz (2009) suggested that during a recession or in situations of ethical dilemmas, the best way is to behave honourably.

DISCUSSION AND CONCLUSION

The area of finance is highly diverse, spreading across financial markets, financial services and financial management, all of which have different types of ethical issues to be addressed. Financial theory has not addressed most of the ethical concerns surrounding financial structures and research, which is highly warranted in an era of corporate scandals and crises.

The ethical and moral issues faced by a stockbroker are different from those of an insurance broker or agent. The morality standards of most financial participants are regulated by professional codes of ethics and government regulations. But sufficient research has not been done on the ethics of financial intermediaries and other players in the financial market. In the aftermath of the financial crisis of 2007-08, the extent of ethics adopted by the participants in case of financial activities needs to be analysed. The role that the top-level executives of financial institutions play during a recession and the role of stockbrokers and agents during a stock market crash and similar issues need to be addressed in financial economics. The significance of these issues has become further highlighted in the recent times after the financial crises of 2007-08. This research finds a strong and an increasing need for understanding the ethical considerations not only in the day-to-day life of individuals, but in business dealings and more importantly, in practice of finance. Lack of significant research in this area is of considerable concern in academia and practice. Findings of this research are of import for academia and practice in understanding the state of affairs in case of ethical research in finance. This is important for educators and practitioners who expect their graduates and employees to behave ethically.

Inevitably, there are some limitations for this paper also. The most important one is that even though the researchers examined a large number of studies, there could have been some papers/studies which were not included. Secondly, in this review, the researchers have not examined the methodologies used by the studies that were considered. The researchers felt that these two are the important limitations of this paper. Overcoming these limitations, this paper brings out the immense significance of the need for increased academic attention in the field of ethics in finance, particularly in the post-crisis period. Authors of this study found that there is a significant gap in literature relating to ethics in finance. The financial crisis of 2007-08 has shed light on various ethical issues that need academic attention; this study recommends an in-depth examination of ethical behaviour of market participants from a finance point of view. A greater emphasis on ethics and morality in finance will be able to highlight what had gone wrong in the recent crises and hence, what could be prevented in the coming times.

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