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ETHICS AND GOOD CORPORATE GOVERNANCE: A WAY TO RESTORE INVESTORS' CONFIDENCE IN FINANCIAL MARKET

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ABSTRACT:

- **Objective:** At present the field of ethics is barely found in Finance. Although standard business ethics courses in universities give some attention to ethical issues in business, in general, but the ethical issues in finance is rarely given emphasis; few finance department of businesses includes a treatment of ethic. But a good signal is that interest in Ethical Finance is growing, and many experts of finance believe that ethics should receive some attention in finance education. This study aims at analysing the current Indian Scenario with reference to ethical behaviour in financial sector particularly and in business in general; and key ethical challenges faced by financial sector including the lessons learnt so far.
- **Methodology**: The approach used in this study is Descriptive in nature. The study encompasses the analysis of major corporate scams exposed so far and thereby depriving the role of ethics and morality in avoiding these scams. In solving the ethical dilemma, both Kantian Deontological ethics and Mills' Utilitarian ethical approach have been used.
- **Findings:** The metamorphosis of the financial sector is one of the main reasons which justify the importance of ethical standards in this sector. The major finding of the study shows that once a person has got a conviction that he will not subdue to any sort of pressure and will strict to his moral standards and hold his values, then he will definitely continue to be of high ethical standards and of high moral character.
- **Limitations:** This paper deals with analysing ethical behaviour of financial market participants, executives, management that directly relates to Human behaviour which is unpredictable. Therefore, the results and findings may vary across regions, cultures.

KEYWORDS: Business Ethics, Ethical Finance, Corporate Scams, Deontological and Utilitarian Ethics, Human Behaviour.

1. INTRODUCTION:

Financial Market, more specifically Finance, the lifeline of every economy has been inflicted with many cancerous issues ranging from Securities Scam, IPO Scam, Harshad Mehta Scam, Ketan Parekh case to Insider Trading, Window-Dressing and Agency Issues in Corporate group, and more recently Sharadha Group scandal and Vijay Mallya, the Director of Kingfisher Airlines', loan scam.

The above mentioned scams are enough to shatter the confidence of an average investor who puts his hard earned money in a wish to earn something more. And the lack of confidence due to scams and scandals, in turn are driving retail investors away from stock market.

While there are ample of regulations, the scams and scandals still takes place frequently. This proves the inability of laws and regulations to prevent financial scams. Though no doubt laws and regulations are needed in society to have a peace treaty.

But the regulations alone are not sufficient. As there are numerous laws to prevent frauds, there are ample of loopholes to escape the laws. When 'Needs' becomes the 'Greed', to accumulate more and more (wealth), one can go far to satisfy the Greed. Here comes the question of Human Intension. If people have intension to satisfy the Greed, no law can prevent them. On the counter part if they have pre-disposition to do what is right, which embedded in there character, no incentives to satisfy their greed can indulge them to do things that harms others. Here comes the role of moral judgement, Ethical values.

2. REVIEW OF LITERATURE:

Antonio Argandona (2011): He has argued that ethics is an equilibrium condition of individuals, organisations and societies. This equilibrium is dynamic, because whenever an action takes place, the agent undergoes a change & produces change in others. He inferred that ethical solution in finance will not be developed by the moralist, but by the economist, taking into account the criteria of ethics. He concluded that ethics based on external rules (laws, social norms, corporate codes) and not on the acting person, may not be good guides for action.

V. Suresh & T. Janaki (2012): In this paper they have shown present business and financial scenario as marked by high turbulent because of several causes – inter alia – unethical practices and declining values and short of value-based leaders in corporate affairs and in financial market. They concluded that value based principles professed in Holy Scriptures especially Bhagavad Gita, which remained valid even today. Blending these treaties with modern management theories evolved into 'Corporate Governance'. According to them "Though a corporation is a single entity (a micro system), but essentially its governance make an impact on the whole corporate world (macro

system). The basic tenet – "Yathapinde, tathabrahmande" – as a simile, exhort that entire universe behaves in similar fashion to that of micro unit."

Marianne M. Jennings (2013): In this paper it has been shown that ethical issues financial analysts face today are no different from the ethical issues financial advisers, fund managers, and analysts have faced over the decades and centuries that financial markets have existed. Two conclusions of this paper: (1) History does repeat itself, and (2) when analysts depart from three simple questions (Does this violate the law? Is this honest? What if I were on the other side?), complex issues are resolved through a thicket of codes, laws, and regulations that encourage further interpretations and exceptions and cloud judgment.

3. OBJECTIVE OF THE STUDY:

In this study attempt has been made:

→ To throw light on the recent scenario of financial market.

→ To throw light on the ethical issues in financial market.

4. DATA AND METHODOLOGY:

The approach used in this study is Descriptive in nature. The study encompasses the analysis of major corporate scams exposed so far and thereby depriving the role of ethics and morality in avoiding these scams. In solving the ethical dilemma, both Kantian Deontological ethics and Mills' Utilitarian ethical approach have been used.

5. MAJOR FINANCIAL SCAMS IN LAST 25 YEARS IN INDIA:

A brief idea some of the leading financial scams in India from 1991 to 2016, which have affected a large population of investors and involved a large amount of money. They managed to shake the very foundations of our financial system and were driven by that of human instincts i.e. Greed. In most cases, it was the greed of just one individual, or a very small group of individuals, who managed to pull of such huge scandals:

5.1. HARSHAD MEHTA SCAM (1992): Harshad Mehta was an intelligent broker and he knew the exact loopholes with Indian Economy and the banking system. He used the Ready Forward (RF) and Bank Receipt (BR) and took the price of ACC from Rs.200 to Rs.9000. that was an increase of 4400%. The stock markets were overheated and the bulls were on a mad run. Since he had to take profits in the end, the day he sold was the day when the market crashed. This involved Rs.4000 crores.

5.2. THE IPO SCAM (1993-1996): This scam had two parts – The First was perpetuated by then existing companies, which ramped up their share prices in order to raise money at highly inflated premium to fund Green Field projects and mindless diversification. Most of which either failed to take off or were lacking the spirit. The second part of the scam had a multitude of traders, businessmen, Chartered Accountants, who teamed up with bankers and investment bankers to float new companies to raise public funds. The messed up M.S.Shoes case exemplifies the first type of scam, while the second type, which involved several thousand crores of rupees was known as the 'Vanishing Companies' scandal. This IPO bubble lasted for three years from 1993 to 1996. The investors' disappointment was so strong that the primary market remained dead for the next three years, almost until the beginning of 1999.

5.3. CRB CAPITAL MARKETS: C.R. Bansali, a man with dubious history, was the man behind the CRB Capital Markets. He procured an A+ rating for his Mutual Fund (MF) and even succeeded in obtaining a bank licence. His Non-Bank Financial Company (NBFC) attracted investors in large numbers from various sectors of the society, particularly retired and pensioners. When his company fell down lick a pack of cards in 1997, an amount to the tune of over Rs.1000 crores vanished into thin air.

5.4. THE 1998 COLLAPSE: In 1998, Harshad Mehta, Scamster of 1992, made a comeback by floating a website and writing columns in several newspapers giving tips on stocks. As a result BPL, Videocon and Sterlite shares' collapsed. This led to illegal opening of the trading system in the middle of the night by BSE officials to cover up this issue.

5.5. KETAN PAREKH'S CASE (1999-2000): Ketan Parekh, a Mumbai based stock broker and a qualified chartered accountant had large borrowings from Global Trust Bank during its Merger with United Trust of India Bank. He got a loan of about Rs.250 Crores from Global Trust Bank's Chairman Mr. Ramesh Gelli. The prices of the selective shares constantly increased due to rigging .The investors who bought the share at higher prices thought that the market prices were genuine. Soon after the discovery of the scam of 1999-2000, the price of the stocks came down to the fraction of value at which they were purchased. The investors lost heavily. Even the banks faced a tremendous loss. The amount involved in this scam was estimated to be around Rs.1500 crores.

5.6. 2G SCAM (2008): Former Telecom Minister A. Raja is the prime accused who is considered to be the mastermind in this scam by CBI. He stands accused of under-valuing spectrum as the country's Telecom Minister and selling it to companies he favoured, though they were largely ineligible for licenses to run mobile networks. The loss to the national exchequer is pegged by the government auditor at a mind-boggling Rs.1.76 lakh crores.

5.7. SATYAM COMPUTER SCANDAL (2009): Mr. Raju Ramalinga, the former Chairman and Chief Executive of Satyam Computer Services admitted to falsification in the company accounts and various other irregularities. The estimated fraud was Rs.700 Crores billion.

5.8. COMMON WEALTH GAME SCAM (2010): The Scam involved Rs.70000 crores. The main accused was Suresh Kalamadi, Shela Dixit – the then Chief Minister of the State Delhi.

5.9. SHARADHA GROUP FINANCIAL SCANDAL (2013): The Sharadha Group, which organised Ponzi schemes in West Bengal, had a meteoric rise. It is estimated that the Group collected over Rs.20000 crore deposits through approximately 100-odd companies and an equal number of schemes. Most schemes promised extraordinary returns, like growth by over 34 times in 25 years through investing in plantations. Some schemes also promised doubling of deposits in 15 months by investing in real estate or potato trade, most of which were fictitious. When the group went bust in early 2013, lakhs of investors lost their investments, and a number of them committed suicide. The chief accused of the case are Sudipta Sen, Kunal Ghosh, Madan Mitra – the minister of the state and many more.

5.10. KINGFISHER AIRLINES' LOAN SCAM (2015): According to a statement made by Arun Jaitley in parliament, Kingfishers owes Rs.9091.4 crores including interest to 17 banks as on November 30, 2015. Though CBI claims the amount would further increase. The Serious Frauds Investigation Office (SFIO) has issued notice to 17 companies that lend money to disclose the source of funds given to Kingfisher Airlines. These companies which are not Non-Banking Financial Companies (NBFCs) have borrowed money from banks and lent to Kingfisher Airline. Mallya is currently fighting at least 22 cases in various courts relating to loan default by Kingfisher Airline. At least three banks – the United Bank of India, State Bank of India, and Punjab National Bank has declared Kingfisher and Mallya as "wilful defaulter".

6. MICROFINANCE: GETTING MONEY TO THE POOR OR MAKING MONEY OUT OF THE POOR?

R.P. Christen (1997) defines microfinance as the means of providing a variety of financial services to the poor, based on market-driven and commercial approaches. These services may include savings, insurance, money transfers and credit. However the microfinance movement to date has generally favoured microcredit, which is the provision of small loans to households who are perceived to be too poor to qualify for loans from formal financial institutions. But instead of helping the poor by providing easy term loans, some microfinance companies are making money out of the poor. For example a Special Investigation Team of the CBI has filed a charge sheet against chit fund company Micro Finance Ltd. in connection with the multi-crore-rupees chit fund scam (2015) in Odisha. It was said in the charge sheet that the company duped investors of at least Rs.400 crore by floating six companies in the state.

Business Insider report goes like this, "First they were stripped of their utensils, furniture, mobile phones, televisions, ration cards, heirloom jewellery. Then some of them drank pesticide. One woman threw herself in a pond. Another jumped into a well with her children. Sometimes, the debt collectors watched nearby." It further claims, "More than 200 poor, debt-ridden residents of Andhra Pradesh killed themselves in late 2010, according to media report complies by the Government of south Indian state. The state blamed Microfinance companies – which give small loans intended to lift up the very poor – for fuelling a frenzy of over indebtedness and then pressuring borrowers so relentlessly that some tool their own lives"

In this regard a suicide note of an 18-years-old girl, pressured until she handed over Rs.150 – meant for a school examination fee – drank pesticide, goes like this, "Work hard and earn money. Do not take loans." Her suicide note reveals how massively she was pressurised and it puts question on the very system at large.

7. PUBLIC PERCEPTION OF FINANCE INDUSTRY:

The scams and scandals as mentioned above are enough to shatter the confidence of an average investor who puts his hard earned money in financial market, more specifically in stock market in a wish to earn something more. Although the finance industry is growing at a multiplier rate with all efforts being directed towards investors security, but the public perception of most financial firms as interested in making money at the expense of all other considerations seems to be unchanging. The financial services sector has an increasingly difficult task of balancing the demands of a lengthening list of 'stakeholders' - shareholders, the community, investors and pressure groups and demands of the regulator as well.

8. CORPORATE GOVERNANCE TO RESTORE INVESTORS' CONFIDENCE IN FINANCIAL MARKETS:

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. It provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance as determined. The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy.

Corporate Governance by the following ways helps to restore investors' confidence in the Financial Market:

Firstly, enhancing good corporate governance practices by improving the institutional set-up of listed companies to provide sufficient check and balance mechanisms and to enhance accountability of the Board of Directors.

Secondly, making stringent regulatory framework.

Thirdly, punishment of the offender in a first track manner.

Finally, auditors have a great deal of function in preventing big frauds by whistle-blowing as early as he finds something mischievous in the companies' books of accounts under audit.

Although, all these measures can force the organisations, management, auditors and others to comply the regulatory framework, but that cannot ensure that they are actually complied with. If it could so then the frauds and scams had been so frequent.

What actually needed and lack here is moral incentive. There is an absolute need to acknowledge the objective standards of morality. What moral incentive the scammers getting to indulge in such a degraded way to get money, even from the poorest section of the society? As discussed in section 3 of this paper, what led the 18-years-old girl who left with no option but to commit suicide for just Rs.150 debt? But for those, who directly or indirectly forced her to do so, Rs.150 doesn't matter to them. Here actually comes the role of Ethics and morality to judge and shape their moral reasoning to transform their thinking from individualism to collectivism which is more society oriented, encompassing every creature of the world.

9. ETHICS TO RESTORE INVESTORS' CONFIDENCE IN FINANCIAL MARKETS:

Too many people, if not all, "Ethical Finance" is something unimaginable. But ethics in financial market is nothing but the study and practice of appropriate behaviour of the market participants. A question may be raised why behaviour of 'participants'? The answer is very obvious, because market, be it a market for commodity or a market for financial products, is nothing but a cluster of buyers and sellers (both can be an individual or an organisation). And both the buyers and sellers need to deal ethically in carrying out all business and financial transactions, by telling the truth, rendering fair value for payments received, not turning the eyes when subordinates or colleagues are defrauding customers or investors, rejecting bribes, and acting to insure the solvency of the corporations, financial market, rather than maximizing its profits in the current quarter to the detriment of its viability in the long term. The relativists would question whether ethical standards, such as these, should be asserted as always in force? Relativist would say that it all depends on the person, or the transaction under consideration, or the circumstances. But in reality, there are objective standards: The legal system prosecutes individuals who violate them. So it would be worth

people's time to consider this fact and acknowledge that these standards are reasonable and we need to adhere to them.

9.1. SOME ETHICAL DECISIONS IN STOCK MARKET: The stock market is a vast financial entity characterized by many players – large and small. Motivations behind buying and selling stock widely vary. Different techniques not only require a different risk tolerance, but also a consideration of ethics. While many investors may not find themselves in an ethical dilemma regarding their stock transactions, others are faced with it frequently.

9.1.1. SHORT SELLING: Many investors have heard of the "buy low, sell high" trading strategy. However to meaningfully profit in a stock, this order may be reversed. Short sellers first sell at a high price, and then later buy the stock back at a lower price. They sell stock initially that they do not own. This is a common strategy that nearly any brokerage account may utilize. But it is characterized by a negative stigma. After all, short sellers are making money while other investors watch their portfolios dwindle. To short sell in stock market is an ethical decision that some will eventually face if they choose to expand their trading techniques. Part of the Ethical dilemma is widely perceived attitude that short selling causes significant market declines and even stock market crashes. While there is no specific evidence that short selling is influential in this regard, some traders do feel unethical if they trade in this way.

9.1.2. PUMP AND DUMP: Penny stock attracts a lot of attention due to their vast potential for future gains. Many scammers engage in "Pump and Dump" strategy where they 'pump' the public full of inaccurate information to inflate the conception of a penny stock. When public start buying the stocks in expectation of future gain, price rises based on this speculation. Then the scammers sell their holdings by 'dumping' the shares. Investors who were gullible and bought into the false rumours are left holding a penny stock that will eventually fall back to its original price when the market wakes up to these rumours. While such a strategy is illegal for those who promote false information, it is still possible to legally profit by joining in on the penny stocks rise and being quick with your exit strategy before the rest of the participants realise they were duped. To engage in such a profit is no doubt unethical to some traders.

9.1.3. INSIDER TRADING: Insider trading refers to any stock transaction based on privileged information about the company's future. This may be illegal if financial agreements prohibit a conflict of interest in the trader's behaviour, but some insider trading activity is authorized and acceptable. Nonetheless, if one works for a company and have some information about its future activities, one may face an ethical decision about stock trades based on this information, regardless of the legalities.

9.2. MORAL ASPECT OF CHOICES: The consideration is how people take decision – choice from amongst two or more alternatives – like whether to take advantage of 'pump and dump' legally or to make people aware of the situation? So what are the moral aspects of a choice?

Moral decision-making has been considered by two key normative theories, Kantian Deontological theory and Mill's Utilitarianism or Consequentialism. The deontological approach, derived from the Greek word for duty, takes the perspective that a particular act or action is right or wrong; the consequentialist considers, of the act, what the consequences of doing something might be (Tanner et al., 2008). Of course these are not mutually exclusive concepts, as the consequence of an act often defines whether it is right or wrong. So each and every event should be analysed from these two points of view. Then it will reveal that the use of privileged information for personal gain, the act itself is morally not right. And its consequences can be so dangerous that the entire society at large may have to suffer.

Some empirical studies have shown a positive correlation between the degree of trust in a country and growth of its investment sector (Zak-Knack, 1998). Trust is very important in all financial transactions, but in the financial sector it becomes a 'sine qua non' condition for it to function, essentially because financial activities are transacted over more than one period of time (Arrow, 1972), which tends to create uncertainty. In order for the market to achieve mutually beneficial results, individuals must choose the right courses of actions to promote trust.

9.3. FROM PHILOSOPHY TO ACTION: Getting back to our main focus, it is not by merely attempting to apply ethics as a Band-Aid that we'll be able to heal the deep injury produced by the excesses of finance. For us, the question is how can we weave ethical concern or the interior dimension into the very fabric of everything we do in relation to ourselves, others, and organisations. In other words, one mode of framing the concept of ethics is that being ethical is about leading oneself with the purpose of being – and staying in alignment with one's values, thereby demonstrating personal integrity. In relation to others, ethical concern is about cultivating mutuality and engaging with others with the intention of fostering reciprocation and interdependence. Still at an organisational, inter-organisational level and beyond, ethical concern is about being compelled to act with the purpose of advancing sustainability.

One particular practice that can blend these three objectives is called "Action Inquiry" ___ "It is a way of simultaneously conducting action and inquiry as a disciplined leadership practice that increases the wider effectiveness of our actions" (Torbert, 2004). The action part refers to our behaviours – what we do, what we say. The inquiry part points to questioning and reflecting – within ourselves, or in relation to others – as we engage in anything that we do.

9.4. DIET, A PRACTICAL APPROACH TO PROPAGATE "ETHICAL FINANCE": Mere philosophy will not serve our core intention of restoring investors' confidence in financial market. What we need is a more practicable framework to infuse ethical behaviour into the financial market. A DIET Framework may be helpful in this regard:

D - Debate

I - Incentives

E - Education

T - Training

Frequent **Debates** can be organised for business leaders, market participants, university students on some serious ethical issues in finance, like "whether to make a legal but unethical profit from a Pump and Dump situation?" Their participation in such debates will open them to more contemporary practical issues on ethical behaviour in business in general and more specifically in finance.

Secondly, both moral and economic **Incentives** can be provided for good governance, ethical performance in market etc. For example, in 2013, Thomas Reuters and Abu Dubai Islamic Bank (ADIB) partnered to launch the world's first "**Ethical Finance Innovation Challenge and Awards" (EFICA)** to inspire and recognise fresh ways of thinking and promote the most dynamic actionable solutions that advances ethics in the world's financial services. Out of many incentives in the form of awards they give, one is "Ethical Finance Initiative Award" which looks for new or existing ethical financial solutions or initiatives that can be implemented within the financial sector. A single prize of $50,000 is awarded.

Thirdly, the **Education,** which cannot be substituted by anything. The ideas that financial theory tends to create about market players ends up by influencing their actual everyday behaviour. A study carried out among students from different faculties in a university in the United States showed that Finance and Economics students educated in the way rational agents should act are more likely to act in a selfish way than students from other disciplines. This happens because the individuals concerned perceive that if they act in a way that is contrary to what is considered rational the consequences would be a loss of time or money. Education is one of the most powerful drivers of cultural change. Creating a financial system that can make a contribution to the common good depends on education. It is therefore vital that universities and business schools include ethics as a basic element of their study programmes across the board, rather than as optional courses or one-off seminars. Fortunately, after the latest crises, more and more centres of financial studies have recognised the importance of teaching ethics to their students. If the majority of institutions were to

follow suit, a good critical mass of ethical financiers of the next generation would already be in training.

Last but not the least; continuous **Training** is of vital importance. Mere teaching ethics in colleges and universities is not enough. As the market practitioners, on an average spend their 30 to 35 years at their work place, where they spends hardly 3 to 5 years in colleges and universities. As a result the role of organisations cannot be neglected in this regard. Business organisations and social organisations can make tie ups with industrial psychologist to arrange for training and shaping socially desirable behaviour. Training can be given to analyse every financial decision ethically. The general guiding principles of ethics can be gained by answering the following three questions:

(I) whether the course of action under consideration is legal? – If the answer is "no" then the course of action is immediately rejected. And if the answer is "Yes" then move to the second question. (Deontological Decision)

(II) Whether the course of action under consideration is ethical? (Whether the action will provide equal advantages and disadvantages to all concerned parties. If it favours any particular party to an extent, it is not fair and therefore it is not ethical.) – If the answer is "no" then the course of action is immediately rejected. And if the answer is "Yes" then move to the last question. (Deontological Decision)

(III) What could be my reaction if I would have been on the other side? – This means an analysis of the effect of the action on the other parties. – The action is good if it produces or tends to produce the greatest amount of satisfaction for the greatest number of stakeholders affected by the action. (Utilitarianism)

So while deciding right and wrong, it is advisable to consider both the Deontological and Utilitarian views of the decision. If these can be implemented, good corporate governance is inevitable, and in turn investors' confidence can be regained.

10. CONCLUSION – A LINKAGE:

It would be an understatement to say that the discipline of finance has not been strongly associated with ethics; if anything, the two areas have been opposed to each other as mutually exclusive. Even where such an opposition is not maintained, it remains true that the ethics of finance is underdeveloped compared to the fields of business ethics or professional ethics. Most financiers have not had in-depth ethical training, whereas ethicists lack an understanding of the technicalities of financial management. The situation is thus self-perpetuating. In recent years, however, following a series of stock market crashes, scams and scandals, and the present general financial instability,

there is a renewed interest in the interface between ethics and finance. The ethics of finance has thus arrived at an auspicious time, and it gained considerable attention. Its central aim is to show that the theory of finance, with its assumption of self-interested opportunism and maximisation of wealth on the part of every agent, cannot explain what really happens in financial systems. Additionally, taught in a fundamentalist and uncritical way in business schools, the ideology behind the theory of finance leads to the distortion of agents' behaviour in practice, and the undermining of the proper functioning of a healthy financial system. It is worth noting that a proper theoretical understanding of finance requires a necessary foundation in some set of ethical assumptions that reach beyond the sphere of technical financial. In other words, an ethical basis to the operation of finance is not a constraint or a limitation placed on financial agents, but rather the prerequisite condition that will allow the financial system to continue to exist. And if investors starts perceiving that financial market deals with ethical finance, then the investors trust gain be regained and investors' confidence can be restored.

PRACTICAL IMPLICATIONS – The results of the Study, if implemented, would help financial market participants, executives and senior management officials in practicing good ethical behaviour in general and avoiding scams in particular that leads to wastage of resources as well as loss of trust of stakeholders in the corporation and financial market at large.

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