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Research Paper

A Critical Analysis of Ethics in Finance

Dr. Amarjot Verma
Assistant Professor
Institute of Management Studies
Bundelkhand University, Jhansi (U.P)

ABSTRACT
Now-a-days finance is a function within every business enterprise be it public sector, private sector or non profit organization. Corporate financial managers are responsible for myriad of decisions right from how best to raise and invest capital to planning of mergers and acquisitions. The purpose of ethics is to deter wrong doing and promote honest and ethical conduct of business with full, fair, accurate and timely disclosure of information to ensure compliance with applicable laws, rules and regulations. These are collective set of standards that professionals must hold inorder to maintain trust and confidence among colleagues, clients and the public at large. It is a framework within which an organization has to function to make decisions, creating a positive impact on the parties concerned. It deals with the principles and values that guide both the individual and the organization in taking decisions as business and ethics are highly linked together.
KEYWORDS—*honest, ethical, fair, timely, disclosure, values.*

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I. INTRODUCTION

As individuals are either producers or consumers of financial services, therefore ethical issues in finance affect everyone. Ethics in finance is concerned with the generation, allocation and management of monetary resources, even though the public seems to have a perception that the financial services sector is more unethical than any other sectors of business, be it personal finance--whereby individuals save, spend, invest and borrow money in order to conduct their lives; corporate finance--whereby organization both business and not-for-profit raise capital mainly through loans or the issue of stock and bonds; and public finance-- whereby government raises revenue by means of taxes and fees, spend it to provide services and other benefits to their citizens. These markets facilitate financial activities, providing a platform where money and other financial instruments can be traded by banks and other financial service firms. But this raises the issue of ethical dilemmas of personal conduct, as well as broad question of organizational or institutional practice, especially when important financial decisions that affect the society are involved.

However, in finance some matters are not under legal control and therefore ethics alone holds sway. Compared to profession like medicine, law and engineering which focus on ethical problems of relatively uniform nature, financial ethics involves a diverse range of activities that do not involve repetition in every setting. So the idea of having a single code of ethics for everyone in finance is impractical due to the diversity involved. Besides this, ethics in finance is concerned not only with the ethical problems of individuals in a specific occupation or profession, but also with the problems in financial market and institutions as well as the financial function of corporation and government. Because market regulation is concerned with fairness in dealings, therefore financial ethics needs to address such questions as what is fair trading practice or fair treatment of customers/ clients.

II. CODE OF CONDUCT FOR FINANCIAL PROFESSSIONALS

Professionals need to be involved in ethical behaviour exhibiting--

- *Honest and ethical conduct*--Professionals should act in an honest and ethical manner for handling the actual or apparent conflicts of interest between personal and professional relationship. They are also expected to carry out their responsibilities honestly, in good faith with integrity, exercising due diligence, strictly prohibiting any action to coerce, manipulate, mislead or fraudulently influence the client.

- *Full, fair, accurate, timely and understandable disclosures*--Professionals should produce full, fair, accurate, timely disclosure of information and documents for submitting to the concerned authorities and also for public communication.

- *Compliance with applicable laws, rules and regulations*--The professionals must comply with the spirit and intent of all applicable laws, rules and regulations. They are also required to comply with the code of conduct and anyone who violates this code shall be subject to disciplinary action which can even lead to termination of employment.

III. RELATION BETWEEN ETHICS AND LAW

The close connection of ethics with law raises the question of why these formal mechanisms are not enough and why ethics are required in finance in addition to legislation and regulation. In view of above, financial professionals assume that ethics only provide guidelines for working. Their actual motto is: "*If it's legal, then it's morally okay*." However, this motto is inadequate for many reasons--

Firstly, law is rather a crude instrument that is not suited for regulating all aspects of financial activities, especially those that cannot be easily anticipated, reduced to precise rules or enforced by law**.** Consequently following the moral rule of "being fair" or a standard of suitability may be more effective than a precise legal rule of the form "do such-and-such." Moreover, precise rules can often be gamed to produce results that may be considered unfair and legal sanctions for violation of a rule may be difficult to devise and apply. The example of conflict of interest is illustrative**,** because of the variety of conflicts, a law barring them is difficult to draft and such a law would be subject to difficulties of interpretation and enforcement. Conflict of interest is often a matter of perception so that a strict legal definition would be elusive and proving a conflict would be similarly difficult. Rules designed to prevent conflicts could be effective only if individuals obey the spirit as well as the letter of these rules. The difficulty of bringing legal action against individuals involved in the recent financial crisis also shows the limited use of the law in complex situations where it is difficult to prove individual culpability. Secondly, law often develops as a reaction to activities that are considered to be unethical. It would be perverse to encourage people in finance to do anything that they want until the law tells them otherwise.

IV. THE NEED FOR ETHICS IN FINANCE

Although the need for ethics in finance is quite obvious and people dealing in this profession are dedicated individuals with a strong commitment to service but finance relies mainly on the search for gain which can easily turn into greed. Moreover individuals operate within and through organization, institution and system including markets which may be faulty. Consequently ethical misconduct may occur unintentionally and for which no one bears the responsibility. Many problems result not from deliberate misconduct--doing what one knows to be wrong, but also from rational actions in situations with complex interaction. Ethical misconduct is not always a matter of bad people doing bad things, but often good people who stumble unwittingly into wrong doing. Ethical issues are particularly important in the financial services industry as these institutions perform the task of financial intermediation i.e**.** accepting deposits from savers and providing loans to investors or users of funds. These activities involve a great deal of trust and the opportunity to maintain reliability while using other people's money on their behalf. While many of the possible opportunities and self-serving behaviour in such situation is constrained by rules and regulations pertaining to fiduciaries, no rules can cover all contingencies and there is greater reliance on ethical behaviour. Asymmetric information makes many of these situations worse, i.e. in such cases there are increased opportunities for self-serving behaviour as the financial agents have more knowledge and information than the principal, whose welfare they are supposed to maximize. Ethical behaviour is particularly important as financial decisions may involve other people's money, accumulated wealth and other savings. Since it is a tug of war between self-interest, market efficiency and various aspects of fairness, it is impossible to develop and implement impractical rules of behaviour constraining self serving behaviour or favouring certain stakeholders for every possible contingency in the industry.

Continuing unethical behaviour generally has a contagion effect, even for firms that do not face failure and are not directly associated with unethical issues, which may lead to high operating costs in that industry owing to the increased regulatory and legal action designed to curb such behaviour. Each major epoch of unethical behaviour in the past has been followed by a new government regulation, designed to reduce or at least minimize such faulty instances. Some have even argued that most of these regulations originate as reaction against episodes of significant unethical behaviour among financial market participants. Unfortunately, persistence of such behaviour can erode confidence and ultimately lead to reduction in the number of market participants, lowering the efficiency of such markets. In recognition of the need to address the problems arising out of unequal market power and asymmetric information, most professional associations in the financial services industry have developed ethical guidelines for investor protection. Another ethical issue in finance relates to the desire of many investors to invest only in firms that engage in ethical activities, to reduce the risk of their financial losses. But with so many precautions ethical lapses may occur at times.

V. ETHICAL LAPSES

- *Self-interest*--Sometimes individuals morph into greed and selfishness if left unchecked at the expense of someone else. This greed becomes a kind of accumulation fever and the focus shifts from long-term to short-term profit maximization.
- *Stunted moral values*--The failure to be taught moral values and to look beyond one's own perspective, with lack of proper mentoring leads to distorted moral values in their life.
- *People often equate moral behaviour with legal behaviour*--Irrespective of the fact that even though an action may not be illegal, it may still not be moral. Some people are contended that the only requirement is to obey the laws with a tendency to ignore the spirit of the law.
- *Professional demands can conflict with company* demands--A faulty reward system can induce unethical behaviour, the best example of this type of behaviour.
- *Individual responsibilities may wither due to the demands of the client*--Sometimes the client may force the organization to act unethically: the reason behind it may be a temptation or you like your client or you know your client since a long time or you really want to help out your client.

As professional ethics and standards go beyond the individual, ethics have become an industry wide phenomenon. Employers need to create a workplace that puts contradictorily less pressure on employees. If one of the coworker or peer is involved in questionable activities, it's not enough to disassociate yourself from that individual. Knowingly allowing unethical activities at workplace can result in punitive response. Though nobody likes being in the position to blow the whistle on a coworker or friend but it is ultimately an individual's responsibility to ensure about fair practices in the industry and stand up for one's ethics. This only scratches the surface as it remains superficial, regarding the types of ethical dilemmas and situation that professionals may face. Over the years professionals had been involved in countless scandals and allegation of fraud which have rocked the industry and given them a black eye. By being aware of the guidelines to follow, encouraging safeguards at the workplace and holding the highest level of ethical standards, one can take a leading role for setting an example ensuring that the financial industry remains fair and transparent for everyone involved.

VI. SOME ETHICAL CHALLENGES IN FINANCE

Sometimes, someone's wrong can be your right, which means your right can definitely be someone else's wrong at some point of time. These ethical challenges appear in the form of bribes, conflict of interest, issue**s** of honesty, integrity and whistle blowing. Some of the major ethical challenges may be--

- *Financial fraud and corruption*--Financial fraud and corruption serves as one of the best examples of white-collar corporate crime. Alone or in combination it can contribute to the collapse of corporation or even be a major reason for national or global financial crisis.
- *Employee theft or embezzlement*--Employee theft can be in the form of stealing or misusing an employer's resources without permission. It can be in the form of theft of money, payroll theft, data theft, inventory theft or service theft. While taking away of personal property fraudulently by someone to whom it was entrusted is embezzlement. It can occur in the form of keeping the personal property or transferring it to a third party.
- *Insider trading*--When non-published information from a company is used to make a trading decision by someone with a vested interest in that company. It is illegal to engage in insider trading, but still information is being manipulated by traders to earn profit.
- *Conflicts of interest in investment decisions*--Conflicts of interest arise when the interest of a client are different from those of a financial advisor or firm.
- *Market and wealth manipulation*--Intentional or wilful conduct designed to deceive or defraud investors by artificially controlling the price of securities leads to market manipulation. It may involve: spreading false or misleading information about a company, engaging in a series of transactions to make a security appear more actively traded, pricing trades to make it look like there is more or less demand for a security than is the case.
- *Accounting and transaction fraud*--This specifically refers to the act of intentionally manipulating a company's financial statement by overstating revenue, understating expenses, hiding debts and falsifying financial information.

- *Misrepresentation of financial statement*--Financial statement fraud occurs when financial information is intentionally misrepresented or manipulated to deceive stakeholders and create a false perception of a company's financial condition which can lead to liquidation of the company.
- *Tax evasion and avoidance*--Tax evasion involves lying about how much money you make, pretending that the expenses are higher than they actually are or doing secret transactions with cash. On the other hand, tax avoidance involves legal ways to pay less tax by investing in different tax saving schemes, both posing a challenge to ethics.

VII. SOME COMMON UNETHICAL PRACTICES BY PROFESSIONALS

- *Money laundering*--Money laundering is a crime that involves hiding the origin of money **earned** from illegal activities.
- *Investment frauds*--Investment fraud occurs when people try to trick you by investing money giving fake information about a real investment.
- *Toxic loans*--The loans or debt that have a low chance of being repaid with interest**,** within the stipulated time are toxic loans.
- *Violating norms of regulatory authorities*--Financial institutions need to operate within a regulatory framework eshtablished by regulators that are designed to protect the public (depositors, consumers, investors, creditors, etc.) a**s** non compliance can expose an institution to financial and other risks.
- *Deliberately delaying payments*--The ethical principle underlying any contract is trust which comes from fairness, honesty and mutual benefit. A culture of late payment is an example of how rotten corporate ethics can erode a company from inside.
- *Accounts manipulation*--When the managers of an organization use accounting tricks intentionally and misstate their financial information to favourably represent the entity's performance.
- *Inappropriately reporting expenses*--Inappropriate expense**s** reporting claims are typically the result of creating confusion regarding a company policy or fraud.

VIII. HOW TO RESPOND TO ETHICAL CHALLENGES

- *Create ethical culture at workplace*--An ethical company culture results from hard work and unintentional actions .Organizations can be involved in practicing an ethical culture by providing both statement of ethical values and a code of ethics as well as related training for ethical behaviour. Ethics and accountability play a significant role in maintaining company’s culture right from employee satisfaction, productivity and reputation with customers/business partners.
- *Grant authority and create accountability for ethical behaviour*--A company can foster a sense of accountability by communicating expectations, delegating tasks to different members of the team, explaining the consequences if the tasks are completed incorrectly or late. Transparency and accountability are often legal and ethical obligations which ensure compliance with standards. Organization that are themselves involved in both collecting and reporting financial information are able to maintain their standards in an effective manner.
- *Minimizing ethical dilemmas and pressures*--There is always pressure on an organization to act unethically despite the adoption of ethical codes, which needs to be handled intelligently by building a culture of integrity while remaining focused on organizational values.
- *Promote legislation related to financial dealings*-- As breach of information still remains the biggest concern for a firm, increasing the number of legislation related to corruption and anti-bribery, have been a major challenge for financial institutions.

Enterprise offering financial services has a duty to ensure that their investment does not create a negative impact on society or the environment. They must follow rules to support social welfare and to maintain the integrity and sustainability of financial markets. Therefore a code of ethics in the form of guidelines is designed to hold one accountable for their actions and ensure that right decisions are made by professionals.There is no doubt that greed is a powerful emotion, but sometimes unethical behaviour results from lack of education on the basic principles of financial standards. By taking a look at situations that have often come up over the course of time in a professional's career, helps decide how circumstances should be handled not only to meet these standards but also to exceed them.

IX. CONCLUSION

Ethical issues are ubiquitous and act as an important and cost-effective constraint on self-serving and other undesirable behaviour of managers who have preferential information and who are responsible for management of assets. As it is impractical to cover every contingency in financial transactions through law, ethics in finance are especially important. Financial transactions depend critically on implicit contract and the pursuit of shareholder’s wealth maximization with a reputation for ethical behaviour for growth and development. Investors trust financial institutions putting their faith in the hands of professionals for ensuring highest return. Upholding investor confidence is vital for the success of the investment industry for which high ethical standards are critical for maintaining the public's trust for investment in financial markets.

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*Corresponding Author: Dr. Amarjot Verma