

PalArch's Journal of Archaeology of Egypt / Egyptology

ETHICAL ISSUES IN RELATION WITH BANKING INDUSTRY

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Marwa A Bashawyah, Tahar Tayachi. Ethical Issues in Relation with Banking Industry -- Palarch's Journal of Archaeology of Egypt/Egyptology 18 (13), 412-421. ISSN 1567-214x

Keywords: Ethical Banking; Performance Index; Financial Crisis; Global Banking;

ABSTRACT

This research contributes to illustrate ethical issues in banking industry and its consequences in relation with financial crisis. The literature review will be questioning and analyzing dangerous scandals happened in baking industries which were emerged from ethical issues. The methodology of this research is based on qualitative method and descriptive analysis for the purpose of analyzing the ethical banking. The methodology will gather different literature sources to understand different terms, factors or variables associated to it. It was concluded that performance index has helped in maintaining liquidity, mitigating risk, profitability and asset quality; since it was strengthened by regulations and rules. The research determined that Financial Services in Asia are most driven to be compliant by regulations followed by Europe, UK, Africa, and then America. Even so, risks that followed by global financial crisis were mitigated though not completely removed but was reduced in banking industry.

INTRODUCTION

A bank is a financial center and whether it is a common person, private organization or government organization, all of them are working with banks [1]. Banking of course is delivered through products, services, and other financial instruments as it enables economic activity across market and helps create wealth across society [2].

From 1984 to 2008 there were 10 financial crises around the world and trillions of dollars have been lost. On the last global crisis in 2008 the financial industries reputation took a big hit and its brand got shredded [3,4]. The problem is that some people in finance forgot the core purpose of finance as it is to help people save, manage and raise money. Being a professional with ethics is that need to perform a higher level of good things and might require time and effort to take effects.

Ethics help people to spot issues which save money and keep the markets healthy and functioning for a long term [5]. Carbonic, [6] defined ethical banking as a method to distribute credit to maintainable activities that benefit either community or environment. He stated that ethical banking might present return on investment below than normal average Banks that are ethical encourage proper functioning of markets, avoid bad headlines in media, reduce reliance on regulations and create a reinforcing culture. Unethical banking has been mainly main reason for not just profits were down but that both corporate world and global finance meltdown and printed with corruption and greed.

Goyal and Josh [7] explained in research that due to recent global financial crisis cause millions of dollars got lost and some banks or rather companies got shut down and obviously many job losses happened. The global financial crisis, which happened between 2007 and 2009, has been a sore incident that impacted both large and small economies. Claessens and Kose, [8] indicated that financial disturbances can be considerable move these standard policies and codes of conduct that most banks have. Therefore, it has been concluded that this financial crisis that hit the world economy was filled with many unethical mistakes. Argandona [9] indicated this dilemma began when banks sold mortgages to some third party by making Mortgage Back Securities. Investors thought these securities where a good investment since mortgages were only for borrowers with good credit.

"Bank of Credit and Commerce International" operated as an international bank in 1972 and headquartered in London. The founder, Agha Hasan Abedi, was at height of his power with a spellbinding hypnotic figure to some of cult leaders. Herring, 2010 [10] indicated that there were corrupt politicians and some terrorists who gave bribes to put their money into the bank. There were fictitious accounts created where BCCI started engaging in drug, money smuggling, sale of nuclear technologies and other criminal activities. "London Interbank Offered Rate" decided by a group of banks to set interest rate they are willing to pay to borrow from other banks. It is kind lie of a benchmark for setting a lot of other interest rates for all kinds of financial transactions, mortgage loan and credit cards. Hou and Skeie [11] stated that illegally allegations arose by beginning of 2012; several banks have been colluding with brokers and others to manipulate their interest rate which is a key mechanism to make extra profits or by just showing that they are creditworthy than they were. Wells Fargo Bank was involved in controversy as Tayan [12] clarified that the bank pressurized its employees and abused customer's private information. It was revealed that employees had been covertly creating and operating extra bank accounts without customer authorization.

Mollenkamp and Wolf [13] stated that HSBC has been accused for its sustained and systematic failure to guard against corruption of financial system by money laundering for Mexican drug alliances, terrorist groups and nations like Iran. They were able to deposit cash and spread money out to hundred accounts to make it impossible to trace. These recent cases showed that there has been a lot of bad conduct in banking industry and clearly there is a need to have some work done to analyze its causes and to redesign banking

system. There are ethics polices and preventive controls for compliance to keep bankers from doing bad things. Banks and its employees need to act with integrity, fairly, ethical and within law.

This work will be questioning and analyzing critical scandals happened in banking industry that emerged from ethical issues. The research will examine how ethical issues affect banks and global economy. It will compare different banks and on methodologies to deal with ethics. This work be suggesting behaviors that ought to be prescribed and ethical norms or standards trying to be established which might be considered as a unique contribution for research.

METHODOLOGY

Overview of Methodology

The methodology serves as an important part in the designing and shaping of the research. The methodology of this research is based on the topic of the research conducted whereby the method is chosen. This research focuses on the qualitative method of research. It will carry out descriptive analysis of the content gathered from different sources of the research. It focuses on carrying out in – depth literature survey of the data collected for the purpose of analyzing the ethical banking. The literature survey will gather different literature sources to understand the different terms, factors or variables associated to it. The Figure 1 describes the factors that lead to the ethical banking. Since, the global crisis has affected both people and banks; they are considering the factors that can get back the trust back and retain it for a long time and even in the future. People in the UK have listed some of the important factors from their experience. According to this graph, it displays that people rarely believe banks have high ethical standards or even trustworthy.

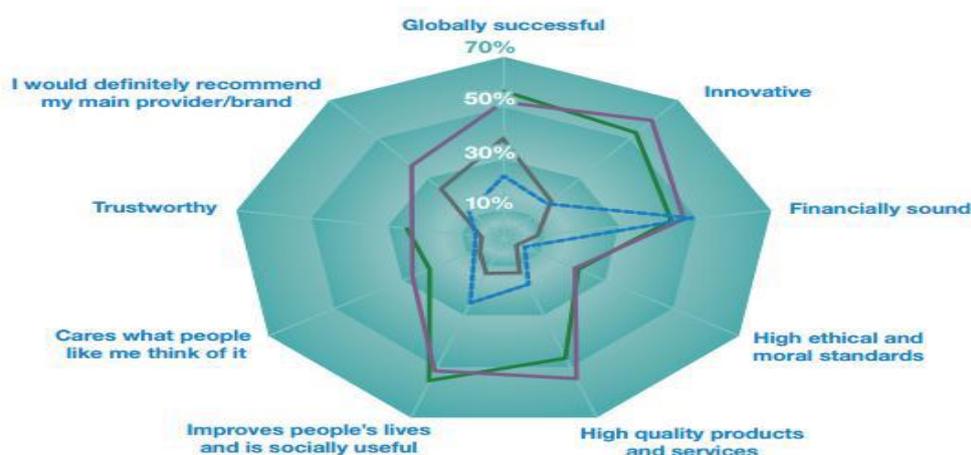


Figure 1. Percentage of Attitude Agreement in UK Banking Industry [14]

The following actions as shown in Table 1 might be significant to improve and strengthen financial difficulties associated in Banking Industry. Both greed and illegality at times of financial crisis could hardly be worse; therefore, well

designed governance procedures are very important to sustain economy and people are getting fair deals.

Table 1. Sustainable Actions to Improve Banking [14]

A	Capping Bankers' Bonuses and Pay.
B	Make Banks more transparent about what they are up to. [e.g., How much money they are actually lending, how much bankers get paid, How much 'bad debt' they hold, etc.]
C	Force all Bankers to be professionally trained and to meet professional standards or else be thrown out of Banking Industry.
D	New Rules to stop Banks taking too much risk, such as Splitting Investment & Retail Banks 'Ring-Fencing'
E	Force Banks to lend more money to small businesses.
F	Make it easier for Homebuyers to get Mortgages.
G	Protect Tax Payers from Bank's Bailouts by forcing Banks to pay a small tax on every transaction they make.
H	Force Banks to hold more cash to make them more stable.
I	New Rules to make it easier to switch Bank Accounts.
J	Sack people running Big Banks and get it New Managers.

Research Design and Hypothesis

Most of the people believe in a trustworthy organization that is financially sound and can perform better even in the crises. They also wanted an organization that cares more about its customers and clients rather than that of their needs and wants. It is not bad to have their own personal desires and wants but customers should be placed first, thereby improving the lives of the people socially and economically. A bank should hold high ethical and moral standards and should not deceit their customers in any circumstances as they are liable and accountable to them. The business should be innovation driven and globally successful. Moreover, they believe that the organization should provide best quality of products and services. The table 2 is systematizing most representative distinctive features and structure of Ethical and Traditional Banks. The ethical banks are full of ethical values in each and every hierarchy of the organization. It targets for both financial (monetary) and social (society) rewards that benefitting both of them and choosing best projects with financing methods. Moreover, Ethical Banks must be crystal clear and transparent to reveal that their financial intermediation activities and customers have to be aware of importance of social responsibility and solidarity.

Table 2. Differences Between Classical and Ethical Banking [15]

Characteristics of Ethical Banking	Characteristics of Traditional Banking
Operate with a clear set or ethical values, known, accepted and respected at all the hierarchical levels.	The activity is subordinated to the reaching of several quantitative objectives, mainly the market share and profitability.
Pursue the obtaining both financial and social gains.	The focus is on maximizing the financial gains.
The investment decision belongs, firstly, to customers [depositors, creditors], by choosing the ethical project to be financed with their funds.	The investment strategy and risk profile are established by bank's management.
Publish on a regular basis a list with all the investment projects that received financing.	Don't provide information concerning the destination of attracted and borrowed funds.
Finance those companies whose project exert a positive influence on society and environment.	Grants financing without taking into account the ethical behavior of the applicant, or the impact of his actions on society and environment.

The methodology also involves evaluating banks of different places all over the world to get a concept of how it varies from place to place and their level of performance based on their ethical banking regulations and rules. After the global crisis, Banks are considered to be the least trusted sector in the economy as shown in Figure 2.

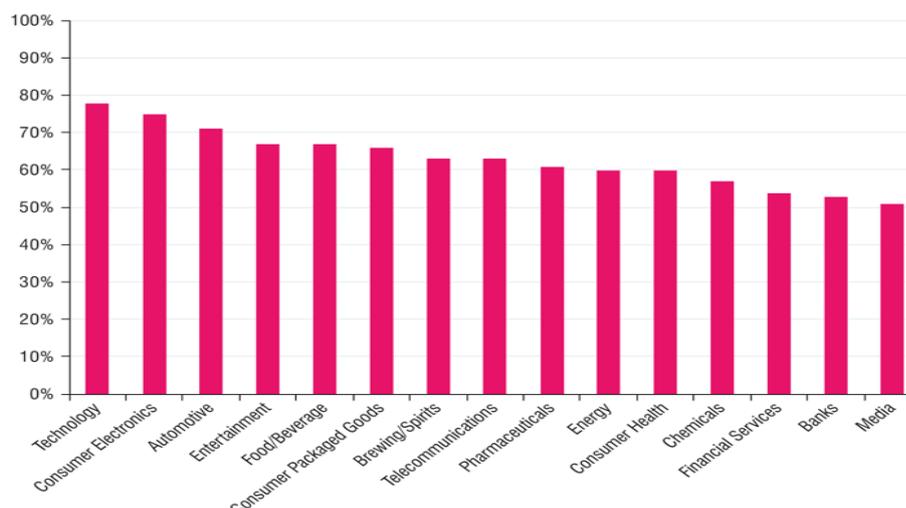


Figure 2. Percentage Of Respondents Who Trust Industry [16]

Research Design and Hypothesis

The US was the most affected country in terms of the losses incurred during the economic crisis period of 2008 and this is clearly visible in the graph illustrated above. It is shown that US Mortgages decreased dramatically in 2008 compared to 2004 where it was at its highest peak. The investors were looking for a good and high return on investment throughout subprime mortgagees than lenders started to create high risk mortgages around this period; but led to higher default rates which caused financial systems to become increasingly fragile. Moreover, It did not end only in US but there were numbers of Europeans who suffered due to these ethical issues that had been raised during 2008. The lending graph in Figure 3 shows a decline whereby trust is a major factor that led to the people lending money very little and for short – term basis. The number of loans decreased in numbers as people were scared of losing their money. The global crisis led aggravated the situation even more and Banks’ Solvency was at stake.

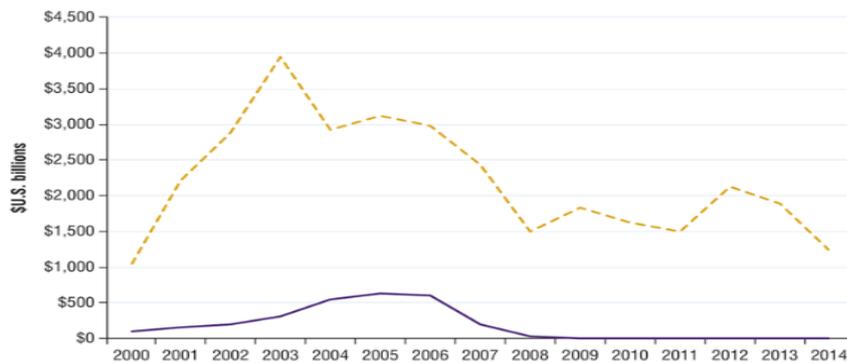


Figure 3. Subprime Lending Ballooned In Mid-2000s [17]

Social and Ethical Funds were operating in Europe but had a great increment and efficiently through last 20 years, as shown in Figure 4 with Absolute Values. It described that financial institutions were into investment processes that incorporate environmental and social influences, with achieving a competitive financial return.

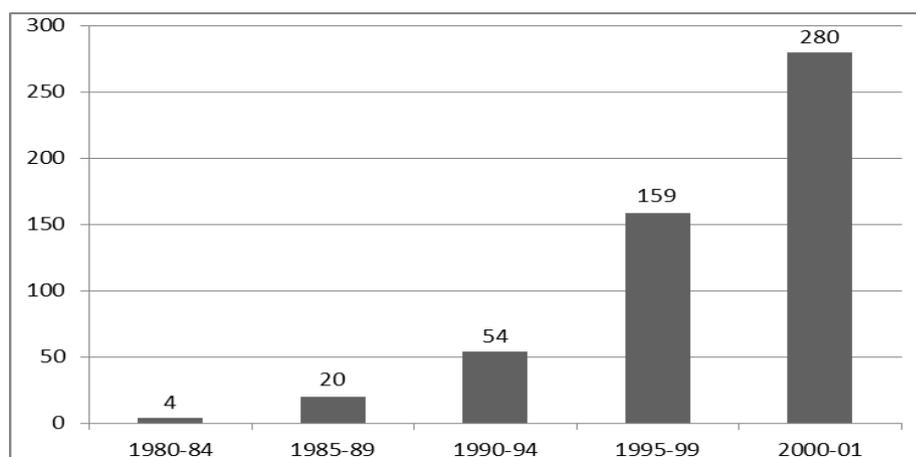


Figure 4. Growth Of Ethical Funds In Europe From 1980 To 2001 [18]

RESULT AND DISCUSSION

The results and findings of this study conclude that there has been an increase in number of funds and improvement in performance with the development of ethics worldwide. However, this research gave us the idea of how the continent of Europe and the country of the US tackled the situations after the global economic crisis. This is probably due to the losses they have incurred in billions at that time and the banks shutting down let to major reformation in the restructuring and functioning of the banks. The ethics are measured in terms of rules, outcomes and principles. The graph in Figure 5 compares the different countries and have shown respective results on how it changed banking system. Financial Services in Asia are most driven to be compliant followed by Europe, UK, Africa, and then America.



Figure 5. Ethics At Work By Financial Service Regions [19]

The graph shown in Figure 6 as was discussed earlier reformed the idea of the ethics and ethical banking. All of them were made to have strict regulations that included retail banking, investment banking, asset management and insurance. This did change the situation years later after the financial crisis occurred as They changed for good. The risk that followed was mitigated though not completely removed but was reduced.

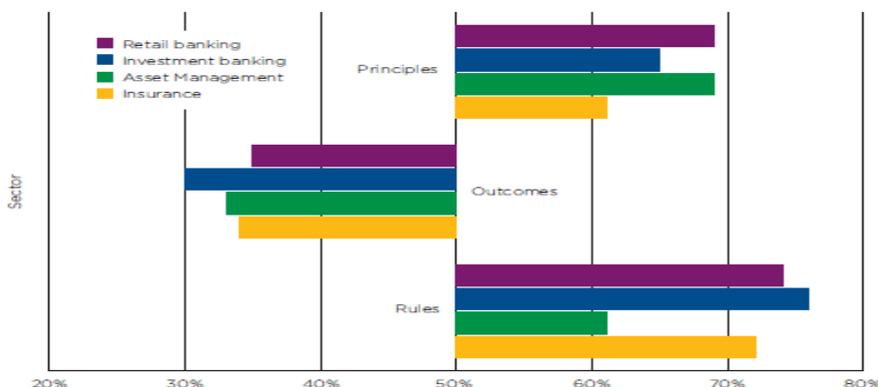


Figure 5. Ethics At Work By Financial Service Regions [19]

When US Banks and European Banks were considered as shown in Figure 6, US Banks were still leading in numbers than that of European Banks. This is probably indicating to a high level of trust that customers place thinking of as a protective way of saving their money. The graph concludes that Euro Area Banking Sector still has considerable bad assets that need to be recognized and documented. Investigation & Evaluation Procedures must be implemented rigorously, and followed up by bank recapitalization or restructuring where needed.

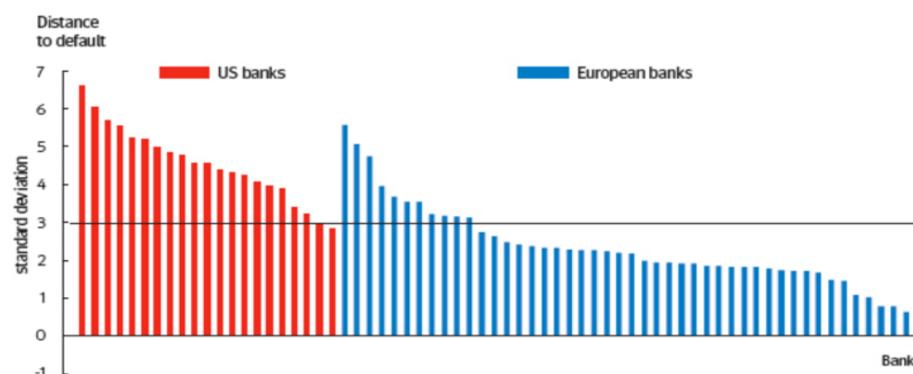


Figure 6. Distance to Default Graph In

2012 US Versus Europe [20]

US banks are considered less defaulting while European banks are considered to be weaker ones as compared to that of banks in US. The descriptive analysis showed that performance of financial institutions such as banks can increase with increase in their ethical performance. Regulations shall be reformed in banking sector properly to help rebuild trust in economics especially when financial crisis will be raised up any time. Governments must audit banking industry regularly to ensure compliance with ethical regulations and no performance has been done to manipulate economy.

CONCLUSION

Successful regulations must continue especially in banking sector regarding asset quality and liquidity management areas; in order to maintain more solid and sound sustainable system. The qualitative method and descriptive analysis are found that performance index is found to be consistent with advance. It is found that banking industry currently is in a good state but requirement for adequate risk management procedure that continue as strong protection during any financial crisis. European Banks are observed to have a lower

performance in managing asset quality and more vulnerable to market risk than US Banks. This might be a major reason of that Euro Sector still has considerable bad assets that need to be recognized and documented to get a clear picture of any differences in ethical approaches. It is thought that conducting inspections in banking industry would help to control variation in values that are integrated in investment process and ethical regulations that manifest in practice. Another significance difference was found between retail and investment banking, insurance and asset management. Retail bankers were higher in compliance with policies but lowest among others to focus in outcomes to customers. While investment bankers are lowest in adherence to principles but have decent outcomes. For further recommendation, it advisable to relate all Islamic fundamental principles and regulations that shape Islamic Banking System; and reflect if this system can cover all ethical concerns during financial crisis compared to Conventional Banking.

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