

Ethics in the Financial & Investment Industry

Kartikay Laddha, Vidhi Kapoor, Kopal Sharma

B.Tech Data Science, NMIMS

B.Tech Data Science, NMIMS

B.Tech Data Science, NMIMS

Submitted: 15-01-2021

Revised: 27-01-2021

Accepted: 30-01-2021

ABSTRACT— The word ‘Ethics’ carries a very sensitive structure which affects even the smallest factor in a situation and also it carries a huge sum of responsibility. It is an entity which could stir a situation in a person’s or company’s favour or not and it also holds an adverse effect in general. Ethical conduct is absolutely vital. Regular reforms to the code of ethics may combat the unethical behaviour in the industry but that alone is not sufficient. Individuals and firms must develop a particular code of conduct and abide by them and it should be applicable to all levels of their operations. This will help individuals and firms to promote the principles of stewardship of investor assets and work towards the betterment of clients. For the Financial Industry, Ethics is not only the pillar of trust but also it is the ladder to success. Through the careful literature survey, it lists some of the discussions of important ethics in the Financial and Business sector.

Keywords— Ethics, Code of Conduct, Professional Standards, Financial Industry, Investment Industry

I. INTRODUCTION

Ethics is a part of philosophy which focuses on morality or moral behaviour and how one should follow these principles in their daily life. Different people come across different ethical questions in their daily life and all of them react differently. By Ethics, we usually assume that people are rational and they make choices correctly. Businesses layout certain rules and regulations for Ethical conduct. Ethical questions can arise like fairness, justness, rightness or wrongness. Ethics in finance and investment are a part of business and their business ethics focuses on what is right or wrong behaviour in their business or investment world. Business persons have to apply different ethical and moral principles to situations that arise in the workplace or while handling a client asset.

Ethics in the Finance industry is a very important concern because when anyone thinks of financial Markets, they think of a huge amount of Money involved. That amount of money greed can introduce unethical actions. financial Ethics is not restricted to individuals. It is also applicable in maintaining the trust between the firm and the client. All people do not possess the same knowledge about Financial markets. Trust is the only way by which the public can believe to invest their lifetime savings in an investing firm. Trust is not something that is built in a day. It takes several years and efforts to build this trust by following ethical behaviour. Good ethics is the fundamental requirement in the Finance and Business sector.

Ethical issues in the Financial and Business sector does not affect only an individual. It affects everyone because even if the individual doesn’t invest or work in that particular field, they are the consumer of the services. So directly or indirectly, everyone gets affected. The public has a very common perception that financial industries follow unethical behaviour more than any other industry/business. Most of the firms have laid down guidelines for ethical conduct to behave responsibly as an individual or a group representing the company. There is a very thin line between ethical and unethical behaviour. Employees might get a wrong belief that if anything is not specifically prohibited, it would be acceptable. Ethical behaviour is governed more by the individual rather than the environment. It is not only immoral to do unethical activity but it's also unethical to not inform other people about the unethical activity. Our society is built on the pillars of trust. Trust comes from moral and ethical behaviour. Ethical behaviour can also become the ladder of success in firms.

II. LITERATURE REVIEW

TABLE I

Publication	Description	Inference
[1]	The paper discusses the basic ethical dilemmas and problems facing the global financial markets. There are centuries of suspicion and loss of trust in the financial market as the time passes. It also helps in understanding how these businesses contribute to uplifting the society and community we live in. They help in creating the much needed capital and allow people to invest and manage risk for ensuring income. We learn about the functioning of the markets and understand the ethical problems that arise during the functioning of these markets.	Professionalism holds the utmost importance in the financial and investment industry because many people are dependent on financial planners, mutual fund managers, insurance agents, brokers, dealers, accountants, valuation specialists, bankers and all other financial services personnel, for their well-being and return. Hence integrity and professional codes of ethics must be followed with objectivity, integrity, professionalism, fairness, competence, diligence and respect for clients' confidence and trust.
[2]	The paper lays emphasis on the importance and vital role of ethics in the modern world and the instinctive ability of businesses and an investment professional to determine what is ethical and what is not. It also helps in understanding the complex nature of this industry and hence signifies that the operation of the banking industry is vulnerable to nefarious intentions. Therefore it	Ethics is similar to honesty, righteousness, obedience and sincerity. Ethics are the codes and guidelines which one follows in order to determine and judge what is right and what is wrong. The term business ethics has originated from the understanding of ethics as a responsibility of the individual towards the society and community as a collective responsibility. This ethical code is the trust and understanding the business and enterprises/companies built with their customers, employees, stakeholders and the environment. To pinpoint, they are the practices one must follow for running a business, corporate governance and corporate social responsibility.

	<p>is more vital and important for everyone to understand the 'ethics in banking'. Honesty, Integrity, and ability to handle huge responsibilities are the prerequisites and must for key banking individuals.</p> <p>Investment individuals such as bank managers safeguard the trust which is entrusted by the customers and the Government institutions to follow a moral and ethical behaviour.</p>	
<p>[3]</p>	<p>The paper helps in understanding the importance of ethics. It explained how the overtures to the 2008 financial crisis in America had begun much earlier. In 2001, there was a slight turbulence in the US economy and it had to go through mild recession, the Federal Reserve of the United States in order to create liquidity in the market had decreased the federal funds rate in the economy. There was a huge buzz regarding these low interest loans which created a rush for subprime and cheap mortgages which incentivized the customers by the availability of easy credit. This environment led to many irresponsible and Ponzi schemes decisions by bankers and investment professionals. They</p>	<p>The 2008 financial crisis depicts that sometimes the market incentivises businesses, individuals and companies to act irresponsibly, and nothing is there to stop these companies from doing so. The ultimate solution to prevent another such crisis is the awareness of the layman. They have to be more conservative and vigilant towards the market and financial transactions. General public may not be aware of the dynamics and the thorough understanding of how attractive investments of their pension funds or insurance premiums lured and blindsided the bankers to take risky investment decisions. There are times when a cheaper insurance policy might excite the investor to take a haste decision which mostly turns out to be wrong in the end. This explains that in a technologically advanced, globalized business world where automation and information technology plays a huge role, the human aspect and instinct has gone missing and technological systems have taken precedence and proved its authority, the thought for social responsibility is not given much credence and importance. Globalization has played a large role in necessitating the presence of large banking and financial institutions. Excellence, engagement, ethics and education can play a huge role in bringing a change.</p>

	<p>thought this lucrative and easy business at that particular time. Then the consequence of this resulted in the worst recession in 80 years. Due to this many banks targeted riskier funds which would give them higher returns.</p>	
<p>[4]</p>	<p>This paper focuses on the identification of unethical issues, if the financial institutions take the customers' for granted and hence take a dig at their own reputation and therefore loose the customers' trust. This Loss of trust in the individuals or businesses is followed by abandonment. Ethics and professionalism conduct in business are not alienated and different from ethical aspects of general life. Many times they are just a reflection of our conduct in real life. Large scale investments can be subject to market process and market forces reflect public opinion, which is indeed very important for investors.</p> <p>But in the case of large investments such as hedge funds, the concern for customers is much lesser, as most banks which deal in hedge funds have a strong reputation to hold and have clients with far reaching influence. Hence they</p>	<p>Most financial crisis occur due to the loss of trust in the financial industry which is due to the unethical behaviour of the investment industry professionals. In 2008, the ultimate reason for the collapse of the financial industry was the greed to make easy money due to lucrative schemes. During the time banks did not think much before taking in deposits and took the customers' deposits for granted and invested them in long term mortgages, which eventually collapsed and took a dig at the industry's reputation, which is still in hot waters.</p>

	do not create a sorry situation for themselves.	
[5]	<p>The paper illustrates that there is a need for reconstructing the existing model of corporate governance in the financial and investment industry, which should be done without violating societal norms where ethical conduct is very important. It helps the reader understand the fact that a company is a distinct legal entity. And as per the law, the company can sue and it can also be sued in its own name. Every employee working under the name of the company, must have a primary objective to further the business interests of the company and for the benefit of the company. In order to stand up to the above mentioned aim the employee is supposed to put the company's interest as top priority and then only any of their personal interests matter. One must prioritize the company, whose main aim is to provide its clients with the best service possible.</p>	<p>The businesses and companies comprise investment professionals who have a huge role to play in these financial markets, and they are also inanimate. All the decisions being made in the name of a company are taken by those professionals, who act for and on behalf of the company. Thus, it is surely a challenge to make the individuals making decisions for the companies imbibe ethical norms and make legal compliance a habit for the betterment of the firm and also to keep the client's interest paramount which is the basic ethical code for the investment profession.</p>
[6]	<p>The paper helps in understanding the relation between business ethics and corporate governance mainly in the countries like Australia, China, Singapore and India.</p>	<p>Australia : Communities, NGOs, and other associations are involved with stakeholder engagement on behalf of financial industries. These groups are secretariats, boards and committees for management purposes. They have their set of business ethics or the code of conduct, protocols and standards by which they maintain their relationships with the clients and other corporations.</p>

	<ul style="list-style-type: none"> - Business ethics involves managing and establishing control procedures which will increase the business integrity and ethical conduct. - The regulation and management of stock market in Australia has quite a long history whereas the ownership of shares by corporates is much more recent. -The Central government in India strongly influences the economy and keeps a good hold over capital markets. - In China and Singapore the government regulations are very firm on the role of employees as stakeholders and it has been strongly driven by regulations. -Ethical issues in China and even to some extent in Singapore rely very less on governance and much more on culture. 	<p>India :</p> <p>Recently there has been a significant increase in state-based and community investor associations and NGOs. The main aim of Association of Mutual Funds in India (AMFI) is to develop the Indian Mutual Fund industry by incorporating the appropriate code of conduct.</p> <p>China :</p> <p>There are less representative bodies supporting financial stakeholders. The regulation in China focuses on the protection of minority shareholders. Thus the ethics concern arises while protecting the financial interests of stakeholders from corrupt controlling shareholders.</p> <p>Singapore :</p> <p>The Investment Management Association of Singapore (IMAS) is a forum for members and it facilitates training for its members and contributes towards investor's education.</p>
<p>[7]</p>	<p>Paper investigates the intriguing relationship between financial reporting quality and corporate commitment to business ethics and hence concludes that companies with higher code of conduct on business ethics report much better quality of financial reporting compared to the</p>	<p>Hypothesis testing is done to verify that there is a positive correlation between Financial reporting Quality and corporate commitment to Business Ethics and professional codes of conduct. They took 11 attributes of Business ethics (disciplinary mechanism, code of ethics, manager's awareness on importance of ethics and so on) and did this testing on 242 Korean companies to prove the positive relation.</p> <p>A mathematical model taking various inputs like FREP (degree of faithful representation ECI (Ethical commitment index) and so on is built for the prediction that companies with higher levels of conduct exhibit better financial reporting.</p>

	<p>companies which have poor code of conduct on business ethics. The cash flows predictions are more accurate in companies with high business ethics than in companies with low business ethics. Customers and other investors consider Business Ethics to be an important factor while buying goods and services and including the company's stocks in their investment portfolio.</p> <ul style="list-style-type: none"> - Companies with high leverage are more concerned in improving their financial positions, as a result companies operating with high leverage are more likely to manipulate their earnings in order to delay the recognition of bad news. - Start-ups are more concerned about growth than business ethics. On the other hand, high-growth companies might be more concerned about business ethics to get media and people's attention. 	<p>Leverage has a negative relation with the ECI. The relationship between growth and ECI is unclear. Descriptive statistics have also been performed to prove the results.</p>
<p>[8]</p>	<p>Ethical investing is considered to be a personal form of investing which is based on an individual's beliefs whether the businesses practices are good and should be encouraged or not. There are some</p>	<p>Majority of investors go for low risk investments but quite a few even go for high risk investments. One of the reasons might be the company's ethical practices which infuses confidence among investors to go for high risk investments.</p> <p>A survey was conducted and it was seen that people who follow ethics diligently have low inclination towards investing in companies engaged in alcohol production or nuclear power generation or unnecessary exploitation of animals and so on. It also concluded that people have a higher inclination</p>

	<p>difficulties faced when it comes to ethical decision making. Because decisions might be subject to various biases as every individual reacts differently when it comes to ethical decision making. Hypothesis testing was conducted on 185 samples. Demographics characteristics of respondents were taken into account. The hypothesis testing indicated a significant difference in the mean of investor investment inclination towards investment in companies engaged in ethical and unethical products across different age groups of respondents. This hypothesis testing also indicated that there is no significant difference in the mean of investor investment inclination towards investment in companies engaged in ethical and unethical products across the different income categories of respondents.</p>	<p>towards investing in companies engaged in environment protection (pollution control, energy saving, etc) than companies which are engaged in pollution control. Findings indicate that individuals from lower age groups and high education, income tend to make ethical decisions while investing.</p>
<p>[9]</p>	<p>The paper starts by criticizing the origin of ethics as a restriction on behaviour. It rather suggests that being ethical cannot be decided by actions; rather they need to be decided by seeing the motivation behind those actions. The financial-economic</p>	<p>Financial markets will become more ethical when financial theorists and practitioners deepen their value base. Securing wealth is not the only possible motivation to work. If the financial theory acknowledges ethical motivations then these will be completely accepted. Securing external goods such as wealth, will then be seen merely as a means to achieve the eventual goal, which is to value internal goods more; respect and integrity in particular.</p>

	<p>theory is based on an assumption. The assumption is that the motive of all agents involved in the financial market is to gather personal wealth. The paper further moves to the topic of Confidence School. This section attempts to explain and encourage ethics as an important condition on the objective of wealth-maximization. MacIntyre introduces something called internal and external goods and draws a clear distinction between them. The financial markets will truly become ethical when securing internal goods rather than external goods will become accepted as a primary objective.</p>	
<p>[10]</p>	<p>Finances and accounting are not just technical tools. They cannot work properly without trust, and to establish trust, ethics are essential. Actions, predictable consequences, people with or without virtues involved are all involved in ethics. Pope Francis supported a change in which ethics was central and proposed the motto: "Money must serve, not rule!". The theory on classical standard economical models keeps forward value maximization as the aim because that</p>	<p>The paper puts forward some current problems regarding the implementations of ethics in the finance and accounting market but still a lot of digging is needed. Further the research needs to go to the root of the problem. There are in particular two issues, one in regard with Separation Thesis and one with a deeper view in ethics. Both of these issues really require more attention. The paper concludes by stating that professional activities are nothing but human activities. In case of full enforcement of ethics in Finance and Accounting it cannot be merely viewed as an economic activity but needs to be seen as a human activity and therefore intentional.</p>

	<p>decision rule leads to a socially effective result. However this could often lead to poor decisions and unethical behaviour. The “fraud triangle” theory is a lot of times used to predict the chances of a fraud happening in an organization. This model however has been doubted since fraud is a phenomenon with many sides, and it would be very difficult to fit it into a framework.</p> <p>In the past many unethical decisions and financial scandals have happened due to pressure of obtaining short sighted results. Such incidents can be however avoided by a management which believes in professional ability and has a strong sense of mission.</p>	
<p>[11]</p>	<p>Virtue ethics are in regard with following a defined way to achieve excellence while keeping moral values as the core. It gives importance to certain generally accepted virtues of a person and the existence of a community which supports these virtues. The difference between the regular approach to business ethics and the way where the virtue-ethics theory is adopted is that in the latter case the focus is on character and</p>	<p>The relationship between ethics and business and professional life is not easy to understand. Balancing the external, financial driven goods along with non-materialistic internal goods is challenging for business professionals. The suggested way to achieve this is by considering ethics as an aim rather than a restriction. The virtues need a nurturing professional environment. Professional fulfilment is only obtained by pursuing moral excellence in a professional community.</p>

	<p>motivation of an agent, and its ability to achieve excellence while staying virtuous.</p> <p>- Solomon quoted “Corporations are real communities . . . and therefore the perfect place to start understanding the nature of the virtues”.</p> <p>An important part of virtue ethics is the dismissal of a rule-based approach. Behaving ethically in a particular scenario is a function of exercising sound moral judgement. In addition to the virtue-ethics theory the successful pursuing of these internal goods require the ability to be able to identify and practice virtues such as honesty, perseverance, consistency and fairness. Virtue-ethics gives us a goal in our professional life. The explanation of virtues leads to discussing concepts such as “good” and “excellence” in the view of business ethics. There are many scenarios where profits and ethics go hand in hand. Opportunism can give return in short term but morally controlled behaviour will lead to benefits and profit in the long run.</p>	
--	---	--

Ethics help in proper functioning of the investment industry and thus are vital in protecting the integrity of the financial market. It brings out the ethical and transparent aspect which helps in protecting the investor. The sense of trust is built in

the investment industry when working professionals make decisions that are ethically sound. A bad and tarnished reputation is often hard to clean and improve on as this profession is equally built on trust and expertise. The absence of trust leads to

lesser participation by the investors in the financial markets, and without proper investing people may not be able to reach their financial goals. This may lead to lesser capital available for companies which may hamper economic growth. Therefore fair treatment of investors is very important as everyone benefits from the financial markets being well functioning.

The behavior and actions of the people who are actively a part of financial markets play an important role in creating and maintaining that trust. The participants of the investment industry which include companies and governments, aim at raising the financial market as a whole. But in the end, the trust finally relies on the actions of all the people who actively participate in financial markets or investment industries.

Although rules and regulations play an important part in the proper functioning of financial markets; yet, they are unlikely to be a solution for every problem that arises. In such critical situations where no clear cut rules are applicable, a person's ability and belief to identify, develop, and apply ethical standards play a very vital role. Trust naturally comes from within and one must be wise enough to abide by the rules and to act ethically. A culture and vision of integrity based on ethical standards can be set by building high standards and putting them on paper, getting adequate and continuous training on professional and ethical standards, by testing the integrity of individuals and groups and taking the appropriate action if there is a breach of integrity and ethical standards.

Due to the immense growth of financial markets, the financial services that are being offered have increased and have become more complex. This perpetual growing complexity puts one in ethical dilemmas every now and then. This situation becomes much worse these days as businesses are conducted across different countries so they are under different regulatory frameworks.

The main job of an investment professionals is to help the investor by providing access to the information about the investment opportunities pertaining to their financial goals and preference in the financial markets. They help investors make investment choices and tough decisions to help the clients add value to the decision-making process. All the people working in the investment industry - outside of the investment management functions or investment decision making process are also equally important and very crucial to the functioning of the investment industry. The individuals might be some employees who are working for security trading and account services, fund monitoring and administration, and other

activities which may include human resources, marketing, legal, sales, information, technology and administration.

The decisions and actions taken by the people involved in the investment industry may directly affect or indirectly affect clients, employers, prospective clients. Therefore these involved individuals have to act in a responsible manner in order to make ethical decisions and to act appropriately for the good of the industry. All in all, they have to make client's realise that they can be trusted upon. In today's highly competitive markets it is very important that high ethical standards and professional codes of conduct guides the decisions and corresponding actions. Investors are reluctant to invest their money and to have trust and confidence in the fair functionality of financial markets if there is not a common belief that the people involved in the investment industry behave with an ethical code of conduct. Various factors such as integrity of investment profession, client's trust, financial markets efficiency, confidence shown by the investor, integrity of financial markets, client's investment goals, public trust, fairness of financial markets, success of the investment industry, etc are dependent on the high ethical standards which must be followed by all the individuals involved in the industry.

For establishing and maintaining the high ethical standards, people must understand general obligations that come with it. Outlining and focusing on these obligations definitely helps an individual or group of people guide their behaviour in order to strive in the industry. Failure of investment professionals regarding the same, may adversely affect the financial system as a whole. These obligations need to be fulfilled using the required professional knowledge of technical aspects and skills, safeguarding client's information, managing risks and treating clients fairly and with respect. One's obligations to their employers will include providing services as per the contract of the employer, executing the supervisory directives as and when required, and most importantly maintaining the professional conduct. The Obligations also include loyalty and care. A company or a firm's effective operations are compromised when its employees do not act according to the guidelines with proper competence. A person in this industry is expected to treat their co-workers with the similar fairness and respect in which they treat their clients and employer. Everyone in the team has to perform up to the best of their limits in order to stove the entire team's performance and chances of success. Sometimes, the neglecting behaviour by one person in the team

can hamper others' results as well and therefore lead to trust issues among the co-workers and in worst cases can result in their dismissal which is a big setback. Unethical and unprofessional behaviour, despite being legal or not, have adverse effects on the financial system and the economy overall.[12]

Investment professionals can help in gaining the investors' trust and strengthen the fairness of financial markets by abiding by the ethical code of conduct. Due to this trust, there is an increased market participation from investors which ultimately leads to markets working efficiently. This helps the investors achieve their investment targets and financial goals. The Increase in market participation will only benefit the people participating in the market and stakeholders. Due to this increased trust and participation there is an increased liquidity due to which investors are able to trade assets and they do not affect the prices majorly. This also helps in spreading awareness to the public about the financial system. And this increased awareness and understanding, in turn, leads to more investor participation as more people tend to invest in the financial markets, which ultimately increases the market efficiency. This Increased efficiency of the markets and trust leads to easy access to equity and debt funding which helps in decreasing the cost of capital for businesses and governments requiring capital. The decrease of the cost of capital due to easy availability of credit, positively influences the development as well as the overall growth of the economy.

III. CONCLUSIONS

Researchers define ethics as a trust between business, customers, employees, stakeholders and the environment. The root cause of the financial crisis is most of the time lack of trust which begins due unethical behaviour in the financial industry. The reason the financial industry collapses is the greed to make a fast buck. Banks take customers' deposits for granted and invest them in long term mortgages. This all comes under unethical behaviour and propels mistrust in the financial industry. Companies with higher code of business ethics have a better quality of financial reporting than companies with poor business ethics. It also concludes that start-ups are more concerned about growth than business ethics. On the other hand, high-growth companies might be more concerned about business ethics to get media and people's attention. Some papers reviewed suggested that securing wealth should not be the only motivation rather it was suggested that it should be viewed only as a way to ultimately achieve internal goods. The link between ethics and a professional life is not an

easy one. Balancing financial based demands in one's professional role along with moral based demands is quite some challenge, and one way to achieve this balance is to see ethics as an aim rather than a restriction. Professional fulfilment is obtainable only by striving for moral excellence in a community.

REFERENCES

- [1]. Laura P. Hartman and Abha Chatterjee (2007) 'Perspectives in Business Ethics – Ethics in Financial Services', Tata McGraw Hill, New Delhi, pp. 387- 403.
- [2]. 6. Jelena Bozovic (2007) 'Business Ethics in Banking', Economics and Organization Vol. 4, No 2, 2007, pp. 173 – 182.
- [3]. Nicholas Fair (2009) 'Excellence, Engagement and Ethics in Banking: An Attempt to Make Sense of the Financial Crisis of 2008', Good Works Project Report Series, Number 62, Harvard Graduate School of Education. Harvard Gardner, Series Editor
- [4]. Greycourt White Paper (2008) 'The Financial Crisis and Collapse of Ethical Behavior', Greycourt & Co., Inc, Greycourt White Paper No. 44, pp. 1-15.
- [5]. Anurag K. Agarwal (2013) 'Corporate Governance: Financial Regulators and Courts Need to be on the Same Page', Vikalpa - The Journal For Decision Makers, Vol. 38, Jan – Mar 2013, No 1, ISSN 0256 – 0909
- [6]. Kimber D, Lipton P. Corporate governance and business ethics in the Asia-Pacific region. Business & Society. 2005 Jun;44(2):178-210.
- [7]. Choi TH, Pae J. Business ethics and financial reporting quality: Evidence from Korea. Journal of Business Ethics. 2011 Oct 1;103(3):403-27.
- [8]. Chaubey DS, Dev R, Patra S. A Study On The Ethical Considerations In Investors' Investment Decisions. Splint International Journal of Professionals. 2016 May 1;3(5):7.
- [9]. Dobson J. The role of ethics in finance. Financial Analysts Journal. 1993 Nov 1;49(6):57-61.
- [10]. Melé D, Rosanas JM, Fontrodona J. Ethics in finance and accounting: Editorial introduction. Journal of Business Ethics. 2017 Feb 1;140(4):609-13.
- [11]. Dobson J. Ethics in finance II. Financial Analysts Journal. 1997 Jan 1;53(1):15-25.
- [12]. CFA Institute's Ethics and Code of Conduct Analysis, Chapter-2, Investment's Foundation Program.



**International Journal of Advances in
Engineering and Management**
ISSN: 2395-5252



IJAEM

Volume: 03

Issue: 01

DOI: 10.35629/5252

www.ijaem.net

Email id: ijaem.paper@gmail.com