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ETHICS IN FINANCE: SURVIVING THE CRISIS

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motions, Personal Ethics and Professional Life: the Lost Link

Second Prize

Meredith Benton
*American,
 MBA student at
 INSEAD, Paris*

Fondamentalement parlant, le système financier a été conçu et est incarné par les humains, et il reste totalement dépendant de leur prise de décision.

Avant de créer un nouveau système financier qui comporterait encore d'autres failles où viendront se faufiler les esprits les plus avides, posons-nous les bonnes questions : qu'est-ce qui pousse les gens à agir ? Par quel mécanisme privilégient-ils une action plutôt qu'une autre ?

A description of the current financial crisis does not need to be repeated here. The reverberations of a failed global financial system will be felt for years, if not decades. The reasons for the felling of our global economic system are innumerable. There were many perpetrators, and many more victims still. While retrospective analysis is essential, of far greater import at this juncture in time is understanding how to avoid future transgressions of this scale and impact. Will greater Securities and Exchange Commission (SEC) oversight, mortgage bank policies, or more thorough investigative journalism help us avoid future similar calamities?

These and all similar efforts would not have prevented the current crisis, nor will they, or other prescriptive solutions, prevent future upheavals. Rather, in discussing the bank leverage, collateralized mortgage obligations, or foreign exchange rate, we need to remember that the core of these institutions and concepts are not laws, corporate charters or global treaties. At the core, the financial system was developed by, is stew-

arded by, and is fully dependant on human decision-making.

Before we create a new financial system, with new loopholes for the creative greedy to slip through, let us ask ourselves: what leads people to act? How do they choose one action over the other? And, are we able to structure our financial system in a way that might encourage ethical behaviour?

The current state of crisis within the financial marketplace exists, in large part, because of a detachment between personal ethics and the professional life.

Who are we?

In 1971, researchers at Stanford University conducted the Stanford Prison Experiment. In this experiment, undergraduate students were assigned either the role of prisoner or guard through the luck of a coin toss. If they were to become guards they were given wooden batons, uniforms and reflective sunglasses. If they were to become prisoners, they were 'arrested' at home, stripped of their personal belongings and reassigned identification numbers. The

En 1971, des chercheurs de l'université Stanford ont mené ce que l'on appelle « l'expérience de la prison de Stanford ». Des rôles de gardiens et de prisonniers ont été attribués à des étudiants. Après six jours, l'expérience a dû être stoppée car les conditions étaient devenues dangereuses pour les prisonniers.

Les facteurs ayant contribué aux abus perpétrés sont la désorientation, la dépersonnalisation et la désindividualisation des victimes.

Pour changer le système financier, pour lui insuffler de l'éthique, nous devons comprendre et assumer ce que nous sommes réellement, nous, les êtres humains.

Nous devons accepter que même des personnes « bonnes » ont été impliquées, dans le passé, dans des scandales financiers et des transgressions de l'éthique.

guards, while cautioned not to physically assault the prisoners, were given full power over them. All students participating in the study were screened ahead of time for psychological stability.

This experiment had to be terminated after six days. Conditions had become unsafe for the prisoners. More than a quarter of the guards were deemed to be exhibiting sadistic or dangerous tendencies. This same phenomenon, where ordinary citizens act with extreme cruelty, has, unfortunately, been observed in far less benign situations, such as Abu Ghraib. While it may be reassuring to view the perpetrators of these injustices as aberrations of humanity, the truth is far less reassuring.

In reviewing these and similar scenarios, psychologists have identified a number of elements which contributed to the abuses perpetrated. These included disorientation, depersonalization and de-individualization of the victims. Within the prison experiment, authoritarian roles were institutionalized, with a strong power dynamic emphasized.

Understanding, and accepting, the human psyche

To change the financial system, to imbue it with ethics, we must do more than write new rules. We must understand and address who we, as humans, truly are. Rather than discuss idealized versions of the self, we must first acknowledge the capac-

ity for evil and cowardice that exists within all - not just financiers.

We must assume that 'good' people have been involved in past finance scandals and ethical transgressions. These perpetrators most likely experienced a level of cognitive dissonance. Cognitive dissonance occurs when holding two conflicting ideas leads to the justification or rationalisation of attitudes or behaviours that would otherwise be considered unethical. This assumes a struggle within the self around ethical beliefs.

To some extent cognitive dissonance is a daily experience. We know that driving is expensive, bad for our health and the environment. But, we have groceries to carry home. Or we need to be somewhere quickly. Or, perhaps, it is too hot, too cold, or raining outside. A rationalization process may often lead to an exponential pursuit of the behaviour or actions originally identified as dissonant. To continue our example, our rationalizations continue, the weather may be warm and we may be on vacation, but we've fallen into the habit of driving, and so we continue. Perhaps, given the amount of time we spend driving, we upgrade to a nicer model of car. Cognitive dissonance encourages the denial of contradictory data and the development of a confirmation bias. Once in our new car, we rarely, if ever, stop to consider our original oppositions to driving.

Cognitive dissonance and self-rationalizations can take many forms.

Une dissonance cognitive survient lorsque le fait de défendre deux idées conflictuelles amène à justifier ou à rationaliser des attitudes ou des comportements autrement considérés contraires à l'éthique.

Dans des expériences où des participants, détenteur d'une conviction particulière, étaient publiquement forcés d'affirmer des positions contraires, les chercheurs ont constaté que ces participants avaient tendance à changer d'avis pour s'aligner sur les affirmations qu'ils avaient eu à faire.

La prise de décision morale a été étudiée par deux théories clés, la déontologie et le conséquentialisme.

Selon l'approche déontologique, un acte ou une action donnée est « bonne » ou « mauvaise ».

In experiments where participants who held a particular belief were publicly forced to state something to the contrary, researchers have found that participants often shifted their beliefs to accommodate the statements that they had made. Interestingly, when participants were induced to make public statements in order to receive some form of a reward, the greater the reward, the less of a shift was observed within their personal belief system (Festinger and Carlsmith, 1959).

The implications of this study must be carefully considered, as they infer that those people who modify their beliefs for small rewards are subject to more internal pressure to justify this changed direction. For corporate and public policy this indicates that rather than watching for shifts in corporate culture at the top of the organization - where there is much to gain by unethical behaviour - attention ought also be carefully focused on the middle ranks, where a combination of powerlessness or minimal authority, small rewards, and cognitive dissonance might combine in very damaging ways.

Moral aspects of choices

Moral decision-making has been considered by two key theories, deontological and consequentialist. 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 do-

ing 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'.

From the allegorical narrative of *The Lord of the Flies*, to internet chat rooms, the Klu Klux Klan and masquerade balls, we are well aware that anonymity allows for the expression of the more 'base', and less culturally supported, human desires. As detailed in the theory of consequentialist decision making, acts are considered with a focus on outcomes - the risks and rewards of the choice. When anonymity is allowed, the risks decline dramatically. With this in mind, a movement has sprung up among the strange bedfellows of institutional investors, environmentalists and human rights activists, aimed at seeking greater disclosure and transparency from companies around their social and environmental programs and policies. A positive feedback cycle is created, as investors increasingly incorporate these data into their valuations, as strong sustainability programs are rewarded by greater investor support, which, in turn is rewarded by greater disclosure and stronger programs.

Research is just now beginning to consider the moral aspects of choice, particularly when trade-offs, or cognitive dissonance, is involved. The term 'protected values' has been developed to describe those beliefs that people are not willing to compromise at any price. Protected values have been shown to be highly associated

Le conséquentialisme considère l'acte par ce que pourraient être ses conséquences. Les actes sont considérés en privilégiant leurs résultats : les risques et les récompenses du choix.

Lorsque l'anonymat est autorisé, les risques diminuent spectaculairement.

Une autre discipline émergente, la neuroscience cognitive morale, nous plonge dans le processus décisionnel de l'être humain : dans ces recherches, les rôles de la délibération, de l'affect et de l'émotion sont mis en avant.

Les décisions professionnelles, néanmoins, correspondent traditionnellement à un cheminement rationnel et délibéré, à un processus libéré de la dimension affective.

with a deontological orientation. When someone has a protected value, they consider the consequences of their decision to be irrelevant, as long as their protected value is prioritized. A 2008 study found that those people having a deontological orientation were more likely to prefer acts to omissions. That is, they were more likely to respond and be motivated by positive statements such as 'bring about good', than negative statements, 'do no harm' (Tanner *et al.*, 2008).

The role of emotion

Another emerging field, moral cognitive neuro-science, provides us with additional insight into the human decision making process. The roles of deliberation, affect and emotion are highlighted through this research. In this field, emotions are defined as somatic changes in response to a stimulus. Feelings, on the contrary, are created by the correlated emotion, as a secondary result. This research field is in direct opposition to the classical Cartesian view of decision-making as a reasoned, emotion-free process. By using brain imaging, positron emission topography and magnetic resonance imaging, researchers have determined that two clear neural processes, cognitive and affective, are involved in decision-making. Business decisions, however, have traditionally assumed a rational and deliberate process - one that is free of the affective.

Current neuroscience research indicates that the mind does not

have the ability to compute without emotion. The cognitive system must work through the affective system. While the cognitive system is responsible for the searching of options and predicting consequences, the evaluation of this data must be done by the affective system. Indeed those people with damage to their affective region were both emotionally flat and poor decision makers.

Research indicates, however, that according to the decision at hand, the brain works in different modes. In research studies, brain activity associated with emotion is significantly higher when participants viewed the situation as being 'moral personal' versus 'moral impersonal'. An example of 'moral personal' would be one that had direct contact with human suffering, such as deciding who to save from a sinking boat. 'Moral impersonal' involved questions around returning money from a lost wallet (Wenstop and Koppang, 2009).

The influence of management

Individual factors identified that influence ethical decision-making includes: gender, moral cognitive development, ego strength, and control. Meanwhile situational factors include: reinforcement, commitment, sense of justice and social pressure. While a company can do little, in legal terms, to address individual factors of ethical decision-making, it can do much to address situational elements.

Alors qu'une entreprise peut faire peu de choses, juridiquement parlant, pour agir sur les facteurs individuels de la prise de décision éthique, elle peut faire beaucoup concernant les éléments situationnels (renforcement, engagement, sens de la justice et pression sociale).

Un lien important existe entre le comportement des dirigeants, la culture de l'entreprise et les décisions personnelles des employés.

Cet article serait incomplet sans la suivante mise en garde : un leadership charismatique organisé autour de valeurs partagées au sein du personnel peut, sans qu'on n'y prenne garde, susciter de la désillusion chez les employés. Cela peut se produire par exemple si les employés perçoivent de l'hypocrisie dans l'expression des valeurs de l'entreprise par leurs dirigeants.

As demonstrated in Dipanker Ghosh's 2008 research, employees determined to maintain high ethical standards 'do indeed become less ethical when corporate management adopts a profit-oriented approach compared to when it values integrity, or when no corporate values are proffered'. It is important to note that in his study, ethics were assessed as they related to the company's own resources. Therefore, employees at companies with inflexible foci on the bottom line were significantly more likely to behave unethically towards their own employers. Ghosh's study also observed that those employees identified as holding high ethical standards were significantly more likely to demonstrate these standards in workplaces where company management actively encouraged and valued integrity-based decision-making. When corporate management did not seek to create and encourage a public sense of integrity, the discernable difference in behaviour between high and low ethical behaviour in employees was significantly lower. Ghosh's study gives significant credence to the idea that corporate attitudes and intentionally created cultures are of great import in developing an ethically run company.

Further research into workplace environments has demonstrated a strong link between management behaviour, company culture and employees' personal decisions. Studies have shown that employees tend to look to their supervisors for guid-

ance on the appropriateness of certain behaviours. A particularly telling study conducted in 1979 by Hegarty and Sims found that when employees were presented with a letter from the CEO that encouraged ethical behaviour, even using a method as indirect as an expression of enthusiasm about a journal article, the employee was significantly less likely to pay kick-backs. Similarly, a study in 1985 showed that employees at companies where work-life balance was emphasized were far less likely to accept kick-backs than employees at explicitly profit-driven companies (Bailey and Alexander, 1993).

Alternatives to the status quo

For a more ethical financial system, the goal must be to empower employees to stand in opposition, to question, to push, and to think creatively about ways to meet corporate goals, rather than developing another set of laws or voluntary codes. It is not feasible to create a universal ethical framework. Any company or oversight body that tries to do so, will find itself slighted - if not in the creation of these codes, then certainly in their implementation.

There are significant advantages to successfully implementing a sense of meaning in the workplace. Studies have identified such positive elements as enhanced commitment, performance, motivation, satisfaction, and trust in management.

However, this paper would not

Existe-t-il d'autres opportunités pour encourager les marchés financiers éthiques ?

Premièrement, les unités en charge des questions de responsabilité sociale de l'entreprise ne devraient pas être conçues pour dépendre d'un seul service ou département au sein de l'entreprise.

La création de centres de citoyenneté autonomes dans l'entreprise permettrait aux salariés de justifier une certaine distanciation avec leur responsabilité propre pour pouvoir incarner l'éthique de la société.

Deuxièmement, les établissements financiers devraient chercher à bâtir des relations avec les ONG et à obtenir des points de vue externes.

L'engagement d'une responsabilité directe envers les parties prenantes externes permettrait de déjouer l'anonymat ; objectif plus que nécessaire.

be complete without a warning, as was issued in a 2006 study by Sandra Cha and Amy Edmondson. These researchers found that charismatic leadership around shared employee values may inadvertently lead to employee disenchantment. Disenchantment is defined by a feeling of violation, a loss of trust and enthusiasm, the presence of anger, resentment, bitterness and outrage with a sense of being betrayed or mistreated. This may occur should employees perceive any hypocrisy in their leaders' in organizational value statements. Values, by their abstract nature, create the opportunity for multiple interpretations of intention. As such, employees and management may read different commitments 'between the lines'.

In addition, there is often a natural conflict between business and communal values. Management, as occurs when staff cuts must be made, is obliged to choose between strengthened business performance and the employees' sense of community. In order to reduce the perception of hypocrisy, leaders are advised to take a number of steps:

- Explicitly acknowledge tensions between work-place values and business decisions.
- Engage in a thoughtful discussion with employees around the company's values.
- In times of stress, conscientiously affirm the company's ongoing commitment to its values.
- Allow for feedback around ar-

reas of employee concern or disappointment. Management is particularly encouraged to discuss feelings arising from unexpected actions or events.

Opportunities for change

Knowing the challenges facing their employees, what other opportunities exist for managers, investors and other stakeholders to encourage ethical financial markets? Innovative thinking is of essence here, and the opportunities for positive change are limitless.

First of all, corporate social responsibility units should not be designated to fall within the purview of only one division or department of a company. While it is essential to have a designated lead in questions of coordination, reporting and management of sustainability, organizations should seek to disallow the rationalizations that we have seen associated with cognitive dissonance. The negative repercussions of creating autonomous corporate citizenship centres allow employees to justify a detachment from their own responsibility to steward the companies' ethics. Their rationalizations can become 'Addressing this is formally the responsibility of someone else, it is not my responsibility, therefore I need not become involved'.

The Stanford prison experiment was not terminated on the sixth day because the sponsoring professor was concerned for his students. Rather, he, Philip Zimbardo, acknowledges that in his role of prison supervisor,

Troisièmement, des rencontres physiques et des relations actives avec les parties prenantes permettraient de faire passer les processus décisionnels d'un mode « impersonnel moral » à un mode « personnel moral ».

Enfin, les dirigeants doivent prendre conscience de leur pouvoir dans la démarche de création d'une culture éthique forte dans l'entreprise.

La distanciation et la marginalisation des convictions et des valeurs personnelles créent une scission injustifiable au sein des marchés financiers.

Il ne suffit pas, pour les dirigeants financiers, de prendre un engagement éthique et de pointer du doigt les brebis galeuses. Ils doivent prendre des mesures délibérées pour intégrer sur le lieu de travail une vraie culture du comportement éthique, de l'éthique personnelle et de l'autonomie.

he was as caught up in the process as the other guards. It was instead a girl he was dating (later to become his wife) who, on visiting the prison, was appalled by the conditions, and who insisted that the experiment ought to be shut down. This anecdote points to the importance of including external stakeholders. Finance institutions should seek to actively build relationships with non-governmental organizations, and actively bring in external viewpoints, perhaps through quarterly open 'town hall' meetings. This would provide relationship-building, communication, an exchange of ideas and culture between people who hold opposing viewpoints. Being directly responsive to external stakeholders would provide a much-needed unmasking of anonymity, the benefits of which were detailed earlier. Management would be stopped, or at least slowed, in slipping down the slope of confirmation bias by receiving occasional external feedback.

Personal meetings and active relationships with stakeholders would also do much to shift decision-making processes from 'moral impersonal' to 'moral personal'. This shift would do more than change the neurological processes seen in financiers' brains from cognitive to affective, it would also address an additional concern highlighted by the Stanford prison experiment: that of the depersonalization and de-individualisation of the victims. By encouraging, and indeed insisting that employees be more connected to the impacts of

their decisions, particularly in how they affect other humans, companies would do much to shift patterns of behaviour.

Finally, management must also be cognizant of its power to create a strong ethical corporate culture. As we have seen, even a casual word of support from the CEO can shift an employee's ethical behaviour in an unrelated activity. More than the occasional sound-byte to the press, or press release, management should recognize and praise those employees who take extraordinary actions to protect the ethics of their organizations. Company leaders need to make daily efforts to build, and re-affirm a culture of employee empowerment. This is particularly important as it is the small, everyday self-rationalizations that shift an ethical compass, not the large, high-reward steps more often associated with financial transgressions.

Integrating ethics in the workplace

The detachment from, and the marginalization of personal beliefs and values creates an untenable division within the financial markets.

The *New York Times* of May 28th, 2009, reports that more than 20% of Harvard's graduating MBAs have voluntarily pledged themselves to an honour code to serve the greater good. This is a fine gesture. But, what happens when these students are faced with decisions that are incompatible with their morals or ide-

als? When their hard-won job would be put at risk, should they choose to follow their code and ‘oppose corruption, unfair discrimination, and exploitation’? It is not enough for financial leaders to espouse a commitment to ethics and point fingers at rogue ‘bad apples’.

These leaders must take conscientious steps to integrate a culture of ethical behaviour, personal ethics and autonomy into the workplace.

If they fail to do this, then these MBAs, however earnest and committed they may currently have made that pledge in vain. •

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