LEARNING FROM THE PAST. ETHICAL CONSIDERATIONS IN MANAGEMENT LITERATURE IN THE POST-CRISIS TIME

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Summary

The last financial crisis, due to its depth and scope, received considerable attention by academics and the media. Academic reflection has been materialized in the form of dozens of books and hundreds of papers published in scientific journals.

The general goal of this paper is to identify the main streams of thought in the post-crisis management literature in respect to ethical issues. There are a considerable number of papers aimed at diagnosing direct and indirect causes of the crisis, factors influencing its speed and scope as well as its internal mechanisms. The paper tries to identify the share of research focusing on ethical issues in the management literature on the last financial crisis. The precise goal of the paper is to verify the following hypothesis: *In the post-crisis management literature ethical issues were neglected*.

The paper concludes with the argument that internal and external control procedures in large corporations – indicated in the literature both as the main cause of the financial crisis and as the main field for improvement - must be accompanied by intensive and harmonized actions aimed at implementation of ethical values of their employees.

Methodology: The paper is a desk study based upon resources available in ScienceDirect (from Elsevier) dated from 2008 until present.

Keywords: global financial crisis, causes of financial crisis, ethical considerations

Introduction

"The root cause of the global financial crisis was not a failure of regulation, but of ethics"

Simon Longstaff, executive director of Sydney's St James Ethics Centre

The 2007-2008 financial crisis was one without precedence in the post Second World War history. It was also declared as the largest of the 122 recessions recorded between 1960 and 2007 in 21 OECD countries (Classens et al. 2010), and due to its scope and depth was comparable to the Great Depression of 1930s (Trichet 2010). Bearing in mind that support by governments and central banks to the financial sector was estimated at USD 13 trillion (Huertas 2010, p.2), one may conclude that the financial crisis of 2007-2008 can be considered a turning point in the economic history worldwide. Not surprisingly, the causes, mechanisms and consequences of the financial crisis of 2007-2008 received considerable attention both from academics and businesses (Huertas 2010).

Considering the causes of the financial crisis one may refer to the exercise of poor risk controls, excessive leverage and the deliberate blindness to the bubble-like conditions of the housing market. Catastrophic decisions in the global financial crisis were largely misjudgments of risk in a financial climate that tolerated high risk. Inadequate regulations are presented as an important factor leading to serious irregularities as well (Sun et al. 2011; Post-Crisis Ethics: Shifting Mindsets or Business as Usual?). Information asymmetry and information failure accompanied by issues related to ownership structure and shareholder engagement are identified as other causes of the financial crisis (Sun et al. 2011).

These are the fundamentally economic causes for the crisis. On top of this was a rise in unemployment, liquidity crisis, inflation, high commodity prices and the collapse of trust in business, especially in the United States - where in 2009 alone, in respect to the S&P 500 corporations, trust in business had dropped by 20 percent (The 2009 Edelman Trust Barometer). In order for the financial firms to regain this trust, a series of bailouts took place in the US (Bear Stearns: $29bl, the Federal takeover of Fannie Mae and Freddie Mac, AIG: $85bl), accompanied by other measures such as money market funds ($50bl), and the Emergency Economic Stabilization Act of 2008 ($700bl). The United Kingdom was worse hit. Walker estimated the total support provided to the banks by the UK taxpayers at £1.3 trillion, or nearly 90 per cent of GDP (Walker 2009, p.90). In October 2009 the International Monetary Fund estimated the total worldwide losses from bad loans and securities at $3.4 trillion (IMF, 2009). It was an enormous financial effort thus the price paid for the financial crisis was unprecedented in the post Second World War history.

However, behind the economic causes and consequences of the financial crisis, one could easily detect unethical behaviors (Pomoni 2010). Curtis (2008) develops this issue further and indicates four types of ethical failures resulted in the financial crisis:1) In subprime lending; 2) among the subprime lending banks; 3) in auction rate securities; and 4) among the Government Sponsored Entities (GSE), like Fannie Mae and Freddie Mac. He adds to these *the conspiracy of silence* attitude by the key financial policy players (such as the United States Secretary of the Treasury Henry Paulson and the Chairman of the Board of Governors of the Federal Reserve System Ben S. Bernanke), the loss of trust and the abandonment of customers. Among the three reforms in the financial sector proposed by Curtis one may find an adaptation of a laser-like focus on customers, the elimination of conflicts of interests and demanding ethical behavior across the board from its executives and employees even if it is sometimes inconsistent with short-term profits, and this behavior needs to be both exemplified and enforced by top executives (Curtis 2008).

It is unquestioned that the triggers for the crisis were the initial decisions in the US to lend money to those who were unlikely to be able to ever repay loans and then to rate these sub-prime mortgages as investment-grade assets. Such practices were unethical (Post-Crisis Ethics: Shifting Mindsets or Business as Usual?). There is anecdotal evidence that a broad ethical discussion is missing not only in diagnosing the causes of the financial crisis but also in the debate on how to fix It. (Reuters 2010).

Consequently, this may lead one to inquire on how ethical considerations are addressed in the management literature since the 2007-2008 financial crisis.

The main goal of this paper is to identify the share of research focusing on ethical issues in the management literature on financial crisis. The following hypothesis: *In the post-crisis management literature ethical issues were neglected* will be tested.

Methodology note

To proceed with a review of the literature, the ScienceDirect (from Elsevier) database was searched. The keywords of the search included*: global financial crisis*, *causes of financial crisis*, and *ethical considerations*. At that stage there were, respectively: 31 983, 37 050 and 74 640 articles found. In the second round, the search was narrowed to publications from 2008 to 2011. The results were, respectively: 11 598, 10 515 and 23 583 articles. After further narrowing the scope of the search to *Social Sciences and Humanities: Business, Management and Accounting* and using advanced search for *global financial crisis* **and** *ethical considerations* and *causes of financial crisis* **and** *ethical considerations* there were respectively 310 and 953 articles found. Then having examined the titles of these articles, a list of 117 potentially most relevant articles was created. Finally, after examination of the abstracts of these articles, a final list of 42 articles was prepared and these were read and analysed.

General causes of the financial crisis 2007-2008

A rich literature on causes of the latest financial crisis has developed. However, due to the goal and the character of this paper, it is neither necessary nor possible to offer an in-depth and systematic review of the various streams of thought regarding the causes and triggers of the global financial crisis. Consequently, positions and opinions presented below do not aspire to offer a complete and ordered review of standpoints presented in the literature. Rather, the subjectively chosen issues below are presented for the purposes of achieving the goal of the paper.

In the literature, the causes of the 2007-2008 financial crisis are analyzed from a wide and/or narrow perspective. The first attitude can be illustrated by Davies' book (Davies 2010) where the global financial crisis is seen as a political as well as an economic episode in history. As Davies demonstrates, failure occurred at the level of the individual decision-maker, the individual organization, and the individual government. Because of connections between these constituents, the disease spread like wildfire. Human greed was fed particularly by a capitalist system based on laissez-faire and grew uncontrollably because of a variety of blind eyes belonging to managers and directors overfed on bonuses and share options, shareholders satiated by dividends and capital gains, consumers duped by fictional yellow brick roads, treasurers and chancellors drowned by tax revenues, and regulators and auditors unable to comprehend the incomprehensible.

Davies points out the failure of auditors to foresee the impending financial crisis in their audit reports (the role of auditors and accountants in the crisis will be further developed in a separate section below).

He also blames credit-rating agencies and their inherent conflict of interest before considering ways in which a repeat of the financial crisis could be avoided (e.g. better ways of providing mortgage finance, limited trade in complex financial products, improved risk evaluation and management, better corporate governance and non-executive directors, and dealing with the bonus culture, fraud, hedge funds, and short-selling). He fails however, to talk about better accounting and reporting.

The narrow, subject-specific perspective on the causes of the financial crisis prevails in the literature. Two main perspectives can be distinguished in this context: 1) financial (including accounting) and 2) economic (Huertas 2010). Such a narrow perspective does not, however, result in a limited scope of the analysis.

For example Rose and Spiegel (2012) include over sixty potential causes of the crisis, covering such categories as: financial system policies and conditions; asset price appreciation in real estate and equity markets; international imbalances and foreign reserve adequacy; macroeconomic policies; and institutional and geographic features. Despite the fact that they use a wide number of possible causes in a flexible statistical framework, they are unable to link most of the commonly cited causes of the crisis to its incidence across countries. This in turn may question the accuracy of ‘‘early warning’’ systems of potential crises, which must also predict their timing.

Of special interest by researchers is the financial sector in general and the role of central banks in particular. Here, several attempts to evaluate proposals regarding the role of the central bank as a systemic regulator, the pros and the cons of locating financial supervision in the central bank, and the conflicts and synergies that such an arrangement entails can be identified (Cukierman 2011).

As it was introduced by Davies, greediness constitutes an important stream in the literature as to the causes of the global financial crisis. Although there is a spectrum of assessments and positions, the approaches that completely blame the greedy acts of executives for the crisis and try to hold individuals accountable for the situation are not applicable. Considering that these individuals work in a social function system with strong internal logic, it is unfair to regard them as the sole responsible party for the crisis (Īçke 2011).

The analysis of the publications available on the causes of the financial crisis leads to the conclusion that ethical issues were either omitted (Huertas 2010; Davies 2010; Sun et al. 2011; Board 2010) or underrepresented, in other words only marginally considered in the literature (Young, Thyil 2011). This is to say that researchers have not considered ethical failures as direct or indirect causes of the financial crisis.

Ethical considerations are present in the literature but are introduced from other perspectives. Here accountancy and accountants represent a substantive part of the literature.

Accountants and their role in the 2007-2008 financial crisis

Although the main disastrous effects of the financial crisis in 2007-2008 were visible in the last quarter of 2008, some textbooks characterized as representing “key contribution to the accounting ethics literature” published in 2009 did not address ethical considerations in the context of the global financial crisis in an appropriate manner. This refers to McPhail and Walters (2009) book which offers nothing more than an introduction to accounting and business ethics.

Even if Gill (2009) raises the issue as to why ethics is perhaps just regarded as a consideration rather than an inherent part of the decision-making process she does not link this with the causes of the global financial crisis. Gill is right for calling on greater ethical reasoning as both a more effective way, than regulation, of averting future accounting and governance scandals and a challenge to reinvigorate professional ethics in accounting. It is argued that simply increasing regulation and the levels of compliance is counter-productive. With increased attention to technical processes rather than to wider ethical dimensions, and with more rules in place, there are more ways of seeking to manipulate the system.

Accountancy and accountants have received significantly negative PR lately and it is argued in the literature that the most recent corporate scandals have set a new low for the accounting profession. Carnegie and Napier (2010) explore how commentators have analyzed the changing activities of accountants (including the rise of consulting) and conclude that changing stereotypes of accountants are evidence of ‘‘negative signals of movement” for accounting as a profession.

The current crisis of the financial system has been linked directly or indirectly to false, misleading, or untruthful accounting. The assertion of a false or misleading financial report implies some belief that there could exist a true or not-misleading report. Accounting-standard setters have finessed this issue by agreeing that ‘‘decision usefulness,’’ not truth, is financial reporting’s ultimate objective. Bayou et al. (2011) provide an argument about how accounting scholars and practitioners might begin to think more cogently about what a truthful type of corporate reporting might be. They suggest that accounting-standard setters have too narrowly construed what accounting’s role in a democratic society is and how the contradictions of current standard-setting jeopardize the essential professional franchise of accountants; that is the audit function.

Nevertheless, it is, after all, the accountants who assist in financial management, prepare financial statements and audit these statements. The latter was researched by Sikka (2009) who notes that many financial enterprises seek state support within a short period of receiving an unqualified audit opinion. Auditors collected large amounts in audit and non-audit fees. The events raise questions about the value of company audits, auditor independence and the quality of audit work, economic incentives for good audits and the knowledge base of the auditors themselves.

Omurgonulsen and Omurgonulsen (2009) researching on creative accounting (based on the Imarbank case study) conclude that deficiencies in the legal frameworks for banking and accounting, inadequacies in the autonomy of governmental regulation and supervision bodies, practical difficulties in enforcing legal and ethical rules due to the slow functioning of the judicial system are significant reasons for creative accounting practices in addition to the personal greed of both owners and the top management of the bank and its customers.

As a corollary to all the above, it can be argued that accountants play a significant role in good corporate governance and ethical sustainable business practices. Taking into account the importance of reliable financial information in good corporate governance, there are calls for greater transparency and corporate governance as well as increased adoption of professional and ethical practices by businesses (Lowa et al. 2008).

Ordinary (regular) studies on business ethics

Apart from research that examines issues related to the roles of accountants and auditors in times of a financial crisis, there are others that deal with ethical issues but without direct references to the financial crisis. This category of publications can be classified as ordinary studies.

Among the several studies which fall within this category, one may find papers either dealing with the ethical perspective in management in general (Le Menestrel, Van Wassenhove 2009) or which address more specific issues such as ethical leadership, sustainable business practices or socially responsible investment.

Inquiries on ethical leadership can further be classified as general (Kalshoven et al. 2011) or more precise. For example, those studies that research the ethic of care versus ethic of justice among transformational and transactional leaders (Simola et al. 2010). Hitt et al. (2010) in his piece about strategic leadership capabilities needed in the 20th century, argues for the necessity of engaging strategic leaders in ethical practices. They maintain that effective strategic leaders are expected to place a strong emphasis on honesty, trust, and integrity in the decision-making process and in the implementation of those decisions. The core values of honesty, trust, and integrity serve as moral filters through which potential courses of actions can be evaluated. These normative values must be instilled in managers and employees throughout the organization.

As Gino and Margolis (2011) prove in their paper an effective way to proceed with such a task is the framing of ethics (e.g., through an organization's ethics code). Proper development and implementation of an ethics codes in organizations influence individuals' ethical behavior and do so differently depending on an individual's induced regulatory focus.

Gilley et al. (2010) develops this further showing that among the ways to enhance leaders' focus on stakeholder value creation is the development and executive championing of an effective code of ethics. Such ''Ethics Code Commitment'' (ECC) – which incorporates characteristics of the code and behaviors by top management - affects a broad number of organizational stakeholders, yielding value for them, thus increasing their psychological and/or financial commitment to the organization while strengthening the firm's corporate culture.

Bernardi and LaCross (2009) while examining the level of international website disclosures of corporate codes of ethics conclude that about two-third of researched corporations listed on the New York Stock Exchange had readily available codes. Their research also indicates that corporations headquartered in Europe were more likely to have readily available codes of ethics than corporations headquartered in the Pacific region.

This strengthens the positions of those who opt for the formalization and institutionalization of various ethics initiatives in business.

Some studies have aimed to improve contemporary business practices and its sustainable performance from the view of stakeholders and their perceived value and development of an iterative model of sustainable business practices based ethical perspective (Svensson et al. 2010; Gilley et al. 2010). It is worth to notice that – according to Kinsella and Kinsella (2012) - reflecting on the solution to the financial crisis will require a reference point which lies outside political power and shareholder value – namely, the 'Common Good'. Also Macintosh et al. (2009) offers a fresh perspective on ethical values expanding on Levinas's ethics-of-being-for-the-other, an ethics that gives place of privilege to ontology rather than epistemology in contrast to much conventional Western philosophy. Their essay illustrates the potential of his ethics for mounting a critique of the use of management and control systems by global corporations.

Another interesting field of analysis focuses on socially responsible investment (SRI). Renneboog et al. (2010) study the money flows into and out of SRI funds around the world. They find that in their investment decisions, investors in SRI funds may be more concerned with ethical or social issues than with fund performance. Therefore, SRI money flows are less related to past fund returns. Ethical money is less sensitive to past negative returns than are conventional fund flows. Their results give evidence on the role of nonfinancial attributes, which induce heterogeneity of investor clienteles within SRI funds.

One may find in the literature many examples which challenge the commonly held belief in the value of honest managerial behavior. Besancenot and Vranceanu (2009) develop a simple decision model of a top executive who must choose between an honest and a dishonest communication policy and then use it to analyze the impact of a tougher sanction for fraudulent disclosure on the indirect cost of bankruptcy. They question the statement that more transparency is always better than less and challenge to some extent this conjecture as applied to corporate communication policy.

Although this concise review is far from comprehensive, it illustrates, however, that ethical considerations are considerably underrepresented in the literature. This is simply because of the absence of books and papers researching unethical behaviors in banks, financial institutions, rating agencies and other organizations, as it relates to the onset of of the global financial crisis. Not only were the causes of the latest financial crisis not adequately researched, but any proposed actions aimed at curing the financial sector do not consider ethical principles.

This is despite the fact that several post-crisis decisions and actions undertaken by both financial institutions and governments pose considerable ethical controversies and urge for a much more serious debate on ethics.

Some negative consequences of the abandonment of ethical issues in diagnosing and curing the global financial crisis

While a lack of governance in big banks and financial institutions, tightly connected with the absence of ethical orientations of individuals and organizations which finally led to the global financial crisis, can be – to some extend – understood, there is no excuse for ethically highly controversial decisions taken later, during the process of recovery. This refers to corporate practices related to compensation policies. It is broadly known (thanks to reporting in the media) that some corporate practices used in the lead up to the financial crisis showed that ethical considerations were completely ignored. This can be illustrated by the way the CEOs of well established firms that collapsed overnight such as Lehman Brothers, Bear Stearns and AIG were compensated with enormous payouts ($34ml, $38ml and $14ml respectively). Although U.S. President Barack Obama proposed tighter regulations on banks, he also admitted that he didn't begrudge the $17 million bonus awarded to JPMorgan Chase & Co Jamie Dimon or the $9 million for Goldman Sachs Group Inc CEO Lloyd Blankfein because "they are very savvy businessmen" and some athletes earned more (Reuters 2010).

Similar practices were noticed also in Europe. For example, the Royal Bank of Scotland, 84 percent publicly owned, offered bonuses of 1 million pounds each to over 100 bankers in 2010 (Reuters 2010).

Even if these CEOs were formally (i.e. legally) eligible to these compensations (which may rise the question about the quality of appropriate regulations) one may question them on the ground of personal accountability for the loss of jobs (in respect to employees) and money (in respect to clients).

One may ask why when stakeholders—including consumers, investors, and employees—pay increasing attention to the ethical, social and environmental footprints of business, companies reengineering supply chains to make them "greener," supporting social causes through volunteer programs for employees, or lobbying for human rights in far flung corners of the globe (Bhattacharya et al. 2011) so many individuals and organizations do not hesitate to present behaviors which apparently conflict with such a basic value as individual and organizational accountability.

Calls for greater accountability from managers and corporations are increasingly being voiced, both in the academic literature and in public discussions more generally. Specifically, it is often suggested that current financial and management accounting practices embody a rather restricted form of accountability that falls short of our mutual responsibilities as more than economic subjects. Against this backdrop, Messner (2009) raises the question of whether more accountability is always and unambiguously desirable from an ethical point of view. He does so by inquiring into the limits that the accountable self faces when giving an account. Messner describes the accountable self as an opaque, exposed, and mediated self that is inherently limited in its ability to give an account of itself. Because of these limits, we cannot expect demands for accountability always to be fully met. This limit in turn leverages the importance of deep ethically rooted managerial attitudes and behaviors.

Acknowledging certain limitations of accountability, some authors investigate the potential for a more 'intelligent' form of accountability grounded in an ethic of humility and generosity (Roberts 2009).

Having acknowledged the importance of good legal (and internal) regulations, one may maintain, that the only antidote against inadequate laws could be: transparency, objectivity, reliability, honesty and prudence which are constitutive for business ethics (Post-Crisis Ethics: Shifting Mindsets or Business as Usual?).

Apparently, the decisions taken by the executives were based on personal compensations, while their ethical considerations were sacrificed. Once the financial industry became disconnected from its ethical base, financial firms focused on their short-term interests without considering the long-term impact on the customers, the US economy and their employees (Pomoni 2010).

The lack of personal accountability of CEOs combined with generous compensation policies they benefited from led not only toward the loss in trust in business (as indicated in the introduction) but also eroded the fundamentals of the business ethic.

This is dangerous two-fold. Firstly, any legal and internal regulations possess their limit. There will always be issues and procedures which either do not fit within the regulations or fell outside the laws. Consequently, managers will always be exposed to situations they will have to make decisions without direct reference to previously well formulated procedures. Second because the business environment is rapidly changing and the directions of these changes are less and less predictable. As some authors indicate, all that was 'normal' has now evaporated as we have entered 'postnormal' times (Sardar 2010). It is the period in-between where the old orthodoxies are dying out, but the new ones have not yet emerged, and nothing really makes sense. Such a diagnosis fits perfectly with the ongoing discussions about the necessity to implement new regulations regarding the financial sector, nationally and globally.

T have any notion of a viable future, one must grasp the significance of this period of transition which is characterized by three c's: complexity, chaos and contradictions. These forces propel and sustain postnormal times leading to uncertainty and different types of ignorance that make decision-making problematic and increase risks to individuals and society. As Sardar argues, postnormal times demands that we abandon the ideas of 'control and management', and rethink the cherished notions of progress, modernization and efficiency. This in turn speaks for a new strategic leadership since the way forward must be based on virtues of humility, modesty and accountability, the indispensible requirement of living with uncertainty, complexity and ignorance. We will have to imagine ourselves beyond the postnormal times and into a new age of normalcy—with an ethical compass and a broad spectrum of imaginations from the rich diversity of human cultures.

That is, making ethical orientation an absolute imperative and all the factors influencing this ethical orientation in a negative way must be seen as seriously threatening to the future of businesses.

Conclusions and recommendations

Having analyzed congruent publications available through ScienceDirect from 2008-2011, one may conclude that our hypothesis: *In the post-crisis management literature ethical issues were neglected* has been positively verified.

Among the conclusions we may mentioned the following:

- There are no publications on direct and indirect influences of unethical managerial behaviors as possible triggers of the global financial crisis 2007-2008. Although there is considerable research on corporate governance failures, the vast majority of conclusions indicate an inadequate control systems as the main reason for organization pathologies, ignoring or under valuating unethical CEOs' practices and behaviors.
- One may notice that while in the scientific literature ethical issues are either absent or underrepresented, the Internet is full of texts, positions, opinions (of various significance). This may suggest that the open public shows much more concern regarding ethical considerations for the global financial crisis.
- Not only the diagnosis of the global financial crisis can be questioned, but procedures used during the financial crisis give rise to considerable ethical concerns as well. The public was confronted with the situation where CEOs directly responsible for corporations' failures were generously compensated. This caused not only a drop in trust in business (in general) but also questioned one of the basic ethical tenets regarding individual accountability.
- Since ethical reflection on the global financial crisis is so shallow one may maintain that we have not learned enough from one of the largest financial crises in the history of the world. It is worth noticing, that the accountant profession did a considerable effort to analyze its role and position before and during the financial crisis. It did so within the framework of business ethics. Unfortunately, such an attitude was not noticed among top managers.
- Although one may accept the notion that control processes and procedures in large financial institutions should be further improved, we must understand that due to the growing instability, complexity and unpredictability of social and economic environment, mastering the control processes is and will not be sufficient to shape effective and socially responsible corporate strategies and actions.
- There is a growing need to develop new and master existing strategies aimed at the framing of ethics.

One may conclude by suggesting actions which should be taken:

- Ethical behavior should not be presented as a trendy attitude but rather as a basic requirement for the existence and sustainable growth of corporations.
- Accountants, top managers, policy makers and other key social players should be guided, mentored and trained in business ethics. Appropriate preparations should start at the very first steps and then being continued on all levels of education.
- Legal and especially corporate internal rules and regulations should be checked for their compatibility with ethic codes.
- Media and the open public should act as ethical values guardians.
- All of us should promote the 'Common Good' as the reference point which lies outside of political power and shareholder value.

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