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ETHICAL ISSUES IN THE INDIAN FINANCIAL SERVICES INDUSTRY

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ABSTRACT

The issue of ethics and economic efficiency in the provisioning and delivery of services becomes complex in the Indian context. Ethical issues in the financial services industry affect everyone, because even if you don't work in the field, you're a consumer of the services. Financial service industry includes banks, securities firms, insurance companies, mutual fund organizations, investment banks, pensions funds, mortgage lenders—any company doing business in the financial arena. Because of its vast size, the industry tends to garner lots of headlines, many of which tout its ethical lapses. This paper tries to look at the ethical aspects of the financial service industry towards stakeholders and an attempt has been made to identify few ethical issues relating to Indian financial sector.

INTRODUCTION

Ethics refers to accepted principles of right or wrong that govern the conduct of a person, the members of a profession, or the actions of an organization. Business ethics are the accepted principles of right or wrong governing the conduct of business people. Business ethics are implemented in order to ensure that a certain required level of trust exists between consumers and various forms of market participants with businesses. An ethical strategy is a strategy or course of action that does not violate these accepted principles. Such practices ensure that the public is treated fairly.

As the globalization process takes hold and the world begins to resemble a global village, so business ethics has become an international issue. The United Nations has produced a document proclaiming norms for conduct and operations of transnational corporations and other business enterprises. These norms cover general obligations to promote human rights as well as recognizing international and national law, including the rights of indigenous peoples and other vulnerable groups such as consumers and workers, and also have regard to environmental protection. A low level of ethics in the business sector is a part of wider socio-economic and political problems faced by many countries: often loopholes in legal and business regulation contribute to the corruption that can plague business operations.

According to Investopedia, "Business ethics is the study of proper business policies and practices regarding potentially controversial issues, such as corporate governance, insider trading, bribery, discrimination, corporate social responsibility and fiduciary responsibilities. Law often guides business ethics, while other times business ethics provide a basic framework that businesses may choose to follow to gain public acceptance."

The financial system of an economy provides the way to collect money from the people who have it and distribute it to those who can use it best. So, the efficient allocation of economic

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resources is achieved by a financial system that distributes money to those people and for those purposes that will yield the best returns.

The financial system is composed of the products and services provided by financial institutions, which includes banks, insurance companies, pension funds, organized exchanges, and the many other companies that serve to facilitate economic transactions. Virtually all economic transactions are effected by one or more of these financial institutions. They create financial instruments, such as stocks and bonds, pay interest on deposits, lend money to creditworthy borrowers, and create and maintain the payment systems of modern economies.

These financial products and services are based on the following fundamental objectives of any modern financial system:

i. To provide a payment system.

ii. To give time value to money.

iii. To offer products and services to reduce financial risk or to compensate risk-taking for desirable objectives.

iv. To collect and disperse information that allows the most efficient allocation of economic resources.

v. To create and maintain financial markets that provide prices, which indicates how well investments are performing, determines the subsequent allocation of resources, and to maintain economic stability in the markets.

COMPONENTS OF FINANCIAL SYSTEM

A financial system refers to a system which enables the transfer of money between investors and borrowers. A financial system could be defined at an international, regional or organizational level. The term "system" in "Financial System" indicates a group of complex and closely linked institutions, agents, procedures, markets, transactions, claims and liabilities within an economy. There are five components of Financial System which is discussed below:

i. **Financial Instruments:** This is an important component of financial system. The products which are traded in a financial market are financial assets, securities or other types of financial instruments. There are a wide range of securities in the markets since the needs of investors and credit seekers are different. They could be categorized into Regulatory, Intermediaries, Non-intermediaries and Others. They indicate a claim on the settlement of principal down the road or payment of a regular amount by means of interest or dividend. Equity shares, debentures, bonds, etc. are some of the examples.

ii. **Financial Markets:** A Financial Market can be defined as the market in which financial assets are created or transferred. As against a real transaction that involves exchange of money for real goods or services, a financial transaction involves creation or transfer of a financial asset. Financial Assets or Financial Instruments represent a claim to the payment of a sum of money sometime in the future and /or

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periodic payment in the form of interest or dividend. There are four components of financial market are given below:

iii. **Money Market:** The money market is a wholesale debt market for low-risk, highly-liquid, short-term instrument. Funds are available in this market for periods ranging from a single day up to a year. This market is dominated mostly by government, banks and financial institutions.

iv. **Capital Market:** The capital market is designed to finance the long-term investments. The transactions taking place in this market will be for periods over a year.

v. **Foreign Exchange Market**: The Foreign Exchange market deals with the multicurrency requirements which are met by the exchange of currencies. Depending on the exchange rate that is applicable, the transfer of funds takes place in this market. This is one of the most developed and integrated markets across the globe.

vi. **Credit Market**: Credit market is a place where banks, Financial Institutions and Non Bank Financial Institutions provide short, medium and long-term loans to corporate and individuals.

vii. **Financial Services:** It consists of services provided by Asset Management and Liability Management Companies. They help to get the required funds and also make sure that they are efficiently invested. They assist to determine the financing combination and extend their professional services up to the stage of servicing of lenders. They help with borrowing, selling and purchasing securities, lending and investing, making and allowing payments and settlements and taking care of risk exposures in financial markets. These range from the leasing companies, mutual fund houses, merchant bankers, portfolio managers, bill discounting and acceptance houses. The financial services sector offers a number of professional services like credit rating, venture capital financing, mutual funds, merchant banking, depository services, book building, etc. Financial institutions and financial markets help in the working of the financial system by means of financial instruments. To be able to carry out the jobs given, they need several services of financial nature. Therefore, financial services are considered as the 4th major component of the financial system.

viii. **Money:** It is understood to be anything that is accepted for payment of products and services or for the repayment of debt. It is a medium of exchange and acts as a store of value. It eases the exchange of different goods and services for money.

OBJECTIVES:

The following are the major objectives formulated to carry out the present study:

- To discuss the meaning and role of business ethics.
- To identify few ethical issues affecting Indian financial service industry.
- To identify solutions for the ethical issues affecting Indian financial service industry.

RESEARCH METHODOLOGY

The present study has incorporated with the collection of secondary data. Secondary information have been collected from different relevant books, journals, news papers and published reports. Information has also been collected from different websites for the study.

SOME OF THE IMPORTANT FINANCIAL SCAMS IN INDIA

Financial Scams have not been uncommon in India. A scam is a means of getting money by deception or in an illicit way with a fake identity or documents. India has now and then seen many scams in the financial world which has shaken Dalal Street. Some of these have caused a lot of financial distress to the common man. The Securities Exchange Board of India has been reviving rules and regulation in as aim to plug the loop holes in the securities market. The major financial scams in India cost the country millions of dollars in lost revenue. These scams weakened investor confidence, and they led to the loss of livelihoods for many people across the nation. Analyzing them is the first step to understanding their impact on India and its people.

i. **The 2010 Commonwealth Games Scandal**

The Commonwealth Games scam was yet another shocking scandal of the nation. The magnificent event was spoiled by blamed made on corruption much before the long wait for the sporting boon which was the light of the day. It is claimed that out of Rs 70,000 crore used on the Games, only half of the money was used on the sportspersons of India. The Central Vigilance Commission that was investigating the supposed corruption in many Commonwealth Games-related projects established disparity in bids which were, overinflated price and bungling in purchase of equipment through tendering, willful delays in execution of contracts payment to non-existent parties, not to mention misappropriation of funds.

ii. **Subrata Roy**

Subrata Roy case is also called Sahara India Pariwar investor fraud case. In this case Subrata Roy, the chairman of the Sahara India failed to return Rs 24,000 crore plus interests to its investors as directed by the Supreme Court of India.

iii. **The Coalgate Scandal**

Unfortunately, the Indian people do not benefit from coal production as much as they should because of corruption. Coal deposits were distributed arbitrarily in which Public Sector Enterprises and Private Firms paid a much lesser amount at the end, which indirectly gave the officials in the government a chance to collect a heavy amount of money with the help of underhand dealings. In March 2014, the Indian Comptroller & Auditor General revealed that Indian taxpayers had lost $28 billion.

iv. **The Fodder Scandal**

This one took place throughout the early 90s. It involved powerful government officials in the State of Bihar in addition to elected politicians and prominent business people. These individuals conspired to documents alleging the

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existence of vast herds of livestock. Then they would allocate money for the procurement of fodder, equipment, and medicine for these herds. These funds would end up in their pockets. In total, the fraudsters in this scandal stole more than $510 million from the people of Bihar.

v. The Satyam Scandal

Founded in 1987 by Ramalinga Raju, Satyam was an IT service based in India. More specifically, 94% of the cash indicated in Satyam's accounting books was fictitious. Satyam shares fell by $2.2 billion.

vi. The Bofors Scandal

This one was a scandal between two countries, i.e., India and Sweden. India received 410 field howitzer guns for $1.4 billion. In return, Sweden benefited from its most massive arms deal in history. In this case, the specific Swedish company that sold these arms to India was Bofors AB. To facilitate this trade, Bofors offered kickbacks to government officials in Sweden and India.

vii. The Harshad Mehta Scandal

Harshad Mehta, a well-known stockbroker in the early 90s, found ways manipulating the stock market in India. More specifically, he focused on the Bombay Stock Exchange. Mehta distorted the value of stocks in this exchange by forging bank receipts. Harshad and his associates initiated a securities scam by diverting funds of about Rs 5,000 crore from the banks to stockbrokers between April 1991 to May 1992. He also took advantage of loopholes in the banking sector siphoning millions from interbank transactions. After the scam was exposed, the stock markets crashed and Mehta was arrested and banned from trading in the stock markets.

viii. Vijay Mallya & Kingfisher Airlines Scandal

Since 2012, Mallya and his company have been involved in financial scams and controversies. 17 Indian banks altogether are trying to accumulate a loan of approximately ₹9,000 crore, which Mallya has supposedly overwhelmed to acquire 100% or a half stake in around 40 companies all over the world. Kingfisher Airlines is an airline which was formed as a huge business venture in 2005 and after some years became bankrupt and because of that, it dissolved in 2012.

Those are the few scams which happened only due to various ethical problems or issue. This study has identified the following five issues influencing such scams.

i. Self-interest sometimes changes into greed and selfishness

Greed and Selfishness, which is unchecked self-interest at the expense of someone else. This greed becomes a kind of accumulation fever. If you accumulate for the sake of accumulation, accumulation becomes the end, and if accumulation is the end, there's no place to stop. The focus shifts from the long-term to the short-term, with a big emphasis on profit maximization.

ii. **Some people suffer from stunted moral development**

This happens in three areas: the failure to be taught, the failure to look beyond one's own perspective, and the lack of proper mentoring. Business schools too often reduce everything to an economic entity and have made fundamental purpose of a business is to make money, maximize profit, or maximize shareholder value.

iii. **Some people equate moral behaviour with legal behaviour**

Disregarding the fact that even though an action may not be illegal, it still may not be moral. Everyone must remember that the reason for all laws is that the moral agreement begins to break down, and the way to get other people in line is to legislate so that we can stipulate punishments. Yet some people contend that the only requirement is to obey the law. They tend to ignore the spirit of the law in only following the letter of the law. For example, Companies Act, Contract Laws etc, regulations repeatedly single out actions with "no legitimate business purpose.

iv. **Professional duty can conflict with company demands**

A faulty reward system can induce unethical behaviour. A purely self-interested agent would choose that course of action which contains the highest returns to him or herself. The purely self-interested agent is just responding to the reward system that is in place. In general, organizations get exactly what they reward. They just don't realize that their rewards structures are encouraging dysfunctional or counter-productive behaviour or turn a blind eye to the outcome.

v. **Individual responsibility can wither under the demands of the client**

Sometimes the push to act unethically comes from the client. It is quite natural and acceptable that people who do business are, for the most part, highly ethical people trying to do the right thing most of the time.

SUGGESTIONS

First of all, consumers need to be better informed. It is customer's responsibility to take control of their own financial security, which doesn't mean one need to know everything about the product he/she is buying in advance, but he/she should read enough to know what some of the right questions are to ask. Ask those insightful questions of an advisor whom you know, trust, and who has the proper credentials, if applicable.

OTHER SUGGESTIONS

i. Incentive compensation better aligned with customers interests rather than agents

ii. More industry trade associations supporting ethics initiatives

iii. The Centre for Ethics in Financial Services growing in influence and impact

iv. Internal and external audit and a compliance department/compliance officer are needed to avoid fraud and other unwanted unethical behaviour.

v. Conflict of interest should if possible be avoided

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vi. Market manipulation should be curbed.

CONCLUSION

No nation can survive and flourish without common moral and social values. Ethical problems and dilemmas abound in any economy, regardless its level of economic development. Business has the potential to provide a major contribution to our societies, in terms of producing the products and services that we want, providing employment, paying taxes, and acting as an engine for economic development. As we all have read, there is an opinion that greed and unethical behaviour by market participants is a culprit for financial crises and therefore it would be unwise to ignore the area of ethics and the requirements ethics put on market participants. Financial intermediaries must keep to rules of law, industry standards and act ethically.

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