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BUSINESS ETHICS IN BANKING

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Abstract. *The intention of the present study is to pay attention to the very essence of the ethics in economy, and especially in banking. There is an always present dilemma between ethics and economy. Nowadays the attention is much more dedicated to this topic, because the lack of ethics norms in business operations produces great damage at the micro and macro level. More than anything else the significance of ethics becomes apparent through establishing of socially accepted ethical norms, affecting in consequence all aspects of life. In the present study we shall try to explain the business ethics as a social responsibility of an individual as well as of collective moral actions followed during all aspects of business activities up to the point where they do not disturb business relations within the business system, as well as within the wider surroundings. Later in the study, some of the banking transactions ethical principles will be given, respecting which banks optimize their micro economy, but also realize significant micro economy function, through their business activity. Finally, in the conclusion of the study, the code of ethical principles is pointed out, the application of which would establish a defensive mechanism in the field of ethical values application.*

Key words: *ethics, business ethics, morals, ethical principles, ethical code*

INTRODUCTION

Although it is a foreign word, ethics has become completely domesticated in our country. In etymological terms, ethics originates from the Greek word "ēthos", which means: custom, behaviour, conduct, and "ēthikos", which means moral. Ethics has become an international word and term.

Ethics was advocated by the greatest Greek philosophers: Socrates, Plato and Aristotle. The creator of ethics as a study of morality was the Greek philosopher Socrates (470-399 BC), who used ethics to define the terms of human virtues. The most important personal values are: righteousness, courage, honesty, tolerance, goodness, sincerity and fairness. In the field of ethics, Socrates and the entire Hellenic world saw the issue of

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goodness in human life or "eudaemonia", i.e. happiness, as the most important. Goodness is a human characteristic and the greatest moral value. Socrates believed that virtue can be taught, i.e. that virtue is knowledge. A man must know what good is in order to do good. According to Socrates, knowing oneself is a prerequisite for happiness. Essentially, happiness is being good.

Plato (real name Aristocle, 428-427 BC) thought of happiness as an inner feeling. The disrespect of ethical principles leads to unhappiness. Thus, those who seek happiness must practise self-control and adjust their behaviour to ethical principles. A similar view is expressed by Plato in his "Republic", where he says that those who are happy are those who are just and those who live an honest life, while those who are unjust are also unhappy, and the tyrant of the state also becomes the greatest tyrant of his own happiness.

A man should strive towards his own happiness, but he has an even greater aim of making his community happy. Similarly, Aristotle (384-322 BC) enumerates the basic principles that happiness can be divided into: wisdom, virtue and welfare. He sees happiness only as the subjective side of goodness. Contrary to the belief that we always want to do good held by Socrates and Plato, Artistotle thought that in order to do good, human impulses and instincts must always be governed by reason and may not be good in themselves. The Stoics and the Epicureans, Augustine, Aquinas, Spinoza, Kant and Hegel further contributed to the theory of ethics based on Aristotle's teaching.

Ethics belongs to philosophy because it studies human behaviour from a certain moral aspect. The focus of ethics is the community, and moral good is seen as the universal welfare of the community. Since ethics and morality mean the same in etymological and semantic terms, they are often used as synonyms. Morality, as a social norm of human behaviour, is a group of unwritten rules and customs governing interpersonal relationships. One of the characteristics of morality is its autonomy because moral norms are valid in themselves (the subject adopts them independently, and not under pressure from others). It is based on the principles that determine how a person should behave. Morality is the goal that we should strive towards. Since morality is a system of values, it serves to decide what is good and what is not, i.e. to differentiate between good and bad actions. Morality is very similar to law, but in contrast to law, it does not involve any political or economic sanctions.

Ethics as the study of morality examines the meaning and goals of moral norms and establishes the criteria for moral evaluation. The main ethical terms include: morality, goodness, conscientiousness, evil, freedom, happiness, love and virtue. Righteousness, morality and economic rationality and self-interest frequently overlap and intertwine [10]. In the said context, love can be described as a strong feeling of commitment. It is a condition that involves the following elements: affection (mutual respect), altruism (mutual selflessness) and helpfulness (readiness to help each other). Love is the basis of all fellowship, it involves support and care, and its ultimate goal can be absolute devotion.

Morality relies on the awareness of the individual and society. An individual has a moral feeling when he hears "the voice of conscience" [2], a sanction that the subject applies to himself in a specific moral situation. Examining one's own actions means that we rationally justify and analyse our actual behaviour. The unconscious element that forms our conscience is the fear of punishment, so that the inner norm serves to prove our moral coherence. Thus, conscience as a moral paradigm is always present within us and we cannot deny it. The evidence lies in the public demonstrations by which we try to prove to the society our righteousness through conscientious behaviour.

1. DEFINITION OF THE TERM "BUSINESS ETHICS"

The subject of business ethics (*collective* or *business ethics*) is the effect of the social nature of morality, and the feedback effect of business morality on the business environment. Thus, business ethics may be defined as a group of moral actions of an individual, as the element of a collective, that he/she adheres to during all forms of business activities without damaging the business relationships within the business system and the wider environment.

Public attention has lately turned towards debates about business ethics, as the social responsibility of the individual and the collective. The question arises as to whether business has anything to do with the morality of the individual and the collective. Many people deny the connection between ethics and business, believing that the place of morality is within religion, while others perceive the interconnection between morality and religion. Every business activity has certain things in common with morality and moral actions of an individual or groups.

Business ethics has two basic dimensions of expression and demonstration:

- ***collective ethics and***
- ***individual ethics***.

Collective ethics includes the application of ethical principles in the management's decision-making that refers both to external subjects and the environment and the ethical relations within the business system itself. Individual ethics involves adherence to the norms of customary business morality. If an individual has a deficit of ethical morality it means that they put their interests before the collective and legal norms, and before the norms of customary business morality, which can damage the business climate. Individual ethics is the basic element of group or collective ethics.

It is certain that opposed stands regarding the relationship between business and ethics are gaining importance. This issue has become increasingly important both in the developing countries and the countries in transition. As John Costa says [3], the business world is full of scandals, starting from trade, banks, insurance to the managers' false expenses. The lack of ethics destroys trust, and trust is a precondition for successful business operations and development. Therefore, each segment of work and operations of a business entity should respect ethical principles. All the employees in a company, from a director to a doorman, should stick to ethical rules. In doing their job, they should always bear in mind the general welfare. The respect of business ethics can be analysed by monitoring the obligations arising from such principles.

The majority of ethical theories agree that if there is a conflict between obligations, the obligations towards society should be given precedence. We should primarily respect the applicable laws of our country because each failure to respect the law means the violation of ethics. The protection of the employer's interests is in practice often referred to as *"the working ethics"*. It is unnecessary to differentiate between the obligations towards the employer and the obligations towards the management because their interests are very rarely opposed.

Every client is important for business. An employee's failure to fulfil their contractual or ethical obligations towards a client may violate the ethical principle. Ethical obligations towards one's profession originate from the same sources as obligations towards one's colleagues. An employee may improve or damage his profession, regardless of their behaviour towards colleagues. For example, constant disrespect for contractual obligations may not only harm the reputation of the person who violates these obligations, but also the reputation of the entire profession.

It is a great challenge for each manager and each employee to set the limits of business morality. It is the question of personal interests, moral integrity and the question of cultural heritage. Anyway, from the moral point of view, cheating is allowed, as long as it remains within the limits of customary business behaviour. Albert Carr calls it "bluffing in business" [4, p.51], or a part of strategy in the business game.

The ambition to achieve business success encourages individuals and groups to disrespect the rules of the game in order to obtain a certain business advantage. Certain business information has to be kept secret so that it cannot be used by the competition. In that case, the ethical principles are not violated and the competition is not endangered.

An argument in favour of ethical behaviour may be found in the following example: if you, by means of advertising and propaganda, manage to make your service successful on the market although it is of lower quality than the competitor's, the ethical principles are not violated. But, if the service of the same quality as the competitor's has gained advantage by means of marketing and its implementation can have harmful effects on the environment, the limits of business ethics are violated. "A wise businessman will not seek advantage to the point where he generates dangerous hostility among employees, competitors, customers, government, or the public at large." [Ibid]. Thus, the limits of ethics are violated if collective gain is achieved at someone's expense or if personal gain is achieved by inflicting damage on the collective.

An important moral task is to define the ethical line between personal moral standards and business morality, i.e. the activity imposed by the bank. This task requires constant questioning to prove the personal worth of an individual. Even the businessmen who are truthful tend not to say the whole truth. This is why it takes a lot of skill to meet both the collective and individual requirements regarding business ethics. We should achieve success without doing harm and being unfair to another. There are numerous examples of different affairs in business practice, which is why this topic deserves special attention in research and education.

2. ROLE OF ETHICS IN BANKING

Ontologism based on the concept of good as opposed to evil helps us define the banking business from the point of view of ethics. The idea of awareness or conscience of the need for banking products or services inevitably comes to mind. This simplified parallel leads us to the conclusion that full awareness of and the related ethics about the importance of banking products and services is imminent to all economies, regardless of their economic development.

The basic ethical principles in banking [11, p.13-14] are:

• ***Principle of mutual trust*** is of special importance for successful functioning of the business system. Important and valuable deals are very often contracted over the phone, in the absence of witnesses, while the relationship between the participants is dominated by the inviolable principle of mutual trust.

• ***Principle of mutual benefit and interest*** means that none of the partners in a business relationship should feel cheated;

• ***Principle of good intentions*** is very important for business ethics and moral behaviour. This principle means that there is no intention to treat the business partner in an immoral way, whether it refers to deception, theft or some other undesirable way of treating a business partner;

• ***Principle of business compromise and business tolerance*** refers to the harmonization of the conflicting interests of participants in the business process;

• ***Principle of ethical improvement of business behaviour*** represents the business partner's readiness to accept the mistake that has been made as a result of his own actions. He should admit the mistakes and respond in an appropriate way;

• ***Principle of demonopolization of one's own position****,* because monopolistic behaviour on the market does not contain any ethical market value *and*

• ***Principle of conflict between one's own interests*** refers to the inability to relate common to personal interests, with simultaneous adherence to the same ethical values.

The violation of ethical principles in banking occurs when the lenders take too much risk, trying to find a loophole that allows them to approve more loans. Strict adherence to the law and regulations in the field of banking makes it possible to grant loans to all the qualified clients in a fair way.

When it comes to general standards, the bank must take into account the following [5, p.551]:

• *The bank must avoid a high concentration of loans in one industrial branch, sector or field, with the exception of specialized institutions that have this as their core activity;*

• *Clients who want to obtain a loan should maintain a certain amount of financial resources as a precondition for loan security;*

• *Loan approval refers to a strictly formal procedure in terms of purpose, source, price, terms and the method of payment;*

• *All loan applications must be accompanied by financial reports of the debtor for the previous year and*

• *Loans are granted with an amortization payment schedule.*

Having in mind the negative effects of credit risks on the bank's operations, and the macrosystem's interest in the rational use of loans for the purpose of avoiding inflation trends, the bank should have a restrictive attitude towards loan applications that could be used to finance new risky investments, and thus avoid possible inflation tendencies.

The theoretical assumption that banks with higher capitalization rates and a better liability structure can enter long-term credit arrangements with a higher risk level has been empirically proven. It stems from the above that each bank should respect the general and the specific principles in formulating its credit policy. Since banks are trying to optimize their microeconomy, they perform a significant macroeconomic function through their activity.

The bank's non-objectivity is most evident when it comes to establishing accurate information about the character of the debtor. Based on its subjective evaluation, the bank makes conclusions about the debtor. This indicator is most obvious when it comes to personal loans, and less obvious when it comes to corporate loans.

The analysis of every loan application requires one or several loans officers who have contacts with the client, one or several analysts who evaluate the client's financial abilities, a board for loan approval or a loan administrator who finally approves or rejects the loan request. By protecting themselves, the banks also protect the efficiency of using the macrosystem's accumulation. In this way, the loss of banking and financial resources in the macrosystem is restricted and the selective and allocative functions of the total system are improved.

A number of companies on the loan market misrepresent their revenues in order to acquire funds and reduce their loan costs. Revenues are thus artificially increased and costs deflated. Such corporations have set their own benchmarks for reporting revenues to lenders and the public, desisting at the same time from generally accepted criteria for determining revenues (GAAP - Generally Accepted Accounting Principles). Therefore, loan officers must be very cautious since many clients may present misleading profit figures. Bank officers should be specifically focused on the financial statement.

It is generally recognized that banks, just like other financial organizations, are prone to manipulations with their financial statements at the end of a quarter or a fiscal year. This "customized accounting" which serves to conceal true financial standing of a bank may seriously harm the financial system efficiency.

A bank is liable to run business books in compliance with the banking chart of accounts, preparation of bookkeeping documents, evaluation of assets and liabilities, drafting of financial statements in accordance with applicable regulations and professional standards (the Central Bank may prescribe, for the purpose of public announcement, a type, form and content of statements, method and deadlines for their publication). A bank must organize the internal audit which should conduct its activities in an independent and impartial manner, and contribute to the development of the bank's operations through its advisory services. The internal audit of the bank's operations should conform to the operating principles and business ethics code pertaining to internal auditors. In its work, the internal audit should harmonize the methods of its work with the work of external auditors. The person in charge of internal audit tasks should not be involved in other activities within the bank. If the internal audit unveils any case of illegal operation and violation of the risk management rules in the course of its inspection of specific fields of bank operations, it must promptly inform the bank's management thereof. If it fails to do so, the bank is running the risk of becoming illiquid, insolvent and its operations insecure.

In the Unites States, FDI has an extensive authority to sanction a misuse in banks, should the officers use their executive positions to gain personal benefit. It may discharge the management of a bank if it finds that they have deliberately caused loss to the bank or it may prohibit a person to have any business relations with the bank if the bank's reputation is thus compromised.

It is interesting to note that the loan derivative market is subject to manipulations as well. It is assumed that some officers in charge of loan operations tend to disclose to dealers and brokers of securities, certain private information concerning the financial standing of the borrower. The dealers who obtained the information in this manner are in the position to enter into lucrative arrangements before such information becomes public. In practice, a lot of dealers and brokers disclose altered information so as to encourage the clients to purchase their securities. It is only when valid information emerges on financial market that these clients realize they have been deceived. To prevent such manipulations two solutions are at hand [6, p.461].

The first solution is that investment banks order a report on analysis of securities from an independent institution. Another solution refers to the establishment of an independent body which would select the companies to render unbiased analyses of securities, chiefly aimed at providing small investors with an objective appraisal of securities issuers.

The point of departure for more reliable information is an effective split of intermediary operations with securities and the sale from the securities analysis. This measure alone would ensure public confidence in dealers and brokers trustworthiness but also in the quality of investment banking. As a consequence of the major economic depression in 1929 and the ruin of many banks, Glass-Steagall Law was endorsed in the US back in 1933. The said law stipulates the so-called "tying arrangements" between commercial and investment banks and their clients. These arrangements facilitate commercial banks which grant loans to corporate clients to exert pressure on their clients, and make the loan conditional upon the purchase of securities that the department for warranting the value is trying to sell. Such behaviour appears as a burden to the client since it is imposed as prerequisite for having a loan granted. The arrangement does not include advisory services as additional ones. In some cases these services are extra charged, at the price which is often above market levels, or they turn to be completely unnecessary to the client.

Notwithstanding the Gramm-Leach-Bliley Law of 1999, providing for the abolition of restrictions imposed by the previous law, certain conditioning appeared on the market when it comes to granting of loans related to the sale of securities. The new law allowed for commercial and investment institutions to purchase each other as well as other financial institutions.

Banking business is attractive for illegal transactions only if the effectiveness of a controlling mechanism for a consistent conformity with the operating principles is missing. Continuous monitoring is a significant activity for banking operations, since the very nature of this activity involves a rapid change along with innovations. In traditional banking activities this problem is clearly seen, since some sort of records is kept on transactions. However, there is an obstacle in the e-banking domain, particularly in regard to detection of illegal money transfer from an account to a card with a deposit amount.

It is to be expected that a more extensive use of e-money will lead to an increasing misuse of ethics. Even though banks, financial companies and clients gain multiple benefits by using the e-banking system, at the same time the application of e-banking jeopardizes the ethical domain, since it gives rise to increased cyber crime. Hackers usually disrupt the operation of information systems and transfer financial funds to their own accounts. The most common targets of such criminals are ATMs. It is not to be neglected that banking technology is getting better, but hackers also develop their skills to steal funds from banks and thus undermine legitimate banking transactions.

One of the ways to fraudulently obtain money is stealth of personal data or identity. It involves a deliberate attempt at unauthorized acquisition of other people's personal data. This type of theft is possible to uncover only if individual users are vary and if they keep track the standing of their accounts each month. Otherwise, this theft could be hardly noticed. This theft represents a major threat to banks, credit institutions and other financial companies which bear the brunt of the loss.

In order to prevent the identity frauds, legislative institutions notify the clients that they safeguard the sources of private information. Bankers should provide more detailed instructions to clients to check the balance on their accounts at least once a month and to report immediately any observed irregularity. Owing to the introduction of e-banking services, clients can check their account balances on a daily basis. Electronic business is possible to apply only if a mechanism for securing financial and other transactions on the

Internet is developed. By using encryption systems and digital certificates it is possible to realize four basic functions of the transaction security, such as: confidentiality, authentication, integrity and incontestability. The efficiency of such measures should be proved by more extensive use of electronic money. The most important benefit of e-business is that financial flows assume different profile, whereas the banks move their desk operations to the clients' computers. Time will show whether we will reach statistical figures from the developed west where more than 80% of transactions are effected electronically [12].

A failure to comply with ethical principles results in increased costs and reduced competitive capacity of a business system, since it affects its reputation in business environment. Any neglect of the ethics implies its misuse. Recent scandals in the corporate world compromise the opportune value of a comprehensive deregulation which took place in the banking sector and on the power supply markets in the late nineties. "Widespread corruption and unethical behaviour are primarily seen as features of institutional fragility and a lack of democratic credentials, found in the developing world in particular."[1]. A syndrome of a weak state and fragility of its institutions should be the key reason for concern in further prevention of unethical behaviour. Post-communist societies in transition are rich in examples of unethical behaviour. The implementation of institutional reforms makes it possible for the economies in transition to reduce unethical behaviour to the lowest possible level.

In practice, more attention is paid to investigating the cause of impairment of ethical principles, particularly in the business world. An ethical principle is impaired if an individual undertakes the activities which do not conform to his/her standards, in order to achieve success. In banking operations, the key cause of ethical principles' erosion lies in using illegal banking transactions for the purpose of acquiring wealth. All banks are obliged to take a proper care of who they work with and to proceed with all required measures for preventing such cases. Therefore, they are obliged to abide by international laws and codes. A growing concern due to the erosion of trust has prompted the governments of many countries to reconsider their approach to ethical codes. For example, the UK introduced the code of public conduct in 1994 [8]. Likewise, the ethical standards for bank officials should be clear.

The bank managers should possess the following qualities:

• ***humane values,*** which is a duty of every individual, a prerequisite for proper life. It involves a correct cooperation with other persons,

• ***unselfishness***, implies that the bearers of managerial functions should bring in conformity their conduct with the bank's business policy. They should not adopt and implement decisions in order to derive financial or material benefits for themselves, their families or friends. In exercising their duties they should demonstrate professionalism.

• ***integrity***, the bank's managers should be very cautious in providing financial services to their clients, so as to avoid clients' influence upon the conduct of their activities;

• ***objectiveness***, impartialness, equitability and an ambition to set even-handed criteria and goals of ethical behaviour.

• ***responsibility*** for all their acts and decisions;

• ***honesty*** in terms of resolving any conflict of interests which may arise;

• ***leadership***, bearers of managerial functions in a bank should promote and support these principles guided by personal example.

Likewise, the clients should be interviewed in order to determine the level of their satisfaction. In case of an inadequate behaviour of subordinate officers, the managers are held responsible as well. Bank officers should comply with key principles which they should apply in their work. In addition, they should be aware of the limits of acceptable behaviour and to exercise their duties diligently in that domain.

CONCLUSION

Ethics is a set of moral values and principles related to society. The application of ethical principles contributes to the attainment of financial moral. The domination of ethical principles implies the elimination of criminal operation of commercial banks, i.e. less frauds, bribery, and corruption. Given that economy cannot successfully function in the absence of ethics and morals, the necessity of introducing ethical code is frequently advocated.

In the banking sector, the business ethics principles would be implemented in an organized fashion, aided by normative and legal regulation in the field of bankers' business activities. The application of the code of ethical principles would establish a defensive mechanism in the area of application of ethical values since the position of a particular profession requires more stringent moral standards and involves sanctions for the breach of the same. In developed countries, the issue of ethics is closely attended to.

The International Monetary Fund, the World Bank and other institutions are trying to shape the environment of international commercial and financial relations by developing standards and codes in the field of economic policy. Some of the examples for the application of standards reflecting the financial policy are the Principles for the Supervision of Banks Foreign Establishment - the Basel Concordat), endorsed by the Basel Committee for the Supervision of Banks in 1983; the Code of Good Practice on Transparency in Monetary and Financial Policies, endorsed by the International Monetary and Financial Committee in 1999.

In the Financial Stability Forum [13] one of the key standards, internationally recognized for a stable financial system, refers to an efficient banking supervision. The endorser of that standard is BCBS organization (Basel Committee on Banking Supervision). An incentive for the compliance with and application of the standard is the improvement of national economic performances. It formulates the norms of proper, regular and correct behaviour, values and duties.

In each profession there is an ethical – moral code of behaviour. Such moral norms are established and applied in order to govern internal relations and the relations with other groups. The adoption of ethical standards in the form of a code of appropriate conduct could contribute to understanding broader community. To that end, it is necessary to do the following:

- *Ethical standards should be formalized in regulations.* The law and other regulations may provide a framework for advisory, reprimanding measures and other restrictions.
- *Professional ethics-related advice* contributes to moral reasoning. An unbiased advice alone can contribute to the resolution of ethical dilemmas.
- *An adequate responsibility mechanism should be established*. In case of a violation of ethical principles, a formal chain of responsibility should be established. There should be clear rules and procedures to be followed by the officers.
- *Bank managers should serve as role models for ethical behaviour and professionalism*. Consequently, they have a leading role since they promote ethical behaviour. Policy and practice pursued by managers should underscore bank's commitment to ethical principles.

Ever since its beginning, the ethics has had an objective to acquaint us with moral values and to take a critical standpoint regarding the current moral practice. Unfortunately, the ethics debate in our country is still neglected. The International Monetary Fund and the World Bank underscore the main remarks concerning the law on our central bank. The task of the National Bank of Serbia is not "to be concerned with the liquidity of banks and other financial institutions", since it is not the job of the central bank but rather that of the commercial banks' management. That is why the World Bank deems that a supervisory role of the Central Bank should be clearly defined. The World Bank insists on the adoption of a sort of "ethical statute", for the purpose of preventing conflicts of interest of key personnel in the National Bank of Serbia.

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POSLOVNA ETIKA U BANKARSTVU

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Ovaj rad ima pretenzije da ukaže na samu bit etike u ekonomiji, a posebno u bankarstvu. Stalno je prisutna dilema između etike i ekonomije. Ovoj temi se sve više posvećuje pažnja, jer odsustvo etičkih normi u poslovanju donosi veliku štetu na mikro i makronivou. Značaj etike najviše se ispoljava preko uspostavljanja društveno prihvaćenih moralnih normi, koje kasnije utiču na sve aspekte života. U ovom radu pokušaćemo da objasnimo poslovnu etiku kao društvenu odgovornost moralnih postupaka pojedinca i kolektiva koji se pridržavaju tokom svih oblika poslovnih aktivnosti sve do granice kada se ne narušavaju poslovni odnosi unutar poslovnog sistema, ali i šireg okruženja. U nastavku, navode se neki etički principi bankarskog poslovanja čijim uvažavanjem banke optimiziraju svoju mikroekonomiju, ali ostvaruju i značajnu makroekonomsku funkciju, kroz svoju poslovnu aktivnost. Konačno, u zaključku, ukazuje se na kodeks etičkih principa, čijom primenom bi se uspostavio odbrambeni mehanizam na području primene etičkih vrednosti.

Ključne reči: *etika, poslovna etika, moral, etički principi, etički kodeks.*