



The financial system, its social responsibility, ethical conflicts and macroeconomic stability in Ecuador

El sistema financiero, su responsabilidad social, conflictos éticos y estabilidad macroeconómica en Ecuador

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ABSTRACT:

The economic and financial crisis in the last two decades, generated by massive institutional bankruptcies and corruption scandals in the global financial system, appears to reaffirm the dominance of the old classical view of businesses' mission about maximizing and optimizing profits, as their sole objective, without a commitment towards social responsibility. This article addresses a critical documental analysis regarding the relationship between Ethics, Social Responsibility and the financial system's behavior, within a frame of competitiveness. It also evidences the existence of a positive relationship between social responsibility and the institutional performance of financial entities, which constitutes, together with ethical values, fundamental elements to achieving a nation's economic and financial stability; also, it evidences a global sharp weakening in the fight against fraud and corruption. The Ecuadorean crisis is presented as an example, which is tied to the pressure exerted by the banking system in favor of laws leading to an absolute "financial freedom", which caused reprehensible behaviors, which at the end plunged the country in a deep crisis with severe consequences in the economic, social, legal and moral context.

Keywords: Ethics, social responsibility, competitiveness, crisis, corruption.

RESUMEN:

La crisis económica y financiera de las últimas dos décadas, ocasionada por masivas quiebras institucionales y escándalos de corrupción en el entorno financiero mundial, parece reaffirmar el dominio de la antigua misión empresarial de maximizar y optimizar sus ganancias, sin el compromiso de responsabilidad social. Este artículo aborda un análisis crítico documental de la relación entre la ética, la Responsabilidad Social Empresarial (RSE) y el comportamiento del sistema financiero, profundizando en las posibles causas que generan la omisión de una actuación social ética, en el marco de la competitividad global, con énfasis en el caso ecuatoriano. Se evidencia la existencia de una relación positiva entre la RSE y el performance institucional de las entidades financieras, que constituyen junto a los valores éticos, elementos fundamentales para la estabilidad económico-financiera de un país; así como un acentuado debilitamiento a nivel global en el combate de los fraudes y la corrupción. En el Ecuador, la crisis se vincula con la presión ejercida por la banca para la promulgación de leyes favorables a una total "libertad financiera", que llevó a conductas censurables y a la postre, sumergió al país en una crisis financiera con graves consecuencias en los ámbitos económico, social, jurídico y moral.

Palabras clave: Ética, Responsabilidad social, Crisis,

1. Introduction

Many firms persist into prioritizing the accumulation of wealth, based on materialism and pragmatism, elements that persist, even in a period where concepts such as social responsibility, code of ethics and ecological consciousness are used globally. As a result of globalization, it would be assumed the existence of a moral evolution in most organizations, as suggested by Harvard Professor (Austin, 2010), for whom the firms' social dimension has experienced drastic changes in recent years, with the creation of social capital. Nevertheless, recent experience shows that many institutions within the financial sector are just pursuing wealth, this being their only objective, generating social and economic problems in many nations. These attitudes set aside moral responsibilities of directors and employees, as well as ethical principles in the entrepreneurial activity.

Although the recent emphasis given on norms and regulations, aimed at reestablishing confidence in the financial system, there has been no success. The relationship between ethics and Corporate Social Responsibility (CSR) with the financial system's behavior apparently has deteriorated in the last two decades, situation that has been evidenced with the global financial crisis in 2009. This crisis showed moral deficiency in banks' behavior and a severe weakness regarding their ethical values (Arbizu, 2016). Here relies the importance about applying a set of values to all activities related to finances, given the fact that their absence would provoke severe impacts and instabilities in a nation's economy and society.

1.1 Ethics and CSR as vital elements in the economy

Being ethics and CSR vital elements for a nation's macroeconomic and financial stability, it is necessary to have a clear conceptualization of the ethical dimension and its impact, not only in institutions or societies, but also in the socio-economic environment. An organization's sustainability should be based on transparent and honest actions. Full confidence and good prestige will determine an organization's continuity and survival. With this statement coincides (Guillen, 2005), for whom an ethical and responsible behavior is the fundamental foundation for an organization to gain trust. It has to be taken in consideration that when institutions maintain a strong commitment with their clients, they generate a better reputation. This prestige allows them to maintain clients' loyalty that remains even in times of financial crisis, thereby reducing its effects.

Also, when firms are socially responsible they exert a positive image in the environment, community's health and in the alleviation of poverty (Mendoza, Hernandez & Garcia, 2013). Being socially responsible also implies responding to social and public demands. For example, one way of being socially responsible implies making viable labor integration, as in the case of the so-called "affirmative action programs". They include giving opportunity to handicapped workers, members of minority and vulnerable groups, displaced individuals, among others.

Arnaud and Koseska (2012), emphasize the trilogy of principles closely tied to CSR: sustainability, transparency and accountability. According to these authors, such principles will lead to economic efficiency. Furthermore, firms that apply CSR in an efficient way will be able to integrate social and environmental problems, thus, contributing more to the economy. Transparency and accountability will allow organizations to be aware of their behavior and accept their responsibility. A close relationship between the firm, society and the State, is therefore established.

An additional point of view in regards to this issue is given by (Munoz, Encinar & Canibano, 2012), for whom the role of CSR in a society's dynamics, within the economy, is given by the different actions that are dispersed within the members of such society and mainly by the goals that the agents imposed for themselves. These goals are a result of ethics that have been internalized in human actions and not just a result of established norms.

1.2 Social Ethical Behavior and CSR

Confidence and prestige are essential for the sustainability of organizations. Therefore, their performance must be based on norms, ethical codes of conduct and regulations. But, nowadays, it seems that the predominant culture in the financial system is the enrichment at all cost, in accordance with the traditional principles and concepts of the classical school of economics. In all the recent crises, a predominant pattern is revealed, being an inefficient management system. For many senior executives and middle management the end justifies the means, setting aside the importance of ethics and CSR. Though, there has been a substantial difference among countries. Spain, Greece, Portugal and Italy are severely affected by this conflictive behavior, while the situation in Nordic countries differs (RobeccoSam, 2016). Such nations have heavily implemented policies concerning social responsibility towards society, thereby prevailing their citizens' economic and financial rights, which are reflected in a better quality of life, in education, health and employment.

The so-called Model of Corporate Ethical Virtues (Kaptein, 2008), is an excellent tool to stimulating an organization's ethical culture. It is based on transparency and norms, values and rules being transferred from senior executives to middle management and finally to all workers. Years later, Novelskaite (2014) applied this model to a Dutch bank, obtaining results compatible with those of Kaptein. Nevertheless, there are other factors that may influence behavior, such as religion, as in the case of Islamic banks (Nuhanovic & Barakovic, 2013). It would be very useful to apply that model to banks in Latin America to validate it or not, taking into account cultural differences.

Also, there are other strategies adopted by financial institutions, as in the case of the Hungarian National Bank. A study of its performance in 2013, (Lentner, Szegedi & Tatay, 2015), showed excellent results in applying CSR, thereby successfully achieving its triple mandate: price, financial and economic stability in the banking system.

Finally, with respect to CSR and ethical behavior, Croitor (2014), defines the first one as a concept very much related to ethical principles, therefore, it must be analyzed like a complement to ethics, not as been the same. Moral responsibility should be considered like a perennial ethical value and CSR must contribute to stockholders as well as to shareholders.

1.3 Competitiveness, ethics and CSR

Although competitiveness is the ideology that should prevail in the business world and in all economic activity nowadays, those efforts realized by institutions in order to obtain competitive advantages and generate higher productivity not necessarily take them to a better positioning or image. But, if those efforts go hand by hand with an ethical and responsible attitude, the possibilities of achieving a sustainable success will be higher. Ethics and competitiveness are not mutually exclusive elements, rather, they are an inseparable duet. In regards to this, a research done by Bockova, Broz and Dohnal (2012), in which they analyzed the performance of small, medium and large companies in the Czech Republic, they found out that those firms' competitiveness was higher when management applied ethical principles and values. The study also evidenced that when there is a positive relationship between management and employees, firms will have a solid foundation to succeed.

Another study applied to small and medium businesses in Spain (Herrera, Martinez & Martinez-Martinez), based on the stakeholders' perspective, proved a strong positive relationship between CSR and the institutional performance of an organization. The incorporation of policies involving social responsibility and actions improved the competitiveness of firms, either directly or indirectly. Another study that shows the relationship between competitiveness and ethical behavior was performed by Shleifer (2004), for whom an unethical behavior and greed are a result of a fierce competition between organizations. In such cases it is necessary to use strategies such as moral persuasion, government regulations or strong pressures.

In regards to government controls, Calvo and Mingorance (2012) mentioned that although the free market is the best system to achieve efficiency in institutions, this does not imply an absence of control by regulators. Financial authorities must apply all required controls and norms to assure a good service to the community.

In regards to CSR, the globalization and internationalization processes have also generated a very competitive environment, forcing organizations to introduce significant changes and innovations responding to their employees' requirements and society's needs. For example, a new attitude towards the ecosystem, health coverage for their employees, direct lines to attend consumers' needs or complaints, financial support to foundations, investments in the community. Firms nowadays want to present themselves as very close to society. Globalization has also been a way to transmit and impose values from one society to another, as well as from the corporation's home office to their branches in other countries (Arnaudov & Koseska, 2012), therefore, their subsidiaries may, in turn, become more competitive with those transmitted norms and values.

Also, society itself is changing the way of doing business. It is now demanding a strong participation in institutions' ethical aspects (Pinzon, Maldonado & Martinez, 2015). CSR, thereby, is a vital tool for implementing a good relationship between institutions and society. Firms' competitiveness, then, is very much tied to their ability to satisfying society's needs, mainly during economic crisis. Those firms that engage in good practices and CSR will have a better chance to overcome a financial, economic or organizational crisis. An economic recession may be an opportunity to implement responsible strategic changes (Navickas & Kountautiene, 2015).

In addition to what has been exposed, by focusing on key social and environmental issues may be a prerequisite to obtain a sustainable competitive advantage in today's markets (Petrovie, Stevanovie & Ivanovie, 2013).

To conclude on this topic, CSR implies doing business ethically, always prevailing transparency, integrity, accountability, justice and equity. Without these elements, it will be very difficult, almost impossible, for a firm to be competitive, since it would not be able to enjoy a good reputation, image and confidence in the community.

2. Methodology

The objective of this paper is presenting a theoretical analysis about this issue, based on a profound revision of the economic literature, which will allow a reflection concerning the need of ethics and CSR, both being fundamental factors, as well as the severe impact that their absence will cause in society and institutions. Likewise, the relationship between those two elements and a nation's competitiveness, innovation and sustainability will be evaluated. Statistical data from governmental institutions such as the Ecuador's Central Bank, National Institute of Statistics and Census, Bank Superintendency was analyzed, as well as those of private sector such as the Banking Association. An inductive-deductive method has been applied. Finally, the Ecuador's case will be presented, nation that experienced an ethical and moral crisis which severely affected its macroeconomic stability.

3. Results

3.1 When Ethics and CSR are omitted

Any omission of ethical principles and CSR would generate serious problems and even the rupture of a nation's democratic institutionalization. In May 2014, the European Commission (Brussels) reported several irregularities incurred by prestigious banks (JP Morgan, HSBC and Cr dit Agricole), institutions that allegedly manipulated financial indicators such as exchange rates, interest rates and other performed collusive actions, working as a cartel, to obtain large amounts of income. These illicit acts were a clear violation to the code of good banking practices, by incurring in fraud and deception, causing the instability of the European financial system.

The case of Hallmark in Bangladesh is another example of a fraud incurred by a

transnational corporation, with the complicity of a banking institution, falsifying financial statements and letters of credit. Munshi and Zaman (2012) made a critical analysis about the permissiveness shown by regulatory agencies in that country. Their study concluded that there is an urgent need to emphasizing supervisors and auditors' role model in society, based on ethics and honesty. The Hallmark case severely affected financial activity in Bangladesh.

Furthermore, the US Securities Exchange Commission (SEC, 2016), under the Foreign Corrupt Practices Act, applied severe fines to many financial institutions that committed fraudulent and deception which provoked heavy damage and financial losses to the US Stock Market. During the period 2010-2016, eighty- two multinational firms were sanctioned due to unethical practices, leading to almost 398 million dollars in fines.

The EY Global Fraud Survey (Ernst & Young, 2016), reveals a deep weakening in the fight against corruption and fraudulent acts. The survey shows that 36 to 42% of 2825 senior executives at European firms would accept unethical behavior in their organizations, if it is necessary for their survival or sustainability of their profits. Moreover, 42% of them would incurred in unethical practices if they felt under pressure. Almost 39% admitted that corruption and bribery were common practices in their countries.

The Institute of Certified Financial Analysts (Chartered Financial Analyst, 2013), also provides powerful insights from 6783 finance executives belonging to 22 nations. Results were very worrisome. Almost 56% of them identified a very scarce ethical culture in financial institutions, leading to a lack of credibility in them.

This lack of confidence in the financial system, caused by the absence of ethics and CSR would lead to a severe financial crisis and economic instability. This was proven to be true with the global financial crisis of 2007 – 2010.

3.2. The case of Ecuador, a moral and ethical crisis

In 1999, Ecuador was severely affected by a deep financial crisis which brought drastic consequences in economic, social, legal and moral aspects. Scarce or nonexistent government controls and sanctions, resulted in economic groups' intervention in all government spheres. Senior banking executives were appointed in top positions, either in the Monetary Board, the Bank Superintendence, Ministry of Finances, Central Bank, the National Development Corporation, among other institutions. Through an intense lobbying, these groups succeeded in the enactment of the General Law of Financial Institutions. Such law granted unlimited rights to banking institutions. Bankers were then allowed to open other businesses such as investment, import, export firms, as well as insurance companies, among many other type of organizations. They were even allowed to make loans between their institutions, at zero interest rate and no credit limits. Many of these credits were granted to non-existent firms, as in the case of a bank that made loans to 86 linked institutions that belong to the bank's owner, for 163 million dollars. Furthermore, the Central Bank became a lender of last instance for the banking system.

As a result of this scarce control, in 1998, there were 48 banks, compared to the 32 in 1994. Finance companies increased in almost double, from 59 to 82 during the same period, leading to an oversizing of the financial system (Mesias, 2002), thereby, generating a fierce and unfair competition among institutions. An unethical behavior became generalized. Interest rates liberalization led to offerings of about 40% interest on savings account and 100% on investments certificates up to one year. Interbank overnight rates were up to 150%. Lending rates reached 120 – 135% per year (Bravo, 2004).

In addition, many new sophisticated financial products were offered to the public that were based on pure speculation, without any type of guarantees against high risk or subject to Basil's norms. Millions of dollars and sucres (the domestic currency) invested in such instruments caused an excessive volatility in the International Reserve, leading to unprecedented losses and taking the country to a situation of insolvency.

Credibility in the financial system totally plummeted. The three main banks in the nation, Filanbanco, Progreso and Pacifico fell. The 'domino' effect followed immediately, since it led

to a loss of trust and image. Massive withdrawals of funds affected not only financial institutions but the overall economy.

At the end of 1999, almost 70% of financial institutions went bankrupt or closed. Financial losses amounted to 8000 million dollars and the government spent 6000 million in an effort to save other banks. The Gross National Product fell by 8%, while the Sucre had devaluated by 195%. Unemployment increased from 9% to 17%, while the poverty gap doubled (Paez, 2004).

It can be concluded that senior banking executives, as well as government officials very much committed to protect bankers, committed unethical actions and demonstrated a null responsibility towards society and the nation. Financial and banking crisis, as Calvo and Mingorance (2012) mentioned: "are generated by bankers' behavior, their speculative actions, their lack of professionalism and other specific factors" (p. 286).

4. Conclusions

A very extensive review of the academic literature regarding these topics has allowed this work's objective: to demonstrate the importance of CSR and ethics required by financial institutions to keep a good performance and for an economy's sustainable good health. Additionally, to evidence that financial institutions are still generating controversy concerning what is ethical and being socially responsible. There have been many positive changes in control systems through Basil II and III, but these regulations have not emphasize an ethical culture. Fiscal paradises, speculative capital investments and bubbles are present globally. Also, setting up excessively high interest rates, evidencing a lack of interest in vulnerable groups and exercising extreme political pressure are still common practices all over the world, although it is expected a continuous commitment from financial institutions and being socially responsible (Darus, Mad & Nejati, 2015).

There is still a need to perform additional analysis about the incidence of sociological and cultural factors, even with respect to idiosyncrasy, in order to obtain more information about the causes for such attempts against ethics and moral values which are drastically affecting not only society but a nation's economy. Those researches will help to find the ways to develop a solidarity culture and visible changes in values, therefore overcoming the typical classical behavior of just maximizing profits and financial returns.

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