

Application of Western and Islamic Philosophy to Business Ethics

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Abstract—The world has witnessed the collapse of many corporate giants as a result of unethical behavior in recent decades. This has induced a series of questions by the global community on why such occurrences could happen, even with corporate governance in place. This paper attempts to propose a philosophical approach from an Islamic perspective to be consolidated with current corporate governance in order to confront contemporary dilemmas. In this paper, ethical theories are presented as a discussion followed by their applications to modern cases of financial collapses. Virtue ethics by Aristotle, justice and fairness by John Rawls, deontology by Immanuel Kant, and utilitarianism by John Stuart Mill, are the four theories which can then be contrasted with the paradigm of Muslim scholars. Despite the differences between the fundamental principles of Islamic and Western worldviews, their ethical theories are aimed at making right decisions and solving ethical dilemmas based on what is good for society. Therefore, Islamic principles should be synthesized with Western philosophy to form a more coherent framework. The integration of Islamic and western ethical theories into business is important for sound corporate governance.

Keywords—Business ethics, Islamic philosophy, western philosophy, Western and Islamic Worldview of Ethics.

I. INTRODUCTION

CORPORATE governance is vital in every corporation, as it sets the framework for internal and external operations to run smoothly. Ethics are pivotal in corporate governance to ensure the highest level of moral standards and to maintain the efficacy of companies. Thus, good corporate governance entails accountability and transparency of companies to investors and having high ethical standards cultivated in its management. Ironically, despite understanding the importance of good corporate governance, many corporate entities collapsed as a result of engaging in unethical conduct, which lead to several scandals. Enron, Lehman Brothers and a litany of other companies have become household names for their involvement in business scandals that eventually lead to their financial collapse [1]. The global community questioned the effectiveness of the corporate governance in place with the financial scandals that were happening in the financial industry.

The answer may be that ethical values were ignored and the financial institutions were focusing on their goals of maximizing profits and accumulating wealth. Whilst it is perfectly acceptable to have such endeavors, it is widely

criticized when they are pursued at the expense of behaving ethically. Concealing of financial records, fraudulent accounting methods and siphoning off of company funds into private accounts, are some examples of the unethical behaviors that have become prevalent in this industry, and as a result, led to their own demise [2]. It cannot be stressed enough that ethics are paramount in the financial sector, as a high degree of integrity and honesty are needed to function well in the industry. As such, business ethical theories need to be revisited to tackle moral dilemmas faced by financial institutions [3]. These theories are often scorned at for taking the utopian view in handling dilemmas. However, these theories are applicable to be used to formulate ways for resolving these issues.

In this paper, ethical theories are discussed and applied to modern cases of financial collapses. It is argued that integrating the Islamic approach is quintessential in abating such crisis.

The paper is organized by distinguishing the Islamic and the modern worldview in part I. This comparison is essential to differentiate between Islamic ethos and the modern philosophy in the context of business ethics. Part II delineates specific ethical conducts that are current issues in corporate governance. Both Western and Islamic ethical theories are applied in relation to these conducts. The core of part III is to examine the modern financial collapse, and similar to previous section, ethical theories are employed to evaluate these cases.

II. AN OVERVIEW OF ISLAMIC AND SECULAR WORLDVIEWS

Both Secularism and Islam have their own worldviews on business ethics, the Secular worldview is based on human reasoning and interpretation of sets of values, while the Islamic worldview is based on principals that are extracted from *Shari'ah*.

A. Secular Worldview

The secular worldview for the contemporary economic system is based on human interpretations of ethical conduct in institutions. It incorporates the philosophies of various ideologies, and therefore, the worldview varies from one person to another depending on their beliefs, and the background knowledge and environment that shaped them [4]. A religious person might have a worldview based on his religious values, whilst another person who is more inclined towards science for example, will view the world under a different set of views and principles. Nevertheless, the secular worldview does not subscribe to a particular philosophy as it applies differently to each of us. Thus, ethics in the context of

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business activities remains subjective; however, it is universally accepted to behave according to what is identified as moral or immoral in society.

B. Islamic Worldview

The Islamic worldview embodies the principles which can be extracted from the three main sources: *Al-Qur'an*, *As-Sunnah* and *Athar*. The concept of *Tawhid* (Oneness of God) is the core of the Islamic economic system; this is clearly contrasted from the modern worldview which is devoid of incorporating any religious value.

The concept of *khalifah* (vicegerent) is another important concept which states that man is conferred with *amanah* (trust) on this earth when dealing with the universe and its environment. This is mentioned in the Suraah Al-Baqarah 2:30:

"Behold, thy Lord said to the angels: "I will create a vicegerent on earth."

This stewardship obliges man to act in good spirit when dealing with the resources given to them. Thus, the underlying philosophy of all human activities, including any financial activity, is towards the objective of *falah* (success) in the Hereafter.

The ethical dimension, as seen in the Qur'an on the principles pertaining to business ethics, is stated in Suraah Al-Baqarah: 283:

"...then if one of you entrust the other, let the one who is entrusted discharge his trust (faithfully), and let him be afraid of Allah, his Lord. And conceal not the evidence for he, who hides it, surely his heart is sinful. And Allah is All-Knower of what you do."

The three principles which can be extracted from this *ayaat* are justice, transparency and accountability. Islam does not condone injustice of any kind; this principle is an essential element of the Muslim faith. There should not be *zulm* (injustice) in business dealings. Transparency and accountability are elements of Islamic corporate governance, and this, are also reflected in the contemporary corporate governance. Accountability, from Islamic perspective, is to be accountable to both God as man is a *khalifah* (vicegerent) entrusted with resources, and also, *Hablumminnanas* (relationship between men), which is contractual relationship [5].

According to Beekun, there are five axioms of Islamic ethical philosophy, which is an extension of Al Ghazali's ethical work [6].

- 1) **Unity:** This is referred to as the concept of *Tawhid*. Islam holds a holistic view that combines all aspects of life such as political, economic, social and religious aspects.
- 2) **Equilibrium:** Fairness or '*adl*' in all aspects of life which will engender best form of social order.
- 3) **Free Will:** Man is allowed to act as he wishes, but it should be within the limits of *Shari'ah*.
- 4) **Responsibility:** Man is answerable to his actions in the Hereafter, thus he has to act responsibly.
- 5) **Benevolence:** Altruism and compassion that ameliorate the lives of others is encouraged but not obliged.

Therefore, the brief introduction of the five axioms of Islamic ethical philosophy shows the difference in Western philosophy.

III. ETHICAL ISSUES

The following section delineated the specific ethical conducts that are considered as current issues in corporate governance. Western and Islamic ethical theories are applied in relation to these conducts.

A. Ethics of Repricing and Backdating of Employee Stock Options

Employee stock options, widely known as stock options, are offered by employers as part of the remuneration package to especially top managers to attract, motivate and retain high level officers with the objective to increase firm performance – to boost company's stock price [7]. It works just as call options; i.e., a type of derivative instrument, where employees have the option to buy shares at the exercise date and become shareholders of the company. Reference [8] explained that stock options allow employees to purchase a particular number of common shares of company stock at a specified price (called the strike price or option price) over a specified period of time, called the exercise date. Typically,

- 1) The option grant date (option date) is chosen when the stock option price is lower than the current price. In such cases, employees are said to be 'in-the-money'.
- 2) The strike price of the stock option is set to equal the market price at the option date to avoid recording compensation expense and incurring taxable income to the recipient [8].

When the option is granted at a certain actual grant date, the company has to record a compensation expense which will give effects to the company's declaration of yearly profit. In the following examples, we describe two possible scenarios happening on the actual grant date¹ and the respective accounting record for compensation expense.

The amount of compensation expense to be recorded by Company A is as follows.

Scenario 1. The quoted market price; i.e., company closing share price on the grant date equals to option price. (In this case, employees who are granted the stock option are said to be 'in-the-money').

On 1 January, 2010, Company A granted 100,000 common shares option at an exercise price of RM 10 per share. The exercise date is on 31 December, 2014 i.e., four years from the option grant date. The company share price closed at RM 10 per share.

1/1/2010	
Market Price of Stock	RM10
Less: Stock Option exercise price	RM 10
Intrinsic: Value per share	0
Compensation expense to be recorded	0

¹ Commonly, the actual grant date is the same as the measurement date. Measurement date is the date when accounting event occurs. It is the first date when the number of option shares and the exercise price are informed to the employees.

(No of option shares X Intrinsic value per share)

4 years

Scenario 2. The quoted market price, i.e., company closing share price on the grant date is above the option price. (In this case, the employees who are granted the stock option are said to be 'in-the-money').

On 1 January, 2010, Company A, grants 100,000 common shares option at an exercise price of RM 5 per share. The exercise date is on 31 December, 2014, i.e., four years from the option grant date. Company share price closed at RM 10 per share.

1/1/2010

Market Price of Stock RM10

Less: Stock Option exercise price RM 5

Intrinsic: Value per share 5

Compensation expense to be recorded

(No of option shares X Intrinsic value per share) RM 125,000

4 years

= 100,000 X RM 5

4

In this paper, however, the discussion on the ethics of repricing and backdating of stock option is not to question or understand the implication of such treatment from the accounting perspective rather, to discuss the ethical issues arising from the manipulation of stock options for the benefits of executives-owners i.e., the employee, via repricing and backdating activity. The following section describes the definition and a brief concept of repricing and backdating of employee stock option.

1. Options Repricing

The term Options repricing refers to the reprice of previously granted stock options to a price below the current market price. Such activity is carried out when the company's stock price fell below the option price, in other words, the option is out-of-the-money, or as it widely known, the underwater stock option. Repricing of a stock option would require variable accounting treatment from the modification date which creates a negative income statement impact equal to the number of repriced shares multiplied by the difference between the original option price and the year-end market price in which such accounting treatment will continue for each year until the options were exercised, forfeited or cancelled [8]. The ethical issue derived from the repricing activity is that, when more of the stock's market price rises after the repricing, there is greater reduction in the future earnings of the company; hence, this generates a lower share price from the investors (non-employee/non-executives shareholders) perspective, repricing of the stock option has lowered the value of the shares they are holding [8]. In other words, executives-shareholders are have the advantage when the stock options are repriced; while, investors who are non-executive shareholders will be disadvantaged with the repricing.

2. Options Backdating

Backdate refers to pricing the option's price to an earlier time than the actual grant date when the stock was trading at a lower price, so that employees gain profit when the stock appreciates in value [9]. It means that the date recorded by the executive is different from the date that the board of directors actually granted the option, and in such a case, the option is recorded in-the-money. Reference [7] shows that, options backdating may arise due to clerical errors, lax record keeping, or internal control system failure of a company. However, the ethical issue concerning options backdating is not with regard to the quantitative effect of options backdating, but with the qualitative aspect; that is, if the activity of options backdating is an intentional backdating is done by manipulating accounting reports and misrepresenting the firm's performance [7].

There are extensive literatures, such as Ryan Huldah [7] and Raiborn [8], arguing that the ethics of options backdating as it is, is done at the expense of non-employees/executives (investors-owners). In other words, the top managers of the company are not acting in the best interest of the investor-owners and other stakeholders; instead, to achieve their personal interest, further posited that the backdating of grant dates is a stock option manipulation as it enables the executive to accumulate additional capital gain, and even, enables executives to benefit from the option before their actual period of service.

3. Repricing and Backdating of Employee Stock Option from Distributive Justice and Virtue Ethics by Aristotle

Aristotle's theory of justice says that everyone is equal, the proportional is what just is and what violates the proportion is unjust. The theory of virtue ethics says that an action is right if it is morally good to oneself and others [10]. While the former is easy to understand from a moral perspective, the latter focuses on good character or virtues in making an ethical decision. An ethical person would ask what sort of person would he or she be. The same situation applies for a company. An action is ethical if it demonstrates the virtues expected by the stakeholders. Integrity and transparency, courage, honesty, truthfulness, trustworthiness, loyalty, fairness, and justice are the values that should be portrayed in the environment of a company.

4. The Application of Distributive Justice and Virtue Ethics to Backdating and Repricing of Employee Stock Option

From the distributive justice and virtues ethics perspective, the action of repricing and backdating of stock options is inappropriate and unethical because shareholders (the employees/executives and non-employees) are treated differently, and such treatment manipulates and deceives other shareholders [10]. While employees and management hold the responsibility for the company's performance and financial results, they should not be exempted from company poor performance. As a consequence of the repricing activity, the investors who do not have the opportunity to have their options reset when the performance of the company is

unfavorable ended up holding a lower value of shares of the company.

From the understanding of the ethics of backdating, the management's inside knowledge discriminates all the other shareholders who do not know the good or bad news of the company performance [10]. By using the backdating strategy, the company is now acting selfishly, as it neglects non-employees shareholders in order to sustain the interest and loyalty of the employees towards the company. Supposedly, all shareholders are investors in the company and are entitled to the profit derived from the business activities of the company; hence, employees and non-employees shareholders shall not be treated differently [10]. In such cases therefore, the company fails to consider fairness and rights of all shareholders and ignoring the virtues expected by the shareholders.

5. Islamic View on Repricing and Backdating of Employee Stock Option.

In Islam, the ultimate goal of life is to achieve *falah* (success) in the world, and the Hereafter. The rule of Allah always supersedes the human's rule of life at all times and situation. In any action, a man should ask himself whether the act is good in the sight of Allah, and whether the action is the *Sunnah* of the Prophet and the practice of the *Sahabah* (*Athar*).

6. Akhlak and Distributive Justice in Islam

In dealing with others, Islam emphasizes on *akhlak* - the act that is motivated by the conscious mind to act well as what Allah and the Prophet has bestowed. Imam Al-Ghazâlî defines that the *akhlak* of human beings in this world are directed towards following the path trodden by the Prophet S.A.W and the righteous ancestors. In everyday dealings with others (human and other creations of Allah), the righteousness or the wrongness of one is towards the purification of the soul and virtues. Al-Ghazâlî gives importance to the consideration of a "public benefit" (*maslaha*) by placing it as part of *Maqasid Shari'ah* (the objectives of *Shari'ah*).

According to Syed Muhammad Naquib Al-Attas, justice implies knowledge of the right and proper place for a thing or a being to be; of right against wrong; of the mean and limit; of spiritual gain as against loss; of truth as against falsehood [11]. Islam recognized the inequality of man among others, as Allah has created men with different skills and abilities. Such differences are natural. Some are responsible and have the capacity to be in-charge of others. That is why the constitution of society includes the employer-employee relationship; capital-labor relationship etc., and therefore, employees are compensated for their work, as mentioned in the verse of the Qur'an, Surah Al-Zukhruf, 43:32:

"Do they distribute the mercy of your Lord? It is We who have apportioned among them their livelihood in the life of this world and have raised some of them above others in degrees [of rank] that they may make use of one another for service. But the mercy of your Lord is better than whatever they accumulate."

The Islamic concept is that, wealth and income should not be concentrated in the hands of a few people, rather it should be distributed – equitably distributed and shared among society as a whole.

7. Repricing and Backdating of Underwater Stock Options from an Islamic Perspective.

In our view, from an Islamic perspective, the repricing and backdating of underwater stock options is unethical. Our arguments are made on the basis that the management of the company with the knowledge of the stock price movements, would allow for the opportunity to manipulate the stock options grant price and make decisions that are not in the interest of all shareholders of the company; therefore, such actions are considered as unethical. Although the company may argue that such treatment is conducted for the company to survive in a competitive market, it does not mean that the interests of non-employee shareholders are not taken into consideration in the company's decision with regard to the sharing of the benefits of the company, as they are all shareholders of the company. The shareholders may view the company's actions as biased and not acting in the best interests of all, as such a decision ultimately shows that the integrity and virtue within the corporate's business profile is not upheld. Shareholders deserve fair treatment from the issuers of the shares, although it is legally accepted. Therefore, based on these arguments, the repricing and backdating of stock options is not considered ethical from an Islamic perspective as well.

B. Ethics and Insiders Trading

Insider trading can be defined as having access to non-public information on buying or selling securities from someone inside the company such as employees or the company's brokerages [12]. In other words, insider trading involves making deals with company stocks or bonds on the basis of information obtained, which is not yet available to the public, in order to increase one's wealth. It is about benefiting from private knowledge that has not yet been shared with the public.

There are obvious ethical issues regarding insider trading. Some market traders have access to non-public information, while others do not have access to that same information. This creates inequalities between the traders in the market.

Based on what we have stated above, we will examine the issue of insider trading from the justice and fairness point of view, and then we will judge it based on the *Shari'ah* perspective.

1. Insider Trading From a Justice of Rights Viewpoint by John Rawls

To assess the insider trading from justice perspective, we have to state that the justice concept has different meanings to different people. There are different views regarding what is considered justice and fair and to what extent such rights should be protected [13]. However, the core of justice goes in line with the concept of deontology which represents society's duty to treat everyone equally and fairly. This concept tends to

see the purpose of justice as the protection of human rights. John Rawls argues that justice cannot be judged based on consequences or utilitarianism because certain acts' consequences may be seen as greater than the violation of people's rights. Rawls considers the purpose of justice as what he called, "natural duty of justice". Thus, the utilitarianism concept cannot be applied to achieve justice because "the law or policy that maximizes aggregate welfare or overall social efficiency might also violate rights, tramples on basic liberties, distributes wealth unfairly, or be otherwise unjust". On the other hand, James Rachels argued that consequences may not be the obstacle to treat somebody just and fair [14]. Moreover, regarding the financial market, the distributive justice concept should be considered as an important factor which is defined by Robert Kolb, as "the moral justification of how the goods and ills, or cost and benefits, of a society are distributed across its members" [15]. There are many theories dealing with distributive justice concept, such as egalitarian theory which focuses on the real distribution of outcomes, other theories taking into consideration different abilities of people because some may deserve more than others due to their ability to mobilize more resource. Libertarian focuses on "right to act in accordance with right to accumulate wealth or whatever which results from those rightful actions is just. These are some other views on distributive justice that may be relevant when dealing with the ethical aspect of insider trading and whether it is just or not.

According to Rawls, justice will take place when everyone takes into account what is needed by others [16]. The social contract between individuals will provide justice despite the existence of self-interest, because such a contract ensures that all parties negotiate from the same power position. His opinion on justice is deemed by many as being more ethical but it goes in line with the contemporary financial theory that is welcomed by the majority of moral agents due to its similarities with religious beliefs that all people are created equally and should be treated just and fair, and thus, no privileges should be given to one group and deprive on others. Thus, how the justice theory could be applied to insider trading to assess the ethical level of this practice?

2. Justice Theory Applied to Insider Trading

Financial market players mostly agree on the social contract that is based on fairness and justice. The contractor's conflict in the market should solve it appropriately to maintain confidence in the market to operate smoothly and properly Reference [17] argued that the meaning of fairness in the financial market could be released when "all parties have equal access to information relevant to asset valuation but are entitled to nothing more"; this statement mentions clearly that, it is unfair to use insider information because that may lead to some participations taking advantage of others, and this may result in the market not functioning as it should. Consequently, investors will tend not to enter the market due the perceived lack of transparency. In addition to that, insider trading violates the principle of "fair game of skill". According to this principle, the more skilled trader, the more chance he will

benefit from his trading. However, with insider trading, he will benefit not because his skills, but because of access to non-public information from an "insider" in the company. Insider trading is unjust because the trader benefits not because of their skills but rather due to the unfair advantage of access to information that other traders do not have.

In our opinion, insider trading could be seen as transferring risk to others, so when the risk is transferred based on informational asymmetries or an unequal position of power, an ethical issue arises, as the risk is transferred from the knowledgeable to unknowledgeable party, who is then exposed to some degree of risk that they may not be willing to accept should the case be known. Kolb stated that when transferring, managing, or avoiding risk, it seldom paused to ask what has happened to the risk that has been escaped. Transferring risk using insider trading does not mean the risk has disappeared, but rather, it remains to harm other traders. As a result, using insider trading to transfer risk to others is not an ethical practice.

Based on the above discussion, we can state that insider trading is unjust, according to Rawls' "veil of ignorance". In his view, correct distributive justice should be the foundation of any financial market practice. If there is violation of distributive justice in the market, market players should be ethical when it comes to dealing with those who are violated. Decisively, Rawls stated that insider trading is unethical, as it violates the theory of justice which means the equal distribution of justice regarding the right to access all information by all traders whether they are inside or outside the company. According to Rawls theory, players in the market should not use inside trading to protect themselves because that may harm others. Moreover, traders have to consider the consequences of trading based on inside information because taking profit out of that is ethically questionable.

3. Islamic View on Insider Trading

Insider trading, as it is stated previously, is prohibited by Islam because it does not in keeping with the principals of trading in Islam [18]. Insider trading is against the principles of justice and fairness, trustworthiness, as well as adequate and accurate information.

4. Insider Trading and Justice in Islam

Insider trading contradicts with the principal of justice and fairness in Islam. It gives one party some advantages which may disadvantaged and harm another party. This is considered unfair as the non-public information will affect the price of the company's securities when that information is disclosed.

According to Al-Attas in his Islamic worldview, justice in Islam means to put things in the right place [11]. Everyone has to be just and fair when dealing with others. Islam came to establish justice on earth; therefore the Holy Quran contains many verses that talk about justice and fairness.

Al-Maidha, 5:8, Allah said:

"Be fair and just, this is nearer to piety (Taqwa) "in Surah Al-Hujurat, 49:9, Allah said "act justly Allah loves

those who are just.”

5. Insider Trading and Trustworthiness in Islam

The non-public information is mostly available for the insider, who is someone trusted to keep that information until such time that it should be disclosed to the public. Until then, the insider, as a trustee, is disallowed in Islam to pass on or to use this information to make someone better off because the information only belongs to the company; therefore, disclosing such information is against the teaching of Islam.

There are many verses and *Sunnah* that emphasize the principals of honesty and trustworthiness. Allah says in the Quran, Surah Al Anfal, 8:27.

“Ye that believe, betray not that trust of Allah and the messenger, nor misappropriate knowingly things entrusted to you.”

The Prophet peace be upon him said:

“The characteristics of a hypocrite are three “he tell lies when he speaks, if he makes promise he does not fulfill it, and when entrusted with something, he commits a breach of trust.”

IV. MODERN ETHICAL CASES IN FINANCIAL INSTITUTION

In order to illustrate how Islamic and western ethical theories could be applied in a contemporary corporation, we have selected two ethical cases in financial institutions, which are the cases of the demise of UK merchant bank, Barings Bank, and of US bank, IndyMac Bancorp Inc. Ethical theories are employed to evaluate both cases.

A. The Demise of Barings Bank

1. Overview of the Case

London-based Barings bank was one of the oldest merchant banks in Britain, founded in 1762 by the Baring family. Baring had been relatively stable financially and was expanding its operations in various countries [19]. However, in 1995, the action of a single trader was able to bring this corporate giant to its knees in matter of days. Nick Leeson's initial success in amassing substantial profits propelled his position to general manager at the bank. Consumed by greed to acquire more, he began to take unnecessary risks in futures trading and then concealed them in a separate account. He deceived the management about his activities and distorted records to cover his tracks. His initial loss of GBP 2 million in 1992 ballooned to GBP 827 million in 1995 when the Kobe earthquake precipitated the crash of the Asian financial markets.

This debacle brought light to the failure of internal controls and the management of Baring bank which could have otherwise detected the financial shenanigans, which is the misrepresentation of financial performance. It became apparent that supervision is paramount in all business activities, and that for effective internal controls, segregation of duties is required.

2. Deontological Ethics by Immanuel Kant

Deontology belongs to a category of ethical theories known

as normative ethics, which studies on appropriate behavior in various situations. The term 'Deontology' is derived from the Greek word "Deon" which means "duty". It is 'duty based' ethics which suggests that actions are judged based on conforming to a given a set of rules because "duty binds you to the rule" [20]. Therefore, it is a moral obligation to act according to a set of principles without the involvement of any human inclinations and desires.

Immanuel Kant theorized the categorical imperatives [3] in his book *Groundwork of Metaphysic of Morals*, which are:

- Act only according to that maxim whereby you can at the same time will that it should become a universal law.

In a nutshell, this imperative is referring to moral actions that are separate from any physical details and that any rational beings are able to use it. This categorical imperative is similar to the Prophet saying:

Don't do unto others what you don't want others to do unto you.

However, this imperative is not binding universally as it depends on different situations.

- Act in such a way that you treat humanity, whether in your own person or in the person of any other, never merely as a means to an end but always at the same time as an end.

This theory states that the end is subjective depending on each of us. However, a person should not use means such as themselves or others to reach an end that has no justice for others; thus, a person should act morally to achieve an end that is fair for everyone.

- Therefore, every rational being must so act as if he was through his maxim always a legislating member in the universal kingdom of ends.

Each person is bound to a set of universal laws which they must abide. However, in certain situations where an injustice takes place, then the person is allowed to act contrary to the laws. For example, lying is not allowed. But in cases where another person's life is at risk, then he is allowed to do so.

3. Application of Deontological Ethics to Baring Bank

In our opinion, the application of deontological ethics in analyzing the financial industry is germane as there are regulations or a set of laws given to abide by. Applying the three categorical imperatives as discussed above, it is clear that Leeson acted beyond the financial means of the company. His initial success in attaining profits spurred him on to acquire more, a move that was done at the expense of risking his company's assets. Instead of using his position as general manager for the bank's benefit, his greed allowed him to trade more assets which resulted in massive losses. Kant's first theory of "don't do unto others what you don't want others to do unto you" is relevant, implying that had his private assets or wealth on the line, he would have been more careful in making such decisions. His reckless behavior resulted in the bankruptcy of Baring Bank, which also would have lead to other employees of the bank losing their jobs. The second categorical imperative is applicable in this situation as his greed to obtain more wealth was at the expense of other

people. Kant stated that people should not be exploited by other people. The exploitation of people is unjust to them.

Lastly, according to Kant, we are bound to universal laws unless in some situations it would adversely affect other parties. Lying and creating fake accounts to conceal the bank's losses are not considered as being bound to universal laws as his actions were to hide the shenanigans he had done. He should have been upfront about his activities even if this means losing his job.

4. The Ethics of Bearings Bank from Islamic Perspective

Although Kant's duty-based approaches seemed to be in line with Islamic principles, there are some differences in Islamic ethical concept [6]. According to Kant, the duty is based on universal laws and acceptance by every rational being. Acting upon our desires or for personal agendas is not morally worthy.

In Islam, acting upon our desires are judged too, as mentioned in the Hadith as narrated by Amirul Mu'minin, Abu Hafs 'Umar bin al-Khattab radiyallahu 'anhu, who said: I heard the Messenger of Allah, S. A. W, said:

"Actions are (judged) by motives (niyyah), so each man will have what he intended. Thus, he whose migration (hijrah) was to Allah and His Messenger, his migration is to Allah and His Messenger; but he whose migration was for some worldly thing he might gain, or for a wife he might marry, his migration is to that for which he migrated."

Thus, Islam acknowledges that it is imperative for a Muslim is to have good intentions. However, in comparison to Kant's theory, good intentions should be based upon Islamic law. A good intention if is to commit an unethical action, is not deemed as ethical.

Furthermore, to commit a forbidden act for the sake of a good outcome is also not allowed. For example, giving *dawah* is a praiseworthy act however if it is done by mixing forbidden acts, then it is not allowed. In a nutshell, the end does not justify the means.

5. Application to Baring Bank Case Using the Ethics of Imam Ghazali

Al-Ghazali's ethics are similar to the deontological ethics. He had pointed out specific duties pertaining to business conduct and some that are discussed by [21].

- The duty of individuals is to avoid behaving in a manner that will cause harm or injustice to others.
- The duty to be honest in transactions by not praising a commodity for its quality, which is not a true reflection of it. Also, defects of the commodity should not be hidden.
- To behave in a way that benefits the other party is considered as a higher duty of individuals.
- To be reminded of the Hereafter (Aakhirah) in all business transactions.

From our understanding, Al-Ghazali's ethical philosophy is similar to Kant's categorical imperatives, as he was concerned with ethical behavior between partners in business transactions to avoid harm caused. In the case of Baring bank, the analysis

is identical to Kant such that Leeson's behavior had resulted in bankruptcy and loss of jobs. He should have been honest with his dealings from the start; especially, if the losses in his trading were starting to get out of control. This could have prevented the Bank from insolvency by managing the damage done.

Leeson may not subscribe to Islamic principles, and thus he will not be concerned about being questioned in the Hereafter. However, to inculcate that fear of losing something valuable as a result of unethical action could prevent one from doing so. The laws have specified the punishments for unethical behavior which in Leeson's case, he was imprisoned for six years. In our opinion, tightening of laws by increasing punishments might prevent future misdemeanors.

B. The Fall of IndyMac Bancorp Inc

In July 2008, IndyMac Bancorp Inc. collapsed as a result of subprime lending. The bank had given loans to customers/borrowers without requiring proper documentation or statement of income and assets of the borrowers. Ironically, the Office of Thrift Supervision (OTS), who was the regulator at that time, allowed IndyMac to backdate a capital infusion from its parent company so that the bank maintained its well-capitalized status. Two ethical questions are developed from this case. First, is it ethical to give out loans to customers without knowing the customer's financial position and its ability to repay the loan as stipulated in the loan agreement? Secondly, is it ethical to allow financially unstable institutions to mislead the stakeholders?

1. The Ethics of IndyMac Bancorp Inc. From Teleological (Utilitarianism/Consequentialism) Perspective by John Stuart Mill

John Locke (1632-1704), Jeremy Bentham (1748-1832), James Mill (1773-1836) and John Stuart Mill (1806-1873) are English philosophers who examined ethics from a teleological perspective. Teleology comes from the Greek word *telos*, which means end, consequence, and results. Teleological theories study ethical behavior in terms of the results or consequences of ethical decisions [22]. According to the theory, an action is right if it promotes the best consequences that promote the greatest pleasure for all people who will be affected by the decision. The utilitarian or consequentialism theory analyzes the case as to what would be the implications of the bank's action to the stakeholders of the company – IndyMac's employees, which include top management, OTS, IndyMac's investors, IndyMac's customers, the communities that IndyMac served such as charitable institution as part of the bank's Corporate Social Responsibility, etc., and from the this point of view, this subprime mortgage is obviously unethical since it has caused misery on the side of the bank itself as well as other stakeholders [2]. As a result of IndyMac's aggressiveness in lending, the bank purposely ignored the capability of the customers to pay the extended loan. In the end, because of greed and its ignorance of credit risks, IndyMac suffered severe liquidity crisis.

To answer the question of whether the bank's action to

mislead stakeholders by portraying the bank as being in a stable condition is ethical or unethical, the utilitarian/consequentialism look at what would be the impact or implications to the stakeholders of the bank [2].

- To the employees and management of IndyMac who were aware of the impending collapse before it actually occurred, guided by their optimist projection that the bank would recover from capital deficiencies, such action was done to maintain its reputation and credibility in the eyes of the stakeholders. By obtaining approval from the OTS to backdate capital infusion from its parent company, the bank may defend such action on the basis that it was part of the bank's efforts to sustain its operation i.e., to avoid losing its well-capitalized status.
- To the OTC, i.e. the regulator's decision to allow the bank to backdate a capital infusion caused its reputation as supervisory authority to deteriorate because the bank finally collapsed.
- With regards to the treatment given by the supervisory authority, i.e. the OTC, the ethical concern is that, by allowing IndyMac Bancorp to post the backdated entry, the bank has misled the investors' perception on the bank's real performance. Though the bank's employees were informed or knew the actual status of the bank, with such back-up and opportunity to hide the real situation, the investors who were the primary stakeholders of the bank were unaware of the bank's capital deficiencies.

Therefore, to the investors as well as customers/depositors, the bank had betrayed their trust to ensure accountability and fiduciary duty as well as transparency in providing them the up-to-date information and performance of the bank.

- To the bank's charitable institution that it served, IndyMac was not able to continue its corporate social responsibility contribution hence affected them too.

As utilitarian or consequentialism argues that the best ethical alternative is the one that will produce the greatest amount of net pleasure to all stakeholders, the act of subprime mortgage and hiding the true situation of the bank are unethical.

2. The Ethics of IndyMac Bancorp Inc, From Islamic Perspective

Despite the similarities between the Islamic and secular ethical view on IndyMac case, still there remarkable differences in approaching this case, in our opinion, Islamic approach seems to be more comprehensive. According to *Shari'ah* teaching, the violation of ethics In the IndyMac case, does not restricted only to the consequences of management actions, but more than that, the actions themselves are not ethical in Islam due to the violation of some Islamic principles. The IndyMac management performs some unethical practices which are considered against the ethics of Islam. In the IndyMac case, there are some Islamic principles are violated such as being greedy, saying lies, and non-accountability which are unethical according to Islamic teachings.

3. Being Excessive Greedy

It is obvious that, IndyMac was blinded by greed to the extent that it gave out loans without respecting any requirements for assessing the credit risk. The Center Responsible Lending's (CLR) investigation shows how the IndyMac is greedy when it is dealing with giving loans to customers who are not reliable to pay back the loan. For example, the Ben Butler, an 80-year-old retiree, received a loan to build a house [23]. Greedy practices such as this lead to the collapse of IndyMac.

Ethics from the Islamic perspective are totally against being greedy. The holy Quran and *sunnah* have clearly mention that people should seek wealth without being greedy because nobody will take more than what Allah has described for him before the time he is born. Allah says in Suraah Hud: 11:6,

"There is no living creature on earth that does not receive sustenance from God. He knows its dwelling and resting place. Everything is recorded in the glorious Book."

It is narrated by Jabure Abin Abdillah on the authority of Ibn Maja that the Prophet (PBUH) said that:

"Obey Allah and seek wealth without being greedy."

4. Lying

It had been reported by the CRL that IndyMac gave the loans based on false or fraudulent information. IndyMac inflated the incomes of its customers to justify giving out loans excessively [23]. The report stated that "The maximum Social Security benefit at the time was barely half that. Mr. Butler had no idea his income had been inflated by IndyMac or the mortgage broker who arranged the deal, his attorney maintains. Even if IndyMac was not the one that puffed up the dollar figure, the attorney says, it should have easily caught such an obvious lie."

Looking at the Islamic view on this issue, we find that Islam does not tolerate any kind of deception. Lying is totally against the Islamic teaching. Allah say in Holy Quran Suraah As Saff: 2-3:

"O you who have believed, why do you say what you do not do? Great is hatred in the sight of Allah that you say what you do not do."

It is narrated by Abu Hurayra in Bukari and Muslim that the Prophet Mohammed (PBUH) said that:

"The signs of the hypocrite are three: when he speaks he lies, when he promises he breaks his promise and when he is entrusted he betrays the trust."

5. Accountability

In the case of the IndyMac crisis, there was no accountability management policy to manage the fund and risk. There was also abuse of positions and the taking advantage of the institution to enrich unrealistic targets. In addition, IndyMac was engaging in extraneous loan activities which competed/interfered with or constrained a bank's primary responsibility. This brief note is aimed at deciphering what happened.

Accountability is an important aspect in Islam. According

to Islamic teaching, “all Muslims should obey all commandments and keep away from all he is forbidden to do and to worship God alone with no partners”. Islam sees every one as responsible for himself toward Allah and toward everyone who deals with.

V.CONCLUSION

Islam is a holistic religion which encompasses even the ethical values that are required when dealing with each other. Therefore, we have seen that although Western philosophy has contributed to the ideal ethical conduct in business, Islam's contribution is as significant. However, this does not mean that we should completely dismiss Western philosophy. Instead, the integration of both Western and Islamic ethics into business is crucial for the financial industry. Ethical issues such as “Reprising and Backdating of Employee Stock Options” and “Insider Trading” can give a better understanding about how Islamic and Western ethical theories could be applied. For the reprising and backdating of employee stock options dilemma, the most suitable theories from the western perspective are distributive justice and virtue ethics by Aristotle. As this theory focuses on equality, therefore, giving advantages to some investors is inappropriate and unethical because the investors should be treated equally. Islamic views that wealth and income do not fall in the hands of only a few people, rather it shall be distributed – equitably distributed and shared. Therefore, based on these arguments, the reprising and backdating and stock options are not ethical from the Islamic perspective as well. Consequently, the insider trading dilemma is unethical from the justice theory perspective which focuses on not taking advantage from closed information to harm others. Islam as a religion of justice, its principles disallowed practices such these and considered them as unethical actions.

In order to be more precise on how Islamic and Western ethical theories could be applied in the Modern Corporation, we have selected two modern ethical cases in financial institution. Firstly, The Demise of Barings Bank case, by applying Deontological ethics we can see that Leeson acted unethically as his actions, which resulted in bankruptcy for the company. From an Islamic view, he acted unethically, as he acted upon his desires and personal agenda, which are not morally accepted by Islam. For the IndyMac Bancorp Inc. case, the practice was unethical from teleological (Utilitarianism/Consequentialism) perspective because the consequences of management actions were catastrophic for all stakeholders of the IndyMac bank. Looking at it from the Islamic perspective, the actions of management were unethical because they stemmed from greed and were based on lies.

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