



# The need to make ethics part of finance: a new dimension in corporate governance in Latin America

Ethics in Finance, Robin Cosgrove Prize  
Iberoamerican edition 2012-2013

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Today's world is governed by modern capitalism, which has led us to seek the innovation, ambition and stimuli that the system has generated. Technology and globalization have caused profound, dynamic changes, and the rules of morality have been pushed aside. Meeting financial targets has become the main concern of major businesses and financial institutions, at the expense of social conscience and market integrity. The financial scandals and levels of corruption seen in various parts of the world have revealed a crisis of ethics, which in turn has led to a loss of trust in capital markets. Capitalism has cannibalized countries' real economies, leading to a concentration of wealth among a global economic elite and exaggerated growth in speculation in securities on financial markets. Politics has become the financial markets' closest ally, for it has proved incapable of controlling

such phenomena as tax evasion and economic crises. An ethical frame of reference that will encourage honest conduct towards society is therefore urgently needed.

Although ethical finance has a long history, it is only in the present circumstances that its potential as a strategy for change and transformation in the business world has started to be appreciated. The declared aim of ethical finance is to raise awareness not only of economic issues but also of social and environmental ones, and to consider the interests of shareholders and the other agents or interest groups associated with businesses. Hence the proliferation of voluntary codes of conduct and good governance designed to reinforce ethical and social principles. At the same time, international institutions such as the Organization for Economic Cooperation and Development (OECD) and the World Bank, as

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Atteindre les objectifs financiers est devenu la principale préoccupation des entreprises et institutions financières. Les scandales financiers et de corruption ont révélé une crise de l'éthique, ce qui a entraîné une perte de confiance dans les marchés financiers. Un cadre de référence éthique pour encourager un comportement honnête envers la société est donc urgent.

L'objectif de la finance éthique est de susciter l'intérêt aux questions économiques, sociales et environnementales. Malgré l'intervention d'institutions internationales comme l'OCDE et les gouvernements, avec l'élaboration de lois et codes de bonne gouvernance, l'éthique financière ne fait encore partie de la gouvernance d'entreprise. Ce constat s'applique aussi à l'Amérique latine, où l'importance accordée à la finance éthique reste faible.

well as national governments, have been active in drawing up laws and codes of good governance. Yet financial ethics is still not clearly part of corporate governance.

Despite the progress and growing importance of corporate governance in Latin America, there is an awareness gap regarding the role and importance of ethical finance as part of good governance in business. In general, the major debates on corporate governance by international institutions such as the Latin American Institute of Corporate Governance or the Round Table on Corporate Governance have focused on such matters as the structure of ownership, the missions and responsibilities of boards of management, and market situations. Little attention has been paid to ethical finance.

This paper will discuss the importance of making ethics part of finance, as a strategic dimension of corporate governance in the emerging countries of Latin America. In this connection it will propose a set of good ethical practices in finance that can be applied to every sector of the economy, and will attempt to answer the following questions. How do we ensure ethical conduct in finance in the emerging countries of Latin America? And how is compliance with financial ethics to be measured in the Latin American region? The paper is also an appeal to the institutions responsible for drawing up regulations and codes of corporate governance, so that ethical finance will become a topic of debate at regional and local level.

## Ethics in finance and corporate governance

When we hear the word 'ethics', we think of a set of moral principles and values designed to promote justice and respect among the members of society. We can also distinguish between acceptable conduct and unacceptable conduct which, in certain situations where ambition is involved, can lead us to make wrong decisions. Ethics is also centred on the old positivist argument about 'being' versus 'having to be'. Business ethics has a multidisciplinary focus, with roots in philosophy, law, economics, psychology and political science. The aim of ethical finance is to curb the unbridled pursuit of selfish interests, setting limits to the gains that businesses may seek to achieve or increase (Ghosh, Ghosh and Zaher, 2011). Even though business ethics has been extensively debated over the past 35 years, we are now facing a global crisis of ethical awareness. Priority must therefore be given to promoting an ethical economic environment based on healthy markets, a fair negotiating environment and efforts to increase trust and integrity.

Corporate governance has become a competitive tool in present-day organizations. Its purpose is to restore trust in markets, which has been undermined by financial agents' unethical conduct. Money laundering, manipulation of accounting data, the housing bubble, high salaries for senior executives and ex-



Ce texte se concentre sur l'importance d'intégrer l'éthique dans la finance, comme dimension stratégique de la gouvernance d'entreprise dans les pays émergents d'Amérique latine. C'est aussi un appel aux institutions en charge des règlements et codes pour que le sujet fasse partie du débat au niveau local et régional.

Le terme «éthique» implique un ensemble de principes et valeurs morales visant à promouvoir la justice et le respect entre les membres de la société. Au niveau des affaires, il s'agit d'une approche multidisciplinaire, avec des racines dans la philosophie, le droit, l'économie, la psychologie et les sciences politiques. La gouvernance d'entreprise vise à restaurer la confiance sur les marchés, affectés par une conduite des financiers contraire à l'éthique.

ponential growth in the derivatives market have been contributing factors in the recent financial scandals that have damaged the reputations and integrity of such major banking institutions as HSBC, Barclays, JP-Morgan, Citigroup, Deutsche Bank and Bankia. At the same time, the current financial crisis in Europe has been largely attributed to the misbehaviour of the banking sector. That is why various international institutions have been actively involved in drawing up regulations and codes of good governance, in order to bring this critical situation, and what has been termed the 'casino economy', under control.

### The proliferation of codes of good governance in the world

In recent years there has been a substantial increase in codes of good governance. By mid-2008, for example, 196 codes of better corporate practice had been drawn up in a total of 64 countries, including in the Latin American region (Aguilera and Cuervo-Cazurra, 2009). Codes of corporate governance are strategic guides to business management and an effective substitute for weak legal regimes, especially where there is inadequate protection for minority shareholders.

'Corporate governance' refers to the ways in which businesses are run and supervised. Its main goal is the voluntary adoption of better corporate practices that enhance the efficiency of the organizational structure

and improve the decision-making process. It focuses on effective supervision, business efficiency and the responsibility of management towards interest groups. The most common aspects of corporate governance are (1) membership and performance of boards of management, (2) shareholders' rights, (3) conflicts of interest, (4) hostile takeovers and (5) transparency of information. Yet financial ethics is not yet a standard part of codes of corporate governance, but has been confined to the occasional, voluntary adoption of a code of ethics or conduct and the exercise of due diligence and loyalty by board members. Due diligence means acting in good faith and in the best interests of society, while loyalty concerns the confidentiality of corporate information.

Corporate governance is essentially based on three disciplines: law, administration and finance (Ryan, Buchholtz and Kolb, 2010). The legal aspect concerns the implementation of contracts between the shareholders in a business. The administrative aspect has recently focused on matters relating to directors' membership of different boards, management of institutional investors, the consultancy role of CEOs, remuneration of executives and its relationship to the business's environmental performance. Finally, the financial aspect has focused on empirical studies that have attempted to link up the dimensions of corporate governance on company results and topics related to ethics and trust

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Les codes de gouvernance d'entreprise sont des guides stratégiques de la gestion de l'entreprise et un substitut efficace pour les régimes juridiques faibles.

Les aspects les plus courants de la gouvernance d'entreprise sont la performance du management, les droits des actionnaires, les conflits d'intérêts, les OPA hostiles et la transparence de l'information. L'éthique financière, elle, n'est pas encore un élément standard des codes de gouvernance d'entreprise.

Alors que la gouvernance d'entreprise repose essentiellement sur trois disciplines, le droit, l'administration et la finance, elle doit inclure un cadre financier éthique pouvant rendre les entreprises plus conscientes des enjeux sociaux. Très peu de règles de gouvernance concernent la performance éthique des organisations en Amérique latine.

Pour promouvoir la finance éthique, il faudrait adopter un code qui lui serait intégralement dédié.

in markets, conflicts of interest and independence when making decisions. Today's corporate governance needs to include an ethical financial framework that can make businesses more aware of social issues.

### The ethics of corporate governance

According to Rossouw (2009), ethics in corporate governance means the ethical values that shape and guide good governance in both legislation and business – in other words, it reflects the values that direct and guide the system of corporate governance. Although most codes of good governance emphasize the importance of supervisory mechanisms (boards of management and support committees, accounting practices, risk management and corporate transparency), very few include instruments that can measure and monitor the organizations' ethical performance. Although codes of corporate governance recommend that businesses adopt a code of business ethics, ethical finance is not yet part of corporate governance, at least in the Latin American region.

Ethics can be manifested at two levels. The first is the basic approach to ethics in the various corporate governance regimes. The other is the governance of corporate ethics, whereby businesses are required or advised to manage their own ethics. Ethics in finance could initially be boosted by make it an integral part of laws and codes of corporate go-

vernance, and it would be useful if businesses were to issue an annual report on their financial ethical performance towards society. Internally, businesses could focus on institutionalizing ethical values among their staff. This could be reflected in ethical management and programmes or strategies to promote ethical finance. One way to do this is to adopt a code of ethical finance.

### The current state of ethics in finance and corporate governance in Latin America

Minority shareholders in Latin America are poorly protected, and squeeze-outs are a major problem (Chong and López-de-Silanes, 2007). Legal and good governance mechanisms are often inefficient or non-existent, and this has led these countries to strengthen their institutions and adopt voluntary codes of good governance. Despite the corporate governance mechanisms adopted in the region, we still find concentration of ownership and partial government ownership of businesses, powerful elites or influential families that have significant control over businesses' capital, and scant protection for minority shareholders. Over the past decade, corporate governance has become a much more prominent issue in emerging Latin American countries such as Argentina, Brazil, Chile and Mexico. It was after the OECD published its principles in 1999 that these countries drew up their own regulations and codes of good governance. The



Depuis 10 ans, la gouvernance d'entreprise est devenue un enjeu très important dans les pays émergents d'Amérique latine.

J'ai analysé les codes de bonne gouvernance des quatre pays émergents les plus importants d'Amérique latine, pour identifier leurs caractéristiques de l'éthique des affaires.

En Argentine, le code de bonnes pratiques de gouvernance prévoit notamment de nombreux points relatifs à l'éthique dans le chapitre consacré à la lutte contre la corruption.

Au Brésil, le même code concerne surtout une dimension de gouvernance d'entreprise portant sur la conduite des affaires et les conflits d'intérêt.

stated aim of these is to promote transparency and efficiency in markets, protect and facilitate the exercise of shareholders' rights, guarantee fair treatment of shareholders, acknowledge the rights of stakeholders, ensure the dissemination of corporate information and guarantee businesses' strategic orientation and effective supervision of management and shareholders by boards of management. Ethics in finance is not included in the principles published by the OECD as an essential part of good governance. I have therefore analysed the codes of good governance in Latin America's four most important emerging economies, identifying the following features of business ethics.

Argentina's Code of Best Governance Practices for Organizations prescribes that the supervisory committee, together with legal advisors, must assess the effectiveness of the company's programme for detecting and preventing infringements of the law and its own code of ethics. As regards social responsibility, it recommends the adoption of environment policies, protection of intellectual property, policies to combat bribery and social investment policies. The policies to combat bribery contain the most important ethical features, such as promoting ethical standards and declaring an unswerving determination to comply with them in the regular course of business, to train company staff in civic ethics and social responsibility, as part of a ma-

ajor educational effort at all levels of the community, and to set up ethics committees within the company, in order to identify and settle conflicts that arise between employees and officials. The document does not mention the adoption of a code of conduct.

Brazil's Code of Best Corporate Governance Practices includes a corporate governance dimension dealing with conduct and conflicts of interest. It refers to a series of topics related to ethics, with a recommendation to adopt a code of conduct applicable to directors and employees, suppliers, shareholders and interest groups. The code of conduct should also specify the company's environmental and social responsibilities. The ethical features of the code mainly concern compliance with laws and payment of taxes, transactions with related parties, appropriate use of company assets, conflicts of interest, use of insider information, policy on trade in company shares, legal and arbitration processes, prevention and handling of fraud, questionable payments made or received, receipt of gifts or favours, donations, political activities, right to privacy, nepotism, the environment, discrimination in the workplace, sexual or moral harassment, safety at work, exploitation of adults and child labour, relations with the community, and use of alcohol and drugs.

Chile does not have a code of good governance, but relies on stric-

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Le Chili ne dispose pas d'un code de bonne gouvernance, mais s'appuie sur des lois plus strictes. Mai il n'y existe pas de dispositions claires concernant l'éthique des affaires.

Au Mexique, le code de pratiques exemplaire encourage les entreprises financières à élaborer leur propre code de déontologie et les principes de responsabilité sociale des entreprises.

Les codes et règlements actuels des quatre pays doivent donc être renforcés s'agissant de l'éthique des affaires et surtout de l'éthique de la finance.

L'objectif de ce texte est d'encourager l'intégration de la finance éthique dans le cadre de la gouvernance d'entreprise, via la législation et les codes de bonne gouvernance, et en même temps de proposer un indice de performance éthique relatif à l'engagement éthique et la prise de conscience du marché.

ter laws such as the New Corporate Governance Act (Act No. 20382) or the Share Acquisition (Public Offers) Act. The former act does not require businesses to adopt a code of ethics or conduct. Section 61 stipulates a major prison term for anyone spreading false or tendentious information in order to mislead the stock market, with an increased penalty for those whose function, position, activity or relationships may give them access to insider information. However, there are no clear provisions on business ethics.

Finally, Mexico's Code of Best Corporate Practices states that the duties of the board of management include encouraging the company to draw up its own code of ethics and principles of corporate social responsibility. For its part, the supervisory committee is responsible for verifying compliance with the code of ethics and the mechanisms for disclosing unlawful conduct and protecting whistleblowers. The code recommends that every business should have a document laying down rules of conduct for board members. However, it does not state general guidelines for such codes of conduct.

We may conclude that the present codes and regulations in all four countries need to be reinforced when it comes to business ethics, and especially ethical finance. Although the Brazilian code is the most detailed in this regard, Brazil has no mechanisms to ensure compliance.

## Proposal for a new ethical finance dimension in Latin America's codes of corporate governance

The purpose of this paper is to encourage the inclusion of ethical finance as part of corporate governance in legislation and codes of good governance, and at the same time to propose a financial ethical performance index that displays businesses' ethical commitment and awareness to the market. The proposal is based on the work of Choi and Jung (2008), which identifies the following basic features of corporate ethical performance: (1) commitment by senior management to emphasize the importance of ethics in business, (2) ethical conduct based on a formal, normative philosophy within businesses, (3) a disciplinary system that severely penalizes unethical conduct; (4) a code of ethics, (5) allowing employees to report unethical conduct anonymously, (6) developing a programme of ethical education, training and workshops in the workplace to improve employees' ethical standards, (7) devoting a substantial proportion of the business's profits to philanthropic causes, (8) the existence of an independent, official department of ethics, (9) giving employees help on matters relating to business ethics via an open communication line or channel, (10) setting up an ethics committee, and (11) developing and implementing a system of ethical assessment by an



Je propose que la dimension de la finance éthique soit incluse dans les codes latino-américains de la bonne gouvernance et de la législation, avec un indice visant à améliorer et mesurer la performance des entreprises en matière de finance éthique.

Il est également essentiel que les entreprises et institutions bancaires établissent un rapport annuel sur la conformité.

Il est devenu nécessaire de promouvoir et mesurer le comportement éthique des décideurs financiers, et d'encourager les entreprises et institutions à s'engager pleinement dans un processus de finance éthique.

La transparence des entreprises est un outil stratégique pouvant encourager la pratique de la finance éthique, car une plus grande transparence contribue à lutter notamment contre la corruption. L'intégrité et la confiance sont des principes devant faire partie des mécanismes actuels de gouvernance d'entreprise.

independent body that is external to the business.

Rossouw (2009) acknowledges that social standards may informally influence corporate conduct. In particular, ethics in corporate governance is determined by the ethical values and practices adopted by the society in which the business is operating. The internal and external dimensions of corporate governance therefore need to be in line with prevailing social and cultural standards. Fernández (2004, p. 13) identifies the importance of and need for an ethical framework in financial activity and in businesses' corporate governance, and states that 'financial activity has an undeniable and irreplaceable ethical dimension' – failing which its very existence would be jeopardized.

In view of all this, and in the absence of ethical awareness in markets, this paper proposes that an ethical finance dimension be included in Latin American codes of good governance and legislation. The index comprises nineteen items designed to enhance and measure businesses' performance in matters of ethical finance. This is then divided into five sub-indexes: institutional commitment; establishment and operation of a financial ethics committee; transparency and measures to combat corruption; environmental issues; and a system for assessing financial ethics. The index is based on previous literature and the Argentinian, Brazilian, Chilean and Mexican codes of good governance. It is recommended that the

index be applied to those responsible for financial management in both industrial and banking/financial businesses in Latin America. Besides making ethical finance an integral part of corporate governance, it is also vital that businesses and banking institutions quoted on the stock market report annually on compliance. Each item on the index is assigned a value of 1 if it is adopted and published by the business, and 0 if it is not. The index is based on the comply-or-explain principle, like the corporate governance practices set out in the codes. Details of this proposed ethical finance dimension in codes of good governance and codes of conduct for businesses are set out in Figure 1.

## Conclusions

This paper has mentioned the absence of an ethical finance dimension in codes of corporate governance, as reflected in the increase in corruption indexes and financial scandals in major businesses. This has affected integrity and trust in markets around the world, triggering an ethical crisis in the financial sector. Hence the concern to promote and measure the ethical behaviour of financial decision-makers. The purpose of the proposal to include an ethical finance dimension in codes of good governance and legislation on Latin American stock markets is to encourage businesses and institutions to commit themselves to ethical finance.

Annual publication of the ethical

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Les organismes et institutions doivent devenir plus conscients, socialement et éthiquement, afin d'atténuer la crise actuelle de l'éthique financière.

finance index on markets and among interest groups will also compel businesses to improve and increase their commitment to society. This paper has suggested a first step towards an ethical finance rating for the Latin American region, and it is hoped that this will be further developed and adapted in various contexts.

We may conclude that corporate transparency as a dimension of corporate governance is a strategic tool that could encourage the practice of ethical finance. Greater transparency helps to curb corruption, promote accountability by business managers and disclose the most tangible unethical activities to the outside world. The main contribution of the paper should not just be to propose an ethical finance index and its inclusion in codes of good governance and legislation, but that the index

should become a frame of reference when making decisions on whether to invest in ethical or unethical businesses, assessing the social value of businesses and deciding what incentives business should receive from governments. In other words, it should become a valuable, informative element for owners and managers of businesses and institutions, giving all companies an incentive to improve their ratings. Corporate governance is a major defence against unethical conduct. Integrity and trust are principles that could become part of the current mechanisms of corporate governance. There is a need for businesses to become more ethically and socially aware, in order to alleviate today's crisis of financial ethics. •

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Figure 1. Ethical finance index as a new dimension of corporate governance		
A) Institutional commitment	B) Ethics committee	C) Transparency and measures to combat corruption
1. Promoting ethical standards and compliance with them 2. A formal and normative philosophy based on financial ethics 3. The business's financial and fiscal responsibilities 4. A disciplinary system to deal with unethical conduct 5. A code of financial ethics/conduct	6. Establishment of a financial ethics committee 7. Clear details of the committee's functions and role 8. Appointment of an external inspector or rating agency	9. An anonymous, open communication channel for reporting unethical financial conduct 10. A training programme on financial ethics and social responsibility 11. Policies to combat bribery 12. Policies on use of assets 13. Conflicts of interest 14. Legal and arbitration processes 15. Prevention and handling of fraud
D) Environmental issues		E) System for assessing financial ethics
16. Environmental policies 17. Policies and procedures for protecting intellectual property 18. Social investment policies 19. Profits devoted to philanthropic causes		20. Internal system for periodic review of the effectiveness of the programme 21. Development and implementation of a system of ethical assessment by independent third parties

*Source: My own index, based on Choi and Jung (2008) and the four countries' codes of good governance*