

## The role of ethical behavior of corporate governance in addressing the global financial crisis

Djillali Bouzekri<sup>1</sup>, Kouider Bouragba<sup>2</sup>, Rym Omri<sup>3</sup>

<sup>1</sup>Tissemsilt University(Algeria), bouzekri.djillali@cuniv-tissemsilt.dz

<sup>2</sup>Ziane Achour University of Djelfa(Algeria), kouider.bouragba@univ-djelfa.com

<sup>3</sup>Tébessa University (Algeria), rymomri1990@hotmail.fr

Received: 03/12/2021

Accepted: 13/12/2021

Published:31/12/2021

### Abstract:

The study aims to achieve a number of objectives, an attempt to highlight the relationship between ethical behavior and the principles of corporate governance and the occurrence of the global financial crisis. and trying to diagnose the global financial crisis by highlighting the reasons of its occurrence and its effects

The study concluded that global financial crisis is caused by the lack of respect of corporate governance principles, including the abandonment of ethical behavior. and the follow of sound principles of corporate governance leads to create the necessary precautions against corruption and mismanagement while promoting transparency.

**Keywords:** Corporate governance; corporate governance standards; Ethical behavior of corporate Governance; the global financial crisis

**JEL Classification Codes:** G23, G34

ملخص:

تهدف الدراسة إلى تحقيق جملة من الأهداف، وفي مقدمتها محاولة إبراز العلاقة بين السلوك الأخلاقي ومبادئ حوكمة الشركات والأزمة المالية العالمية. ومحاولة تشخيص الأزمة المالية العالمية من خلال إبراز أسباب حدوثها وآثارها. وخلصت الدراسة إلى أن الأزمة المالية العالمية سببها عدم احترام مبادئ حوكمة الشركات، بما في ذلك التخلي عن السلوك الأخلاقي. ويؤدي اتباع المبادئ السليمة لحوكمة الشركات إلى خلق الاحتياطات اللازمة ضد الفساد وسوء الإدارة مع تعزيز الشفافية.

كلمات مفتاحية: حوكمة الشركات، معايير حوكمة الشركات، السلوك الأخلاقي لحوكمة الشركات، الأزمة المالية العالمية.

تصنيفات JEL: G23, G34

Corresponding author: Djillali Bouzekri, e-mail: bouzekri.djillali@cuniv-tissemsilt.dz.

## **1. Introduction**

Current global financial crisis led to the occurrence of many companies in crises that made them suffer from financial hardship, and many of them declared bankrupt, in order to avoid the bankruptcy of the rest of the financial institutions and bodies many countries rushed to inject necessary liquidity to save what can be saved.

The situation reached by these institutions stems from the lack of commitment by their managers to the principles of corporate governance, especially those principles related to the ethics of business through the exaggeration in granting bonuses and rewards, ignoring their miserable financial situation and indifferent to the principles of corporate governance and the standards that are required to be applied, such a disposition is considered immoral in the eyes of everybody.

### **Research problematic:**

Through the above introduction it appears the milestones of the research problematic as follows:

**What is the role of ethical behavior of corporate governance in addressing the global financial crisis?**

### **Sub-questions:**

Besides the fundamental question of the general problematic, we can ask the following sub-questions:

- What is the concept of corporate governance?
- What is the background of the global financial crisis and its most important repercussions?
- What is the relationship between the global financial crisis and ethical behavior in corporate governance?

### **The importance of the study and its objectives:**

- The subject of corporate governance is linked to the problem of the growing financial crisis on the local and global level, because the subject is linked to various areas and parties, one of the repercussions of the financial crisis is the bankruptcy and the collapse of many institutions, causing damage to these entities .

The study aims to achieve a number of objectives, including:

- An attempt to highlight the relationship between ethical behavior and the principles of corporate governance and the occurrence of the global financial crisis.
- Trying to diagnose the global financial crisis by highlighting the reasons of its occurrence and its effects.

### **Methodology of the study:**

Due to the nature of the research topic and the attempt to gain access to all its aspirations, the descriptive approach will be adopted when exposing general concepts

especially those related to corporate governance. The analytical method has been adopted through the analysis of data and numbers.

**The structure of the study:**

- ❖ The theoretical framework of corporate governance.
- ❖ The ethical behavior for corporate governance.
- ❖ The current global financial crisis.
- ❖ The importance of ethical behavior as an essential component for corporate governance in managing the current global financial crisis risks.

## **2. The theoretical framework of corporate governance**

The liberalization of the market economy, and the subsequent changes in the financial markets that are witnessed by today's world led to a radical change in the banking environment accompanied by a large evolution and growing banking risks, which creates a state of instability due mainly to staying away from and the lack of proper application of the rules of governance.

### **2.1 What is corporate governance ?**

Interesting in the concept of corporate governance in many developed and emerging economies grows during the past few decades, especially in the wake of the economic collapse and financial crises witnessed by some international companies; this has resulted in the eagerness of many international bodies to adopt this concept.

#### **2.1.1 The concept of corporate governance**

There are numerous definitions that show the meaning of governance, the following is a presentation of some of these definitions:

- "Corporate governance is a set of laws, rules and standards that define the relationship between the management of the company on the one hand, and the shareholders and stakeholders or parties related to the company on the other hand". (Williamson, 1996, p. 12).

Definition of the Organization for Economic Co-operation and Development (OECD): "Corporate governance is the system through which the direction and management of business organizations are achieved, the governance structure determines the rights and responsibilities among the various parties related to the company's activities, such as board of directors, shareholders and other stakeholders". (OCDE, 2004, p. 11).

Corporate governance includes market rules and practices that determine how companies make their decisions, the transparency that governs the process of making these decisions, and the extent to which those responsible for decisions are held accountable. (زهرة، 2016، صفحة 88)

The set of structures and processes necessary to direct and control institutions, define and distribute rights and duties among the main participants, including shareholders, members of the board of directors, and managers, as well as define the rules and procedures for making decisions about the company. (نوارة، 2016، صفحة 73)

So from what has been mentioned, it is clear that corporate governance is the mechanism that govern relations between the principal parties that affect performance, and includes the basic ingredients for the success of the organization in addition to identifying responsibilities within and ensure the rights of all parties.

### **2.1.1 The importance of corporate governance**

Governance has received considerable attention recently as a result of a number of the administrative and financial failures suffered by many large companies in the United States and the countries of East Asia, among the reasons that led to this failure is the lack of governance style.

The great transformations witnessed by the financial arena, especially the liberalization of markets in addition to the accelerated pace of globalization, has led to the application of the rules of governance they can help businesses and the economy in general to attract investment and support the economic performance.

Companies that are interested in ways of governance have many advantages and benefits. The following are the most important advantages that accrue to the companies that have adopted the concept of governance (Aras & Growther, 2009, p. 17):

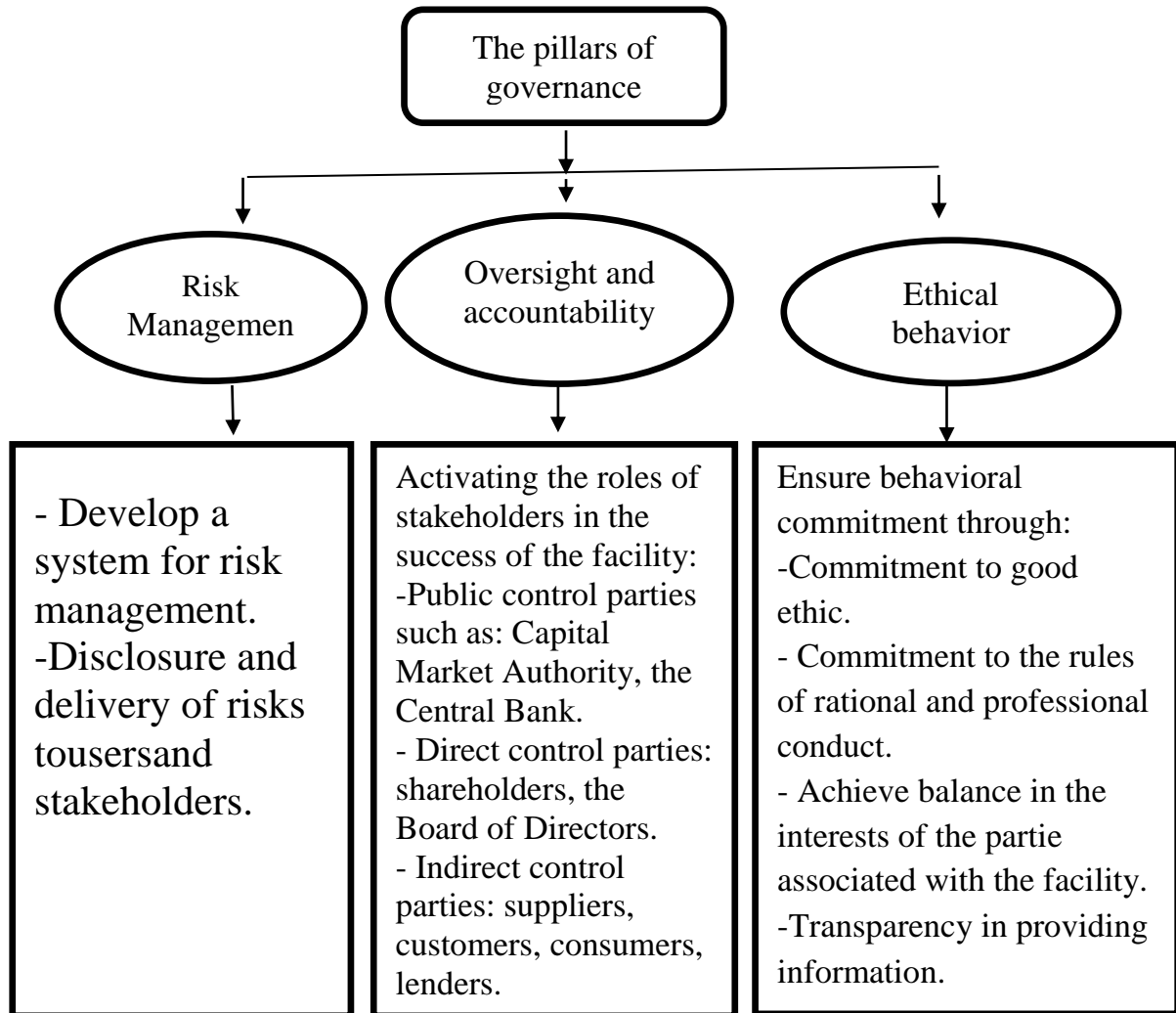
- reduce the risks related to financial and administrative corruption faced by the companies and the state.
- Higher levels of performance for companies and the consequent drive development and economic progress for the countries that belong to those companies.
- Achieve accuracy and transparency in the financial statements issued by companies and the consequent increase investor confidence and reliance upon them in decision-making.
- Strengthen the competitiveness of companies in the global capital markets.

### **2.1.1 The pillars of governance**

Governances based on three elements: Ethical behavior, oversight, accountability and risk management.

The following figure shows the pillars of governance:

**Figure number (01):** The pillars of governance.



**Source:**(Abdlkader & Hammou, 2008, p. 04)

## 2.2 Corporate governance standards

Given the growing and continued attention to governance, a number of international bodies consistently establish the best corporate governance practices, and thus achieve the desired goals, one of the leading organizations in the development of corporate governance principles is the Organization for Economic Co-operation and Development(OECD), which issued in 1999, five criteria amended in 2004, it helps all the Member States and non-members of the Organization to develop legal and institutional frameworks for the application of corporate governance, these standards are (OCDE, 2004, pp. 18-23):

### 2.2.1 The establishment of an effective system of corporate governance

The framework of corporate governance should encourage transparency and efficiency of markets, it should also be compatible with the provisions of the law, and

clearly identify the distribution of responsibilities among supervisory, regulatory and executive bodies.

### **2.2.2 Shareholders' rights**

Corporate governance system should provide protection for shareholders and allow them to exercise their rights, among those rights are participating and voting in the meetings of the General Assembly of the shareholders, obtaining a share from the profits of the company, participating in the decisions relating to any fundamental changes in the company, and having the right of access to sufficient information in appropriate time with regard to the date, place and agenda of the General Assembly, as well as information on topics on which decisions would be made at the meeting.

### **2.2.3 Equal treatment of shareholders**

The framework of corporate governance should ensure equal treatment for all shareholders, including minority shareholders and foreign shareholders, all shareholders should have the opportunity to obtain effective compensation when their rights are violated.

### **2.2.4 The role of stakeholders in corporate governance**

The framework of corporate governance should recognize the rights of stakeholders established by law, or that arise as a result of mutual agreements, and try to encourage active cooperation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound companies. stakeholders means banks, employees and bondholders, suppliers and customers.

### **2.2.5 Transparency and Disclosure**

Corporate governance system must ensure proper disclosure of the information at the right time for all the important topics related to the company, especially the financial position and performance. Among this information:

- Financial results,
- The company's goals,
- Major holdings of shares and voting rights,
- Remuneration policy of the Board of Directors and key executives.

### **2.2.6 Responsibilities of the Board of Directors**

It should within the framework of corporate governance ensures the strategic direction and guidance for the company and the Board of Directors held accountable for its responsibility to the company and shareholders.

## **3. The ethical behavior of corporate governance**

The success of any company in the application of the principles of governance and the achievement of its goals depends over reliance on moral behavior which represents a framework that promotes and supports the integrity of the application of

the principles of corporate governance, and ensures for it to get a positive evaluation of the extent of its commitment to it.

### **3.1 The concept of ethical behavior**

The word ethics has a Greek origin, as it is derived from the word "Ethics", in English the term carries many aspects, including (Vallabhaneni, 2008, p. 82):

- " Ethics is a set of values and standards adopted by the members of the community to distinguish between the concept of right and wrong".

- " Ethics is a set of rules and principles on which are based business organizations for the purpose of distinguishing between what is right and what is wrong".

So as an aggregate of what has been mentioned, it is clear that ethics are the principles that govern the behavior of the individual or a group, it means a standard of decent ethics for the profession, such as business ethics, the ethics of the field of exchange, as well as the ethics of the accounting field.

### **3.2 The importance of ethical behavior**

The most important benefits that can be obtained by business organizations due to its commitment to ethical behavior in the work are as follows (Zimmerle & Others, 2007, p. 37):

- Generate a sense of trust among workers and the pride of belonging to the institution,

- It may cost a lot the business organizations because of ignoring commitment to ethical standards, and here comes the immoral act to put the organization in the face of a lot of lawsuits,

-Enhance the reputation of the organization at the level of the local, regional and international environment, and this also has a positive effect on the organization,

- The recent trends consider that ignoring ethics in business as a displacement towards the narrow self-interest, while the commitment to the moral dimensions of work put them within the framework of the large self-interest.

We can summarize the factors affecting ethical practices in business, and that would lead to wrong actions, as follows:

- The actions of the leadership or officials in the organization, it means whenever they are away from business ethics, employees are encouraged not to be bound by these ethics on the one hand, on the other hand, the degree of sanctions applied by the officials of the organization in the case of non-respect of ethics and business,

- Acts in force in the organization, which are either committed to ethical behavior or contributing in encouraging malpractices,

- The moral aspect in society, on the grounds that " human is social in nature", and therefore the ethics of society are translated in all aspects of life, including that of

the organization.

### **3.3 Principles of Ethical Conduct**

They are as follows (Koslowwski, 2007, p. 39):

- **Trust:** It means in the area of corporate governance that officials, company management and accounting offices should be trustees on their data and information with no distortion, misrepresentation or manipulated.
- **Transparency:** in every sense of the meaning of honesty and inclusiveness in the information as long as the latter represents the rights of the various parties to the relevant organization, which calls the whole truth even trusted by those parties.
- **Justice:** achieving justice in the governance of banks by providing the opportunity for all parties to get the correct information.

### **3.4 Ethical behavior as a tool for corporate governance**

Ethics in business are the core of the framework of corporate governance in the companies, so it turns out that among the causes of the phenomenon of the collapse of the companies is a common moral corruption of those in charge of management both in financial or accounting aspects, lack of proper exercise of control and lack of attention to ethical behavior, if good governance aimed at facing forms of financial and administrative corruption, the morality is the framework most appropriate to support this goal, and that corporate governance cannot be applied in isolation from the moral aspect of the people themselves, and those who are intended to be board members, because the conviction to the principles of corporate governance and its requirements does not benefit if any of them harbored bad faith or ethics that allow him leaking important information before they are issued.

## **4. the global financial crisis (mortgage crisis)**

The global financial crisis caused by the U.S. mortgage crisis is a natural extension of the crises of the capitalist system, but with deepest impact and spreading, it led to collapse and caused significant effects on most countries of the world.

### **4.1 The emergence of the current global financial crisis**

The signs of the crisis backs to the growth in the volume of "Subprime loans"; namely mortgage loans granted to the families of the U.S. at risk of non-payment, no credit is given to families with limited incomes on the basis of a mortgage; it means that these loans did not take into account the level of real families income, and so they took the form of loans with high risk, and the purchase contracts were unfair making a the premium rises with the length of time, and when you do not pay for once take the benefits of the premium multiplied by about three times, and not only that, the impact of interest is variable, not fixed, it is low in the beginning and then goes up, in addition to the monthly payments during the first three years, payments



are intended to pay all the benefits of the loan, which means that the payments were not to go to any part of the ownership of the property until after the passage of 03years (Beilecki & Others, 2011, p. 22).

When the frequency of the inability of borrowers to repay their loans occurs, the financial institutions have taken actions to evict them from their homes guarantors for loans, real estate prices collapsed and financial institutions failed to collect dues, this led to scarcity of liquidity and bankruptcy cases that hit institutions multiplied. Therefore, the essence of this crisis is due to the accretion in the granting of mortgage loans, especially to the category of highly vulnerable to the risk of non-payment, by liberalizing markets, mortgage loans have become not subject to restrictions.

#### **4.2 The causes of the current global financial crisis**

There are several reasons eventually led to the explosion of the mortgage crisis, among these reasons:

##### **4.2.1 loosening of the conditions of granting loans**

The behavior of the banks with respect to the granting of loans usually corresponds with the course of the economic cycle; softening standards when conditions are suitable and emphasis in the case of the volatility of the situation. With regard to the current crisis this factor had its full impact, many of the studies clearly shows that financial institutions indulged in granting loans for families, especially mortgages.

##### **4.2.2 securitization of mortgage debt**

This new financial innovation is one of the reasons that led to the worsening of the financial crisis, when the bank receives a large portfolio of mortgages, it uses this portfolio to issue new securities by which it borrows from other financial institutions by ensuring this portfolio, this is called securitization, the bank did not stop initial lending by guaranteeing these properties, but issued a second wave of financial assets to guarantee these mortgages, and so the property gives to its owner the right to borrow from the bank, but the bank re-uses the same property within a largest portfolio to borrow newly from other financial institutions, and the process will continue in wave after wave, and the property generates sequential lending in the names of the financial institutions, one after the other, and this means that banks and other financial institutions will participate in bearing the risk of the loans granted to people with weak credit record.

##### **4.2.3 poor control and the supervision off financial institutions and instruments**

The commercial banks in most countries are subject to the scrutiny of the central banks and supervisory institutions, but such control is weak or even non-existent for other financial institutions such as investment banks and mortgage brokers, as well as the lack of control over the new financial products such as financial derivatives.

#### **4.2.4 the spread of moral corruption**

Anyone who considers the causes of the global financial crisis would clearly realize that the dimension of moral and human values in the management of economic activity was a crucial factor in the occurrence and the aggravation of the crisis, features of corruption are clearly emerged in the financial crisis in the behavior of individuals and economic institutions in several areas, including the provision of bribes, antitrust and fraud operations, among others.

#### **4.2.5 the system of wages and bonuses as incentives to exaggerate the risk**

It has been observed during the U.S. mortgage crisis that wages of collapsed bank managers were not consistent with their performance, the following table shows some examples of the compensation received by some of the managers of the banks which were exposed to the crisis.

**Table number (01):** «The relationship between the compensation received by managers and losses suffered by banks»

<b>The loss suffered by the bank</b>	<b>Benefit d compensation</b>	<b>Name of the bank</b>	<b>Name the manager</b>
not specified	9.3 million \$	Fannie Mae	<b>Mudd</b>
not specified	14.1 million \$	Fannie Mae	<b>Syron</b>
Deterioration in the value of 31 million shares by 50%.	100 million \$	City bank	<b>Prince</b>
Deterioration in the value of shares.	161 million \$	Merril Lynch	<b>O'Neal</b>
deterioration of the value of the stock portfolio and reached 425 million dollars	undisclosed officially	Bearstearns	<b>Cayne</b>

**Source:** Prepared by Researchers.

This fact actually contradicts with the principles of corporate governance, which states that there is a need for consensus between the wages of managers and long-term goals of the bank and its shareholders.

#### **4.3 The effects of the global financial crisis**

We can highlight the most important effects of this crisis on a number of areas, namely:

- Damage to the global banking sector, as this is the gravest crises suffered by the banking sector, it has led to huge losses and bankruptcy of many banks, and the rate of providing credits has declined in many countries of the world.
- The U.S. financial institutions have offered credit facilities for all the categories of the American society in order to buy real estate in installments and with low interest

rates at the rate of 01 %, and without guarantees only the ownership of the property, this led to a serious depletion of liquidity and restrict it in real estate assets with weak liquidity.

- The crisis is no longer confined to the financial aspects only, but surpassed them to production, international trade, exchange rates, the movement of capital and international investment, this situation had negative impact on the global growth.

- The crisis impacted negatively on savings, a lot of depositors rushed to withdraw their deposits from banks as a result of loss of confidence in banks.

- Exacerbation of unemployment crisis in the world, the financial crisis will have a negative effect by reducing some of the activities and the bankruptcy of many companies, and thus curtail employment.

### **5. The importance of ethical behavior as an essential component of corporate governance in managing the risks of current global financial crisis**

It turns out that the deficiencies in the commitment to the ethics of the business was among the causes of the global financial crisis of 2008, it has been shown to all that among the motives that led to the aggravation of the crisis is the lack of the proper application of the principles of governance, particularly with regard to risk management and managers compensation, these two principles are ethical standards stipulated by most of corporate governance principles issued by the organizations and international control bodies.

As a result of collapses that occurred and the bankruptcy of many U.S banks and companies, Basel Committee focused with respect to ethical behavior on the actions of managers to be committed to ethical administration, in this area, it states three things:

- The need for a consensus between the policies of wages with the moral values of the banking institution as well as with the strategy of the institution,

- the Convention warns managers to carry out speculation in the financial markets, seeking from behind, achieving financial revenues in the short term and without taking into account the element of risk that afflict such operations,

- The Convention imposes on the boards of directors of banks agreement to pay the wages of managers, unless they are compatible with the strategic objectives of the Bank. Accordingly, and in order to avoid excessive risk, the Convention requires that wage policy should not deviate from the policy of the institution so as to not give adequate attention to the performance achieved in the short term.

### **6. Conclusion**

The global financial crisis is the result of non- responsible disposition of the financial institutions managers, and this disposition stems from the lack of commitment to respect ethics of the business, the absence of a strict application of the

laws and the imbalance in the control procedures has helped in its aggravation, the elimination of the crisis and its waste will not be by the re-stabilization of the financial markets, but also it must be accompanied by ethical conduct of each actor in the global economy, it is also required to apply the principles of corporate governance as an important part of the siege of corruption, and all parties having interest in the institutions, whether they are investors or shareholders or managers should play the role assigned to them to establish the principles and the values of ethics and integrity which are the foundation for the culture of improving the performance of companies. This fundamental point applies equally to any kind of institutions.

**Based on the foregoing, the following conclusions can be drawn:**

- The global financial crisis is caused by the lack of respect for the principles of corporate governance, including the abandonment of ethical behavior.
- The follow of sound principles of corporate governance leads to create the necessary precautions against corruption and mismanagement while promoting transparency

## 5. Bibliography List:

- B Abdlkader , M Hammou. (2008 ,11 26) Récupéré sur Behavioral and moral dimension of corporate governance and its role in reducing the effects of the global financial crisis.
- G Aras , D Growther. (2009) *Global Perspectives on Corporate Governance and CSR*. Surrey England: Gower Publishing Ltd.
- Williamson. (1996) *The Mechanisms Of Governance*. New York: Oxford University Press Inc.
- OCDE. (2004) *Principes de Gouvernement d'Entreprise de l'OCDE*. Paris: Les éditions de l'OCD.
- P Koslowski. (2007) *Ethics of Banking*. London: Springer.
- S Vallabhaneni. (2008) *Corporate management governance, and ethics best practices*. New Jersey: John Wiley and sons Inc.
- Wach Zimmerle , Others. (2007) *Corporate Ethics and Corporate Governance*. London Springer.
- Z R Beilecki , Others. (2011) *credit risk frontiers :Subprime crisis, Pricing and hedging, Rating and liquidity*. New Jersey: John Wiley and sons Inc.
- شريط صلاح الدين، لعروسي قرين زهرة. (2016). أثر تطبيق حوكمة الشركات في أداء البنوك التجارية - دراسة حالة البنك الوطني الجزائري وكالة البلدية-.  
مجلة الدراسات الاقتصادية المعاصرة، العدد 1، 85-97.
- عمر قمان، محمد نواره. (2016). متطلبات حوكمة المؤسسات كآلية للحد من ممارسات إدارة الأرباح -دراسة تحليلية-. مجلة الدراسات الاقتصادية المعاصرة،  
العدد: 02، 68-79.