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Examining the Global Financial Crisis from a Virtue Theory Lens

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Abstract: As the financial crisis of 2008-9 has continued to affect the global economy, many wonder whether the proposed solutions contribute to a more stable financial system as well as to better human behaviour. While the Financial Crisis Inquiry Commission (FCIC) Report (2011) identified the factors essential to explaining the causes of the financial crisis as having included credit and housing bubbles, nontraditional mortgages, credit ratings and securitization, financial institutions concentrated correlated risk, leverage and liquidity risk, contagion risk, shock and panic, failure in virtue has also been very patent in the crisis, foremost of them being: excessive leverage and imprudent risk-taking, failure in fiduciary duties and in stewardship, as well as greed, lack of moderation, and fraud. The lens of virtue theory is, thus, necessary to analyze and explore the financial crisis' origins and remedies. There exist ways of measuring such virtuousness or lack thereof among managers and finance industry participants, one of them being the creation of a virtue ethics scale. This paper presents the results of a survey of 141 Philippine managers, which sought to elicit from the respondents which of the virtues listed they considered desirable traits. The major responses were: (1) Honesty and competence, (2) Kind-heartedness, (3) Self-confidence, (4) Innovativeness, (5) Ambition, and (6) Security. The study's results can give practitioners an idea of the virtues or character traits that employees in Philippine companies expect or find desirable in their superiors. In addition, they can inform the crisis debate from a virtue theory perspective.

Keywords: Virtue Ethics, Character, Financial Crisis, Prudential Regulation, Corporate Governance

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After the financial crisis that began in 2007 many have expressed renewed doubts about the basic goodness of the financial sectors, doubts that are related to deeply-held moral principles and traditions of larger society. As the meltdown turns into a global economic crisis which will most likely be measured in years rather than months, it is imperative that we look beyond the symptoms and get to the root causes. The economic crisis, like the bubbles that preceded it, is the direct result of an increasingly unbalanced economy, which has its roots in unbalanced lives. The deep question is whether the proposed solutions contribute to a more stable financial system as well as to better human behaviour. These issues are thrown into stark relief with the financial crisis (Clark, 2009; Shiller, 2012).

In its assessment of the financial crisis, the Financial Crisis Inquiry Commission (FCIC) (2011) Report concluded that the financial system we now live in bears little resemblance to that of previous generations. The FCIC report then identified various factors essential to explaining the causes of the financial crisis: credit and housing bubbles, nontraditional mortgages, credit ratings and securitization, financial institutions concentrated correlated risk, leverage and liquidity risk, contagion risk, common shock and financial shock, and panic. While the same FCIC Report (2011) stated that to pin this crisis on mortal flaws like greed and hubris would be simplistic, the appeal of greed and hubris as causal variables in the economic crisis may stem from their suitability for crafting an engrossing economic narrative. Abstract formulations of the economy or politics, where mishaps and wrongdoings are attributed to systemic failures, can tend to absolve individuals of their responsibility. Greed on the other hand is popularly understood as a personal moral choice, therefore correctly shifting the spotlight to the individual (Vedwan, 2009).

It is widely accepted that the severity of the current economic crisis has no parallel since the Great Depression. Regarding the origins of the crisis, however, there is room for debate. The current economic meltdown is increasingly explained in terms of runaway greed, by laypeople and influential policy-makers alike. Widespread public anger and revulsion are provoked by the steady news of executives of collapsing corporations simultaneously awarding themselves hefty bonuses while begging for government handouts (Vedwan, 2009). This type of analysis necessitates another lens to be used to explore the financial crisis: the lens of virtue theory. Indeed, finance ethicists have begun emphasizing that the focus should be on virtues and the qualities of the practitioner. There is accumulating evidence that the attribution of causes of behaviour is significantly affected by cultural norms and values; this line of research seeks the causes of individual behaviour and attitudes not in a person's particular organizational or social environment but rather in the individual's own personality or dispositions. Virtue theory is situated within this ethical framework of investigating the individual person and his dispositions. Virtue theory is a type of ethical theory in which the notion of virtue or good character plays a central role; it can provide guidance for action and illuminate moral dilemmas. Whereas the attention to consequences or duty is fundamentally a focus on compliance, it is believed that one should also consider whether an action is consistent with being a virtuous person (Hursthouse, 1999; Pfeffer, 1997; Bruner, Eades, & Schill, 2009).

Several prominent commentators and academics have asserted that the current global financial crisis was caused, in part, by the dysfunctional behaviour of corporate leaders who acted out of greed and personal gains—thus promoting self-serving and grandiose aims—and with an intellectual pride and selfishness of the will. In addition, numerous studies had shown that the market, even before the financial crisis, was full of hidden perils. There was contagion,

the infectious over- or under-estimation of stock market values; there was herding, the instinct to follow those who seem to have attracted the most followers; adverse selection, the choice not of the best but of the most loudly asserted value; moral hazard, the way that being insured against risks makes them seem less risky, and so on. Virtue theory can effectively dissuade actors from such a preference for calculative over reflective reason, and a vision of reality that undermines appreciation of finer human virtues and the spiritual aspirations that sustain these. Such ethics of wisdom implies skepticism about one's own and other people's knowledge, caution about exaggerations, and verification of the objective situation and the quality of the service or product. Discussions of such values as practical wisdom or *phronesis*, as it is known in Greek ethics, lead us, then, to Virtue Ethics as a useful salve and medical treatment: what is required for the proper functioning of the economy is, therefore, not only financial and social capital, but it must be built on the practice of the virtues (Boatright, 2010; Arjoon, 2010; Koslowski, 2010).

It is believed that the crisis was a result of human mistakes, misjudgments, and misdeeds that resulted in systemic failures for which the world has paid dearly. Specific firms and individuals acted irresponsibly; they ought to have known that their institutional roles carry an extra burden of responsibility to strive for virtue. Responsibility in this sense most often is synonymous with accountability and dependability (as in being accountable for performance and being dependable in achieving promised performance). Responsibility is also commonly associated with freedom of action and empowerment, indicating that responsible individuals have discretion or volition and the necessary authority. It refers to the ability or inclination to act in an appropriate fashion (as when an individual acts responsibly). The concept of appropriateness is the key to this connotation in that it associates responsible action with what is right, correct, or best. Behaving responsibly in this sense means *being good* or *doing good*. Of course, what is considered good is often controversial, but one term that connotes universal standards of rightness, correctness, and goodness is the concept of virtuousness. This concept is a universally accepted standard for the best of the human condition (Cameron, 2011). And it is this conception of *good human behaviour* that has been sorely missing in the financial crisis debate.

An Ethic of Virtue: Literature Gap in the Financial Crisis Debate

The financial crisis of 2008-9 revealed that our broad model of corporate governance is broken, independent of the shortcomings in the regulatory system. Managers and boards of directors in scores of systemically important firms failed to protect employees, customers, or shareholders, and placed the global financial system at risk. The worst firms had lethal combinations of strong incentives, weak control and risk management, flawed internal and external accounting, low skill and/or low integrity people, and corrosive cultures. Some corporate leaders substituted robust risk management for greed and personal gains by promoting self-serving and grandiose aims. This manifests moral failings and loss of sense of reality stemming from a spiritual disease, namely, an intellectual pride and selfishness of the will (Arjoon, 2010; Sahlman, 2010).

The necessity for exploring the recent financial crisis from a virtue theory lens can be gleaned from Aristotle in *The Politics*:

> For man, when perfected, is the best of animals, but, when separated from law and justice, he is the worst of all; since armed injustice is the more dangerous, and he is equipped at birth with arms, meant to be used by intelligence and virtue, which he may use for the worst ends. Wherefore, if he have not virtue, he is the most unholy and the most savage of animals, and the most full of lust and gluttony. But justice is the

> bond of men in states, for the administration of justice, which is the determination of what is just, is the principle of order in political society. (1990, p. 6)

The market system flourishes when it functions in an ethical and juridical framework in which the vulnerable is protected and the arrogance of the powerful is curbed. In other words, there ought to be "two hands" to ensure smooth running of the market economy: the invisible and the juridical. There is evidence that gross and unregulated individual behaviour in market activity affects the stability of companies and nations. The distrust engendered by vice raises wasteful transaction and monitoring costs to levels that can paralyze the marketplace and is manifested in a variety of ways: by taking imprudent and excessive risks with other people's money, by selling products and services that harm others, and by engaging in outright fraud (Arjoon, 2010).

The literature on the economic crisis argues that lack of adequate regulation combined with excessive corporate greed was sufficient to cause the problems. If regulation had been more stringent, or executives less greedy, the crisis would have been averted. Yet, one wonders what corporate manager with hindsight would have wanted what has happened to happen. Everyone, including those who behaved unethically and those who were consumed by greed ended up getting battered. Surely, independent of the existence of a strong and competent regulatory regime, sensible actors would have self-policed. Even greedy executives would not have wanted to see their companies disappear or their net worths vaporize. Sadly, there seem to be few new lessons from this crisis; the underlying managerial failures were no different than in previous episodes of financial excess. Managers made dangerous and foolish decisions, consumers and investors engaged in risky behaviour, and regulators were ineffective. Greed played a role but the bigger problem was incompetence (Sahlman, 2010).

Financial crisis origins and suggested remedies

Literature points to globalization and financialization of the economic systems as well as "incentive divergence" as major causes of the 2007-08 financial crisis (Zaharia, Zaharia, Tudorescu, & Zaharia, 2010). Was it a function of excessive risk taking by financial institutions, made possible by lax regulation and supervision? Or was it the inevitable consequence of excessive government interference in financial markets? Was it merely a collapse of confidence, a withering of what John Maynard Keynes called the "animal spirits" of capitalism? Or was it the inevitable consequence of the fact that some portions of the economy were (and arguably remain) excessively leveraged and effectively bankrupt? Put differently, did the crisis result from a mere lack of liquidity or from a more profound lack of solvency? If the latter, what does that portend for the future? (Roubini & Mihm, 2010).

All these formed part of the roots of the crises; and all of them have some relation to lack of virtue, which this section will point to. I enumerate the following:

(1) **Excessive leverage and imprudent risk-taking**. It was found that too many financial institutions, as well as too many households, borrowed to the hilt. By one measure, their leverage ratios were as high as 40 to 1, meaning for every $40 in assets, there was only $1 in capital to cover losses. Trillions of dollars in risky mortgages had become embedded throughout the financial system, as mortgage-related securities were packaged, repackaged, and sold to investors around the world. And the leverage was often hidden—in derivatives positions, in off-balance-sheet entities, and through "window dressing" of financial reports available to the investing public. Panic fanned by a lack of transparency of the balance sheets of major financial institutions, coupled with a tangle

of interconnections among institutions perceived to be "too big to fail," caused the credit markets to seize up (FCIC, 2011).

Failure in virtue: With regard to this deceptive (fraudulent, untruthful) financial reporting, we know that performance reports that are significantly inaccurate or misleading lead to a distortion of the decisions that reliant owners, lenders, and others should take, and to an inability to properly assess the risks that investors face. This misdemeanor manifests a gross lack of the virtues of honesty, prudence, and sense of responsibility (Boatright, 2010).

(2) **Failure in fiduciary duties and in stewardship**. The captains of finance and the public stewards of our financial system ignored warnings and failed to question, understand, and manage evolving risks within a system essential to the well-being of the general public. The prime example is the Federal Reserve's pivotal failure to stem the flow of toxic mortgages, which it could have done by setting prudent mortgage-lending standards. Financial institutions and those working in them were likewise to blame: financial institutions made, bought, and sold mortgage securities they never examined, did not care to examine, or knew to be defective; firms depended on tens of billions of dollars of borrowing that had to be renewed each and every night, secured by subprime mortgage securities; and major firms and investors blindly relied on credit rating agencies as their arbiters of risk. Regulators continued to rate the institutions they oversaw as safe and sound even in the face of mounting troubles, often downgrading them just before their collapse. And where regulators lacked authority, they could have sought it (FCIC, 2011).

Failure in virtue: Too often, those in authority lacked the political will—in a political and ideological environment that constrained it—as well as the fortitude to critically challenge the institutions and the entire system they were entrusted to oversee. Likewise, imprudence reigned: financial institutions and credit rating agencies embraced mathematical models as reliable predictors of risks, replacing judgment in too many instances. Too often, risk management became risk justification (FCIC, 2011).

(3) **Greed, lack of moderation, and fraud**. Compensation systems—designed in an environment of cheap money, intense competition, and light regulation—too often rewarded the quick deal, the short-term gain without proper consideration of long-term consequences. Predatory lending was rife: mortgage loan data indicate borrowers likely took out mortgages that they never had the capacity or intention to pay. One would read about mortgage brokers who were paid "yield spread premiums" by lenders to put borrowers into higher-cost loans so they would get bigger fees, often never disclosed to borrowers (FCIC, 2011).

Failure in virtue: There was a systemic breakdown in accountability and ethics. An erosion of standards of responsibility and ethics that exacerbated the financial crisis has been observable. This was not universal, but these breaches stretched from the ground level to the corporate suites. They resulted not only in significant financial consequences but also in damage to the trust of investors, businesses, and the public in the financial system. Reports catalogue the rising incidence of mortgage fraud, which flourished in an environment of collapsing lending standards and lax regulation. The number of suspicious activity reports—reports of possible financial crimes filed by depository banks and their affiliates—related to mortgage fraud grew 20-fold between 1996 and 2005 and then more than doubled again between 2005 and 2006 (FCIC, 2011).

Why Virtues Should Matter in Deterring the Next Financial Crisis

As we have seen thus far, there is accumulating evidence that the attribution of causes of

behaviour is significantly affected by cultural norms and values; this line of research seeks the causes of individual behaviour and attitudes not in a person's particular organizational or social environment but rather in the individual's own personality or dispositions (Pfeffer, 1997). This issue looms larger than ever, in the wider context of the current corporate crisis, corporate scandals, breakdowns of trust, and perceptions that some senior executives are more interested in personal power and wealth accumulation than in their company's future. Serious infringements on basic ethical rules, the erosion of trust between shareholders and corporate officers, and a vague impression that some CEOs wield absolute power have brought questions about the way the market economy works to the forefront of the debate (Canals, 2010).

To the extent that ethical motivation prevails, there is economic prosperity; to the extent that it wanes, there is economic stagnation and crisis. When vices stemming from dysfunctional human behaviour (especially envy, greed, and hubris) are introduced into the free market system, the economy suffers crises as a result of the weakening of moral virtues and ethical values. No free market system, however, would work justly or efficiently unless it is governed by decision-makers who are not only technically competent but also morally competent or virtuous (Arjoon, 2010). Put another way, good corporate governance—being a political activity that necessarily takes into account the various dimensions of human agents and of the groups they form or inhabit—can only be achieved through the governors' education in the virtues, for, without the virtues, neither the goods nor the objectives that a corporation should seek could be properly identified, nor the rules, procedures, and structures it should follow correctly formulated, interpreted, and implemented (Sison, 2008).

With the resurgence in recent times of the interest in aretaic or virtue ethics, especially that which was found in Aristotle's ethical doctrine, ethics literature has come to propose virtue theories as one which unites the descriptive and the normative, yet insists upon doing so in the pursuit of a purpose unlike that proposed by the other theoretical systems. The theory of virtue addresses the question "What is the purpose of business?": it provides a recipe by which any organization can define its own purposeful existence. By so doing, Aristotelian virtue is just as focused on outcomes as consequentialism, and as concerned with the act itself as non-consequentialist theory, and this places high value on pure motives like Kantianism. Specifically, for Aristotle, character development is an inevitable outcome of the act. In addition to that, his system places tremendous weight upon the act because life itself is an energeia or activity of performing various acts (Koehn, 1995; Crockett, 2005).

Virtue ethics is perhaps the most important development within late 20th century moral philosophy. Virtue ethics can provide guidance for action, illuminate moral dilemmas, and bring out the moral significance of the emotions. Virtue ethics is currently one of three major approaches in normative ethics. It may, initially, be identified as the one that emphasizes the virtues, or moral character, in contrast to the approach which emphasizes duties or rules (deontology) or that which emphasizes the consequences of actions (consequentialism) (Hursthouse, 1999). But what is *virtue*? Virtue may be defined as follows: "The virtue of a kind of thing is an enduring trait which places it in good condition and enables it to carry out its distinctive work well. The word 'virtue' represents what the classical philosophers meant by the Greek term *aretê* (*ἀρετή*) and the Latin term *virtus*. Classically, a virtue is a strength or excellence. A virtue strengthens, improves, and perfects that which has it. This meaning is evident in the Latin term, which comes from the word for 'man', *vir*. In Latin, a virtue is literally the same as 'manliness'" (Pakaluk & Cheffers, 2011, p. 82).

Virtue Ethics can add to the understanding of the recent financial crisis through a sharper

understanding of the regulation of business behaviour. Since Virtue Ethics looks upon the virtuous agent—the manager, the professional—as the person habituated with the desire to do what is good and noble, it thus has the merit of inviting us to re-evaluate and revise notions of managerial choice, act, and outcome, and thus offers us an alternative understanding of business problems, one that is based on a keener and more proper inspection of the individual and his or her actions and decisions in the financial sphere (Koehn, 1995; Racelis, 2014).

The literature on managerial excellence has already revealed that virtue ethics and virtue language is fluently used by practicing managers, and that, whereas the set of virtues defining the excellent manager can be expected to be dependent on the societal, industry, and organizational context, such a set of manager virtues can be identified and prioritized within a particular organizational milieu (Whetstone, 2003). Empirically, this can be carried out through a survey, and this is the subject matter of the next section.

RESULTS

Virtue among Philippine Managers

Failure in virtue is very patent in the crisis, foremost of them being: excessive leverage and imprudent risk-taking, failure in fiduciary duties and in stewardship, as well as greed, lack of moderation, and fraud. The lens of virtue theory is, thus, necessary to analyze and explore the financial crisis' origins and remedies. There exist ways of measuring such virtuousness or lack thereof among managers and finance industry participants, one of them being the creation of a *virtue ethics scale*, which this paper does.

The empirical study in this paper is an extension of an earlier empirical virtue ethics study I have done, which consisted of a survey of 141 Philippine managers, and revealed the following as the observed character traits of the superiors of the respondents: (1) care and concern, (2) competence, (3) ambition, and (4) superiority. This paper, on the other hand, presents the results of the second part of that same survey which elicited from the Philippine managers what they thought were the desired or *desirable* managerial traits—those that they would wish to see in their superiors. The following were the managerial virtues viewed as desirable character traits among superiors: (a) honesty, (b) innovativeness, (c) competence, (d) kind-heartedness, (e) security, and (f) self-confidence.

The survey questionnaire, consisting of the 34 virtues of Shanahan and Hyman (2003), was administered to a convenience sample of 141 postgraduate business and finance students who are managers in Philippine companies (A full listing of the 34 virtues is found in Appendix A). The questionnaire sought to elicit from the respondents which of the virtues listed they considered *desirable traits*.

A series of factor analyses and reliability tests were performed until an acceptable reliability coefficient of at least .60 and measure of sampling adequacy (appropriateness of applying factor analysis) of at least .50 (Hair, Anderson, Tatham & Black, 1998) were obtained. Based on an analysis of the responses to the 34 items on the survey questionnaire, the resulting virtue or trait factors are as presented on Table 1, namely: (1) Honesty and competence, (2) Kind-heartedness, (3) Self-confidence, (4) Innovativeness, (5) Ambition, and (6) Security. Only 22 items out of the 34 original traits loaded onto the resulting six virtue factors. [Original full questionnaire is available with the author.] The Rotated Factor Matrix can be found in Appendix B along with the KMO and Bartlett's Test (reliability coefficient) results.

Some of these results agree with some of the desirable traits coming out of character traits studies. For example, research by Lickona

(1989) revealed that people in general recognize the following values as essential for survival: (1) respect and caring, (2) responsibility (valuing work), (3) trustworthiness, (4) fairness, (5) civic virtue, (6) cohesiveness, (7) discipline, (8) cooperation, and (9) moral reflectiveness. Lickona (1989) proposed these traits or virtues as paramount in an integrative vision of moral education.

A survey of preferred traits by Boen (2010) revealed that the top three preferred traits mentioned were: (1) Respect, (2) Responsibility, and (3) Honesty, but that there were differences in the overall listing and rankings depending on ethnicity, position, and socio-economic status. Her overall findings are summarized in Table 2.

Table 1

Desirable Traits for Managers – Virtue Factors

	Factor (Description)	Items/Variables loading onto the Factor
1	Honesty and competence	Reliable, Honest, Competent, Hardworking, Respectful, Achievement-oriented
2	Kind-heartedness	Generous, Sincere, Friendly, Pleasant, Reassuring, Supportive, Open
3	Self-confidence	Superior, Proud, Attractive
4	Innovativeness	Innovative
5	Ambition	Aggressive, Ambitious
6	Security	Secure

Table 2

Top preferred traits – Survey of schools in the U.S.*

Categories/Rankings	Preferred Traits: Findings/Responses
Top 3 cited preferred traits	Respect, Responsibility, Honesty
Next highest ranked preferred traits	Trustworthiness, Self-Control, Self-Esteem, Setting/ Achieving Goals, Courage
Relatively high (top 10) ranking	Compassion/Caring, Loyalty
Next to bottom set of preferred traits	Adaptability/Flexibility, Conscience, Sincerity, Diligence, Attentiveness
Bottom set of preferred traits	Chastity/Celibacy, Contemplation, Humility

* Boen (2010)

The virtue factor "Honesty and competence" is akin to Lickona's (1989) "Responsibility" and to two of Boen's (2010) top three traits "Honesty" and "Responsibility", while "Kind-heartedness" is akin to their "Respect" and "Compassion/ Caring". Dobson (1997) proposed eight basic tenets or "virtues": (1) due care and concern for others in professional activities, (2) respect, where appropriate, for confidentiality, (3) fidelity to special responsibilities, (4) avoidance of conflicts of interest, (5) willing compliance with the law, (6) acting in good faith in negotiations, (7) respect for human well-being, and (8) respect for the liberty and constitutional rights of others. Clearly, our resulting virtue factors "Honesty and competence" and "Responsibility" are easily explained away by these traditional work-related values. "Compassion/Caring" likewise was highlighted in the *ethics of care*—a theory that creates an environment where learners feel welcomed to practice being good—that ensued from moral or character education programs (Boen, 2010).

The resulting virtue factors of "pride", "ambition", and "superiority" seem to be a rather perverse result, although some of the marketing literature tells us of the recent addition of these "virtues" among the preferred marketing and business virtues. "Ambition" is defined as "getting ahead and being tenacious", while "pride" refers to holding one's head high or being admired by others. Their classification as "virtues" seems to be a departure from the classic list of virtues according to Aristotle who would list meekness and modesty as true virtues, while vanity and shamelessness would be "vices" (Moberg, 1999; Shanahan & Hyman, 2003). While this might be explained away by some evidence of the mutability of virtues due to development by heredity and environmental influence, a cultural and historical explanation of these *new business virtues* might be in order.

"Innovativeness" may find its explanation in Solomon's (2003) discussion of such important business virtues as cooperation, trust, loyalty, honesty, kindness, and directness as central to successful businesses. Without cooperation, employees and employers cannot unite to engage in a common enterprise. Without trust, companies cannot rely on their suppliers nor can consumers ever rely on the business to provide quality products. Similarly, loyalty, honesty, and kindness are all virtues of character that enhance the day-to-day life of the workplace community, enabling production to take place efficiently and with some semblance of humanity.

The survey results can give practitioners an idea of the virtues or character traits that employees in Philippine companies expect or find desirable in their superiors, in the same way that the preceding survey study (Racelis, 2013) elicited from respondents what they observed to be the virtues or character traits in Philippine managers. In the larger scheme of things, empirical studies on virtue ethics would serve to shed light on the fact that a large part of the problems that emerged so prominently during this financial crisis can be traced to the deficiency in the value system that guides individual and group decisions (Sahlman, 2010). Further analysis of the details of the results, as they relate to the financial crisis, is done in the next section.

The financial crisis from a virtue theory lens

Indeed, as opposed to irresponsibility and greed, respondents call for the virtues of honesty and competence. Likewise, as against hubris and deception, integrity and humility are called for. This section highlights the prominence of the call for honesty, integrity, competence, and kindness in the survey results.

(1) **Honesty**: Almost every professional code that governs professional associations within the financial services industry requires its members to act with integrity. However, the interpretations of integrity, even within a business context, exhibit a high degree of diversity. Integrity is

usually understood as "equivalent to honesty in a wide sense of that term" (Boatright, 2010, p. 301). Most interpretations of integrity tie it to honesty. Lying is a symptom of the lack of integrity and does not quite get to the core meaning. For another, more basic meaning we need to get to the word's origin as a mathematical concept. It comes from the word integer, which refers to whole numbers. Thus, another definition of integrity is the quality or state of being complete or undivided. Therefore, integrity means wholeness, the kind of wholeness referred to when people are praised for "having themselves together" (Boatright, 2010, p. 301). In the recent financial crisis, there was grave breakdown in honesty and integrity, as evidenced by widespread deception, irresponsible lending, including predatory and fraudulent practices.

(2) **Competence**: Major codes of ethics that have been adopted by various professional organizations of financial services practitioners, including bankers, accountants, financial analysts, and financial planners and advisers contain seven basic principles, namely integrity, objectivity, competence, fairness, confidentiality, professionalism, and diligence. Banking, in particular, is the financial service that touches the life of the most people, whether through checking and savings accounts, credit cards, consumer loans, home mortgages, or trust administration. In addition to providing essential services to customers, commercial banks serve the important economic function of aggregating people's savings and making the funds available to individuals and businesses that need them. The economic health of any community depends on the soundness and the competence of its banks, especially in their money management and lending practices. In addition, investment banks provide some of these services as well as advisory, underwriting, and financing services for corporations that seek new capital or are engaging in a merger or acquisition. Investment banks can also engage in proprietary trading for their own account. All of these activities require not only strong technical skills but also an ability to address myriad ethical issues. These issues arise because of the important interests at stake in managing such large amounts of money and the conflicts that occur among different interests in typical bank dealings (Boatright, 2010). In the recent financial crisis, there was grave incompetence: financial institutions made, bought, and sold mortgage securities they never examined, did not care to examine, or knew to be defective. Firms depended on tens of billions of dollars of borrowing that had to be renewed each and every night, secured by subprime mortgage securities; and major firms and investors blindly relied on credit rating agencies as their arbiters of risk. Widespread failures in financial regulation and supervision proved devastating to the stability of the nation's financial markets. The sentries were not at their posts, in no small part due to the widely accepted faith in the self-correcting nature of the markets (FCIC, 2011).

(3) **Temperance and Moderation**: When we think of the human person as an *open system*, ethics can be understood as the science of the interconnection among free systems: the coming together of prudence, obedience, and command/control. Along with this, we affirm the need for courage—for without it, the administrator will not be able to administer anything at all—as well as temperance, because the intemperate will simply allow himself to be led by the waves. Virtues make us free: only the virtuous are masters of their acts. Aristotle (1984) devoted central passages of the *Ethics* to intemperance, saying that some intemperate people are able to cease being so, but that others seem to not cease being so because they never learn: and in this they are truly *slaves* (Polo, 1997). In the recent financial crisis, there was a view that instincts for self-preservation inside major financial firms would shield them from fatal risk-taking without

the need for a steady regulatory hand, which, the firms argued, would stifle innovation. Too many of these institutions acted recklessly by taking on too much risk, with too little capital, and with too much dependence on short-term funding. Compensation systems encouraged the big bet—where the payoff on the upside could be huge and the downside limited (FCIC, 2011).

(4) **Kind-heartedness**: Kindness is one of the universally admired traits of character: a person is universally recognized as deficient in moral character if he or she lacks kindness, and those negative traits that are the opposite of this virtue—malevolence, dishonesty, lack of integrity, cruelty, and so on—are substantial moral defects, universally so recognized (Beauchamp, 2003). Kind-heartedness is akin to the Aristotelian magnanimity, a moral virtue which is a middle state between vanity (deeming oneself unjustifiably worthy of great things) and smallness of spirit (being worthy of great things but not claiming them). The former (the vain man) does not possess the amplitude of spirit to wield the most obstinate powers on earth and should not boast as if he could, while the latter, out of some defect of character, does not claim them. The magnanimous man, on the other hand, is extreme in the greatness of his claims but a mean in the rightness of them—he claims what is in accordance with his merit (Boozer, 2009). In the recent financial crisis, malevolence was patent in the widespread fraud and deception by finance sector workers. As the markets crashed, foreclosures mounted, firms failed, and consumers stopped spending. Vast Ponzi schemes came to light, as did evidence of widespread fraud and collusion throughout the financial industry. What was worse, regulators looked the other way as firms and banks engaged in creative or fraudulent accounting devices to hide the extent of their losses (Roubini & Mihm, 2010).

(5) **Humility**: Recent work in positive psychology seems to posit that humility and modesty are human qualities very likely derived from the experience of loss and coping with this experience. Indeed, seven virtues have been identified in the Barker and Coy (2003) study, one of them being *humility.* Similarly, Tait's (1996) UK study found that character consisted of honesty, fairness, compassion, humility, and being one's own person. Humility is defined as "the quality of being humble or a modest sense of one's own significance" (Sarros, Cooper, & Hartican, 2006, p. 687). Hubris, along with the drive to improve yields, may have been the real cause of failure in some of the failed firms. The partners began to drift away from their core disciplines into arenas in which they had little experience, like currency trading and equity arbitrage (betting on takeovers), even as they steadily increased leverage ratios. Why did senior management permit the misaligned structure to persist? Were they not aware of what was going on? Were they aware but were blinded by false hopes as to the consequences of their policies? Did some managements succumb to hubris? (Morris, 2009; Prager, 2013).

Managerial Implications

There are existing studies that provide evidence of failure in virtue among finance professionals and managers during the recent financial crisis. For instance, Graafland and Van de Ven (2011) inspected three core virtues—namely honesty, due care, and accuracy—by comparing and contrasting certain banks' codes of conduct with their actual behaviour that led to the credit crisis and find that in some cases banks did not behave according to the moral standards they set themselves. The current study of virtues in finance provides a more moral perspective to the economic crisis debate. At the finance industry level, it sheds light on the emerging "prudential regulation" as suggested in the U.K., for example, or on the "banker's oath" recently recommended in the Netherlands. It has been argued that if prudential regulators are prepared

to restore the concept of prudence to re-engage with its classical range of meanings, then they may be able to rediscover within it a simple cultural, psychological, and ethical prescription for good judgment which can help protect firms from executive excesses.

While the striving to improve prudential regulation in the wake of the recent financial crisis—for example the major announcement issued by the UK government's Treasury department that the old Financial Services Authority (FSA) regulator would soon be replaced by a new Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA)—seems laudable, this general tendency for regulators to restrict themselves to an output-based view of prudence is bound to falter, as what is needed is prudential behaviour on the part of finance workers, and in particular, finance executives. Also, in an effort to restore trust in the banking sector, the Advisory Committee on the Future of Banks in the Netherlands made a recommendation, which has since been adopted, that bank executives be required to swear an oath akin to the physician's Hippocratic Oath. While the Dutch oath is admirable in its lofty exhortations, it fails to provide a reliable guide through the many difficult judgments that must be made in banking. Instead, demanding from these same professionals a more virtuous behaviour would be more reliable (Boatright, 2013; Marshall, Baden, & Guidi, 2013).

Living in a world of regulations and compliance is not sufficient to develop virtuous behaviour: it must give way to a framework that aims at improving the personal ethics of each and every professional. This means that all market participants—with special emphasis on finance executives—should engage in a dual process of education (due to high rates of financial illiteracy in the society) and dialogue over the division of the financial industry in contributions to the common good. A return to the classic definition of prudence as the mold and "mother" of all the cardinal virtues—of justice, fortitude, and temperance—is a step in the right direction. This framework teaches that none but the prudent man can be just, brave, and temperate, and the good man is good in so far as he is prudent (Kuriata, 2012; Pieper, 1965).

The integrity of our financial markets and the public's trust in those markets are essential to the economic well-being of our nation. The soundness and the sustained prosperity of the financial system and our economy rely on the notions of fair dealing, responsibility, and transparency. In our economy, we expect businesses and individuals to pursue profits, at the same time that they produce products and services of quality and conduct themselves well (FCIC, 2011). Even the Dodd-Frank Wall Street Reform and Consumer Protection Act itself addressed these *moral* issues, for instance, on bearing the title "to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes" (Shiller, 2012, p.7). The predominantly moralizing language here suggests that protecting people from dishonesty, subterfuge, and abuse is paramount (Shiller, 2012).

This study corroborates the many findings that show that the symptoms of the recent financial crisis had a lot to do with incompetence, hubris, and greed, such as, for example, the development of the shadow banking system and opaque products. As a result of this lack of transparency and of the *perverse incentives* system, the financial sector managers were induced to take more risks than they could swallow. That the performance measures for top management were largely the earnings they generate relative to their peers put undue pressure on them to keep up: follower-bank bosses ended up taking excessive risks in order to boost various observable measures of performance. These dysfunctions

in turn made governance at both the institutional and market levels extremely difficult, if not impossible. The lesson to be learned is that regulatory reform without ethical reform will never be enough. And this current work is an effort in the direction of ethical reform (Rajan, 2005; Weitzner & Darroch, 2009).

CONCLUSIONS

According to the literature, the crisis was caused by moral deficiencies on the part of market parties in the financial sector: unrealistic and risky mortgage loans to poor residents; packaging and selling of these loans in a way that disguised the real risks; unreliable ratings by specialists; risky investment policies (of banks), driven by an exorbitant bonus culture of top management, and so forth. These same writers and analysts have, thus, taken a moralistic stance toward the financial sector, and have suggested that a renewed sense of the importance of ethics is necessary to prevent a future similar crisis. In particular, such literature has done a moral evaluation of the conduct of the professionals in the financial sector along with an analysis of the systemic causes of the credit crises to arrive at a clearer understanding of what can and cannot be expected from an appeal to ethics (Graafland & Van de Ven, 2011). This paper adds evidence to this claim: that an appeal to ethics and to virtue theory can add clarity and sharpness to the financial crisis debate.

These studies attempting a moral evaluation of the actors and behaviours that triggered the economic crisis provide clear evidence that the level of moral reasoning is related to the choice of action that is advocated and is related to people's value positions and stands on important business issues. In other words, moral judgment is not a value-neutral and purely cerebral style of intellectualizing, but is connected with values and virtuous decision-making (Rest, 1980; Racelis, 2010). To the extent that ethical motivation prevails, there is economic prosperity; to the extent that it wanes, there is economic stagnation and crises. When vices stemming from dysfunctional human behaviour (especially dishonesty, hubris, and greed) are introduced into the free market system, the economy suffers crises as a result of the weakening of moral virtues and ethical values. No free market system, however, would work justly or efficiently unless it is governed by decision-makers who are not only technically competent but also morally competent or virtuous. A return to the core virtues in the financial sector will therefore only succeed if a renewed sense of responsibility in the sector is supported by institutional changes that allow financial institutions to put their mission into practice (Arjoon, 2010; Graafland & Van de Ven, 2011).

All told, the following may be worthwhile research directions for the future, in relation to the discussion of virtues and the 2007-08 financial crisis: (1) validating the virtue ethics scale done in this study, among (a) a target group of finance professionals in the Philippines, and (b) a more representative sample of Philippine managers; (2) replicating the study of Graafland and Van de Ven (2011) in the Asian or Philippine setting, that is, investigating the codes of conduct of finance sector companies to identify the type of virtues that are needed to realize their core mission and then to compare and contrast these codes of conduct with the actual behaviour of financial institutions and individual participants during specific moments of crises; (3) analyzing the micro-prudential and macro-prudential regulations suggested in the U.N. Report *Reforming the International Monetary and Financial Systems in the Wake of the Global Crisis* (Stiglitz, 2010) from the lens of cardinal virtue theory; and (4) a meta-analytic study of how regulatory reform combined with ethical reform via virtue training can help deter any future financial crisis.

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APPENDIX A

Virtue Ethics Inventory (Shanahan & Hyman, 2003)

1	Achievement-oriented	**18**	Leading
2	Aggressive	**19**	Mature
3	Ambitious	**20**	Open
4	Attractive	**21**	Proud
5	Competent	**22**	Pleasant
6	Concerned	**23**	Reassuring
7	Confident	**24**	Reliable
8	Controlling	**25**	Respectful
9	Intelligent	**26**	Socially-responsible
10	Exciting	**27**	Secure
11	Friendly	**28**	Sincere
12	Generous	**29**	Spirited
13	Hardworking	**30**	Straightforward
14	Honest	**31**	Superior
15	Imaginative	**32**	Supportive
16	Independent	**33**	Sympathetic
17	Innovative	**34**	Trustworthy

APPENDIX B:

KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		**.897**
Bartlett's Test of Sphericity	Approx. Chi-Square	2425.351
	df	561
	Sig.	.000

Rotated Factor Matrix(a)

	Factor					
	1	2	3	4	5	6
VAR00024	.739	.078	.151	.212	-.039	.206
VAR00014	.706	.442	.034	-.042	.093	.031
VAR00005	.642	.089	-.027	.031	.408	.160
VAR00034	.617	.212	.033	.148	.113	.026
VAR00013	.591	.235	.106	.081	.147	-.057
VAR00025	.532	.184	.054	.072	.060	.255
VAR00001	.531	.066	.029	-.008	.416	-.053
VAR00009	.496	.107	.193	.150	.283	-.056
VAR00016	.468	.377	.175	.097	-.034	.266
VAR00019	.438	.259	.098	.300	.171	.251
VAR00030	.408	.406	.147	.301	-.075	.075
VAR00012	.157	.653	.238	.056	-.001	.062
VAR00028	.378	.648	.100	.149	.017	.089
VAR00033	.058	.639	.156	.317	.171	-.013
VAR00011	.151	.579	.137	-.167	.099	-.056
VAR00022	.283	.542	.227	.021	.031	.300
VAR00023	.109	.515	.123	.291	.098	.381
VAR00032	.320	.515	.067	.475	.215	-.004
VAR00020	.276	.508	.053	.335	.161	.287
VAR00006	.262	.482	-.031	.122	.298	.248
VAR00029	.194	.479	.273	.200	.116	.266
VAR00026	.201	.468	.230	.262	.090	.268
VAR00010	.144	.447	.350	.080	.061	.057
VAR00031	.104	.062	.673	.297	.128	.001
VAR00021	-.091	.172	.587	.073	.071	.245
VAR00004	.061	.348	.562	-.009	.053	.115
VAR00008	.081	.086	.483	-.072	.099	-.049
VAR00015	.341	.217	.399	.167	-.043	.149
VAR00017	.485	.270	.169	.533	.182	.075
VAR00018	.443	.153	.172	.482	.216	.232
VAR00003	.202	.137	.384	.178	.536	-.003
VAR00002	.221	.083	.387	.086	.504	.208
VAR00007	.337	.274	.167	.207	.403	.138
VAR00027	.266	.336	.416	.069	.152	.595

Extraction Method: Principal Axis Factoring.
Rotation Method: Varimax with Kaiser Normalization.

a Rotation converged in 13 iterations.