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978-1-107-01735-1 - Wall Street Values: Business Ethics and the Global Financial Crisis

Michael A. Santoro and Ronald J. Strauss

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Wall Street Values

Wall Street Values chronicles the transformation of Wall Street's business model from serving clients to proprietary trading and explains how this shift undermined the ethical foundations of the modern financial industry. Michael A. Santoro and Ronald J. Strauss argue that postmillennial Wall Street is not only "too big to fail" but also a threat to the economy even when it succeeds. They describe how, more than a year before the government acknowledged the financial crisis, Wall Street icon Goldman Sachs saved itself by misleading its clients and impeding the information flow needed for the efficient functioning of free markets, thereby prolonging the mortgage bubble and adding to the financial and human cost of the crisis.

Santoro and Strauss make a compelling case for vigorous government enforcement of the Dodd-Frank Act in the face of Wall Street's opposition. Effective government regulation is not enough; economic prosperity will be sustainable only if Wall Street professionals themselves begin an urgently needed conversation about their values and business ethics.

Michael A. Santoro is a professor of management and global business at Rutgers Business School in New Jersey, where he has taught since 1996. Among Professor Santoro's books is *Ethics and the Pharmaceutical Industry* (Cambridge University Press, 2005, co-edited with Thomas M. Gorrie).

Ronald J. Strauss is an assistant professor at the Montclair State University School of Business and has more than twenty-five years of experience in the financial services industry.

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Preface

More than four years after the financial crisis that erupted in September 2008, there has been no dearth of books analyzing its origins. Numerous government hearings, documentary films, journalistic investigations, and a national independent commission report have all added to our understanding of the crisis. Certainly a reader might reasonably question the purpose of a new book on the subject. Our simple answer is that the financial crisis was fundamentally a crisis of business ethics rooted in almost three decades of moral, financial, and institutional transformation on Wall Street. Indeed, the most important finding of *Wall Street Values* is that business ethics and values matter, and that no amount of structural reform and government regulation will ensure the stability of the global financial system unless the ethical practices and values of Wall Street professionals are aligned with market efficiency and the public welfare. In

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this book we detail when and how Wall Street's business model and values diverged from the public interest, and we offer a roadmap for realignment.

At the same time that we seek to avoid the Charybdis of redundancy, we are mindful too of the Scylla of obsolescence. As *Wall Street Values* goes to press, each week brings fresh news of Wall Street's ineptitude and malfeasance – the botched Facebook offering by a once top-tier investment bank, a “London Whale” losing billions of dollars in unsupervised trading bets for a global bank renowned for its risk management prowess, and a financial firm entrusted with executing market transactions for customers big and small losing nearly half a billion dollars in one morning because of a software glitch that kept automatically trading without any human control. A reader might reasonably question the point of a book written before these developments fully unfold. Again our answer returns to the primacy of ethics, particularly in a time of change and turmoil. Two and a half millennia ago, Confucius, writing at a time of great transformation and uncertainty in ancient China, compared virtue to the North Star, remaining in its place while all the other stars moved about it. So too we believe that focusing on the ethical roots of the financial crisis elucidates how our financial institutions can operate in a manner that nurtures both profits and social prosperity.

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Just as after the stockmarket crash of 1929 and the subsequent sea change in government regulation of the securities industry Wall Street reinvented itself by focusing on fidelity and service to customers and clients, we believe there is an opportunity today for financial institutions to evolve to a more economically sustainable and socially beneficial business model. This process has already begun. Game-changing reforms, most notably the Dodd-Frank Act, are slowly reawakening and reinvigorating long dormant and outflanked regulatory institutions. The financial industry itself is fitfully undergoing dramatic transformation and reinvention as established institutions try to protect their customary turf and new players endeavor to edge in to prominence. Much more can and needs to be done.

We hope *Wall Street Values* will be of interest to different kinds of readers – concerned citizens, legislators, and regulators, as well as academics and journalists – collectively striving to understand the lessons of the financial crisis for our future. We are also hopeful that *Wall Street Values* will resonate with a global audience. The 2008 financial crisis originated when U.S. financial institutions stimulated a bubble in the U.S. mortgage market. The effects and lessons of the crisis are, however, global. The term “Wall Street” encompasses a global industry, not merely an address in downtown Manhattan. The

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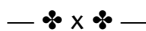
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capital markets are global; the financial system is global. The activities associated with Wall Street – raising capital, originating securities, advising on mergers and acquisitions, trading, brokerage and investment advising – are performed around the clock, across the United States in St. Louis, Chicago, San Francisco, and Dallas, and around the world in Toronto, London, Frankfurt, Paris, Milan, and Tokyo. Moreover, Dubai, Hong Kong, Shanghai, Mumbai, Singapore, and São Paulo, to name but the most obvious, have also emerged as leading financial hubs. Hence, while the great majority of our analysis concerns U.S.-based financial firms and developments in U.S. government regulation, we believe that shrewd observers throughout the world will understand that they have a stake in understanding the ethical roots of the 2008 financial crisis, if only to ensure that they not repeat America's mistakes.

We hope especially that *Wall Street Values* will engage the ingenuity and imagination of financial professionals at all levels of management from the boardroom to the trading floor. Much of what we write about the financial industry is highly critical, but our intention is to engage with industry leaders to initiate a much-needed dialogue about the role of ethics and values as well as the economic and social relationship of Wall Street to Main Street. In the wake of the financial crisis, public opinion about



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Wall Street is at an all-time low. In September 2011, the Occupy Wall Street movement tapped into an outpouring of popular discontent. The predominant image is of individuals who are greedy, unethical, and dismissive of the danger they pose to the broader interests of society. Sad to say, there is no shortage of individuals who fit this stereotype. We also know from our research and personal experience working in the business world that there are many thoughtful executives and leaders on Wall Street who want to make a positive social impact at the same time that they pursue the great personal and corporate wealth the financial industry makes possible. We hope *Wall Street Values* can answer many of the questions and concerns accompanying the increased scrutiny of the role of Wall Street in our economy and society, and also help focus reform efforts to channel this discontent into progressive institutional change. We strongly believe that our collective economic prosperity and our social cohesion will in the future depend on the courage and ability of Wall Street leaders to provide moral leadership. We invite them to consider the moral and economic analysis we present in this book and begin a long-overdue dialogue about Wall Street values.

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Finally, Ron would like to express his gratitude to his wife Jennifer and son Ben for their understanding and encouragement during the writing of this book. Jennifer has been a cherished partner, always available to edit, comment, and exchange ideas. To Ben, Ron writes: "My hope for this book is that it contributes to a better world for you and your generation."

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