

# Corporate social responsibility: benard madoff investment



\n[[toc title="Table of Contents"](#)]\n

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1. [2. The Case](#) \n \t
2. [2. 1 Situation and key facts](#) \n \t
3. [2. 2 Key stakeholders and their involvement](#) \n \t
4. [2. 3 Ethics and Values](#) \n \t
5. [3. Solutions](#) \n \t
6. [4. Evaluation](#) \n \t
7. [5. Conclusion](#) \n \t
8. [6¼ŽBibliography](#) \n

\n[/toc]\n \n

Corporate social responsibility (CSR), building on the literature from 1950s and 1960s (Carroll, 1999), actually is not a new concept, and in recent years, it has become increasingly popular and significantly important. As early as 1920s, Theodore Roosevelt (n. d. Cited in the Economist, 2009), then the president of United States, said 'Corporations are indispensable instruments of our modern civilization, but I believe that they should be so supervised and so regulated that they shall act for the interest of the community as a whole.' Obviously, free-marketers would argue that there is an invisible hand to self-regulate the marketplace, an opinion from Adam Smith (1776). But in the case of Benard Madoff, who committed one of the largest financial fraud, Ponzi scheme, in history and 'made a loss of nearly \$65 billion' (The Wall Street Journal, 2009), people do see some reasons to enhance the regulations in financial market. Also, the burst of the financial crisis in 2008-

09 urged people to rethink the financial mechanism and social responsibilities of financial services and securities firms.

The aim of this article is to get some benefit experience from CSR issues in financial market by means of analysing the case of Benard Madoff. The article will mainly focus on three aspects: the impact on various stakeholders, the solutions of the case including the costs and benefits of each course and the evaluation of solutions in a wider text and from a global view.

## **2. The Case**

### **2.1 Situation and key facts**

On December 11, 2008, as the arrest of Benard Madoff, the former non-executive chairman of NASDAQ and chairman of Bernard L. Madoff Investment Securities LLC, many investors, big firms, banks, charities, universities and even governments were in panic, realizing that they were involved in a giant financial fraud, 'all just one big lie'(Paley, 2008).

According to an official document on March 12, 2009 from the Department of Justice of United States (n, d), Madoff pleaded guilty to eleven felony counts related to a massive Ponzi scheme and faced a statutory maximum sentence of 150 years in prison. Actually, what Mr. Madoff did was simple; He continually paid high returns to existing clients with the funds injected by new investors without engaging in any form of legitimate investment activity and this is what people call 'the Ponzi scheme', named after Charles Ponzi who did such kind of financial fraud in 1920's (U. S. Securities and Exchange Commission, n. d.). However, it is easily understanding financial fraud that

tricked investors billions of dollars, not just because of the golden reputation of Madoff and the greediness of investors for 'high return', but mainly because of the lack of regulation of the financial markets. Even Madoff said, he could have been caught in 2003, but the investigators of the Securities and Exchange Commission (SEC) overlooked the problems and missed the chance again and again (NY Daily News, 2009). Besides, a federal prosecutor said the fraud could be dated back to at least the 1980s (Business Week, 2010).

## **2. 2 Key stakeholders and their involvement**

When the case was revealed, large numbers of stakeholders were involved and its victims are now scattered from Hollywood to Zurich to Abu Dhabi. Mr. Madoff has said, the losses of his clients might be \$50 billion. (Henriques, 2008) Among the stakeholders, many of them are prominent and famous executives and organizations while many of them are hidden victims.

In the list of big losers, some of them are familiar organizations like Bank Santander (\$3. 1 billion), Bank Medici (\$2. 1 billion), HSBC (\$ 1 billion) and Korea Life Insurance ( \$ 50 billion) while others are not known by many people but still are quite big multinationals for example, Tremount Group ( \$3. 3 billion), Ascot Partners (\$1. 8 billion), the world's largest sovereign wealth fund Abu Dhabi Investment Authority (\$400 million) and the biggest loser in the whole case, Fairfield Greenwich Group (\$ 7. 5 billion) which worked with Madoff's company for 20 years.(New York Times, 2008)

Other than firms and banks, some charities and universities were involved in the case. For instance, Elie Wiesel Foundation and Charities for Humanity (\$

15. 2 million) has been an investor since at least 1998 and nearly all of its assets were in Madoff's fund. Picower Foundation (\$958 million), the largest foundation that has announced its closure due to Madoff's fraud, had its founder Jeffrey Picower (a noted philanthropist) found dead at the bottom of his own swimming pool in October, 2009 (Bloomberg, 2009). Universities like Yeshiva University and Tufts University lost \$120 million in total. ( New York Times 2008)

In terms of the amount of money, the losses of many other ordinary clients seem not as much as the big stakeholders listed above but these clients and victims actually suffered severe loss. For example, a retired soldier Mr. Fox, who invested nearly \$ 1 million in Madoff's fund, killed himself after realising that all his life savings were gone ( BBC, 2009). Many foundations of charities closed down due to the fraud and as a result, scientific projects, healthy care campaigns supported by those charities were forced to close. For example, Innocent Project, a justice organization using advanced DNA detecting technology to help those wrongly imprisoned people, could not do more because its backer JEHT Foundation lost all of its money in Madoff's Ponzi scheme (BBC, 2009).

## **2. 3 Ethics and Values**

While many people were still in the despair of the financial crisis, the revelation of the case of Madoff not long after the crisis, undoubtedly gave another shock to the world. Just like The Wall Street Journal (2009) said 'Mr. Madoff's decline and fall added to national crisis of confidence and distrust of financial system. And the human cost has also been severe, with some investors losing all their money and at least one committing suicide.' It is <https://assignbuster.com/corporate-social-responsibility-benard-madoff-investment/>

obviously that a financial fraud ran by a major figure (former NASDAQ chairman) from market regulation and administration boards would yield many ethical issues/debates and distrust of the financial system.

### **3. Solutions**

From a speech made by President Obama (2009, cited in Guardian, 2009) on pushing an overhaul plan for financial regulation, 'Unless your business model depends on bilking people, there is little to fear from these new rules'. After the financial crisis, many defects and drawbacks of the existing financial system was exposed to the world and it was necessary to make a change and set new rules to rebuild people's confidence as well as the financial system. There are three solutions I have searched for and found valuable.

Firstly, creating new rules to protecting consumers and setting new customer financial protection agency to monitor the rules.(New York Times, 2010) The first solution aims at setting an agency that provide customers adequate information to make sure they clearly understand the rules of investments to enable them avoid the fraud. Also the new customer financial protection agency will force companies to behave within the rules, thus customers do not need to worry too much if there are hidden fees on the contract or if they will have burden on implicit responsibilities. One main reason that many people were attracted to Madoff's Ponzi scheme was the proud feeling of upper class due to the extreme ambiguity and high standard permission, thus no one knew what exactly the company did to generate the profit (The Times, 2009). In addition to the benefits that stakeholders can get on more information and clear rules to avoid unnecessary tricks, it may also restrict <https://assignbuster.com/corporate-social-responsibility-benard-madoff-investment/>

customers' choices and restrain the innovation from the financial companies (Horwitz, 2008)

Secondly, finding out the loopholes of the financial system and filling it to promote transparency and accountability. 'Where there were gaps in the rules, regulators lacked the authority to take action. Where there were overlaps, regulators often lacked accountability for inaction. These weaknesses in oversight engendered systematic, and systemic, abuse.'(Obama, 2009). As mentioned before, Madoff admitted that he could have been caught several years before, but the investigators of SEC overlooked the problems again and again. According to New York Times (2008), Madoff who used to be the chairman of NASDQ, had intimate relationship to the officer in SEC and his niece's husband was an officer in SEC. In addition, Madoff has donated nearly \$240, 000 to federal candidates, parties and committees since 1991 and thus gain access to Washington's lawmakers, regulators and other top grade groups (New York Times, 2009). These two main reasons lead to Madoff's long lasting financial fraud and his caught in such late time.

Therefore, it is necessary to set rules that the major figures of the market regulation committee should be chosen outside the financial industry and government regulators and lawmakers should not accept money from bankers or entrepreneurs, whether in terms of donations or other excuses. Also a totally independent inspection committee which has no constraints from other organizations or big figures is needed to maintain the legitimate investigation activities (Galbraith, 2008, cited in Public Broadcast Service, 2008).

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These rules can obviously increase the accountability and transparency of the government regulation departments and rebuild the confidence of investors. But on the other hand people from outside the financial industry can not well manage and understand the financial industry which may lead to the low efficiency of working.

Thirdly, the pressure from victims and communities can well push companies to behave responsibly to society and urge government to take corresponding actions to help them or make new laws. As a report from Wearden (2009) said, thousands of victims who lost their savings invested in Madoff's Ponzi scheme joined up and launch legal action. They actively asked government to enhance regulation of financial regulation and asked for compensation from Madoff's company. After they got united and protested, they successfully caught the attention of the news agencies which in return gave a lot of pressures to government. However, the over concern of the scandal by news agencies may weaken people's confidence towards financial market, and it may spoil some victims who try to get compensation that more than their actual losses.

#### **4. Evaluation**

For the three solutions above, the first two are the government solution which indicates the government intervention; the third one is customers' solution which indicates customers actions on their own initiative. As Sloman (2009, P329) stated, people can use cost-benefit analysis to weight the outcomes of a solution or decision. The basic theory of cost-benefit analysis is to outline the costs and benefits in terms of monetary aspects and non monetary aspects like psychology effects of the human mind.

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Firstly, from the government's angle, government intervention is necessary to tackle the financial crisis and financial crime. One of the main reasons of the burst of the financial crisis is lack of regulation and companies kept selling various financial derivatives to earn the money that belongs to the future (IMF, 2009, cited in Economist, 2009). Due to the high complexity of financial derivatives, hedge fund crime is hard to be revealed and what Madoff did was to pretend to sell hedge funds. So setting strong rules and independent regulation agencies is a crucial step in preventing this.

President Obama (2009) used to say 'we (government) have a responsibility to write and enforce these rules to protect consumers of financial products, taxpayers, and our economy as a whole.' But on the other hand, the too tighten rules may probably stifle innovation and enterprise, thus the government need to work closely with the financial industry to handle to an extent what they need to achieve.

Secondly, standing on the consumers' solution, if consumers who suffer a lot in financial crime actively get united and launch legal action or protest, the news, the whole society will pay more attention to the case and then urge government to take further corresponding actions urging companies themselves to self regulate and compensate victims. However, there were negative effect in the case of Madoff, where the protest by victims and over concern of the case by news agencies caused panic to other people and in turn many people lost their confidence on the financial market, which worsened the financial crisis (Wall street journal, 2009). Also, consumers themselves should be cautious before they buy financial products from

financial service firms and should not easily believe high purported return products.

## 5. Conclusion

In the case of Madoff's financial fraud, which made a \$65 billion dollar loss, there are many reasons why it happened. Reasons include; the irresponsibility of Madoff and his company, consumers' greed for high return and their incautiousness and mainly because of the lack of regulation in the financial market, which is also the main reason for the financial crisis. To enhance the regulation, there are two main methods, one is the direct intervention from government and the other is the pressure from various communities and organizations. Now the government regulation is more important and urgent to the financial market. The governments still have a lot of work to do, not just for the financial market but also for the whole business and for the world as a whole. Whether it will work and create a brighter future, time will give the answer.

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