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Diagnosis of Financial Corruption of Iranian Banking System

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ABSTRACT: In many countries of the world, banking system financial corruption has become a central issue and a major obstacle to the course of national development. Basically, financial corruption stands on the opposite side of “accountability” and “governance of law”, undermining public trust in government and particularly the banks. Iranian banking system has always been encountered by major dilemmas which are attributed to type of ownership, type of activities, governing laws, scarce resources, number of supervising bodies, hardware/software inefficiencies, lack of understanding and trainings as well as improper managerial methods. This research aims to conduct a course of diagnosis on Iranian banking system. This is a survey research with bank staff, professionals and academic professors as statistical population. Random cluster method was used for sampling which were ultimately 196 individuals in size. For the purpose of data collection, questionnaire was used, then Likrat tests was used to analyze data, and reliability and validity were ensured using Cranach Alpha. Descriptive statistics such a frequency distribution/frequency percentage tables and column figures were used to review demographic variables of the statistical population of this research and to determine frequency distribution of respondents of questioners. Further, deductive statistical including Pearson test was used to find the relationship between factors and Friedman test was used to prioritize such factors using Microsoft Excel and SPSS. Results indicate that each factor has a significant role on financial corruption in banks.

***Keywords*:** Banking, Financial Corruption, Law-Breaching Inclination, Supervision.

INTRODUCTION

Financial corruption is an organizational concept which has dramatically troubled countries development. Misusing the authorities and committing financial corruptions occur from the very beginning time of emergence of states/government and establishment of administrative bodies and public entities posing threats to communities and public.

Financial corruption has emerged in different forms from when human relation started, to which the old Greek philosophers have referred repeatedly in their writings (Gong, 1994).

Financial corruption is a multi-dimensional concept with great variety of causes and different functions in different contexts. It has sometimes emerged as a result of an inefficiency in political structure and economical system, and sometimes it is resulted from a personal ethical/cultural wrongdoing.

Corruption may result in social losses when it is accompanied by motivation decline and it can end in political losses when accompanies by weakness in existing authorities and end in economical damages when resources are appropriated unfairly. United Nation Developmental Program (UNDP) defines corruption as an act of misusing administrative/gorvnmental authorities for the benefit of some personal interests, which is characterized by bribery, extortion relatives orientation, cheating, embezzlement, and equates it with increased exclusive power and personal dissection and declined responsibility and lack of transparency (UNDP, 2004).

Banks play a strong, influential role in countries’ economies. They are powerful enough to cause and control much of economical/financial crises. More importantly, banking processes are to much extent subject to corruption. Interestingly, criminals tend to penetrate in banks and control them to launch their illegitimate activities.

In view of the central role that banks financial corruptions may play in economical and developmental programs of every community, and the importance of banking diagnosis, this article intends to highlight such aspects in order to make an insightful understanding of this concept in governmental managers and authorities, particularly banking sector, to prevent it.

Problem Definition

Financial corruption has always drawn much attention of states and international organizations including ECO, International Monetary Fund, World Bank etc., because of its profound negative role on performance of administrative, economical and banking organizations. It can add to income inequalities through giving the opportunities for bribery and misuses and providing for breaching others' rights. A powerful and effective campaign against financial corruption in every country requires a proper understanding by public and officials. Studies on financial corruptions in banks level indicate that it is increasingly becoming complicatated, requiring optimal solutions for its eradication.

Concentrating on influential factors in emergence of financial corruption in banking system, this article seeks to define the importance of each factor from bank managers/employees/professional/academic professors' perspectives.

Research Necessities and Importance

Since banks are the main backbone of any given economical system, and the effective role they may play and their functions in economies, they are required to be scrutinized closely in order to prevent factors that influence financial corruption and its spread over banking system, and to find proper ways to eradiacte it. This process must be structured and organized with proper plans. Since no corruption shall be eradiacted without such pre-requiestes. Therefore, to conduct an efficient anti-corrutpion campaign we need to identify the aspects of a financial corruption in Iranian banking system and conduct an insightful review on the depth of the corruption in society. Our current position in Iran suggests that we not only need to direct all our instruments to conduct such an action, but we need certain corrections on our existing sutructes and systems.

Research Goals

Primary Goals

To get some insightful understanding on root causes of financial corruption in banking systems

Secondary Goals

1- To understand relationship between lack of sufficient supervision and financial corruption in banks
2- To understand relationship between insufficient performance and financial corruption in banks
3- To understand relationship between law-breaching inclination and financial corruption in banks
4- To understand relationship between lack of an efficient punitive system and financial corruption in banks
5- To understand relationship between poor trainings and financial corruption in banks
6- To understand relationship between individual personal orientation and financial corruption in banks

Research questions

What are the corruption aspects and factors and which ones are more important?

Research Hypothesis

There are meaningful relations between factors imposing financial corruption in banking system

Figure 1- research process

Review of theoretical bases of research

Prior studies
Devising theoretical framework
Field studies
Data collection
Data analysis
Conclusion

Research Methodology

Our research method is compatible with a theoretical framework. It is a method designed to collect data in which a number of individuals are asked to answer to a certain number of questions. Such answers form part of our research data (Hejazi, Sarmad, Bazargan, 2000).

Survey is a method designed for social research which provides a structured collection of data. A survey research seeks mainly to find a “cause and effect” relation and to document the hypotheses that are formulated as cause-effect (Delavar 1990, 2013). Questionnaire is the simplest and the most common technique used by a survey method.

Data Collection & Analysis

For the purpose of our theoretical fundamentals, we conducted library studies including books, monthly magazines, research publications, theses, articles, internet etc., and used them as references to form our theoretical part. The next part of our research was conducted in the field. Questionnaires were used to collect data that we needed to test our hypotheses, because they are the mot important instrument and technique for a data analysis process (Daus 1996: 4).

As a direct way to collect data, questionnaire is, therefore, primary instrument to make measurements.

After data collection, data analysis using SPSS is started. We used deductive and descriptive statistics, wherever it deemed necessary. For the purpose of hypothesis testing, we sought relationship between variables and started to analyze it using relevant statistical tests such as variance analysis, Pearson coefficient correlation.

Statistical Population and Sample

Our statistical population is comprised of banks staff, academic professors, professionals and a number of bank clients.

Sample Size

Since our statistical population size is unlimited, we can determine the size of our sample through the following relation:

Since we aim to estimate the variable feature, we can use the following relation:

Studies indicate that if , in data collection, a method designed to estimate polling P is used , then determination of “d” within the scope of 0.04 to 0.07 is acceptable (Azar, Adel, 2009: 239)

Validity & Reliability

Validity

Content validity is a structural feature of the instrument which is fabricated at the time of devising the test (Hejazi, Sarmad, Bazargan, 2000).questions of our quesioaire are identical to the questions that have been used in similar studies. 18 questions were initially extracted from research literature and then were distributed among 10 university professors, professionals, managers and bank experts. 12 questions were finally agreed by the above-said elite to form our research questions. Therefore, we can be sure that our questionnaire has validity.

Reliability

To ensure reliability, Cronbach Alpha was used. “Cranach Alpha coefficient relation” is commonly recommended for “multiple options” questionnaires which are:

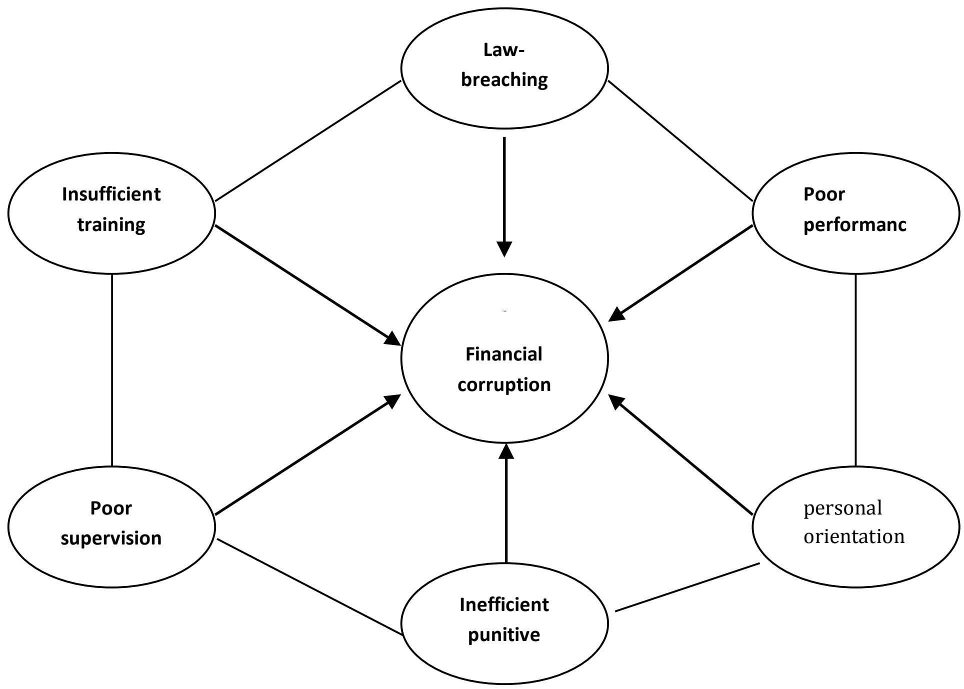
The alpha coefficient was calculated using SPSS to be 0.95. Hence, it can be claimed that our questionnaire has reliability: that is, the answers are not casual and random, instead they are as a result of the variable impact which was used.

Research Method

This research is applied, in terms of its objective, and its implication is to achieve some practical results with respect of the impacts of a variety of factors of financial corruption on banking system corruption. From data collection manner perspective, it is a descriptive research whose principal instrument is questionnaire.

Research Model

The following is Author’s recommended model:



Research Hypotheses Testing through Regression Model

In this section, we regard the six variables (research hypotheses) as six separate variables as factors influencing financial corruption on banks.

Table 1. Regression of Factors Influencing the Financial Corruption in Banks

Meaningfulness	F value	Mean Squares	Freedom Degree	Mean Squares	
0.002	10.58	11.84	6	71.76	Regression
		1.11	233	260.675	Remainder
			239	331.733	Total

Considering the 0.002 meaningfulness (which is lower than 0.05), it can be observed that there is a meaningful relationship between the factors and financial corruption in banks.

Table 2. Factors Coefficients

Meaningfulness	T value	Standard Eroor	Coefficient	
0.130	-1.520	0.707	-1.075	Origin width
0.009	2.745	0.110	0.302	Inefficient punitive system
0.009	3.908	0.083	0.326	Poor supervision
0.016	2.487	0.129	0.320	Law-breaching inclination
0.032	2.111	0.108	0.227	personal orientation
0.008	2.941	0.140	0.411	Poor performance
0.033	2.088	0.076	0.158	Insufficient training

Since each factor’s meaningfulness is lower than 0.05, it can be concluded that all the six factors have impact on financial corruption in banks.

Friedman Test

As was observed in the prior section, respondents believed that there is a relationship between the six factors and financial corruption in banks. Now we aim to use Friedman test to find which one has more significance from respondents’ opinion, or is there any difference between the factors in terms of their impact or not.

Considering the meaningfulness of 0.004 which is lower than 0.05, it can be concluded that there is a difference between the said factors in terms of their impact on financial corruption in banks, as is evidenced by the above table which shows that every factor with higher rank has more significance.

financial corruption

Great many definitions have been provided of the "financial corruption in banks" so far. Some scholars have some more serious definitions. The term "Corruption" (in Persian language) is derived from a word which means "to prevent from sound and perfect actions". In English language, it is derived from "rumpere" which means "to beach/to violate something". Sometimes the "something" may be a regulation or administrative process (Tanzi, 1999).

Corruption definitions vary by area and process (Dadgar, 2004).

Hence, financial corruption is referred to an illegitimate possession of governmental properties and misusing one's position and powers. It is characterized by bribery, extortion relatives orientation, cheating, embezzlement, economical misuses, illegal exploitation of properties, misusing financial advantages etc. in simpler words, financial corruption can be defined as misusing one's governmental (public) positions and authorities for some personal benefits (Sterfield, Bita: 20-13).

Financial Corruption Consequences

Spread of financial corruption in a country results in some economical implications including:

1-12 Negative Consequences Financial Corruption on Resource Allocation

Financial corruption can paralyze a sound process of resource allocation by government, and can undermine principal national priorities, giving illegitimate interests a higher priory. That is how individuals are inclined to take illegal routes and tend to achieve immediate and easy profits instead of doing something to flourish capabilities and talents.

Negative Consequences of Financial Corruption on Income Distribution

Such consequences are attributed to decreased oil revenues, in turn, undermining government's ability to complete constructional, basic and infrastructural projects and to push developmental plans ahead. Improper income model causes inequality and sharp class differences, preventing accomplishment of social justice in the long-run, and lowering social welfare of the low-income class of the society, stopping the investments of government to do something in the benefit of that class of society.

In our country, financial corruption has long been a common thing. Most of our kings and governmental officials were typically corrupt, with and inclination to misuse their positions and authorities in large-scale transactions. Under Pahlavi, Iran was fiercely suffering from from bribery, embezzlement, and financial corruptions in such a degree that it had become a national phenomenon. In that era, governmental got used to coincide with corruption leaving the root cause aside forever (Nejati, 1997).

Negative Consequences of Financial Corruption on Economical Productivity

Corruption draws attentions to itself and so little attention and efforts remain to be made for legal economical activities. Domination of corruption strengthens corrupt intentions and incurs lethal consequences.

Negative Consequences of Financial Corruption on Economical Growth

Financial corruption deeply affects economical growth leaving an adverse influence on economical development. Decreased economical productivity, improper allocation of scarce resources and inappropriate income distribution accompanied by investors' reluctance to make investments in the long-run leave negative impacts on economical growth (Litt and Wideman, 1999).

Improper Allocation of Scarce Resources

Corruption in budgeting undermines development networks and social security. In a corrupt system, main portion of the budget is spend for small-populated areas instead of spending them for densly- populated areas with higher social priorities.

Financial corruption disturbs governmental expenses system, because corrupt statesmen tend to spend resources everywhere which yields higher profits for them. For instance, they prefer to allocate resources to purchase war planes and high profile large-scale projects instead of book industry and increasing teachers wages (Hosseini, 2001).

Financial corruption slows down the economical growth rate, because it makes domestic and foreigner investors unwilling to make investments. Studies suggest that countries with higher corruption impose to their investments an additional 20% tax compared to countries with little corruption (Gholipour, 2004)

When corruption permeates deep into a system for a long time, people get accustomed to coincide with it and so no motivation shall remain to fight against it even if everybody knows s/he shall be better-off without corruption. Assume that you are a low-rank employee of a governmental agency with corrupt managers, and you are offered bribes – tax exemptions for instance. You reject it. After a while, your boss offers you a promotion if you assist his friend, otherwise he shall get you transferred to a far-distant area. Under such circumstances you accept the bribe and therefore you become a part of their corruption.

Negative Consequences of Financial Corruption on Society

In the recent decades, some scholars believed- for reasons that prove unreasonable now- corruption can play a facilitating role. They claimed that financial corruption may occasionally be an effective way to shortcut interfering regulations for the benefit of enjoying economical opportunities and projects, therefore offering bribes for such intentions can yield fruitful results (Linn 1986-341 and Huntington 1968).

However, corruption makes decision-makers make faulty decisions, because they tend to back under-standard, complicated, cost-consuming projects which cannot be audited easily in order to gain more and more from them (Gholipour 2004, 41).

Financial corruption intensifies class differences and inequalities because resources are allocated to the sectors which can afford to repay. In other words, individuals with better financial and position abilities are likely to attract more resources, which , in turn, causes فاصله طبقاتی ------------- to sharpen (Goldtourp, 1991)

Country's Banking System

Diagnosis bases itself on the insightful understanding of how an organization works. Theoretical frameworks that have been devised by organizational development scholars are known as "diagnostic models". Such models play a decisive role in organizational development plans (Farhangi, 2000).

Much attention has recently been paid to economical implications of corruption in various countries. A number of studies indicate that the most important factors that intensify corruption in a given society include: beaurocracy, governmental pays, laws functions particularly anti-corruption laws, natural resources availability, competitiveness, free trading as well as industrial policies of countries.

According to the definition introduced by Shifler and Veshini in 1993, corruption is "misusing governmental properties for some personal benefits. With respect to dishonest to Islamic Government Reserve, Imam Ali warned (letter no. 20) Ziad Bin Abieh- Constitute of Basra Governor- that " I swear to God that once it was reported that you have committed dishonest acts with respect to Islamic financial resources that have been given to you in trust, I shall punish you very seriously that you become unable to even feed your household." Such a warning can show the importance of keeping monetary resources away from any misusing and dishonest acts. Imam Ali had a high degree of sensitivity to such acts, as is evidenced by the above-mentioned letter. just like many other developing countries, our country's financial system depends on banking sector. On the other hands, banking system has the greatest role – and sometimes an exclusive role- in provision of financial resources. Such a structure has brought about many dire consequences for our economical system.

Governmental Domination, Ownership and Management over Banking System

Perhaps a major trouble of our banking system can be attributed to the governmental environment that our banks operate in. our economy is governmental in essence, which means that government has a direct ownership and involvement in it, leading to direct engagement of government to meet large portion of our national economical needs and use banking system as a reserve to back its plans, inject resources to any sector it aims. That is why certain discussions such as credit ceilings, commission facilities, preferred interest rates etc., are posed and the monetary policy serve to back governmental financial plans, and at the time of resources allocations, mere political and non-economical criteria are taken into account instead of productivity and economical standards. Hence (resources are not allocated optimally accompanied by governmental reluctance and poor managerial methods) imposes annual budget deficit and so the government finds no option but to resort to borrowing from Central Bank whose symptoms include increased national money base and increased inflation taxes which surface gradually.

Under such circumstances, any resource that government allocates to economical sectors loses their profitability and much of them are wasted to pay delayed debts. Here in this situation, banks lose their motivation to fulfill their missions to maximize their profits.

Lack of a Totally Independent Central Bank

A main Iranian problems in banking sector is a dependent Central Bank which is based on the monetary and banking laws of 1972 and their subsequent amendments. After Islamic Revolution, Central Bank was dominated by Ministry of Economical Affairs.

This led the Ministry Economical Affairs to take advantage of banking sector and Central Bank – the government's financial policy-maker- to accomplish its programs. It, in turn, causes the monetary policies to serve financial policies and gradually lose its efficiency. Constant budget deficit for two decades of Islamic Banking operation in Iran as well as government's borrowing from Central bank resulting in overwhelming increase in national money base and also double-digit inflation and imposing unfairly a full burden to the public are all attributed to the dependency of Central Bank to government. Indedpence means that Central Bank only fulfill its natural duties; i.e., to engage solely in handling national monetary policies, if so, it doesn't matter how it must deal with government or other bodies, just as it is not the case in most of the developed countries.

Improper Monetary Policies

Central Bank has always been expected to make efficient monetary policies; an expectation which has not yet been met. The monetary policies adopted by the said Bank during the recent two decades has been fiercely influenced by governmental financial policies from one hand and has put the full burden of government's budget deficit to the public, fueling the economical sufferings and poverty in the community, and has limited banks to attract resources and has led them to allocate resources for non-deserved purposes.

After implementation of interest – free banking system, Central Bank has used "legal cashflow ratios, credit ceilings, interest rates control, credit controls" in its monetary policy making. Also known as monetary policy instrument, such factors not only have proved inefficient in inflation control and optimal allocation of resources in Iran, they have been substituted by indirect instruments. Such indirect instruments such as "legal deposits, facilities for additional withdarawal, public sector deposits, credit sales, open operations in primary and secondary markets and currency swap operation" can be used provided that they lead to economical stability in large scale and lead to optimal allocations.

In fact, government has compensated its budget deficit by lowering people's purchase power and imposing unfair taxes to people, instead it could borrow from people and could commit itself to pay back its borrowing, without undermining purchase power of the people.

Complementary Facilities High Role in Iranian Banking System

A main trouble of Iranian banking system is commission facilities which has sharpened optimal resources. Due to heavy budget deficits after Islamic Revolution, government's attention shifted from budget financial resources to banks financial system. From here, semi-governmental involvements in financial system started and repeated uses of financial resources made the government take them as budget resources. Government domination over banks sharpened this vision as well. It had a multiple aftermaths.

Lack of Transparency

Lack of transparency in bank interests has created an additional trouble to Islamic Banking. While depositing and facilities are provided under certain rules, most of money suppliers and money demanders resort to unofficial markets, resulting in negative consequences on economical stability and sharpend inflation.

Causes of Fiancial Corruptions in Banking System

1-15 lack of transparency and sense of accountability in administrative processes: in an open system, higher non-transparency and unaccountability toward clients and the organization, specifically toward supervisory bodies, higher administrative corruption and vice-versa. It must be noted that this rule is more important in higher levels of the organization. When top level of an organization has higher degree of commission, the sense of commission shall be passed down to the middle classes and clients.

2-15 Excessive Authorities to Managers: in some systems, it is observed that a manger is both responsible to executive affairs and supervisory processes. This structure can decline transparency and unaccountability in that system.

3-15 Instablity in Management: when a maanger finds its position instable s/he shall become reluctant to his/her duties, which, in turn, results in administrative corruption.

4-15 staff sense of occupational insecurity

5-15 faults, complications, conflicts in laws and administrative rules

6-15 lack of a wise system in admissions and dismissals: lack of a wise system in admissions and dismissals is a main cause of administrative corruption.
7-15 inefficient and poor administrative system
8-15 lack of trained staff
9-15 relatives orientation
10-15 lack of motivation systems and promotion/punitive processes
11-15 small knowledge managers

Recommendations in Prevension of Corruption and Financial Offences in Banking System

1-16 strengthening religious foundations in staff
2-16 implementation of a deserve-orientation system in organization
3-16 wise treatment with staff , based on scientific, Islamic and human dignities and standards
4-16 direct attention to payments and bonuses
5-16 application of an effective promotion/punitive system
6-16 implementation of self-controlling system in individuals through strengtheining their common sense
7-16 holding training courses aiming to improve knowledge and insight in personnel
8-16 getting staff participated in plans, programs and organizational decisiosn
9-16 job and position changes
10-16 creation of reliable environment accompanied by trusts and cooperation based on human decent relations among personnel
11-16 identification of advantages and disadvantages of personalities, duties and knowledge
12-16 efforts to expand administrative justice and removing discriminnatios
13-16 strengthening law- commission sense
14-16 privitization and down-sizing the government
15-16 taking advantage of successful experiences of other countries

Research Results Analysis

1-17 the most effective factor in financial corruption in banks is law-breaching orientation which was found through Friedman variance. It requires to identify causes of corruption and to make relevant corrections
2-17 smilification of methods and processes to minimize corruption possibilities
3-17 creation of multiple supervisory bodies which were created mainly after Islamic Revolution. Variety of duties and goals and lack of proper information exchange and lack of coordination in polices pariticlarly in cross-sectional policies
4-17 performance assessment makes assessments on factors that have been chosen scientifically and practically. Assessors have been trained as to how they must make a proper evaluation on ourcomes and how to pass them to staff in order to make an analysis and diagonosis on the existing mechanisms to provide an appropriate model that is compatiblbe to overall stragetis adopted by bank.
5-17 bank mangers must review their organizational structure aiming to devise a proper model taking bank considerations into account in order to get the existing processes reengineered .

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