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The Bank-Shares Regulation Affair and Illegality in Israeli Society: A Theoretical Perspective of Unethical Managerial Behaviour

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Deviant managerial behaviour, involving senior members of the administration, society and the economy is a universal phenomenon. In Israeli society it has recurred several times, gradually becoming more common since the establishment of the state some fifty years ago. The Bank-Shares Regulation Affair, which came to light when the stock market collapsed in October 1983, is regarded as one of the gravest cases to date in terms of its consequences and implications for Israel's economy. Its investigation by a national commission of inquiry, headed by Judge Moshe Bejsky, exposed not only the flawed structure of norms and values that became entrenched in major parts of the Israeli governmental system, but also the deep economic implications of government involvement in the capital market.

The regulation process, which took place in the late 1970s and early 1980s and reflects a significant phenomenon in Israel's macro-economic, social, political and cultural space, poses two questions: first, what led senior managers of Israel's financial elite to violate conventions of behaviour, norms, procedures and laws? And secondly, what were the mechanisms in the environmental and organizational contexts in which the bankers operated that constructed the legitimacy and motivations for this deviant behaviour?

The aim of this paper is to discuss these questions through a historical and theoretical analysis of the bank managers' behaviour in the regulation affair, focusing in particular on the environmental and organizational contexts in which they acted. For this purpose we used social science theoretical models, specifically those relating to factors, processes and mechanisms that influence decision-making and organizational behaviour.

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The empirical material for our research is based on the 1986 findings of the National Commission of Inquiry headed by Judge Bejsky, and those exposed in Verdict 524/90 by the Jerusalem District Court in 1994. In addition, we analysed interviews in the daily press with the bankers and other personalities connected with the affair during and after the regulation. The argument of this paper is that deciphering the processes and mechanisms in the organizational environment is necessary in order to isolate the factors that encourage managers to employ deviant behaviour, and to develop an approach that can identify and limit the recurrence of such behaviours and malpractice in the future.[1]

A THEORETICAL PERSPECTIVE

The term 'deviant behaviour' denotes behaviour that the members of a society consider dangerous, embarrassing or annoying to the extent of placing sanctions on the deviants.[2] A deviant is someone who has been effectively labelled as one.[3] The only way that an outside observer can determine whether behaviour is deviant is to learn about the criteria used by the society as it reacts to such behaviour. That is to say, this is a term with social and political contents that also reflects the social power to label others' behaviour. This kind of labelling serves to identify deviants, mark them and single them out.[4] It is done in order to guard the boundaries of society, have its members restrict themselves to a certain circle of activity, and regard any behaviour that deviates from it as improper or immoral. In this way the community maintains its cultural identity.[5]

On the other hand, a differential association approach would suggest looking at this phenomenon from a socialization perspective. It suggests that delinquent behaviour is learned or acquired through interaction and communication with other people, and that the main part of the learning process takes place in intimate groups (the top bankers in the case under discussion). When delinquent behaviour is learned, it includes techniques for committing criminal acts, as well as motives, pressures, rationalizations and attitudes.[6] In this sense, a person has to learn not only the technique of committing crimes but also how to internalize the 'proper' attitudes towards them. Moreover, individuals cannot systematically and consistently do things that are in conflict with their principles and values without finding some suitable justification. As they are not entirely dissociated from the norms of society, they need 'neutralization' techniques, namely forms of thinking and rhetoric that both enable them to accept that they are performing illegal acts, and to neutralize feelings of guilt that arise from their practice.[7]

Furthermore, the direction of the pressures and motives that act on a person to keep the law or break it is influenced by socialized positive or hostile conceptions of the various laws. In some societies the individual is surrounded by people who see the law as an imperative, while in other societies individuals are influenced by groups that favour and legitimize law breaking.[8] Thus, with regard to the shares regulation affair it was essential to examine societal values and norms in order to determine how far groups in Israeli society lent support to law-breaking, which groups the bankers interacted with, what they learnt and acquired, and how they neutralized their misbehaviour.

Analysis of the phenomenon is further facilitated by an integrative model developed by Vardi and Wiener for the identification of deviant behaviour in organizations, known as 'Organizational MisBehaviour' (OMB). The concept refers to 'any intentional action by members of organizations that violates core organizational and/or societal norms'.[9] Their model distinguishes between different types of deviant behaviour in organizations according to the main intention behind it. One of these is deviant behaviour intended for the good of the organization (OBM type O), which is more prevalent among managers at the strategic level (for example, concealing information from an external party or scheming to cheat the authorities). Normally, actions designed for the good of the organization are based on such strongly held attitudes as identification and involvement with the organization. The model suggests that unethical or deviant managerial behaviour might be a result of such attitudes, though it also ascribes importance to other contributing factors, such as organizational goals, cultural cohesiveness and opportunity structure.

No less telling is the examination by Hosmer[10] of the decision-making processes of managers in situations of ethical dilemma, focusing on three groups of antecedent factors. First, the economic factors, which reflect the typical answers of business managers, such as the desire for efficient use of resources and the maximization of profit in the context of market pressures and lack of resources. Secondly, the social factors, which are associated with the question of the application and acceptance of social norms and laws. Finally, ethical considerations, which refer to ethical norms. These factors may serve in an analysis of managers facing an ethical dilemma.

Focusing on managers, Izraeli developed a model of 'Stakeholders Circles', which situates the manager in five circles of environmental factors: social, business, professional, intra-organizational and personal. The first four circles include factors of the organization itself, while the fifth circle is indirectly affected through the managers' interaction with their personal environments. Each circle contains various types of stakeholders, who influence the organization and are influenced by it. Thus, Izraeli's model assumes that the behaviour of senior managers, who are present in every one of these circles, is influenced (owing to the fact that they represent the organization and liaise between it and the environment) by the social, cultural and political constraints of their environment, and the value system and cultural norms derived from it, as well as by the economic constraints (the state of the market, the competitors and the company's financial balance) which are, in fact, the sources of legitimization and motivation for their ethical/unethical behaviour. At the same time, they are influenced by the specific characteristics of their organizational environment: the role structure that gives them broad autonomy in decision-making, and the ability to influence many 'stakeholders' in their organization and in the immediate environment.[11]

These theoretical perspectives facilitate a system-level analysis of the bankers' managerial behaviour, namely, the examination and identification of the characteristics of the socio-cultural, economic, political and organizational environment, while focusing on the interactions of the bankers as a group with each of these components or circles in the system. Our main assumption is that the group of bankers involved in the regulation, and the way in which they operated, were the product of these reciprocal interactions, of institutionalized partnership relations, which constructed regulatory mechanisms and arrangements between the bankers and the Israeli state. These relationships influenced the deviant behaviour, and led to the settlements, which resolved the bank-shares crisis. First in order, therefore, is the discussion of the *relationships in the environmental and organizational context* that influenced the bankers, and constructed the legitimization and motivation for their deviant behaviour.

The use of this analytical framework, rather than focusing on the personal characteristics of the figures involved in the regulation affair, raises the question as to whether it is possible to understand and explain managerial behaviour in general, and deviant managerial behaviour in particular, through examination of the social, cultural and economic contexts that embody the norms, values and customs of the environment in which the bankers operated. Thus, to what extent can the mechanisms in the socio-cultural environment help explain the 'normative ecology' in which the bankers functioned, and the orientations of the public and the political elite towards the legal system? Can characterization of the economic environment that made the regulation possible assist in comprehending their perceptions of their actions? Furthermore, to what degree is managerial policy, its goals and methods in particular, the result of environmental-situational constraints on the organization? And are the sources which motivated and legitimized the bankers to embark on share regulation to be found in the social, cultural and organizational environments?

Accordingly, we begin with a description of the affair and a presentation of our research method. In the second part, the affair is analysed at a systems level, namely, the socio-cultural and economic environment. The third part focuses on the organizational level: the organizational culture and its influence on the bank employees, the opportunity structure of the senior managers, and the mutual impact of managerial colleagues on behaviour.

THE BANK-SHARES REGULATION AFFAIR

For six years, from 1977 to 1983, the highest echelons of Israel's banking system behaved fraudulently in order to draw in as many investors as possible, while exploiting their power in the economy in general and its institutions in particular. The aim of the scheme was to maintain bank profitability and stability, threatened by rising inflation and by competition with government-issued bonds.[12]

The 'regulation affair' involved bank intervention in the prices of their shares. Through regulation the banks sought to mobilize capital from the public so as to enable them to issue shares independently of supply and demand and the shares' real financial value.[13] The bank managers used various techniques to effect a change in the working of the free market, a market in which supply and demand determined the shares' value. Throughout the regulation period the banks were able to 'grant' their shareholders real positive returns at a higher rate than the capital market's financial instruments (the Local Resident Foreign Currency Account and the Government Loan Stocks). The regulated share became a unique financial good, a share that rose constantly regardless of the state of the market.

Apart from the need of the banks to find sources there was also a legal difficulty. Clause 139a of Israel's Company Ordinance states that a company will not directly or indirectly give any person financial assistance – in the form of a loan, bond or guarantee, or in any other way – for the purpose of purchasing its shares, or in connection with such purchase that has been made or is about to be made.[14] As a company that acquires its own shares in fact reduces its capital, and as reduction of capital is permitted only by a special court order, the bank managers overcame this difficulty by ensuring that shares would not be acquired directly. They therefore set up straw companies in countries where business was exempt from taxes, and used seemingly external companies, which were engaged in manipulating bank-stocks and other shares associated with it.[15]

These companies were, in fact, connected with the banks, acting according to their instructions and serving as the main organs for acquiring the bank-shares during the regulation period. In this way the banks' direct involvement was concealed. The assumption was that if the demands for shares were scattered among many companies, it would be easier to hide them from the state's supervisory authorities. The straw companies were thus the pipelines through which the money was channelled. However, they succeeded in swaying the trends and level of the shares by systematically exploiting the stock market trading method, the 'leader' system, in which orders for the purchase or sale of the various shares were given before trade had opened. This was done in breach of clause 54a (2) of Israel's Securities Act, which determines that anyone who fraudulently influences fluctuations in rates of securities contravenes the law.[16]

Technically, the regulation was achieved by introducing fictitious demands in the leader, which is the daily sum of all the purchase and sale orders that reach the offices of a member of the stock exchange up to a set hour before the beginning of trade. Since the leaders of the large banks constituted a large part of the stock market activity, they provided an indication as to what was expected in trading in the various shares that day. Therefore, the leader allowed for the hiding of the real situation of the stock market. The banks acted simultaneously as a leader that pooled together demand and supply, as a financial institution with (ostensibly unlimited) means, and as a member of the stock exchange that could give instructions to buy and sell during the trading. This duality allowed the banks to channel demand or supply to the leader as easily as they wished, and thus turned into a gross violation of the aforementioned Securities Act.

By using leaders, scattering demands through separate bodies under their control, and making a significant proportion of their transactions outside the stock exchange, the banks were able to hide the share regulation from the public and the supervisory authorities. The prospectuses published by the banks up to mid-1979 contained no mention of the regulatory actions taken. However, at the end of 1980, in view of the many findings on the scope of their intervention in stock regulation, the banks were compelled to publish their activities in the prospectuses, but the bank managers asked the authorities to exempt them from giving information during this prospectus season.[17] As the process continued, the bankers did not hesitate to ignore the regulations, issuing incomplete reports and failing to report on ways of financing the purchase of shares or on the real quantity of shares in the regulating companies, provident funds and trust funds.[18] The bankers thus knowingly violated Israel's Securities Act, clause 20 (which requires those issuing shares to include in the projection all the information that is important to the investor, and to describe truly all that is presented in the prospectuses). The purpose of this transgression was to reinforce and enhance the banks' status. Ultimately it put their stability in jeopardy. Furthermore, the banks made every effort to present to the public only the advantages and opportunities of the regulated bank-shares, while deliberately hiding the risk involved in holding them. For this purpose they presented a misleading display of the shares' characteristics, using the banks' consultation system. Employees, consultants and managers were recruited for aggressive share sales campaigns, creating expectations that this was a secure share that bore a positive long-term yield.[19] Their status as a professional authority gave them broad scope for manipulating and exploiting the trust placed in them by their clients.

The bank-shares crisis began in September 1983. Following rumours of imminent devaluation, many shareholders preferred to acquire foreign currency and sell their shares. Facing this excess of supply the banks began unprecedented purchases of their own shares, and had no choice but to request further credit from the Bank of Israel in order to finance share purchases. The bankers' urgent attempts to find a solution that would extricate them from the crisis proved futile. On 6 September, the banking system was actually on the verge of collapse. The banks, as described by the Bejsky Commission, had on that day reached the end of their tether.[20] It was clear to both bankers and the authorities that without immediate help from the Bank of Israel they would not be able to continue absorbing the supply of shares from the public. The liquidity problems that developed threatened their existence, and Israel's banking stability in general. Consequently, the government decided to take the bank-shares under its wings and both protect and compensate the shareholders. This 'Bank-Shares Settlement' eventually cost the state coffers seven billion dollars.[21]

The bank managers' behaviour had far-reaching implications. In the short term, it led to the financial collapse of firms, bodies and individuals who had invested in their shares. In the long term, it caused a loss of public faith in the banking system, injured the image of Israeli banking in the world, and placed a heavy burden on the state budget, due to the financial commitments undertaken by the government. The process that was expected to expand the banks' capital basis and their financial power, in fact caused them to suffer huge losses, placed them in danger of collapse, and finally turned them into government-controlled public corporations.

THE SOCIAL AND CULTURAL ENVIRONMENT

To what extent did the mechanisms and processes in the cultural, political and economic environment, in which the bankers operated, influence their decision to embark on and persist with manipulative regulation? Most organizational behaviour studies that deal with deviance focus primarily on the attitudes and behaviour of individuals, and less on the processes and mechanisms operating in the social environment.[22] However, senior managers are extensively exposed to the influence of the environment through their role as representatives of the organization and as a liaison between it and the environment.[23] In this sense, management patterns are contingent on the environmental constraints in which the organization operates.[24]

A discussion of the characteristics of this environment may thus identify the sources of legitimization and motivation, and the latter's influence on their managerial behaviour. It is worth reiterating that those placed at the head of the financial system usually serve as a model for their staff. They significantly mould organizational norms and orient the shaping of organizational culture according to their own interests. Furthermore, the impact of the social and cultural environment is transmitted through social processes. These can be explained by social learning theory, which describes how people acquire forms of behaviour and knowledge in a social framework. It clarifies how socialization takes place, and how society impacts on the learning of behaviour through identification, imitation and internalization. Accordingly, the individual's moral behaviour may reflect a process of receiving and absorbing (that is, learning) a normative codex and rules from a variety of social sources and peers. In the case under discussion, managers' norms and values were significantly derived from the cultural and social norms of their environment.[25]

In the Israeli context, learned behaviour is closely associated with illegality, which plays an important role in the normative environment of the country's politics and society at large. In a nutshell, it denotes an orientation that does not see respect for the law as a basic value, but as a certain type of behaviour that can be practised according to considerations of worth.[26] A system thus oriented is characterized by an instrumental approach to the law. The law will be obeyed when it is worthwhile to do so, or when there is clear danger of effective sanctions – but it will be disregarded whenever possible.[27] The view of illegality as an overall cultural perception that deviates from the conventional approach – obedience to the rule of law on the part of the legislative and executive ranks – has its source in the concepts of 'political culture' or 'civic culture'. These concepts refer to the orientations of the public and of the political elite towards the legal system, their behaviour patterns and way of internalizing the system. In Israeli society, increasing sections of the public have come to disdain the normative system according to which they are supposed to function. They do this openly out of a strong sense of justice based on ideological grounds on the one hand, and on legitimacy that feeds on the government's permissiveness with regard to these actions, on the other.[28]

Cultural legal-disobedience (or disregard of legal norms) in Israeli society largely originated in the Diaspora and local (pre-state) sub-cultures. These generated behavioural patterns of 'getting around' the law, and reaching compromises that promise the maximum benefit.[29] In fact, what developed in pre-state society was an instrumental orientation towards the law of a foreign ruler, in which bribery, lobbying and promising favours became accepted methods. Well experienced in the Diaspora ghetto culture, on coming to Palestine many Jewish immigrants before the 1920s perceived the foreign Ottoman regime as 'corrupt', a confirmation of their situation in the Diaspora. Accordingly they could easily reproduce Diaspora behaviour patterns in order to cope with the regime, particularly in terms of getting around the law and making compromises with it.

Moreover, under British rule the elite of the Jewish community between the 1920s and 1940s – particularly the labour movement which largely dominated this community's politics – were influenced in many ways by the organization of the regime in Russia after the 1917 Revolution.[30] This regime served as a model of a centralist ideology, which regarded government as the most suitable organ to direct manpower and the means of production, and to achieve stability, security and economic growth. Bureaucratic centralization came to characterize many facets of the institutional makeup of the labour movement, expressing as it did the subordination of economic activity to the aspirations of the politicians and the planned state. The emergence of this style of political culture was further related to the economic conditions that existed in Palestine at that time, conditions that encouraged a collectivist-organizational dynamic.[31]

The inferiority of Jewish workers in the labour market, and their inability to force Jewish employers to prefer them to Arab labourers, gave impetus (even before the British conquest of Palestine) to the collectivist organization of Jewish labour and the establishment of the historical alliance between the nascent labour movement and the World Zionist Movement.[32] This collectivist structure perceived the individual as subject to society as a whole and de-legitimized the idea of a division of power. Among the increasingly dominant labour leaders, it led the construction of what can be termed as bureaucratic idealism, namely a mixture of ideological-based and power-interest-based pursuit of political domination.[33] Consequently, the gap between the normative expectations for the functioning of the system, and the actual level of its performance (due to the low level of bureaucratic efficiency and its resources), laid the ground for the development of many informal mechanisms for solving problems that the official system was not capable of handling.[34] These are the kind of mechanisms that create a unique orientation of instrumental preferences and expediency. As a result, in an organizational culture of this type, the level of legalism is unsurprisingly very low.[35]

The control by Mapai (Israel's long-dominant Workers Party) of the national institutions and the Histadrut (the trade union federation) helped to blur the boundaries between politics and economics.[36] The leaders of the party, who came from eastern Europe (where the ghetto and *shtetl* sub-cultures dominated), established organizational patterns that were reflected in the organizational culture in the Histadrut, where politics and economics were inextricably intertwined. Gradually it turned into a bureaucratic body characterized by a high level of politicization and rigid institutionalism. The symbiosis between the political and bureaucratic elite provided many benefits to the heads of the system. In fact, Mapai's position at the intersection of institutions through which people and capital flowed to Israel was vital for its rule.[37]

After the establishment of the state, Mapai used this position to establish one-party control, promote rapid economic growth and solidify the 'state in the making'. The national imperative was the fulfilment of the pioneering and Zionist ideology by settling the land and building the nation, a mission that had to take precedence over all the economic, and sometimes also moral, criteria.[38] Thus during the British Mandate, illegal patterns of action were consolidated and became internalized in the Israeli culture, in particular the instrumental orientation towards the rule of law.[39]

This pattern, whereby politics dominated the economy, and the good of the state-building oriented labour movement took precedence over considerations of profitability and proper management, persisted for a long period. Although the functions of state-building now passed from the labour movement and the Histadrut to the state, hardly any efforts were made to create new organizational and institutional patterns. During the first decade of the newly established state, when the bureaucratic political machinery had yet to establish proper criteria, corruption was perceived, especially among public-sector white collar workers, as a kind of *force majeure*, which could not be avoided in circumstances of accelerated economic development. The source of this perception lay in the absence of clear norms that would distinguish between personal or party interest and public interest.[40]

The 1960s witnessed intensive economic growth in Israel. Concurrently distorted ways of dealing with the economy and public resources developed, nicknamed the 'Sapir Method' (after Pinchas Sapir, the leading figure in Israel's economic development), which perpetuated pragmatism and instrumentalism.[41] This orientation largely disregarded universal criteria of legalism, identified the state totally with the good of the ruling Labour Party, and generally operated on the basis of personal preference, which refrained from a respect for public law and order.[42]

Consequently, sectarian preferential practices, personal elitism and corruption ensued, providing fertile ground for the growth of financial, cultural and political illegality. The latter surfaced during the 1970s in many cases of bank and company corruption, all involving high-ranking members of the financial and political elite. In an effort to legitimize their acts, those involved persistently claimed that they were part of a 'system' that had been secretly evolving and was born out of the long experience of pre-state and post-1950s illegal practices.

The bureaucratic economic and organizational pattern that was based on the members' loyalty to party ideology, both before and after the establishment of the state, served to relieve managers and public officials of personal responsibility for ethical principles and moral imperatives in favour of achieving the organization's aims and ensuring its survival. From a historical perspective, most of those involved claimed that they acted out of idealistic motives, believing that losing their positions of power in the political and economic structures would threaten the Zionist enterprise altogether. Against the background of the entrenchment of illegality in Israeli culture, particularly among the political elite, it is understandable how almost the entire banking sector saw itself entitled to act in contravention of the law. No wonder that the bank managers' behaviour in the shares regulation affair was explained in terms of ideological rationalization.[43]

Social values, originating in a previous historical period, seemed to have been assimilated by the financial elite, allowing them both to adopt easily a deviant managerial behaviour and to justify it. In terms of differential association theory, the pressures and motives operating on the bankers created a suitable environment for breaking the law. The justification they found for neutralizing their guilty-feelings lay in a legitimate action for bank profits, no less than in their willingness to take risks for the development of Israel's economy. Indeed, when the public discussion erupted after the bank-shares crashed in 1983, and when the bankers were harshly criticized for their responsibility for the crisis, Ernst Yaphet, the powerful manager of Bank Leumi, maintained that, 'They are trying to make us scapegoats for all the mistakes'.[44] Furthermore, in the summing-up for the defence of the bankers before the Bejsky Commission, it was claimed that the shares regulation was a social phenomenon made possible by particular circumstances. The commission was not investigating ordinary criminals, but bodies that were perceived as fulfilling nationally vital roles.[45] In fact, the ideological rationalization for the deviant behaviour of the bankers repeated the patterns of earlier periods; the bank-shares regulation cannot be considered a transgression because it was an action performed for the good of the country and the general public. In this respect, the symbiotic relationship that developed between the capitalist class and the political elite in Israel was translated into self-licensing for deviant behaviour. The bankers were part of an elite that evolved in this discursive environment.[46]

The Shimron Commission of Inquiry, which was established in 1978 to examine various aspects of crime in Israel, determined that the impact of the law on behaviour depends on the law's moral status being accepted by the various social forces and frameworks. The law is kept to the extent that its tenets match the values and rules of behaviour of the people in the various groups.[47] Thus, illegality does not develop in a vacuum. An atmosphere must be created in which deviation from the instructions of the law will not be seen as an option, said the Bejsky Report, not just for fear of the watching eye of the legal authorities, but also in normative terms.[48]

The Shimron Commission's report concluded that there was no commitment among political leaders and senior officials to keep the law and impose it, thus contributing to the serious failure that has developed in this area. The members of the commission claimed that the patterns of financial supervision that had existed since the state's establishment had created fertile ground for dubious contacts between the representatives of the government and the actors and entrepreneurs in the economy.[49] Contacts of this kind had increased from the beginning of the 1950s, a period when the Minister of the Treasury granted the banks rights to issue many shares as a reward for activity that the government wanted to encourage.[50] Moreover, it used the banking institutions as agents for granting loans for various purposes, or for collecting loans that were granted directly by government ministries.[51] In this way, the government could use the professional machinery of the banking institutions, while the latter gained considerable revenue through interest differentials.[52] An unhealthy symbiosis emerged, whereby the banks served the government and the government took care of the banks.[53] Michael Bruno, former president of the Bank of Israel, confirmed the above arguments: 'There was an unwritten alliance and a kind of deal between the banks and the government, whereby the banks would mobilize capital for the government and the government would turn a blind eye to the stock regulation'.[54] In this way, the banks and the government struck an informal 'treaty', as 'the banks were not left alone in the battle: no matter what they did, the treasury would come to their rescue'.[55] Whatever happened, the government would help to find a solution that would prevent the system from collapsing.[56] This relationship legitimized and motivated the bankers not to accept responsibility for resolving the crisis. 'The banks ... were too big to fall, and their heads knew it very well ... The thinking was, "we won't stop the snowball now, when its dangers are clear to us, but let it keep rolling. In the end a solution of some kind will be found, because the country needs the banks"'.[57]

In terms of a neo-corporatist approach, an institutionalized partnership was contrived between the banks and the government. It created arrangements that were based on the common understanding of the need to build further regulation mechanisms that would allow the banks and the government to impose their interests on society at large. Thus, the political and financial leaderships' adoption of illegality as a way of life stemmed from lack of interest on the part of the authority responsible for enforcing the law. This provided legitimization for the bankers' behaviour and contributed significantly to the process. Regulation of the bank-shares, contended the Bejsky Report, could not have reached the proportions it did if the Bank of Israel and the supervisory authorities had not stood aside and allowed the banks to act as they had.[58]

Throughout the entire period, these bodies took no real action to stop the matter, neither by using the powers invested in them by law nor by exercising effective supervision.[59] Some may argue that it was not in their interest to do so, or that it shows a tacit understanding between the government and the banks.[60] This can be substantiated by the fact that after the enormous damage the stock regulation had done to the national economy became known (in October 1983), the heads of the financial system continued to function as if nothing had happened. Only at the end of 1986, under pressure from the Bejsky Commission, did the bank managers resign their positions. Not surprisingly, their resignation was accompanied by a heated public debate, though the bankers' statements in this debate merely reflected the depth of the illegality in Israel's normative context.[61]

THE ECONOMIC CONTEXT

The specific characteristics of the economic environment in which the bankers functioned affected their behaviour patterns in the stock regulation affair. One of these characteristics was the centralization of the Israeli financial market. The Bejsky Commission noted that without the banks' control of many branches of the capital market, the stock regulation, and hence the crisis, could not have reached such grand proportions. It was bank control of the credit market, the issuing of shares, foreign currency and stock market trading, that ensured such a massive flow of capital to the bank-shares.[62] Centralization increased in the early 1960s, when the major banks, Bank Leumi, Bank Ha-Poalim and Bank Discount, concentrated in their hands almost two-thirds of all the bank transactions, and reached its peak during the regulation, when they handled 97 per cent of all the transactions in the financial markets.[63] This structure was made possible by the absence of legal limitations on the areas of activity permissible to banks, and because of the absence of independent institutions capable of recruiting capital or supplying credit and financial services.

Despite the power and control of the capital-market system by the banking institutions, their actual freedom of action in recruiting and using capital was restricted because of government involvement. In fact, the government policy of cost-of-living indexation completely neutralized the banking institutions as independent actors in the public assets markets. The representative of the Bank of Israel told the Bejsky Commission that this involvement went beyond anything known in the free world, and reflected the government's growing need to cover its deficits.[64] The involvement was expressed in the fact that most of the money accumulated in the banks' various medium- and long-term savings schemes, including savings accounts, provident funds, pension funds and insurance schemes, was channelled to the government budget through a legal ordinance which dictated them to hold 75 per cent of these assets in government bonds.[65]

In addition, the banks were not allowed to collect higher interest than that set by the Interest Law. Under these conditions, the banks became largely dependent on the government. Dependence was so great that the

Treasury Minister could force a bank to lower its interest rates by holding the issue of securities for ostensibly technical reasons.[66] Government involvement turned the banking institutions into brokers, channelling money from the private to the public sector and back. In contrast to what is common practice in the West, where banks channel savings from private households to companies, the banks in Israel funded the government's budget deficits through the financial transactions they conducted until they started the regulation process and later. In many respects, the banks became agents of the government in mobilizing money and granting credit.[67]

The incompatibility between control of the capital market and their inability to develop the business of the banking system led the bankers to seek opportunities to expand their capital and profits. Expansion of the issuing market during 1977–80 provided the bankers with an excellent opportunity to exercise their power in the system and recruit from the public capital free of government supervision and supervision.[68] The absence of rules in the stock market that distinguished between regulation designed purely to stabilize random fluctuations in rates (which is permitted by the authority) and regulation designed to manipulate prices,[69] made it easier for the bankers to start regulating shares in order to expand their capital. This combination, of extreme centralization in the capital market on the one hand, and deep government involvement on the other, gave rise to unique financial problems with which the bank managers had to contend. They also provided legitimization and motivation for their deviant behaviour. Combining business strategy and unethical practice, in the context of political and financial structures, this removed the regulation affair from the area of narrow private interest, of some infringement or other, and turned it into a matter of much broader financial and social meaning.

Another factor that may affect managers' behaviour in business firms is the perception of the firm's financial balance. Usually there is a positive relationship between a firm's profitability and its managers' unethical behaviour. In situations where there is a shortage of resources, the odds of discovering unethical behaviour increase. Furthermore, when a firm's financial balance in a competitive atmosphere indicates losses, and its managers are worried about its competitive ability, financial considerations will overcome moral principles.[70] In the wake of increasing inflation in the second half of the 1970s, the financial balance and profitability of the banks was seriously threatened. During this period, the index rose from an annual rate of 30 per cent to 131 per cent, the burden of taxes doubled, and profits significantly declined. The bank managers preferred, therefore, to shirk their commitment to ethical values, and chose stock regulation as a strategy for dealing with the problems. It is hard to know whether they felt any ambivalence over choosing this strategy, because at the end of the affair some of them still continued to justify it. As the Bejsky Report noted, the regulation was necessary for the bankers to be able to fulfil their roles in the economic arena.[71]

In fact, a discrepancy was widening between ends and means. Senior managers are usually subject to pressure from shareholders to focus on reaching financial profit with whatever means they can employ, and this pressure is conducive to searching for illegal solutions.[72] Organizational deviations are sometimes a functional need, permitting an organization to achieve its aims while struggling with scant means. Our argument is that the inflation and the heavy taxation that eroded the banks' profits made the aims of the organization and the means at its disposal incompatible; the latter consequently triggered the bankers to increase their capital base and led them to embark on the regulation.[73]

Another issue relevant to ethical considerations in business management is that of competition in a free market economy.[74] The government's deep involvement in the capital market, and the banks' almost total control of the securities market, set them face to face as rivals competing for the same capital market reserve. In this historical competition, contended the Bejsky Commission, could be found the source and the explanation for many phenomena in Israel's capital market in the late 1970s and early 1980s, a period when the banks increased their involvement in the trading of their shares.[75] With the escalation of inflation and the consequent increase in government deficits, the competition between the banks and the government intensified. The Treasury Bonds that were linked 100 per cent to the Local Resident Foreign Currency Account and the Government Loan Stock, assured the investors of protection against inflation, while giving them a fixed yield for their investment. In this situation, the bank managers saw themselves bound to make sure that the value of their shares should rise at least as much as did the government bonds and the interest-yielding deposits, so that they could go on recruiting capital from the public. Thus, the perception of competition influenced managerial behaviour. Consequently, the bankers reached the conclusion that, in the conditions of the Israeli capital market, only systematic intervention in the trading of their shares would assure their victory in the struggle with the government over the capital market reserve.[76]

ORGANIZATIONAL CULTURE AND EMPLOYEE BEHAVIOUR

As was suggested above, the impact of the social, cultural and financial systems on managerial behaviour was crucial as a source of legitimization and motivation for the bankers' deviant behaviour. However, organizational factors and processes were no less influential. The behaviour of employees is influenced by elements in the organizational environment, among them the organizational culture, the senior manager's opportunity structure, and the influence of colleagues on the manager's behaviour. In this sense, the shaping of the organizational culture in the 'right direction' and its assimilation by the members of the organization (staff and management) affected the entire bank-shares regulation process.

Organizational culture can be defined as a set of assumptions, beliefs, values and aims that are shared by the members of a given group and distinguish them from the members of other groups. Culture influences employees' behaviour in that it also represents the 'shared ethical values' of the organization.[77] Corporate ethical values are those common to the members of a group or corporation, and dictate the ethical norms according to what is appropriate or forbidden in the framework of the organization and on its behalf. Since leadership norms are expressed in determining the goals and priorities of the organization, senior managers in the organization have a strong influence over individuals' ethical decisions. Hence, the organization's ethical conduct clearly depends on the values of its leaders. Moreover, in a strong organizational culture, characterized by conformity to norms set by the top echelon of the organization, the management can use its power to engender unethical behaviour in the entire system.

In such an organizational culture, the management shapes the norms of what is considered appropriate behaviour. The employees' and junior managers' commitment to fulfil the expectations of the top management, and the latter's power to label even deviant behaviour as acceptable, motivates employees to co-operate. In addition, the individual's behaviour is influenced by the values and beliefs of his or her social reference group, sometimes referred to as 'significant others' or 'referent others'.[78] Managers and colleagues in work environments are, in fact, agents who influence the employees' moral decisions and behaviours. When the top management, which serves as 'significant others', behaves according to a certain norm, the entire body of employees can be influenced to conform to the same norm. Thus, through social learning and moulding, it is possible to transmit to employees unethical norms of functioning.[79]

In light of these research findings, which stress the influence of organizational norms set by the manager on the employees' behaviour, it can be gauged to what extent the bank managers' 'declared philosophy' became not just a guide for employee behaviour, but an exclusive criterion for determining the acceptable and moral organizational culture. This philosophy was expressed in the setting of priorities for the organization, namely the massive sale of shares to the public. The bank managers personally contacted clerks and instructed them to raise the issue of purchasing shares while working with the clients. 'Promoting the rates of shares will continue to be our central interest', it was claimed in the Bejsky hearings. 'It is our duty to aim for every client of the bank to acquire shares, not just those who possess securities'. Circulars distributed to branch managers said, 'Distribution of our bank's shares is our primary interest ... we attach great importance to the number of orders processed by each branch'.[80]

The bank managers created a feeling among their employees that they were partners in achieving an important moral aim, and thus guided their behaviour. The following citation emphasizes the method by which managers influenced employee misbehaviour:

> We are happy to note that a considerable number of branches have attained good results, but on the other hand, in many other branches there is a significant decline in stock holdings. We are sure that those branches that did not manage to increase the distribution of the bank-shares during this period will make every effort to succeed in the future.[81]

Furthermore, when top management and staff behave according to the same code, this intensified the assumption that it is the right and proper way to behave even if it contradicts the wishes of some individuals. The emphasis on the commitment of the personnel to meet management's expectations was translated into quantitative measures, which made it easier for the bank managers to see which employees and managers contributed and saw themselves as committed in practice. Sales targets were set for the branches and translated into daily quotas. The branch managers were required to initiate telephone contacts with various clients in order to fill the quotas required of them. The managers aroused a feeling among their employees that they were in a constant race to achieve a very important aim for top management. Monthly charts were sent to the branch managers to help them estimate their own part in distributing bank-shares. Branches that excelled in selling shares won perks, and their managers moved nearer to potential promotion.[82] Managers ensured that branch managers would adopt the organizational norms they set, and that each and every employee would feel that top management evaluated his or her behaviour. Client consultation became a tool – a method to exploit the naivety of small investors to persuade them to act according to the interest of the bank. In fact, the consultants were directed, both verbally and in writing, to deliver certain messages in order to catch as many investors as possible.[83]

In sum, the aim became common to all ranks, leading to the feeling that these actions were normative and acceptable. A situation developed whereby non-normative actions, such as cheating clients, coincided with normative organizational actions, such as the evaluation and reward of personnel. Through this tactic they reinforced neutralization and the blurring between proper and improper behaviour. Thus, the socialization process that takes place in an organization acquaints employees not only with standard norms of performance, but also with unethical behavioural norms. It thus becomes clear how the shaping and development of the organizational culture virtually gives managers control over their employees.[84] Such control is liable to lead many of them to misbehaviour, as is shown here. In organization-cultural terms, the planning, implementation and maintenance of the stock regulation mechanisms in the banking system may be seen as a kind of socializing experience, shared by all parties: top officials, clerks and customers.

THE SENIOR MANAGER'S OPPORTUNITY STRUCTURE

The opportunity structure of the senior management is an essential factor for facilitating easy access to unethical behaviour without punishment. The higher the level of managers in the organization hierarchy, the more they are exposed to a structure of opportunities convenient for deviation. This is due to the amount of information at their disposal, the extensive contacts they establish, the absence of supervision and control of their activities, and the degree of autonomy in their role.[85]

In the Vardi and Wiener model,[86] the opportunity structure that is built into the organizational system is one of the causes of OMB type O that is generally characteristic of deliberate deviation from conventional organizational and/or social norms by top management for the benefit of their organization. Such opportunities are factors at the level of the organization that create convenient conditions for unethical behaviour. These conditions may result from the lack of a corporate policy defining clearly what is allowed and what is forbidden, and from a defective punishment system that gives rise to a normative code whereby those who deviate receive backing if their action was for the benefit of the organization. Indeed, managers tend to behave unethically when the potential results of their behaviour are moderate, and the risk of punishment is small compared with the chance of increasing the profits of the organization. Managers' unethical behaviour can thus originate in an implicit assumption that they will not be caught, and that if they are caught they will not be sanctioned.[87] Corporate policy that does not define clearly what is allowed, and what is not, provides a convenient opportunity for deviation. Theoretically it may be argued, therefore, that the bank managers' unquestioned control of their organizations, their power and their status in the economy created a convenient opportunity structure for deviation. The absence at the time of rules in the stock exchange distinguishing between permissible regulation (limited to stabilizing random fluctuations in rates) and manipulation (also called regulation) made it easy for the bankers to present their actions as legitimate, and served as an excuse for the stock market itself and other authorities not to intervene in the bankers' actions. In fact, the subject matter was not dealt with in any practical way until October 1983, following the outbreak of the stock crisis.[88] In this situation, where the field was wide open in terms of rules and laws, the risk of punishment was negligible compared with the prospect of increasing the profits of the organization.

The lack of commitment of the political leaders and the senior civil servants to keep the law and enforce it was another element in the opportunity structure, and a basis for the bank managers' assumption that even if their deviant behaviour was discovered they would not be punished. Indeed, the exposure of the regulation did not stop them nor did it impose any sanctions on their activities. The bankers' status as a ruling elite in the financial system, their unchallenged control of their organizations and their broad autonomy in initiating actions without supervision or control, coalesced to form a convenient opportunity structure for deviation that was built into the organizational system. This control gave them the means necessary to carry out the shares regulation: they were the ones who decided exclusively and surreptitiously on the regulation, and they were also the ones who approved the decisions as chairpersons of their boards of directors.[89] The boards implemented the regulation without the directors having any real knowledge of its scope, character, funding or form.[90]

It was only in 1981 that the directors learned of the regulation, when it became obligatory to publish it in the banks' prospectuses.[91] Even the auditors of the major banks testified that the term 'regulation' did not appear in the books or minutes, and that their information about it came from the press.[92] Though positioned as inspectors of the banking system, they were not able to perform their role satisfactorily in the face of the bankers' power; they therefore appealed to the banks' supervisor to use its authority and force the bankers to reveal matters openly in their prospectuses.[93] Thus, the mechanisms that were in place during the period of the regulation did not work properly. Nor did those involved in the work think that it was part of their job to criticize or question the actions of the most senior staff in the banks. The result was that the management ruled absolutely, and were freed of any accountability and any form of internal inspection.[94] This explains how the bank managers' deviant behaviour in the regulation affair occurred so easily.

COLLEAGUE INFLUENCE ON MANAGERIAL BEHAVIOUR

In the course of social interaction, individuals tend to adopt the beliefs and behaviour patterns of people with whom they come into regular contact. Differential attachment may change in frequency, duration and intensity, and it depends very much on the 'significant others', the people one perceives as important. These include one's associates, who as 'significant others' are a key to understanding the influence of the social environment on moral behaviour.[95] Justice Naor's verdict refers to that social influence: 'The fact that all the large banks in the country were in the same catch strengthened the hands of the accused. This was not just a single bank manager who found himself in trouble because of his actions, but most of the bankers in Israel'.[96] In fact, the decision of all the managers of the major banks to enter into the regulation process was made at the same point in time – the end of 1977 (when they had to decide whether they wanted to go on issuing stock, regardless of the fluctuations of supply and demand in the capital market, in order to expand their capital base). 'All the banks', maintained the Bejsky committee, 'unanimously decided on an identical share-issuing policy that would be independent of the state of the market. And the evidence shows that in the second half of 1978 the three main banks issued more shares than they had issued between 1971 and 1976'.[97]

As the values of the social reference group become a guide to their colleagues' behaviour, it is no wonder that even if a certain bank manager was hesitant at first about embarking on this process, in the end he adopted the behaviour approved by his peers. This was the case with Bank Mizrahi, which began the regulation policy in 1979, following the large banks, when its managers adapted to the behaviour of their colleagues.[98]

Anything that was done in one of the banks immediately influenced the others.[99] In early 1979, for example, when Bank Leumi stopped intervening in the prices of its shares (with the intention of moderating the regulation, not stopping it), the other banks asked it to return to its previous policy. Similarly, as the bankers prepared to implement the regulation they found sources of funding by an identical solution: establishing straw companies abroad through which the demands were channelled. This was also the case with regard to the methods of persuasion they chose – the use of a leader, and exploiting the bank's consultation system for the purposes of the regulation.[100] Imitation and mutual adoption of methods of operating thus became a matter of routine. In early September 1978, Bank Ha-Poalim launched a share sales campaign based on what was called a 'triangular deal': the bank offered its clients a loan on easy terms, the sum of the loan was used to purchase bank-shares, while the shares were mortgaged as a collateral for the loan. Within a short time, Bank Leumi 'learned' from Bank Ha-Poalim and adopted the same method, and it appears that Bank Mizrahi also conducted transactions of the same kind.[101]

The bankers formed a 'social network', whose members helped each other to hide the manipulations entailed by the regulation. On the eve of announcing the financial balance reports, for example, the bank managers conducted one-sided deals – the selling of shares by one bank to another and the repurchasing of these shares after publishing the balance – all in order to avoid showing any decrease of capital. In these cases, Bank Leumi passed its shares from 'Leumi Cayman' to Bank Discount, and purchased them back after the date of the balance.[102] The same kinds of deals were done with regard to securities, which were at the disposal of the banks' provident funds and trust funds.[103]

The banks' approach to solving the crisis which they themselves created was also identical. In meetings with the government authorities (the chairman of the stock exchange, the bank supervisor, the top echelons of the treasury and the Bank of Israel), the bankers presented a united front, opposing any real restriction on the regulation.[104] The fact that it was not a matter of one single bank manager, but the overwhelming majority of all the bankers in Israel, strengthened the hand of the bankers.[105] The sense of togetherness and the influence of their 'significant others' guided their managerial behaviour and their functioning in the regulation affair. As Asher Yadlin, a well-known Israeli white collar operator remarked when convicted in his own (unrelated to the bankers') trial, 'What an individual person would never allow himself to do, a group will often allow itself with the excuse of the good of the company to which it belongs'.[106]

The bankers' deviant behaviour was therefore a learning process through interaction and communication with other people, particularly with their intimate group – their fellow bankers. This learning included both the criminal techniques (the regulation, setting up the straw companies, and so on), and the motives, pressures, rationalizations and attitudes. The latter meant particularly the perception of their action as legitimate and normative in the situation of the firm and the state of the market, and in the light of their relationships with the legal authorities.[107] In these terms, the case under discussion here underlines the need to identify the 'significant others' who constitute the managers' cultural reference group in their organizational-professional environment, in order to explain managerial behaviour in general and deviant behaviour in particular.

CONCLUSIONS

This article has attempted to explain, from an historical and theoretical perspective, the behaviour of the bank managers in the share regulation affair, and in doing so to focus on the social and organizational environment in which they operated. The regulation was a unique phenomenon: for six years top bankers in Israel operated deceitfully, trapping in their net as many investors as possible, while exploiting their strength and power in the economy in general and its organizations in particular.[108] It was argued that the identification and characterization of contextual processes and mechanisms could assist in deciphering this behaviour. At the system level, the social, cultural, political and economic environment in which the bankers operated was analysed. This environment, following various models, included the value system, the laws and the cultural and social norms that influenced the behaviour of individuals through social learning processes. This level of analysis also included situational factors related to the economic and financial characteristics of the environment in which the banks operated.

It was also observed that the lack of commitment on the part of political leaders and senior civil servants towards keeping and enforcing the law contributed to the development of a serious managerial distortion. Out of a strong sense of justice and legitimacy they permitted public organs to flout the normative legal system, with the rationalization that action taken for the benefit of the public or the national economy could not be considered illegal and/or immoral. This rationalization illustrated those illegal aspects of Israel's political culture, expressed as it was in behaviour guided by instrumental considerations rather than out of respect for the law. The shares regulation became possible not because of legal lacunae, but because of the bankers' infringement of existing laws and a lack of enforcement by the authorities responsible.[109]

The motivation for the bankers' misbehaviour was no less related to financial and political environmental constraints in which they functioned. The business market was characterized by deep government involvement that frustrated the bankers' ability to act freely and develop their businesses. The shares regulation was, in their view, a possible avenue for solving their problem. Another source of deviant behaviour in a competitive financial environment was found to lie in the extent to which the banks were endangered by financial loss. In such conditions, senior managers tended towards deviant behaviour to increase their profits, while compromising their basic values of justice, honesty and loyalty. Managers could even explain this behaviour as a functional need that allowed them to accomplish the goals of the organization. Indeed, as inflation escalated and government deficits increased, competition between the banks and the government over investors in the capital market intensified. Thus, facing the guarantees given to investors in government bonds, the bankers had to find a suitable and attractive answer, which focused on ideological (national and economic) justifications for competitive and interest-oriented behaviour.[110]

The socio-cultural system was found to be crucial for understanding deviant managerial behaviour since the managers embodied the norms, values and behavioural codes that influenced the characteristics of conduct. Analysis of these mechanisms helped explain the normative environment in which the bankers operated, and the orientation of the political elite towards the legal system. Furthermore, managerial policy and its aims, and ways of achieving them, were derived from the environmental and situational factors, in particular the financial characteristics of the environment in which the banks functioned. Their identification provided a framework that showed how the banks perceived their ways of operation, and the sources of legitimization that motivated them to regulate their stocks.

One of the salient organizational characteristics was the bank managers' power and ability to shape the organizational culture and determine its priorities. Using their power and professional authority, bankers made their deviant behaviour normative by virtue of the fact that they were the 'significant others' to their staff, and were able to label deviant behaviour as acceptable. This allowed them to induce their employees to collaborate. The more senior that managers were in the hierarchy, the more they were exposed to situations that provided a convenient opportunity for deviation, owing to control of the information, the autonomy and the extensive contacts with government bodies. Hence the ease with which the bank managers deviated from the laws and rules and bent the government system to their needs.

The influence of colleagues, as a dominant factor in managers' behaviour, also proved to be significant. The fact that it was not a question of an isolated bank manager who found himself in trouble because of his acts, but rather that the affair involved the majority of banks in Israel, strengthened the hand of the bankers – as did their sense of togetherness and of being part of a macro-social phenomenon.[111] Evidence of this was found in the models of operation chosen by the bankers. Indeed, throughout the regulation period they learned, imitated and helped their colleagues to deviate from the norms, laws and rules of behaviour. Above all, the bankers' evasion of their social obligation to choose the best alternative for the good of all concerned harmed the functioning of the organization they headed and the trust of their clients. In the end this collusion had a tremendous effect at the societal level, mainly because of the government's undertaking in the framework of the settlement reached to solve the crisis (seven billion dollars), which cast a heavy burden on the state budget for years to come.

This discussion chose to deal exclusively with the level of the system and the organization. However, factors at the individual level that influenced behaviour were also of great importance and should not be ignored: values, moral judgements, commitment, knowledge, needs, subjective norms and so forth. These were not addressed both because managers actually acted in the same fraudulent ways as a group, and because of an inability to expose additional personal evidence at this stage because of the principle of *sub judice*. Still, the identification of the managers' sub-culture and its unique value profile may explain the motivation in that group during the affair and in similar 'scandals' which took place a decade later. Such issues certainly require further scholarly treatment.[112] Likewise, another limitation stems from an approach to illegality and deviation as a static normative phenomenon, in the course of which there is a constant process of labelling 'deviants' in order to guard the boundaries of society.[113] In fact, the affair was a dynamic social phenomenon – a process in which a struggle between different social groups was waged. However, this conflict may have actually led to changing the society rather than guarding it, as the proponents of the social conflict approach would argue. From this point of view there is a need for further research that will anchor deviant behaviour in Israeli society in its social and political history, and in a comparative history with other nation-building societies.

Because of their power, the bankers succeeded in shaping a strong culture characterized by conformity to norms and priorities set by them, even if these were illegal and unethical. The top management's absolute control neutralized the operation of the internal and external control mechanisms that were supposed to locate any fault or deviation from the law and proper management. Nor were warnings, in the form of citizen complaints and reports from observers from the stock-market authority, heard.

Thus, the proper functioning of control bodies is a direct interest of society at large, because every deviation may have wider social repercussions, especially in countries where the social and financial systems are so closely intertwined. It follows that any analysis of the behaviour of managers and organizations should relate to the broad aspect of supervision and control over senior managers in public institutions. Furthermore, education for business ethics in the various educational frameworks should be further stressed as part of the socialization process. This is particularly true for those frameworks that train senior managers, such as schools of business administration. In those frameworks it is necessary to focus not only on financial skills, but also on the future managers' abilities to cope with a wide range of dilemmas, while remaining committed to the principle of social responsibility.

NOTES

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