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Why do good people do bad things?

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Introduction

On 26th October 2012 in New York, *Judge Jed S. Rakoff* said of *Rajat Gupta*, former CEO of *McKinsey & Company* and philanthropist, who was convicted for insider trading in 2012: "*He is a good man. But the history of this country and the history of the world is full of examples of good men who did bad things.*"

As we near the fifth anniversary of the implementation of the UK Bribery Act 2010, it is worth bearing in mind Judge Rakoff's comment, as we see no let up in ostensibly honest business executives being hauled before the courts, both in the US and Europe, accused of bribery and other corporate misdemeanours. This continual parade begs the question, why do good people do bad things?

Psychologists say we generally consider ourselves to be more than averagely honest, ethical and trustworthy (thereby clearly making a nonsense of the word 'average'). When we succeed, we attribute our success to our own abilities and talents; conversely we often blame failure on circumstances or third parties. Having a positive self-image is a necessary survival technique, but psychologists now believe that we flatter ourselves too much and are actually less ethical than we think. According to *Ann Tenbrunsel*, co-author of '*Blind Spots*: Why *we fail to do what's right and what to do about it'*, this distorted self-image leads us to overestimate ourselves and underestimate others; to be less critical of ourselves; to take more risks.

Combine this working hypothesis with the classic anecdotal assumption that each one of us 'has his price'. Neurological research[1] helps towards identifying how the brain operates when making choices of honesty versus self-interest. A 2014 scientific study discovered that generally, most of us prefer to behave honestly, even if lying is beneficial. "People feel good when they're honest and they feel bad when they lie" said one neurological researcher but the scientists were able "to manipulate the costs and benefits of honesty to quantify the tipping point"[2] for each person. If we all have our price, are we sufficiently honest with ourselves to know when we might be in danger of approaching it? Do you have the integrity and self-knowledge to avoid situations that might tempt you? Do your colleagues?

The Head of Internal Audit at a media conglomerate once confided to *Kasalana*: "We have 350 finance directors in the group globally. Statistically, some of them have got to be on the fiddle". In

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[1] Virginia Tech Carilion Research Institute and the University of California at Berkeley, September 2014

[2] http://research.vtc.vt.edu/news/2014/sep/02/price-honesty/

a similar vein, a forensic accountant's rule of thumb holds that 20 per cent of people in general will not steal anything, even if they have the chance to do so. So where does that leave the 80 per cent majority?

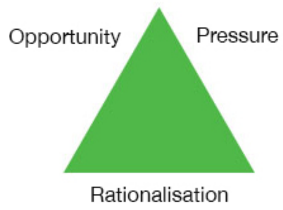
The collapse of companies like *Enron* or *MCI*, the sub-prime mortgage fiasco, the recent announcement that the *Serious Fraud Office* is investigating *Tesco* for 'accounting irregularities' is all regular fodder for the media. However, academics in the fields of psychology and business ethics, are increasingly interested in the apparent 'normality' of those responsible for big frauds and scandals. It is seldom the case that an individual, or group of individuals, deliberately set out to destroy a company. So how does it happen?

This paper seeks to address some of the motivations and characteristics of the corporate fraudster and provide examples and context. Considering methods of promoting positive and ethical behaviour in organisations to avoid succumbing to fraud will be the subject of a separate Kasalana White Paper later in 2015.

The Fraud Triangle

The Fraud Triangle, first developed by criminologist *Donald Cressey* in '*Other People's Money'* published in 1973, is as good a place as any to start. The Triangle posits that "trusted persons become trust violators" once they perceive themselves to be under a particular pressure; have the opportunity to relieve that pressure; and can rationalise their actions, convincing themselves that they are doing what is acceptable under the circumstances.

Of course, the Fraud Triangle, whilst a useful tool, does not explain every fraud. People's motivations and actions cannot be neatly segmented and shoehorned into a geometrical shape for an analyst's convenience. However, for illustrative purposes, we can take each side of the triangle and add some examples and explanation.



Pressure, Motivation & Incentivisation

Pressure on an employee can take many forms and it is not always obvious to a line manager when that that pressure can make an employee 'tip' over the edge and commit a fraud. Such pressures might include pressing personal financial burdens; an addiction that needs to be supported; a divorce settlement; astronomical fees for private schools, nursing homes and so on. It is not uncommon for employees to keep quiet about their personal financial predicaments whilst at work and for colleagues to be oblivious to the pressures under which individuals make decisions.

Reportedly, *Martin Siegel,* managing director at *Drexel Burnham Lambert* (who ultimately co-operated with the US authorities to reduce his sentence for his role in the insider trading scandals of the 1980s) felt overwhelmed by the expense of his lifestyle: "suddenly he felt like he was having trouble making ends meet on more than half a million dollars a year – even though, in fact, his income was more than adequate. He was also feeling the pressure of work. The intense, high-stakes combat of a hostile takeover pumped him up with adrenaline, he'd be putting in hundred-hour weeks, then it would end"[3].

Martin Siegel felt the pressure of keeping up with his peers to maintain a particular image – the successful Manhattan-based financier – but also the unusual, intense pressures of a particular working environment. In this, he has not been alone. Some of the largest, most notorious financial frauds have been committed by so-called 'rogue traders'. *Nick Leeson* at *Barings* and *Jérôme Kerviel* at *Société Générale* were both young men working long hours in a highly pressurised environment. For *Kerviel*, one of the incentives was the 'pat on the back' from his bosses. When he exceeded his targets, "it was exciting to win more and more, you know. The boss comes over and says, 'Jérôme, you are a cash machine'.[4]"

The pressure to meet productivity targets and the expectations of those higher up the managerial chain can be overwhelming for some employees. And for those running the company, the pressure of shareholder expectations and market demands as well as the perception of their place among their peers in competitor companies can achieve the same detrimental results.

Tesco has long been one of the UK's most successful and innovative supermarket chains. After commercial pressure from its competitors, it has recently emerged that the company has

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[3] *Den of Thieves*, James B. Stewart

[4] May 9, 2014, *Financial Times, Jérôme Kerviel's long walk to captivity* by Michael Stothard

‘accounting discrepancies’ caused apparently by booking promotional income and rebates from suppliers ahead of time. The ‘discrepancies’ are such that the *Serious Fraud Office* launched a criminal investigation into the company at the end of October 2014. While the investigation is obviously ongoing, the company’s executives have declared that no individual has made any personal financial gain from the misstatements. Fraud, if that is what it is proved to have happened, was not perhaps the result of individual greed, but rather collective hubris.

In academic papers, like *Goals Gone Wild*, 2009, the authors argue that: “the beneficial effects of goal setting have been overstated and that systematic harm caused by goal setting has been largely ignored. We identify specific side effects associated with goal setting, including a narrow focus that neglects non-goal areas, a rise in unethical behaviour, distorted risk preferences, corrosion of organizational culture, and reduced intrinsic motivation.”

A prime example of this is *Enron* and its ‘rank and yank’ system of rewarding performance. In an organisation where employees are regularly rated, and executives are constantly expected to deliver higher targets and better returns, year on year, it becomes as one observer puts it, “more acceptable for individuals to act opportunistically and dishonestly to get ahead”. Corporate culture – the behaviour and example set by management; the espousal of corporate values and the reward systems used within a company – can be critical to creating a working environment that fosters or inhibits fraudulent behaviour.

Then there are those who turn a blind eye to the misdemeanours of others in their midst. Why does the fraudulent activity of one employee, or a group of employees, go unchecked when it must surely have been apparent to those around them? *Tenbrunsel* describes *Bernie Madoff* as a ‘bad apple’ but admits that he was “surrounded by ‘good apples’ who nevertheless turned a blind eye to his deceptions[5]”. She goes on to postulate that it is the organisation or community structure – the apple barrel – that can be rotten and can re-orientate its inhabitants’ moral compasses. It is the corporate culture that determines how people behave and can provide the opportunity for fraud to occur.

Opportunity

In April 2004, *Joyti De-Laurey*, a personal assistant to senior *Goldman Sachs* bankers, was convicted for committing a £4.3 million fraud. She had been in a position of trust to three investment bankers and was able to forge their signatures and transfer funds from their accounts into accounts belonging to herself and her family. She exploited her position and knowledge of

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[5] *Why Good People Do Bad Things,* Michael Hardy, University of Notre Dame, May 2012

her employers to siphon off considerable amounts of money before they were even aware of it themselves – indeed, much of the media coverage at the time focussed critically on two of the three defrauded bankers who were apparently so wealthy that they never noticed the funds going missing until their successor analysed his own accounts.

Opportunity to commit fraud in an organisation can present itself in a number of ways. This is also the area where prevention, on the part of a compliance, internal audit or security department, can focus effectively. While it is important to institute controls across an organisation, there is often more, however, than regulation and compliance protocols, to curbing opportunities to defraud an employer.

Researchers examining the question "it's lawful, but awful" look at the harmful consequences of legal industries[6] (like tobacco, gambling and fast food) on wider society. In the mind of a potential fraudster, lack of regulation provides opportunity, but so does a wider culture of acceptance for morally dubious behaviour. If you are working in a department or field that does not make certain behaviours explicitly wrong, and if there are a lack of perceived consequences for behaving in a certain way, the opportunity to do so becomes more attractive. Everyone else is doing it, why can't I?

A good example here is the ongoing LIBOR investigations and prosecutions. Prior to the financial crisis of 2007-08, it is alleged that the London Inter-Bank Lending Rate, had been manipulated over time by dozens of traders and submitters in London, New York and Tokyo. The LIBOR rate was essentially self-regulated by the *British Bankers' Association (BBA)*. Only after the financial crisis did the alleged misconduct come to light when it was claimed that *Barclays* had manipulated LIBOR submissions to give the bank a better credit rating to enable it to raise funds. It took until the end of 2008 for the *BBA* to produce a draft document about how LIBOR rates should be set and the requirement for the process to be audited as part of a banks' compliance procedures. And even then it took *Barclays* until June 2010 to tell its submitters of the 'fundamental rules' it required of them.

In June 2012, then Bank of England Governor *Sir Mervyn King* called for a "cultural change" with regard to LIBOR – "The idea that one can base the future calculation of LIBOR on the idea that 'my word is my LIBOR' is now dead" he declared.[7] In February 2014, the *Intercontinental Exchange Group Benchmark Administration (IBA)* officially took over as the new administrator of LIBOR.

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[6] *It's Legal but it Ain't Right*, Nikos Passas and Neva Goodwin, University of Michigan Press

[7] *Bank of England Head says Banks Must Change Culture*, BBC, 29 June 2012

In this example, the working culture and assumptions of those involved with submitting LIBOR rates appears to have been such that they did not perceive it to be wrong because they were suffering from, what some describe as, "moral bankruptcy" even though they were among the "most talented of their generation"[8]. They had the opportunity to manipulate submissions because there were inadequate controls, and because their peers were doing the same. They could thus rationalise their actions and behaviours – 'everyone else is doing it, why not me'?

Rationalisation

Muel Kaptein, professor in business ethics at the Rotterdam School of Management, describes some experimental research whereby academics asked 285 participants from 43 countries to state to what extent they would be prepared to "slip an official some money in exchange for a tax reduction, preferential treatment in a legal case or faster treatment in a hospital"[9]. The nationality of the participant, they found, correlated with the extent to which bribes were offered and accepted. The higher the position of their country of origin on *Transparency International's* corruption index, the higher their willingness to accept or receive a bribe. His conclusion is that it is not simply the case that an individual, given the opportunity, might be pressured into wrongdoing, but that corrupt behaviour can be so ingrained in an environment that there is no objectivity. Corruption in a country, an industry or a company can become so entrenched, and part of normal behaviour, that its participants are not just wilfully blind, but genuinely oblivious that their actions are wrong. They can rationalise illegal behaviour because those around them, from whom they take their moral bearings, act the same way.

Kaptein goes on to give examples where people use euphemisms to lend legitimacy to unethical behaviour: 'joking around' instead of bullying; 'facilitation payments' or 'oiling the wheels' instead of bribery. Fraudulent practices can hide behind phrases such as 'creative accounting' or 'financial engineering'. Using descriptive terms like these allow those in an organisation to hide the reality of what they are doing from themselves and from others. *Kaptein* also emphasises the danger of seeing work as a 'game' as this disconnects you from the real-world repercussions of your actions[10].

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[8] *The Wrong Stuff*, The Economist, 9 February 2013

[9] *Why good people sometimes do bad things: 52 reflections on ethics at work*, Muel Kaptein, KPMG

[10] Surely a warning to all those in the world of finance (or as Michael Lewis, author of Liar's Poker would say, "the most absurd money game ever".

It is not just semantics that enables a person who reaches that tipping point to find a way of rationalising their behaviour. It could be argued that there are certain recognisable traits in people who can persuade themselves to commit fraud. Some categories of these are as follows:

Strict constructionists

The term strict constructionist refers to those who favour giving a narrow conservative definition of a given rule or instrument, e.g. if it is not explicitly outlawed it is legal. Into this category fall those traders and other financial criminals who claim that they might not have broken any rules but may have indulged in 'sharp practices'.

Prisoners

Employees can be 'prisoners of circumstance' or 'prisoners of friendship'.

- An individual might feel obliged or persuaded to aid a colleague and a friend even when there is no direct benefit to themselves (thereby persuading themselves that they have not acted unethically for their own benefit).

- In another situation, a newly promoted manager might discover a fraud or identify fraudulent activity when taking over his new role. At that point, some individuals might shirk their wider responsibilities and not report it in the hopes that it would just go away.

- Other 'prisoners of circumstance' can persuade themselves that authority figures ignore them or do not understand the burdens under which they operate.

Submissives

These people do what is expected of them, either in order to gain acceptance, or because their self-confidence is not sufficiently strong to enable them to act independently. They might also rationalise their behaviour by reflecting on the 'Nuremberg Defence' – that they were only following orders and were not the principal wrongdoer.

Social researchers have proposed the existence of three goals for influencing behaviour: normative goals (behaving as you should); hedonic goals (feeling good) and gain goals (improving your material situation)[11]. These goals are weighted according to environmental factors. Simply put, if an individual sees that others violate rules, that individual is more inclined to violate them

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[11] *The Spreading of Disorder*, Kees Keizer, University of Groningen 2010

too. Since many theorists believe that most of us imitate others around us, in order to combat widespread violation of rules, even minor rule-breaking should be dealt with quickly in an organisation to prevent an escalation of misdemeanours, or the promotion of a sloppy corporate culture[12].

Entitlers

In contrast to those who might be categorised as 'submissives', there are the 'entitlers', broadly defined as those who feel that the rules do not apply to them. In this category might fall individuals like *Conrad Black* or 'Fast Eddie' the self-styled *Lord Edward Davenport*. *Jérôme Kerviel* told an interviewer that he had been so successful that even when he was losing money, he was confident because he "had always been right before".

While some entitlers might feel that they are above the rule of law, there are others who might best be described as 'free riders'[13]. These people take liberties (maybe simple ones like using colleagues' milk from the office fridge) knowing that their colleagues will do the right thing (and keep buying their own milk and not using other peoples). As *Muel Kaptein* writes: "occasionally taking office stationary home can't do any harm, as long as your colleagues don't do it too… of course it's a problem if everyone thinks this way[14]".

A last word from *Jérôme Kerviel:* "Rogue trading happens all the time, it's just that, if they lose, they quietly get fired. If they win, no one cares. Do you imagine we would be talking here if I made €4.9 billion? Have you ever heard about any rogue trader that has won?"

[12] The 'Broken Windows' Theory that prompted New York City's programme of Zero Tolerance in the 1990s illustrates this point and is well described by Malcolm Gladwell in *The Tipping Point,* Part Four, 'The Power of Context'.

[13] *Why do some owners allow their dogs to foul the pavement? The social psychology of a minor rule infraction*, Journal of Applied Social Psychology, Paul Webley and Claire Siviter, 2000

[14] Ibid

Conclusion

According to neurological scientists[15], our brain tries to simplify the world and establish patterns on which we can base future decisions. If we do something once which has a positive outcome, we tend to do it again and the more we do it, the less we think about it. As noted in many fraud, and indeed other criminal cases, taking the first step to committing a crime is often the hardest. Once that step has been rationalised in the mind of the perpetrator, subsequent behaviours unless checked, can repeat and magnify the initial misdemeanour.

Creating a corporate culture to promote ethical behaviour is not only about creating a list of corporate ‘values’ or ‘mission statements’ to adorn an office wall or company website. After all, *Enron’s* corporate values in 2001 were listed proudly as: “Communication; Respect; Integrity; Excellence”. In a paper[16] analysing the culture at *Lehman Brothers* vis-à-vis its ethical code, the authors found that the “code was an artefact; something external to the culture and existed because companies like *Lehman Brothers* needed a code for public relations purposes and to protect themselves from conduct against the firm”.

Without its managers and leaders setting an example across every sphere of corporate life, any corporate environment is open to abuse and many a ‘good’ employee could find a justification for acting unethically.

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[15] Trevor Cole, *Why good people do bad things; Are we living in an unethical era?* University of Toronto Magazine, Winter 2005

[16] *An Analysis of the Lehman Brothers Code of Ethics and the Role It Played in the Firm,* Betsy Stevens, Scott Buechler, Journal of Leadership, Accountability and Ethics vol. 10(1) 2013

Further reading

- Muel Kaptein, *Why good people sometimes do bad things: 52 reflections on ethics at work*.
- Ann Tenbrunsel & Max Bazerman, *Blind Spots: Why we fail to do what's right and what to do about it*, 2011, Princeton University Press
- A.E. Tenbrunsel, K.A. Diekmann, K.A. Wade-Benzoni, and M.H. Bazerman, *The Ethical Mirage: A temporal explanation as to why we aren't as ethical as we think we are* (Harvard Business School: Working Paper 08- 012, 2007