Introduction:
What Makes People Cheat? (Or Not)

ARIELY’S CHEATING EXPERIMENT

<table>
<thead>
<tr>
<th>Task</th>
<th>20 Math Problems</th>
<th>$ Reward For Each Correct Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Control Group</td>
<td>Experimental Group</td>
</tr>
<tr>
<td>Variable: Risk of Detection</td>
<td>No Chance to Cheat</td>
<td>No Chance of Getting Caught Cheating</td>
</tr>
<tr>
<td>Outcome: Average Test Score</td>
<td>4 Correct Answers</td>
<td>7 Correct Answers</td>
</tr>
</tbody>
</table>

Source: Dan Ariely, "Predictably Irrational," (2008), Chapter 11; Ariely, "Why We Think It’s OK to Cheat and Steal (Sometimes)," TED talk, March 18, 2009 http://www.ted.com/talks/dan_ariely_why_we_think_its_ok_to_cheat_and_steal_sometimes.html

*Or: Sign an acknowledgement of the school’s honor code.
Agenda

- Command and Control Compliance Model
  - ...and its limitations
- Values-Based Model
  - Pioneering Studies on Comparative Effectiveness
  - Legitimacy: What Gives Your Rules Moral Authority?
  - Group Dynamics, Commitment and Framing
  - Culture and Reporting of Misconduct
  - Culture and Incidence of Misconduct
  - Putting it all Together – Command, Control, Culture and Compliance

---

If people are good only because they fear punishment, and hope for reward, then we are a sorry lot indeed.
— Albert Einstein

Culture, more than rule books, determines how an organization behaves.
— Warren Buffett

---

Command and Control Compliance Model

- Aims to control or influence employee behavior mainly through negative and positive incentives
- Based on assumption that humans behave in accordance with the rational choice theory of classical economics:
  - We compare Reward for Misconduct to Risk
  - Estimated Risk
  - Probability of Detection
  - Severity of Punishment
- Highest number wins – Risk or Reward
- Heavy reliance on monitoring, detection, punishment and deterrence to increase perception of risk
- Relies more on rules than on empowerment and judgment
Even if the rational-choice model is accurate, improving compliance rates via Command and Control has built-in limitations:

- Sanctions must be proportional, or they can become counterproductive—reporting of violations declines if punishment is unfairly harsh.
- Very expensive to increase perceived likelihood that violation will be detected (“Cop on every corner” method).

Self-interested rational choices for individuals aren’t always good for the organization:

- Individual circumstances may distort the equation.
- Some issues ought to be non-negotiable.
- How often does risk/reward calculus encourage reporting of misconduct by others?
  - Risk of not reporting versus risk of blowing whistle.
  - What utilitarian rewards come from being a whistleblower?
  - Internal vs. external rewards, internal v. external reporting.
Command and Control Limitations

› Rationality is Overrated: In actual human beings, well-known cognitive biases distort risk/reward decision-making processes (See, e.g., Predictably Irrational, Nudge, Thinking Fast and Slow, Freakonomics)
  › We consistently over-value definite, near-term events – such as the rewards of rule-breaking
  › We under-value uncertain, future events, even if catastrophic – such as the risk of getting caught


Command and Control Limitations

› More cognitive biases that distort risk/reward and ethical judgments:
  › Self-Serving Bias and Dunning/Kruger Effect
  › Confirmation Bias and Motivated Reasoning
  › Conformity Pressures
  › Remember the Asch experiments?


Command and Control Limitations

› Hidden costs of strong Command-and-Control Focus:
  › Mistrust of employees communicated through multiple channels
  › Projection of negative expectations may inhibit employee self-regulation
  › Adversarial relationship with employees – resentment and backlash
  › Risk/Reward framing can crowd out ethical thinking
  › Deterrence message is one of pursuing self-interest (avoiding punishment) rather than doing the right thing
  › Bottom Line: Command-and-Control alone is, at best, an inefficient (and therefore expensive) way to influence behavior

Command and Control Limitations – The Effect of Framing

Framing is why a weak Command-and-Control system is the worst of all worlds:
- Strong punishments work better than weak ones
- BUT: In some contexts, no punishment also works better than weak punishment – affects how people frame the issue
- Is management serious?
- Weak penalties and weak values message encourage economic, risk/reward framing of issues (since the stakes are low), rather than ethical framing
- In risk/reward market framing, there are no absolute rules
- If the dominant message is values-based, people feel trusted, assume personal responsibility, and frame issues more in terms of “the right thing to do,” where absolutes abound


Values-Based Approach – The Paradigm Shift

- Traditional Command and Control Paradigm:
  - Prevent “bad” employees (5%? 20%) from breaking rules
  - Forcibly raise employee behavior up to Company standards -- impose Company values upon recalcitrant employees
  - Business and rules-based framing
- Values-based, Self-Regulatory Paradigm
  - Harness the positive values of good people (80%? 95%)?
  - Make sure Company is seen as measuring up to employee’s values
  - Ethical framing
  - To win loyalty – and voluntary adherence to rules – show that you deserve it – Walk the talk

Values-Based Approach: Motivating Compliance via Ethical Culture

- Ethical Culture = Engaging Employee Values so that Employees Identify Positively with the Organization and Act Accordingly
  - “Your values are what you do when you think no one is looking”
  - When employee embraces Company values, motivation is intrinsic, compliance is voluntary and doesn’t depend on monitoring, detection and fear of punishment
- Tyler’s Studies of Workplace Compliance:
  - Value-based factors (legitimacy and value congruence) explained over 80% of variance in compliance behaviors
  - Punishment and reward systems explained less than 20%
Culture and Compliance

Values-Based Compliance Programs produce better results than those with a Command-and-Control, deterrence emphasis. Cultural Markers

- Ethical leadership (Executive and Supervisory levels)
- Fair treatment of employees
- Rewarding ethical behavior
- Punishing misconduct
- Open discussion of ethical issues
- Ethical issues considered in decisionmaking
- Employee and Community Focus

Compliance Goals

- Reducing unethical conduct
- Reporting misconduct
- Increasing awareness of ethical issues
- Increasing advice-seeking on ethical issues
- Comfort delivering bad news
- Better ethical decision-making
- Increasing employee commitment to employer

Values-Based Approach -- Legitimacy and Culture

- What Drives Voluntary Adherence to Rules? (Tyler)
  - Company’s values and policies are perceived as measuring up to employee’s moral values
  - Company is perceived as a legitimate source of authority: employee believes it deserves to have its rules followed
  - These factors are more influential than likelihood of detection or fear of punishment (80/20)
  - So, how can we promote these perceptions?
    - Measuring up on values: “When managers say ‘ethics,’ employees hear ‘fairness.’”

Values-Based Approach – Fairness, Legitimacy and Culture

- Fairness Perceptions and Ethics Outcomes (Treviño and Weaver)
  - Measured effects of company’s perceived fairness to employees
  - Fairness strongly correlated with less observed unethical conduct and with more reporting of infractions
  - What Works/What Hurts: Of all variables, fair treatment had the strongest correlation with employee commitment to the company and with comfort delivering bad news

Values-Based Approach -- Legitimacy and Culture

> Leading criteria for legitimacy of authority (Tyler):
>   > Procedural fairness in decision-making
>   > Quality of interpersonal treatment of employee
> These factors exert more influence than:
>   > Fairness of actual decision outcomes
>   > Whether outcomes are favorable to employee
>   > Rewards of employment: salary and incentives
>   > Risk of punishment

Source: Tyler, Deinhart, & Thomas

Values-Based Approach -- Legitimacy and Culture

> What is Procedural Fairness?
>   > Opportunity for input from affected persons
>   > Understandable, articulated rules and processes
>   > Consistency over time and across similar cases
>   > Objectivity as opposed to ad hominem and ad hoc
>     > Same rules for everybody
>   > Communicate reasons for decisions

Source: Tyler, Deinhart, & Thomas

Values-Based Approach -- Legitimacy and Culture

> What Makes for Quality Interpersonal Treatment?
>   > Respect employees’ rights: necessary but not sufficient
>   > Courtesy and dignity – respect the person
>   > Employee feels trusted
>   > Listen
>   > Communicate reasons for decisions
> Trust: Managers at all levels must earn trust
>   > Actions speak louder than words (or Codes of Conduct)
>   > “Mood in the Middle” as well as Tone at the Top
>   > Treatment of employees is primary
>   > Interactions with third parties also count

Source: Tyler, Deinhart, & Thomas
Does the Company Measure up to Employees’ Values? Corporate Body Language

- Guaranteed ways to sabotage your values message:
  - Unscrupulous or opportunistic dealings with suppliers, customers, investors or the public
  - Cut corners on obligations
  - Differences in public and private statements – hypocrisy
  - Different rules for top performers
  - Failure to address reports of misconduct
- These negatives are all very memorable and strongly influence employee perceptions

Consistency is Crucial

“It takes many good deeds to build a good reputation, and only one bad one to lose it”

-Benjamin Franklin

“Bad is Stronger than Good”

-Review of General Psychology, Vol 5 No. 4 (December 2001) by Baumeister, Bratslavsky, Finkenauer and Vohs.

Group Dynamics, Commitment and Framing

- People use groups to support and nourish our identities and our positive self-concepts
- Identification with the group promotes commitment and cooperation
- Fair and respectful treatment tells employees that they are important and valued, encourages identification, commitment, and cooperation with the group
- Pride in the group also encourages identification

Group Dynamics, Commitment and Framing

- Social/Group norms can govern behavior more effectively than market norms
  - Social norms = Culture
  - Market norms = Reward and Punishment
- Social vs. market framing: People will do things for free, for social reasons, that they won’t do for money; and social penalties can trump economic ones
  - The power of social PLUS ethical framing: “Around here, we do what’s right.”


Promoting Employee Commitment

- Positive: Employee commitment strongly linked to:
  - Management’s actions show character and integrity
  - Management welcomes those seeking advice about reporting policy violations
  - Training on guidelines for acceptable behavior
  - All 9 Ethical Culture measures in the What Works/What Hurts study

- Negative:
  - Culture – The less ethical the work environment, the less likely employees will go above and beyond job requirements or use extra effort
  - Program Focus – The more prominent monitoring, penalties and incentives are, the more likely they will “crowd out” intrinsic motivations and commitment


Committed Employees Boost Compliance

- Benefits of Committed Workforce
  - Voluntary rule adherence
  - Less need for surveillance/monitoring
  - More likely to report suspected violations or other bad news, rather than turn a blind eye
  - Less accommodating environment for rule-breakers – more “eyes on the street”
  - Significant increase in voluntary actions to benefit the organization
  - Psychopaths less likely to climb the ladder of success high enough to do catastrophic damage

Culture and Reporting of Misconduct

› Employees are the company’s eyes and ears: they have access to every transaction, trading partner, facility, product, peer, and manager…
› 47% of fraud discovery comes from tips; employees furnish 51% of all tips and another 12% are “anonymous”
› Don’t bet on eliminating all the bad apples
› Motivate the rest to report what they see
› The best monitoring is an ethically aware, loyal workforce

Sources: 2012 AFCE Report to the Nations on Occupational Fraud & Abuse; Feldman and Lobel, The Incentives Matrix, Texas Law Review (2010). 47% applies to companies with more than 100 employees.

Culture and Reporting of Misconduct

› What Works/What Hurts: Every one of the 11 ethical culture measures was a better predictor of increased reporting than were program orientation or formal program characteristics
› Cultural factors had an even stronger relationship to perception that “it’s OK to deliver bad news”
› Follow-through on ethics and compliance issues and fairness to employees both strongly affect of internal reporting
› ERC Fellows: Ethical leadership, strong ethical environment, and strong organizational support for the employee are each significantly correlated with increased reporting
› NBES 2009: In strong ethical cultures, reporting rate was 26% higher than in weak ethical cultures

Culture and Incidence of Misconduct

What Works: All 9 positive ethical culture factors

- Fair and respectful treatment, ethical leaders, values-based messaging, open door policy, etc. go a long way for the “good people” and the great majority in the middle – BUT:
- Not everyone is alike, and some temptations are stronger than others
- Around 3-4% of every population operates without a conscience (psychopathy, antisocial personality disorder) and do not take values, group membership, or loyalty into account in their decisionmaking
- Monitoring, detection and discipline are essential
- Sentencing Guidelines and other leniency programs require robust command-and-control elements
- Command-and-Control elements, if not the dominant features of the compliance program, reinforce the culture message and improve results

What Hurts: Ethics Resource Center identified 5 “Negative Work Environment” factors:
- Success is rewarded regardless whether achieved through questionable means
- Mistrust of top management’s promises and commitments
- Mistrust of supervisors’ promises and commitments
- Dissatisfaction with information from top management
- Dissatisfaction with information from supervisors

Strong correlation between these negative factors and workplace misconduct

Number of Negative Workplace Factors Present

Sources: Trevino, Weaver, Gibson and Ether: Ethics Research Center, 2007 Business Ethics Survey

Wow! Is it really that simple? (Of course not...)

- Employees of companies with weak ethical culture are nearly 3 times as likely to observe misconduct as employees of companies with strong ethical cultures
- Values-based factors explain >80% of employee compliance; fear of punishment or desire for reward explains <20%

Complementary Effects of Culture and Compliance Programs

- A comprehensive compliance program, with its anonymous reporting channels, can nearly double reporting, if ethical culture is otherwise strong

Sources: Ethics Research Center, 2007 Business Ethics Survey, Tyler, Deinhart, and Thomas
### Complementary Effects of Culture and Compliance Programs

<table>
<thead>
<tr>
<th>Companies with a strong ethical culture:</th>
<th>Companies without a strong ethical culture:</th>
</tr>
</thead>
<tbody>
<tr>
<td>24% of employees observed misconduct in a year</td>
<td>98% of employees observed misconduct in a year</td>
</tr>
<tr>
<td>Companies with a comprehensive Ethics and Compliance Program:</td>
<td>Companies without a comprehensive Ethics and Compliance Program:</td>
</tr>
<tr>
<td>29% of employees failed to report observed misconduct</td>
<td>61% of employees failed to report observed misconduct</td>
</tr>
</tbody>
</table>

With both Program and Culture, undetected risk = incidence of 24, multiplied by 29% unreported

Score = 7

Source: Ethics Research Center, 2007 Business Ethics Survey

---

### The Bottom Line

- You must have Command-and-Control elements: rules, policies, training, monitoring and deterrence
- They produce important benefits, and the Sentencing Guidelines and other leniency programs require them
- But Sentencing Guidelines also require a "culture of ethics and compliance"
- Values-based elements and emphasis dramatically improve Compliance Program results; dominant message should be values-based

---

### The Bottom Line

- Model the message through the broader company culture:
  - Treat employees with respect and conspicuous fairness
  - Keep your door and your mind open to employees
  - Engage and communicate -- consistently
  - Transparency about responses to misconduct
  - Be the change you want to see; live up to employee values and they'll internalize yours
  - Create a place where people are proud to work
Questions?

Scott Killingsworth
scott.killingsworth@bryancave.com
404.572.6702

Bryan Cave LLP
One Atlantic Center
Fourteenth Floor
1201 West Peachtree Street, NW
Atlanta, GA 30309
Tel.  404.572.6600
Fax.  404.572.6999
www.bryancave.com