

CONFIDENTIAL

Compliance Fast and Slow: Lessons from Behavioral Economics

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Overview

- Key Questions:
 - » How can we use lessons from behavioral economics to encourage the reporting of misconduct?
 - » How can we use lessons from behavioral economics to encourage witnesses to be more honest once we're investigating?

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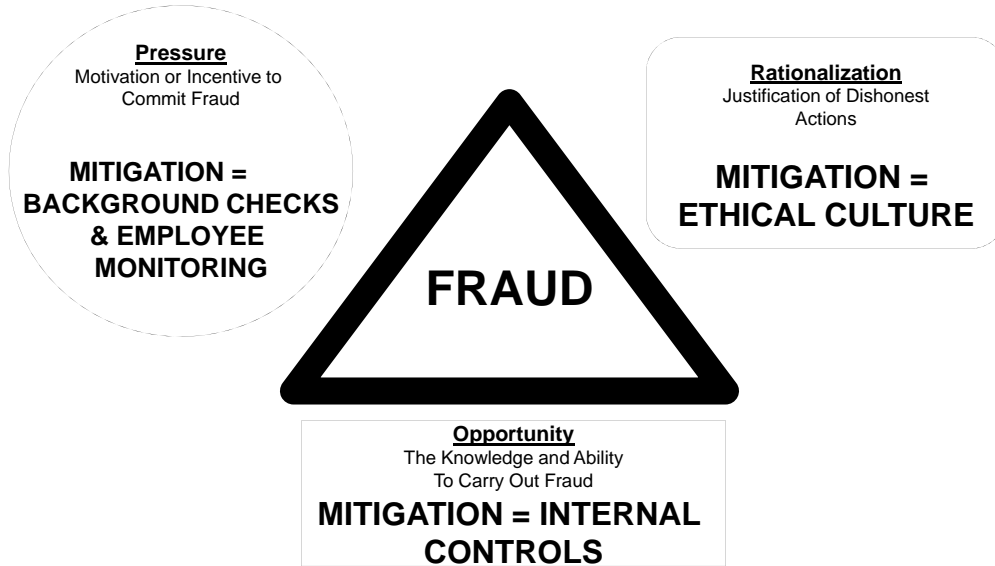
Overview

- “Traditional” Economics
 - » Assumes that where markets are fair and information is freely available, the “Rational Economic Actor” will behave in such a way as to maximize utility, i.e. get the most out of every dollar spent and avoid unnecessary costs
 - » However, not all actors behave rationally—at least not all the time
- Behavioral Economics
 - » Recognizes that individuals do not always behave rationally
 - » This irrationality is itself often predictable
 - » Can be anticipated and even manipulated
 - » Places a greater reliance on psychology and the study of human behavior

Overview

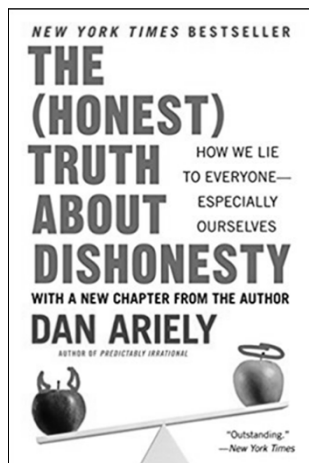
- Social Norms Define Your Corporate Culture
 - » Misconduct, Rationalization, and Culture go Hand in Hand (in Hand)
- Choice Architecture
 - » Improve Your Defaults
- Priming for Honesty
 - » Thinking About Honesty Obligations at Key Moments

The Fraud Triangle



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The Honest Truth About Dishonesty – Dan Ariely



- Most of us like to think of ourselves as honest people (and we'd like others to think of us that way as well)
- However, most of us will also cheat just a little bit when given the chance
 - » We will cheat right up to the point when the cheating begins to make us question whether we are honest people
- The delta between these two points is the "fudge factor"

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The Fudge Factor

- The fudge factor and rationalization are closely linked
 - » Cultural conditions may allow the fudge factor to increase as the employee is able to rationalize more and more misconduct
 - Not a cost-benefit analysis
 - It is a function of social norms
 - » For that reason, a corporate culture which stresses honesty and integrity will decrease the fudge factor because the employee will have a harder time rationalizing misconduct

Rationalization and Culture – Example 1



VS.



- Group honesty check: one pen vs. a case of pens
 - “No big deal” vs. “crossing a line.” Why?
 - Answer: Social acceptability.

Example 2: The Matrix Experiments

- Ariely's team conducted experiments in which subjects took math tests together in a room and were paid for the number of correct answers
 - » Control condition (no cheating possible): Average was 7/20 correct
 - » Test condition (cheating possible): Average was 12/20 correct
 - » Actor (in-group peer) flagrantly cheats: 15/20 correct
 - » Actor (out-group peer) flagrantly cheats: 9/20 correct

Social Norms, (cont'd)

- In summary, social norms are critical
- Of paramount importance is the cultural message that employees receive about honesty and integrity
 - » Social and cultural cues influence notions of what is and is not acceptable, and therefore affect the "fudge factor"
 - » If employees see their peers behaving ethically and with integrity, they are far more likely to do so themselves
 - » Regular reminders about honesty and the expectation of integrity substantially drive down dishonest behavior
 - » A culture of integrity and honesty makes it much more difficult for employees to rationalize bad behavior

Appeal to Social Norms

- Idea 1 - Appeal to Social Norms: Tell Them What Others are Doing
 - » Increasing Awareness of a Norm Increases Compliance With the Norm
 - “90% of your fellow Minnesotans have already complied with the new tax law.”
 - “Most Montana teens (70%) are tobacco free.”
 - » Reporting Mechanisms – Let Them Know That Others Use the Process
 - “125 of your colleagues raised concerns via the Hotline last year, and 546 more asked questions.”
 - People are more likely to use it if they think others do, too
 - Reduces the risk that they won't seem like a team player for reporting a concern

Appeal to Social Norms (cont'd)

- Idea 1 – Social Norms (cont'd)
 - » Witness Interviews - Phrasing Tips
 - No – “Compliance received a complaint through the Hotline.”
 - Yes – “One of our colleagues was concerned about an issue, and felt so strongly that s/he contacted my office so see if we could look into it.”
 - » Other possibilities
 - “Several people have already spoken to me and provided helpful information.”
 - “All of the team members to whom I have spoken have been very cooperative.”
 - “Based on my conversations with other team members, others are concerned about this issue as well and went to help make sure we get it resolved.”
 - » CAVEAT – Don't breach confidentiality; may need to strike a balance

Choice Architecture

- **Choice Architecture** is the practice of influencing choice by changing the manner in which options are presented to people
- Of critical importance is the “default” option
 - School cafeteria
 - Your company’s 401(k) plan
 - Your smartphone

Choice Architecture (cont’d)

- Idea 2 - Choice Architecture and Defaults: Make It Easy
 - » Most reporting processes place the burden on the employee to affirmatively raise and report issues (i.e. deciding there is an issue worth reporting, finding the hotline, submitting the concern, etc.)
 - This alone can be enough to stop an employee who feels overworked or is otherwise sitting on the fence from raising an issue
 - Direct solicitation of the employee about misconduct might only happen annually (e.g. Code of Conduct Attestation, COI Questionnaire, etc.)
 - » Alternatives:
 - Increase the frequency of direct solicitation – Quarterly? Monthly?
 - Embed a question in a more frequent process (e.g. boot-up of computer, weekly pop-up window, etc.)

Priming

- **Priming** describes how ideas prompt other ideas later on without an individual's conscious awareness
- Once people begin thinking about honesty, they tend to stop cheating
 - » Matrix experiment - When students were asked to sign a statement **before** the test acknowledging that the test fell under the school's Honor Code, the number of correct results reported was the same as the control (non-cheating) condition (7/20)
 - » Insurance industry experiment - Customers who signed an honesty attestation **before** completing annual mileage attestation declared driving 15% more miles than those who signed the attestation at the bottom of the form

Priming (cont'd)

- Idea 3 - Priming: Prompting Honesty at Key Moments
 - » At the start of the interaction with the employee, inform him/her of honesty obligations, under the Code of Conduct, Investigation Policy, etc.
 - Witnesses Interviews – At the start of the interview, have them sign a witness form which sets out the honesty obligations
 - Or, let them know at the start of the interview that they will be expected to sign such a statement at the end
 - Annual Code of Conduct Attestation or Conflicts of Interest Disclosure form
 - Typically structured so that they sign at the end; move it to the start
 - If all else fails, belt and suspenders—sign in both places

Conclusion

- “Corporate Culture” is another way of saying “**Social Norms** in the Workplace”
 - » People are more inclined to do what they see others doing
- Use **Choice Architecture** to your advantage
 - » Adjust the default options to encourage contacts from employees
- **Prime** your workforce for honesty at key moments
 - » Remind them of their honesty obligations before they need to be honest

Questions



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Encouraging Reporting and Honesty (cont'd)

- Idea 4 – Highlight the Risk and Impact of Dishonesty
 - » Emphasize the risk and impact of fraud or dishonesty on the company, as well as **the individual**
 - Fines, settlements, and lost business might seem abstract, but if you can translate that into lost bonuses or a dip in the stock price, you might make headway
 - If the business area still has to meet its targets while it is bogged down in a government investigation or remediation for an issue that didn't get disclosed, that will likely mean a lot more work for everyone
 - » Explain the risks of remediation as well as the consequences for those caught being dishonest
 - It's not the crime, it's the cover-up—people are often fired for lying about conduct that itself would have merited a much lower level of discipline