Businesses need better approach to compliance programs, research finds

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Recent reports of sexual harassment committed by powerful men also highlight the failures of corporate compliance programs designed to protect employees. This is because few companies understand how their employees reach unethical and illegal decisions or have compliance strategies aimed at curbing them, according to research by a professor in the Indiana University Kelley School of Business.

"Despite a sustained focus on curbing bad corporate behavior over the past two decades, and a resulting boom in the compliance industry, corporate America is still searching for compliance strategies that are evidence-based, demonstrably successful and cost effective," said Todd Haugh, assistant professor of business law and ethics at the Kelley School.

"When we work in organizations that fail to encourage employees to report unethical behavior—or worse, punish those who do report—a collective feeling can emerge that nothing will change even if someone does speak up," Haugh added. "This leads employees to rationalize their own ethical failings as normal or acceptable within the organization, reinforcing the culture of silence and leading to wide corruption within a company."

Haugh, a former criminal defense attorney, is the author of two research papers that present the value of using a behavioral science approach to better understanding what causes white-collar crime and corporate wrongdoing. Most corporate compliance programs are built around what the law requires, and many are run by former regulators or criminal law attorneys.

In a paper in MIT *Sloan Management Review*, "The Trouble With Corporate Compliance Programs," he identifies eight rationalizations most frequently used by those committing unethical and criminal acts within companies:

- Denying responsibility, such as suggesting that they were acting under orders or for reasons with larger economic implications.
- Denying injury, when an offender excuses their behavior by claiming no real harm exists. This often happens when the victim is insured or when harm is to the public as a whole, such as during insider trading or antitrust cases.
- Denying the victim, when the offender claims the victim "deserved" being harmed or when the victim is not clearly defined. It frequently is used in fraud cases against the government.
- Condemning the condemners, shifting attention to the motives of others, such as regulators, prosecutors and government agencies.
- Appealing to higher loyalties, when the offender claims they were sacrificing societal norms to protect a boss, bolster a failing business or maximize shareholder value.
- Using a ledger metaphor, when people balance their negative actions against their positive accomplishments.
- Claiming entitlement, when they simply believe they deserve the fruits of their illegal activity.
- Claiming relative acceptability or normality, which involves comparing an offender's bad actions with those of others to relieve moral guilt.

Haugh's research helps to explain why instances of harassment by entertainers, media moguls, politicians and other high-profile individuals often went ignored and unreported.

"It's been reported that the Weinstein Co.'s board knew of its CEO's actions, yet didn't act to stop him," Haugh said, citing the example of allegations against former film executive Harvey Weinstein. "One common rationalization those board members might have been employing is called the appeal to higher loyalties, in which employees put the company's interests above that of larger society, or here, the interests of the harassed women."

In this and another new paper, "Nudging Corporate Compliance," in *American Business Law Journal*, Haugh studied whether nonmonetary incentives can positively impact compliance.

"The best approaches to compliance focus not on how government regulators will react to a compliance initiative but on how employees—the real 'customers' of compliance—will be affected," he said. "They consider the behavioral implications of the compliance program at every turn, particularly how company policies might foster or defeat employee rationalizations."

In the "Nudging" paper, Haugh studied companies' use of simple interventions to influence good behavior, following the concept established by 2017 Nobel Prize-winning economist Richard Thaler.

Examples of corporate nudging include brief written reminders of morality for employees completing travel reimbursement forms and checklists before client funds are transferred. Other companies employ more sophisticated methods, including using algorithmic software to monitor employee activity.

In short, Haugh discovered that while subtle suggestions from management can influence positive employee behavior, it also can backfire and become a tool of unwanted behavioral manipulation. He recommends an approach that balances preserving employee autonomy with an understanding of broader benefits.

In the paper, he pointed to the recent scandal at Wells Fargo, where now former employees allegedly created fake customer accounts despite extensive training on the company's code of conduct and banking regulations as well as explicit messages to "not create fake bank accounts."

"At first glance, this situation appears perfect for a first-degree, 'just-in-time,' certification-type nudge, in which employees are prompted to consider moral standards before opening additional employee accounts," Haugh said. "Yet a deeper look demonstrates that even if employees had received the nudge perfectly, they would interpret it against the backdrop of their true preferences—here, to act unethically to save their jobs while telling themselves that it is necessary, everyone else is doing it or that no one will really be harmed by their actions.

"These are classic rationalizations employed by white-collar offenders, and they act as powerful counters to any behavioral ethics nudges that reach employees. Yet rationalizations are employee-specific, and they may overlap and interact in a multitude of ways," he added. "Although delivered with precision, the behavioral ethics nudge used here simply may have no effect given the varied and variable social and organizational pressures making it more likely that good people will do bad things."

But Haugh concludes that behavioral ethics nudging has potential to be "one of the most important advances in corporate compliance in decades—a unique tool in the fight against corporate wrongdoing benefiting employees, companies and the public."

More information: sloanreview.mit.edu/article/th … compliance-programs/

Provided by Indiana University