Behavioural ethics

Don’t rely solely on good intentions
The business ethics debate is still hampered by our abiding fascination with the story of the goodies and the baddies, the heroes and the villains. The real picture, of course, is a little more complicated. In this article, Jeffrey M Kaplan, Partner, Kaplan & Walker LLP, looks at how a better awareness of the psychological factors influencing our ethical choices can help companies improve the effectiveness of their compliance and ethics programmes.

The governing models of business ethics – at least in the West – are based in large measure on two schools of philosophy: utilitarianism (sometimes called consequentialism), which is derived initially from the work of Jeremy Bentham and John Stuart Mill; and deontology (sometimes called the rights-and-duties school), which begins with the writings of Immanuel Kant. Both offer criteria for individuals to use in making ethics-related decisions, and assume that such decisions will be made rationally, with wrongdoing typically seen as the product of a deliberate choice.

But both schools are increasingly criticised for being based on a view of human nature that is at odds with an emerging understanding of how people actually make decisions – which is often anything but rational, at least in the traditional sense. That critique is the foundation of a field of study known as ‘behavioural economics’, which examines the effects of various social, cognitive and emotional factors on economic decision making. In experiment after experiment, behaviourist researchers have shown the limits of traditional notions of rationality. Behavioural economics has recently entered the mainstream of business thinking – it is now being used to a substantial degree, among other things, in the realms of finance and marketing. Indeed, it was the basis of the 2002 award of the Nobel Prize in economics to Professor Daniel Kahneman of Princeton, a pioneer in the field.

Behavioural ethics is the application of behavioural economics ideas and information to the realm of ethics. The implications of behavioural ethics indeed extend across a whole spectrum of contexts – from the personal decisions we make in our private lives to public policy determinations that could affect us all.

My interest is in what could be considered the middle part of this spectrum – the ethical issues in business organisations. In this article, I explore aspects of behavioural ethics that seem to have the most practical applications to the work of corporate governance and compliance professionals – and particularly to the operation of compliance programmes.

Implications for conflicts of interest

Conflicts of Interest (COIs) present significant risks in virtually every organisation of any size and in many should be a point of significant compliance focus. COIs have also been the subject of particular interest to several behavioural ethicists who have shown that disclosing COIs may not have the mitigating effect you might expect. Firstly, those who disclose conflicts may feel that they are therefore released from the moral restraint that the conflict should impose on them. Secondly, those to whom a COI has been disclosed may feel the need to accept the conflict out of concern that they would otherwise be suggesting immorality on the part of the conflicted party.

These surprising findings suggest a range of compliance measures companies

Highlights

- recognising the behavioural and psychological factors influencing ethical choices can help companies improve the effectiveness of compliance and ethics programmes
- high risk areas for ethical compliance include where individuals are acting indirectly through a third party or where the potential victims of an ethical decision are ‘invisible’
- disclosure of a conflict of interest does not always have the mitigating effect it is assumed to have
should consider, such as:

- educating those involved about the generally under-appreciated dangers of COIs
- ensuring that decisions about COI waivers and COI management are made by those who are independent and possess relevant expertise (for example a compliance and ethics officer, not a line manager)
- having a sufficiently rigorous COI management process, and
- auditing the process and report on the audits to senior management and maybe the board of directors.

Implications for compliance risk assessment

A number of behavioural ethics experiments shed light on circumstances that tend to create compliance risk, including those already mentioned. There are also many others.

For instance, one experiment showed that acting indirectly – that is through a third party – can blind individuals to ethically problematic behaviour more than direct action does. This suggests that companies should recognise the limits of what could be called ‘inner controls’ – meaning personal moral restraints – in their dealings with third parties. So, as a matter of risk assessment, an organisation may have to make up the difference with enhanced compliance measures (internal controls) in dealings with suppliers, agents, distributors, joint-venture partners and others.

Another experiment showed that it is easier to disregard the interests of unknown individuals in making an ethical decision than those of known ones. This finding could help explain the relative ease with which so many individuals engage in offences where the victims are not identifiable, such as insider dealing, government contracting or tax fraud. Here, too, as a matter of risk assessment, an organisation may have to make up the difference left by weak ‘inner controls’ with enhanced compliance measures.

Of course, as is true of a number of behaviourist findings, this insight is not a complete surprise. Indeed, Ben Franklin once said, ‘There is no kind of dishonesty into which otherwise good people more easily and more frequently fall than that of defrauding the government’. Still, being able to prove with real data what is otherwise known just anecdotally or intuitively may be useful to compliance professionals in getting the company to devote extra attention to a risk area.

The same can be said for a behaviourist experiment showing that individuals with depleted resources tend to have greater risks of engaging in unethical conduct. When faced with this knowledge it may be difficult for management or a board to ignore a recommendation to either reduce pressure or focus extra compliance and ethics mitigation efforts on parts of an organisation where employees are subject to greater-than-ordinary stress.

A more counterintuitive finding in this field concerns what might be called the risk of good intentions. Several behaviourist studies have shown that being cognisant of one’s ethical failings actually increases the likelihood of subsequently doing good, and that the converse is true as well. Examples of this phenomenon are that acts promoting gender equality ‘licence’ discriminatory ones, being reminded of one’s humanitarian traits causes reductions in charitable donations, and purchasing ‘green’ products licenses unenvironmental behaviour. While unsettling, these findings suggest a need for compliance programmes to pay extra attention to risks that could arise from particularly virtuous-feeling activities.

Implications for training and communications

Providing training and other communications constitutes much of the day-to-day work of compliance professionals and such training/communications are the principal interface that most employees have with a company’s compliance programme. The
relevance of behavioural ethics to these key parts of a programme is two-fold.

First, there is the issue of how to train and communicate. Currently much compliance training is considered ineffective, in that it takes up a lot of employee time and other company resources but provides relatively little in the way of risk reduction. However, behavioural ethics suggests that there is a way to pay less and get more in this key compliance programme area.

Specifically, one of the most striking experiments in the behavioural ethics field shows that being asked to read an honour code shortly before being presented with the opportunity and motivation to cheat significantly decreases the incidence of such cheating. That so much mitigation can be achieved with relatively little effort is encouraging because there are many ways in which this ‘just-in-time’ approach could be applied to reduce significant compliance risks. Such possibilities include the following risk areas and timing strategies:

- **anti-corruption** – right before interactions with government officials and third-party intermediaries
- **competition law** – right before meetings with competitors (for example at trade association events)
- **insider dealing** – during key transactions, before preparing earnings reports, and
- **protection of confidential information** – when receiving such information from third parties pursuant to a non-disclosure agreement.

Note that some of these just-in-time communications are deployed already, but not nearly enough given the significant impact they can have. For the compliance professional this behavioural ethics insight points the way to much ‘low hanging fruit’ in terms of programme enhancement.

Secondly, behavioural ethics can help inform the content of compliance training and communications. There are indeed a great many possibilities in this regard and I mention here only a few.

- **Provide training on the danger of ‘slippery slopes’**. That is, one important behaviourist finding of relevance to compliance programmes – including but not limited to training – is that people are more likely to accept unethical behaviour engaged in both by others and also themselves when such behaviour occurs as part of process of a gradual ethical decay, rather than appearing abruptly. Compliance training should expressly identify these dangers so that employees can be alert to them.

- **Provide training on the particular need for senior managers to have heightened ethical awareness.** Yet another behaviourist finding is that individuals in positions of power are not only more likely to condemn cheating in others, but also more likely to engage in cheating themselves than others. Of course, the notion that power corrupts is hardly news (and Lord Acton’s famous dictum on that point – ‘power corrupts; absolute power corrupts absolutely’ – is 125 years old). But being able to show the extent of the risk with hard data may be useful in persuading managers to exercise extra vigilance when it comes to their own conduct.

**Implications for supervisory accountability**

Another noteworthy finding of relevance to managers concerns ‘motivated blindness’. As described by Max Bazerman of Harvard, another one of the long-time leaders in the field: ‘We often fail to notice others’ unethical behaviour if it’s in our interest not to notice. This failure of oversight ...is unconscious and common.’

**Behavioural economics and behavioural ethics resources**

- D Kahneman, *Thinking Fast and Slow* (Farrar, Straus & Giroux 2011)
- *Ethics Unwrapped* – a website maintained by the McCombs School of Business at the University of Texas at Austin (http://ethicsunwrapped.utexas.edu), which has, among other things, a series of short behavioural ethics videos that can be used for teaching.
From a compliance perspective, this danger of ‘motivated blindness’ underscores the importance of meeting the expectations of the ‘Sentencing Guidelines for Organisations’ – the leading compliance programme standard in the US and one which has influenced official standards throughout the world – that organisations should impose discipline on employees not only for engaging in wrongful conduct but ‘for failing to take reasonable steps to prevent or detect’ wrongdoing by others. While this compliance standard has existed for more than two decades, relatively few companies pay attention to its dictates to a meaningful degree – and some do not do so at all.

More specifically, companies should consider taking the following compliance measures, among others:

• build the notion of supervisory accountability into policies, for example in the managers’ duties section of a code of conduct

• speak forcefully on the issue in training and other communications for managers

• train company investigators on the notion of managerial accountability and address it in the materials they use in investigations so that they are required to consider it in all inquiries if a manager’s being ‘asleep at the switch’ led to the violation in question

• publicise (in an appropriate way) that managers have in fact been disciplined for supervisory lapses, and

• have auditors take these requirements into account in their audits of investigative and disciplinary records.

A new approach
Finally, while many of the uses of behavioural ethics in compliance programmes concerns individual programme components – those discussed above and others – the most important use, to my mind, is on a more basic level. That is, in a general way behavioural ethics findings can help business leaders fully appreciate the need for strong compliance programmes.

I do not suggest that most business leaders are hostile or even indifferent to such programmes. But, like the great majority of people who still harbour a hyper-rational view of ethics, they often think that good intentions are largely enough to ensure ethical conduct in the workplace, and fail to see the extent to which expertise, resources and effort are needed for success in this area – as is the case in more traditional areas of business management.

The overarching point of behavioural ethics is that many, indeed most, individuals are not either wholly good or wholly bad. Such individuals often need help in staying on the right side of the various law and ethics lines. And compliance programmes – if they are treated with the same desire to achieve results that animates other business initiatives – can provide that help.

Jeffrey M Kaplan
Partner, Kaplan & Walker LLP

Jeffrey Kaplan has practiced compliance programme law for more than 20 years, and is an adjunct professor of business ethics at New York University’s Stern School of Business. Links to, and more information about, the various studies discussed in this article can be found on the author’s blog: www.conflictofinterestblog.com, under Interests/ Moral hazard and bias.

“there is no kind of dishonesty into which otherwise good people more easily and more frequently fall than that of defrauding the government”

Benjamin Franklin (1706-1790)
US politician, writer, diplomat and scientist