

Levelling the Score: The Role of Individual Perceptions of Justice in the Creation of Unethical Outcomes in Business

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Abstract

Rationalist models of ethical decision making assume that higher order conscious reasoning dominates the ethical decision making process. However research shows that psychopaths have a similar capacity for ethical decision making to the rest of the population. In contrast, research from the fields of social psychology, criminology and neurocognitive science shows that personal and contextual factors play a much larger role in the creation of unethical outcomes and that subconscious pattern matching processes are more prevalent than higher order conscious reasoning.

This paper presents a Causal Factor Model synthesized from inter-disciplinary research that illustrates the dynamic interplay between personal and contextual factors, perceptual blindness and moral neutralisations. The model has been tested using a multiple case study method involving interviews with people who have either been convicted of corporate crimes at a senior executive or board member level, or who have been involved as whistle-blowers. Initial findings indicate that individual perceptions of justice regarding the subjective assessment of unfolding reality have a cumulative effect on the behaviour of individuals involved in creating unethical outcomes in business. When subjects perceived reality to be unfair or unjust they were more inclined to use moral neutralisations to justify acts that would objectively be considered to be in violation of their aspirational moral values. This perception and the invoked justifications then blinded them to the moral aspect of the issue at hand and allowed them to create unethical outcomes that they perceived to be just.

Keywords: ethics, moral intention, perceptual bias, rationalisations, existentialism

Introduction

One of the paradoxes of our times is why well educated people in high paying responsible positions with reputations as good family and community members come to create bad outcomes involving fraud, bribery, insider trading and market manipulation. These affect the wider community in extremely negative ways. Since the late 1980s business schools have made concerted efforts to improve education in business ethics and corporate social responsibility. However there is little evidence to show these efforts have yielded the expected results (Desplaces, Melchar, Beauvais, & Bosco, 2007; Jazani & Ayoobzadeh, 2012; Jewe, 2008).

Numerous researchers have criticised the narrow band of existing theory and have called for the development of new theory to address this (Casali, 2010; Craft, 2013; Ghoshal, 2005; O'Fallon & Butterfield, 2005). This paper presents a causal factor model developed from synthesizing the existing research in the fields of business ethics, social psychology, criminology and neuro-cognitive science. This paper presents the results of testing the model using a multiple case study methodology and then presents the evolved model and the implications for ethics education and training.

Perceptions, Bias and Rationalisations

In 1970 Milton Freidman responded to calls for business to be more socially responsible by writing in *The New York Times* (1970) that the social responsibility of business is to increase its profits. Freidman went so far as to say that businessmen promoting the social responsibilities of business were undermining the basis of a free society. However, soon after this in 1971, the US government was forced to bail out Lockheed to the tune of US\$195 million. Subsequent investigations uncovered the Lockheed bribery scandal (*Time*, 1975) which involved Lockheed executives bribing foreign officials to win aircraft sales from the 1950s to the 1970s. A further SEC investigation in the mid-1970s discovered over 400 companies admitting bribery and illegal payments to foreign governments, political parties and others. The result was the Foreign Corrupt Practices Act of 1977 which banned US businesses from making illegal payments to foreign officials.

The revelation of these corporate scandals prompted increased debate on values, ethics and the role of business schools. Some scholars (Miller & Miller, 1976) proposed that by the time a person reached university it was too late to teach them business ethics. However, in 1976, the President of Harvard University, Derek Bok (1976), cited statistics showing how Americans had lost faith in their leaders and proposed that as the sources of moral standards, such as churches, families and communities, had declined in importance, educators had a responsibility to contribute to the moral development of their students.

Underpinning this increased focus on ethics was an understanding of how moral development occurs, which was based on Piaget's (1932) work with children. Kohlberg (1969) applied Piaget's work to the field of business and proposed cognitive moral development theory (CMD). This theory proposes that moral judgement and knowledge is gained through a process of rational reflection and reasoning (Kohlberg, 1969; Piaget, 1932). Scholars then used this theory of moral development to propose several models that explained ethical decision making (Dubinsky, 1989; Ferrell, 1989; Hunt & Vitell, 1986; Jones, 1991; Rest, 1979; Trevino, 1986).

The two key models that dominate the business ethics research into ethical decision making in the past 30 years are – Rest’s (1986) four stage framework and Jones’ (1991) moral intensity model. Rest’s model is closely aligned to Kohlberg’s CMD, however, one of the limitations of Kohlberg’s CMD is that tests of moral judgements are limited to how a person thinks about an issue not what they would actually do in a situation. These theoretical models were therefore developed to explain the overall process of ethical decision making. In 1986, Rest proposed a four component model linking individual ethical decision making and behaviour. According to the model a person: (1) recognises the moral issue, (2) makes a moral judgement, (3) resolves to place moral concerns ahead of other concerns (establish moral intent), and (4) acts on the moral concerns. Component (2) is related to CMD. Rest considered these stages to be conceptually distinct such that a person may for instance successfully recognise the moral issue but be unable to make a moral judgement. From the perspective of this model a good person may create an unethical outcome due to failure to recognise the issue, making a poor moral judgement (this is the stage related to CMD), lacking the resolve to put this moral concern above other concerns, or lacking the will or courage to take action. Rest’s model is shown below.

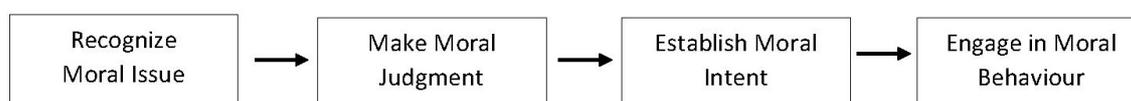


Figure 1: Rest’s ethical decision making model (Rest, 1986).

In 1991 Jones considered existing models and proposed that they failed to place enough emphasis on the characteristics of the ethical issue itself and cited research from social psychology that suggested that individuals react differently in different situations due to differences in the moral issue. As an example, he proposed that fewer people would approve of embezzling company funds as would approve of padding an expense account. Jones combined the existing models (Dubinsky & Loken, 1989; Ferrell & Gresham, 1985; Hunt & Vitell, 1986; Rest, 1986; Trevino, 1986) into the synthesized model shown below.

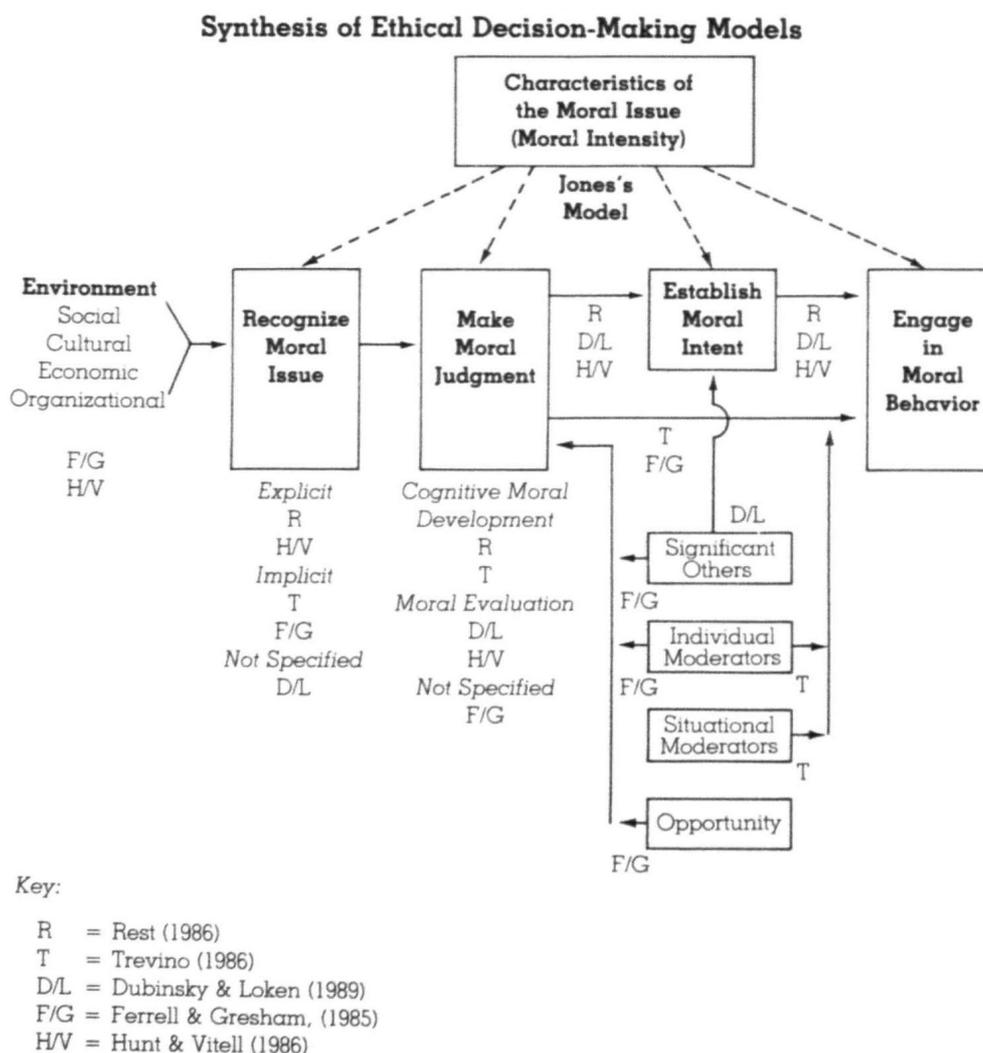


Figure 2: Jones' synthesis of ethical decision making models (Jones, 1991, p. 370).

Jones proposed that the characteristics of the ethical issue would affect all four of the stages (recognition, judgement, intent and behaviour) of this synthesized model. His proposition was that the differences in the way people made ethical decisions were due to differences in what he termed moral intensity.

At the heart of both of these models is Kohlberg's CMD and underpinning this approach to ethics is the assumption that the ethical decision making process is one dominated by higher order conscious reasoning. From this perspective, the rational and logical answer to why good people do bad things is that they are lacking in moral development – this may be a lack of character, bad values or greed (Heath, 2008). The solution to “fix” good people that have done bad things is to re-educate them to think better (Burton, Johnston, & Wilson, 1991; Mintz, 1996; Rozuel, 2012).

Reviews of the ethical decision making literature (Craft, 2013; Ford & Richardson, 1994; Loe, Ferrell, & Mansfield, 2000; O'Fallon & Butterfield, 2005) show that Kohlberg's CMD and the two ethical decision making models proposed by Rest (1986) and Jones (1991) dominate the empirical ethical decision making research. However, as has been already noted, the results of the research are mixed and ambiguous with none of the 357 findings detailed by

Craft (2013), claiming to have found the “holy grail” of ethical decision making that if addressed would reduce unethical outcomes. This raises the question of whether there is a problem with the theory or with the research.

This paper proposes that the problem lies with the theory and that the existing models for ethical decision making are based on flawed assumptions. Research from the fields of neuro-cognitive science, social psychology and criminology questions the assumptions that the ethical decision making process is a higher order reasoning process and that dispositional factors such as character, values and greed are key. This inter-disciplinary research can be synthesized to produce a causal factor model (CFM) that explains the creation of unethical outcomes.

Synthesizing a Causal Factor Model

In proposing his model in 1991, Jones noted the effect of perceptual bias and blindness and cautioned that if a person didn't recognise the moral issue in the first place there was no access to the decision making model. The part of Jones' (1991) model which is supported by the inter-disciplinary literature is the link between moral intention and moral behaviour. This causal linkage is well accepted in the business ethics literature, and research based on the theory of planned behaviour also supports the link between behavioural intentions and actual behaviour (Ajzen, 1985). However, the predictive power of behavioural intention depends on the strength of those intentions (Ajzen, 2011).

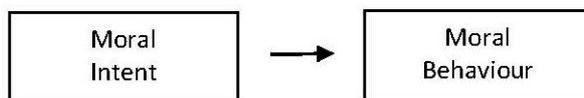


Figure 3: Moral intent to moral behaviour.

However, moral intent does not stand alone and is instead a subset of a person's behavioural intention. It is the ability to prioritise moral values, such as fairness, justice and equal consideration of others, over other instrumental values, such as profitability, achievement and efficiency (Craft, 2013). Social psychology research (Werhane et al., 2011) indicates that a person's behavioural intention will consider moral issues when an ethical decision making schema is applied.

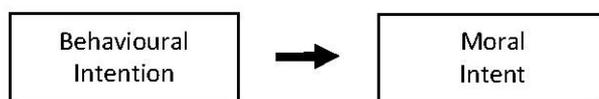


Figure 4: Behavioural intention to moral intent.

Behavioural intention is influenced by a dynamic interplay of personal, situational and contextual factors (Mencl & May, 2009; Rallapilli, Vitell, & Barnes, 1998; Reynolds & Ceranic, 2007; Ruedy & Schweitzer, 2010; Zimbardo, 2007).

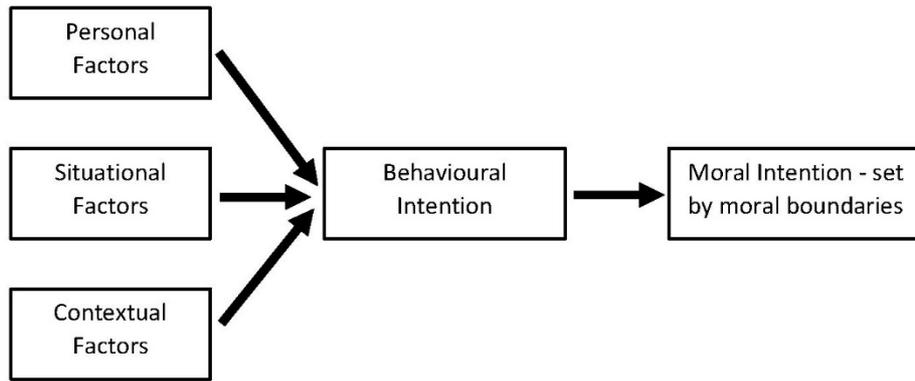


Figure 5: Personal, situational and contextual factors influencing intention.

However, recognition of the moral issue is influenced by perceptual biases and “bounded awareness”. Bounded awareness can lead to “ethical blindness”, which prevents a person from “seeing” the ethical issue (Palazzo, Krings, & Hoffrage, 2012). For example, ethical blindness may result from a dynamic interplay of specific personal, situational and contextual factors. Factors that have a negative impact on moral awareness include personal stress and sleep deprivation, a competitive, profit orientated environment and a time pressured context. In this situation, it is proposed that a person’s moral intent and moral boundaries are not activated and when a trigger event occurs the moral issue is not recognised. A trigger event should be considered as an event that requires a decision to be made and action taken. For example, a business executive who is tired and stressed and working in an environment that rewards sales above all else may be confronted with a situation where a potential customer indicates that if the executive matches a competitor’s offer to provide them with a “sign on bonus” they will win the business. In this scenario, the person may see the issue as a business issue rather than an ethical issue and as such engages a business decision making schema such as profit maximisation, rather than an ethical decision making schema considering moral values.

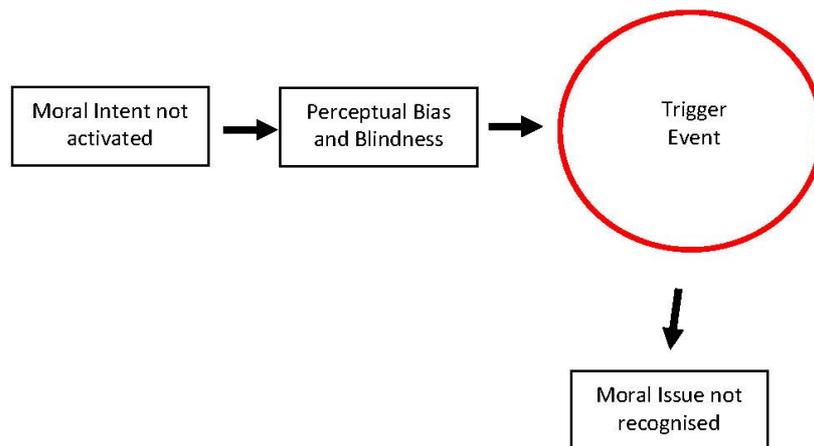


Figure 6: Moral intent not activated.

The opposite of this situation is one where perceptual awareness has been activated. Perceptual boundaries can be influenced by “priming”, and ethical “priming” can be done by drawing attention to “ideals” such as the Ten Commandments and honour codes (Mazar,

Amir, & Ariely, 2008). Ethical priming activates moral intent by influencing perceptual awareness and drawing a person’s attention to ethical issues.

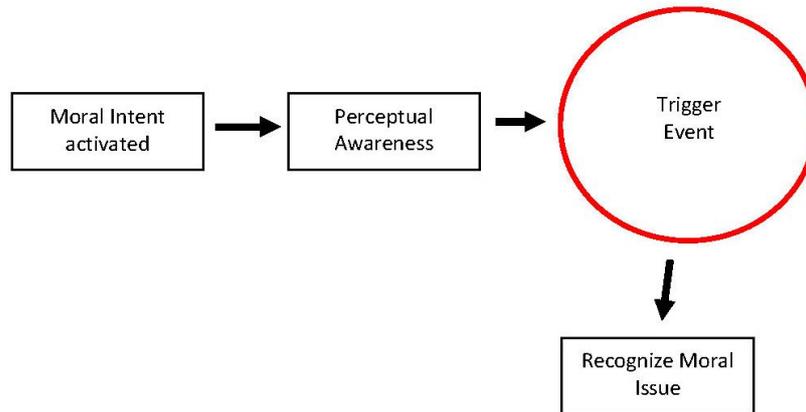


Figure 7: Moral intent activated.

To summarise the progress so far, the model looks as follows.

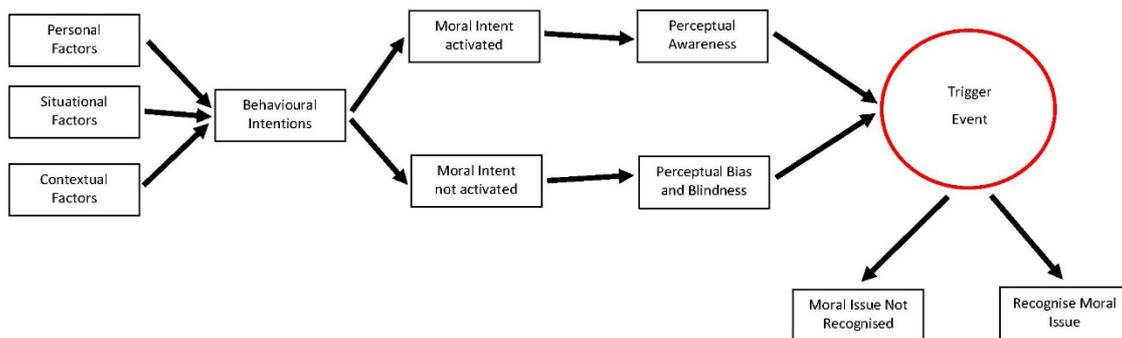


Figure 8: Intention and the recognition of the moral issue.

If the moral issue is not recognised the ethical aspect of a decision will not be considered however, a decision will still be made using other criteria. If, however, the moral aspect to the issue has been recognised, a moral judgement can be made.

Once a moral issue has been recognised a moral judgement can be made.

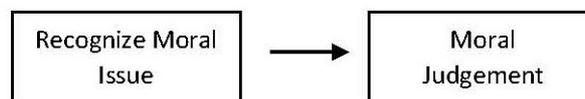


Figure 9: Recognition of the moral issue and moral judgement.

Based on Kohlberg’s cognitive moral development theory, this process of moral judgement is a conscious cognitive process, however, once a “trigger event” has occurred, scholars in the field of neuro-cognitive science have proposed a dual process model for how we actually make ethical decisions (Borg, Hynes, Van Horn, Grafton, & Sinnott-Armstrong, 2006;

Cushman, Sheketoff, Wharton, & Carey, 2013; Reynolds, 2006). Reynolds' (2006) neuro-cognitive model proposes that most ethical decisions are made by reflexive judgements – pattern matching to existing prototypes, whereas higher order reasoning is engaged for more complex dilemmas and those where an existing match is not available. Reynolds also proposed that the higher order reasoning function is able to play a “supervisory” role to the reflexive pattern matching. Haidt's (2001) dual process model is similar, with the two processes dominated by intuition and reasoning. The challenge of enacting moral intent is that often the “moral” outcome will involve a diminished benefit to the self and hence desire must be thwarted. Haidt (2001) suggests that self-regulation is more important than moral reasoning abilities in determining moral behaviour, hence the challenge that Kant identified of the will versus desire.

The dual process models proposed by Haidt (2001) and Reynolds (2006) support the view that there is a reflexive pattern matching process, which is sub-conscious and a higher order conscious reasoning process. A trigger event causes the process shown below.

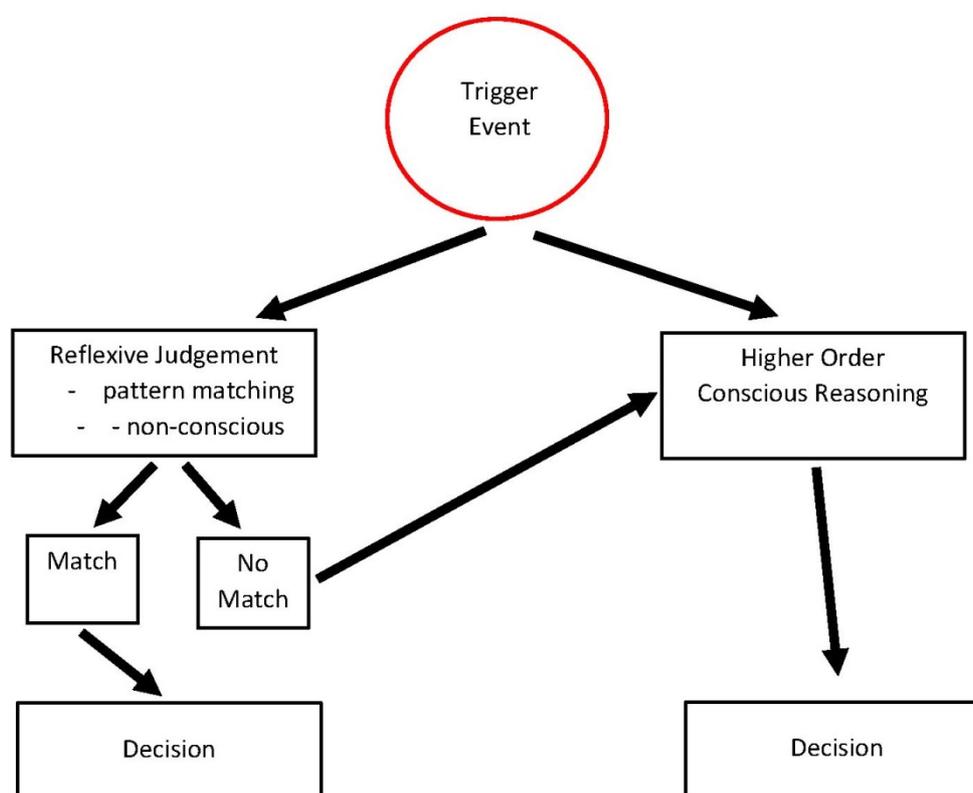


Figure 10: A trigger event and pattern matching or reasoning.

Once a decision has been made, Haidt (2001) proposes that justification for the decision to one's self or others will arise from a trigger event occurring after the initial ethical trigger event. Examples of a trigger event include any event that requires the action taken to be justified. This could include an internal process such as a report to senior management or the Board, or an external process such as shareholders or the general public requiring an explanation.

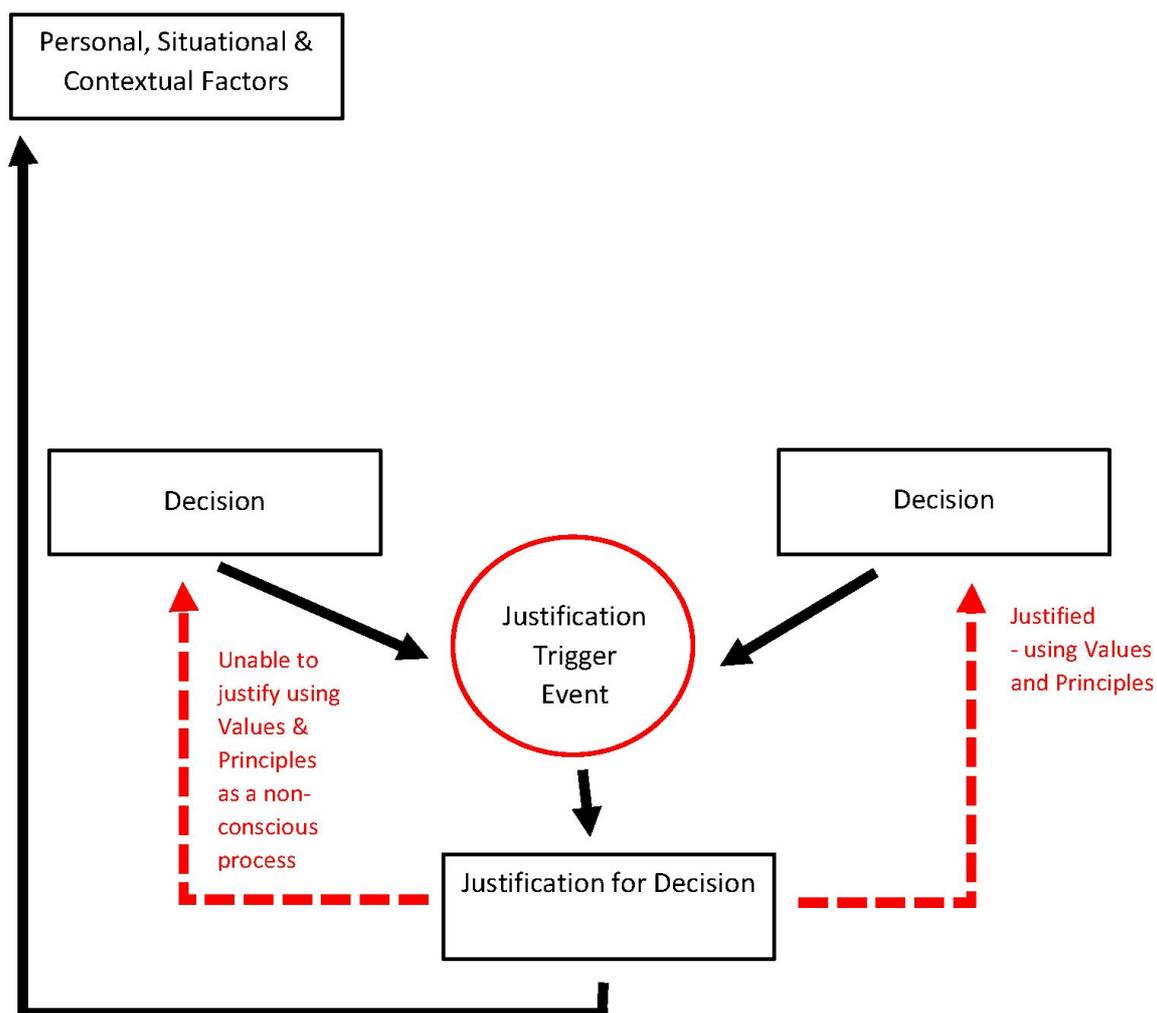


Figure 11: Justification trigger event and effect.

Justifications for decisions made can be done using values and principles – for example, the refusal to give preferential treatment to customers in the form of incentives on the basis that it is unfair to other customers and violates the organisation’s principles of transparency. However, when self-regulation fails, and a person has violated the organisation’s principles the potential result can be guilt and a bad conscience. In this scenario, social psychology research proposes that, in order to protect the self, the rational mind engages in justifications that neutralise the moral values and hence compromise moral intent (Heath, 2008). By absolving the self of guilt and justifying the action taken, one’s moral self-identify does not have to be re-assessed (Aquino & Reed, 2002). Hence a “good” person who has done a “bad” thing can avoid having to reassess their self-identify as “bad”.

Criminology research supports the concept of using justifications to neutralise values. As far back as 1957, researchers (Sykes & Matza) questioned the focus on dispositional factors and the assumption that delinquent youth had anti-social values. Sykes and Matza (1957) proposed that rather than having anti-social values, the delinquents instead held the same values as mainstream society but used a range of justifications for deviance that were valued by the delinquent but not by wider society. Sykes and Matza (1957) propose that there are five “techniques of neutralisation”:

1. The denial of responsibility

The key here is that the individual sees his or her action as “unintentional” and that they are therefore not responsible due to forces beyond their control. For example, poor upbringing, unloving parents or “just following orders”. “It’s not my fault” is the catchcry.

2. The denial of injury

The distinction here is that the act is seen as wrong but not immoral. “It’s not hurting anyone” is the common justification. An example could be the act of creating graffiti.

3. The denial of the victim

Denial neutralises the rights of the victim so that in some way the circumstances justified the act and hence the perpetrator may even be cast as the “avenger”. The story of Robin Hood robbing the rich to give to the poor is the classic example where the justification is “they deserved it”.

4. The condemnation of the condemners

Claims of unfairness and hypocrisy are key here with motives being questioned. Police are corrupt, teachers unfair, parents take out their issues on their kids. The wrongfulness of the act is repressed. “You think I’m bad but you should see them” would be a typical claim.

5. The appeal to higher loyalties

Societal norms are rejected owing to higher loyalties, for example to family, gang members, etc. The extreme example of this would be bikie gangs or street gangs and their “codes”. “Live by the code of brotherhood” would be an example.

To these five neutralisations, Heath (2008) adds two more:

6. Everyone else is doing it

The key here is that the perpetrator claims they have no choice. This is particularly prevalent in competitive situations, such as doping in elite sport, where the justification would be “everyone else was doing it so I had no choice other than to follow suit”.

7. Claim to entitlement

Entitlement is a justification based on rights or karma: “I did this so therefore I deserve that”. An example might be “I have worked back for the last five days straight so I deserve to use the company credit card to buy myself and my family dinner”.

Neutralisation Theory (Sykes & Matza, 1957) supports the notion that “good people” use rationalisations to absolve themselves of internal moral conflict. The critical aspect of neutralisation theory, according to Sykes and Matza, is the element of self-deception it introduces and the opportunity to do “bad” things without damaging one’s self-image. Heath (2008) in discussing neutralisation theory states:

. . . this theory puts considerable emphasis upon the way individuals think about their actions . . . Rather than sustaining an independent system of values and moral principles, different from those of the mainstream, the function of the subculture is to create a social context in which certain types of excuses are given a sympathetic hearing, or perhaps even encouraged (p. 604).

Heath's view supports the notion that the key elements in unethical behaviour are social context, self-deception and one's interpretation of reality. When the context becomes competitive and outcome orientated, it follows that neutralisations would become more prevalent due to this overwhelming focus on outcomes. Heath (2007, 2008) proposes that business might constitute a peculiarly criminogenic environment on account of: the large impersonal nature of big business; the detachment from consequences; hostility to government and regulation; and, the isolating nature of the business sub-culture.

The inter-disciplinary research from the fields of social psychology, neurocognitive science and criminology can be synthesized into a deduced causal factor model shown below in Figure 12. Research from social psychology informs the model by showing how personal, situational and contextual factors can influence behavioural intentions (Ajzen, 1985; Tenbrunsel, 1998; Zimbardo, 2007). Perceptual bias and blindness then determines whether or not the person actually "sees" the ethical dilemma (Chugh & Bazerman, 2007). Neurocognitive research then shows how we make decisions in this "blind" state using either higher order reasoning or sub-conscious pattern matching (Reynolds, 2006). A post decision trigger event then causes the engagement of justifications which can either be based on moral values or may be moral neutralisations (Heath, 2008; Sykes & Matza, 1957). The decision made then feeds back into contextual factors.

DEDUCED CAUSAL FACTOR MODEL OF UNETHICAL OUTCOMES

A.C.Ping 2014

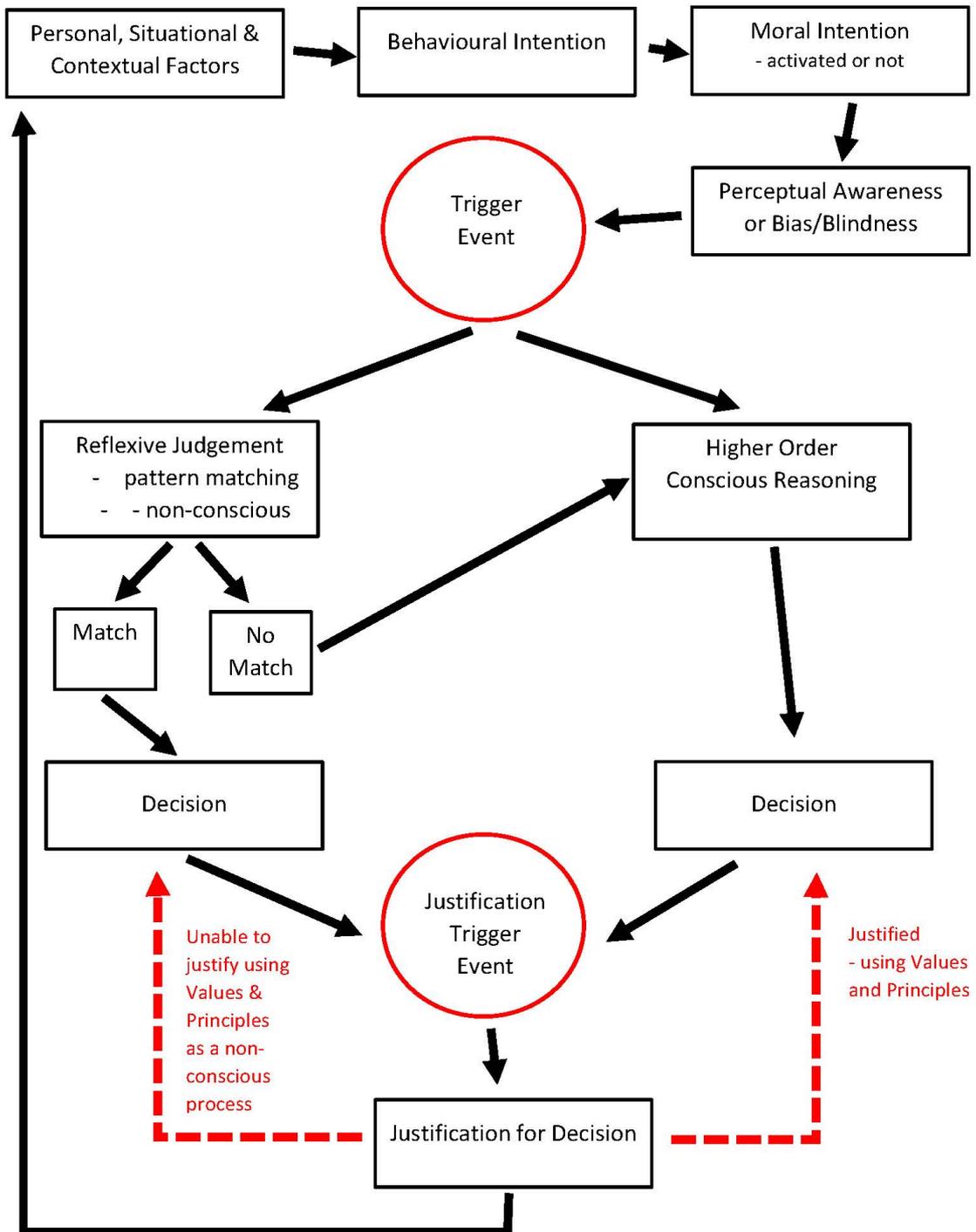


Figure 12: Deduced Causal Factor Model of Unethical Outcomes

Testing the Model

The inter-disciplinary model shown in figure 12 above is subjective and falls within the social constructivism paradigm. The philosophical base for this paradigm is hermeneutics and phenomenology, which proposes that reality is socially constructed and the world does not present itself objectively to the observer but is rather known through human experience, which is mediated by language (Eriksson & Kovalainen, 2008). Given this research paradigm, testing the model was done by using reflective phenomenology.

There is significant industry and academic research which suggests that the leverage point for reducing unethical outcomes in business is at the Board and senior executive levels. The epistemology of this research also indicates that the most useful and valid way of actually testing the theoretical construct is by interviewing people who have actually been convicted of corporate crimes or who have had first-hand experience with such an event.

Potential participants were identified using media reports and the annual reports of the Australian Securities and Investment Commission (ASIC). The ASIC reports detail key convictions of corporate criminals and this information was distilled to identify people who had been acting at the Board and senior executive levels when convicted. The aim in selecting potential cases was to try and find cases that dealt with the key issues identified in Industry reports (Ernst & Young, 2013; KPMG, 2005, 2013), for example; bribery and facilitation payments, insider trading, fraud and managing conflicts of interest. Cases were chosen using replication logic – in this case where the participants fit the subjective criteria of “good people doing bad things”. Sampling was then done for sameness and for difference – the sameness being the nature of the crime, for example fraud. The difference being the circumstances – for example mortgage fraud versus corporate insider fraud. To gain a different perspective on events, one of the participants selected was a whistle blower and another an internal investigator who became a whistle blower.

The six cases chosen to test the model were:

1. A non-executive director of an Australian company jailed for two-and-a-half years after pleading guilty to four criminal charges including: disseminating information knowing it was false and that it was likely to induce the purchase of shares by others; one count of being intentionally dishonest and failing to discharge his duties as a director in good faith and in the best interests of that company; one count of obtaining money by false or misleading statements.
2. A Managing Director of a US mortgage broking company jailed for two years after pleading guilty to bank fraud, in excess of US\$100 million and tax evasion through falsifying tax records.
3. A whistle blower in an Australian case involving foreign bribery and the falsifying of documents.
4. A director of an Australian financial services company which collapsed resulting in ASIC alleging that the directors were intentionally dishonest and failed to exercise their powers and discharge their duties in good faith in the best interests of the company.
5. A director of an Australian manufacturing company who pleaded guilty to charges of insider trading.
6. An internal investigator and whistle blower of a 12-year internal fraud at an Australian construction company totalling over \$20m. The protagonist pleaded guilty to all charges and was sentenced to 15 years in jail with a non-parole period of six years.

Semi structured interviews were conducted exploring the variables identified in the theoretical construct: personal, situational and contextual factors, moral intention, perceptual bias and moral neutralisations. The aim, as per Eisenhardt's (1989) advice, was not to be fixed on how these variables were related and allow the participants to reflect on the phenomena they had experienced. Triangulation was then applied using data collected from media reports, corporate communications and court reports. The interviews were transcribed and coded using the initial categories of meaning as determined by the causal factor model deduced from existing inter-disciplinary theory.

Levelling the Score – the Ultimate Justification

After the initial coding of data and development of units of meaning, these unit categories were then refined and the patterns and relationships between the categories explored (Maykut & Morehouse, 1994). Once the categories of meaning had been refined, the data was analysed for patterns of sameness and difference. The analysis showed support for the model regarding the effect of personal, situational and contextual factors and the use of flawed justifications. However an addition category of meaning revealed itself as “A sense of moral obligation” or “A sense of entitlement”.

The existence of this factor influenced the subsequent actions of the protagonists. In each case study, the key protagonist had a sense of moral obligation to a significant other or group of people. The sense of moral obligation created a moral intent to uphold that obligation. A trigger event then occurred which either violated or threatened to violate the moral obligation. This event then triggered a justification to take action in order to balance the scales of justice. Emboldened with a sense of “self-righteousness” the protagonist typically persisted down a path which often became a “slippery slope”.

What becomes evident in examining the raw data is that the sense of moral obligation is personal and the trigger event is also seen from a personal perspective and this in turn clouds the objective judgement of the protagonist such that they seem justified to take action to balance the scales of justice – to level the score.

For example, in case 1 the protagonist had an existing moral obligation to “his” people who had been absorbed into the company that had taken them over. As part of the take-over deal he had been promised by the Managing Director that his people would be looked after.

“I had a number of promises from DL (the Managing Director) in an ongoing sense.”
“I had my people in the company”

The initial trigger event was the breaking of these promises.

“ . . . he had lost me because he broke his word to me . . . I found the conversations at Board level insulting. . . . He lost all respect. I lost all respect for him.”

This trigger event causes the intention to be outcome orientated.

“You solve problems, you don't walk away from problems. I thought I could solve it with DL and I thought he would work with me but it didn't happen. He actually fought me. That annoyed me Then I was annoyed so then I punished him.”

The justification is then flawed. In this case it is an appeal to higher loyalties.

“But I wouldn’t have done it if he had kept his word to me. Once he broke his word to me it was over . . . I had my people in the company”

The common theme that emerges at this point is the belief that the protagonists can “fix it”.

“I had a similar problem at GTB [the family company that had been taken over] and I saved it . . . I have all this knowledge . . . I’m uniquely placed”

What became evident from the case study data is that there is a significant ongoing dynamic relationship between the decisions that are made initially and the subsequent decisions made. Justifications may be made for the initial decision that empowers the protagonist to act in order to balance the scales of justice. However, the violation of other values, principles or laws causes a decay in the protagonist’s personal circumstances which in turn affects their ability to make higher order decisions. There is also a significant decay in the personal relationship(s) that triggered the initial threat to the perceived sense of moral obligation.

Analysis of the data enabled the creation of a new causal factor model (CFM) – shown below in Figure 13. This causal factor model was then overlaid across the case studies to determine if it did actually explain how the unethical outcomes were created.

CAUSAL FACTOR MODEL OF UNETHICAL OUTCOMES

A.C.Ping 2015

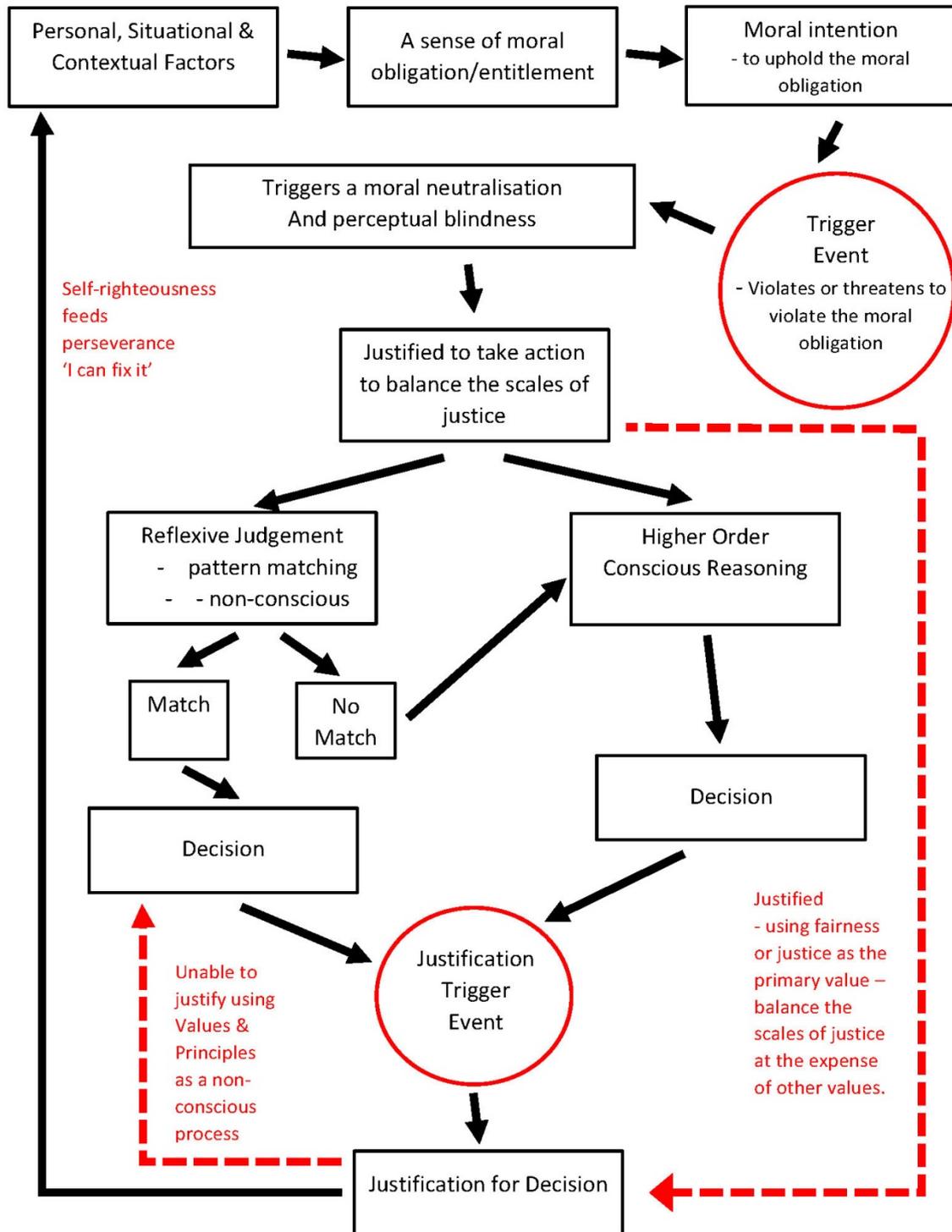


Figure 13: Causal Factor Model of Unethical Outcomes

An examination of the cases in view of the CFM reveals the fit to be very good.

In case 2 the protagonist had an older brother who had been convicted of fraud. At the time his brother had been convicted, his father had broken down and had made the protagonist promise this would never happen to him. The result was an existing moral obligation.

“I think that there was no doubt a fear that I was going to let my dad down.”

The trigger event was the revelation that the documents the company were using were out of date which caused a major cash flow crisis.

“I was well-known for this (looking after people) because people, they wanted to come and work for our company . . . then, when this pops up, we’re basically like, hell no. No way. We’re not going down by something like this after everything that we’ve done, which was a little . . . That’s bad thinking. That’s a little arrogant. You’re thinking like, oh, we’re so honourable that we can’t make an error. You’re going to end up getting your ass kicked if you think that way.”

The reaction is again outcome orientated.

“What was I going to do? That didn’t even occur to me. All it was, was I need to fix what the problem is today.”

The justification is again flawed. In this case “I have no choice”.

“Pay that loan off and just go on with life like that never happened. That was a lot more attractive, not to lose everything over having this fraud in our company. I thought I’ll pay that off. I’m talking to myself . . . The right thing to do because what’s going to happen if I don’t? The buck stops with me. I need to pay that off and take responsibility and then we’ll just go on.”

Similar to case 1 the protagonist then believes they can fix it and the slide down the slippery slope begins.

“I saw that as if I don’t fix all that, if I don’t fix it for other people, I’m certainly not going to be okay so I have to make sure . . . I need to take the most direct route . . . I’m now going down the path. Now it’s going to be very difficult to turn around.”

Case Study: Nick Leeson – Barings Bank

The further question to ask with regard to the CFM is whether or not it has external validity. Does it explain the causes of unethical outcomes?

On February 26th 1995, Barings Bank, Britain’s oldest merchant bank, which had been trading continuously since 1762, was wiped out by the actions of a solitary “rogue trader”, Nick Leeson who caused losses of £832 million. Leeson was barely 28 years old at the time and his case and the collapse of Barings Bank is worth considering from the perspective of the causal factor model and how it could be used as a teaching case study.

Firstly, was Leeson a good or a bad person and did he have ill intent? Colleagues (Wallop, 2015) at the time remember him as “an ordinary fellow, from an ordinary background, doing an ordinary job” and the lawyer who represented him for many years recalls, “I was due to meet him for the first time, and I remember thinking am I going to meet an arch-villain or some sort of spiv? And I just met a very quiet, calm and straightforward boy from Watford.” Leeson himself claimed he failed to realise the cataclysmic effect his actions would have. “Not once did I consider the bank would collapse. I don’t think I knew what the bank was worth.”

It is fair to assume from these comments that Leeson was not a bad person doing a bad thing with ill intent but rather a good person with reckless intent.

The second point to note with regard to this case is that the massive fraud did not occur overnight, but rather evolved over a six year period (Brennan, 2015). Leeson joined the settlements department of Barings Bank in 1989 and was sent to Singapore in April 1992 when he was appointed to run the back office of the derivatives operation at the Singapore International Monetary Exchange (SIMEX). The first significant event occurred in July of that year when an accounts technician created the infamous “Account 88888” for Leeson at SIMEX, as an “error account”, initially intended for inexperienced traders to report their losses. Significantly, the account is excluded from general reporting lines.

In September 1992, Leeson passed the SIMEX trading exam which entitled him to trade on the exchange floor – of note is the fact that his application for a City of London trading license had earlier failed due to an outstanding county court case against him – a fact that Barings withheld from the Singapore authorities.

Almost immediately, Leeson began making large unauthorised trades on the Japanese Nikkei Futures Index and by the end of September had accumulated losses of approximately £6 million in account 88888. By the end of the year, Leeson reported profits of almost £10 million and was rewarded with a bonus of £150,000 to supplement his £50,000 salary. In truth, account 88888 now held losses of £2 million.

Leeson’s recollection (Rodrigues, 2015) of that period is clear, “We were all driven to make profits, profits, and more profits . . . I was the rising star.” There was also a significant incentive for the Bank to turn a “blind eye”, financial markets consultant Dominic Findley says (Wallop, 2015), “Barings should have worked out something was out of the ordinary, because he was requesting vast funding to be transferred to Singapore. But they wanted to believe they had found a magic money making machine.”

From the perspective of the causal factor model, there are personal, situational and contextual influences in place. Importantly, what happened next is that the initial unethical actions were not corrected but rather the slippery slope began. By December 1994, Leeson had accumulated losses of £280 million in account 88888 whilst claiming to have made massive profits. In January 1995, an audit official noticed a discrepancy in Leeson’s accounting but rather than confessing, Leeson concocted a story about a paper trade between two clients and created a false payment to back up his story. This action prompted Leeson to take even more risks, with larger trades, in an attempt to reverse his losses. However, on the morning of January 17, 1995, a massive earthquake hit Kobe, sending the index into a spin and causing Leeson more losses. Again, Leeson tried to trade his way out of it but instead created more losses that eventually totalled over £800 million.

Reflecting on the lessons learned 20 years later (Leeson, 2015), Leeson says, “I was surrounded by people that could have helped and steered me in a different direction but I thought I was able to deal with the situation and, as we now know, I wasn’t. Asking for help and advice early in my time in Singapore would have seen a very different outcome.”

Leeson’s recollections show how his self-righteous belief that he could “deal with the situation” contributed to the eventual collapse of the bank – they also fit the causal factor model developed in this thesis and show how self-delusion contributes to good people creating bad outcomes. Leeson was eventually sentenced to six and a half years in prison and served four years in a Singapore jail. He now earns a living as a dinner speaker talking about how he brought down Barings.

Conclusion and Implications

Although this case study analysis is limited in scope the initial testing of the causal factor model shows that it significantly explains the process of creating unethical outcomes. As Reynolds (2006) proposed, once an initial decision has been made using higher order reasoning the subsequent decisions follow a sub-conscious reflexive pattern matching process. Furthermore this model supports the idea that a justification for a certain type of action is in the mind of the protagonist before the action is taken which was first proposed by Sykes and Matza (1957) in their theory of delinquency.

Of interest is the common concept of “A sense of moral obligation”. In the case studies this related to a moral obligation made to “my people”, “my father”, “the board” or “my community”. However, it is possible to propose that a distinction between good people doing bad things without ill intent and bad people doing bad things with ill intent, could be captured by the difference between “a sense of moral obligation” and “a sense of entitlement”. Both of these subjective perceptions precede intention and action. A sense of moral obligation can trigger a flawed justification for action that neutralises an intrinsic value such as honesty. For example, the sense that one should not let down one’s father could trigger the justification of “I’m doing it for him” hence providing the basis for violating the principle of honesty.

Recent research into the socially aversive personality traits of Machiavellianism, narcissism and psychopathy (Jones & Paulhus, 2014) attempted to identify subscales for each trait. With regard to narcissism, Jones and Paulhus identified narcissism as a clash between grandiose identity and underlying insecurity. Narcissistic grandiosity promotes a sense of entitlement (Bushman, Bonacci, van Dijk, & Baumeister, 2003) if that grandiosity is threatened. Jones and Paulhus (2011) concluded that ego identity goals drive narcissistic behaviour. Further research is needed to consider the relationship between a sense of entitlement and unethical outcomes in a corporate setting where highly narcissistic egos are commonplace.

In conclusion, this is significant research with wide ranging implications both for training and education in ethics and also for the prevention of unethical outcomes in business. This research indicates that the creation of unethical outcomes is not isolated to the decision making process but rather is the results of a dynamic interplay between personal, situational and contextual factors. Further, the creation of unethical contexts does not occur quickly but rather results from an ongoing decay in the moral environment.

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