Why They Do It – Eugene Soltes

[00:00:06] I'm Alexandra Wrage. Welcome back to Bribe, Swindle or Steal. Today, I'm speaking with a professor of business administration at Harvard Business School. His research focuses on corporate misconduct and fraud and how organizations develop compliance systems to address these. He's also the author of "Why They Do It: Inside the Mind of the White Collar Criminal," which is a fascinating study of why wealthy and successful executives engage in deception, fraud and, ultimately, theft. Eugene Soltes, thank you for joining me.

[00:00:38] Thanks much for the invitation.

[00:00:39] Let's dive in. To the extent that we can generalize, which is always a bit risky, are white collar criminals just ordinary criminals who've lost their way? Or is something else going on?

[00:00:50] I think there's something special about white collar crime, but not necessarily the individuals who engage in white collar crime. Let me clarify that. White collar crime is different than other offenses in that the harm associated with — whether we're talking about fraud, embezzlement or bribery — the victims are much more distant from the actual perpetrators. This leads to a feeling that you're doing something harmful, in many instances, when people are actually engaging in it. In that regard, white collar crime is a quite special form of criminal activity.

[00:01:22] We often hear people talk about how corruption is difficult to address. Corruption is obviously one kind of white collar crime and is difficult to address for exactly that reason. The impact is both distant and diffused, but when you are an executive at a major multinational company, your shareholders and your colleagues are all around you.

[00:01:43] Those people are around you but, in many instances, what's interesting — what I heard again and again when I was doing these conversations with these former executives, which, I should note, in most instances were just brilliant and by and large successful individuals throughout the majority to their career. Their failure is actually pretty extraordinary, if one looks at the entire course of their career. At the time they engaged in the misconduct, they actually saw, in many instances, benefits associated with it. Not only benefits for themselves, we could say myopically in terms of the compensation, but benefits in terms of the firm. It helped get past a difficult period, a challenging quarter, helped acquire a contract. At the time they were actually engaging, it didn't actually look like it was going to be harmful, necessarily, for the people around them.

[00:02:29] That's really interesting. In an earlier podcast, we had Peter Solmssen, the former general counsel of Siemens, talking about how infuriating it was when people would say, "I did it for the company," because he said they made their numbers. They got their bonuses. The fact that the company also had a good quarter was just incidental, but that sounds like a pretty widespread justification.

[00:02:50] I think one of the challenging parts of a lot of misconduct, and one of the things that I'm particularly fascinated by, is that the intent of some things that are illicit and inappropriate are oftentimes the same things that are pretty not only widely accepted, but actually legally — at least technically — acceptable. That makes for a very confusing world. There's not two ways to kill someone: You either do it or you don't do it. But in the case of a lot of white collar, there's ways of managing and manipulating statements. There's ways of, I would argue, legally essentially paying bribes, and then there's illegal ways to pay bribes. That is a pretty weird setting to be operating in. I think managers are actually operating in a much murkier world than saying things are right or wrong or on this side or the other side of a line.

[00:03:38] Gosh, that's really interesting. I think that's a dilemma that companies haven't faced head on. I know Peter Elkind, who wrote "The Smartest Guys in the Room," the story about Enron, referred to legal fraud. I think we're still at a place in the compliance world where we're talking about these issues as much more black and white than they actually are. Did you find that people started on the legal side of the ledger and then slipped over with time? Or they just lost track? Or they just used it after the fact as a justification?

[00:04:14] One of the best quotes I heard that describe this, who is a former partner at one of the large professional services firms, he basically described it as he understood, at this point — well, you'll see him in prison — that he clearly went past the line, way past the line. That was pretty obvious. But if he looks back at his career and says, "Can I point out exactly when I walked past that line? To be honest, I don't know when that was," because so much of what he did — which was tax structuring, financial engineering — is very murky. You're operating on this ever-moving, ever-changing gray zone. He would argue — and I believe it's probably true — that he started on the right side of the line and then at some point crossed over that line but, in some sense, can't pick out what day that was because the intent of the actions, even when they were legal, really were effectively the same as when they became illegal.

[00:05:07] So interesting. It's almost like a gateway drug where they get more comfortable with it over time, and then the misconduct spirals downward. Did you speak to anybody who was so clearly over the line and had been for a long enough period of time that they really understood that their position was no longer tenable? Or were they continuing the justification?

[00:05:29] I think one of the things I was most surprised by is what I would call the lack of remorse and the lack of true understanding of the harm associated with actions. I'll say by and large the executives I spoke with could understand what they did was at least technically wrong, so it became very much of an intellectual exercise of understanding where they may have strayed incorrectly. But the fundamental crime, which is that this was deeply harmful, oftentimes devastating, to investors and employees, was still such an abstract concept. This is one of the things that, certainly in my classroom with students in our executive education programs and some of the compliance programs I do, one of the things that I try to focus on is this blurriness of the intent between right and wrong in the business world and just how murky it is.

[00:06:18] What do we do with that? If you were advising companies first how to identify and then how to head off crime in their midst, what do you tell them?

[00:06:28] The first thing I like to try to do is try to actually cultivate humility. I think we have this tendency, which is not unreasonable, that we are ethical. We are moral people. We're the smart people. We're not the type that would engage in misconduct and have civil sanctions or go to prison. Those are bad guys. But that's the same attitude that I saw these executives having at the time they were actually engaging in misconduct, too. It's not because of a lack of prosecutors being able to go after these individuals but just simply an inability to process that, "I am doing something that actually has these types of consequential devastation, if I continue down this path." So I want to cultivate humility, and I think the way to do that is actually place people into really, really difficult dilemmas and actually help them understand that they're not probably going to resolve those potentially successfully. One of the cases that I do, and this is a fraud case, but it's examples from Computer Associates in which they have some contracts that come in on Monday and Tuesday, and they ultimately backdate them to the prior Friday. For these actions, ultimately seven executives from Computer Associates went to prison. Most students, most participants and programs look at this and say, "I obviously would never move a contract that comes in on Tuesday to the prior Friday. I would never do that." OK, and that's reasonable sitting the classroom to say that. But then you start really kind of pushing it a bit more and you say, "Well, suppose" — this is one hypothetical — "Suppose that you were about to close that deal with the client, and it was Friday night, and they were about to hop on a plane. The CEO promises to fax you that signed document as soon as they land. And because an unforeseen flight delay, they don't arrive till 3:00 in the morning on Saturday morning, and then they immediately fax it to you. Now it has Saturday morning. It's one day past the end of the quarter. Would you really still not count that in prior quarter, potentially risking your team's bonuses to the extent that this is a material contract? Maybe you're going to miss quarterly earnings estimates. Someone's job might be cost because of this." You start seeing people say, "Well, if it's an hour or two, then it's OK." The second you get someone to say, "Well, an hour or two is OK, but not three days," you've now entered that zone where we can see a slippery slope. "An hour's OK. Well, what about three hours? What about five hours? What about one day?" Doing many kinds of situations and hypotheticals of that very quickly humanizes individuals to say, "You know what, I could see how, if you put me in the right circumstances with the right pressures and the right kind of norms, yeah, I could imagine myself potentially doing that."

[00:09:12] That's a great example. I know your classes are wildly popular. Are you surprised by responses to these, or have you been doing this long enough now that it's pretty predictable?

[00:09:21] At the beginning of every class, what's interesting is when we start, I'll say 80-90% of the class will say, "We would never do this. My firm would never do this." What inevitably happens, maybe 20, maybe 30 minutes in, someone will raise their hand and say, "I want to believe what everyone is saying here, but come on, guys." Then they give a hypothetical, generally from their experience, and that is the threshold where the conversation starts to change, where then you start to see people start reflecting a little bit differently, saying, "OK, well under this circumstance, under that other circumstance," and then an hour later, you start seeing the class shift from 80 percent saying, "I would never do it" to 80 percent saying, "I could see myself doing that." That's really scary. That's what leads to next part of the discussion: What can we do about it? We think we're moral people, and we are, sitting in the classroom right now or sitting in this training exercise, but you place us in this difficult, complex circumstance where we might not be identifying that situation. What can we do, and what process can we design to intercede prior to maybe going down that bad decision without even realizing it?

[00:10:28] This is really interesting that. To the extent that I've been engaged in discussions about why they do it, it's often broken down into personality. Is there some fundamental criminal personality defect versus circumstances — financial problems, divorce substance abuse — that start somebody on the path of this? But it sounds like it's really just a matter of justification. Sorry if this is an obvious statement, but if that's the case, then no one is immune. It's just a matter of being surrounded by people, presumably with whom you can justify these acts.

[00:11:07] I would readily agree with that notion that we're all susceptible. I actually think it's the sense when we lack, in some sense, that moral humility that we're not susceptible is when we even become more susceptible. I think one of the parts that I look actually in some sense of a tragedy of some of the executives I spoke — which were really extraordinary leaders throughout the majority of their career, people like Rajat Gupta, who led McKinsey for decades — is that it's not a failure of being able to be thoughtful or actually make the right decision, but it's a failure of being able to actually identify when that situation is in front of you. After a board meeting, calling someone at a hedge fund 23 seconds later and divulging that information is something that you don't need a case discussion. You don't need to do a training course to understand you shouldn't do that. Everyone knows that. But at the same time, someone as brilliant as him fails to see that, in that context, really shows the difficulty of actually resolving all these kinds of dilemmas successfully, in the context in which they are actually made.

[00:12:10] Clearly, case studies are very powerful, and they're working for you, and they're effective. How do we take that to the next step? You've established humility. Everybody in the room has determined that, if you use your slippery slope examples, that they've determined that they may well be susceptible themselves. Do you then have them actually project forward to how they will respond in those situations? What do you do to get them out the other end of the tunnel?

[00:12:39] This is where I like to focus much more on processes, and while I don't like to call it compliance because it doesn't have that same kind of inspirational tone to it, but it's very much the processes that are put in place. One example that I discussed my book, which I thought has really influenced my thinking about this, is the venture capitalist Ben Horowitz. He hired a new CFO for one of his firms, and the CFO came in, looked at some of the executive compensation policies and said, "You know what, from my prior firm and what other firms in Silicon Valley are doing, we should adjust the option dates to make them more attractive for their executives." Ben said, "This actually looks really attractive. It looks costless and will make us more competitive. Great." But he also realized that his intuition and gut instinct when it came to an accounting policy might not always be on target. He was kind of a technology, visionary-type individual, not an accounting, finance whiz when it came to his instincts. Any time he was about to make a finance or accounting change, he put a routine process in place that he wanted to contact someone that was a friend and an attorney to get an outside look, someone that sat outside this little bubble. He brought this new policy change to his counsel and looked at it and said, "I don't have any idea why this would be legal. I know maybe a lot of other firms in Silicon Valley are doing this. I know their law firms are even signing off and suggesting this, but I don't feel comfortable with you doing that." Ben came back and said, "You know what? I know everyone else might be doing this, but it didn't pass the process I put in place, so we're going to have to find some other ways." Fast forward a couple years, the CFO was actually criminally indicted for options backdating associated with her actions at the prior firm. As Ben reflects on this, he says, "The only thing that kept me out of prison was the right organizational design." This had nothing to do with the kinds of things we often talk about helping people stay out of misconduct, like values and authenticity and a moral compass. This had to do with the fact that he understood where his limitations and weaknesses potentially lay and put a process in place to intercede prior to falling down that path.

[00:14:47] That makes so much sense, getting an independent set of eyes on what's going on in the corporate petri dish because we're all living in our own environment and talking to each other, and if there is budding justification for close calls, it's difficult. We've seen this over and over again with whistleblowers. It's really difficult for somebody to stand up and say, "Maybe that's not such a good idea." But a truly independent look, where the person's compensation is not tied to the idea, and they don't have to bump into each of the employees in the coffee room, will give you a clearer perspective.

[00:15:22] It's offering the opportunity for people to actually genuinely seek different points of view. One firm I was speaking with was doing some compliance training, and the general counsel mentioned that anyone in the room was always welcome to come to him to actually get advice and talk about something if they had concerns about it. But he also noted that people were welcome, if they had an external counsel, if at any point they just wanted to get to another point of view or speak to someone else, they were welcome to call that external counsel for review. I was actually really impressed, in some sense, the humility and the openness that the general counsel was offering employees, which was saying, "I want to give you multiple avenues to actually get different points of view." Now this doesn't make it easier to actually identify those tricky situations that you need outside points of view, but at least it was a firm that was offering different options for people.

[00:16:10] That's a really interesting idea. Was it the same firm that the company would ordinarily go to, or was it somebody else that they had on retainer who would be truly independent of the person paying the bills?

[00:16:20] It was someone on retainer, someone that was genuinely separate, was seeking to provide, what you could say — some firms have a kind of helpline or hotline — this was just a legal version of that. But offering it to people that, "You don't need to go through me, get my opinion, and if I don't know, then go to our outside counsel," but rather saying, "There's these multiple paths, and I want you to find the path that ultimately helps you reach the right judgment that's in the best interests for this firm."

[00:16:47] That's really very interesting. I haven't heard that before. I've certainly heard of multiple avenues but usually within the company. You can go to your immediate manager. You can go to the audit committee. You can go to the general counsel. But an external person, particularly if there is some sort of confidentiality assured — I'm not sure how that works with outside counsel — but clearly having the ability to talk it through with somebody who isn't in your reporting chain is going to make people more willing to chat. But as you said, that's only once they've identified the issue.

[00:17:18] Oftentimes, it's the hardest part.

[00:17:20] A little bit of background on your book: You spent almost eight years investigating 50 executives who had been convicted, not just investigated for but convicted of white collar offenses. How willing were these guys to speak with you about their crimes? Did they brag? Were they defensive?

[00:17:38] For a variety of different positions, I'm fortunate being an academic in a school that is very, very supportive of spending a long time on a project that I was able to commit to individuals, that I wasn't just going to hop in and spend an hour speaking and then try to write an article. But I could spend months, in some cases years, speaking with them to really try to understand how they view the world. We would speak not just about their case but about their career, more broadly. I would also oftentimes discuss things that were going on in the news, the financial crisis. I would oftentimes send them examples of things I was reading and cases I was assigning my students. Had I read your most recent edition of "How to Pay a Bribe," I actually would have sent a couple of these cases to them because it's seeing how they would think through and actually resolve some of these dilemmas that I found particularly illuminating.

[00:18:28] You just started corresponding to them right out of the blue, right? You just wrote to them and said, "Will you have a conversation with me?"

[00:18:34] Exactly. This project actually began not as an academic endeavor but, really, one of personal curiosity. The question I think we all ask ourselves and every judge asks as they are about to sentence one of these extraordinarily prominent individuals — the kinds of people that we see on the cover of Fortune, gracing the cover The Financial Times, The Wall Street Journal, speaking commencements — and then we see them engaging in these acts of misconduct that just seem so uncharacteristic of their broader career. It was a conversation that started out of curiosity, of just trying to understand these individuals in their different contexts and some of the challenges they faced because of mistakes they made.

[00:19:16] The only person I've reached out to — I wanted to see if he'd be interested in doing an interview for the podcast — is Bernie Madoff, and he has a lot of time on his hands. He's a prolific pen pal but hasn't agreed to speak with me on a podcast, on a public record. What was your experience of him? We've had his defense counsel on this podcast, but everything I've read shows that he has vacillated wildly from fairly penitent to really outraged and blaming the victims and indicating that it was their fault for not doing more due diligence and pressing him for more details. What was your experience?

[00:19:57] He's a fascinating individual in that I think deeply thoughtful, but in a way that leads to extraordinary rationalization of many of his crimes. When it comes to the victims, he does see the victims themselves as, in some sense, guilty of their own failures in due diligence. Even things like the charities that I would speak to him about, he saw most of those charities, the reason they had a US$100 million in assets is because they made money, sometimes through their parents or grandparents, over decades, and that's why the charities had so much money. So to the extent that the charity doesn't have money anymore, it was kind of like he gave the charity US$100 and then he took the US$100 back, but no one was really worse off. He did this to virtually basically all the victims that were ultimately harmed in his Ponzi scheme. How he's able to see the world, which is, I think, different than most other people in that he's simply not as empathetic, which is the part that I struggled the most spending time with him.

[00:20:59] That certainly comports with my understanding of him and what I've read in your book and elsewhere. We're wrapping up in a second. I asked you about advising companies. Imagine, though, that a young executive who is on the fast track in Fortune 50 company comes to you and says, "They have an aggressive sales model, and I'm heading in there, and I want to take the place by storm. But I want to stay out of trouble." What is your advice to that junior executive?

[00:21:26] I would think very carefully about that firm. So many of the students I have oftentimes will come to me after class, and they have a view which is, "I've spent two years at a leading business school, and I know myself. I know my values, so I can enter any kind of environment, and I can know what's right and wrong. I will identify that at the time." But I think the challenges are that, for example, if you spend two years in a business school or you spend a couple of dozen hours in a training program, that dwarfs in comparison to the amount of time you're going to be surrounded by a very different set of norms and culture. I think in many instances what happens is that, a year or two down the road, you end up forgetting what you had in that mind, what those values and what those norms were earlier, and you end up adopting what's around you. That's where people get into trouble. I would suggest that you have a little bit more humility about how successful you'll be able to actually confront dilemmas and pressures when they're faced. You need to come up with some type of really, really rigorous process in order to stay on the right track because I've seen, unfortunately, a number of people fall down this path of thinking they're going to be able to operate in, for example, a really, really corrupt environment. They know that they're going into a corrupt industry in a corrupt part of the world, and they think they're going to be able to do it differently. Then I find out a couple of years later they're unfortunately not, and I find that why this is so difficult.

[00:22:59] Well, on that very discouraging note — no, you're absolutely right. We have to be clear-eyed about the challenges out there. When we do training, we spend a lot of time on just those case studies. "You're headed into a corrupt country and ask yourself, 'How are you going to respond when the demand comes?'" Because it will come. What you don't want out of that training scenario is for them to say, "Well, I will refuse to pay a bribe," because of course that's the right answer, but what are you actually going to say? What words are you going to use in response to that demand? I lived in Syria for a year in the late '90s, and Lebanese friends said, "Before you move to the Middle East, you need to figure out 20 different ways to not quite say no." The gist of it is "no," but it's a relationship-ending in the Levant to say no, so instead you say, "I wish that I could but, for the following reasons, I can't." Or if it's just somebody at an airport shaking you down, say, "Let me check with the embassy, and if it's OK with them, it's certainly OK with me," knowing that you'll never be allowed to reach for your phone. Those sorts of things, though, the actual language, because "just say no" definitely doesn't work.

[00:24:08] I love that piece of advice because I think what I see among some of the smartest, smartest people I know is not the attitude to "just say no" and "think about how to say no," but rather "think of a more clever way of potentially doing it." I think of the example, actually in your book, around charitable contributions, where one solution is to say, "We're just not going to donate in a way that could be pay-for-play in some way, with charity in any way." But I see in other circumstances, and I've spoken to some attorneys in places, that essentially I would argue to help people loophole around that, which is saying, "We just need to design the charitable contribution program such that if it's actually scrutinized, it would still pass muster." But effectively you still want to do the same thing. For example, spreading your donations across many firms across time, so diffuse but you're effectively bribing that one person. That's loopholing around rather than actually a substitutive act that you're trying to prevent. I think that's where people get in problems, when people are very, very clever and think that's the solution rather than ultimately what you're saying, which is, "You just need to know how to say no and do that in the way that's appropriate in that setting."

[00:25:19] Absolutely. With charitable contributions, one of the great things about Western multinationals — and, really, especially American multinationals — is they do take corporate social responsibility seriously, and we don't want to discourage that kind of charitable giving, but ensuring that it has been thoroughly de-linked from the business rather than just as a sort of sham, as you describe. It's really important to explore the motivation and justification behind these financial crimes and not just read the cases and summarize them and tell people to stop behaving badly. Thank you so much for the important work you're doing on this. As I said earlier, I gather your classes are incredibly popular with midlevel and senior executives. That's not surprising. This is an important issue.

[00:26:06] I think it's probably a lot of fun making people get a little bit more uncomfortable, but I think doing that in the comfort of a classroom or a training exercise is a lot better than not having that happen in the actual context.

[00:26:17] Absolutely. Thank you so much, Eugene.

[00:26:18] Thank you.