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Enron, KPMG... what can we learn about making ethical choices? (Part One)

The recent KPMG saga involving SARS, the Guptas and who knows what else seems to be a case of the more things change, the more they stay the same. After all, it was the Enron scandal in the US in the early 2000s that brought down another accounting giant, Arthur Andersen. We may want to speculate whether KPMG in South Africa will suffer the same fate, but a more important question seems: how does a professional services firm with all the ethics bells and whistles that comes with having the responsibility of auditing the ethics of others come so badly unstuck?

Perhaps the most accurate explanation is that “to be human is to err”. If this is the case, then trying to run an ethical business is an uphill and ongoing challenge. Which is probably why every profession, despite having onerous intellectual and academic qualifications, require their members to adhere to a Code of Ethics and have the requirement to complete Continuous Professional Development in the field of Ethics. Doctors, lawyers, accountants, financial planners… there is no escape. Being a professional is not enough. Ongoing ethics training is needed.

Yet whenever we run an Ethics session for financial planners someone will ask the question, “Why do we have to do this? We’re all ethical aren’t we?” I suppose the answer to that question is, “well…yes…but”. After all, who of us haven’t crossed an ethical line in our lives? I know I certainly have. For purposes of illustration I’ll just admit to one breach in this public document…treating that orange traffic light as a sign for go, rather than slow, and squeezing through on red. I’m comfortable that I’m not alone in this breach and to compound it, this is not only an ethical breach, but it is in fact breaking the law.

The interesting thing is that KPMG as yet have not been found guilty of breaking any laws. But they have acted unethically. When is a qualified audit more than just that? This world of ethics is blurry and grey. But at the heart of it, is the fact that Ethics is all about choices. As the wise Professor Dumbledore advised a young Harry Potter in JK Rowling’s Harry Potter and the Chamber of Secrets, “It’s our choices, Harry, that show what we truly are, far more than our abilities”.

Given the Wizard’s insight, the obvious question to ask in the light of most ethical scandals is, Why do ethical people make unethical choices? Even Bernie Madoff, the mastermind behind the largest Ponzi scheme in history said in an interview in prison that he wasn’t a bad person, “things just got out of hand”. Former US Federal Prosecutor, Serina Vash observed that “When I first began prosecuting corruption, I expected to walk into rooms and find the vilest people. I was shocked to find ordinarily good people I could well have had coffee with that

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morning. And they were still good people who'd made terrible choices"

Why does this happen?

Behavioural Economist, Dan Ariely, provides some profound and disturbing insights. He came to prominence in 2008 as the author of the book Predictably Irrational. But four years later he wrote *The Honest Truth about Dishonesty – How we Lie to Everyone especially Ourselves.* He became particularly interested in why people cheat at the time of the Enron scandal. He wondered if such scandals are simply the result of a few really bad apples, doing very bad things, or whether there is something more to it than that. His research has provided disturbing insights into the fact that our personal moral and ethical codes are in fact very fragile, on a very broad scale. Ariely discovered that at a personal level, most, if not all people will act unethically, as long as it does not affect his or her self-image. He gained this insight through conducting experiments that focused on the problem of cheating.

One experiment was to get students to take a Maths test of 20 questions in an unrealistically short time so that not all questions could be answered. For each question a person got correct they were given a dollar. The average amount handed out was $4 per person. Then Ariely increased the temptation to cheat by telling people they could shred their test paper when the time was up and just tell him how many they got correct. The average handed out now was $7 per person. In this experiment, along with many others that Ariely conducted, where he raised the amount of money and the temptation to cheat, he got the same result: a lot of people cheated, but only a little bit.

Ariely's view was that if you applied rational economic theory to the problem of cheating, it would require a simple cost benefit analysis that would involve three questions:

- What is the prospect of getting caught?
- What is the benefit of cheating?
- How bad will the punishment be if caught?

But to Ariely's surprise, as the benefit of cheating increased, or the prospect of getting caught went down, people did not necessarily cheat more.

To explain this, Ariely found two forces at play when it comes to ethical choices: 1) an individual's sense of self, and 2) the context in which the individual finds themselves.

With respect to a sense of self, Ariely suggests that if a person cheats, and their image of themselves stays the same, then it is okay to cheat. He refers to this as the personal "fudge factor", and it is something that can be increased or shrunk depending on certain factors.

When it comes to money, it seems that distance helps to increase the fudge factor. In other words, if there is some distance between the cheater and the money, the chances are the cheater will cheat more. So when Ariely did his maths test experiment and replaced the dollar bills with tokens that could be exchanged for cash in a neighbouring room, the level of cheating increased dramatically. Just being one step removed from the benefit of cheating caused this increase. Ariely points out that this finding has profound implications for the financial services industry and is a key explanatory factor for the 2008 Global Financial Crisis. The more sophisticated the financial instrument, the greater the distance between the actual money and the ethically compromised players. It is not surprising then that Warren Buffett talks of derivatives as financial "weapons of mass destruction."

When it comes to decreasing the fudge factor, Ariely found that when people are reminded of values or morals, their cheating declines. For example, he did an experiement where people were asked to recite the Ten Commandments before taking the Maths test. Whilst nobody in the experiment could actually remember all Ten Commandments, nevertheless just trying to recall them led to a complete absence of cheating. In a similar way, when students were asked to sign a Code of Honour at MIT, before taking the test, there was no cheating.

These experiments highlighted that it is possible to influence a sense of self through "moral" or "ethical" framing which reduces the personal "fudge factor." But while we are all prone to cheating just a little bit, it is our social context which also influences our appetite to cheat.

This social element is the second force that compels people to cheat, or not. To demonstrate this, Ariely did an experiment in his maths test where all participants were given the amount of money you would get for all the questions, and asked that they give any extra money back after the test. But after about 30 seconds, one of the participants, an actor who was planted in the group, stood up and announced he was finished, which of course was impossible. Nevertheless the moderator said he could go home. Clearly all the other participants knew he had cheated, but their response to this was influenced by their perception of who this person was. The experiment was done at Carnegie Mellon University, and when the actor had a Carnegie Mellon sweatshirt on, the level of cheating in the group went up. The students saw

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that one of "them" had cheated and gotten away with it, and also made them think that because one of "them" had done this, that it was acceptable if they did it too.

When the actor had the local rival University of Pittsburgh sweatshirt on, things changed. The students in the room saw how that student had represented their own university and felt that they should represent theirs better. The result being that no one cheated. Essentially what happened was when the person was seen as part of the “in-group”, this made cheating okay. When they were part of the “out-group” this made it not okay, and the level of cheating in the group declined.

The social context of the individuals involved in this experiment usurped personal issues such as the benefit from cheating and the probability of getting caught. Now the key influencing factor was whether there was a “norm” for cheating or not.

Ariely’s work presents two challenges for business owners. Firstly, how do you get individuals to shrink their personal “fudge factor” in the workplace? And secondly, how do you create a social context at work where people see ethical behaviour as the “norm”? We will address these questions in Part Two of this article next week.

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