REFINITIV EXPERT TALK

Seeing and avoiding the financial crime before you commit it

Dr. Eugene F. Soltes of Harvard weighs in on the ability of data analytics to help spot ethical issues before they become criminal ones.

If someone already seems to have it all, what would inspire them to risk their liberty, their reputation, their finances and likely much, much more to commit a financial crime? That's a question that Dr. Eugene F. Soltes (Jakurski Family Associate Professor of Business Administration at Harvard Business School) asked himself which led to the compilation and publication of his book, ***Why They Do It: Inside the Mind of the White-Collar Criminal***. From key players at Enron and Tyco to Bernie Madoff and Allen Stanford, Dr. Soltes spent several years corresponding with the key players behind some of the most notorious corporate crimes in modern times.

What did Dr. Soltes uncover in exploring their motivations that could be illustrative for today's business decision maker? What ethical blind spots did they fall prey to? And what role can artificial intelligence and data analytics play to help companies and professionals avoid potential compliance and misconduct issues? Dr. Soltes expounded on these topics and more in the following exchange.

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Dr. Eugene F. Soltes, Harvard Business School

REFINITIV: As you were preparing your book on white-collar crime, you had previously shared that in interviewing criminals, you found there to be an awareness gap. They didn't seem to internalize the actual damage their crimes did because they couldn't see the people they were hurting. That said, what needs to be done to strengthen awareness of the impact of financial crimes so as to give potential criminals pause?

EUGENE SOLTES: That's exactly my overarching thesis, in that one of the challenges with most corporate misconduct is it doesn't immediately resonate with the person engaging it. The victims, so to speak, are distant (psychologically and physically), but also even temporally offset. It doesn't necessarily instigate that same feeling of wrongness or of having actually engaged in harming an individual at the time.

The easiest case to think about this is insider trading, where we would say that the integrity of the market is harmed. It's not actually a person. I've thought about this question: "How should we try to approach it, given that this is an abstract issue?" Not surprisingly, since I'm a management professor, I think about the cases that we generally do with our students and participants at Harvard Business School.

If we do a case study on insider trading in class, there isn't really a ton of discussion around "Should you do this, or shouldn't you?" In many of these instances, like those in my book, it's pretty black and white. They are in many instances pretty egregious cases when it gets to the criminal level. The question then is, "Why can students seemingly resolve this so easily within a classroom but then we see high-profile individuals seemingly make that error in practice?"

I think there are three different dimensions that separate the classroom or corporate training experience from the real world. That is, in the real world, no one's going to point it out for you. I t's not like a case study where we hand you the decision, so you've already issue spotted the challenge. You have to make decisions quickly. Unlike in a classroom or training exercise, you don't get half an hour to think about it. Also, you're going to make the decision in the real world among people who generally hold homogeneous or similar views. Working at the same firm, you may not have that diversity of opinion brought in.

I think what we need to cultivate more in organizational settings is finding answers to these questions: "How do we actually help people better identify those potentially slippery decisions?" and "How do we bring in heterogeneity of thought and opinion?" We say this a lot, "We want diversity of views when we're making decisions." In practice, a lot of firms actually don't genuinely cultivate or actually allow people to speak up. Plus, to the extent that some of the decisions need more time, how do we make sure there is bandwidth to actually execute upon that?

REFINITIV: In your estimation, what more should be done to teach and encourage a greater degree of ethics in business decision making? How can executives be better prepared to meet the high-pressure challenges they may be faced with that could lead to shortcuts and potential criminal activity?

SOLTES: If I think of the challenge that is most salient in many of the instances I was looking at in my work, it is that the actors just didn't see it at the time. With the benefit of hindsight, a lot of these decisions seem so egregious and pretty obvious. But at the time, what's remarkable is you see these extraordinary individuals seemingly overlooking the consequences. I would like a lot more attention placed on how to better spot the issues at the time.

This is something where I think we're approaching a point in which data analytics and the ability to extract more information from our environment can potentially help us do better in spotting issues. It's an easy analogy. Think about a credit card company. When we run through a charge, the company is running some data analytics behind the scenes to risk score whether this might be a fraudulent transaction or not, and ultimately to stop it from going ahead, if needed. Could we imagine doing the same thing with some decisions that are occurring within corporate and organizational settings?

Consider if someone were about to sign a deal and they didn't realize that it was about to get into an aggressive zone of potentially engaging in something like bribery. Perhaps it was due to mis-intent, but perhaps they were just being sloppy. What if data analytics allowed the company to see trouble ahead so it could intercede to stop the deal or otherwise rectify it soon thereafter? That would be better than having it be an issue that only comes to light several years down the road when some regulator spots it, and then the organization understands the dramatic repercussions associated with it. That's one area where I'm particularly excited by the tremendous amount of progress ahead.

REFINITIV: What safeguards and solutions, be they regulatory or technological, would you recommend be added to the current financial landscape to prevent financial crime?

SOLTES: This is an area where I'm particularly excited. I think we're on the cusp of changing things dramatically on how organizations function when it comes to understanding potential misconduct, and hopefully both more effectively preventing it and detecting it. We see in the anti-money laundering space that most large banks are doing this quite aggressively, and they actually brought a lot of technology into that sphere. It's a much, much broader area where many firms outside the financial industry and even within can use this in a much broader set of applications.

Consider transaction monitoring and anti-bribery concerns. There are characteristics associated with every transaction that one does. Imagine risk scoring the characteristics associated with a transaction. What if you could effectively predict the likelihood that a transaction is one that you may be concerned about, and what if your organization could use its investigative and compliance resources both more efficiently (because it knows what it's looking at) and more effectively.

Ultimately, I think the challenge with most compliance and misconduct issues is because they are "needle in the haystack" issues. The question is effectively honing your resources to find those. We're entering the point where firms can't just keep hiring people into their compliance department to look at more things. Rather, they need to take what resources they have and simply use them more effectively. That's where data analytics and machine learning can be used in increasingly effective and efficient ways to analyze transactions.

REFINITIV: Are you seeing white-collar criminals increasingly cooperating with more explicit criminal elements such as organized crime, terrorist financing, drug dealers, hackers, etc.? Or is white-collar crime largely the activity of lone wolves embezzling money, inflating stock prices and the like?

SOLTES: I feel the more challenging crime lies in between those two. I'd say it's organizational misconduct, in which the organization itself is not able to witness and understand what it's actually doing wrong.

I'm thinking of some recent corporate cases in which it was not single, isolated individuals who were acting rogue. The corporations were extraordinary organizations in which the overwhelming majority of the organization is doing fantastic things. Nonetheless, there were subcultures within them that were engaged in very, very serious misconduct. It wasn't one, two or five, but quite a few senior-level individuals involved.

In these cases, we're talking about potentially thousands of individuals who were surrounded by an organizational culture which encouraged either creating extra products for customers or deceiving regulators. When a culture like that develops within an otherwise high-integrity or well-functioning organization, that makes me concerned. This is where people can go home at the end of the day and they don't think they're mobsters. They don't think they're felons by any means because by and large, they're not. What they are involved in is corporate misconduct that they're surrounded by and engaged in.

They go home saying, "I'm a high-integrity person. I work for a high-integrity organization." They're nonetheless still engaged in misconduct, and they don't see that disconnect. We see that occurring at large organizations regularly.

REFINITIV: Do you see an alignment gap between what's considered unethical with what is illegal? If so, how might that be rectified?

SOLTES: That's an incredibly important question, especially when we start thinking of very smart people who are on the borderline between doing things that would be considered highly valued and very, very clever and those things that are potentially illicit and unethical.

We saw this in the last financial crisis in which even President Obama admitted that there were a lot of actions that were clearly unethical, but not necessarily illegal. Many people were very frustrated by this. The reputational consequences for organizations can be as large, or in some cases, even larger than the regulatory consequences. This is where I see the real challenge for senior leadership is to say, "Well, maybe we can find a structured solution for this. Maybe we could do this."

A really nice example from a number of years ago was inversions. A lot of firms figured out you could do inversions up until some regulation was passed. There were some organizations that actually pulled back on doing that. Although they could do it, they saw the reputational ramifications were not actually worth the benefit associated with it. Those are the senior-level strategic decisions that need to be made in this context.

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Eugene Soltes is the Jakurski Family Associate Professor of Business Administration at Harvard Business School where his research focuses on corporate misconduct and fraud, and how organizations design cultures and compliance systems to confront these challenges. He teaches in several of the school's executive education programs and was the recipient of the Charles M. Williams Award for outstanding teaching. Professor Soltes' work on corporate misconduct and fraud culminated in the book "Why They Do It: Inside the Mind of the White-Collar Criminal," which was described by Kirkus Reviews as "a groundbreaking study" on white-collar criminality. This research has been published in leading finance, accounting and economics journals and has resulted in numerous awards including the Hillcrest Behavioral Finance Award, California Corporate Finance Conference Award and the Financial Research Association Best Paper Award. Professor Soltes is a popular keynote speaker and frequently advises firms about their compliance programs and training. He is regularly invited to speak to regulators, including the Department of Justice, Securities and Exchange Commission, United States Treasury and the Federal Bureau of Investigation. Prior to joining the faculty of the Harvard Business School, Professor Soltes received his Ph.D. and M.B.A. from the University of Chicago Booth School of Business, and his A.M. in statistics and A.B. in economics from Harvard University.

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