Prevention of White-Collar Crime by Knowledge and Learning in Business Organizations: An Empirical Study of Chief Financial Officer Management

Petter Gottschalk and Hans Solli-Sæther
BI Norwegian Business School, Norway

Knowledge and learning are important in combating financial crime generally and white-collar crime in particular. The purpose of this research is to generate insights into prevention approaches in practice that may reflect on a contingent approach. The five hundred largest business companies in terms of annual turnover were identified in Norway for our empirical study of white-collar crime. A paper letter was mailed to the chief financial officer (CFO) asking him or her to fill in the questionnaire to be found on a web site using a password found in the letter. The open-ended question in the questionnaire to CFOs about prevention of white-collar crime was formulated as follows: *How can white-collar crime best be prevented in your company?* Survey results indicate an even distribution of respondents emphasizing control and respondents emphasizing influence. This empirical research steps back from many best practice articles and provides insights into preferences of chief financial officers on how to prevent white-collar crime in the company.

Keywords: white-collar crime, CFO, auditing, internal control system, knowledge, learning

Introduction

An important consequence of the dark side of leadership is the potential of white-collar crime by executives (Fleet and Fleet, 2006; Furnham, 2007; Ouimet, 2010). White-collar crime is not as visible as conventional crime and detection is difficult. For instance, in a homicide case, there is generally a body and forensic evidence. In the case of financial crime, Hansen (2009) argues that accounting and computer forensics are currently the investigator's best tools in detection and implemented in most white-collar investigations in recent years. Applications of science and technology to white-collar crime cases is increasing, and advances in technology have led to a greater dependence on expert testimony in white-collar crime cases, keeping in mind that expert opinion cannot be given with absolute certainty.

Perhaps, Hansen (2009) argues, due to the financial resources to defend

their cases available to elite individuals and corporations who are brought to justice, plus aversion to negative publicity, plea bargaining prior to charges is more intense as compared to that in conventional crime cases. Formal charging is more likely to be viewed as a failure by prosecutors, because of the larger number of resources that prosecutors have to be diverted to prosecute white-collar crime cases. Also due to the greater stigma attached to jail or prison time for elites, they may be reluctant to negotiate a plea bargain if incarceration is included in the deal. On the other hand, it is not unusual for convicted defendants to suddenly decide to cooperate in investigations in order to receive leniency at sentencing.

Regulation played a major role in the waves of white-collar crime that have struck many developed economies. During the 1980s, deregulation in many countries led to creative financial schemes, some legitimate, but others clearly criminal. Insider trading was rarely investigated or prosecuted by regulatory agencies, even though it was and is illegal. Deregulation is viewed as a culprit in allowing bad accounting practices, including the practice of hiding losses or debts, as in the case of Enron, as well as overstating profits and assets. By regulation in response to major corporate crimes, it is like closing the barn door after the sheep have all escaped. It is a difficult task to rein in malfeasance, particularly if the monetary reward continues to outweigh sanctions (Hansen, 2009).

Self-regulation as a strategy for private industries is dependent on the actions each business is willing and able to take to prevent white-collar crime. Therefore, this paper addresses the following research question: *How will the chief financial officer (CFO) prevent white-collar crime in his or her business organization?* Results from a survey of CFOs in Norway are applied to answer this research question.

Managerial auditing is important in combating financial crime generally and white-collar crime in particular. The purpose of this research is to generate insights into prevention approaches in practice that may reflect on a contingent approach to managerial auditing.

Self-Regulation

According to Hansen (2009), self-regulation does not appear to be a solution either. Much of evaluation, either by external groups or internally, is ceremonial. For example, managers at a technology company may have only a rudimentary knowledge of chemistry, biology or computers, but employ technological experts to do the core work of the company. In other examples, there is a conflict of interest, as in the case of Arthur Andersen who served as both auditor and paid consultant to Enron. In addition, certifiable standards have not proven to be successful. One reason is the frequent disconnect between certification and consistent compliance.

Self-regulation in terms of private policing of economic crime does not appear to be a solution to Williams (2005) either. He identified five barriers to this kind of governability:

1. *Secrecy, low visibility and discretionary justice* lead to informal negotiations, easy termination, loose coupling between investigations and formal legal frameworks, and potential privileges for some individuals but not others.
2. *Multiple legal standards and forum shopping* lead to legal and procedural standards that tend to vary on a case-by-case basis depending on the specific legal avenue or forum that is selected.
3. *Multiple legal actors* with distinct credentials and qualifications apply a variety of different professional and quasi-professional codes, standards and obligations.
4. *Multiple stakeholders and interest groups* tend to have conflicts of interest. However, to speak of accountability and governance, one is inevitably required to adopt a particular point of view.
5. *Public-private dichotomy* leads to a liberal legal tradition, where the distinction between public and private remains an enduring feature of legal thought. It hinges on two related principles that bear directly on the activities of internal investigators. The first is that corporations enjoy the same legal rights as individuals and are thus defined as private legal actors. The second is that there are fundamental limits to the authority and jurisdiction of the state that preclude unnecessary interventions and incursions into the private realm.

Similar to both Hansen (2009) and Williams (2005), Schneider (2006) studied privatizing economic crime enforcement by exploring the role of private sector investigative agencies. A financial investigative agency refers to an accounting-based, private sector organization that provides investigative, risk management, consulting and litigation support services addressing economic crime.

A special kind of self-regulation is self-protection, where protection is potentially achieved by educating actors. An example is investor protection by weaknesses of initial public offerings (IPO). Solaiman (2009) argues that it is generally understood that investment knowledge empowers investors to protect themselves from the culpability of issuers, their professionals and intermediaries who are called gatekeepers. Investors' ability to make prudent investment judgments for allocation of resources is regarded as an important element in every market economy.

In addition to self-protection, Solaiman (2009) argues there is a need for regulators in protecting investors. Investor protection by securities reg-

ulators can be divided into two: indirect and direct protection. The former refers to empowering the investors to protect themselves, whilst the latter concerns protection by regulator through making, administering and enforcing.

Private policing of financial crime will have to build on organizational justice as perceived by organizational members. Scott, Colquitt, and Paddock (2009) find that a quarter century of research on organizational justice has revealed a great deal about how employees react to justice rule adherence and violation on the part of their managers. Employees evaluate justice along a number of dimensions: fairness of decision outcomes, fairness of decision-making processes, adequacy of explanations, and perceived sensitivity of interpersonal communication.

These dimensions are part of what Rodell and Colquitt (2009) call anticipatory justice: distributive justice, procedural justice, informational justice, and interpersonal justice. The effects of anticipatory justice have been explored in the context of organizational change. Change is a natural component of employees' working lives, and employees may experience a variety of changes during their organizational tenure, ranging from large-scale changes such as organizational relocations or mergers, to new policies such as fringe benefit bans.

As part of anticipatory justice, Zapata-Phelan et al. (2009) studied procedural justice and intrinsic motivation among employees. What stands out most from the results of their study is the significant relationship between procedural justice and intrinsic motivation. The relationship was supported using a self-report measure as well as reference motivation to both specific tasks and multifaceted tasks in terms of overall job duties. Such relationships will tend to influence the role and performance of financial investigative agencies.

Schneider (2006) recommends that public policies and programs be developed that nurture an increased and more formal role for financial investigative agencies within the context of a partnership with government agencies. In Norway, a public debate in the media indicated that the role of financial investigative agencies should be reduced and more resources should be made available to the police (Føler meg rettsløs, 2008).

Research Design

The five hundred largest business companies in terms of annual turnover were identified in Norway for our empirical study of white-collar crime. A paper letter was mailed to the chief financial officer (CFO) asking him or her to fill in the questionnaire to be found on a web site using a password found in the letter. 50 respondents first filled in the questionnaire, representing a response rate of ten percent. After a reminder was mailed to the sample, 61

more respondents filled in the questionnaire, representing a response rate of 22%. In addition, there were 28 incomplete responses, thereby creating a total of 28% response rate.

The survey research was carried out from January to March 2010. Average number of employees in the responding companies was 1,671 persons. The largest responding company had 30,000 employees. All letters were mailed to the CFO, and most of the respondents were CFOs, while some were CEOs and financial controllers.

The average age of respondents was 46 years, and they had on average 4.8 years of college and university education after high school. Most of the respondents were men, as there were only 19 women among the 111 complete responses.

The open-ended question in the questionnaire to the CFO about prevention of white-collar crime was formulated as: *How can white-collar crime best be prevented in your company?*

A total of 91 respondents provided answers to this open-ended question. Responses were classified by applying content analysis (Riffe and Freitag, 1997). In the first round of text reading, potential topics were identified.

Two main topics were identified. The first group of responses is concerned with the ability to control by means of efficient and effective control routines, transparent guidelines, reactions and consequences for offences and misconduct. This main topic is labeled the reactive strategy in prevention of white-collar crime.

The other group of responses is concerned with the ability to influence by means of values and ethics, recruitment and hiring processes, attitudes of integrity and accountability, and visible and determined leadership. This other main topic is labeled the proactive strategy in prevention of white-crime.

Based on the discussion of self-regulation in prevention of white-collar crime, we conceptualize self-regulation as consisting of both the reactive as well as the proactive strategy. Thus, self-regulation consists of control and influence.

Research Results

As mentioned, the open-ended question in the questionnaire to the CFO about prevention of white-collar crime was formulated as: *How can white-collar crime best be prevented in your company?* Examples of control statements provided by respondents include:

- Good internal control.
- Banks have a relatively strong regulation regime, external + internal auditor, finance authorities, compliance and risk controllers, control

committee, auditing group and money laundering regulation.
- Good control routines and internal procedures.
- Access control and reliable approval procedures.
- Control routines with division of responsibilities.
- Efficient systems and routines, regular internal controls.
- Implement effective control systems.

Examples of influence statements provided by respondents include:

- Continuous work on culture – values – ethics, show zero tolerance in relation to misconduct.
- Openness with contacts and financial information.
- Attitudes of honesty and accountability as a culture in the company at all levels.
- An explicit and visible leadership that monitors the organization.
- Good hiring procedures.
- Focus on ethics, where management is a good example in all situations.
- Build common culture, behavior, set of values and company identity.

Among the initial responses of 47 completed questionnaires for this question, the following distribution was identified:

- *Control.* 25 out of 47 respondents would focus on controlling and auditing, thus 53% for control.
- *Influence.* 22 out of 47 respondents would focus on influencing and behavior, thus 47% for influence.

This is an interesting result as there is almost an even distribution between the two main themes, where half of the respondents emphasize control, while the other half emphasizes influence.

After a reminder was mailed to non-respondents, a total of 47 completed questionnaires were received, which is exactly the same number as in the first round. The distribution among chief financial officers in terms of responses to the open-ended question was as follows:

- *Control.* 20 out of 47 respondents would focus on controlling and auditing, thus 43% for control.
- *Influence.* 27 out of 47 respondents would focus on influencing and behavior, thus 57% for influence.

We find an even distribution among control and influence, but the majority in this second round emphasizes influence to prevent white-collar crime. In

total, the following distribution for all 94 respondents that filled in this open-ended question was as follows:

- *Control.* 45 out of 94 respondents would focus on controlling and auditing, thus 48% for control.
- *Influence.* 49 out of 94 respondents would focus on influencing and behavior, thus 52% for influence.

In terms of self-regulation, respondents who emphasize influence are slightly more than respondents who emphasize control.

Discussion

White-collar crime contains several clear components (Pickett and Pickett, 2002):

- *It is deceitful.* People involved in white-collar crime tend to cheat, lie, conceal, and manipulate the truth.
- *It is intentional.* Fraud does not result from simple error or neglect but involves purposeful attempts to illegally gain an advantage. As such, it induces a course of action that is predetermined in advance by the perpetrator.
- *It breaches trust.* Business is based primarily on trust. Individual relationships and commitments are geared toward the respective responsibilities of all parties involved. Mutual trust is the glue that binds these relationships together, and it is this trust that is breached when someone tries to defraud another person or business.
- *It involves losses.* Financial crime is based on attempting to secure an illegal gain or advantage and for this to happen there must be a victim. There must also be a degree of loss or disadvantage. These losses may be written off or insured against or simply accepted. White-collar crime nonetheless constitutes a drain on national resources.
- *It may be concealed.* One feature of financial crime is that it may remain hidden indefinitely. Reality and appearance may not necessarily coincide. Therefore, every business transaction, contract, payment, or agreement may be altered or suppressed to give the appearance of regularity. Spreadsheets, statements, and sets of accounts cannot always be accepted at face value; this is how some frauds continue undetected for years.
- *There may be an appearance of outward respectability.* Fraud may be perpetrated by persons who appear to be respectable and professional members of society, and may even be employed by the victim.

Self-regulation in the form of corporate governance cannot alone prevent

white-collar crime. Governance in the form of clear policies and procedures, formalized cross-company communication, along with performance-based salary for board members and employees reduces incidences of white-collar crime within corporations. An ethical issue is whether there should be a material reward for not committing a crime. Such a reward policy might be perceived as paying drug dealers for not selling drugs, if the same strategy were to be applied to ordinary criminals. Also it insinuates that board members and corporate executives are not well compensated already, which is not the case in many industries that are plagued with white-collar crime, including the financial sector (Hansen, 2009).

Policing financial crime – according to Pickett and Pickett (2002) – is concerned with whistle blowing and detection, roles of shareholders and main board and chief executive officer and senior executives, investigations, forensics. Policing financial crime – according to Levi (2007) – is concerned with the organization of policing deception, the contexts of police undercover work, covert investigations of white-collar crime, prosecution and relationship to policing fraud. Covert activity is restricted mainly to the informal obtaining of financial information or the official obtaining of information about suspected bank accounts without the knowledge of the account-holder.

Another limitation of self-regulation is 'know-nothing' CEOs. Hughes, Louwers, and Reynolds (2008: 115) argue that much of the national media in the US has paid attention to corporate scandals where 'know-nothing' CEOs and complacent/conflicted auditors missed the accounting frauds:

In each case, 'revelations' abound as to lax corporate control environments and defective or non-existent audit procedures that prevented identification of potential abuses.

Furthermore, internal auditors' performance may largely depend on their moral decisions when faced with ethical dilemmas. Woodbine and Liu (2010) found that the moral choice of internal auditors can be explained by the leadership style, personal needs strengths and demographic variables.

Conclusion

49 out of 94 responding CFOs in Norway would prevent white-collar crime by influencing the organization in terms of culture, values, behavior, leadership and ethics. 45 out of 94 responding CFOs emphasized control in terms of internal and external control, guidelines and procedures, audits and accounting. In the self-regulation circle, slightly more respondents emphasized influence rather than control. Future research might explore the interactions between control and influence. Implications for a contingent approach in managerial auditing need to be explored in future research.

Furthermore, future research might be expanded to make sure that

the entire variety of white-collar crime is considered by respondents. This could be done by structuring the questionnaire into additional sub-questions linked to the original open-ended question.

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Petter Gottschalk is Professor of information systems and knowledge management in the department of leadership and organizational management at the Norwegian School of Management. Dr. Gottschalk has published several books and research articles on crime and policing. *petter.gottschalk@bi.no*

Hans Solli-Sæther has an MSc degree from the University of Oslo and a PhD degree from the Norwegian School of Management. He has been the CIO of Norway Post and has several years of practical experience in management. Dr. Solli-Sæther has published several books and research articles on outsourcing and IT management.

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