Alain Cohn, Ernst Fehr, and Michel André Maréchal. Business culture and dishonesty in the banking industry. Nature. November 19, 2014. doi: 10.1038/nature13977

Presentation of the problem: public perception of business culture in banks

- In recent years, there were many cases of fraud in parts of the banking industry, which led to a considerable reputational loss for the industry.
- The business culture, i.e. the unwritten and informal norms that prevail in the banking industry, were often held responsible for this. It has been claimed that these behavioral norms implicitly tolerate or favor dishonest behavior.
- However, there was no scientific evidence for this sort of cultural effect up until now.

The study

- The scientists recruited approximately 200 bank employees for the study, 128 from a large international bank and 80 from other banks. Each person was randomly assigned to one of two groups.
- Participants in the experimental group were reminded of their occupational role and the corresponding behavioral norms with appropriate questions (e.g. Which bank do you work at? How long have you been working in the banking business?). They were thus made aware of their occupational role before the actual experiment began.
- In contrast, participants in the control group answered questions about their non-occupational role in their leisure time (e.g. What is your favorite activity in your leisure time?); they were thus reminded of the norms associated with their non-occupational role.
- Following this, all subjects participated in a task where they could increase their income by up to 200 U.S. Dollars with dishonest behavior. They had to toss a coin and indicate whether it showed “heads” or “tails”. They had the opportunity to lie, as the result was not controlled. The researchers, however, were able to determine if the subjects told the truth on average or not, by using probability calculus.

Results

- The results of the study showed that bank employees in general are not less honest people. Bank employees in the control group were honest *on average*.
- In the experimental group, where the employees were reminded of their occupational role, the bank employees were *on average* significantly less honest than their occupational colleagues in the control group, where the employees were not reminded of their occupational role.
- A very similar study was then conducted with 133 employees of other industries. In this case, as well, employees were asked questions about their occupational or their leisure-time roles.
- Unlike the bank employees, the employees in these other branches were not less honest when reminded of their occupational norms.
- The results indicate that bank employees who participated in the study work in a business culture that tends to tolerate or promote dishonest behavior. This result is consistent with the hypothesis that a problematic business culture prevails in parts of the banking industry.

- In conclusion, banks could encourage honest behavior by trying to change the unwritten, informal norms, i.e. their business culture. The changes in explicit norms and rules for increasing compliance should thus go along with a change in the implicit, unwritten rules.

Possibilities for increasing compliance

- Banks should examine the concrete work routines in various departments in order to find out where and when the employees make ethically critical decisions. In a second step, a common understanding should be created as to which behaviors are socially desirable and which are not. In a third step, group pressure can also be used to enforce socially desirable behaviors.
- We also think that financial incentives and bonuses must be examined more closely in order to make sure that they are in line with a business culture of honesty. The incentive system should clearly express that the satisfaction of customer and societal interests is important to the bank.
- Several experts and supervisory authorities suggest that bank employees should swear a professional oath, similar to the Hippocratic Oath for doctors. An oath like this could encourage bank employees to act more in the interest of the customers and society in general. The empirical effectiveness of an oath remains to be tested, however.

What the study does <u>not</u> show

- "Bank employees are *generally* dishonest." The study does not support this statement. On the contrary, the results from the control group show that bank employees behave honestly on average, even though there were strong financial incentives to behave dishonestly.
- "Bank employees *generally* behave dishonestly in their occupational role." This statement, as well, is not supported by the study. The results show an average effect. This probably means that some of the participants behaved dishonestly, while others did not. On average, we find more dishonest behavior when employees are reminded of the occupational role in the bank instead of the leisure-time role.
- "The banking industry has a *general* business culture that promotes dishonest behavior." The study does not support this statement either. The main experiment was completed with 128 employees of an internationally active major bank. We also used 80 further participants from other banks. The results do not differ statistically between employees of the major bank and the other bank employees. We thus conclude that this is not a phenomenon of one individual bank. We cannot conclude, however, that the banking industry in general has a business culture that tends to tolerate or promote dishonest behavior. This statement can only be empirically secured in its entirety if the experiment were conducted with a random sample of the entire banking industry. Generalization is a problem for every empirical study whenever only some members of a group are examined, and when this is not in a representative random sample. The results strengthen the hypothesis, however, that the scandals of the last few years (LIBOR, foreign currency exchange manipulations, overstepping risk limits, etc.) were partially caused by a problematic business culture.