# Banking on team ethics : a team climate perspective on root causes of misconduct in financial services

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# Part III
# Social psychological root causes of misconduct

## Chapter 8
## Theory on team climates facilitating misconduct

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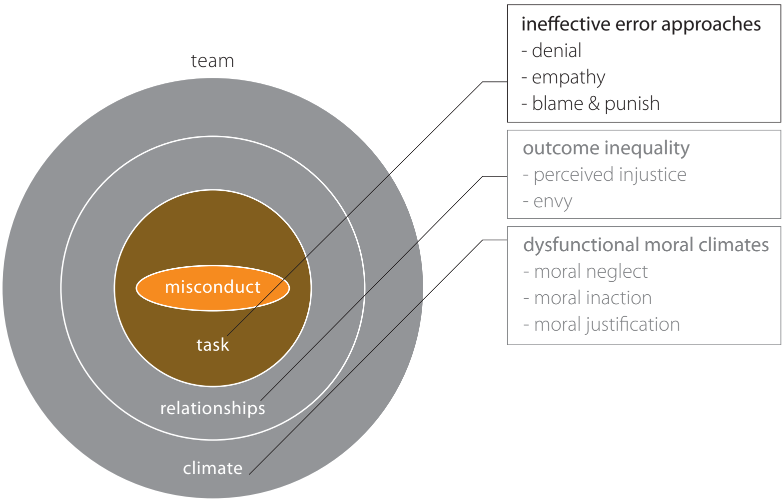
In Study 3 I assessed two trading teams, using an assessment framework based on the Corrupting Barrels model (Figure 3.2, Chapter 3). Before I report Study 3, I elaborate on the underlying theory of the Corrupting Barrels framework. This underlying theory refers to three key social psychological mechanisms that may facilitate unethical behaviour within teams: ineffective error approaches (paragraph 8.1), outcome inequality (paragraph 8.2) and dysfunctional moral climates (paragraph 8.3).

### 1. Ineffective error approaches: denial, empathy and blame & punish

The way a team deals with task relevant errors may facilitate misconduct (see Figure 8.1).

*Figure 8.1. Ineffective error approaches at task level of team climates*

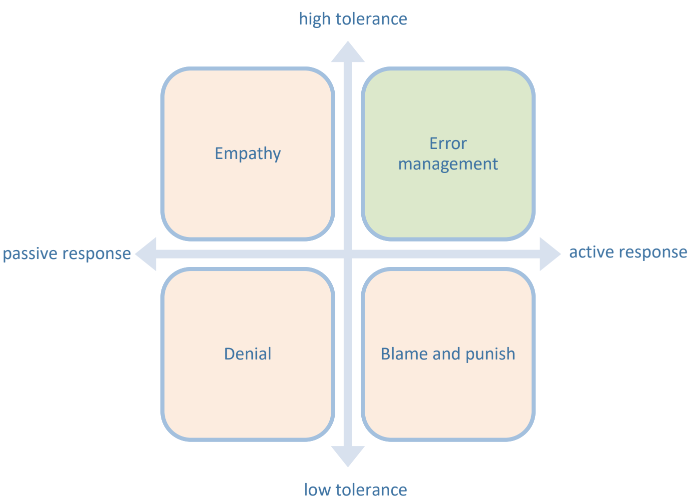



Errors refer to all kinds of unintended performance failures, ranging from experiments with novel procedures that have undesired outcomes, to severe mistakes (Van Dyck, Baer, Frese, and Sonnentag, 2005; Van Dyck, Van 't Hooft, De Gilder, and Liesveld, 2005, Frese, 1995). For instance in trading, errors may include investment decisions based on expected returns that turn out to be unrealistic, or accidentally using wrong numbers in important calculations. Errors occur whenever people are at work. They are by definition unintended and thus exclude intentional misbehavior. Thus, the occurrence of misconduct in itself should not be considered an example of erroneous behaviour. However, how a manager and teammates respond to errors, implicitly teaches traders how to deal with their task, how to act in ambiguous situations, and how management responds to problems. Moreover, the way such errors are typically dealt with determines the likelihood that employees are open about performance aspects they feel uncertain about, their willingness to discuss questions they have about behaviour of co-workers, and their ability to improve their work behaviours. So, when errors are managed ineffectively, this also creates conditions where the risk of unethical behaviour more likely emerges and remains unchecked, even when observed by others. This chapter introduces three ineffective error approaches that have been identified in the social psychology literature and elucidates how these ineffective error approaches can facilitate misconduct.

### 1.1 Ineffective error approaches

Teams and organizations differ in how they approach errors. We distinguish between different approaches to errors, that can be organized along two orthogonal dimensions: the level of tolerance for errors, and the type of response. The combination of possible responses along these two dimensions thus characterizes four different organizational approaches that can be observed (Homsma, 2007; Van Dyck *et al.*, 2005). More systematic empirical evidence for these four organizational approaches to errors – see Figure 8.2 – has been obtained in prior research on organizational error handling in a variety of work settings. Homsma (2007), for example, uses these two dimensions in his analysis of organizational assumptions of errors: tolerance or errors and decisiveness towards errors. Van Dyck, *et al.* (2005) examined naturally occurring differences in error cultures in businesses with interview data. Results from these investigations allowed them to categorize organizational responses into four categories of approaches plotted in Figure 8.2: error aversion or denial (not tolerating errors and responding passively), empathy (tolerating errors and responding passively), blame and punish (not tolerating errors and responding actively) and error management culture (tolerating errors and responding actively).

***Figure 8.2.*** *Four organizational approaches to errors (based on Homsma, 2007)*




*Error management*

Before three ineffective error approaches – denial, empathy and blame and punish – are introduced, first the most effective strategy is explained here. When people communicate openly about errors, are willing to reveal errors, when errors are quickly detected, analysed and corrected and knowledge on errors is shared in the organization, this is referred to as an "error management culture" (Van Dyck *et al.*, 2005, Rybowiak *et al.*, 1999). The concepts of error management culture and error management climate are sometimes distinguished from each other in literature on error management. Whilst error management culture refers to organizational practices, error management climate refers to people's perceptions of these practices. In this analysis, I use the term error management culture to refer to organizational practices, but I assume these impact on employee perceptions.

The error management approach induces a learning orientation in employees. The error management approach accepts errors as an inevitable aspect of professional performance, where it is impossible to fully predict, prescribe or control every performance aspect (Rybowiak *et al.*, 1999). Errors are acknowledged, or 'tolerated', as something that is an inevitable part of professional life. However, this acceptance is contingent on the understanding that action is taken to redress any negative consequences, and that there is a clear ambition to learn from errors made. It requires an active response to errors by stimulating evaluation of errors and organizing means and practices to learn from them, so that ideally, the same error is not made twice. In this approach errors are primarily viewed as a chance for organizational development and improvement.

- *An illustrative example from supervisory practice (Nr. 12, see Table 2.1).*

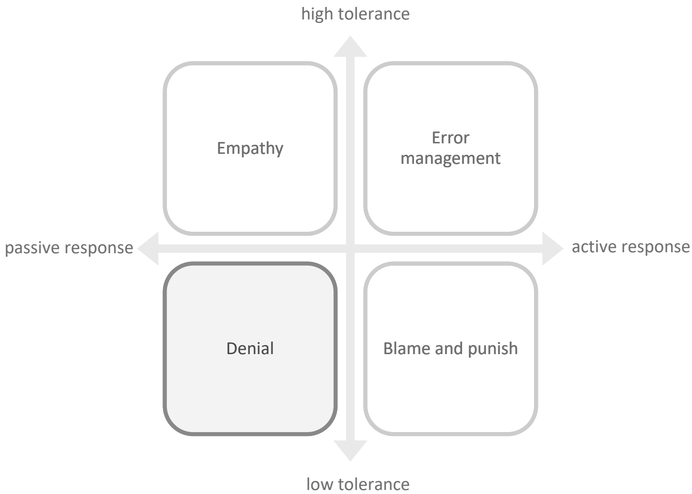
  An executive board of a too big to fail bank discovered an error of a senior manager and calls him up as soon as the error is discovered. The senior manager gets summoned up to the executive floor actively and immediately and is asked to report and explain what has happened. He is welcomed with an introduction from the executive board such as: 'We assume you have thought this over. Please explain to us your reasoning on these events'. The senior manager gets the chance to explain the situation to an executive board that takes him seriously and trusts him unless proven otherwise. This response to errors is evaluated positively by the senior manager. It stimulates him to openly and thoroughly evaluate the error together with the executive board, making full use of the learning potential an error has to offer.

This type of error management approach is negatively correlated with unethical behaviour (Van Dyck *et al.*, 2005): more error management leads to less unethical behaviour. Approaches to errors at work may fall short of this optimal form of error management in different ways, which can be ineffective in their own way (Homsma, 2007; Van Dyck *et al.*, 2005). Below, I explain three alternative approaches, and explain why these are less effective.

*Denial*

A first ineffective error approach assumes that current regulations and guidelines should fully prevent the occurrence of errors (no tolerance of errors). The denial that errors can and do occur, characterizes this error approach (see Figure 8.3). It does not acknowledge that errors are inevitable in professional life; errors are simply not tolerated or accepted. Therefore errors are not considered as a possibility and ignored when they occur.

*Figure 8.3. Error approach 'Denial'*




In this approach, due to the assumption that the possibility of errors has been ruled out (for instance by increased external supervision) no provision is made for the occasion when errors do occur. Errors made do not lead to organizational level changes (passive response). Silencing errors, implies that the circumstances leading up to their occurrence are not scrutinized, and therefore nothing is learned from them. As a result, nothing is done by the organization, by management, or by employees to learn from prior mistakes or failures. However, if there is a flaw in the system, or circumstances that were not anticipated in standard guidelines repeat themselves, similar errors may continue to occur time after time. Furthermore, this approach makes people avoid thinking about failure, and renders them unwilling to critically consider their work behaviours to search for improvement opportunities in work routines. It enhances tendencies to hide problems that occur, and to become defensive when work practices are challenged.

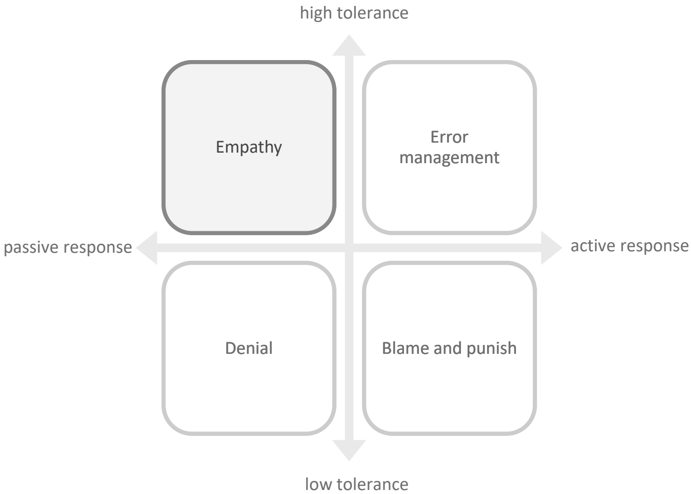
- *An illustrative example from supervisory practice (Nr. 13, see Table 2.1).*

An employee had a leading role in a project that failed. Apart from unforeseen circumstances, errors were made in this project by the employee and by other employees involved. Months after this happened, the employee received negative feedback on his performance from his superior, in the context of a performance review. Although he was aware that his performance in this project had been substandard, he was surprised that he received this feedback only then. The failure of the project was not explicitly evaluated and other causes of this failure, next to the errors the employee made, were not examined. Years later he feels that the errors he made in this project negatively affect his reputation, performance appraisal and career opportunities within the organization. Another employee of the same bank, a colleague, acknowledged this, when proffering his take on the failed project – in which he was not involved. He stated that he knows this employee erred and that the failure of the project was apparently his fault. But what error exactly had been made by the employee responsible for the project, was unclear to this colleague. He indicated that there was no transparency about what happened on this project, and consequently, no one else had the chance to learn from what went wrong there. The colleague confirmed that the reputation of the employee was damaged, although the blame of the failed project on the employee stayed implicit. The colleague felt that everyone knows there were issues, but no one talked about it. As a result, the employee did not get the chance to clear his reputation and move on.

*Empathy*

A second ineffective approach towards errors is – again - a passive response, in combination with an acceptance of errors (see Figure 8.4). As in the former approach, nothing is done or organized to evaluate errors and learn from them. Contrary to the former approach, however, in this case the fact that mistakes can happen and failure occurs is accepted. In this approach, errors are tolerated and seen as an inevitable aspect of reality. There is sympathy for the ones who are involved in making the error. However, nobody acts to use these experiences of failure for the better.

***Figure 8.4.*** *Error approach 'Empathy'*




Although there is some understanding for the fact that errors occur, the conditions leading up to undesired outcomes are not assessed for improvement opportunities. This induces employees to respond passively and makes them lax towards errors and other problems at work. As long as their shortcomings at work are simply accepted, and management does not signal these shortcomings, they are not particularly motivated to prevent work behaviours of themselves or others that may lead to problems later on or to help each other to do a better job. Their experience is that work routines are not changed or improved, even when errors are made (repeatedly).

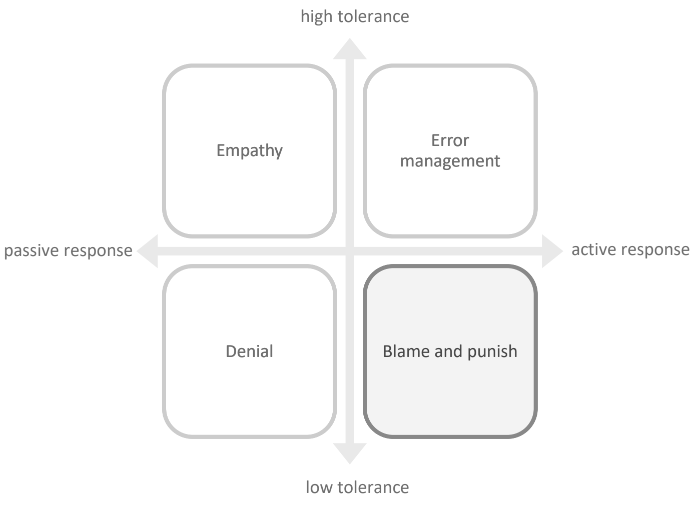
- *An illustrative example from supervisory practice (Nr. 7, see Table 2.1).*

  A chair of a management team in a bank was known for covering up detrimental social behaviour of team members. The underlying mindset of his reluctance to speak about this detrimental behaviour consisted of two assumptions. When asked about this, he explained that in his view giving feedback on behaviour was inappropriate. In his view, individuals have their own 'professional responsibility' in how they act. He did not think it was his place, as chair of this team, to say something about behaviour of individual employees, as he considered individual behaviour as reflecting stable differences in personality. "*That is just the way he is*". In this line of thinking, talking about this behaviour, or giving feedback to someone who behaves inappropriately, has no use. This chair of the management team did not believe that behaviour in a professional context could change. He accepted the occurrence of errors as a part of professional reality and made no effort to change either the individual or the situation to prevent future errors. This example might seem an exceptional case of incompetent leadership. Yet, this was a chair of a senior management team within a significant bank, who had been in this position of key decision maker for years.

*Blame and punish*

Banks may intensify supervision and controls, and increase sanctions for mistakes that are made, to communicate that errors are not acceptable, and to deter individual workers from making future errors (see Figure 8.5). Whilst this is a common response of banks when things go wrong, it is an ineffective response since the imposition of (deterrence) sanctions generally undermines employee trust and reduces rule compliance (Mooijman *et al*., 2015; Tenbrunsel & Messick, 1999).

***Figure 8.5.*** *Error approach 'Blame and punish'*



In this third ineffective error approach of blame and punish, errors are not tolerated and they are responded to in an active manner by increasing sanctions for individual employees or a group of employees involved in making the error as the targets for deterrence. The primary responsibility for any errors made is placed with individual employees, regardless of the circumstances leading up to these errors or the broader organizational context in which these were made. In this approach, the standard response to errors is to increase sanctions for individuals or groups of employees involved in making the error. This primarily creates fear of the consequences of errors for the individuals involved (Van Dyck *et al.*, 2005; Mooijman *et al.*, 2015). It makes it unsafe to talk about errors or even to acknowledge that errors have occurred to evaluate them. Therefore, this error approach in fact stimulates the tendency to cover up errors, making it less likely that something is actually learned from them (Van Dyck *et al.*, 2005). When the quality of work behaviour is seen as the responsibility of individual workers alone – while leadership takes no responsibility for allowing or inviting these behaviours - this raises anxiety and stress, and reduces the willingness to comply with organizational regulations.

- *An illustrative example from supervisory practice (Nr. 14, see Table 2.1)*

  A senior manager who was responsible for an error explained how his executive board had reacted in this particular situation. This executive board had called in the senior manager as soon as an error made under his authority was discovered. In strong words – including swearing - he was summoned up to the board floor. The senior manager dreaded these calls and what would come next. Facing the executive board, he was personally blamed for the error that was made in his division. The executive boards' response to errors had a negative effect on him. The senior manager felt oppressed by the executive boards' responses to failure. He indicated feeling stressed and powerless as errors will continue to be made under his responsibility in the future, and he will suffer the shameful consequences.

### 1.2 How ineffective error approaches facilitate misconduct

All three ineffective approaches to performance errors – denial, empathy and blame and punish - can contribute in their own way to the emergence and continuance of unethical behaviour. How teams or organizations approach and handle errors – whether errors are hidden or discussed and evaluated openly – also influences how individual employees approach and handle errors (Frese & Keith, 2015, Van Dyck *et al.*, 2010, Van Dyck *et al.*, 2005, Cannon & Edmondson, 2001, Hofmann & Mark, 2005). This relates to employees' beliefs or experiences regarding the common responses to errors within the team or organization. These beliefs and experiences in turn influence their behaviour. Cannon and Edmondson (2001) argue that people hold tacit beliefs about failure and responses to errors. People within teams and banking organizations talk to each other, interact and communicate about courses of events and reactions of managers to failure or mistakes. This collective sense making is an important source of shared beliefs on failure (Morrison *et al.*, 2011). The relation between these shared beliefs on failure (e.g. 'it is not easy to discuss mistakes' and 'problems cannot be addressed quickly') and their ethical behaviour was empirically demonstrated (Cannon & Edmondson, 2001).

Low tolerance for errors – that characterizes the 'denial' and 'blame and punish' approaches – makes the occurrence of errors more negative to people. Making an error often leads to stress and negative emotions (Heimbeck *et al.*, 2003). Negative emotions and stress as a result of failure can be sources of new errors in themselves and distract people from analysing the error made, hindering a learning effect. An ineffective approach to errors contributes to employees feeling more negative emotions and increased stress when they make a mistake or fail to accomplish something. In addition, employees are more distracted by stress caused by errors (Hofman & Mark, 2006).

Furthermore, another mechanism related to negative emotions as a result from failure, underlies the tendency to ignore or deny errors. This mechanism refers to one's ability to balance the tendency to correct and prevent errors with the will to learn from them. When a mistake is made, preventing the error next time is often focused on. A first response is to hide or cover up a mistake and energy of the one making the error goes to negative emotions such as shame and guilt. The person making the error feels self-conscious. When negative emotions following the error inhibit people to balance between correcting their mistakes and learning from them, they focus on themselves instead of focusing on improvement. Their cognitive resources are wasted on self-focused attention when errors are approached with a rigid focus on prevention (error averse) (Homsma *et al.*, 2007 (a); Van Dyck *et al.*, 2010).

Finally, when errors are denied or punished, people within an organization are reticent to speak up and are concerned that raising issues will be ineffective (Morrison *et al.*, 2011; Edmondson, 2003). A culture where people do not feel safe to speak up is a result of social interactions and collective sense making of prior experiences people have with speaking up. People look out for social cues from the past about the potential consequences of their 'voice behaviour'. If voice behaviour is responded to by the organization with punishment, ridicule or bad evaluations, people within that organization will think twice before they utter opinions on practices they feel uncomfortable with.

Ineffective error approaches allow or invite errors to occur in the future through different underlying processes such as those related to the experience of stress and negative emotions such as guilt and shame. Furthermore, the three ineffective error approaches as discussed impair open communication on errors and team members speaking up on issues or mistakes. These negative effects of ineffective error approaches facilitate unethical behaviour. As I explained in Chapter 2, my conceptualization of misconduct refers to *intentional* unethical behaviour, whilst error refers to *unintentional* performance failures. I argue that ineffective responses to unintentional errors pave the way for intentional unethical behaviours. Employees who experience stress and negative emotions such as shame resulting from ineffective responses to errors, are inclined to explore ways to resolve these negative emotions which could lead to an increased need to save face by financially performing well. This increased need to perform in combination with a lack of open communication on errors, could create an environment where unethical behaviour is more likely and less visible. I argue that ineffective approaches to unintentional errors therefore create a '*slippery slope*' to intentional unethical behaviour to occur. Gronewold, Gold and Salterio (2013) showed that team members tend to behave less ethically in a team with an ineffective error approach, by examining this amongst auditors reporting errors they discovered themselves. When these auditors could easily choose to ignore or not to report errors that were made, this ineffective error approach reduced the likelihood that self-discovered errors were reported. This was different when errors were approached openly and constructively in the company, so that employees felt their error reports would be seen as a way to increase work effectiveness (Morrison *et al.*, 2011; Edmondson, 2003). On the basis of this theory and prior research I argue that ineffective error approaches discourage team members to discuss concerns they may have or to improve faulty business practices. Instead, these error approaches invite workers to cover up errors that are made instead of confronting and redressing them. These effects of ineffective error approaches contribute to the occurrence and persistence of unethical behaviour at work.

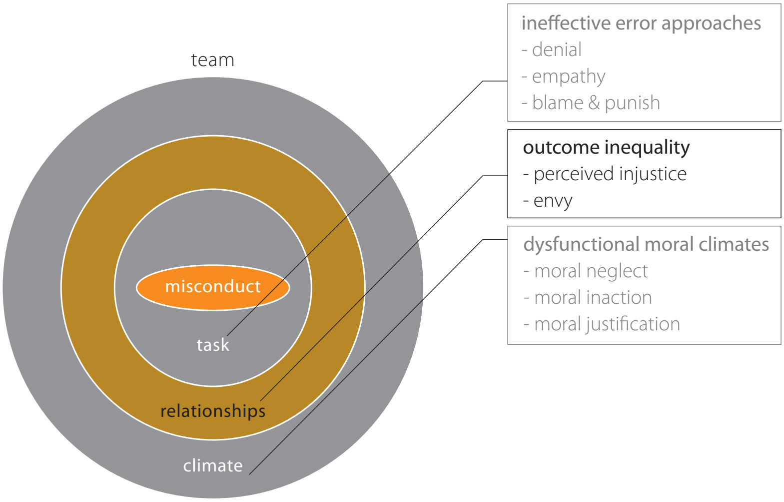
Based on the reviewed theory, I argue that assessing error approaches as a characteristic of team climates adds value to preventing future misconduct within banking. In Study 3 (Chapter 9) I will examine whether team climates can be identified and assessed on this characteristic. Furthermore, I argue that by improving error approaches within for instance trading teams, can mitigate the risk of future misconduct by team members. Improving error approaches involves first an increased awareness and deepened understanding by (senior) leaders of the variation in error approaches and their potential detrimental effects. Second, it requires an active approach to assess the current error approach in a team, and depending on the assessment findings, improve the way a team deals with errors. In Part IV, Chapter 10, I elaborate on these preventive approaches in more detail.

### 2. Outcome inequality: unequal relationships leading to perceived injustice and envy

In addition to ineffective error approaches, the way a team deals with outcome inequality can facilitate misconduct. Inequality in outcomes occurs whenever people work together in a team (see Figure 8.6). Team members do not receive the same salary, bonuses or opportunities for promotion or professional development. Different tasks are allocated to team members and often some tasks are perceived as more enjoyable, interesting or status enhancing than others. In day to day work, outcomes as income, promotions and tasks are not allocated equally over all team members.

Unequal outcomes within a team easily raise feelings of dissatisfaction and perceived imbalance. Especially when the inequality is (too) large, and the justification for these large outcome differences remains unclear. If not managed well, emotional consequences of outcome inequality can contribute to or evoke unethical behaviour of team members. This chapter introduces two emotional consequences of outcome inequality and elucidates how these emotional consequences can facilitate misconduct.

*Figure 8.6.* *Outcome inequality*




## 2.1 Negative emotional consequences of outcome inequality

My conceptualization focuses on two emotional consequences of inequality – through social comparison - that can lead to unethical behaviour: perceived injustice and envy. Before elaborating on these two emotional consequences, I explain the underlying process of social comparison.

*Social comparison*

Traders within a team, as all humans, compare themselves to each other (Festinger, 1954). This process, called social comparison, is inevitable in social interaction and thus a basic aspect of organizational life (Duffy, 2008; Brown *et al.*, 2007; Greenberg, 2007). According to Adams's (1965) equity theory, employees evaluate the fairness of their situation by comparing the ratio of their own inputs and outcomes with the ratio of inputs and outcomes of a co-worker. Employees compare themselves to others, for instance when their performance is evaluated by superiors relative to each other (Mumford, 1983) or when employees know how their pay compares to that of others (Blysma & Major, 1994). These comparisons increase when there are no objective standards on when performance or pay is perceived as 'good' or 'good enough'. When ambiguous standards lead to insecurity of team members, they use the process of social comparison to value their own inputs and outcomes (Festinger, 1954).

A trader can compare him/herself with a co-worker who is better off, called upward social comparison, or who is worse off than him, an example of *downward* social comparison (Brown *et al.*, 2007). Motives for these types of comparison differ. Through downward social comparison an individual feels better about him- or herself in comparison with a co-worker who is worse off. Upward social comparison can be driven by a motivation to learn from the other who is better off. However, when the team member experiences low autonomy and control in his or her job, comparison with a colleague who is better off can induce perceived inequality. Perceived inequality resulting from social comparison is aversive and painful (Brown *et al.*, 2007; Tai *et al.*, 2012; Festinger, 1954).

Box 7. Example of emotions when receiving a bonus

*People responded (to bonus award information) in one of three ways when they heard how much richer they were: with relief, with joy, with anger. Most felt some blend of the three. A few felt all three distinctively: relief when told, joy when it occurred to them what to buy, and anger when they heard others of their level had been paid much more.* – From Michael Lewis' book Liar's Poker (p. 201) on investment banking, as quoted by Duffy (2008).

A competitive environment as can be found in the banking industry drives the negative emotional effect of (upward) social comparison processes (Brown *et al.*, 2007). Incentive structures influence the level of social comparison and competitiveness (Garcia *et al.*, 2013). The banking industry has a tradition of incentive structures in which a relatively high proportion of income depends on variable performance indicators. This induces substantial pay inequality within banks and teams within banks such as trading teams. Traders compete with each other for superior performance appraisals, which are linked to the incentive or bonus system, and determine career development opportunities. Although performance management systems aim to provide an objective standard to be used in performance reviews, in reality their performance is reviewed relative against the performance at the desk. These performance incentive systems, and how these are used in practice, thus invite individual workers to compare their efforts and outcomes against each other (Bylsma & Major, 1994; Mumford, 1983) and therefore enhance the possible detrimental effects of social comparison processes at work.

Performance incentive systems used in trading environments, and banking in general, are often result oriented. The key performance indicators used to assess performance are focused on results – i.e. profit and loss, or 'P&L' - and not so much on the efforts and actions the trader took to reach that P&L. In a markets business, fluctuations of the market can be unexpected. A trader acts upon these market dynamics, and, whilst a trader might be able to predict these changes depending on skill and experience, he or she cannot control these market dynamics and therefore cannot fully control his or her financial performance. Since this financial performance is often the key indicator for a positive performance review, hence a bonus, this can create a sense of helplessness and insecurity. The 'relief' felt in the example in Box 7 illustrates the tension a trader might feel around performance appraisal and bonus allocation. When tension or stress distracts a trader from his or her tasks, or hampers the quality of his or her decision making, this tension can be counterproductive for business. And, as discussed in paragraph 8.1.2, stress can result in errors and even unethical behaviours.

*Perceived injustice*

Substantial inequality in pay, performance appraisals and promotion opportunities within a trading team, are likely to lead to feelings of dissatisfaction (Brown, *et al.*, 2007; Greenberg, 2007). This inequality induces through social comparison processes perception of unfairness. When for instance relatively small performance differences can lead to large differences in outcomes, team members can feel unjustly treated by their supervisors or managerial authorities making performance appraisals (Ambrose & Cropanzano, 2003; Bies & Moag, 1986; Cohen-Charash & Spector, 2001).

Perceptions of injustice can stem from distributive, procedural or interactional concerns (Cohen-Charash & Spector, 2001). Distributive justice refers to the perceived justice of outcomes that individuals receive (Greenberg, 2007). These outcomes can for instance relate to height of pay and bonus (i.e. 'expecting 30% of fixed salary a priori whilst receiving 12,5%'), promotion decisions, decision on task allocation (i.e. 'who gets to do certain clients or transactions') and acknowledgement and praise. This concerns in a trading context for instance the decision to promote a team member, or the height of a bonus.

- *An illustrative example from supervisory practice (Nr. 15, see Table 2.1)*

  A trading-desk manager explains during a supervisory interview, that he perceives large income inequality within his team. "*I earn disproportionally more than my juniors*". He continued with his perception that this skewness is perceived as unfair by traders within his team. According to him, the juniors think "*Stop preaching to me, with your income you do not need to worry about making more money like I do*".

Procedural justice, defined as the perceived fairness of the process by which outcomes are determined (Lind & Tyler, 1988). Procedural justice concerns in this context for instance the extent to which (desk) managers come to these outcomes in a fair manner. As stated above, when uncontrollable market dynamics have impacted financial performance negatively and resulted in a lower bonus than expected, this can be perceived as unfair by a trader. His or her efforts and actions taken to achieve that financial result is outweighed by the actual (disappointing) result. Another example of procedural justice concerns situation where desk- heads receive credit for the financial performance of the desk whilst the efforts of individual traders that they took to achieve this outcome is insufficiently recognised.

Finally, interactional justice is an extension of procedural justice, and refers to the perceived fairness of the way management is behaving towards the trader in question (Bies & Moag, 1986). For example, did management explain how performance was reviewed, how bonuses were allocated or what exactly led up to a decision to promote a colleague over another? It concerns for instance whether a trader feels his desk manager treats him with honesty and respect. Managerial behaviour is here a signal of fairness (Vecchio, 2000). Perceived unfairness here can result from managers stealing ideas or taking credit for profitable business decisions.

- *An illustrative example from supervisory practice (Nr. 16, see Table 2.1)*

  A trader recalls during a supervisory interview that he was treated unfairly by a former manager. The trader had approached his manager about a proposed transaction. The trader felt that this transaction, requested by a client, included taking high risk for the bank. He therefore suggested to his manager to call a joint meeting with the compliance officer to discuss the level of risk, before deciding on next steps. His manager agreed to the traders' suggestion. During the meeting with the compliance officer, the manager and the trader, who brought a colleague from his team involved in the proposed transaction, the manager led the compliance officer to believe that he himself signalled the excessive risk and urged for the meeting to happen. The trader felt betrayed and stated to the supervisor during the interview: "*He made us look like we were criminals! I never have been so angry*". This example of interactional injustice still caused the trader to recall the situation vividly and show distress whilst discussing it.

The three kinds of perceived justice as described above are interlinked. Ambrose and Cropanzano (2003) have introduced a 'monistic approach' that treats distributional, procedural and interpersonal justice as one construct, showing that they represent outcomes that are not mutually exclusive and occur simultaneously. Thus, whilst there are three different kinds of reasons for perceived injustice, the impact of the perceived injustice is alike. As I will elaborate on in paragraph 8.2.2, this perceived unfairness can form a root cause of unethical behaviour.

*Envy*

Social comparisons and perceived inequalities may cause people to experience *envy* (Duffy *et al.*, 2008). As with perceived injustice, there are some organizational or contextual 123 antecedents of this emotional consequence of inequality. Envy in the workplace is easily elicited by perceived inequity in financial outcomes (Tai *et al.*, 2011) and is fuelled by competitive reward structures (Vecchio, 2000; Duffy *et al.*, 2008). Studies by Vecchio (2000, 2005) revealed also other contextual antecedents of envy, namely the employee's autonomy (the less autonomous, the more envious) and considerateness of leadership (the less considerate, the more envious). Consequently, envy arises easily amongst employees and between employees and management in organizational contexts where there is outcome inequality and competitiveness (Moore & Gino, 2013; Vecchio, 2000, 2005) as a result of unfavourable social comparisons and perceptions of unfair outcomes (Cohen-Charash & Mueller, 2007). Cohen-Charash and Mueller (2007) for example showed in their experimental study that, when envy is experienced in unfair situations, counterproductive work behaviours are augmented. Schaubroeck and Lam (2004) examined envy amongst Chinese tellers of Hong Kong branches of an international bank who were considered for promotion to teller supervisor. The most talented tellers were moved into management, and a commission including their management and HR made these promotion decisions. A month after the promotions the rise of envy amongst the tellers who were denied promotions was measured. Finally, studies of neurological activity (Takahashi *et al.*, 2009) demonstrate that envy is genuinely painful. In these studies, MRI's evidenced that parts of the brain that process social pain were activated when experiencing envy.

Envy and perceived injustice are related: envy is higher when the situation is perceived as unfair (Cohen-Charash & Mueller, 2007; Shaubroeck & Lam, 2004). Also, envy can lead to social undermining behaviour such as spreading rumours about colleagues and failing to defend a colleague. (Duffy *et al.*, 2012, Vecchio, 2005). Envy motivates employees to reduce the perceived superiority of the one who is envied. Social undermining behaviours can serve that purpose and simultaneously help to channel feelings of hostility (Cohen- Charash & Mueller, 2007, Duffy *et al.*, 2012). These social undermining behaviours could in their turn feed into perceived (interactional) injustice by the ones being socially undermined.

### 2.2 How negative emotional consequences of inequality facilitate misconduct.

Both perceived injustice and envy can facilitate unethical behaviour. Perceived injustice in outcomes or treatment makes people feel disrespected by organizational authorities (Lind & Tyler, 1988; Vecchio, 2000). Research shows that perceived injustice elicits dysfunctional work behaviours, such as organizational retaliation behaviour or lack of compliance with relevant guidelines (Cohen-Charash & Spector, 2001; Zoghbi *et al.*, 2014). As negative reactions to perceived injustice, behaviours such as theft, sabotage and retaliation have been demonstrated (see for an overview of these behaviours: Cohen-Charash & Mueller, 2007). Greenberg (1990) for instance found that as a reaction to perceived underpayment inequity, employee theft increased. When workplace practices are perceived to be unfair, employees are more easily tempted to reframe theft as an earned 'benefit'. This is especially true when traders compare themselves unfavourably to others (Cohen-Charash & Mueller, 2007). Through this mechanism, variable performance incentives raising perceptions of inequality can be a root cause of misconduct.

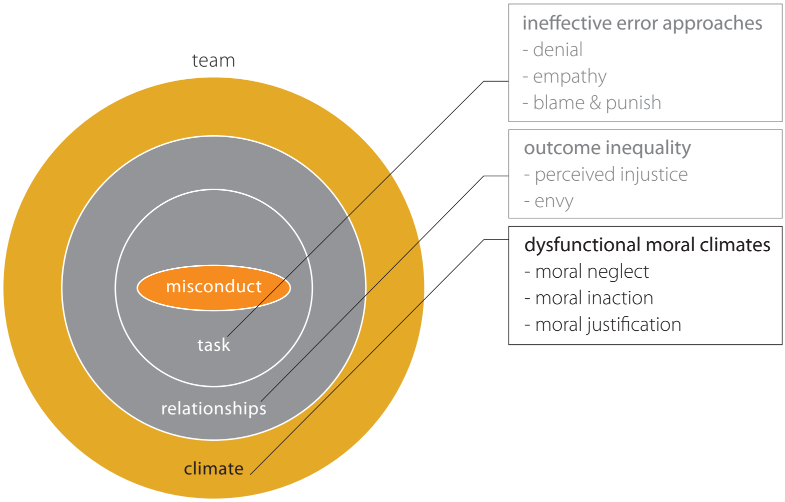
Envy can lead to the justification of unethical behaviour by believing that this behaviour helps to 'restore equity' (Moore & Gino, 2013). Furthermore, envy evoked by inequity causes team members to be motivated by the desire to aggress against the inequity and the team mates envy (Vecchio, 2000). Research showed that envy leads to dishonesty and damaging behaviour (Gino & Pierce, 2009), for instance by withholding information or sabotaging others at work (Duffy *et al.*, 2008; Cohen-Charash & Mueller, 2007).

In sum, prior empirical evidence suggests that perceived injustice and envy can facilitate misconduct. I argue that assessing inequality and its negative emotional consequences as a characteristic of team climates, adds value to preventing future misconduct within banking. In Study 3 (Chapter 9) I will examine whether team climates can be identified and assessed on this characteristic. Furthermore, I argue that reducing actual outcome inequality such as income differences within teams and banking organizations (Vecchio, 2000) can mitigate misconduct risk. Also, emotional consequences of inequality such as perceived injustice and envy can be managed in a way that mitigates the risk of these emotions resulting in unethical behaviour. In Part IV, Chapter 10, I elaborate on these preventive approaches in more detail.

### 3. Dysfunctional moral climates: neglect, inaction and justification

A third element I want to consider besides ineffective error approaches and the injustice of outcome inequality is the moral climate within a trading team (see Figure 8.7). This team climate characteristic can also facilitate misconduct. Moral climate refers to the way the team typically deals with the moral dimension of its work: which decisions and actions are considered 'right' or 'wrong'. Trading decisions are not straight forward: they may be complex, relying on changing market dynamics, taken under time pressure and leading to uncertain outcomes. Different stakeholders are involved, long-term implications are not always clear, and doing what is right for a client may contradict guidelines endorsed by others (e.g., regulatory requirements). Thus, in a trading context, knowing what decisions are 'right' or 'wrong' may be challenging and not straight-forward. In such instances, the importance of what our colleagues perceive as 'right' and 'wrong' rises.

*Figure 8.7.* *Dysfunctional moral climates*




Members of the same group or work team help us define what is moral and considered ethically good (Ellemers & Van der Toorn, 2015; Ellemers & Van den Bos, 2012; Haidt, 2001). Shared moral values tell us what is considered ethical, and specify how we should behave to be respected as a loyal team member (Ellemers *et al.*, 2013; Rai & Fiske, 2011). This is also the case for traders (Cohen & Morse, 2014). Over time, characteristic group values can be internalized and affect people's moral convictions (Manstead, 2000). Moore and Gino (2013) argue for this 'social nature of morality' and explain how this can overrule individual moral norms as we lose sight of our own 'moral compass' (Gino & Galinsky, 2012; Moore & Gino, 2013). Our 'inner voice that tells us what we should and should not do', as Moore and Gino (2013) put it, is under the influence of the group we feel we belong to. In sum, evidence from psychological research demonstrates that internal moral standards are shaped by the groups we belong to. Hence the moral climate within a specific work team impacts on the moral behaviour of its members. This chapter introduces three dysfunctional moral team climates and elucidates how these moral climates can facilitate misconduct.

### 3.1 Dysfunctional moral climates

My conceptualisation of morality follows Moore and Gino (2013) and distinguishes three types of moral climate within teams that facilitate unethical behaviour. These moral climates foster (a) *neglect* of the moral content of actions, (b) *failure* to behave morally, and (c) *justification* of immoral actions. Below, these three types of dysfunctional moral climates are explained.

*Climate of moral neglect*

The mildest form of dysfunctionality is moral neglect. Moral neglect refers to a team climate that allows team members to remain unaware of the moral content of decisions, or the moral consequences of actions (Moore & Gino, 2013). Paragraph 8.3.2 elaborates on the way this team climate of moral neglect is facilitating unethical behaviour.

The organizational context can invite or enhance moral neglect through for instance organizational goals and socialisation (Moore & Gino, 2013). Organizational goals such as pressure on revenue, reducing costs and growing a business can direct behaviour in a way that undervalues the moral content and implications of decisions and actions (Grant, 2012). Socialisation refers to the process of new employees within a team to have them adopt social norms within that team – this can happen even if these norms are morally corrupting (Ashforth & Anand, 2003). Organizational socialisation, rule orientation and goals can support a team climates of moral neglect, though a process of 'moral fading'. That is, the moral content of decisions is not considered or is a 'blind spot' for a team and its members (Tenbrunsel & Messick, 2004), because the focus is on business or legal concerns (i.e. rules) only.

- *An illustrative example from supervisory practice (Nr. 17, see Table 2.1)*

A middle manager, overseeing several trading desks that carry out transactions in the oil shipping industry, reflects during a supervisory interview on the alignment between his work and his moral values. He concludes a certain misalignment by stating "*It is kind of strange isn't it... I work in oil, but I personally do not think it is good for our climate and environment*". Within the bank where this manager was employed, financing and handling transactions around oils shipping was a growth market, driving excellent revenue for the business line. Although the supervisory interview did not explicitly address the organizational drivers of this misalignment, it seems plausible that the organizational goal of business advantages of engaging with this industry blinded those involved to the moral implication of financing oil shipping. These moral implications are neglected, as they are not seen as a valid concern for doing business in this industry.

Next to organizational drivers of moral neglect Moore and Gino (2013) highlight social psychological drivers of this dysfunctional moral climate. Social or shared norms within teams that neglect morally relevant consequences facilitate moral neglect (Churchland, 2011). An example of such a social norm could be that a trading desk collectively think that credit risk is covered by the credit team and is not owned by the traders, disregarding that they have a responsibility in managing credit risk in each transaction. If these 'local' shared norms do not address or include moral aspects of decisions, this dampens moral awareness.

Next to social norms, social categorization is a social psychological mechanism that leads to traders distinguishing between their own team (the *ingroup*) and other teams or others (the *outgroup*) (Hogg, 2007,). This mechanism of social categorization can drive moral neglect (Moore & Gino, 2013) in two ways. First, it can lead to a psychological closeness to the team traders identify with (their ingroup), and through this process we can be blinded to the implications or mere nature of unethical behaviour of their teammates (Gino, Ayal, & Ariely, 2009). Second, it can lead to a psychological distance to others outside their own team, as for instance other teams and stakeholders such as clients. Because of the social categorization mechanisms, the well-being of these 'outgroup others' is less important than the well-being and interests of the ingroup. This psychological distance to others outside the team traders identify with can be augmented by the general tendency within trading businesses to work long hours and be focused on work and markets outside of the trading floor as well. This may create traders to work 'in a bubble', with little outside-in perspectives.

*Climate of moral inaction*

Moral inaction refers to the failure to behave ethically even when realizing that the behaviour is unethical. In contrast with moral neglect, this is because when a team member is aware of the moral content of his actions, he or she feels unable to follow through with the ethical behaviour that is required (Moore & Gino, 2013).

A possible driver for a climate of moral inaction is obedience to authority (Moore & Gino, 2013). A study showed for instance that participants obeyed the request of supervisors to discriminate against potential employees, regardless and independently of their own beliefs about race (Brief *et al.*, 2000). In addition, Moore and Gino (2013) highlighted social conformity and diffusion of responsibility as social psychological drivers of moral inaction. Through a process of social conformity, individuals often conform to the decisions and behaviours of their team members (Asch, 1955). Asch showed in his research that individuals go along with the perception of a group, even when this contradicts their own perception. This process could contribute to a climate where team members do not act when they are aware of immoral behaviours. For example, when a trader thinks a certain transaction is unethical, he will be less inclined because of social conformity mechanisms to act upon his own judgement when the majority of his colleagues at the desk perceived this transaction as being ethical. Diffusion of responsibility also reduces the likelihood of team members to act in case of immorality. Team members are less likely to respond to immoral behaviours that they observe, when others are observing these behaviours with them and do nothing (Darly & Latané, 1968). This 'bystander effect' and social conformity both could explain low whistleblowing numbers. A plausible explanation for low whistle blowing numbers is that employees are reticent to report unethical behaviour when the majority in their professional context shows this behaviours. Research shows that less than half of a team that see immoral behaviour would report it (Rothschlid & Miethe, 1999).

- *An illustrative example as reported in the media*

The Financial Times article on Kweku Adoboli referred to in the Introduction offers a quote from one of Adoboli's colleagues that appears to indicate a climate of moral inaction. This colleague told the author of the FT article that Adoboli was the man to turn to if you had screwed up. He would fix it for you, and "*We didn't know how he did it, but we didn't want to know*". This quote suggests that the colleagues of Adoboli were aware that the solutions Adoboli found were potentially unethical. Nevertheless, this awareness did not prevent them from consulting him for help nor did they address or question his ways. In fact, this quote indicates that Adoboli's team mates consciously chose to remain ignorant.

*Climate of moral justification*

Moral justification refers to the tendency to reframe immoral actions in a way that distorts individuals understanding of the moral content of their actions (Moore & Gino, 2013). A climate of moral justification refers to a team climate that allows team members to reframe immoral actions as defensible.

A possible driver for a climate of moral justification is group loyalty (Ashforth & Anand, 2003). Pershing (2002) for instance showed that within the U.S. Military, loyalty to fellow officers provided a justification to normalize officially prohibited behaviour. Moore and Gino (2013) argue that self-verification facilitates moral justification. Self-verification induces team members to verify their existing view of themselves (Swann, 1983). As we would like to see ourselves as moral (Cohen & Morse, 2014; Vecchione & Alessandri, 2013), the need for team members to self-verify may lead to them regarding their behaviour as ethical and thereby motivate them to justify unethical behaviour of themselves and others. Next to self-verification, moral justification can be driven by unfavourable social comparisons (Monin, 2007). In line with outcome inequality – as described in paragraph 8.2 – negative emotional consequences of social comparisons could serve to justify immoral behaviour.

- *An illustrative example as reported in the media*

A climate of moral justification in trading was observed for instance when traders involved in the Libor manipulation stated that "*Everyone knew*" and "*Everyone was doing it*" (see Box 1 in Chapter 1). In their perception, the widespread awareness and occurrence of the manipulation implied it was morally acceptable.

### 3.2 How dysfunctional moral climates facilitate misconduct

The climates of moral neglect, moral inaction and moral justification all increase the risk of unethical behaviour or misconduct (Moore & Gino, 2013; Kish-Gephart, Harrison & Trevino, 2010). In a team climate of moral neglect, a trader might fail to recognize the moral consequences of his or her actions. This makes it easier to behave unethically, free from psychological distress, guilt, or regret. As paragraph 8.3.2 explained, a possible driver for a climate of moral neglect is the nature of 'local' shared norms that neglect morally relevant consequences (Moore & Gino, 2013; Churchland, 2011). If these shared norms within a team do not address or include moral aspects of decisions, this dampens moral awareness and reduces vigilance against possible unethical behaviours. When a trader is unaware of the moral content, unethical behaviour is less psychologically taxing and more likely to occur (Moore & Gino, 2013; Butterfield *et al.*, 2000).

A team climate of moral inaction obviously leads to unethical behaviours – failing to act morally can imply to act immorally. The fact that these unethical behaviours remain unchallenged, can be perceived as 'social proof' that these behaviours are acceptable according to the team's moral norms. The more team members behave unethically, the more compelling this behaviour becomes (Goldstein *et al.*, 2008). A more general effect of continued immoral behaviour might be that team members lose their belief in the effectiveness of addressing it. In interviews with traders who had left the trading business, Luyendijk (2015) reports that these traders indicated their frustration about feeling unable to change business practices they considered unethical after their attempts to address these practices. Moral inaction can also result when initial attempts to address immoral behaviour are unsuccessful.

Finally, a team climate of moral justification allows traders to reframe immoral behaviour as defensible. This reduces the dissonance or guilt that may prevent unethical behaviour. The justification of immoral behaviour in the present, paves the way for behaving unethically in the future (Moore & Gino, 2013).

In sum, evidence from prior studies suggests that the dysfunctional moral team climates of moral neglect, inaction and justification can all facilitate the occurrence of misconduct. Based on the insights in the personal and organizational drivers of these moral climates and the way these climates elicit or contribute to the persistence of unethical behaviours, I argue that assessing moral climates within teams adds value to preventing future misconduct in banking. Furthermore, I argue that improving dysfunctional moral climates within teams can mitigate the misconduct risk. This requires an increased awareness and deepened understanding by (senior) leaders of moral climates, their drivers and their possible detrimental effects on ethical behaviour. Based on this understanding moral climates within trading teams may be improved in order to prevent unethical behaviour from occurring. In Part IV, Chapter 10, I elaborate on these preventive approaches in more detail.