EUGENE SOLTES

WHY THEY DO IT

INSIDE THE MIND *of the* WHITE-COLLAR CRIMINAL

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Managing in the Gray

> It is hard to understand why someone who has reached the pinnacle of success would risk all that for more.
>
> —US DISTRICT JUDGE RICHARD SULLIVAN

> You never really understand a person until you consider things from his point of view—until you climb into his skin and walk around in it.
>
> —ATTICUS FINCH, *TO KILL A MOCKINGBIRD*

In 1999, two of the world's leading executive headhunters teamed up to write *Lessons from the Top: The Search for America's Best Business Leaders.* Their book profiled fifty executives who exemplified, in the authors' view, the defining characteristics of great leaders. They encouraged readers "to learn from and pattern themselves" after those they profiled in order to improve their own management acumen. "We are confident in saying," they wrote, "that these 50 individuals are collectively among the very best—and most successful—business leaders in America."

With decades of combined experience, the headhunters had filled hundreds of chief executive positions for the largest and most prestigious multinational corporations. Making their list was a significant achievement. Yet, within just a few years, three of those selected—Kenneth Lay (the chairman of Enron), Dennis Kozlowski (the CEO of Tyco), and Bernie Ebbers (the CEO of WorldCom)—were convicted of white-collar crimes and headed to prison. Three more were charged with overseeing fraudulent practices and collectively fined over $20 million. And Rajat Gupta, the former managing director of McKinsey and Company, who provided a glowing testimonial describing the book as "truly groundbreaking," was himself convicted of insider trading.

The dramatic fall of leaders once held in such high esteem is startling. These were the same people who spoke at university commencements, graced the covers of *Fortune,* and donated generously to charities. They had prided themselves as being role models for employees and aspiring business school students alike. Their failure surprised even those who knew these executives and had watched their careers blossom. My colleague Clayton Christensen remarked of Jeffrey Skilling, his business school classmate and the former CEO of Enron, that "the Jeffrey Skilling I knew of from our years at HBS [Harvard Business School] was a good man. He was smart, he worked hard, he loved his family. . . . When his entire career unraveled with his conviction on multiple federal felony charges relating to Enron's financial collapse, it not only shocked me that he had gone wrong, but how spectacularly he had done so." Each time another celebrated executive unexpectedly descends into the netherworld of criminal activity, we are perplexed and stuck asking "why." Why do they do it?

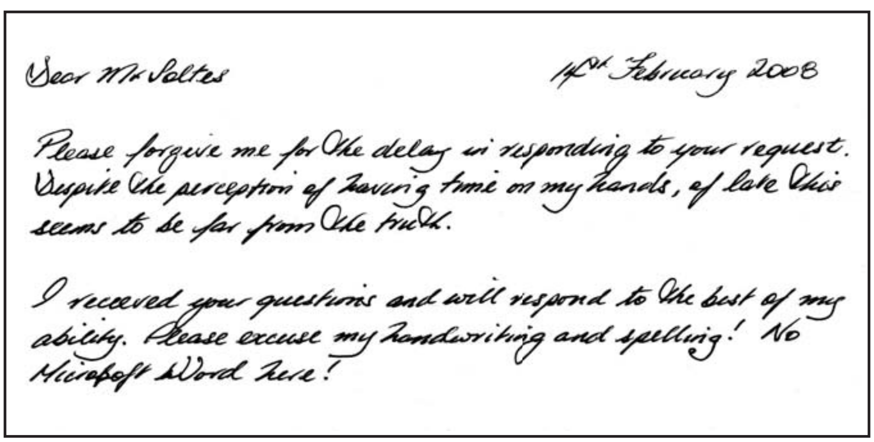
While flipping through the television channels late one evening almost a decade ago, I stumbled across *Lockup* on MSNBC. Somewhere between a documentary and a reality television show, *Lockup* featured interviews with felons at prisons around the country. The inmates described their lives before prison and the circumstances that led them to commit brutal and often violent crimes such as assault, murder, and rape. Not surprisingly, financial troubles, drug addiction, and gang affiliations provoked many of their offenses.

While watching the show, I began to think about a different group of offenders whose motivations were far more puzzling. The names of once-respected corporate titans from Enron, Tyco, and Computer Associates regularly led the business news. Then, as now, it was a rare week when the *Wall Street Journal* didn't feature a story about some miscreant executive. Yet, none of these white-collar offenders lived the harsh lives of those discussed on *Lockup*. In fact, before their crimes, many lived extraordinarily comfortable lives, both personally and professionally. Despite all their privileges, these executives engaged in criminal activities that had deleterious consequences not only for themselves and their families but also for their employees, investors, and companies.

Driven by curiosity, I decided to write to several former executives who were now in prison. I typed a brief letter with the first dozen questions that came to mind. What were the most significant pressures they faced? How did the way they were compensated influence their decision making? What were their intentions once they were released? I found their addresses online using the surprisingly convenient Federal Bureau of Prisons inmate locator website and dropped the letters into the mail the following day. I went back to my other research and soon forgot about my letters.

A month later, I unexpectedly started to receive responses. One executive offered to speak with me if I visited him in prison, another volunteered to discuss over the phone, and several others wrote to say that they would consider carrying on a correspondence by mail.

One particularly poignant response came from Stephen Richards, a former senior executive at Computer Associates. Richards sent me a somber letter written in elegant cursive describing the challenges he had faced in the software industry. As global head of sales, Richards helped backdate contracts that were signed by clients after the quarter officially ended. His actions inflated quarterly earnings and temporarily propped up the firm's



Dear Mr Soltes 14th February 2008

Please forgive me for the delay in responding to your request. Despite the perception of having time on my hands, of late this seems to be far from the truth.

I received your questions and will respond to the best of my ability. Please excuse my handwriting and spelling! No Microsoft Word here!

Introduction to the letter from Stephen Richards.

stock price. When the deception was ultimately revealed, eight executives from Computer Associates, including Richards, were convicted. "Unfortunately the world is not black and white," Richards concluded at the end of his letter. "Senior managers spend most of their life in the gray regardless of their responsibility and that can be a dangerous and hard place to be."

I wrote a case study based on Richards' letter that became part of the MBA and executive education curriculum at Harvard Business School. The intimacy of Richards' comments sparked lively debates. Some students harshly criticized Richards for the ease in which he had succumbed to institutional and market pressures. Others appreciated that what he did was wrong, but also imagined themselves facing similar challenges in their own careers. It was easy to rationalize why Richards deserved to be punished for breaking an accounting rule, but whether a sales contract was dated Friday or Monday didn't create a strong feeling of anger or indignation among many students. There was an uncomfortable disconnect between what we all intuitively felt and what we intellectually believed was right and wrong.

Struggling to resolve these questions myself, I started searching for explanations. I soon found a bewildering number of theories about why white-collar criminals "did it." Some people argued that criminality stemmed from psychological aberration. Others said it might be due to overconfidence or stress. Still others argued that it was simply a result of excessive greed or ambition. Many different reasons were suggested by prosecutors, scholars, and the media, but often with little concrete evidence or support. Much had been written about the decisions that led to these executives' success, but surprisingly little was understood about the choices that led to their downfall.

In the years that followed, I began to correspond with and visit more than four dozen of the most senior executives who oversaw some of the most significant corporate failures in history. Some, like Bernie Madoff, had gained celebrity status and were effectively serving life sentences in prison. Others, like Sam Waksal, the founder of ImClone who was convicted of insider trading, had managed to rehabilitate themselves and reignite their careers. Many I would get to know only from the confines of their cell, but others I spent time with before and after their incarceration, at home and with their families.

Investigating how these former executives made decisions required getting to know them as people—their personalities, desires, and temperaments. I shied away from formal interviews in favor of interactions that were more conversational and casual. We often discussed recent financial news and politics, topics I was teaching in my classes, and books we both read. I sought to place myself in their positions and to understand the world as they saw it. It sometimes took months, even years in several instances, before we developed a relationship that gave them the comfort to discuss their views more frankly. But over time, many removed the superficial veils that they had become accustomed to wearing. These former executives opened up about the frustrations and personal challenges they faced during their professional careers and current predicaments. I was given an opportunity to intimately see how they viewed themselves and the world around them.

Incarcerated and coping with the stigma associated with their criminal conduct, many of these executives were not the confident men they had once been. Life in prison was humbling. "I receive only nine cents per hour as a tutor for inmates studying to take the GED exam," sighed Russell Wasendorf, a CEO who previously ran one of the most successful futures brokerage houses in the United States. "I have to work about six hours to earn enough money for a postage stamp." A few former executives were reluctant to speak about their experience—in some cases, because they, too, were struggling to understand their own behavior.

Several provided commentary that differed from, even conflicted with, their court testimony. In many instances, executives who testified against others in return for leniency were more concerned with appeasing prosecutors than with accurately describing the complexities of working in a highly charged corporate environment in an unbiased way. In court, they often reduced the complexity of the real world to make matters appear black and white. During one discussion, a CEO casually described to me the hours he had spent with his attorney rehearsing how to express contrition in preparation for his parole hearing. While he felt little reason to repent, his attorney advised him that he needed to effectively convey penance to improve his chances of parole. After much practice, the former CEO was soon able to present a convincing, albeit false, display of remorse.

The deliberate distortion of narratives by cooperating witnesses to win over prosecutors not only undermines the judicial process but also contorts our understanding of what the executives thought and felt while their crimes unfolded. During our discussions, however—now that these events were behind them and there was no longer a need to maintain a particular narrative—many described far rawer motivations, emotions, and expectations to me. In these unencumbered discussions, a different and more nuanced picture of why executives engage in malfeasance emerged.

Many people, federal prosecutors, scholars, and media commentators claim that executives make decisions, including criminal ones, through explicit cost-benefit calculation. Although such deliberate reasoning is consistent with the way many business decisions are made, this explanation seems at odds with how these former leaders made choices that eventually led them to prison. Many were not mindfully weighing the expected benefits against the expected costs. If they had been, even the remote chance of being caught and sent to prison, upending their otherwise comfortable lives, would have weighed heavily on their conscience. But I didn't see this. Instead, I found that they expended surprisingly little effort deliberating the consequences of their actions. They seem to have reached their decisions to commit crimes with little thought or reflection. In many cases, it was difficult to say that they had ever really "decided" to commit a crime at all.

I struggled to understand why they didn't anticipate the adverse and often extraordinary consequences of their decisions. Their failure to see the personal and professional consequences of their choices seemed deeply myopic and inconsistent with the very traits that made their prior success possible. Even if they had total disregard for the well-being of others, it seemed inexplicable that they would want to potentially risk their personal wealth, reputation, and family to acquire more. It was not that they simply believed they wouldn't be caught and they could engage in corporate crimes with impunity, either. It was a broader lack of recognition of the consequences of their actions.

Over time, I began to understand the reason for this shortsightedness. They put little effort into these decisions because they never deeply felt that the decisions were actually harmful to themselves or others. Because they didn't perceive this harm, they had little reason to pause and reconsider their course of action. It wasn't that these executives recognized that other people were going to be harmed and simply didn't care. Rather, they never even stopped to consider that their actions would harm, even devastate, real people.

It may seem hard to believe that an intelligent executive could fail to see the harm created by fraud, embezzlement, or price-fixing. To victims, the negative ramifications of such crimes are readily apparent. However, while manipulative corporate conduct has the same financial effect as stealing money from an investor's wallet, there is a crucial difference between these types of crime from the perspective of the perpetrator. Stealing money from another's pocket involves a high degree of intimacy. The perpetrator sees the victim, physically touches his property, and witnesses his immediate reaction after being robbed. But manipulative corporate conduct lacks all these sensations associated with theft. Executives never need to get close—physically or psychologically—to their victims. Instead, the victims of financial crimes often remain distant and amorphous.

The distance between individuals in modern business dealings creates a problem for managers and executives. The human ability to sense the potential for harm is significantly affected by physical and psychological proximity. Just consider your own reaction to harm or suffering. Your instinctive response to seeing those you are closest to suffer produces a much stronger emotional reaction than similar harm caused to strangers. Similarly, if you witness suffering firsthand, you have a much stronger desire to relieve it than if you simply hear or read about suffering in some far off part of the world, even if this suffering afflicts many more people. Proximity deeply affects our instinctive ability to sense and react to harm. As distance grows, our ability to empathize with others shrinks. In business, where many transactions occur at "arm's length" among unrelated parties, there is often no natural tendency to empathize with individuals on the other side of a transaction, let alone those derivatively affected second- or thirdhand. The nature of modern commerce has made it perilously easy to wander into the penumbra—that "gray zone" between right and wrong.

Ultimately, these are not simply tales of hubris, greed, or ambition. While those who falter often display such characteristics, so too do many successful executives whose lives are not described in these pages. This also isn't a story about executives just suffering from psychological aberrations or deploying careful calculated reasoning to motivate breaking the law. Instead, I'll describe people just following their intuitions and primitive gut feelings—poor guides to the straight and narrow in the modern business world.

If this book had been written a hundred years earlier, much of the business misconduct described here would not have been illegal. To the extent that the law prohibited this conduct, violations produced little public condemnation and few prosecutions. Remarkably, just a half-century ago, the public often stood behind executives who were prosecuted for white-collar offenses. Throughout the twentieth century, however, public sentiment grew increasingly unsympathetic toward deceptive business practices and regulators increasingly designed and enforced laws to restrict this behavior. Part I of this book tells the story of how white-collar crime came to be criminalized.

After describing these changes, I begin exploring the "why." For centuries, people sought to explain criminal conduct by appealing to physical aberrations and psychological abnormalities. After researchers realized that individuals were not necessarily bound by their biology, crime became viewed as a choice. Among federal prosecutors, economists, criminologists, and many in the media, cost-benefit analysis became the favored rationale for understanding corporate malfeasance. In Part II, I explore these explanations and how the cost-benefit explanation of executive deviance fails to fit the evidence.

Drawing from research in psychology, neuroscience, legal theory, and philosophy, I then investigate how poor managerial intuitions, rather than failed reasoning, can motivate fraudulent behavior. Explaining misconduct in this way allows us to understand how intelligent, even brilliant, executives can commit fraud—often without perceiving the harm they cause.

The chapters in the final section of the book focus on my conversations with former executives and how they reflect on their actions. Readers especially keen on hearing from these executives can begin with Part III. While the historical circumstances underlying white-collar criminality and the theories explaining this misconduct provide the context for these narratives, the later chapters can be enjoyed without this background.

Some of the conduct described in this book can stir strong emotions. Hearing these individuals describe their actions dispassionately will inevitably inflame these emotions for some of my readers. Although the book is an attempt to better explain why these executives perpetrated these acts, it is emphatically neither a defense of their actions nor an attempt to reduce their culpability. Ultimately, this book represents an attempt to study and hopefully learn from the mistakes they made.

This project has a distinctly personal aspect for me as a business school professor. With few exceptions, no one leaves a leading business school or embarks on a new career with the aspiration of doing harm. And after becoming wealthy, most successful executives don't set out to engage in fraud during the final years of their careers. Yet we sometimes see people of extraordinary talent and promise doing just that. Among the several dozen Harvard Business School graduates who ended up in prison, something must have happened along the way.

In a sense, then, this book is not just about "them" but also about "us." Part of what I hope to illustrate is that the errors made by these executives are ones that we are all susceptible to. Obviously, this is not to say that we'd all necessarily behave similarly if placed in their situation. Rather, my point is that, in our own small ways, we are all susceptible to making the same mistakes as these former executives. Fortunately for us, the consequences are considerably less significant in most instances for ourselves and others. At the same time, by illustrating how we all share certain limitations, I hope the following pages instill some degree of humility.

We devote plenty of time and thought to the factors that contribute to making our careers and personal lives a success but much less time pondering what might undermine these accomplishments. By better understanding how and why these executives failed, I hope that we can begin a more thoughtful dialogue about how we too might err.