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# Doing a Madoff: The Psychology of White-collar Criminals

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This article deals with the problem of white-collar crime—nonviolent financial crimes that include Ponzi schemes, insider trading, fraud, identity theft, copyright infringement and many more. White-collar crime is a major reason why approval and trust in businesspeople have eroded public opinion.

The concept of the "Fraud Triangle" is introduced, identifying three major forces that influence white-collar crime: pressure, opportunity, and rationalization. There is evidence that white-collar criminals spend surprisingly little time thinking about the consequences of their actions.

The article considers the extent to which personality differences play a role in white-collar crime, examining factors like greed, poor self-control, thrill-seeking, narcissism, and psychopathy. Neuro-criminological observations suggest that individuals with psychopathic tendencies show decreased amygdala and orbitofrontal cortex responses to emotionally provocative stimuli.

Concerning the detection and exposure of white-collar crime, journalists and whistleblowers are apparently more proactive than standard law-enforcement agencies. The article concludes with a discussion of the preventive measures that can be taken to pre-empt white-collar crime, including a potentially important role for business schools to play.

Keywords: White-collar Crime; Fraud Triangle; Personality; Narcissism; Psychopathy; Antisocial; Rationalization; Greed Factor; Low Self-control; Thrill-seeking Personality; Neuro-criminology; Whistleblowers; Business Schools

*Government has coddled, accepted, and ignored white-collar crime for too long. It is time the nation woke up and realized that it's not the armed robbers or drug dealers who cause the most economic harm, it's the white-collar criminals living in the most expensive homes who have the most impressive resumés who harm us the most. They steal our pensions, bankrupt our companies, and destroy thousands of jobs, ruining countless lives.*

*—Harry Markopolos*

*My father used to always say to me that, you know, if a guy goes out to steal a loaf of bread to feed his family, they'll give him 10 years, but a guy can do white-collar crime and steal the money of thousands and he'll get probation and a slap on the wrist.*

*—Jesse Ventura*

*It's the classic white-collar crime because it's the old adage, the best way to rob a bank is to work for it.*

*—Peter Henning*

**Introduction**

Here we go again. Yet another financial scandal. The Australian financier Lex Greensill, the founder of Greensill Capital, a company focused on supply chain finance and derivative financial products, has not only filed for insolvency protection, but is also facing legal scrutiny over alleged fraudulent activities. In addition, questions are being raised about Lex Greensill's relationship with Sanjeev Gupta, an Indian-born British businessman whose financial wizardry has also attracted the attention of the financial authorities. The latter, who has been described as “a scrappy outsider on a mission to rescue dying industrial communities” (earning his nickname as the “savior of steel”), is also under investigation. Like Greensill Capital, the viability of Gupta’s extremely opaque empire has been questioned. In the meantime, these two gentlemen seem to have been living the life of Riley with their estates, private airplanes, and luxury yachts. Even as the financial foundations of his empire were falling apart, Gupta bought a six-story mansion in London's upmarket Belgravia for £42 million—albeit in his wife's name.

Reading the account of these people in the *Financial Times*, I was reminded of *The Wizard of Lies,* an American TV biopic of Bernie Madoff whose Wall Street company was one of the world’s largest investment funds. Madoff enjoyed a stellar reputation as a successful and influential financier, broker, financial consultant, and generous philanthropist. Eventually, however, the house of cards he had built fell apart. It turned out that his success as an investor was a sham. In truth, Madoff had built a Ponzi scheme that robbed $65 billion from his unsuspecting victims, making it the largest fraud case in US history. When reality hit, Madoff was sentenced to 150 years in prison. And if that that judgement wasn’t devastating enough, his gigantic fraud had horrific consequences for his family.

The term “white-collar crime” has been associated with the educated and affluent ever since it was first coined in 1939 by criminologist Edwin Sutherland. Sutherland defined it as “a crime committed by a person of respectability and high social status in the course of his occupation."[1] White-collar crimes tend to refer to financially motivated, nonviolent crimes that generally take place in the office environment and involve the manipulation of accounting and finance systems. Typical white-collar crimes include Ponzi schemes, insider trading, fraud, bribery, forgery, money-laundering, embezzlement, cybercrime, identity theft, and copyright infringement. Sutherland also pointed out that, taking a socio-demographical point of view, white-collar criminals are quite different from the typical street criminals, in that they are married, have an above average education and a high income, are regularly employed, are homeowners and have moderate to strong ties to their community, family, and/or religion. To all appearances, they have no reason to commit a crime, but they still do. When their crime is detected, a common reaction is genuine incredulity, such is the faith of others in their integrity and the perceived unlikelihood that they would ever commit such an offence.

However, it is clear to see that white-collar crime is a serious problem. It is estimated that these high-level frauds cost the global economy over US$5 trillion every year.[2] Furthermore, from the point of view of the general public, white-collar crime appears to be a key reason why approval and trust of businesspeople has been eroded. According to Gallup's annual updates, business executives rank near the bottom on a list of professions in a category of perceived ethics and honesty.[3]

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[1] Edwin Sutherland (1949). *White Collar Crime*. New York: The Dryden Press, p. 272.
[2] https://www.crowe.com/global/news/fraud-costs-the-global-economy-over-us$5-trillion
[3] https://news.gallup.com/opinion/gallup/211793/ceos-employees-trust.aspx

Financial costs aside, white-collar crimes often prove to be literally deadly. Consider, for instance, the 1984 Bhopal disaster in India, when a massive gas leak in a pesticide plant contributed to some 8000 deaths and half a million injuries. Or take the Chinese milk scandal of 2008, when it was discovered that top managers of the dairy company Sanlu were fully aware that a toxic compound used in making plastics was being added to its milk products. The contamination led to the poisoning of 300,000 people, mostly infants. Again, the recession of 2008 was a result of the manipulation of the real estate market by Wall Street firms, costing numerous Americans their homes and their savings. While the crude fraud schemes of a few people on Wall Street enabled them to build lavish beach houses in the Hamptons, other people's retirement funds were decimated, causing property values in their neighborhoods to collapse, and forcing over four million people into foreclosure. Another more recent example of fraud is the so-called "diesel dupe." In 2015, car manufacturer Volkswagen was found to have inserted software in 11 million cars that would detect when they were being tested, changing their engine performance to improve their emission test results.

Why did these apparently respectable people do these awful things? What drove them? Did the environment in which they operated make them do it or were they bad apples from the start?

**The Fraud Triangle**

To help us understand such behavior, we can apply the "Fraud Triangle," a conceptual framework commonly used in auditing to help explain the reasoning behind an individual's decision to commit fraud.[4] According to this framework, three major forces are at work: pressure, opportunity, and rationalization.

If we take *pressure*, the question becomes whether a company has strict parameters in place so that people are deterred from committing a crime, even if they want to do so. However, it may well be that these people operate in an ethically challenging environment, where a certain amount of deviant behavior is accepted—a culture of "let's see what we can get away with." In other words, will a person's propensity to become a white-collar criminal depend on how much they associate with other criminals? In a company where unethical and unlawful business practices are par for the course, it can become a form of learned behavior. For example, a company might pressure employees to participate in a crime, under the guise of incentivization, by offering a reward or compensation. If employees believe that they are being ordered to do something wrong, they might not have a sense of personal responsibility. They might think that "others" are responsible.

In fact, the specifics of a situation can play a significant role in determining people's behavior. *Opportunity* is essentially a situation or combination of circumstances that create a pathway toward fraud. For example, opportunities might be embedded in defective internal controls, inadequate accounting systems, a toxic, unethical corporate

[4] Donald R. Cressey (1972). *Other People's Money: Study in the Social Psychology of Embezzlement.* Belmont, California: Wadsworth Publishing Company.

culture, or dysfunctional leadership. In addition, opportunity could be enlarged by perpetrators in positions of authority.

Again, if an enterprise is focused exclusively on profits, white-collar criminals may be able to *rationalize* that whatever they're doing is for the good of the organization. They could use the rallying cry, "Everybody does it." Another form of rationalization is to represent unethical practices as victimless crimes. For example, ethically challenged stockbrokers may view what they are doing as harmless, as there are no direct victims of their actions. The same point can be made concerning inflated claims against insurance companies.

In fact, fraudsters are masters of rationalization, capable of compartmentalizing their feelings and personal ethics, denying responsibility, and absolving themselves from guilt. Extraordinarily, many of them are just as surprised at their egregious behavior as anyone else once the game is up. Whereas in an assault, rape, or robbery, an individual comes face-to-face with a victim, white-collar crimes tend to be more faceless. Quite often, perpetrators never actually interact with, see, or meet the people affected by their unethical practices. They may even go as far as to maintain that the victims had it coming to them, or that the system, the prosecution, the judge, the press, or anyone who condemns them for their actions is to blame. And if that doesn't do the job, another justification could be that they operate according to a superior set of laws or code of conduct. An example would be engaging in criminal activities in the name of their religious beliefs.

Studying the evolution of the behavior of people involved in white-collar crimes reveals that it tends to start small, so small that it may not even look like a fraud. Unfortunately, it generally continues to grow until it comes to bite them. In other words, most of corporate crooks aren't masterminds who carefully calculate their illegal acts, weighing the risks and rewards before embarking on their nefarious activities. In fact, more often than not, they haven't even thought through the consequences of their actions—the tragic story of Madoff being an excellent example of this. Instead, most people reach their decision to commit crime with very little thought or reflection. They never stop to consider that their actions will harm, even devastate, real people.

Many white-collar criminals never need to get close—physically or psychologically—to their victims. In fact, manipulative corporate conduct lacks the degree of intimacy that comes with, say, directly robbing someone. And proximity tends to affect how we assess a situation. With less proximity, the ability to empathize with the potential victims shrinks. Somehow, it creates a degree of detachment. Hence the reason why many of these white-collar criminals fail to see the harm created by fraud, embezzlement, or price-fixing. Still, this begs the question whether a certain kind of person will be psychologically more predisposed to commit white-collar crime—even without pressure. And this question brings us to the people equation.

**The people equation**

To expand the "Fraud Triangle," the idea of the "Fraud Diamond" has been introduced, adding a fourth model component: capability.[5] Fraud examiners have begun to recognize that a combination of personality and circumstances—a delicate "dance" between situational forces and personality dynamics—could help explain why people like Madoff, end up as white-collar criminals.

*The greed factor*

There is a social aspect connected to white-collar crime. From time immemorial, success in life has always been measured by the accumulation of possessions (tools, shelter, an abundance of food and other necessities, and any ancillary items that mark people as successful). Throughout history, these benchmarks of success have remained unchanged. In other words, as a marker of success, many people engage in conspicuous consumption—the practice of publicly displaying wealth rather than merely supplying our basic needs. Some people, however, experience a greater need to parade material objects as indicators of social position, power, and status. But while acquiring new "toys" or "trinkets" provide a temporary high, all too soon these people adjust to their new possessions and, in terms of happiness, are back where they started. It is like they are on a hedonic treadmill, having to work harder and harder to earn more to buy more to maintain the same level of satisfaction. Therefore, considering the greed factor, some people decide to look for short-cuts to maintain their level of satisfaction. Given their extravagant needs, their income is no longer sufficient. As a matter of fact, many white-collar criminals seem to be living way beyond their means at the time of their fraudulent

[5]https://digitalcommons.kennesaw.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2546&context=facpubs

activities, a factor that encourages them to do what they do. So, an attachment to hedonistic behavior, combined with opportune circumstances, can motivate and entice people toward unethical conduct.

*Low behavioral self-control*

When some people are exposed to enough pressure and opportunity, a characteristic like low self-control can facilitate white-collar crime. Of course, exposure to stress can also affect people's self-control and inhibit restraint. If so, it can make some people more prone to lie and to cheat, at least temporarily. In other words, situational forces can affect innate factors, leading to criminal behavior. Generally speaking, however, it is executives with impaired self-control, thrill-seekers who look for instant gratification, who are more likely to resort to risky or reckless behavior and engage in white-collar crime.[6] For people with low self-control, risk-taking can turn into a drug. But like any drug, the effect of a hit soon wears off, so they engage in ever riskier behaviors to get the same high—until they self-destruct.

*Narcissistic disposition*

White-collar criminals can get so caught up in the fact of how easy it is to transgress that they don't think about what might happen if they get caught. The reason they think this way may be related to a narcissistic disposition. Narcissistic individuals are only concerned with what is good for them, what will benefit them, or what will enhance their position. Generally speaking, true narcissists have illusions of grandeur and possibly

[6] https://knowledge.insead.edu/blog/insead-blog/managing-thrill-seekers-4793?ct=14652&ct=14652&ct=14652

exhibitionistic tendencies. They are always on the lookout for uncritical admiration. But their inflated sense of self often hides unexpressed feelings of inadequacy and inferiority. This explains why they're always looking for constant positive reinforcement from others, at every level of life. Narcissists also possess feelings of entitlement. They believe that the rules apply to everyone else—but not to them. And their superior attitude toward others makes them quite convincing, even when they're engaged in fraudulent activities. In fact, because narcissists think that everyone around them is beneath them—and less smart than they are—they are led to the false belief that no one is smart enough to catch them if they engage in crime.

*Corporate psychopathy*

There is also the aspect of psychopathy or antisocial behavior. Clinical psychopathy is characterised by four features: callous affect, interpersonal manipulation, erratic lifestyle, and anti-social behavior.[7] However, in the context of corporate psychopathy, there is also an absence of empathy, guilt, and remorse when people exploit others for their highly personal ends. Basically, corporate psychopaths lack the ability to appreciate the emotional impact of their actions on others. Like true psychopaths, they are less likely to feel the same natural tendencies of guilt or remorse that ought to accompany their wrongdoings. However, people with these antisocial (psychopathic) tendencies—these psychopaths "light"—typically appear quite normal. But the mask of normality hides people who are always on the lookout for opportunities to meet their deep-seated need

[7] Manfred F. R. Kets de Vries (2014). The psycho-path to disaster: coping with SOB executives, *Organizational Dynamics*, 43 (1), 17-26.

for power, status, and money. They are masters at sizing up situations quickly and manipulating others to cooperate with their schemes. Sadly enough, their charm can keep their victims in the dark for quite some time. What's more, even when they are caught, their charm often helps them to talk their way out of the criminal activities in which they are engaged. Many successful fraudsters have the ability to lie convincingly lie and convince themselves of their lies. Not surprisingly, people with this kind of personality makeup are often quite successful in large organizations, which are great places for them to hide. In reality, however, their apparent success flows all too often from a series of subversions, betrayals, and nonstop rule breaking. Corporate psychopaths in senior positions, given their talent for persuading and manipulating others, can influence the moral climate of entire organizations—that is, alter the scope of what are perceived as acceptable norms and behaviours. This can in turn normalize the sorts of behaviours that can contribute to the institutionalization of acts of white-collar crime.

*Neuro-criminology*

In the context of white-collar crime, criminologists have also resorted to neurological studies, particularly looking at the functioning of the amygdala, the part of the brain that drives the so-called "fight or flight" response and where empathy and emotions are processed. MRI scans have shown that psychopaths tend to have an undersized amygdala and significantly weaker connections between the region of the brain associated with evaluating rewards (the nucleus accumbens—the basal forebrain) and the region associated with decision-making (the ventromedial prefrontal cortex). They also appear to have reduced grey matter in regions of the brain associated with understanding other people's emotions. Hence, decreased amygdala and orbitofrontal cortex responses occur when given emotionally provocative stimuli. Therefore, we may hypothesize that if the amygdala doesn't function properly, it will influence these people's decision-making capabilities.[8] In other words, this weakened connection could partly explain psychopaths' tendencies to overvalue immediate rewards and neglect the consequences of imprudent or immoral behaviour. Having this deficiency reduces the ability of these people to feel the distress experienced by their victims.

**Ways of prevention**

Concerning the detection of white-collar crimes, journalists seem to be the primary detectors of these kinds of fraudulent activities, even more so than the standard law-enforcement agencies. The obvious explanation is that the law-enforcement agencies generally cannot spare the large amount of time or resources required to unveil such crimes. In comparison, it often becomes the job of journalists and reporters to investigate these matters and uncover any deviations. All in all, however, whistleblowers tend to be the most important sources in detecting white-collar crimes. As they work inside these organizations, they have first-hand information about the crimes or fraud that are taking place. Most white-collar offenders have been detected by whistleblowers, who then tip off journalists and other authorities.

[8] R. J. R. Blair (2010). Neuroimaging of Psychopathy and Antisocial Behavior: A Targeted Review, *Current Psychiatry Reports*, 12 (1), 76-82.

However, preventing white-collar crime from taking place would be a much better alternative than acting after the event. Bernard Madoff’s $65 billion Ponzi scheme did raise serious public concerns about the effectiveness of regulatory oversight and due diligence. Not surprisingly, a white-collar crime like Madoff’s triggered public outrage. Many people realized that someone who steals a small item from a convenience store could go to prison, while a white-collar criminal could get away with crimes that represent enormous costs to society. Madoff’s exposure forced people realize that there is no such thing as a victimless crime—and this applies not only to the direct victims of these crimes, but also to the families of the perpetrators. From the seizure and forfeiture of assets and huge tax fines to having a parent incarcerated, and the accompanying social stigma, the price tag of these crimes far outweighs any gains. The suicide of one of Madoff’s sons and the estrangement of his wife are terrifying examples of this.

Notwithstanding the immense costs of these white-collar crimes, from a societal point of view there is still not enough attention paid to their price tag. One reason often given is that many people don’t feel their impact directly. The general public want protection from “traditional” crimes, like theft, robbery, assault, rape, murder, and so on, tangible and familiar threats. In comparison, white-collar crimes seem less serious or injurious. Consequently, not enough resources are made available to deal with them—and white-collar criminals get away with it.

If preventive steps are taken, however, the “Fraud Diamond” can be a guide to help implement proactive measures to prevent white-collar crimes from happening in the first place.

*Corporate culture*

As a starter, the prevailing corporate culture will play a central role. Leadership oversight and tone set at the top will be important enablers of an ethical, transparent culture and the foundation for effective corporate governance. An organization’s leadership should make it very clear that ethics and compliance matter. In other words, they need to embed a culture of compliance in all decision-making processes. C-suite executives should have a zero tolerance for any form of “creative accounting” or other dishonest activities. To facilitate compliance, open communication, and transparency must be elements of the corporate culture. An environment of secrecy offers opportunities for potential white-collar crime—and any system that prefers profit over values is a very dangerous one indeed.

*Leadership development*

Leadership development programs, 360-degree feedback systems, and regular surveys of employees can help those in charge of an organization make regular assessments to determine the ethical health of its corporate culture. These surveys can be highly effective ways to drive toxicity out of the organization. Leadership development programs can be considered early warning systems, assessing whether the culture of the organization is built on bedrock or on sand. Obtaining these data points can serve as a countervailing influence to prevent toxic practices from getting the upper hand—to prevent obsessing about good numbers on the balance sheet at all costs. In fact, playing these kinds of numbers games can have short-term benefits but will contribute to long-term disaster. In comparison, companies with a reputation for fairness and integrity—as reflected in satisfaction, climate, and leadership surveys—will do much better in the long run. They will have more satisfied employees, more loyal customers, and suppliers—and will be more attractive to their investors. All in all, reputation is not only an output of profit and revenue but rather an equal function of the organization's ethical culture.

*Entry and exit*

Of course, society and culture outside the office will also play a significant role in shaping people's personalities. With respect to entry, background checks and due diligence can play a vital role in preventing white-collar criminals from gaining traction. This implies that careful vetting of newcomers and well-designed organizational socialization programs should be par for the course. With respect to exit, if the process is conducted respectfully, exit interviews can provide honest feedback about any misconduct or toxicity within the organization. These exit interviews can also serve as an early warning system, signifying potential problem areas of which the organization could be unaware.

C*ontrol systems*

Well-designed internal reporting mechanisms are going to be a sine qua non for pre-empting white-collar crime. Tight financial control systems will be important to reduce opportunities for fraud. By establishing systems of control, inclusive of ethical standards, organizations can significantly reduce the financial and reputational risks associated with fraudulent activities. An obvious candidate for redesign is existing compensation systems. The design of these systems can have direct social and moral effects, not least in providing opportunities for exploitation, which is why executive compensation is a critical corporate governance issue. All too often, compensation systems fall victim to manipulation. Also, ethics and compliance could be made elements of an organization's annual appraisal process. Organizations could even incentivize ambitious people by rewarding those who demonstrate commitment to their ethical values.

**The perfect crime**

The perfect crime is, of course, the crime that's never detected. Unfortunately, white-collar crime frequently comes into this category, going unnoticed or indeed not perceived as criminal at all. And even though it's said that crime doesn't pay, in many instances, white-collar crime seems to pay quite well. So, apart from preventive legal and organizational measures, a different level of prevention is called for. For example, business schools can play an important role in this. Their challenge is that the students they attract—those who will go on to lead organizations—already have a fully-fledged set of values by the time they arrive. Most ethics training occurs long before these students reach the classroom, from parents, other family members, friends, peers, and teachers. The values they have already internalized will be the bedrock of their behavior. Teaching ethics at this level and at this stage in their career will be daunting at best and impossible at worst.

Nevertheless, something needs to be done, not least because many of the star players in these criminal dramas have been graduates of business schools. All too often, they're taught that a businessperson’s only responsibility is to make money. Too many business schools teach only ROI, shareholder value, and maximization of profits, all of which are seen as incompatible with ethics, because ethics necessitates making sacrifices for the common good. Ethics in business requires organizational leaders to put the interests of others ahead of their own, which for all too many has been to maximize their pay packages.

Little by little, however, with the greater exposure of unethical business practices—and a better understanding of how they impact people at all walks of life—ethics has begun to play a more important role in business school education. But a designated ethics course isn’t going to make much of a difference. Unless all business school professors can inculcate a strong moral compass within their curriculums, it is highly unlikely that they will stop producing new robber barons. Business schools would be much more effective in preventing fraudulent behavior if they emphasized ethics and morals in every course and drove the point home with cautionary tales about the consequences of unethical behavior.

Fortunately, a new generation of leaders seem to be showing a change in their major concerns. They seem to be preoccupied with ethical decisions *and* bottom lines. To say that the only goal of a business enterprise is to maximize profit has become outdated. An increasing number of business leaders understand that profit cannot be the only goal if they want to engage their employees. Also, many organizational leaders recognize that companies can do more to address society’s ills. As a result, business schools are beginning to discover that they better need to catch up with their students' world view. Happily, they are having to deal with fewer and fewer Gordon Gekkos and are now much less likely to have to tackle his assertion that "greed, for lack of a better word, is good."