# Situational Prevention and the Reduction of White Collar Crime

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*This article investigates an often overlooked and inexpensive approach to decreasing a significant amount of unethical conduct and white-collar crime within organizations. It first examines the government's criminal justice response of detecting, deterring and sanctioning white-collar crime. It then examines the government's civil law approach of regulating organizational misconduct. In both cases, it is found that there is over-reliance on the government with limited results. Misconduct is then shown to stem, in part, from organizational processes rather than solely from individual behavior. Finally, the article emphasizes situational prevention instead of exclusively focusing on a potential offender and the government's response.*

## THE ISSUE

The argument can be simply stated. Instead of exclusively concentrating on the offender to reduce white-collar crime, emphasis should be placed on reducing the opportunity to commit crimes within organizations. However, within this simplicity there are complex realities about white-collar crime and our customary ways of attempting to control misconduct within organizations.

One of the main realities of the American criminal justice system is that it is a county/state based system. Reflecting the non-federal emphasis, the vast majority of incarcerated inmates are state and not federal prisoners. The last census of those incarcerated listed 1.8 million inmates in state prisons and county jails and only 150,000 in the federal prisons (BJS, 2003).

Given the complexity and difficulty of detecting and successfully prosecuting white-collar crime, almost all local jurisdictions have no ability to emphasize white-collar crime. In addition to the difficulty in prosecuting white-collar crime, there is a common perception that white-collar crime is not a "serious" problem (Benson and Cullen, 1998).

Consequently, most of the prosecutions in white-collar crime are held at the federal level. Yet, most of the federal government resources are directed towards other crimes. As Figure A illustrates, only 21% of all federal convictions can be interpreted as white-collar crimes.

**FIGURE A**
**DISTRIBUTION OF OFFENDERS FY 2001 FEDERAL CONVICTIONS**
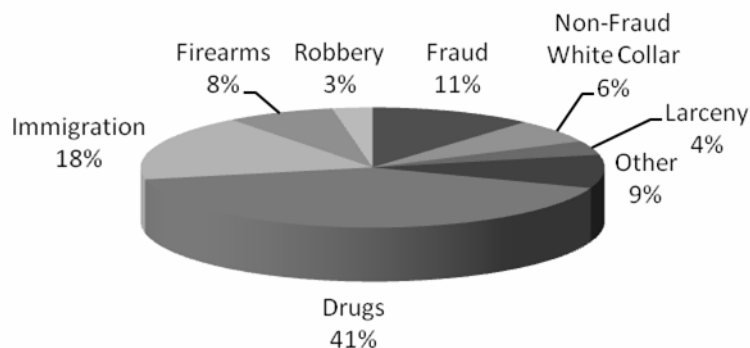


*The Non-Fraud White Collar Category includes the following: Embezzlement, Forgery/Counterfeiting, Bribery, Money Laundering, and Tax. Source: U.S. Sentencing Commission, 2001 Datafile, USSCFY2001.

Even if there was an exponential increase in federal resources to "fight" white-collar crime, that effort would not be in alignment with the prevailing mode of dealing with corporate misconduct, which is the regulatory (civil) approach instead of the criminal approach. The goal of regulatory law is to gain compliance as opposed to the punishment approach of criminal law (Simpson, 2002; Skrzycki, 2003). Also, given the standard of proof is significantly less with the regulatory approach - "preponderance of evidence" as opposed to "beyond a reasonable doubt"; gaining compliance is much more feasible than the punishment approach (Simpson, 2003).

The difference between the regulatory and criminal approaches is striking. In the period of 1997-2000, over 3,000 civil cases were brought to court by the Securities and Exchange Commission (Leaf, 2002). However, in the much longer period of 1992-2001, only 609 of its civil cases were referred to U.S. Attorneys for criminal charges and of those only 87 actually sentenced to prison (Leaf, 2002). In addition, this was during the tenure of Arthur Levitt as Chairman of the SEC, who was generally regarded as an aggressive opponent of white-collar crime (Skrzycki, 2003).

Given these complex realities, this article argues that more emphasis should be placed on organizational processes specifically in regards to white-collar crimes; it is argued that misconduct can be significantly reduced by increasing the focus on reducing the opportunity for wrongdoing.

## WE HAVE OVER-RELIED ON GOVERNMENT TO REDUCE CRIME IN ORGANIZATIONS

### The Criminal Law Approach

It should not be misconstrued that the authors are calling for less government involvement in detecting, prosecuting and imprisoning white-collar offenders. To the contrary, it is believed that the federal system should leave most drug prosecutions to the states and instead concentrate on

white-collar crime and terrorism. However, given the complexities and difficulties with the government approach described below, the effects will be limited.

## Policing and Prosecuting

It is extremely difficult to police and prosecute white-collar crime. Compared to a burglary or a murder, white-collar crime is markedly complex (Alvesado, 2002). Evidence is extremely difficult to gather and authorities are usually called in after an organization has conducted its own inquiry. Given that time lapse, it is relatively easy to destroy or conceal evidence. Further, our local police authorities (who account for the vast majority of policing in our country) are simply not trained to detect white-collar crime.

Even if a white-collar crime is detected and reported to authorities, prosecuting such a crime is complex, time consuming and expensive. In his study of the defense of white-collar crimes, Kenneth Mann found that defense attorneys usually have much earlier involvement in civil law cases than they have in criminal law cases. Consequently, a major objective of the defense is to control information. Investigators are employed to gather all pertinent information. Clients and other potential witnesses are instructed not to disclose any information. The bulk of the information control can usually occur before a search warrant is issued and an arrest is made. Furthermore, indictments can be "headed off" in exchange for a client's cooperation. If a plea is not arranged and a case goes to trial, defense lawyers typically have superior resources to challenge the case (Mann, 1988).

Given the lack of white-collar crime prosecutions, the overall prosecution strategy seems to be one of vigorously pursuing a high profile defendant in the hopes that harsh punishments will serve as an example and deter future offenders. The familiar "perp" walk of an arrested white-collar defendant is meant to deter others.

## Deterrence

Deterrence is one of the most dominant concepts in criminal justice and while it makes intuitive sense, it has been difficult to prove empirically. As a derivative of utilitarianism, the classical school of criminology holds that if society makes a sanction severe enough, certain enough and swift enough, potential offenders will be deterred. Utilitarianism posits that we are rational individuals who seek to maximize pleasure and minimize pain. Accordingly, deterrence theory states that a "tough on crime" stance by society will inhibit offenders (Simpson, 2002).

While this is not the place to consider the other various theories on what motivates offenders, it is important to note that deterrence seeks to demotivate offenders. In contrast, the primary argument of this article is that we should instead put more efforts into reducing the opportunity for misconduct. This enables a proactive solution to white-collar crime as opposed to the current reactive solution that is applied.

The concept of deterrence raises important questions about our current strategies to reducing white-collar crime. Sally Simpson, Professor and Chair of Criminology and Criminal Justice of the University of Maryland, recently reviewed the deterrence literature and the available literature on corporate crime and concluded, "The evidence in favor of deterrence is equivocal (Simpson, 2002, p.42)." Simpson goes on to state that early deterrence studies used poor methodology to conclude that deterrence in fact did work. More recent studies that take advantage of sophisticated research designs have been unable to produce the same results.

**Sentencing**

A corollary to the "equivocal" literature on deterrence is the sentencing of white-collar offenders. With the enactment of the Sentencing Reform Act of 1984 and the consequent creation of the United States Sentencing Guidelines in 1987, federal sentences for white-collar offenders have become considerably more stringent. With every public financial crisis, the prison sentences are made longer and more certain. For example, former Tyco CEO Dennis Kozlowski will serve between 8½ and 25 years for his role in the theft of hundreds of millions of company dollars.

As a component of deterrence, it is assumed that the enhancement of sentences will reduce corporate misconduct. Please keep in mind that few cases are criminally pursued and even fewer are sentenced. Given there is such a minor chance of detection and an even smaller chance of prosecution and conviction, it is astonishing that more white-collar criminals do not gamble with the weak probability of a sentence.

**The Regulatory Approach**

Most of our efforts to control white-collar crime are based on the civil law regulatory system and the desire for potential offenders to comply with these regulations. The overwhelming number of actions taken against corporate America is with the civil approach of fines as sanctions. The regulatory agencies in turn refer a very limited number of offenders to the Justice Department for criminal charges (Leaf, 2002). Criminal referrals are statistical anomalies and are wishfully intended to "deter" wrongdoing by others.

Two aspects of the regulatory approach are important for this discussion. While regulatory agencies are obscure to most citizens and many policy makers, they carry enormous influence and the political battles that exist to determine who runs these agencies are critically important (Skrzycki, 2003). The successful efforts of the accounting industry to keep John Biggs of TIAA-CREFF from chairing the new securities oversight board underscores how industry strives to keep the rule-making process friendly to their interests.

The other important aspect of regulatory law for this discussion is the liberal belief that more rules might mitigate corporate misconduct. Consider how very difficult it is to actually convict someone of insider trading. Even a high-profile case such as Martha Stewart's ended with obstruction of justice charges rather than the more serious insider trading charges. Therefore, this illustrates that increased regulation on insider training will not necessarily decrease misconduct.

In fact, it has been argued by some that too many regulations might actually increase corporate misconduct. Diane Vaughn illustrated this point in her famous case study. Vaughn studied the successful multi-agency prosecution of the Revco drug firm in Ohio in the late 1970s. She found that regulations that are too numerous, too complex or too old could actually lead organizations to ignore them and intentionally break the law (Vaughn, 1983). One encouraging line of inquiry on regulations is the seminal work done by John Braithwaite of Australia. While it is not discussed here, his notion of "enforced self-regulation" fits in well with our central argument of reducing opportunity of misconduct in that ethical responsibility is placed with both the organization and the government (Braithwaite, 2000).

**THE ORGANIZATION CONTRIBUTES TO DEVIANCE**

When examining white-collar crime and its causes, it is important to realize that the organization as a whole can contribute to the deviant acts of individuals. Many approaches place

the blame directly on the individual who commits the crime, rather than delving into the organization that may have enabled or even encouraged such acts.

Research in this area has determined multiple ways in which the organization as a whole can facilitate white-collar crimes.

## Structure versus Agency Logic

Organizational theory stresses two separate concepts when considering who is culpable for deviant acts. Some subscribe to the notion that an individual chooses to commit a crime in order to maximize some sort of satisfaction, perhaps power or profit. This choice is made with an eye on the exponential punishment that may come from getting caught in said crime. At the heart of this idea, labeled agency logic, is that an individual chooses their action rationally and with knowledge of the costs and benefits (Erman and Rabe, 1997).

Unfortunately, white-collar criminals may commit their crimes not as a rational decision to maximize their good, but because the organization allows for such deviant actions. As organizations become more complex and tasks are further compartmentalized, individual workers' goals drift from that of the whole overarching organization. This creates the opportunity for deviant acts to be more prevalent. An auditor may need to sign off on materially misstated financial statements in order to obtain a bonus that he/she desperately needs, in essence placing the goals of the company after their own individual needs. These choices are not the result of a long, drawn out study of which option will provide the most utility, but instead are the product of organizations that encourage or fail to discourage deviant acts.

The following sections will describe how an organization can facilitate white-collar crime in individuals. In an important study of organizations, Erman and Lundman found three main ways organizational processes can facilitate organizational deviance through: incomplete information, psychological influences, and normalization of extreme risk (Erman and Lundman, 1996).

## Incomplete Information

In this situation, individuals in a large organization are not able to see the larger framework that their job contributes to. For example, accountants may work on a small part of a large audit, and therefore not realize that a small mistake, purposeful or not, can have major consequences on the larger project.

A famous example of incomplete information within the organization would be the individual decisions made in the design and sale of the Ford Pinto. No single engineer, safety expert, or executive set out to make an unsafe car, but each lacked knowledge of the whole overarching project. The cumulative effect of this led to egregious safety mistakes that could have been prevented if the individuals involved had complete information (Ermann and Lundman, 1996).

## Psychological Influences

In organizational culture, certain psychological influences can cause individuals to act in ways that they might not believe possible.

The first type of influence is the idea that unethical behavior can be authorized by key players in an organization. Key employees with decision-making authority can either implicitly or inadvertently encourage deviant behavior from those ranked below them. If a senior partner in a law firm asks a recent hire to commit a deviant act, it may make the act seem legitimate because it has been vetted by a higher positioned individual of the organization.

The next psychological aspect present in organizations is the idea that jobs become so routine that after a while deviant behavior becomes embedded in that routine. Certain jobs may require cursory glances at complex reports so often that employees routinely take part in deviant acts without a second thought. In the case of the Ford Pinto, safety inspectors saw such an abundance of accidents everyday that the Pinto seemed like another run of the mill accident that did nothing to jolt them from their daily routine. And yet if one were to remove the safety inspectors from their everyday jobs and show those the horrifying pictures and descriptions of Pinto accidents, each one would most likely realize that the car was not suitable for the market. Unfortunately, organizational structures, such as these, do not allow workers to take an outsider's view, as one must be invested in their job in order to complete everyday tasks quickly and efficiently.

Finally, dehumanization takes place in organizations to the point that employees feel as if their deviant acts hurt no one. There is a distance that exists between white-collar criminals and how they rarely see the victims they are defrauding, cheating, or harming in some way. This is in contrast to street crime, where the victims are front and center of the crimes committed. Enron executives likely never considered the thousands of employees they were bankrupting. Since there was no human aspect to their crime, just financial statements and figures, it was easier for them to commit such deviant acts. These same executives would likely find the idea of mugging someone abhorrent, but in the end their crimes robbed workers of millions the same as a mugger would (Kelman and Hamilton, 1989).

**Normalization of Extreme Risk**

When all of these effects come together, organizations can become a locus for deviant acts. In a seminal study, Diane Vaughn examined the Challenge Disaster and NASA. Instead of finding a fault of leadership or amoral calculators, her study found an organizational culture that facilitated misconduct.

Vaughn found that NASA's organizational culture contributed to the disaster by which she termed the "normalization of risk". That is, previous decisions relative to the O rings in launches, though risky, became routine when the launches seemed successful.

Another aspect of the organization she found at fault was that of structural secrecy. Parts of NASA and their subcontractors were ignorant of activities in the larger enterprise that had real meaning for them. This secrecy "not only prevented the reversal of the scientific paradigm but it perpetuated the view that the faulty O rings were an acceptable risk (Vaughn, 1996)."

While organizational literature is rich with examples of how organizational processes can facilitate misconduct, there is little on how organizations can arrange themselves to prevent misconduct. One of the most promising ways is the adoption of the notion of situational prevention.

**SITUATIONAL PREVENTION**

Broadly speaking, one of the most important factors of social control theories of crime is the situation surrounding the offense. While there are variations such as the Routine Activity Approach (Felson, 1994), the most innovative work on controlling the situation is that of R.V. Clarke. With many correlative theories (Jacobs, 1961; Newman, 1996) Clarke's work can be summarized as situational crime prevention. In his work, he outlines sixteen opportunity-reducing techniques. Of these, the most celebrated technique is called "target hardening." In

this technique, offenders are discouraged by increasing their perceived effort to participate in misconduct.

## Situational Prevention in Street Crime

After Clarke's groundbreaking work, practical experiments were conducted to gauge the effectiveness of situational prevention. Based largely in England and Western Europe, these experiments were a resounding success.

One example of situational prevention would be the installation of steering-wheel locks on cars in Britain and West Germany. Both countries not only required the use of anti-theft devices, the locks were colored bright red to make them extremely visible to potential thieves. The West German law, which required all cars to have locks, saw a significant decline in automobile thefts. The British law, which only required new cars to use the devices, saw a decrease in new car thefts but a steady increase in the rate of older cars being stolen. In this example, situational prevention worked, but the differing results demonstrates the complexity of the idea as a whole.

Another example of situational prevention in street crime is the decision by New York City authorities to eliminate graffiti on subway cars. Instead of attempting to catch individuals in the act of defacing the cars, they decided that any car that was painted would not run until it was completely cleaned. Since graffiti artists derived such satisfaction from seeing their artwork travel around the city, this policy took away any incentive the offenders might have to paint the cars. Authorities found the underlying rationale for the deviant acts and eliminated any reward the criminals might have received. Simply put, they did not focus on the offender but reduced the opportunity for misconduct.

## Situational Prevention in White-Collar Crime

It is the argument of this treatise that we should institute organizational structures and processes that reduce the opportunity for crime in organizations and in regulations. It should be stressed that reducing opportunity in organizations is not conceptualized as increasing surveillance. It is neither "micro management" nor any of the well-known techniques of Theory X type of management (Heil, 2000). It is certainly not any of the intrusive management techniques such as worksite drug testing or honesty testing. While many managers are drawn to these techniques, there is little reliable literature to support their effectiveness (Murphy, 1993).

To illustrate reducing opportunity, the fraud at Enron might have been avoided had the Arthur Andersen consultants been separated from the Arthur Andersen auditors. Consider the pressures on a new audit associate if a senior partner from the consulting division assures him/her that it is acceptable to sign off on a fraudulent financial statement. Rather than wish for more virtuous leaders or different members in an organization, reducing the opportunity for misconduct is more effective in advancing ethical conduct. Take NASA for example, which has changed its leadership numerous times and still fosters an environment prone to the same type of disasters time and time again.

Before illustrating situational prevention within organizations, we will examine how regulations can utilize situational prevention.

## Sarbanes-Oxley: Elements of Situational Prevention

The Sarbanes-Oxley Act (SOX) of 2002 contains several elements that clearly illustrate situational prevention in regulations. SOX was created in response to a number of major corporate and accounting scandals. The legislation establishes new and enhanced standards for

all U.S. publicly traded companies and public accounting firms. The Act establishes a new quasi-public agency, the Public Company Accounting Oversight Board (PCAOB), which is responsible for overseeing and regulating accounting firms in their roles as auditors of public companies.

One such element of SOX is that it requires the audit engagement partner to rotate from clients every five years. This rotation reduces the opportunity for ongoing misconduct and/or detection of illegal conduct.

Most relevant to this discussion is the element that certain non-audit services are prohibited from being performed by a client's audit firm, such as consulting services, further reducing the opportunity for undue pressure on the auditor.

**Situational Prevention within Organizations**

Finally, reducing opportunity within organizations is a matter of common sense more than strategy. For instance, in small organizations it is easy to achieve the separation of duties between the employees that authorize, record, and have custody over cash and its related transactions. In fact, many large organizations require employees to take vacations. The underlying assumption is, in part, that a temporary replacement should alert potential misconduct.

## IN CONCLUSION

We do not assert in this article that situational prevention is a panacea. Rather, we view it as an important complimentary approach to the usual methods of relying on the government either to detect, prosecute and sanction white-collar offenders or to gain compliance to regulatory law. There is a growing appreciation of how reducing opportunity can decrease "street crime." It is our contention that a similar emphasis should be placed on reducing opportunity for white-collar crime.

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