The battle against fraud, corruption and bribery

In spite of copious new rules and guidance, are we that much closer to curbing corruption, bribery and fraud than we were ten years ago? And if not, why not? Nigel Iyer and Øyvind Kvalnes examine the moral dissonance we experience and how ordinary and respectable people take the first step into muddy waters. The key could lie in how we neutralise our own emotions. They examine the challenges of adopting a new moral responsibility, and how we can start committing to ethical behaviour because we want to and not just comply because we feel forced to do so.

Are we turning our back on fraud and corruption? If so what are we turning away from?

A battle far from won

A few months ago, when commenting on the 10th anniversary of the war in Afghanistan, retired US General Stanley McChrystal said, “The US and NATO are only 50% of the way towards achieving their goals in Afghanistan.” He also issued a harsh indictment of his country’s campaign and Americans’ “frighteningly simplistic” view of the situation. [1]

If we also take a ten-year perspective on the permanent “war against fraud and corruption”, starting with the landmark Enron scandal, which was revealed October 2001 and which also exposed one of the biggest audit failures in modern history, could we honestly say that we are half-way to achieving our goals? And given that human greed, corruption and fraud have been around for centuries, is our view that more rules and regulation will be the answer also “frighteningly simplistic”? [2]

Perhaps the first point to make is that no goals were ever set for this war (but were any set in Afghanistan either?) although most of us would like to believe the implicit aim was to eradicate fraud and corruption. Looking back over the last ten years, we have brought in, arguably, more legislation than ever before, starting with the Sarbanes-Oxley Act and followed by a whole plethora of new laws, local regulations and codes of conduct. If, as many people believe, the amount of observable fraud and corruption in the world has increased, in the past decade, we need to question whether our whole strategy of forcing people to comply with more and more is, in fact, counter-productive, leading to a culture of “blind box-ticking”. Even in countries where corruption is said to be “rife”, such as India, and new legislation is proposed and introduced constantly, it does not seem to make a difference and campaigners for reform have to resort to desperate measures such as hunger strikes.

In numerous seminars and training courses we ask our participants to estimate the annual cost of fraud and corruption, taking into account all potential impacts, including such as direct cost, loss of value, damage to reputation and culture. We ask them to express this in terms of the turnover of a company or in terms of gross domestic product of an economy. The range of responses is often in the region of 1% to 5%, an alarmingly high figure, which corresponds to structured research findings. Paradoxically, when we ask top management for their personal view of the true cost of fraud and corruption in ‘their’ company, they prefer to say that it is very low and point to a large number of counter-measures and improvements in recent years. Interestingly, they do not deny the overall picture but, for one reason or another, like to believe that their organisation is special.

Corporations are quick to claim the moral high ground in policy documents but do their value statements survive the commercial imperative? Milton Friedman neatly summed up the dilemma back in 1970: “A corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.”
Today, businesses are bombarded with rules and regulations from all sides. Currently, many are trying to get to understand the practical consequences of the UK Bribery Act 2010. We would like to believe that the underlying aim of any such statute is to increase the level of moral responsibility in business and society. However, the danger with a weighty piece of legislation is that it translates into another box-ticking exercise around a whole set of mandatory actions.

This article is not about changing laws, many of which are sound and necessary; it is about understanding ‘why’, as humans, we look for easy ways out, and also how we can rise to the challenge and really keep fraud and corruption at bay by making more room for morals. We believe that how we deal with fraud and corruption needs to be re-thought. In the next section we examine the “moral dissonance” people experience when confronted head-on with fraud and corruption and how they manage it through techniques of “moral neutralisation”.

We define fraud and corruption in the widest terms to cover all possible forms of unethical behaviour in business. We also recognise that the first steps into this minefield are sometimes quite innocuous but it is precisely the thinking at this point that often holds the key to why we don’t see fraud and stop it.

We need to re-ask the question: is fighting fraud and corruption simply about compliance with a set of rules or should we be doing something more and if so, what?

Moral dissonance and its effect on us

Real-world example 1 – Moral dissonance [3]

Tony is the managing director of Multinat Plc and has taken close interest in the company’s new code of ethics and anti-fraud policies. He has expressed zero tolerance of any form of unethical behaviour in the company. “Multinat shall only realise profits in ways that are ethical and sustainable” was a quote from a recent webcast to employees around the globe. At the same time Tony is concerned about falling revenues.

James is a sales director in Multinat and for the moment he also is concerned about falling revenues. In recent months he has been under a lot of pressure from top management, including Tony, to branch out into new territories and markets.

At last James has an opportunity to enter into a new contract with a new customer that promises long term and stable revenues - if it is secured. During the initial negotiations, however, it becomes clear that the opportunity is the result of an introduction by a consultant. The consultant says he will ensure that James and others in Multinat are given the right levels of access to the client, which will offer the greatest chance of success. The consultant’s terms are a retainer of UK£1800 per month and a success fee of 3% of the net value of the contract should Multinat be successful. The consultant tells James that there is no need for concern as he is honest and ethical, having willingly signed up to Multinat’s Code of Conduct.

Dialogue between consultant, customer and James occurs without any involvement of the top management in Multinat. James hopes that winning the contract will take some of the pressure off him and put a smile back on Tony’s face. Ideally, he would like to know more about some of the consultant’s methods but the signature on the code of ethics gives him comfort, as do the regular invoices he submits on headed paper of a legally registered company. James feels he could not do more under the circumstances.

In the above story, the sales director, James, could easily be party to corruption and bribery if he pays the consultant to help him secure the contract for Multinat. However to what extent, if this is true, could he be held morally responsible?

British philosopher Peter Strawson, in his work on “freedom and resentment”, related moral responsibility to our reactions and attitudes towards other people and their conduct, reactions like gratitude, forgiveness, resentment, and hurt feelings. A person perceived to have done something morally right or wrong often meets with these reactions. Their conduct is seen as an expression of goodwill, contempt or some other moral attitude and this makes a difference to our moral judgment: “If someone treads on my hand accidentally, while trying to help me, the pain may be no less acute than if he treads on it in contemptuous disregard of my existence or with a malevolent wish to injure me. But I shall generally feel in the second case a kind and degree of resentment that I shall not feel in the first.” (Strawson, 1974)

People who deny moral responsibility for corruption will try to claim they had no other choice, whether due to an unhappy set of circumstances or forces beyond their control; they identify with the person who accidentally steps on Strawson’s hand while trying to help him, and reject any suggestion that they could be a reasonable target for moral resentment or criticism.

How does someone with integrity move to a position where they are able to act contrary to their own initial moral judgment or see little wrong in accepting the corrupt alternative?

Managers faced with opportunities to significantly improve sales but in some doubt about the methods that might be used, will often experience some moral uneasiness. This discomfort, or gap, is “moral
The term “dissonance” originates from music, it is the discordant effect of hearing tones that don’t sound pleasant when played at the same time.

A person whose moral convictions do not harmonise with their intended actions engages in moral neutralisation, a term coined by sociologists Sykes and Matza (1957). The process, which has to operate in advance of the act, requires self-justification: “I really didn’t have a choice”; “Nobody will get hurt because of what I do”; “Those who are critical of such conduct don’t understand the unwritten rules of business”; “This is simply how things are done in our sector.”

We believe that business people need to acknowledge moral responsibility for their decisions and conduct, which, after all, can have widespread social consequences. It is therefore important to find practical and constructive measures to counter corruption. How can people like James and Tony guard against encountering sets of events that invite moral dissonance, leading to moral neutralisation and conduct that is contrary to their professed moral convictions?

Any situation which gives rise to conflict between a person’s beliefs and the choices they face creates “cognitive dissonance”.

In Example 1, James is tempted to pay the consultant to secure a type of sales contract that Multinat, Tony, the board and he all desire. At the same time James does the best he can to follow the company’s ethical code. The code, with its phrases like “We should attempt at all times to fight bribery and corruption”, resonates well with James’ own moral beliefs. However, he harbours doubts about the consultant and his methods; parallels that might run through his mind include:

- the athlete who is convinced that use of certain performance-enhancing drugs is unacceptable but at the same time competes in an environment where they are readily available to everyone in the sport;
- the financial adviser in a bank who wants to make the customer’s interest paramount but is under pressure to achieve sales targets for the bank’s own products.

James feels he has a near impossible job. If he asks too many questions of the consultant, he fears that the dissonance he is experiencing will grow while, at the same time, he is obliged to follow and conform to the ethical rules laid down by Tony and the board.

There also exists a small group of managers who do not experience any degree of dissonance between so-called “moral” and “corrupt” alternatives; they fall into three categories: one, those how are completely unaware of the risks; two, others whose integrity is total – they would never entertain a corrupt alternative; and three, some who believe corruption to be acceptable and even, in some cases, moral.

The term “moral saint” was introduced by Susan Wolf (1982). A more popular expression for the amoral cynic is “corporate psychopath” (which is described more fully by Brytting, Minogue and Morino [2011]). In reality there are few moral saints and few corporate psychopaths. Most people live in the various shades of grey between the two extremes. Accordingly, we are most interested in the thoughts, judgments and acts of the moral doubter.

Real-world Example 2: Does the level of dissonance experienced depend on the person who experiences it? [4]

When does a white lie become a serious lie? A CV is often called a marketing document but how much should the truth be stretched? Probably never but the dissonance felt is worth noting. In a recent proposal Engineer A, who was highly experienced but new to the business of tendering for bids in a developing country, felt extremely awkward that his experience in designing multi-storey car parks had been stretched from four to five years by Engineer B (who was leading the proposal). On another proposal Engineer B had effectively neutralised his dissonance, even though Engineer A pointed out that in fact he had none.

Engineer B had effectively neutralised his dissonance, if he ever experienced it in the first place. For a manager who experiences moral dissonance, the level will depend both on their own make-up and on the situation. In the above real life example, Engineer A felt very uncomfortable, firstly because he had previously only worked in environments where embellishing CVs was frowned upon and he felt that four years’
experience was sufficient anyway. For Engineer B, who had completely different experiences, padding CVs was simply “part of the game”. In other words, whilst the scale of the untruths about Engineer A were minor compared to Engineer B, it was Engineer A who experienced the much higher level of moral dissonance because he had completely different experiences to Engineer B.

Whether someone often or seldom experiences moral dissonance depends on personal as well as situational aspects, on their convictions, attitudes and values. Are they well-tuned to the business environment in which they work?

Nagel (1982) has pointed out how luck can affect a person’s moral record: “The things we are called upon to do, the moral tests we face, are importantly determined by factors beyond our control. It may be true of someone that in a dangerous situation he would behave in a cowardly or heroic fashion, but if the situation never arises, he will never have the chance to distinguish or disgrace himself in this way, and his moral record will be different.”

Moral luck, then, can determine how frequently a person actually faces morally demanding situations, and will experience moral dissonance. The Aristotelian tradition in ethics focuses on how each person depends upon good role models to develop character. In order to become an honest person you need to meet and socialise with people who are already honest, and behave in exemplary ways when challenging moral situations are encountered. Nagel considers this to be another area where moral luck sets in, this time in the shape of what can be called “constitutive moral luck”. Has Engineer A had good moral luck of this kind – has he worked in companies and environments dominated by honest people – and Engineer B had corresponding bad moral luck, having encountered managers and colleagues who served as bad role models?

Situations encountered and role models in formative years are likely to affect the level of moral dissonance a person experiences. The phenomenon of moral luck is a challenge when we want to assign moral responsibility to people who engage in fraud and corruption. If the difference between Engineer A and Engineer B can be accounted for merely as a difference in luck, how can we continue to praise the former for his honesty and criticise B for lying on his CV? Engineer B’s reasoning could be as follows: “I never had the proper role models, and I have fallen into all these moral traps without any proper guidance from peers. No wonder I became involved in fraud and corruption.”

It seems that bad moral luck – both situational and constitutive – can be used as an excuse for acting wrongly. A justification of this kind is only valid if moral luck takes away all personal aspects of moral judgment and behaviour. That is not the case. The moral attitudes and responses described by Strawson remain even when we know the sometimes unfortunate personal histories of each individual. Even though Engineers A and B have not been in full control of their moral developments, they have had the opportunities to shape them. When they face difficult choices they have, as rational adults, the capacity to weight their options and consider the consequences.

**Stop turning away to start turning the tide**

**Justifications, moral neutralisation... or plain excuses?**

When normal people such as Tony or James, in our first example, experience moral dissonance, an initial, natural response is to look for a way out of the situation. One option is to walk away and do something else. The other is to try to understand the cause of the dissonance and then re-cast it to avoid further moral discomfort. Both approaches entail “moral neutralisation”.

Moral neutralisation is nothing new. [5]. In essence, the theory states that people will not do something if they think they it is going to bring shame on them. Moral neutralisation, therefore, happens before a decision to act is taken; it differs from the typical rationalisation of fraud and corruption, which occurs after the event. [6]

Sykes and Matza focused on juvenile delinquents, young criminals, and their peers with similar backgrounds, who did not end up breaking the law. Social environment and upbringing was common but their conduct radically different. The sociologists hypothesised that the delinquents used moral neutralisation techniques to overcome moral dissonance.

Sykes and Matza came up with five moral neutralisation technique categories; the table below illustrates these by reference to Example 1 above – here are methods that James can use to neutralise the dissonance he experiences between his moral values and his need to win the contract by paying the consultant.

Often a combination of these techniques contributes to reducing the moral dissonance - James and his people will probably agree to pay the consultant, even though it likely to mean corruption somewhere along the line.

Sumantra Ghoshal [7] claims that these attempts to deny moral responsibility rest on an unfounded
assumption about determinism in human conduct: when managers, including CEOs, justify their actions by pleading powerlessness in the face of external forces, they are resorting to dehumanisation of practice. When they claim that competition or capital markets are relentless in their demands, and that individual companies and managers have no scope for choices, they use the false premise of determinism to free themselves from any sense of moral or ethical responsibility for their actions.

Charles Prince in Citigroup is an example of a business leader who reasoned in the way Ghoshal criticises. Interviewed about his bank’s practice of extending loans on hazardous terms even when the warning lights were starting to flash, he famously said, “When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you’ve got to get up and dance. We’re still dancing.” *(Financial Times, 9 July 2007).*

Prince apparently had no choice but to carry on come what may. In Goshal’s view, this is denial of responsibility. Prince sought refuge in a metaphor that allowed him to do as he pleased; after all, he was not the conductor of the orchestra.

**Case studies – extreme neutralisation techniques and moral blindness**

**Real-world example 3 – Dissonance and neutralisation, even amongst the watchdogs?**

Do external auditors shy away from finding fraud? This is not an easy question to answer but typically when we ask senior management if they expect their auditors to pick up ongoing frauds they reply, “yes”. Officially, the answer is that external auditors only have a marginal duty of care when it comes to detecting fraud, which is enshrined in International Standard of Auditing ISA 240, called, simply, “Fraud”. In plain English, the external auditor needs to assess whether there is a risk of fraud occurring, in both the organisation and its financial statements, and if the external auditor believes that this risk is significant, they are supposed to adjust their audit approach accordingly.

At the start of a training session for 90 partners and executive managers in a Big 4 audit firm [8] one of the authors of this article asked: “How many of you can name the external audit standard that deals with fraud, citing the two main issues that it addresses specifically?” No-one was able to answer without resorting to the internet.

In their defence, maybe one reason why external auditors discover very little fraud and corruption is that they, like many senior managers, consider the incidence in any company they audit to be very low. Another, more interesting explanation could lie in the realms of moral dissonance, ie, moral neutralisation techniques. External auditors don’t like to think of their clients, who are, after all, their paymasters, as criminals. So an auditor who comes across something suspicious may experience a level of dissonance. If he or she decides to overlook it as immaterial, the next time it occurs the dissonance may grow. In the end, refuge will have to be sought in neutralisation techniques.

The example above also raises the bigger question of how far all involved in assurance work, like regulators, should go in looking for unethical behaviour. Consider the Icelandic economic crash a few years ago: is the collective guilt of the few individuals who probably commit fraud less than the sum fault of all the ‘good’
people who saw something not quite right but chose to do nothing?

Real-world example 4 – Bad news hurts: bring on neutralisation!
The Group CEO was presented, on the one hand, with numerous intelligence and other reports from fraud and corruption investigators and specialists, which indicated that most of the supply chain of one country’s subsidiaries had been infiltrated by organised criminals, while, on the other, internal audit reports, supported by the country manager, found the internal controls to be first class. The Group CEO chose to believe the more positive news.

Later on, the judiciary, who were investigating organised crime in that country, revealed that a sophisticated organised crime group had taken control of 11 of the 12 most important subcontractors unbeknownst to senior management. [9]

So why did no-one in the company or group management realise that a large part of the company had been taken over by criminal gang?

We believe that if a person has been through the cycle of dissonance and neutralisation in relation to fraud and corruption, they will become conditioned not to see it; in other words, the neutralisation has a more permanent effect. This may explain why people find it very hard to spot the warning signs of fraud and corruption, they are simply blind(ed) to it.

Psychologist Daniel Simons has produced a number of short films to demonstrate the shortcomings of our senses, for example, to show what can happen once our eyes become accustomed to seeing our environment in a particular way, or when we focus on certain aspects of a situation at the expense of others.

The most famous of Simons’ films shows two teams of three people, passing a basket ball between themselves. The spectators are asked to count the number of times members wearing white manage to pass the ball to each other. By concentrating they come up with the correct answer of 16 passes. The spectators are then asked whether they noticed anything else when they watched the film. A few people may claim to have seen a black figure moving across the field of play. When the film is shown a second time, everybody can see that halfway through a huge gorilla (that is, someone in a gorilla suit) enters the field and moves slowly across it. The spectators are astonished they didn’t spot it the first time.

A similar phenomenon exists in business; it may be termed moral blindness. Even people with strong convictions can become blind to moral aspects of their own work and come to see nothing wrong in using bribes and corruption to win contracts. They concentrate on one task – doing well in business – and lose track of other significant aspects of their conduct.

Outsiders and people who are new in an organisation often ‘spot the gorillas’ that are invisible to the people who have spent a long time there. Organisations that are serious about countering corruption should thus invite these people to speak up about what they see.

How to deal with dissonance and regain moral responsibility
It is becoming increasingly clear to many people that today’s wealth of rules and regulations and checklist box-ticking is not having a real impact on the root cause of fraud and corruption. On the contrary, probably the more copious and confusing the rules become, the more opportunities are created for the fraudster.

Moral neutralisation is a way to avoid feeling any form of moral responsibility if confronted with a situation that initially causes distress and discomfort. Strawson (1974) believed that moral responsibility goes hand in hand with the typical defence mechanisms most of us feel. As mentioned earlier, if someone steps on our hand we would normally, and immediately, feel angry; this is based on belief that the person knew what they were doing and deliberately tried to cause us pain. If, afterwards, it is shown that in fact the person doing the stepping was either mentally disturbed or had some kind of muscle disorder so that he or she could not control where they placed their foot, we would in fact re-assess our first reaction. We would probably no longer hold the person morally responsible for stepping on our hand.

Traditional moral philosophy has addressed the topic of freedom and determinism in order to assess the extent to which people can be held morally responsible for their decisions and actions. How far are individuals free to choose between different courses of action? To what degree are events decided in advance and outside our own sphere of influence? Strawson believes that the practice of holding people morally responsible for their actions does not have to rest on a theoretical platform, which, once and for all, proves that people have freedom and are not determined by external forces. We consider people to be morally responsible for what they do, unless we receive information that they did not possess the normal capacity to reason.

Business leaders often find themselves in the grey zone between moral saint and moral cynic where there is plenty of room for doubt and flexibility. In the first example, Tony and James experience tension between what they believe they should do from a
moral standpoint and what they believe is best for the profitability of Multinat and its shareholders. Ethics and profitability should go hand in hand but when they are in opposition the result is moral dissonance.

Business should be aware of this phenomenon and take seriously any claims from leaders and employees who experience moral dissonance. The Canadian philosopher Frederick Bird has interviewed business people about their moral convictions and how they express them in practice. He concludes that business managers tend to be morally mute; they do have moral convictions but hesitate to express them, uncertain about how this will be perceived by others. Moral muteness in organisations can lead employees to keep quiet about their own experiences of moral dissonance and pave the way for morally dubious decisions and actions.

How can we start to make a change?

Opinion on how well we are doing as a whole in the war against fraud, bribery and corruption is bound to vary from person to person but there is, we submit, a broad consensus that a lot more needs to be done and that if we continue in the same vein the situation will probably deteriorate. True change will happen more readily if we recognise a well of discontent around us rather than try to ignore it. In other words, we should allow ourselves to experience our own dissonance, not try to neutralise it as quickly as possible. We certainly don’t have all the answers but believe that the following ten points are a useful starter in encouraging companies, organisations and individuals to take on new ethical challenges in a positive and constructive way:

Take the first step: listen to, and don’t shy away from the dissonance in the battle against fraud and corruption. Unethical behaviour is part of everyday life and once we recognise that the costs are high and that traditional techniques of dealing with it are not working well, or just dealing with the tip of an iceberg, we can begin to make a change.

Dispel the myth that corruption only occurs in less developed countries. Corruption, in its widest sense, can occur anywhere; it’s all about people.

Develop tolerance and understanding of the dissonance and dilemmas we all come up against at times, especially people who are at the front line of business. Blindly repeating statements such as ‘zero tolerance’ make Codes of Conduct so unrealistic that they are virtually impossible to follow, except on paper.

Avoid the scapegoat mentality and look for root causes instead. Avoid sanctions that are aimed primarily at the people lower down in organisations and society.

Wherever you are in the organisation, try to make it clear that management and employees are expected to take responsibility and challenge, rather than play the role of cogs in the system which blindly follow instructions.

Look for, listen to and take seriously employees’ own experiences of moral dissonance; it is there but for years employees have been reluctant to bring matters up for the fear of branding as a bringer of bad news. Encourage a climate in which people talk about their own experiences of moral dissonance. Try to respond positively to anyone who reports what, on the face of it, sounds like ‘bad news’. Once the dissonance and disharmony is audible, rather than mask it out, tackle the root cause.

Create greater awareness of the techniques people use all the time to neutralise the dissonance they experience.

At every level try to make room for morals: perhaps the time has come for shareholders to consider ethics in the mandate they define for executive management – to not only allow permit true ethical business conduct but to require it. For example, the Articles of Incorporation might be modified to state: “… to engage in any activity which may promote the interests of the corporation, or enhance the value of its property, to the extent permitted by law and compatible with ethical the principles of honesty and fairness towards those who may be affected by our activities.”

Think critically about the number of rules we have already and the impact of simply adding more. Simplification is needed, and a commitment to principles, rather than even more complexity. As Albert Camus, the French writer, once said, “Integrity has no need of rules.”

And finally,

Recognise that for years we, as humans, have been conditioned not to see the red flags of fraud and corruption. If we suddenly start to ‘look for the gorilla in our midst’ we will be shocked, but once we come to expect it, and are prepared, that shock will be considerably lessened.

In our first example, whether James in Multinat ends up paying the consultant who promises him a new large contract will depend on whether he can neutralise his own associated discomfort. He has the power to decide this himself but may also seek advice from his CEO, Tony. The degree to which the CEO experiences moral dissonance will depend on the facts presented to him and on his own opinions and beliefs about how business should be conducted. Embedded in Multinat’s code of conduct is zero tolerance of corruption of any
kind. An approach from James of this sort could prove a tough test of Multinat’s code of conduct. No-one is forced to dance, even if the music is still playing.

Management schools are now helping senior managers engender a spirit of integrity throughout their organisations – from top to bottom; this is a new approach to how senior managers and team leaders can become the internal trend-setters and make their operations much more resilient to fraud and corruption. But at the end of the day, if something is going to change it will be down to individual behaviour; in Ghandi’s words, “You must be the change.”

Notes
2. Anna Hazare http://timesofindia.indiatimes.com/topic/Anna-Hazare
3. Based on a recent incident on which one of the authors is working. Names have been changed and circumstances amended slightly in order to avoid recognition.
4. Based on a current case observed by Nigel Iyer.
5. Moral neutralisation was first discussed by the sociologists Sykes and Matza in 1957 and later by Bandura et al in 1996.
6. For an in depth discussion, see “The Anatomy of Fraud and Corruption” by Brytting, Minogue and Morino.
8. The training was conducted in May 2011 when 90 partners and senior managers attended a two-hour session on fraud and corruption as part of their four-hour annual mandatory CPD.
9. Taken from a 2011 case in which the subsidiary of a European multinational was, in the course of eight years, gradually taken over by organised criminals.

Relevant literature referenced in this article


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