CAUSES OF FRAUD

In the broadest sense, the causes of fraud are summarized in an axiom known as the Fraud Triangle, developed from the work of Dr. Donald Cressey. The three elements of the Fraud Triangle are: Pressure or Motive—Opportunity—Rationalization. Generally, fraud occurs when someone with a financial need (motive) gains improper access to funds (opportunity) and is able to justify the act to themselves and/or others (rationalization). In other words, people commit fraud because they need, or think they need, the money; they believe they will not be caught; and they have justified the act to themselves.

Though this makes virtually everyone a potential fraud offender, the Triangle suggests there are at least three general ways of preventing fraud—by altering the motives of individuals; by limiting the opportunities for secretly gaining funds; and by undermining common rationalizations, through general education or the interrogation of individuals.

Why Don’t People Commit Fraud?
The Coalition Against Insurance Fraud (CAIF) has studied why people sometimes refrain from committing fraud. Sixty-three percent of respondents answered “moral character.” Other deterrents cited were fear of being caught (15%), fear of prosecution (7%), lack of opportunity (3%), and religious beliefs (2%). Though about one-third of the respondents said they had “no tolerance” for fraud, the majority left room for fraudulent acts with proper rationalization. Sixty percent thought people who committed insurance fraud were looking for a fair return on the premiums they paid. Another third thought that people were forced into fraudulent behavior to obtain insurance. This pattern holds true with other types of fraud. Though most employees admit that fraud against their employer is wrong, many do so anyway and rationalize the act as making up for poor wages or unfair working conditions. Professional cons admit they are committing an unethical act but they absolve themselves by insisting, “You cannot cheat an honest man.”

Is the Fraud Offender Deviant?
Scholar James Coleman has written, “In seeing the [criminal] deviant as a wholly different kind of person from ourselves, we bolster our self-esteem and repress the fear that under the right circumstances, we, too, might violate the same taboos. But this system of facile psychological determinism collapses when applied to white-collar criminals. The embezzling accountant or the corporate manager serving in her firm’s illegal schemes conforms too closely to the middle-class ideals of American culture to be so easily dismissed.”

Coleman cites an experiment in which business students were asked to decide on a course of action for a pharmaceutical company, which had just discovered that a highly profitable drug was dangerous. The scenario was drawn from an actual incident, in which the company’s management had refused to withdraw the drug from the market and actively obstructed regulators in the courts and legislature. Seventy nine percent of the business students made the same decision.
Causes of Fraud, Major Theories
Most theories of crime have some basis in behaviorism. As propounded by B.F. Skinner, behavioral theory holds that behavior is conditioned over time by an individual’s interaction with the environment. Any act—criminal or otherwise—can be explained as the product of an individual’s desires and the person’s understanding of consequences; i.e., a person will perform any act that gratifies desire without inflicting pain or causing deprivation. Fundamentally, behaviorism holds that behavior is (to a great extent) learned, and can thus be modified.

Donald Cressey and the Fraud Triangle
In Other People’s Money: A Study in the Social Psychology of Embezzlement, Cressey concluded that individuals commit fraud when three factors are present: (1) a financial need that cannot be shared, (2) a perceived opportunity for illicit gains, and (3) a personal rationalization of the act. Cressey reportedly asked offenders why they had not committed violations at other times and received three basic replies: “There was no need for it like there was this time”; “The idea never entered my head”; and “I thought it was dishonest then, but this time it did not seem dishonest at first.” Cressey’s ideas have become known as the Fraud Triangle:

![The Fraud Triangle]

Cressey catalogued six types of “nonshareable” problems that provoke fraud: inability to pay debts, problems resulting from personal failure, business reversals, physical isolation, status gaining, and employer employee relations. Individuals rationalized their crimes as noncriminal, justified, or as part of an environment over which the offender had no control. The opportunities for fraud are always myriad, though the lack of internal controls over funds is a chief factor. Removing temptation remains the best deterrent of all.

Edwin Sutherland
In Principles of Criminology and White-Collar Crime, Sutherland developed his theory of differential association. Sutherland studied fraud committed by business executives against shareholders and the general public. Rejecting what he saw as criminology’s emphasis on Freudian psychology, Sutherland wrote:

- General Motors does not have an inferiority complex,
- United States Steel does not suffer from an unresolved Oedipus problem, and the DuPonds do not desire to return
to the womb. The assumption that an offender may have such pathological distortion of the intellect or the emotions seems to me absurd, and if it is absurd regarding the crimes of businessmen, it is equally absurd regarding the crimes of persons in the economic lower classes.

Sutherland drew from the work of E.A. Ross, who published *Sin and Society* in 1907. Ross asserted that American capitalism was threatened by “the criminaloid,” i.e., businessmen whose greed and moral impairment drove them to put acquiring money above all other considerations, including the welfare and lives of thousands of citizens and the continued health of the capitalist system. The criminaloid prospered because a complacent public allowed him to hide behind a façade of respectability.

Sutherland coined the term *white-collar crime* and first used it publicly in a 1939 speech to the American Sociological Society. He defined the term as “A crime committed by a person of respectability and high social status in the course of his occupation.” Though the actions and perpetrators might vary, these crimes all involved “The violation of delegated or implied trust.” The cooperative, if clueless, victim was necessary for the predication of the crime.

Sutherland’s work focused on business crime. In *White-Collar Crime*, published in 1949, he examined crimes committed by members of 70 of the largest U.S. corporations. All had at least one criminal or civil decision against them, and most of the corporations had committed multiple offenses. Sutherland charged that 97% of the corporations were recidivist offenders.

Sutherland asserted that people interacting in close association learn criminal behavior. Rather than imagine an individual suffering from a pathological mental condition, Sutherland argued that people learned how to be criminals—from pickpockets to corporate embezzlers—by consorting with other criminals.

The criminal learning process includes physical techniques and strategies for committing crime as well as the sharing of motives, drives, rationalizations, and attitudes toward crime. In other words, one not only learns how to commit the crime, but why to commit the crime. Chief among the rationalizations, Sutherland found, was an acquired sense of legal codes as unfair and/or unfavorable. The causes of corporate crime were unrelated to the psychology of its perpetrators, Sutherland believed, as evidenced by the fact that criminal corporations may continue committing offenses over time while personnel come and go. However, Sutherland did not consider that management tends to promote people like themselves, so the psychological profile of the typical manager may remain constant through several administrations.

In his theory of *differential association*, Sutherland asserted, “Criminal behavior is learned in association with those who define such behavior favorably and in isolation from those who define it unfavorably... a person in an appropriate situation engages in...
such criminal behavior if, and only if, the weight of the favorable definitions exceeds the weight of the unfavorable definitions.” White-collar crimes were driven by peer pressure. Later scholars and anti-fraud practitioners have criticized Sutherland’s work. As summarized by David Friedrichs, observers charge “Sutherland overemphasized an individualistic framework (and social psychological factors) and largely ignored social structural factors (for example, capitalism, profit rates, and business cycles). He failed to make clear-cut distinctions among white-collar crimes, and he did not adequately appreciate the influence of corporations over the legislative and regulatory processes. Still . . . it is difficult to imagine the study of white-collar crime without Sutherland’s contribution.”

**Albrecht, Howe, and Romney**

Dr. Steve Albrecht, Keith Howe, and Marshall Romney, studied frauds in corporate settings in *Deterring Fraud: The Internal Auditor’s Perspective*. They classified nine motivators of fraud.

1. Living beyond means
2. Overwhelming desire for personal gain
3. High personal debt
4. Close association with customers
5. Perception that pay was incommensurate with duties
6. “Wheeler-dealer” attitude
7. Feeling challenged to beat the system
8. Excessive gambling habits
9. Undue family or peer pressure

Perpetrators of large frauds in their study used the proceeds to purchase new homes and expensive automobiles, recreation property, expensive vacations, support extramarital relationships, and make speculative investments. Those committing smaller frauds applied their gains to more pedestrian ends, such as paying the rent or normal monthly bills. Lack of segregation of responsibilities, placing undeserved trust in key employees, imposing unrealistic goals, and operating on a crisis basis were all pressures or weaknesses associated with large frauds.

Albrecht developed the “Fraud Scale,” ranking situational pressures, perceived opportunities, and personal integrity.

When situational pressures and perceived opportunities are high and personal integrity is low, occupational fraud is much more likely to occur than when the opposite is true.
Albrecht describes situational pressures as “The immediate problems individuals experience within their environments,” usually high personal debts or financial losses. Opportunities to commit fraud, Albrecht says, may be created by deficient or missing internal controls—those of the employee or the company. Personal integrity “Refers to the personal code of ethical behavior each person adopts.

While this factor appears to be a straightforward determination of whether the person is honest or dishonest, moral development research indicates that the issue is more complex.”

**Hollinger-Clark**

Richard Hollinger and John Clark surveyed 10,000 American workers for the book, *Theft by Employees*, and concluded that employees steal primarily as a result of workplace conditions. External factors such as Cressey’s “nonshareable problems” sometimes play a role, but Hollinger and Clark emphasized the structure and behavioral norms of the workplace, declaring that worker dissatisfaction was the single most determinative factor in provoking acts of fraud. A person might need funds to pay off a debt, or the person might feel underpaid and motivated to commit fraud even without an immediate financial need.

Hollinger-Clark concluded that the same kinds of employees who engage in other workplace deviance are also principally the ones who engage in employee theft. They found persuasive evidence that slow or sloppy workmanship, sick-leave abuses, long coffee breaks, alcohol and drug use at work, coming in late and/or leaving early were more likely to be present in the employee-thief.

The researchers found that the single most effective way to prevent theft was to raise the chances, or the employees’ perception of the chances, of getting caught: “The stronger the perception that theft would be detected, the less the likelihood that the employee would engage in deviant behavior.”

Social control in the workplace, according to Hollinger-Clark, consists of both formal and informal social controls. The former control can be described as the internalization by the employee of the group norms of the organization; the latter, external pressures through both positive and negative sanctions.

These researchers, along with a host of others, have concluded that—as a general proposition—informal social controls provide the best deterrent. “These data clearly indicate that the loss of respect among one’s acquaintances was the single most effective variable in predicting future deviant involvement.” Furthermore, “in general, the probability of suffering informal sanction is far more important than fear of formal sanctions in deterring deviant activity.”

**Merton and Schur**

Robert Merton determined that social structures provide the chief motivation for misconduct. Capitalist competition, the importance of money in society, and the erosion
of norms that encourage legitimate moneymaking behavior all encourage individuals to commit crimes.

To Merton, modern industrial societies emphasized the ends (making money) over the means (ethical earning behavior), producing a state of “anomie,” or normlessness, in its citizens. Without ethical guidance, a person will use any means necessary to attain money and power. Edwin Schur also located the impulse for economic crime in social structures. Schur asserted that America hosted so much crime because “American society has what might be termed capitalism with a vengeance—a reverence for the values of individualism, competition, and profit of such intensity as to provide incentives to crime that go well beyond a level that must be considered inevitable in a modern complex society.”

The Fraudster Personality Type
There is no clinical evidence to suggest a single personality type of the average fraud perpetrator. For one thing, acts of fraud and white-collar crimes in general vary widely, from embezzlement to market manipulation to junk science to price-fixing. A few studies have suggested two broad labels often apply to fraudsters: “egocentric” and “reckless.”

Psychologist Walter Bromberg commented on the personality of a successful banker who was convicted for breach of fiduciary duty and who sought treatment at Bellevue Psychiatric Hospital: [The banker] “impressed the examiners as a realistic, though relatively uncompromising individual, independent rather than stubborn, yet unaware of his rather strong tendency toward recklessness. On a deeper level, one could sense in him a certain rigidity of character expressed openly in stubbornness, independence, and lack of compromise. Egocentricity and an unconscious feeling of omnipotence shone through his character structure.”

John Spencer found that most of the thirty white-collar offenders he examined were “reckless and ambitious,” remarkable for “their ambition, their drive, their desire to mix with people of higher social position than their own, and to give their children an expensive private education, and their willingness to take financial risks in the process.” But Spencer cautioned, “It would be a mistake to see the adventurous and ruthless gambler as typical of the white-collar criminal. Such men did not account for more than one-third of the sample.” There were plenty of “muddlers and incompetent men” in the group.

A comparison of 350 white-collar offenders in prison with a control group of executives with no criminal or civil record found the convicted executives were more irresponsible, less dependable, and held a stronger disregard for rules than the control group. Stanton Wheeler examined risk factors to answer the query, “Why do people who are already extremely wealthy individuals risk involvement in white-collar crimes…?” Wheeler asserts that many offenders are “risk seekers” who find their crimes thrilling, who possess “greed as a personality trait: people who want even more, more than they already have.” Another personality is driven to defalcation by “fear of falling” from privileged status.
An analysis led by David Weisburd found a similar force at work in its sample of convicted white-collar offenders. Weisburd reported, “The fate of organizational success and failure, or the changing nature of the economy in their line of work, may put them at least temporarily under great financial pressure, where they risk losing the lifestyle they have achieved.”

These inconclusive results suggest that white-collar criminals, while generally incautious and driven by ambition, are a varied lot. Some are charismatic, energetic promoters while others are reserved, calculating embezzlers. Coleman suggests, “A particular personality orientation will facilitate criminal activities in one occupational situation and discourage them in another, so that no single set of characteristics is conducive to crime in all situations. For example, nonconformists might well be more likely to become involved in an occupational crime directed against an employer but less likely to go along with an organizational crime demanded by the employer” while a strict conformist would tend in the opposite direction.”

**Social Sanctions Essential to Prevent Cheating**

Drs. Ernst Fehr and Simon Gachter published the results of a series of experiments designed to test people’s propensity to cheat in social situations, and the effects of economic punishment and social sanctions on known cheaters.

The experiments involved 240 students who were placed in scenarios to determine the “public goods,” or altruistic acts, each was willing to commit, how much cheating would take place, and how members of the group responded to cheaters. The students received real money according to how well they fared in the various scenarios. Each was given 20 “monetary units” and played games with rotating groups of three other participants.

The members of each group independently decided how much of their sum to contribute to a community project, then shared in the total proceeds at the end. The more generous each contributor, the better the group did as a whole. But the more each person held back, the greater “profit” each made. For example, A might put in 20 dollars but receive the same dividend at the game’s end as B, who put in only 8 dollars. In a real-world analogy, A represents an honest citizen contributing a fair share, while B is a scofflaw or fraudster. After each round, students learned the investments made by others in their group. In some cases, the participants were powerless to sanction their fellows. Under these conditions, cooperation quickly broke down and everyone contributed less to the community chest each round.

In other instances, the group was allowed to sanction shirker participants. An indignant group member could donate 1 monetary unit to punishment, forcing the shirker to match the contribution with 3 units. A key factor was that penalizing shirkers cost the cooperative members money as well. The stakes were real because the students only took home as much real money as they managed to acquire in the game. Still, however costly, punishment was a popular choice:

- 84% of participants chose to punish shirkers at least once.
- 34.3% punished five times or more.
Almost 10% punished 10 times or more.

Fehr and Gachter concluded they had evidence people will seek to punish a cheat even when the punishment is costly them and offers no material benefit. These factors match the general definition of altruism, i.e., selfless acts for the communal good. The doctors speculated that the threat of such punishment might have been crucial to the development of human societies.

Participants exhibited a high degree of indignation at others’ wrongdoing. When asked to describe their feelings toward shirkers on a seven-point scale, from “no big deal” to “very angry,” 84% ranked themselves a five or higher. A sense of emotional outrage is very easily evoked, said Dr. Fehr, and sometimes it feels almost good to indulge and stoke it. “It’s a very important force for establishing large-scale cooperation,” Dr. Fehr told the New York Times. “Every citizen is a little policeman in a sense. There are so many social norms that we follow almost unconsciously, and they are enforced by the moral outrage we expect if we were to violate them.”

Dr. David Sloan Wilson, an evolutionary biologist at the State University of New York at Binghamton, said, “People are used to thinking of social control and moralistic aggression as forms of selfishness, and that you must be punishing someone for your own benefit. But if you look at the sort of punishment that promotes altruistic behavior, you see that it is itself a form of altruism.”

Sources: