The Origins of Ethical Failures

Lessons for Leaders

Dennis Gentilin

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DENNIS GENTILIN

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About the Author

Dennis Gentilin is a financial services professional who has been employed in the banking industry for over 15 years. His first ten years were spent working in a variety of roles in financial markets, and more recently he worked within corporate strategy.

Without question Dennis's defining career moment was his association with the FX trading scandal that rocked the National Australia Bank (NAB) in 2004. Although he was publicly named as a "whistleblower" in that incident, he has been reluctant to allow this label to define him (for better or worse) and become central to his identity.

This being said, it goes without saying that this experience profoundly shaped Dennis and his view of the world. What's more, his inquisitive nature and capacity for deep thought means that he reflected on the incident like very few would, allowing him to develop a unique perspective on business ethics.

It is only recently that Dennis felt compelled to share his insights. The result is this very unique business book that combines a memoir on a real life experience with a meditation on our flawed humanity. Within these pages Dennis has managed to salvage, in a way very few could, the lessons associated with an ethical failure.

Dennis's primary motivation for writing *The Origins of Ethical Failures* is to educate. He hopes that the lessons herein will be valuable to all leaders, and illustrate the central role they play in creating institutions that are more resilient to unethical conduct.

However, in addition, Dennis hopes the book will play a role in continuing the push we have seen in recent times that looks to make ethics a key priority in the business world. As he himself says, the costs associated with failing to do this are too great:

> *Ethical failures produce no winners. The victims are not just those found guilty of engaging in illegal or unethical conduct. Community*

and customers lose faith in a brand they once believed in, shareholders suffer considerable losses, and employees are left to deal with the drawn out consequences associated with loss of trust and greater scrutiny. Ultimately, society at large carries the cost.

Dennis lives in Melbourne, Australia with his wife Kate and two daughters Amelia and Charlotte.

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Foreword

In January 2004 a "whistleblower" in the currency options team at the National Australia Bank (NAB) raised concerns about the team's trading position. Two weeks of internal investigation revealed $360 million in losses due to unauthorised transactions. By mid-February 2004 both the bank's CEO and chairman had resigned. Four currency traders and their supervisor were dismissed and the bank's executive general managers of corporate and institutional banking, markets and risk were replaced. One of the traders, head of the foreign currency options desk, subsequently received a gaol sentence. Of course, the biggest losers, collectively, were NAB shareholders. As investors lost confidence in a corporate culture that could incubate this sort of employee behaviour, NAB's share price plunged and the organisation quickly lost its status as Australia's biggest bank. Ultimately, the losses suffered by shareholders were several multiples of the financial losses incurred by the currency options team.

Whistleblowing takes a great deal of courage. And it is easy to understand why those who do blow the whistle on their colleagues might want to walk away from an organisation that had put them in such a difficult position. Instead of walking away, Dennis Gentilin asked himself "why?". The behaviours that he had observed, and which had led him to blow the whistle, were not obvious instances of people confronting an ethical dilemma, having to choose between "right" and "right"; rather, people were choosing "wrong". Was this because of who they were (a few "bad apples") or because of the situation in which they found themselves (a "rotten barrel")?

This book was motivated by a particular set of experiences in a particular corporation. But this is not a book principally about those experiences, nor is it a book principally about the NAB. This is a book about business ethics with general applicability. The questions it raises are those that affect all businesses. And the lessons will prove valuable to those with leadership (and "followership") responsibilities in all commercial organisations; to all of those who have a responsibility to insist on compliance with rules, regulations and other artefacts of governance, but who know that their most important obligation is to lead, through character and morality, the development of an ethical business culture.

Successful leaders will embrace humility. All organisations are fallible. And the coercive imposition of rules and regulations, and even credible transparency mechanisms, cannot be relied upon to ensure ethical conduct; in certain cases these can even make things worse.

There are no simple answers in this book. But there are answers. And there are important truths, supported by deep and rigorous analysis. These should be of interest to all corporate leaders, in both executive and non-executive roles. One such truth is that "leaders must strive to articulate a meaningful social purpose for their organisations that is underpinned by a virtuous set of values". Not all corporate leaders will appreciate the connection between this proposition and the enhancement of shareholder value; that is, until they read this book.

Dr Ken R. Henry AC, NAB Chairman

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Introduction

If only there were evil people somewhere insidiously committing evil deeds, and it were necessary only to separate them from the rest of us and destroy them. But the line dividing good and evil cuts through the heart of every human being.[1]

Aleksandr Solzhenitsyn, The Gulag Archipelago

WHY CAN'T THE BANKING INDUSTRY SOLVE ITS ETHICS PROBLEMS?

Neil Irwin, *The New York Times*, 29 July 2014.

The financial crisis that nearly brought down the global economy was triggered in no small part by the aggressive culture and spotty ethics within the world's biggest banks. But after six years and countless efforts to reform finance, the banking scandals never seem to end.

The important question that doesn't yet have a satisfying answer is why.

Why are the ethical breaches at megabanks so routine that it is hard to keep them straight? Why do banks seem to have so many scandals—and ensuing multimillion dollar legal settlements—compared with other large companies like retailers, airlines or manufacturers?

Some of the world's leading bank regulators are trying to figure that out. And they have taken to sounding like parents who have grown increasingly exasperated at teenage children who keep wrecking the family car.

After reading the beginning of this article by Neil Irwin, my first response was to check the date it was published. Had I accidently clicked on a link that took me to an article written five or maybe ten years earlier? Is Neil Irwin caught is some sort of time warp? Surely, with everything that we have experienced and learned, we are still not angered, discouraged and perplexed by the poor behaviour of bankers?

Sadly, I was mistaken. Although I had been toying with the idea of writing a book on the origins of ethical failures in business for some time, reading this article made me realise I had no choice but to insert myself into the conversation. Not that the conversation needed another person expressing a view, but I believed I had a contribution to make. And for good reason.

My first foray into corporate life exposed me to an experience that brought to life the issue of ethics as it applies to the business world in the most dramatic of ways. As a young, bright-eyed and impressionable graduate, I joined a team that became involved in a FX trading scandal that resulted in the resignation of the chairman and CEO, the upheaval of the board of directors, significant financial loss and incalculable reputational damage to one of Australia's largest banks, the National Australia Bank (NAB). In the years that followed the incident and subsequent court cases, there was one question that preoccupied me and continues to fascinate me today. How could a group of intelligent, well-educated people from privileged backgrounds be involved in behaviour which was by anyone's measure clearly unethical?

What made this question even more intriguing was the nature of the ethical dilemmas that were faced by both the traders and the leaders within the business, that are typical of the majority of the dilemmas underpinning the well-known ethical failures that have plagued the banking and finance industry and the broader business world. The ethical dilemmas did not involve a decision between "right versus right", where one must make an excruciating choice between competing moral values.[2] Rather, they involved "right versus wrong" decisions, where a choice needed to be made between an alternative that was clearly ethical and one that was clearly not. That is to say, the dilemmas pitted a moral value against basic self-interest, and in the end self-interest won out, despite what was ethical and "right" being clearly distinguishable from what was unethical and "wrong".

At the time of the FX trading scandal, the field of business ethics primarily focused on compliance. This is hardly surprising as scholars in the field adopted the so-called "normative" approach, which assumes that individuals are rational, self-interested beings who are aware of the ethical dilemmas they face and understand the implications of unethical conduct (so-called *homo economicus*). This approach is compelling because it is both simple and intuitive – people understand the rules, and if they break them they do so knowingly, fully understanding the implications. My experience illustrated to me in no uncertain terms the shortcomings of this approach. What's more, the litany of ethical scandals that have occurred since the FX trading incident, despite the heightened focus on compliance, further illustrate that rules, regulation and governance are only part of the story.

This does not mean that compliance has no role to play in promoting ethical conduct. To the contrary. Boundaries are required, but once established, boundaries can and will be broken. As Oscar Wilde famously said, "I can resist everything but temptation" – compliance and regulation cannot engender character and morality. I have spent the years since the trading scandal searching for an explanation as to why people don't behave as the normative approach dictates. Why do intelligent, well educated individuals transgress ethical boundaries when confronted by them? And what's more, why do these same individuals transgress these boundaries even though doing so is clearly unethical?

Serendipitously, when I joined the trading desk as a graduate, the field of behavioural business ethics began to emerge. Behavioural business ethics is the point of intersection between the fields of business ethics and psychology, and attempts to address the shortcomings of the normative approach. Namely, the field attempts to provide explanations for why humans, when faced with an ethical dilemma, respond in ways that the normative approach would label irrational. Behavioural business ethics has provided significant insight into the topic of business ethics, and more importantly, many of its key findings speak to my experience. By highlighting these key findings, this book builds a coherent narrative to explain the why: Why unethical conduct is and will continue to be part of the business world.

There is a cautionary note for readers here. Although insightful, we must be careful on how we interpret and apply the findings emanating from the research in this field. Specifically, making conclusions about its broader applicability must be done prudently. Like research from any domain, there is always a question mark over whether the findings can be applied to real-life settings (the so-called "external validity"). This is especially the case when the research is conducted in a laboratory, where the context and participants (in the case of psychology typically undergraduate university students) are not representative of that which exists in the setting to which the findings are being applied. Readers who follow the field of psychology would be familiar with the reproducibility project – the results from its recent attempt to replicate the findings of 100 psychological studies were sobering and illustrative of this point.[3] They provide cause for pause and reflection among both psychologists and those who report on and apply their findings. This cautionary note aside, it would also be remiss to neglect or underestimate the insight provided by the field. The sheer volume of the findings, coupled with the calibre of the academics behind it, make it very compelling.

In addition to borrowing from the field of behavioural business ethics, this book also draws heavily from my own personal experience on the trading desk. This is not done to explain the what, when, who and how of the incident – this has been adequately covered in other publications.[4] Rather, the insights this experience has provided me with are used to complement the theory. Readers should not assume that the key lessons from the book are therefore only relevant to the world of financial markets. My subsequent corporate experience and research into other cases of unethical conduct have taught me that there are similar dynamics underpinning most of the well-documented ethical failures. Be it phone hacking in journalism, drug taking in cycling or rate fixing in financial markets, there are parallels in how the unethical conduct associated with these events originated. Where possible the book draws on examples from other ethical failures to illustrate this point.

I have not written this book as an academic, a philosopher or an ethicist. Rather, I have written this book as a practitioner, in the truest sense of the word. My objectives are fourfold. Firstly, I aim to enlighten leaders in the business world of how unethical behaviour can occur, despite the presence of robust governance and compliance frameworks. Secondly, I want to illustrate how explanations for unethical behaviour are not straightforward – reasons for unethical conduct are multi-layered and complex. Thirdly, I hope to make leaders recognise that we are all susceptible to unethical conduct, regardless of how scrupulous our characters may be. Finally, I want to illustrate the central role leaders play in developing cultures that are more resistant to ethical failures, and cultures that are better equipped to deal with the fall out of unethical behaviour when it occurs.

Leaders need to be warned that building ethical cultures is not easy. There is no technical solution to this challenge, no lever that can be pulled to drive ethical conduct among all of an organisation's employees. Creating an ethical culture is a classic adaptive problem, because it involves winning the hearts and minds of employees. As Ronald Heifetz and Marty Linsky outline in their book *Leadership on the Line,* adaptive problems require a special type of leadership, because by challenging people's "habits, beliefs and values", they stimulate resistance.[5] They go onto say:

> *Because real leadership – the kind that surfaces conflict, challenges long-held beliefs, and demands new ways of doing things – causes pain. And when people feel threatened, they take aim at the person pushing for change.*