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# PRIVATE POLICING

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## Chapter 9

# SELF-REGULATION AND THE CONTROL OF CORPORATE CRIME

JOHN BRAITHWAITE  
BRENT FISSE

Much has been written in recent years on the sheer volume of corporate crime and on the very slim enforcement resources available to control it (Geis, 1973, 1982; Reiman, 1979; Clinard and Yeager, 1980; Grabosky, 1984; Wickman and Bailey, 1982). What this literature shows us is that corporate crime is responsible for more property loss and more injuries to persons than is crime in the streets. Yet we know it is politically and fiscally unrealistic to expect that our generation will see the public resources devoted to corporate crime control approach anywhere near those expended on crime in the streets. Thus, the relevance of assessing how much private enforcement might contribute to corporate crime control.

Corporate crime is defined here as conduct of a corporation, or of individuals acting on behalf of a corporation, that is proscribed and punishable by law (Fisse and Braithwaite, 1983: 317). It is not difficult to understand how private policing by corporations can have an important role in protecting corporations from being victims of crime. Indeed the editors of this volume have been the leaders in fostering such an understanding (Shearing and Stenning, 1981). But why should corporations spend resources on private policing programs to stop offences when they are the offenders and the intended beneficiaries of the wrongdoing?

There are many reasons why they do. First, the question assumes an overly economically rational view of corporate behavior: Corporations are at times moral actors that are concerned to obey the law because to do so is ethically right, even if costly (Stone, 1985). Second, corporations are in many ways even more concerned about their reputations than are individuals; individuals often sub-

jugate economic rationality to preservation of their good name and self-respect, and so too do corporations (Fisse and Braithwaite, 1983). Third, corporations often invest in self-regulation to preempt the less palatable alternative of government regulation (Cranston, 1984: 59). Indeed, governments sometimes enter into a tacit social contract with business: unless business makes self-regulation work, public intervention will be the result. There are other reasons as well, but we need not devote time to them. The simple fact is that companies do spend considerable resources on self-regulation, so that the study of how effective self-regulation can be is an important topic. Self-regulation is defined broadly to include social control against corporate crime engaged in by both individual corporations and trade associations. It includes private enforcement of the law and private enforcement of corporate policies designed to prevent corporate offences (such as accounting policies designed to prevent slush funds and bribes).

Over the past decade we have been involved in three empirical studies of how corporations regulate themselves (Fisse and Braithwaite, 1983; Braithwaite, 1984, 1985). The illustrations in this chapter are drawn from these studies, though much of the material did not appear in any of the three books. The case studies used describe the situation as it existed in the companies discussed at the time that the fieldwork was conducted between 1978 and 1983.

### THE VIRTUES OF SELF-REGULATION

Clinard and Yeager (1980: 95-97), among others, have documented the abysmally ineffective coverage of workplaces by occupational health and safety inspectors, pollution outlets by environmental inspectors, consumer product safety lapses by consumer protection officers, and so on. A program of self-regulation has the potential to expand coverage dramatically. Under the terms of Section 15A of the Securities and Exchange Act of 1934, for example, the National Association of Securities Dealers (NASD) inspects offices, books, and records of its members for violations of SEC regulations. In 1968, 45% of NASD members were inspected under this program (Katz, 1976: 161, 167). In 1969, by way of contrast, SEC inspectors surveyed only 5 1/2% of dealers who were not members of the NASD (Securities and Exchange Commission, 1969).

In addition to a capacity to achieve wider coverage, self-regulation can achieve greater inspectorial depth. In the interna-

tional pharmaceutical industry, for example, a number of the more reputable companies have corporate compliance groups that send teams of scientists to audit subsidiaries' compliance with production quality codes. In one Australian subsidiary of an American firm visited, inspections by the headquarters compliance group were conducted twice yearly and were normally undertaken by three inspectors who spent over a week in the plant. The government health department inspection, on the other hand, consisted of an annual one-day visit by a single inspector. Although employees had advance warning of the government inspection, the corporate compliance group arrived unannounced.

Corporate inspectors also tend, at least in the pharmaceutical industry, to be better trained than their government counterparts. It is commonplace for corporate inspectors to have doctorates. Corporate inspectors' specialized knowledge of their employer's product lines also make them more effective probers than the government inspectors, who are forced to be generalists. Their greater technical capacity to spot problems is enhanced by a greater social capacity to do so. Corporate compliance personnel are more likely than government inspectors to know where "the bodies were buried," and to be able to detect cover-ups. One American pharmaceutical executive explained in part why this is so:

Our instructions to officers when dealing with FDA inspectors is to only answer the questions asked, not to provide any extra information, not to volunteer anything, and not to answer any questions outside your area of competence. On the other hand we [the corporate compliance staff] can ask anyone anything and expect an answer. They are told that we are part of the same family, and unlike the government, we are working for the same final objectives.

Perhaps this statement exaggerates the goodwill between company employees and internal compliance inspectors. The production manager of the Guatemalan subsidiary of another company was asked: "Do you think of the internal quality auditors from headquarters as part of the same team as you?" His answer probably grasped the reality: "I think of them as a pain in the ass."

The power of corporate inspectors to trap suspected wrongdoers is often greater than that possessed by government investigators. One quality assurance manager told of an instance where this power was used. His assay staff was routinely obtaining test results showing the product to be at full strength. The manager suspected that

when they found a result of 80% strength, the laboratory staff would assume that the assay was erroneous, simply mark the strength at 100%, and not recalculate the test. The manager's solution was periodically to "spike" the samples with understrength product to see whether his staff would pick out the defects. If not, they could be dismissed or sanctioned in some other way. Government inspectors do not have the legal authority to enter a plant and entrap employees with a spiked production run.

Another example of the greater effectiveness of internal inspectors concerns a medical director who suspected that one of his scientists was "graphiting" safety testing data. His hunch was that the scientist, whose job was to run 100 trials on a drug, instead ran 10 and fabricated the other 90 so they would be consistent with the first 10. The medical director possessed investigative abilities that would have been practically impossible for a government investigator. He could verify the number of animals taken from the animal store, the amount of drug substance that had been used, the number of samples that had been tested, as well as other facts. His familiarity with the laboratory made this easy. As an insider, he could probe quietly without raising the kind of alarm that might lead the criminal to pour an appropriate amount of drug substance down the sink.

We have seen that corporations may be more capable than the government of regulating their business activities. But if they are more capable, they are not necessarily more willing to regulate more effectively. Although self-regulation can be potent in theory, all too often in practice it is little more than a symbolic activity. Our comments earlier about corporations being concerned about much more than profit maximization do not mean that economic rationality does not place an enormous constraint on self-regulation in practice.

This is why elsewhere we have developed the idea of enforced self-regulation—a proposal for exploiting the superior breadth and depth of self-regulatory surveillance by forcing it upon industry, as it were (Braithwaite, 1982; Braithwaite and Fisse, 1985). This is also why sophisticated regulatory agencies often effectively compel self-regulation by threatening draconian government intervention unless industry produces solid evidence that self-regulation is working well. Moreover, one of the best ways of securing industry commitment to making corporate compliance systems work is by prosecutions of senior executives: executives—particularly chief executives—who are afraid of conviction will impose much greater demands on their self-regulatory systems.

This chapter is not about how to force industry to self-regulate; it is about how to make self-regulation effective, given a commitment to this approach. But this does not imply any naive assumption that we need rely only on the goodwill of business to secure these achievements.

### THE ESSENTIAL REQUIREMENTS OF AN EFFECTIVE SELF-REGULATORY SYSTEM

One of the authors examined, largely on the basis of interviews with executives, the characteristics of the internal compliance systems of the five American coal mining companies with the lowest accident rates for the industry in the early 1980s. He also reviewed other empirical work on the organizational characteristics associated with safety in mines (Braithwaite, 1985: 41-71). A characteristic that consistently emerged was that companies with good safety records had detailed plans of attack to deal with identifiable hazards. This may be a characteristic that is not as relevant to determining the effectiveness of other kinds of internal compliance functions as it is for occupational health and safety. However, the other features that emerged from this empirical work seem to us of likely general relevance. Companies that effectively self-regulate share the following characteristics:

- (1) a great deal of informal clout and top management backing is given to their compliance personnel (safety inspectors in the case of mine safety);
- (2) accountability for compliance performance is clearly defined and placed on line managers;
- (3) that performance is monitored carefully and managers are told when it is not up to standard;
- (4) compliance problems are effectively communicated to those capable of acting on them; and
- (5) training and supervision (especially by front-line supervisors) for compliance are not neglected.

These characteristics of successfully self-regulated corporations will be considered in turn.

### CLOUT FOR INTERNAL COMPLIANCE GROUPS

At a recent seminar on laws to control animal experimentation one of the authors asked the animal welfare officer from a very



large Australian research institution how she dealt with researchers who refused to comply with Australia's voluntary code on the use of animals in experiments. "Easy," she said, "If they don't do what I ask, I don't give them any more animals." Her role encompassed the ordering and delivery of animals to experimenters. This gave her organizational clout in dealing with researchers. Most fundamentally, then, clout for internal compliance groups comes from their control of resources that are important to those who must be made to comply.

Clout is central in the same way to the success of government regulators. Health departments find it easier to control drug companies than food outlets, and find it much less necessary to resort to law enforcement to do so because health departments hold sway over so many decisions that affect the success of pharmaceutical companies. They decide whether new drugs will be allowed on the market, and if so, with what promotional claims, at what price, and with what quality-control requirements during manufacture. Organizational actors are more compliant with requests from actors who control vital resources (such as approvals and licences) for the organization.

Often it is organizationally difficult to give compliance staff control over contingencies that matter to those regulated. In these circumstances, it is important for top management clearly to communicate the message to the organization that in any dispute it is likely to stand behind its compliance staff. Regrettably, in most organizations the opposite message is part of the folklore of the corporate culture—that when the crunch comes, management will stand behind its production people and allow them to push aside that which impedes output. In contrast, with the coal mining safety leaders visited, when a company inspector recommended that a section of a mine be closed down because it was unsafe, in all five companies it was considered inadvisable for line managers to ignore the recommendation because of the substantial risk that top management would back the safety staff rather than themselves.

Quality-control directors in many pharmaceutical companies are given clout by quite formal requirements that their decisions can only be overruled by a written directive of the chief executive of the corporation. This gives quality control unusual authority because not many chief executives want to risk their career by overruling their technical people for the sake of a single batch of drugs, when the danger—however remote—is that this batch could kill someone.

## CLEARLY DEFINED ACCOUNTABILITY

A senior pharmaceutical company executive once explained, "There's a Murphy's Law of a kind: If someone else can be blamed, they will." Active policies to resist this tendency are needed for companies to be effectively self-regulating. At all five coal mining safety leaders, the line manager, not the safety staff, was held accountable for the safety of his work force. A universal feature was also clear definition of the level of the hierarchy that would be held responsible for different types of safety breakdowns. They were all companies that avoided the problem of diffused accountability: People knew where the buck stopped for different kinds of failures.

In contrast, companies with little will to comply sometimes draw lines of accountability with a view to creating a picture of diffused responsibility so that no one can be called to account should a court look into the affairs of the company. Everyone is given a credible organizational alibi for blaming someone else. Perhaps worse, other non-self-regulating companies calculatedly set out to pass blame onto others. Thus, some pharmaceutical and pesticide companies have some of their most dicey toxicological testing done by contract laboratories that survive by telling large companies what they want to hear. They get results indicating the safety of their products without risking the consequences of a conviction for the presentation of fraudulent data. The use of sales agents to pay bribes is perhaps the best-documented device of this sort in the corporate crime literature (Reisman, 1979; Boulton, 1978; Coffee, 1977).

At three of the large American pharmaceutical companies visited it was revealed that there was a "vice-president responsible for going to jail," and two of these were interviewed. Lines of accountability had been drawn in these organizations such that if there were a problem and "someone's head had to go on the chopping block," it would be that of the "vice-president responsible for going to jail." These executives probably would not have been promoted to vice-president had they not been willing to act as scapegoats. If they performed well, presumably they would be shifted sideways to a safer vice-presidency. Corporations can pay someone to be their fall-guy in many ways. Exceptionally generous severance pay is the simplest method. In summary, most companies make little effort clearly to define lines of responsibility for compliance: The result is that when something does go wrong the complexity of the organization is usually sufficient to make it difficult to convict any individual. Calculatedly noncompliant companies

sometimes create lines of accountability that will point the finger of responsibility away from their top managers. And effectively self-regulating companies have principles of responsibility that make it clear in advance which line managers will be held responsible should certain types of noncompliance occur. However, a number of the pharmaceutical companies visited had an each-way bet: They had clearly defined lines of accountability for their internal disciplinary purposes, while contriving to portray a picture of confused accountability to the outside world. The fact that the latter does occur is one reason why "private police" can be more effective than "public police," and why self-regulation has the potential more effectively to punish individuals than government regulation.

### MONITORING COMPLIANCE PERFORMANCE

Two of the surprising findings from the survey of the organizational characteristics of coal mining safety leaders were that the size of the safety staffs of these companies varied enormously, as did the punitiveness of their approach to disciplining individuals who breached safety rules. It was expected that among the defining characteristics of companies that were leaders in safety would be that they would spend a great deal on safety staff and would be very tough on safety offenders. Although a large safety staff is not necessarily a characteristic of safety leaders, putting enormous accountability pressures for safety on line managers is. Although a policy of sacking or fining safety offenders on the spot is not typical, communication of the message that higher management is deeply concerned when individuals break the rules is universal for safety leaders.

There is no magic formula for how this is achieved, because, as Bethlehem Steel's Director of Safety pointed out, "You can't cook-book safety." Each company must find a solution appropriate to its corporate culture. But to illustrate how one company monitors safety performance and communicates the message that top management cares about safety, we will use U.S. Steel. This will be followed by case studies of Exxon and IBM.

#### U.S. Steel

U.S. Steel leaves no ambiguity in its official communications about where safety stands in the hierarchy of priorities. For example, the corporate "Safety Program" document states the following:

It is doubtful that any company ever made significant safety progress just by being "interested in" or "concerned about" safety, as it is so often expressed. Rather, management—top management—must have strong convictions on the necessity for placing safety first, above all other business considerations (p. 4).

On the monitoring side, foremen, departments, and entire plants must all produce summary safety activity reports either weekly or monthly. These indicate how many safety contacts, observations, injuries, disciplinary actions, job safety analysis conferences, unsafe conditions, and inspections there have been during each week. These reports ensure the accountability of foremen, department heads, and superintendents for the safety performance of their units.

The accountability mechanism for general superintendents of mining districts is more interesting. The general superintendents attend a monthly meeting with the president of the mining company and other senior executives at corporate headquarters. Each general superintendent, in turn, makes a presentation on his or her district's performance during the previous month—first, on safety performance (that is, accident rates) and, second, on productive performance (tons of coal mined). After the safety presentation, the corporate chief inspector of mines has the first opportunity to ask questions. If the accident rate has worsened in comparison to previous months, or to other districts, the question invariably asked is, Why? The 24 or 25 senior people who attend these meetings exert a powerful peer-group pressure on general superintendents whose safety performance is poor. It is an extreme embarrassment for general superintendents to have to come back month after month and report safety performances falling behind those of other districts.

These meetings, incidentally, also fulfill the function of regulatory innovation. Each mining district, rather than the corporation as a whole, writes its own rule book. General superintendents who have introduced new rules or technologies that have worked well in reducing accidents will score points by mentioning these successes in their reports. Other districts will then adopt these controls. An advantage of the combination of decentralized rule making and centralized performance assessment is that creative approaches to reducing accidents may be more likely to emerge than under the stultifying influence of a corporate book of rules.

## Exxon

A different example of how a large corporation can monitor the compliance performance of its far-flung operations is provided by the oil giant, Exxon. Exxon has a controller, a vice-president who has responsibility for monitoring compliance with all types of corporate rules—from environmental protection to accounting rules. Each region (for instance, Esso Europe) has a regional controller, and each subsidiary within the region has a controller. In addition to reporting directly to the chief executive of the subsidiary, the local controller has an important dotted-line reporting relationship through the regional controller up to the controller's office in New York. Even though the local organization is paying for its controller and the local auditing staff, the corporate controller ultimately determines the size of the local controller's work force. Auditors are therefore not tied to the purse strings of those whom they are auditing.

The controller is given responsibility for operational as well as financial auditing. Audits serve the dual purpose of improving operational efficiency and detecting deviations from proper bookkeeping procedures. Control activities, such as inventory, which were formerly independent of the auditing function, are now integrated into a total system of audit and control. Audits incorporate an assessment of whether standard operating procedures adequate to ensure compliance with company policies are in place, and whether these procedures are being consistently followed. An audit of a manufacturing facility includes, for example, an assessment of whether corporate industrial safety policies are being followed. Because of the range of skills that such operational audits demand, interdisciplinary teams that include engineers as well as financial auditors are used. The internal auditing function involves more than 400 people worldwide.

Responsibility for the accounting integrity side of the audit rests with the general auditor, who reports administratively to the vice-president and controller. However, the general auditor can bypass the controller and report directly to the audit committee of the board, which is composed entirely of outside directors.

Like U.S. Steel, Exxon therefore has centralized monitoring of compliance, albeit covering a more all-embracing range of areas of compliance under one controller function. Even though Exxon has much more centralized rule making than U.S. Steel, with detailed manuals of standard operating procedures being issued by the con-

troller in New York, there is provision for local units to engage in principled dissent from the manuals. For example, deviations from corporate accounting principles are allowed, but must be approved "by the appropriate Regional Controller and Regional General Auditor in writing, and will be recorded in a central registry in the regional office, and at the affiliates' offices" (Exxon Corporation, 1973).

The controller function aims to create an organization full of "antennas." It was set up in response to top management's shock when it was discovered that bribery was happening on a massive scale in its Italian subsidiary during the 1970s. But like U.S. Steel, and like all companies with outstanding compliance systems, control is a line—not a staff—responsibility. The job of the controller's staff is to monitor and ring alarm bells to top management when corporate policies are not being enforced by line management. In the words of the controller: "Audit is not the control. Audit is the monitor of the control."

An underlying principle of the Exxon system is that no one is to have unaccountable power. Consider the question, "Who audits the auditors?" This problem is dealt with by peer review. The headquarters auditing group might audit the Asian Regional Auditing Group and the European Regional Group might audit the headquarters auditing group. Auditors are auditing other auditors all over the world.

In addition to formal audits, all subsidiaries have a kind of self-audit in the form of a triennial "business practice review." In this review, managers, after having refreshed their memories on the objectives of corporate ethics policies, assess all their current practices—bookkeeping, bidding, making gifts to customers, expense accounts, the lot—to root out any areas that leave open the possibility of abuse. It is a kind of corporate "cultural revolution," an attempt to keep alive among the masses the fervor to be watchful against unethical practices. Business practice reviews were introduced in 1976 in part as a way of dealing with Exxon's morale problems from the Italian bribery disclosures. Exxon management wanted to make their employees believe in the honesty and integrity of the company. The business practice reviews achieved that goal. By involving middle and junior managers in the campaign to eliminate unethical practices, Exxon convinced its own people that it was serious about its new ethics policy. Some company units found that the reviews were so effective and so good for morale that they involved lower-level employees, such as salespeople, in the



process. The controller had never really intended that the reviews widely involve these lower levels; but he was happy enough with the result. Quite apart from the other favorable effects, he felt that the reviews had helped managers in the field to understand the reasons for many of the requirements imposed on them, and therefore made the task of the auditors easier. The reviews must also help keep the controller's staff on its toes to ensure that a problem that should have been identified does not surface in a business practice review.

## IBM

To ensure compliance with its corporate policies—indeed, in all areas of business—IBM relies heavily on its so-called contention system. The contention system sets up a friendly adversariness between staff and line. If the general counsel of a subsidiary makes an objection to the subsidiary chief over a marketing practice perceived as contravening company policy, and if that objection is overruled, this must be reported to division counsel. If the latter agrees with the local counsel, the objection is taken up with the division chief executive to whom the local chief answers. Should the division chief executive support the local chief whereas the division counsel supports the local counsel, the contention will move up to a higher level of the organization. Ultimately, it might be decided in a discussion between the chairman and the general counsel, in which the chairman will have the final say. Such a formalized contention system between the line and staff reporting relationships increases the probability that problems will be flushed out into the open.

At the outset, we said that the contention system was friendly. Organizations cannot afford to undermine cooperation by fostering a war of all against all, so certain informal codes of fair play are followed. When a staff person feels compelled to blow the whistle on a line manager up through the staff channels, good form is to warn the line manager before the event. This gives the line manager two possible "outs." Recognizing that the staff person means business, the line manager can back down. Or, the line can itself report the problem up through staff channels. The latter protects the line manager from any accusation that he or she was trying to cover up problems from staff scrutiny.

IBM has a control function run by the internal audit group that monitors compliance with both financial and nonfinancial policies in a way similar to the Exxon controller. As in Exxon, their role is to assist the control of top management over the total management system. A total of 260 internal auditors check compliance with all corporate policies within each subunit on approximately a three-year cycle.

IBM executives, like those at Exxon, argue that the costs of the control function are paid for by the savings it generates in rooting out inefficiency or catching employees who are ripping off the company. A pleasant irony of self-regulation is that programs to detect corporate crime also uncover crimes against the corporation by employees (Fisse and Braithwaite, 1983: 180). Overly costly controls are reduced or eliminated by challenging employees to identify controls that have proven cost-ineffective. The control function also pays its way through being vital to the corporation's system for monitoring performance. IBM is a corporation based on action plans, and individuals and subunits are evaluated according to comparisons between actual results and those that are projected in the action plan. An important efficiency rationale for the control function is, therefore, that it ensures that the performance indicated in the books (be it production, profits, or industrial accidents) reflects the reality. If you manage by commitment, control over the measurement of performance is essential. By ensuring that everyone's performance is measured by the same yardsticks, the control function minimizes the loss of motivation that comes from feeling that others are exceeding their targets because they are using different counting rules.

Important among the action plans are those that result from the discovery of deficiencies in audits. A determinate period for the implementation of measures to rectify the deficiency will be set, and at the end of the period there will be an audit of compliance with the remedial requirements. The IBM management system is based on the notion that "we don't want surprises." Each year the local controller sends up an "early warning system report" to the divisional controller and so on up to the corporate controller. The early warning report is to identify any business control problem that may be emerging. It is a way of dealing with the problem of the executive who says, "I would have reported it up, but first I wanted to be sure that something was wrong." Any problem that suddenly emerges in full-blown form will attract a reprimand of "How come I wasn't seeing that in the early warning report?"

We asked representatives from the environmental, health, and safety management areas what they thought of the job that auditors did in ensuring compliance with environmental, health, and safety policies. The responses were guardedly critical. Executives from specialist areas see the internal audits as broad brush and, at three-year intervals, too infrequent for their specialized compliance purposes. Internal audits tend to ignore detail, which is vital to assessing environmental, health, and safety compliance (such as checking the calibration of equipment) and lack a sophisticated understanding of what constitutes reasonable levels of exposure to dangerous substances. Generalist auditors, in spite of any scientific training they might have, are seen as lacking the specialized training and experience to pick the real problems (which might have nothing to do with observance of the rules) that could cause an environmental or safety crisis.

On the other hand, there are important advantages in having nonfinancial compliance audits conducted together with financial audits. The whole point of the control function is to alert top management to control deficiencies. In contrast, normal environmental and health and safety management systems are not designed as vertical reporting systems right up to the top management suites. They are partly horizontal, partly vertical mixes of dotted- and solid-line reporting and/or advisory relationships that have built into them various possibilities for communication blockages capable of preventing "bad news" from getting up the organization. Hence, it would be undesirable to limit the controller's role or the role of the internal audit group to reporting up only financial violations unearthed in audits. Interdisciplinary auditors are capable of picking up many, if not most, gross deviations from prudent environmental, health, and safety standards. To the extent that auditors do expose such deviations to the purview of top management, middle managers with the power to prevent the deviations will get busy doing so.

It may be that corporations can get the best of both worlds with a dual system that combines (1) the total performance assessment of an interdisciplinary control function with its stronger guarantees that the bad news will reach the top, and (2) the more frequent and intensive specialized compliance audits by relevant technical experts with their stronger guarantees that the real problems will be identified. Further, when the former audit the latter there is a synergy unattainable under any other compliance structure. The specialists ensure that the real problems are identified and the control func-

tion ensures that these problems are communicated to top management and rectified to the satisfaction of top management. Both IBM and Exxon have such a dual system. The control function has by no means completely replaced environmental, occupational health and safety, and other specialist staff.

### COMMUNICATION OF COMPLIANCE PROBLEMS

It has already been suggested that a fundamental requirement of effective internal compliance systems is that there be provision to ensure that bad news gets to the top of the corporation. There are two reasons for this. First, when top management gets to know about a crime that achieves certain subunit goals, but that is not in the overall interests of the corporation, top management will stop the crime. Second, when top management is forced to know about activities that it would rather not know about, it will often be forced to "cover its ass" by putting a stop to it. Gross (1978: 203) has explained how criminogenic organizations frequently build in assurances that the taint of knowledge does not touch those at the top:

A job of the lawyers is often to prevent such information from reaching the top officers so as to protect them from the taint of knowledge should the company later end up in court. One of the reasons former President Nixon got into such trouble was that those near him did not feel such solicitude but, from self-protective motives presumably, made sure he did know every detail of the illegal activities that were going on.

There are many reasons bad news does not get to the top. Stone (1975: 190) points out that it would be no surprise if environmental problems were not dealt with by the board of a major public utility company that proudly told him it had hired an environmental engineer: The touted environmentalist reported to the vice-president for public relations! More frequently, the problem is that people lower down have an interest in keeping the lid on their failures. Consider how a cover-up of bad news about the safety and efficacy of a pharmaceutical product can occur.

At first, perhaps, the laboratory scientists believe that their failure can be turned into success. Time is lost. Further investigation reveals that their miscalculation was even more extensive than they had imagined. The hierarchy will not be pleased. More time is wasted drafting memoranda communicating that there is a prob-

lem, but in a gentle fashion so that the shock to middle management is not too severe. Middle managers who had waxed eloquent to their supervisors about the great breakthrough are reluctant to accept the sugar-coated bad news. They tell the scientists to "really check" their gloomy predictions. Once that is done, they must attempt to design corrective strategies. Perhaps the problem can be covered by modifying the contraindications or the dosage level? Further delay. If the bad news must go up, it should be accompanied by optimistic action alternatives.

Finally persuaded that the situation is irretrievable, middle managers send up some of the adverse findings. But they want to dip their toes in the water on this. Accordingly, they first send up some unfavorable results that the middle managers earlier predicted could materialize and then gradually reveal more bad news for which they are not so well covered. If the shock waves are too big, too sudden, they'll just have to go back and have another try at patching things up. The result is that busy top management get a fragmented picture that they never find time to put together. This picture plays down the problem and overstates the corrective measures being taken below. Consequently, they have little reason but to continue extolling the virtues of the product. Otherwise, the board might pull the plug on their financial backing, and the sales force might lose the faith in the product that is imperative for commercial success.

In addition, there is the more conspiratorial type of communication blockage orchestrated from above. Here, more senior managers intentionally rupture line reporting actively to prevent low-level employees from passing up their concern over illegalities. The classic illustration was the heavy electrical equipment price-fixing conspiracy of the late 1950s:

Even when subordinates had sought to protest orders they considered questionable, they found themselves checked by the linear structure of authority, which effectively denied them any means by which to appeal. For example, one almost Kafkaesque ploy utilized to prevent an appeal by a subordinate was to have a person substantially above the level of his immediate superior ask him to engage in the questionable practice. The immediate superior would then be told not to supervise the activities of the subordinate in the given area. Thus, both the subordinate and the supervisor would be left in the dark regarding the level of authority from which the order had come, to whom an appeal might lie, and whether they would

violate company policy by even discussing the matter between themselves. By in effect removing the subject employee from his normal organizational terrain, this stratagem effectively structured an information blockage into the corporate communication system. Interestingly, there are striking similarities between such an organizational pattern and the manner in which control over corporate slush funds (in the 1970s foreign bribery scandals) deliberately was given to low-level employees, whose activities then were carefully exempted from the supervision of their immediate superiors [Coffee, 1977: 1133].

The solution to this problem is a free route to the top. The lowly disillusioned scientist who can see that people could be dying while middle managers equivocate about what sort of memo will go up should be able to bypass line management and send the information to an ombudsman, answerable only to the board or chief executive, whose job it is to receive bad news. General Electric, Dow Chemical, and American Airlines now all have such short-circuiting mechanisms to allow employees anonymously to get their message about a middle-management coverup to the top.

The ombudsman solution is simply a specific example of the general proposition that if there are two lines to the top, adverse information will get up much more quickly than if there is only one. For example, if an independent compliance group answering to a senior vice-president periodically audits a laboratory, scientists in the laboratory have another channel up the organization through the audit group. Naturally, the middle managers responsible for the laboratory would prefer that they, rather than the compliance group, give senior management the bad news. The control function at Exxon and IBM is in part a systematic approach to sniffing out bad news and reporting it to top management. But there are also ways of creating de facto alternative channels up the organization. Exxon has a requirement that employees who spot activities that cause them to suspect illegality must report these suspicions to the Law Department. In most companies, a financial auditor who noticed in the course of his or her work a memo suggesting an antitrust offense would ignore such evidence because it is not his or her responsibility and because of the reasonable presumption that he or she is not expected to be an expert in antitrust law. Exxon internal auditors, however, would be in hot water if they did not report their grounds for suspicion to the Law Department.

Once a violation is reported, there is an obligation on the part of the recipient of the report to send back a determination as to whether a violation has occurred, and if it has, what remedial or disciplinary action is to be taken. Thus, the junior auditor who reports an offense and hears nothing back about it knows that the report has been blocked somewhere. He or she must then report the unresolved allegation direct to the audit committee of the board in New York. At the time of the field work, this free channel to the top has never been used by a junior auditor. However, the fact that it exists, and that everybody is reminded annually that it does, makes it less likely that it will have to be used. The most effective control system is one incorporating such strong situational incentives to compliance that it never has to be used.

Of course, many communication problems are more mundane than the failure of top management to become aware of the slush funds that were being used to pay bribes at Exxon. A worker notices chemicals dripping from a pipe outside the plant and does not think or bother to report it to someone with responsibility for environmental matters. A design engineer notices a claim in an advertisement for a technical capacity of a company product that he or she knows it does not have, yet does not report this to the advertising department. Getting the bad news to the right desk is not always easy in large organizations. But any organization can do at least three things:

- (1) Make sure that routine formal reporting relationships are designed well enough and appropriately enough for the unique environment of the company, to ensure that most recurrent problems of noncompliance are reported to those with the power to correct them.
- (2) Make sure there is a free route to the top, bypassing line reporting relationships, to reduce the likely success of conspiratorial blocking of bad news.
- (3) Create a corporate culture with a climate of concern for compliance problems that are not an employee's own responsibility, an organization "full of antennae." There are formal ways of fostering communication of problems that fall outside routine reporting relationships, from the Japanese ringi (Clark, 1979) to the free-floating matrix management of many high-tech American companies (Kanter, 1983). But the fundamental solution is not formal—it lies in the corporate culture. Corporations must strive for a culture of compliance, a commitment to being alert, to noticing and

reporting how others, as well as oneself, can solve compliance problems.

### TRAINING AND SUPERVISION FOR COMPLIANCE

It is not enough for top management to know when noncompliance is occurring and then to tell those with clearly defined responsibility for the problem to bring the company into compliance. Often the problems are complex and formal and systematic training is needed to ensure that all employees know *how* to comply in their area of responsibility, and supervision is needed to ensure that the lessons of the training have been learned.

Thus, all legal and marketing personnel require training in anti-trust law and related corporate policies. Industrial relations staff need training in labor relations law. All production people need occupational health and safety training. The mistake that many non-compliant companies make is in communicating the relevant knowledge to middle management and then glibly assuming that they will pass it down.

The five coal mine safety leaders were all characterized by extraordinary measures to ensure that first-line supervisors were training and supervising their workers. At U.S. Steel, for example, department heads are responsible for developing training plans ensuring that foremen provide all workers with training in a set of safe job procedures that are written by the foreman for the job of each employee in his or her care. Each foreman must make at least one individual contact each week with each employee under her or his supervision to consolidate this training. With inexperienced workers, these contacts are usually "tell-show" checks whereby the worker is asked to explain what should and should not be done and why the approved procedure is the safest one. Foremen are required to make at least two planned safety observations of each employee each month. The safety observations are planned so that they cover systematically all job operations for which the employee has received instruction. In addition to the safety observations, which are planned and scheduled at the beginning of each week, foremen are expected to perform additional "impromptu observations" following chance recognition of unsafe practices. Whenever a foreman observes an unsafe condition or work method, whether in a planned or impromptu safety observation, he or she must correct it immediately and report the occurrence to higher management



or a "supervisor's safety report." The foreman can tell whether a worker who deviates from a procedure or rule has been trained in it by looking at the employee's record. For all employees a record is maintained by their foreman, noting their safety history—basic training, safety contacts, planned safety observations, unsafe acts, violations, discipline, and injuries. When workers move from foreman to foreman, their records move with them, so a new foreman can discover at a glance what safety training a worker lacks for a new job.

In short, effectively self-regulating companies do not tell middle managers how to comply and assume they will tell the troops; they have training policies and programs to guarantee that training is happening and working down to the lowest reaches of the organization. They audit compliance with compliance training programs as assiduously as they audit compliance itself.

#### WATCHING PRESSURES FOR NONCOMPLIANCE

Having covered the five basic principles for creating an effectively self-regulating company, consideration might be given to another even more basic principle. This is that companies must be concerned not to put employees under so much pressure to achieve the economic goals of the organization that they cut corners with the law. The role of excessive performance pressures on middle managers in creating corporate crime has been frequently pointed to by the literature (Clinard, 1983; Cressey and Moore, 1980: 48). *Corporate Crime in the Pharmaceutical Industry* illustrated the problem thus:

Take the situation of Riker, a pharmaceutical subsidiary of the 3M corporation. In order to foster innovation, 3M imposes on Riker a goal that each year 25 percent of gross sales should be of products introduced in the last five years. Now if Riker's research division were to have a long dry spell through no fault of its own, but because all of its compounds had turned out to have toxic effects, the organization would be under pressure to churn something out to meet the goal imposed by headquarters. Riker would not have to yield to this pressure. It could presumably go to 3M and explain the reasons for its run of bad luck. The fact that such goal requirements do put research directors under pressure was well illustrated by one American executive who explained that research directors

often forestall criticism of long dry spells by spreading out discoveries—scheduling the programme so that something new is always on the horizon.

Sometimes the goal performance criterion which creates pressure for fraud/bias is not for the production of a certain number of winners but simply for completing a predetermined number of evaluations in a given year. One medical director told me that one of his staff had run 10 trials which showed a drug to be clear on a certain test, then fabricated data on the remaining 90 trials to show the same result. The fraud had been perpetrated by a scientist who was falling behind in his workload and who had an obligation to complete a certain number of evaluations for the year [Braithwaite, 1984: 94].

One might say that this is an inevitable problem for any company that is serious about setting performance goals for its people. But there are differences in the degrees of seriousness of the problem. At one extreme are companies that calculatedly set goals for their managers that they know can only be achieved by breaking the law. Thus, the pharmaceutical chief executive may tell her regional medical director to do whatever he has to do to get a product approved for marketing in a Latin American country, when she knows this will mean paying a bribe. Likewise, the coal mining executive may tell his mine manager to cut costs when he knows this will mean cutting corners on safety.

The mentality of "Do what you have to do but don't tell me how you do it" is widespread in business. Eliminating it is easy for executives who are prepared to set targets that are achievable in a responsible way. It is a question of top management attitudes. IBM is one example of a company that we found to have the approach we have in mind to target setting. IBM representatives do have a sales quota to meet. There is what is called a "100 Percent Club" of representatives who have achieved 100 percent or more of their quota. A majority of representatives make the 100 Percent Club, so the quotas are achievable by ethical sales practices. IBM in fact has a policy of ensuring that targets are attainable by legal means. Accordingly, quotas are adjusted downward when times are bad.

As Clinard (1983: 91-102, 140-44) found, unreasonable pressure on middle managers comes from the top, and most top managers have a fairly clear idea of how hard they can squeeze without creating a criminogenic organization. In the words of C. F. Luce, Chairman of Consolidated Edison: "The top manager has a duty

not to push so hard that middle managers are pushed to unethical compromises" (Clinard, 1983: 142).

This "duty," however, takes us back to the fundamental problem of self-regulation. Companies have got to want to make themselves comply with the law sufficiently strongly to let this override other corporate goals. This sixth "principle" therefore really reduces to companies being motivated to be effectively self-regulating. As we said earlier, we believe companies can be so motivated both from their internal deliberations as moral agents and, more important, from external pressures calculated to make effective self-regulation an attractive policy. The design of these external pressures is the topic for another publication.

### FROM CORPORATE TO TRADE ASSOCIATION SELF-REGULATION

Most of the discussion in this chapter has been about self-regulation by individual corporations rather than by associations of corporations. We believe that the same general principles of effectiveness are applicable to self-regulation at both levels, and for the same reasons. That is, effective self-regulation programs run by trade associations will

- (1) give a lot of informal clout and backing from top management of member companies to compliance personnel employed by the trade association;
- (2) ensure that managers in member companies who will be responsible for ensuring action on noncompliance detected by the association are identified in advance;
- (3) monitor compliance performance carefully and let companies know when it is not up to standard;
- (4) have effective communication of compliance problems to those capable of acting on them (for example, having mechanisms for ensuring that communication blockages within the trade association to protect favored member companies do not occur); and
- (5) emphasize training and supervision for compliance.

Skepticism has often been voiced about the efficacy of self-regulation through trade associations. This is partly because of instances where such self-regulation has patently failed (see, for instance, Blakeney and Barnes, 1984), and partly because of the

antitrust law implications of cooperative self-policing within an industry (Baum, 1961; Page, 1980; Zwicker, 1984). But assuming that trade associations could be spurred into running stauncher programs of self-regulation, and putting aside problems of anti-trust violation, does self-regulation by trade associations have the same potential for compliance as that apparent in the context of self-regulation by particular corporations? Several critical differences suggest a negative answer.

One difference is that self-regulation by a trade association presupposes a transcorporate system of compliance rather than a system geared to the operations of one company. To the extent that compliance depends on an approach that is universalistic throughout a given industry rather than particularistic in relation to each member of an industry, it is likely to be less effective. In terms of command structure, access to information, and personnel loyalty, trade associations necessarily lack the capacity that each corporate member of an association has to police its own organization. Trade associations are outsiders attempting to pull the levers of intracorporate controls.

A second major difference lies in the difficulty trade associations have in mounting credible sanctions. At the level of informal sanctions, trade associations tend to lack the authority or influence that is found in many companies. We surmise that use of formal sanctions against noncompliant employees is not a necessary characteristic of effectively self-regulating companies because informal social control inside well-run companies can be so effective. In this sense, companies are like families; we do not expect the effectiveness of socialization in families to be necessarily related to how frequently children are smacked. However, nothing could be less like a family than an industry association. They are commonly uneasy alliances of companies that are trying to do each other in. It would be expecting a lot for informal social control to work in such a setting. There is no credible basis for shaming or for executives to turn away from disapproved conduct in the hope that this will earn "brownie points" for some future reward such as promotion. Thus, trade association self-regulation is likely to be only a faint symbolic activity unless breaches are punished by means of formal sanctions.

Trade associations can and sometimes do resort to formal sanctions—termination of membership, curtailment of membership benefits for a period, fines, press releases directing adverse publicity at the behavior of the offending company, or requests for regulatory

action by the relevant government authority. However, it is notorious that even where formal sanctions are available they are rarely used (Blakeney and Barnes, 1984). The benefits offered by membership of a trade association tend to be less tangible or rewarding than the benefits offered by employment in a company, and hence a trade association lacks the control over vital contingencies necessary to impose formal sanctions with teeth. Here it is instructive to contrast the position of corporate trade associations with that of professional associations, some of which are empowered to discipline their members with the highly potent sanction of disqualification from practice.

To sum up, self-regulation by industry associations is devoid of any solid foundation for either informal or formal social control, and lacks the potential that self-regulation has at the level of the single company.

### CONCLUSION

Our empirical research of the past eight years suggests to us that there are organizational characteristics distinguishing companies that are effectively self-regulating from those that are not. Equally, our data question some conventional wisdom—such as that relatively large compliance staffs are necessary for effective self-regulation.

Second, we have argued that there are grounds for pessimism that the most compliance-conscious trade associations can ever deliver the self-regulation of which the most compliance-conscious individual companies are capable. It follows that there is more mileage for regulators in strategies to elicit intracorporate private policing than trade association policing.

Such strategies exist. Direct regulatory enforcement—by prosecution, license suspension, adverse publicity, or other means—is one outstandingly important way of putting pressure on companies to self-regulate. Indeed, given what we have said about the greater resources, expertise, and capacity to get to the truth available from corporate compared to government compliance efforts, government regulatory strategies should be evaluated less in terms of their direct deterrent effect on deviant managers and more in terms of how successfully they trigger corporate controls to bring deviant managers to heel.

Regulatory agencies do not have to sit back and hope that their direct enforcement efforts will trigger self-regulatory enforcement. They can actively negotiate social contracts with individual companies. In the absence of convincing evidence that certain of the self-regulatory guarantees discussed in this chapter are in place, companies can be told that they will be targeted for more interventionist direct enforcement. Alternatively, self-regulatory practices proven to be effective by the most vigilant companies, in some circumstances might appropriately be made mandatory for all companies.

In short, understanding what makes self-regulation tick is not a field of interest only to optimists who see appeals to corporate social responsibility as the best route to ethical corporate conduct.

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## Chapter 10

## THE WIDENING WEBS OF SURVEILLANCE: Private Police Unraveling Deceptive Claims

NANCY REICHMAN

Private policing is expanding rapidly. As early as 1970 the number of private police was roughly equivalent to the number of public police (Shearing and Stenning, 1983). With retrenchment in the public sector and expansion in the private, private police are now believed to outnumber public police by approximately two to one (Cunningham and Taylor, 1983). Even these numbers may greatly underestimate the extent of private policing. Surveillance of private places and transactions is being conducted by actors who traditionally have not been counted as among the rank and file of private police. Insurance adjusters who monitor insurance claims, corporate risk managers, and "loss consultants" often are not included in estimates of private police strength.

The growth in private policing has been linked to socioeconomic changes demanding more extensive, intensive, categorical, and preventively oriented social control (Foucault, 1977; Spitzer and Scull, 1977; Donzelot, 1979; Spitzer, 1979; Shearing and Stenning, 1981, 1982, 1983; Mathieson, 1983; Bottoms, 1983, as well as others). The extension of corporate involvement into all facets of economic life has led to greater private interest in social regulation (Spitzer and Scull, 1977; 25). The development of "mass private property," shopping centers, high-rise buildings, manufacturing complexes, and the like has increased the amount of public life that occurs in privately owned places, and consequently is subject to

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