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The Influence of Critical Events on the Social Control of Misconduct: Regulatory Enforcement in the European Banking Industry

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Abstract

An emerging stream of research has identified critical events as spikes in societal interest that increase public attention to firm and industry behavior and can function as exogenous triggers for change. With respect to misconduct, firms vary considerably in how they respond to critical events, and for a visible change in their undesirable behavior to transpire, there needs to be ongoing accumulation of work by social-control agents. While social-control agents are often boundedly rational in their decision-making, most studies have overlooked the ability of critical events to restrict or redirect collective attention among such agents. Drawing on the case of a regulatory agency's enforcement actions against violations of anti-money laundering regulations by three European banks, we investigate the influence of critical events on social-control agents' enforcement behavior. This study achieves two goals: first, we identify three types of fieldwide critical events that influence social-control agents' behavior, and second, we demonstrate that these events may shape the regulatory environment in which firms operate, thus allowing for different organizational responses to enforcement actions. Our findings contribute to the literature on critical events and organizational misconduct.

Keywords: organizational misconduct, critical events, social-control agents, regulatory agencies, banking, anti-money laundering

In 2012, global banking giant HSBC entered into a deferred prosecution agreement with the U.S. Justice Department and consented to paying a $1.9 billion fine for laundering vast sums of dirty money for Mexican and Columbian drug cartels. Remarkably, despite court documentation and media coverage exposing the global bank's malfeasance, HSBC continued to move illicit funds for criminals (Woodman, 2020). Corporate scandals – including, in addition to HSBC, the Volkswagen emissions scandal and Wirecard's fraudulent accounting practices – tend to attract significant media coverage, spur major corporate governance reforms and fuel influential social movements. Such *critical events* are defined as "contextual dramatic happenings that focus sustained public attention and invite the collective definition or redefinition of societal problems" (Hoffman & Ocasio, 2001: 414). Because of their ability to expose harmful social norms and practices, critical events can function as spikes in societal interest that heighten public attention to firm or industry behavior and evoke organizational change. However, as illustrated by the example above, some events appear to be less consequential in pushing firms to cease their misconduct.

With respect to misconduct, previous research has examined critical events such as media reports of ethical transgressions (Chandler, 2014), enforcement actions (Dewan & Jensen, 2020), the introduction of new legislation (Mohliver, 2019) and long-lasting financial crises (Roulet, 2019). Critical events have been shown to be effective in drawing public attention to misconduct (Graffin et al., 2013), mobilizing fringe stakeholders (Daudigeos, Roulet, & Valiorgue, 2018) and pressuring executives to implement change (Briscoe, Chin, & Hambrick, 2014). This corresponds with the model proposed by Clemente, Durand and Roulet, according to which "critical events […] raise questions about the value or appropriateness of a logic" (2017: 24), thus provoking organizational and institutional change. However, the extent to which critical events actually lead to changes in firm or industry behavior is contingent on their saliency, duration and focus of attention. In light of this,

scholars distinguish between *firm-specific* events that affect individual organizations and *fieldwide* events that influence an entire organizational field (Chandler, 2014; Hoffman & Ocasio, 2001). In the following, we adhere to this distinction.

While some critical events may push firms to correct their undesirable behaviors, research shows that for a visible change to transpire, there needs to be an ongoing accumulation of work by social-control agents (Castro & Ansari, 2017; Greve, Palmer, & Pozner, 2010). Social-control agents, such as government agencies and the media, enforce rules and norms, and therefore have the authority to bring a charge of misconduct against an organization for its alleged violation. Although these actors often face role conflicts and cognitive constraints (Barnett, 2014; Heese, Krishnan, & Moers, 2016), the literature suggests that fieldwide critical events can function as crucial catalysts for stakeholder action against misconduct (e.g., Daudigeos et al., 2018; Dewan & Jensen, 2020). Yet, we currently lack understanding why some critical events are more effective than others in shaping the efforts of these boundedly rational actors. This is surprising not only because understanding the determinants of social-control agents' behavior is critical if we are to fully understand the emergence and persistence of misconduct (Greve et al., 2010), but also because fieldwide and firm-specific critical events are potentially closely intertwined in terms of their influence on organizational conduct.

In this study, we respond to this gap in the literature by investigating, first, how fieldwide critical events shape social-control agents' actions against misconduct and, second, how offending firms may respond to the ensuing changes in social control agents' behavior. We conducted in-depth case studies of three European banks' violations of anti-money laundering regulations over a 16-year period (2005-2020). This context is particularly appealing because of the endemic nature of this issue within the global financial system and the intensifying narrative of criminalizing gatekeepers' roles. Whereas the media has been the

focus of recent scholarly work on stakeholders' responses to misconduct (e.g., Clemente & Gabbioneta, 2017; Roulet, 2019), governmental bodies have been at the forefront in the efforts to crack down on money laundering. Yet, recent corporate scandals have highlighted that these regulators have failed to decisively curb such transgressions. Our focus is therefore on the various critical events that have shaped the enforcement behavior of regulatory agency in contesting rule violations in the field. In doing so, this study achieves two goals: first, we identify three types of fieldwide critical events that shape social-control agents' behavior, and second, we demonstrate that the changing social-control agent behavior helps in explaining different types of organizational responses to firm-specific critical events.

Together, these goals contribute to the organizational misconduct literature by explaining the distinctive ways critical events can shape the actions of social-control agents and the ensuing behavior of offending firms. First, while social control-agents are often boundedly rational in their decision-making (Barnett, 2014; Heese et al., 2016), we find that fieldwide critical events function as exogenous triggers that can restrict or redirect their cognitive capacity and, consequently, their enforcement actions toward misconduct. We thus respond to calls for studies to focus on the determinants of social-control agents' behavior (Greve et al., 2010; Palmer, 2012). Second, we find that the responses of offending firms to enforcement actions can, depending on the attention, resources and tools of social-control agents, be perverse, myopic, or involuntary. We thus underline the interplay between the influence of fieldwide events on social-control agents' behavior and organizational responsiveness to enforcement actions. By doing so, this study complements prior research that has mainly treated fieldwide events and firm-specific events as independent occurrences (Chandler, 2014; Ocasio & Hoffman, 2001).

THEORETICAL BACKGROUND

Misconduct and Social-Control Agents

Organizational misconduct can be defined as "behavior in or by an organization [that is judged] to transgress a line separating right from wrong" (Greve et al., 2010: 56). In addition to a growing body of research that addresses the antecedents, corrective actions and consequences of misconduct (e.g., Hersel et al., 2019; Greve et al., 2010; Palmer, 2012), scholars have begun to explore misconduct through a labeling perspective, which describes how misconduct is constructed by the behaviors of social-control agents. According to this approach, misconduct can be understood as a "property imposed on a behavior when a social-control agent labels the focal behavior as misconduct" (Dewan & Jensen, 2020: 1654). Social-control agents are authority figures that have the "institutional role" of drawing the line that defines legal, ethical or socially irresponsible behaviors, and enforcing when that line is being trespassed (Clemente & Gabbioneta, 2017: 287). By deciding where the line is between good and bad behavior, social-control agents can create the very notion of misconduct. The media and external auditors represent such collectivities that can impose public scrutiny on firms for their alleged wrongdoing (Roulet, 2019; Mohliver, 2019). Similarly, governmental entities, such as regulatory agencies and public prosecutors, have the authority to bring a charge of misconduct against a firm and impose sanctions (Dewan & Jensen, 2020; Heese et al., 2016). The actors described above are considered crucial for maintaining order in the social system because they have the ability to monitor, scrutinize and enforce firm behavior.

Recent scholarly work has asserted that to understand the causes and remediation of misconduct, we must assess how successfully and vigorously social-control agents label behavior as misconduct and enforce the law. Prevalent in these studies is the assumption that different actors – those implicated in the wrongdoing, those who are harmed, and the social-control agents that label the wrongdoing – may differ in their view on whether the focal act constitutes misconduct (Greve et al., 2010; Palmer, 2012). The task to punish and label

behavior as misconduct is therefore often a complex and cognitively demanding task for social-control agents (Barnett, 2014; Heese et al., 2016). Extant research suggests that the decision to investigate or sanction transgressions is not simply "a straightforward implication of a set of laws, ethical principles, and/or social norms" (Greve et al., 2010: 56), as social-control agents judge instances of potential misconduct based on various factors, including self-interest, budgetary constraints and bureaucratic routines (Greve et al., 2010). Furthermore, the primary social-control agents in the legal system, such as regulatory agencies, are politically entrenched and have to consider various, and often contradictory, goals when deciding to act against misconduct. In other words, social-control agents are boundedly rational actors and therefore restricted in their ability to detect, gather evidence and assess the nature of misconduct (March & Simon, 1958).

As a result, social-control agents are often restricted in their capacity to monitor firms and sanction them for their misbehavior. The methods for providing feedback by social-control agents (e.g., media scrutiny, regulatory reports) occur infrequent, are often ambiguous and "loosely coupled" to the rule being violated (Lehman & Ramanujam, 2009). Evidence for such bounded rationality is provided by Heese and colleagues (2016) who found that conflicting institutional pressures, complex goals and fragmented internal structures within regulatory agencies operating in the U.S. health care industry led to selectivity and leniency in enforcement. Studies that highlight the potential adverse outcomes of insufficient scrutiny by social-control agents abound, including the routinization of noncompliance (Vaughan, 1996) and the normalization of corruption (Ashforth & Anand, 2003).

Because the labeling decisions of social-control agents have significant consequences for both the focal firm and relevant stakeholders, it is crucial to understand the forces that shape their behavior. Barnett (2014), for instance, provides a cognitive view to explain the inconsistencies in stakeholders' punishment of firms. He demonstrates that social-control

agents face cognitive constraints that bound their rationality and so limit their ability to consistently reward and punish firms for their actions. Extending this idea, scholars have begun to address the institutional forces that shape the focus of attention of social-control agents (e.g., Dewan & Jensen, 2020; Mohliver, 2019). Particularly insightful in the context of this study is the research that highlights how critical events focus stakeholder scrutiny on firm behavior (Chandler, 2014; Clemente et al., 207; Haunschild et al., 2015). Investigating the role of such events in determining the behavior of social-control agents resonates with the assertion of Greve et al. that "an important gap in our understanding […] is in the analysis of more systematic evidence on how social-control agents choose their agendas" (2017: 57).

Challenging Misconduct and the Role of Critical Events

To understand social-control agents' actions against firms more comprehensively, it is important to analyze the institutional forces that enable or constrain these actors. We therefore draw on an emerging stream of research that addresses the relationship between critical events and the ways organizations interact with their environment. With respect to misconduct, critical events can draw attention to specific aspects of firm or industry practices and strategies, mobilize key stakeholders and put pressure on firms to change their behavior (Castro & Ansari, 2017; Daudigeos et al., 2018; Dewan & Jensen, 2020). However, the impact of critical events varies widely (Hoffman & Ocasio, 2001) and research shows that the extent to which firms and key stakeholders respond is largely determined by the scope, saliency and duration of the event in question. Drawing on the concept of institutional waves, for instance, Chandler (2014) studied firms' attention to business ethics and differentiated between firm-specific critical events and fieldwide critical events. Although both types of events can arise from a wide array of societal actors (e.g., the government, media, social activists), the distinguishing feature of firm-specific events is that they focus attention on the

actions of individual firms, whereas fieldwide events can influence whole populations of firms across industries and field.

In terms of misconduct, the role of firm-specific critical events (e.g., enforcement actions, media reporting of ethical transgressions) in shaping firm behavior has, of course, not been ignored. Highly publicized scandals, such as the excessive executive bonusses at Skandia AB (Jonsson, Greve, & Fujiwara-Greve, 2009) and Volkswagen's emission manipulations (Clemente & Gabbioneta, 2017), can expose harmful practices and strategies and trigger changes in how the firm in question engages with its environment. Concretely, such events have been identified as important drivers for reprioritization by top management (Briscoe et al., 2014), the reallocation of scarce resources (Desai, 2014) and the implementation of new laws (Chandler, 2014). However, Hersel and colleagues (2019) show that not all firm-specific critical events evoke substantial and lasting changes. Indeed, firms may respond only symbolically or temporary to these events, especially when they do not believe in the efficacy of the imposed changes (Kostova & Roth, 2002), experience limited reputational harm of defiance (Barnett, 2014), or perceive that there is a lack of external scrutiny (Bromley & Powell, 2012).

Fieldwide critical events are exogenous events that occur across industries and fields (Chandler, 2014; Hoffman & Ocasio, 2001). In contrast to firm-specific critical events, fieldwide events tend to have broader implications that go beyond an individual firm and can impact the cognitive and normative perception of key stakeholders. Such fieldwide critical events may include brief jolts that temporarily draw attention to malfeasant practices, such as an industry scandal (Dewan & Jensen, 2020) and the introduction of new legislation (Mohliver, 2019), or longer periods of social turmoil that combine multiple salient events, such as the 2007-2008 financial crisis (Clemente et al., 2017). Scholars have explained the role of fieldwide events in providing opportunities to change institutionalized practices

(Oliver, 1992) and yield field reconfiguration (Hoffman & Ocasio, 2001) through shaking up well-established beliefs and behaviors. The collapse of Enron in 2001, for instance, transformed into a long-lasting fieldwide event that generated heightened societal demands for business ethics and "became emblematic of moments in time and lead to heightened demands for organizational change" (Chandler, 2014: 1724). Because such fieldwide critical events can "expose the conflicts between different belief systems and lead to the condemnation of what was previously accepted as normal" (Roulet, 2019: 1457), they have the potential to function as turning points at which society is reconfigured and structures are unveiled (Clemente et al., 2017; Hardy & Maguire, 2010). However, notwithstanding prior studies that have alluded to the field-reconfiguring potential of critical events, scholars have tended to largely ignore the role of critical events in enabling and constraining the behavior of social-control agents.

Not all critical events are perceived as equally impactful and for a visible outcome to transpire and create substantial change among firms, there needs to be ongoing accumulation of work by purposeful actors that can create a critical juncture or a setting that is ripe for change. At the same time, critical events can provide a "window of opportunity" (Castro & Ansari, 2017) or "opportunity structures" (Daudigeos et al., 2018) for actors to push their specific agenda. In other words, the impact of critical events on offending firms is contingent on the work of social-control agents that influence how disruptive or important such events become. For instance, Castro and Ansari (2017: 13) argued that critical events can empower social-control agents, in their case Brazilian anti-corruption agents, to "engage in the ongoing deinstitutionalization of highly entranced practices". Similarly, Dewan and Jensen (2020) found that the Securities and Exchange Commission (SEC) was more likely to label behaviors as misconduct when these violations were part of a highly publicized multi-actor scandal. These fieldwide critical events can thus pay off and lead to breakthroughs that had previously

seemed unlikely by offering social-control agents the resources, tools and momentum needed to challenge firms' malfeasant practices and strategies (Castro & Ansari, 2017; Daudigeos et al., 2018; Mohliver, 2019). However, it remains unclear why, at times, fieldwide critical events seem to matter more, while at other times much less so, in influencing the actions by social-control agents. Here, we focus on the actions of regulators against banks' violations of anti-money laundering regulations and seek to understand why some critical events are more consequential than others in mobilizing social-control agents to push firms to cease their malfeasant practices.

METHODS

Research Setting, Design and Case Selection

According to the European Supervisory Authorities, financial crimes such as money laundering, corruption and tax evasion, undermine the integrity of the global financial system. One of the key advancements in the fight against such financial crimes has been the "responsibilization" of commercial, non-state actors, such as banks, insurance companies and pension funds (Lord, Inzelt, Huisman, & Faria, 2021). Financial firms occupy a vital role in the fight against such illicit practices and are increasingly expected to act as "gatekeepers" and to maintain the integrity of the broader financial system. This legally imposed role requires firms to implement strict customer due diligence practices to promote high ethical and professional standards in the financial industry and prevent the financial infrastructure from being used, intentionally or unintentionally, for criminal activities. The context these financial firms are operating in can be qualified as an institutionally complex environment in which various field actors exert their pressures. Governmental agencies, politicians, shareholders and the media all have a vested interest and exercise their influence on the behavior of these firms. In this study, we focus our attention on regulators as a specific type of

social control-agent. Such governmental agencies are regarded as the primary social-control agents in the legal system as they have been vested with the statutory powers to conduct oversight, enforce the remediation of misconduct and impose sanctions (Greve et al., 2010; Heese et al., 2016).

Despite the significant developments of national and supranational anti-money laundering (AML) and combating financing of terrorism (CFT) standards during the previous decade, the violation of these regulations has become a ubiquitous phenomenon within the financial industry. For instance, in the period 2009-2017 banks globally paid €304 billion in fines for an abundance of regulatory failings, ranging from money laundering to market manipulation and tax evasion (Grasshoff et al., 2017). The recent sanctions imposed against various European and U.S. banks for money laundering and terrorist financing have highlighted an emerging narrative of criminalizing gatekeepers' roles. Drawing on these developments, we investigated a regulatory agency's actions against the violation of AML/CFT regulations by financial firms over a period of 16 years (2005-2020). Since we wanted to understand both the influence of critical events on regulators' enforcement behavior and the potential responses of firms to such a changing regulatory environment, we also examined the emerging behaviors of three European banks, "EastCo", "SouthBank" and "WestGroup" (pseudonyms). These cases were theoretically sampled for their similarities in size, international operations and history.

Data Collection and Analysis

We collected data from three types of sources – archival material, in-depth interviews and media data – thus creating a rich and reliable data set. We systematically collected a wealth of archival material, both from the regulatory agency and the three financial firms. This material included, among others, regulatory audit reports, interview transcripts,

statements of facts, remedial action plans, annual reports and press releases. We complemented this archival material with retrospective and semi-structured interviews with two heads of the financial crime department and five financial crime regulators (FCR1-7) who worked within the regulatory agency and were responsible for conducting various regulatory inspections over the years. During these interviews, we asked informants to reflect on 1) the historical developments of financial crime supervision at the regulatory agency, 2) the impact of these developments on the regulatory strategy with respect to our case firms and 3) the firms' responses to enforcement actions by the regulatory agency. We managed to compile a body of textual data (232 documents, 4,792 pages) across the 16-year time period (See Table 1).

[Insert Table 1 about here]

Our study is grounded in a qualitative, inductive approach. This kind of approach is appropriate because the goal of this study is to build theory about a phenomenon that is not well explained by the existing literature. We applied the Gioia-methodology following the standard procedure in the literature (Gioia, Corley, & Hamilton, 2013) moving the abstraction of our data analysis from first-order codes to second-order themes, and finally to aggregate dimensions. The first stage of data analysis involved a detailed reading of the collected textual materials, which enabled us to develop a longitudinal narrative account. We subsequently bracketed our stream of longitudinal data into separate time periods, creating a visual map of key fieldwide and firm-specific critical events. With this timeline in hand, we used the textual data to develop an increasingly rich and comprehensive description of our cases. As we constructed the timelines, we were able to distinguish two key themes that, taken together, presented us with a puzzle: first, the number and nature of *firm-specific critical events* (e.g., regulatory audits, enforcement actions) had changed over time, from incidental and lenient to increasingly frequent and stringent, and second, despite this increased regulatory scrutiny,

firms continued to violate AML/CFT regulations. As we returned to our empirical material, we began the process of "open coding". We used the qualitative data analysis software Atlas.ti to code for first-order empirical topics around the actions of the regulatory agency and firms' rule violations. Iterating between researchers and reading the texts multiple times, we merged the initial codes to 90 first-order empirical codes.

Second, we engaged in "axial coding" to categorize the first-order codes into second-order themes. As we started to develop the different processes and relationships between second-order themes, we interviewed informants to gain a better understanding of why firms persisted in their rule violations despite the gradual increase of regulatory scrutiny. Interestingly, the informants indicated that the changing enforcement behavior of the regulatory agency coincided with several *fieldwide critical events* (e.g., financial crisis, publication of state-commissioned reports, industry scandals) and this prompted us to review literature on critical events. Information provided by interviewees thus helped in the active construction of the theoretical categories.

Finally, we applied the second-order themes back to the regulatory changes and our histories of the three case firms to determine how these interacted with each other. By mapping the second-order themes to the changes in enforcement approach of the regulatory agency and the case histories of our firms, we identified three episodes. Each of these episodes featured a unique combination of fieldwide critical events, firm-specific events and firm responses. Concretely, we identified three types of fieldwide critical events that influenced social-control agents' behavior. These events shaped the regulatory environment in which the financial firms operated, thus enabling different organizational responses to enforcement actions. Figure 1 provides a simplified timeline of key events.

[Insert Figure 1 about here]

FINDINGS

In the following section, we summarize the key patterns that unfolded between 2005 and 2020. This finding section is structured according to our aggregate dimensions, in which we discuss our second-order themes and provide representative supporting data. We divide our narrative account into three episodes. Within these episodes, we describe three types of fieldwide critical events that shaped the behavior of the regulatory agency, *constraining*, *conducive*, and *clustered*. In parallel, we identify three types of organizational responses to enforcement actions, *perverse*, *myopic* and *involuntary*.

Episode 1 (2005-2013)

Constraining fieldwide critical events. In 2005, regulatory agencies began to scrutinize financial firms' AML/CFT practices and strategies through various industry-wide audits. These regulatory audits revealed a range of transgressions regarding firms' due diligence and transaction monitoring operations. However, our data suggest that the political and regulatory context prior to and during the 2007-2008 global financial crisis significantly constrained regulators' ability to act upon the identified violations. Indeed, the regulatory agency had focused its attention on the ability of financial firms to meet their long-term debt and other financial obligations. Such prioritization came at the expense of the agency's ability to scrutinize firms on non-financial issues, with limited capacity and resources allocated to the agency's financial crime department. Consequently, the intrusiveness of regulatory actions against violations of AML/CFT regulations was severely limited. Reflecting on this episode, a head of department at the regulatory agency indicated:

> We did not give firms the impression that a great deal of action was expected and that that we considered this a critical issue. And conversely, we did not perceive [noncompliance] as very problematic against the background of the financial complications that were significant during the financial crisis (FCR2)

Other interviewees echoed this position by explaining that since the agency prioritized firms' solidity and solvency over non-financial issues, leadership had come to perceive punitive sanctions (e.g., a regulatory fine) for non-financial transgressions to be potentially harmful to firms' financial stability and the public confidence:

> Financial risks were especially important, and that was triggered by the financial crisis. The perception was that banks could collapse if they had toxic assets on their balance sheet … or if they did not have enough liquidity. There was a lot of focus on those elements, by the banks, but also by us, which resulted in a blind spot towards those non-financial risks (FC6)

Thus, and in the light of the many uncertainties affecting the entire financial industry during the financial crisis, regulators were only authorized to sanction the violation of AML/CFT regulations if there was clear and unambiguous evidence of the criminal offence of money laundering or terrorist financing. The mere violations of so-called *procedural norms* (e.g., deficiencies in client due diligence and quality assurance), aimed at preventing money laundering and other financial crimes, rarely elicited regulatory enforcement or sanctioning, as depicted in Figure 1. The following quotation from a senior regulator illustrates the reasoning and implications of such supervisory approach:

> We can keep blaming the firms, but we also made mistakes: capacity issues, attention, the way we gave feedback following on-site inspections, the threat we communicated through our feedback. Because the truth is, if our leadership had gone to their CEO and said: 'you must solve these issues', it would have had a much greater impact (FCR5)

In the rare occasion that regulators did enforce the correction of rule violations, hardly any evidence of remediation was demanded from the offending firms. For instance, an industry-wide regulatory audit revealed major deficiencies in the due diligence of wealthy clients. Responding to these findings, EastCo emphasized that any remedial action, including the reallocation of resources or hiring of temporary staff, would negatively impact the firm's financial performance and stability. Although EastCo refused to correct the identified

shortcomings, our data indicate that regulators explicitly informed the firm that they had no intention to sanction EastCo:

> If an instruction imposed by us is not complied with, the usual next 'intervention step' is a regulatory fine. We have decided not to do this … The importance of an improved governance structure, and consequently an improved internal organization, currently outweighs a formal enforcement measure in response to the internal audit reports (EastCo: regulatory audit interview).

Because regulators were unable to penalize firms' disregard of regulatory feedback, firms began to consider such violations a normal and accepted practice.

Perverse responsiveness to regulatory enforcement. In the process of analyzing our data, we came to understand that the 2007-2008 financial crisis, as a major fieldwide critical event that focused societal attention on firms' financial health, bounded regulators' capacity to supervise firms on non-financial issues. At the same time, firms began to perceive AML/CFT regulations, requiring firms to collect and document client information, as disproportionally burdensome and as bureaucratic 'red tape'. Interestingly, according to the head of the financial crime department of the regulatory agency this was a shared perception: "We assessed [noncompliance] as 'administrative sloppiness' as well … how else can we explain our reluctance to sanction irregularities?" (FCR1). Our analysis suggests that the repeated regulatory restraint toward such administrative irregularities may have reinforced the belief among firms' management that complying with AML/CFT regulations could be considered a low priority. Consider, for instance, the approach the regulatory agency took to communicate the findings of an industry-wide due diligence audit conducted at EastCo. Regulators characterized the identified rule violations as a "financial crime", urging the firm to remediate its shortcomings. In practice, however, this pressure to remediate was all but backed up by actual enforcement actions or sanctions. This process is illustrated by the following quote from a senior regulator, who recalls a conversation he had with a manager of the bank:

> We asked him why they were unable to remediate, and he said "We get ten priorities from [our] head office. And anti-money laundering is on number nine. The top five priorities are really the 'must does', the 'must haves'. And well, [preventing money laundering] is a 'nice to have' (FCR4)

Importantly, we argue that the limited enforcement actions against violations of procedural AML/CFT rules had a *perverse* influence on firm behavior; namely, the belief that violating such rules was a practice that had become accepted in the eyes of the regulators. At SouthBank, for instance, regulators probed the firm's ongoing due diligence operations and discovered a discrepancy between the high number of transactions monitored and the low number of alerts generated and suspicious transactions reported. While regulators instructed the firm to evaluate the effectiveness of the transaction monitoring system, they did not validate any corrective actions. The archival material shows that SouthBank did not address the identified irregularities and consequently systematically missed suspicious and illegal transactions. SouthBank's CEO later acknowledged that "in hindsight, these non-financial risks did not receive the required attention and priority at the boardroom table" (SouthBank: regulatory audit interview). We suggest that the 2007-2008 financial crisis constrained the enforcement capacity of regulators, thus creating a regulatory environment in which firms may have become increasingly complacent and convinced that rule violations required little attention.

Episode 2 (2013-2017)

Conducive fieldwide critical events. We identified that the 2007-2008 financial crisis triggered a shift in political and social discourse that emphasized increased public demand for ethical behavior by financial firms. However, during this episode, the publication of multiple state-commissioned reports, evaluating the (dis)functioning of the various regulatory agencies in the build-up to the financial crisis, mainly focused societal attention on the deficiencies in

institutional oversight. The evaluations assessed that while, overall, the oversight of solvency, liquidity and capital had been adequate, authorities had not sufficiently enforced behavioral, governance and internal control issues. These reports assessed that regulatory agencies should have addressed transgressions earlier (and perceived them as more serious) and were reluctant to vigorously enforce deficiencies in 'checks and balance' requirements. Following these critical evaluations – and reflecting on its own function during the 2007-2008 financial crisis – the regulatory agency implemented a strategic change initiative and advocated for a more stringent and intrusive enforcement approach. Their supervisory strategy and organization, an internal report stated, would have to reflect this new approach:

> Intrusive supervision means that we will also have to dig deep into these less tangible areas, address firms for transgressions and ensure that shortcomings are remediated … This will lead to more interventions and enforcement in these areas (Regulatory agency: internal documentation)

Senior regulators stressed that these developments were accompanied by substantial management support and increased resources within the department responsible for policymaking, auditing and enforcing of financial crime. In fact, during the period of 2013-2017, this department acquired new regulatory tools, took on more responsibilities and grew by more than 60%, which at first glance reflected an increased priority by senior management.

Interestingly, however, this surge in attention and resources did not directly lead to more stringent enforcement actions. In addition, because national legislation did not provide regulators with the means to publicize their enforcement actions, transgressions rarely attracted public attention. As a result, firms underestimated the risks to which they were exposed:

> Firms experience little threat with regard to regulatory noncompliance. At the same time, we see that where threats are underestimated, the degree of control of financial crime risks is overestimated. The chance that risks materialize and the impact of

> potential risks are not estimated as high enough to trigger action (Regulatory agency: internal documentation)

Moreover, whereas the state-commissioned reports had highlighted the deficiencies in institutional oversight of non-financial issues, there were few signals that firms' violation of AML/CFT regulations was a widespread phenomenon. Consequently, although the intrusiveness and amounts of regulatory audits conducted during this episode increased, as portrayed in Figure 1, in practice regulators were primarily focused on remediating shortcomings while remaining reluctant to sanction firms for their transgressions.

Myopic responsiveness to regulatory enforcement. As firms had been gradually lulled into complacency during the previous episode, they now repeatedly failed to recognize that regulators were demanding more management attention for AML/CFT issues. Consider SouthBank, where the firm's management had become increasingly convinced that identified regulatory shortcomings had been resolved. The following quotation from a senior regulator illustrates how this attitude was expressed in the interaction with regulators:

> During the period from 2012 to the end of 2016, SouthBank took on this kind of complacent attitude towards us, saying: "you can tell us whatever you want, but we have it all figured out" … almost to the point of arrogance (FCR6)

At the same time, the existing supervisory toolkit did not sufficiently enable regulators to convey the moral imperative of complying with procedural AML/CFT regulations. For instance, addressing WestGroup's failures to properly collect and document client information, regulators merely condemned the firm's apathy towards the identified violations:

> We stress that the shortcomings as identified in the client files … should not be considered as 'sloppiness', as implied by you during the last meeting … but do in fact constitute serious violations of laws and regulations (WestGroup: regulatory audit report)

Consequently, firms' responsiveness following enforcement actions was often *myopic*: remedial actions occurred incident-driven and their results were often only temporary in nature. At EastCo, for instance, inspections revealed that employees had illegally conducted

business transactions for wealthy clients. However, internal signals about these illicit practices were not recognized by senior management at the head office as potential symptoms of a more widespread problem within the bank:

> This incident did raise some red flags at head office … EastCo defined remedial actions, [but] the incident did not lead to a broader client review or sample monitoring, as it was ultimately perceived as … an isolated incident, rather than an example of the way staff performed due diligence on their clients (EastCo: regulatory audit report)

Furthermore, although firms' immediate response to enforcement actions was to demonstrate to regulators that actions were being taken, managerial attention often ebbed off as the focus of senior management shifted to other subjects, as noted by regulators:

> A pattern that [we] are confronted with is that firms adjust their investment agendas because of internal commercial pressures … as a result, investments in customer due diligence … tend to fall over time. In practice, this means that, after following up on previous investigations, [we] must again enforce the remediation of ethical business operations (Regulatory agency: internal documentation).

Our analysis suggests that this wavelike pattern was due to the limit management priority and the significant amount of resources required to implemented AML/CFT standards in day-to-day practices. For instance, SouthBank had systematically invested too little in meeting its legal obligations because, during this episode, compliance with procedural regulations was considered as subordinate to the commercial objectives of the firm:

> SouthBank focused mainly on the profitability of the organization and the achievement of its commercial objectives. The lack of investment in the required capacity, both in terms of personnel and technology, has contributed to the continuation of serious irregularities and rule violations (SouthBank: regulatory audit report)

In many of the examples described above, the enforcement actions were inadequate in exposing the violation of procedural regulations and thus to incentivize firms to change.

Episode 3 (2017–2020)

Clustered fieldwide critical events. Until 2016, regulators had been unable to convey the moral imperative of complying with the predominantly procedural AML/CFT regulations. However, we identified various fieldwide critical events that, taken together, significantly impacted the behavior of the regulatory agency. First, the European financial industry became engulfed in numerous high-profile corporate scandals. The €20-80 billion Russian Laundromat scheme, involving the movement of money out of Russia through a network of global banks, the Danske Bank money laundering scandal, and the €775 million settlement with ING for failing to spot the movement of illicit funds, irrevocably signaled the pervasiveness and severity of AML/CFT rule violations. These scandals brought to light widespread rule violations and generated a moral indignation over the failures to combat money laundering. These salient events challenged the ingrained belief among complacent firms that rule-breaking would not elicit sanctions or negative social evaluations. Indeed, this episode was characterized by a global rise of sanctions for AML/CFT related transgressions, with €9 billion in fines in the recent 15-month period contrasting significantly with the period of 2008 to 2018 when the total amounted to €23 billion (Fenergo, 2019). This surge in fines signaled to executives the ramification for their firm's profitability and reputation if they were to be sanctioned:

> WestGroup set up a specialized AML department … partly as a result of regulatory audits and the criminal investigation at [peer firms] and other AML related transgressions in Europe. WestGroup indicates that, following the criminal investigation of [peer firm], it has conducted an extensive analysis of possible weaknesses in its own organization (WestGroup: regulatory audit interview)

Second, the highly publicized scandals suddenly exposed years of firms' myopic responses to enforcement actions and deficiencies of the existing institutional arrangements. In response, the regulatory agency began to lobby for far-reaching changes in legislative and regulatory tools. Key in this regard were new domestic legislative amendments that necessitated firms to, among others, formally assign an executive accountable for ensuring compliance with

AML/CFT regulations and thus strengthened public scrutiny of these "captains" of the financial industry. In communicating the findings of a regulatory audit at EastCo, senior regulators stressed:

> We hold the CEO and the chairman of the board of EastCo personally responsible for the realization of the remediation … We expect the CEO and chairman to report periodically on the progress of the improvement process, and thereby giving openness about any bottlenecks and newly identified problems (EastCo: regulatory audit report)

Also, in this period transparency developed as a crucial element of good supervision which led to legislation that provided the ability to disclose enforcement actions and sanctions to the wider public.

Involuntary responsiveness to regulatory enforcement. Although the highly publicized scandals throughout the European financial industry conveyed the moral reprehensibility of violating procedural rules, by themselves they proved inadequate in achieving substantial compliance. Interestingly, our data suggest that such clustering presented regulators with momentum to further intensify their pressure on offending firms. Capitalizing on the legislative changes, for instance, regulators began to increasingly emphasize executive accountability and to disclose their enforcement actions to the wider public. Moreover, in their discussions with the firm's management, regulators leveraged the recent criminal investigations and sanctions by emphasizing the consequences of future rule violations, including new sanctions and a potential reassessment of the executives' reliability and suitability, as is illustrated by this data segment:

> We have considered the possible negative consequences of a formal enforcement action for WestGroup, such as an antecedent for top management and possible additional financial commitments necessary to comply (hiring extra personal and external experts). However, we believe that these negative consequences do not outweigh the overriding interest in enforcing the rule laid down in the law (WestGroup: enforcement documentation)

Our interpretation of the data indicates that regulators leveraged the clustering of fieldwide events to pressure executives, through signaling the potential financial and reputational consequences of rule violations, to publicly acquiesce to ceasing the rule violations. In 2019, for instance, our case firms invested cumulatively an estimated €1 billion in AML/CFT controls. Importantly, we observe that the remedial actions by firms were significantly driven by executives' concerns about potential enforcement actions and thus focused on demonstrating strict compliance with procedural regulations. Due to the procedural nature of AML/CFT regulations, these activities were mainly aimed at clearing backlogs in the due diligence of existing clients by, for example, recollecting client information and information on ultimate beneficial ownership. As a result, over 60% of the resources committed in 2019 were directed at remediation programs, client look-back actions and recovery processes. Illustratively, in a root cause analysis conducted by EastCo, the firm assessed that management's responsiveness had been predominantly driven to meet the requirements set out by the regulatory agency:

> During the last three years, AML/CFT related issues seem to have mainly been addressed reactively in a project management mode, i.e. to remediate observed gaps with short-term goals. Priorities given by the executive levels seem to have been influenced by external pressures, i.e. the regulators' findings, and less by a proactive, systematic, risk-based analysis (EastCo: internal documentation)

These actions described in this archival segment, however, still did not address the underlying causes of the rule violations nor seem to connect AML/CFT practices with the core business of the firms. Importantly, we understood that the requirements for sound AML/CFT practices and the associated bureaucracy were experienced as so stifling that it was more attractive for firms to simply not provide any services at all to high-risk clients, leading to de-risking practices.

DISCUSSION AND CONCLUSION

In this study we developed a theoretical model that explains how fieldwide critical events can shape social-control agents' actions against misconduct and how offending firms may respond to such event-driven changes in enforcement behavior, summarized in Figure 2. In this final section, we discuss our theoretical contributions, the limitations of our study and the possibilities for future research.

[Insert Figure 2 about here]

The Implications of Critical Events on the Social Control of Misconduct

An emerging stream of research shows that critical events can heighten stakeholder attention to firm behavior and can push wrongdoers to cease their malfeasant practices. We identified three types of fieldwide critical events that shape social-control agents' behavior. Moreover, we find that these events can shape the regulatory environment in which organizations operate, thus enabling different responses to enforcement actions. These findings provide two important insights for the literature on critical events and organizational misconduct.

First, the impact of critical events varies widely and for a visible change in firm behavior to transpire, there needs to be ongoing accumulation of work by purposeful actors (Castro & Ansari, 2017; Daudigeos et al., 2018). Prior research has documented that such actors often face conflicting goals, cognitive constraints and limited resources (for a review, see Barnett, 2014), and thus boundedly rational in their decision making (Heese et al., 2016; March & Simon, 1958). Yet, most studies have overlooked the ability of critical events to redirect or restrict collective attention among such actors. Our study fills this gap by studying how fieldwide critical events may significantly influence how priorities are set within these social-control agents and, consequently, their actions against misconduct. In doing so, we respond to calls for studies to focus on the determinants of social-control agents' behavior (Dewan & Jensen, 2020; Greve et al., 2010; Palmer, 2012). We find that long-term fieldwide

critical events that focus societal attention on a specific issue, such as the 2007-2008 financial crisis, can narrow attention within these social-control agents for less salient issues and drive them to function based on a set of flawed assumptions and expectations. Such constraining events thus have the ability to "crowd out rather significant events when more newsworthy events coincide" (Barnett, 2014: 687) and force social-control agents to sanction some type of firms, or label some type of misbehavior, more quickly than others (Dewan & Jensen, 2020; Mohliver, 2019), when in fact such sanctioning may be necessary to convey the undesirability of violations and generate deterrence effects among industry peers.

We also identified the rules' content as a crucial element in understanding social-control agent behavior. That is, rules that prescribe procedural actions rather than ethical behavior (Lehman & Ramanujam, 2009), are unlikely to obtain a high degree of issue legitimacy among the social-control agents, especially during fieldwide critical events that constrain their cognitive capacity and resources. Prior research suggests that for critical events to have a meaningful impact on how key field actors judge malfeasance, these events must expose the underlying assumptions, beliefs systems, and prescriptions that cause such behavior (Castro & Ansari, 2017; Clemente et al., 2017; Hardy & Maguire, 2010). We complement this line of research by demonstrating that when fieldwide events, such as highly publicized industry scandals, expose the deviant practices of an entire industry, rather than of one individual firm, they can unveil the pervasiveness and rule violations and deficiencies of the existing institutional arrangements (e.g., legislation, regulatory tools) designed to counter misconduct. The clustering of such fieldwide events can function as turning points for field actors by reducing their cognitive constraints and changing their normative perception. Social-control agents can capitalize on such clustering to demand changes in institutional arrangements in order to convey the moral reprehensibility of the industry-wide violation of procedural rules.

Second, prior research has mainly treated fieldwide events and firm-specific events as independent occurrences that predict different firm responses (Chandler, 2014; Ocasio & Hoffman, 2001). Here, in contrast, we highlight the possible interplay between fieldwide critical events and firm-specific critical events, such as enforcement actions. When social-control agents are unable to convey the undesirability of rule violations, firms may respond in a perverse way; namely they learn that it is an acceptable practice. The violation of customer due diligence norms by banks, for instance, became a normalized practice because the benefits were clear and immediate (e.g., deferring costly remedial actions) whereas negative outcome or feedback was ambiguous or lacking. We highlight how fieldwide critical events, by constraining social-control agents' cognitive capacity and bounding their ability to consistently punish firms for their actions (or omissions), can lead initial rule violations in the field to gradually become taken-for-granted. In doing so, our study also contributes to research on the normalization of misconduct (Ashforth & Anand, 2003; Vaughan, 1999). We further elaborate on this process by illustrating that when the violated rules emphasize procedural rather than ethical norms and create bureaucratic 'red tape' (Lehman & Ramanujam, 2009), the persistent restraint in enforcement actions may gradually lull firms into complacency and drive them to enact malfeasant practices without conscious awareness of their morel reprehensibility.

Prior studies emphasized the importance of visibility of malfeasant practices in challenging such behavior (Castro & Ansari, 2017; Daudigeos et al., 2018; Roulet, 2019). We refine this view by showing that when enforcement actions against the violation of procedural rules are unable to evoke negative social evaluations, complacent firms might allocate only limited attention and resources to resolving misconduct and thus preserve the status quo. Complacency, in other words, functions as a barrier for change by blunting the need of actors to search for and address the underlying causes of misconduct, making responsiveness

fundamentally myopic. With regard to misconduct, we demonstrate that such myopia can bound organizational responsiveness to external mandates both spatially and temporally, with managers resolving violations only in isolation and temporarily.

Conversely, the clustering of critical events can suddenly present important discursive opportunities for social control-agents to convey the personal and organizational consequences (i.e., financial, reputational) of rule violations, significantly enhancing issue legitimacy among transgressing firms and their leaders. Importantly, our findings suggest that such strict enforcement of procedural rules after a major industry scandal or a long period of transgressions may lead to involuntary responsiveness. The involuntary response to external mandates, prior research shows, tends to evoke “shallow learning” and processes that will fail to address the underlying assumption, beliefs and prescriptions that cause misconduct (Haunschild & Rhee, 2004; Kostova & Roth, 2002). Indeed, we find evidence that although firms’ leadership will tend to publicly display their conscious obedience to stakeholder pressures in the wake of exposed misconduct (Hersel et al., 2019 Oliver, 1991), their primary aim is to avert further firm-specific critical events that cause reputational damage or shareholder unrest. This finding touches on the process of means-ends decoupling (Bromley & Powell, 2012), meaning that while institutional policies and structures are thoroughly implemented, they have an opaque relationship to the underlying causes of misconduct. Over time, as the relationship between implemented practices and intended outcomes remains ambiguous, corporate leaders and employees are likely to become disillusioned and the adopted practices perceived as increasingly illegitimate (MacLean & Behnam, 2010; Sonenshein, 2016). Policymakers and regulators should thus be aware that strict enforcement of rules alone will not directly lead to genuine commitment because the perception of the morality of regulated behavior is not addressed, especially when rules emphasize procedural rather than ethical norms.

Limitations and Future Research

Our study has three main limitations which open up opportunities for future research. As the focus of our study was on a regulatory agency, we did not explicitly consider other social-control agents relevant to our case. We recognize that critical events may also mobilize or constrain other actors in detecting and challenging misconduct (e.g., Daudigeos et al., 2018), yet the efficacy of fieldwide events on firm behavior is contingent on concerted actions by multiple social-control agents. For instance, whereas the media has the ability to impose public scrutiny on firms for their ethical transgressions (Clemente & Gabbioneta, 2017; Roulet, 2019), the media is less likely to form and disseminate evaluations of wrongdoing when regulators are unable to disclose cases of misconduct to the wider public. Therefore, studies on media or political discourse surrounding cases of misconduct would be promising – especially when including how such discourses lead to broader institutional changes. Relatedly, although our research offers some insights into the ways in which social-control agents may potentially influence corporate behavior, more research is needed to establish such causal links. One fruitful research direction would be to investigate how salient events lead to coordinated or uncoordinated processes of practice deinstitutionalization, such as following the #MeToo movement, tax evasion revealed by the Panama Papers leaks or, more recently, the Russian invasion of Ukraine. We expect that the latter example, with the proliferation of international sanctions targeted against Russia, provides a particularly interesting case of how critical events might evoke collective action among politicians, financial firms and the media.

Although our study is grounded in the idea that role conflicts are prevalent within social-control agents, we have not been able to gain in-depth and longitudinal insight into the intraorganizational dynamics that result from such tensions. We therefore see ample opportunities for future research to investigate how key actors inhabiting these social-control

agents experience and address competing institutional demands. Such research could provide insights into how these actors effectively balance multiple important goals (e.g., financial integrity, social welfare, fiscal efficiency) or, conversely, are driven to unconsciously facilitate the emergence and diffusion of misconduct. Recent corporate scandals have also revealed more malicious forms of active or passive facilitation of misconduct, such as in the case of the U.S. Federal Aviation Administration's oversight failures over Boeing or the efforts of the German watchdog BaFin to silence media reporting on Wirecard. Building on these salient cases, we encourage scholars to investigate the organizational and institutional conditions under which social-control agents are more likely to become co-opted by the firms they are legally or ethically obliged to monitor (e.g., regulatory capture) or to obstruct the ability of other key stakeholders to expose and challenge misconduct.

Another limitation of our study is that some of the archival material we collected to understand firm misbehavior was drafted for supervisory purposes by professionals who had the regulator's goals, interests and preferences in mind. To enable a more thorough form of triangulation, future research should also consider the voices of other involved stakeholders. In this regard, we see opportunities for scholars to engage with the experiences of the people who are actually working within the offending firms and explore the unanticipated consequences of critical events that focus collective scrutiny on their organization. We observe, for instance, that government agencies tend to set detailed, verifiable goals and quality requirements after a long period of rule violations. We find that such increased coercion may lead to "regulatory creep", in which the focus of those being regulated is skewed away from the key objectives of institutional rules ("the spirit") toward the activity of demonstrating strict adherence to the external mandate ("the letter"), delivering little – if any – additional benefit. In this regard, one fruitful research avenue would be to investigate the impact of regulatory or media encroachment in the wake of industry scandals.

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Table 1. Data collected.

	Archival material (2005-2020)	Interviews
EastCo	Annual reports 2008–2019; regulatory interview transcripts; regulatory audit reports; management statements; internal audit reports; written reactions to regulatory findings; remediation action plans	
	Total: 86 documents; 1,442 pages	
SouthBank	Annual reports 2006–2019; regulatory interview transcripts; internal audit reports; regulatory audit reports; written reaction to regulatory reports; settlement agreements; statements of facts; validation reports	
	Total: 69 documents; 1,112 pages	
WestGroup	Annual reports 2007–2019; regulatory interview transcripts; regulatory audit reports; written reactions to regulatory reports; remediation action plans; validation reports	
	Total: 68 documents; 1,364 pages	
Regulatory agency	Annual (strategy) reports 2010–2019; enforcement and sanction decisions; intervention strategies; reports of internal meetings; parliamentary inquiry findings; supervisory strategy change action plans; timelines of regulatory actions	Heads of financial crime supervision department [2] (FCR1-2); Senior regulators financial crime [5] (FCR3-7)
	Total: 26 documents; 766 pages	
Total	225 documents; 4,684 pages	7 interviews; 108 pages of transcript

Figure 1. Timeline with Key Events.

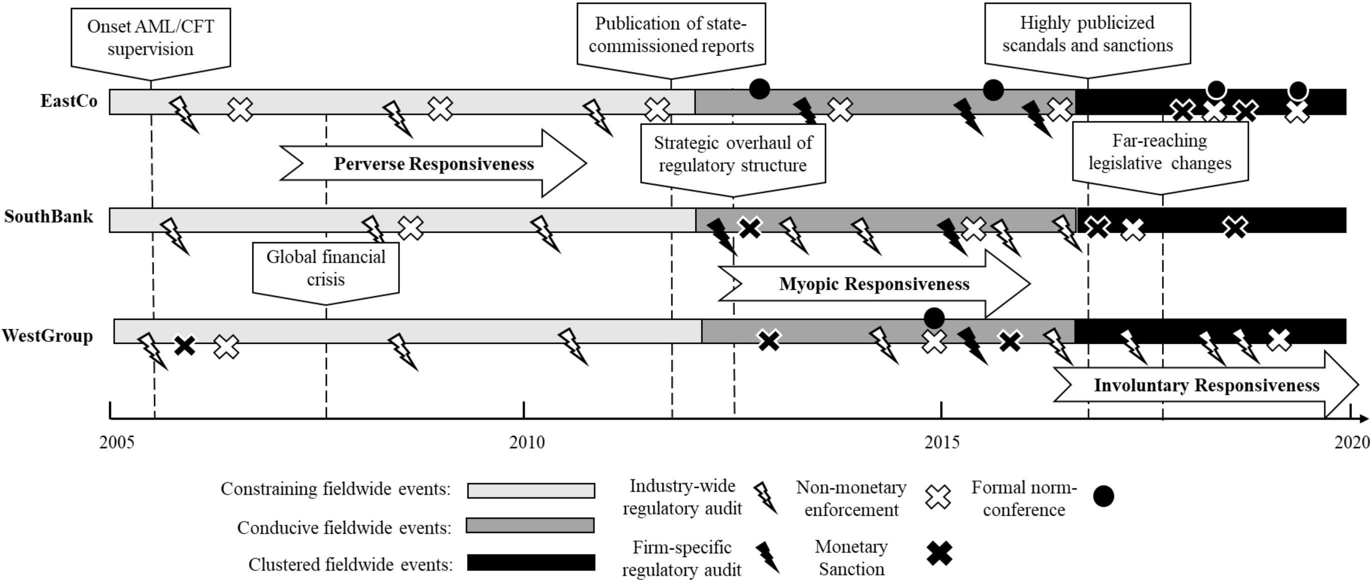

Figure 2. The Influence of Critical Events on the Social Control of Misconduct