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THE DANGERS OF DECOUPLING: THE RELATIONSHIP BETWEEN COMPLIANCE PROGRAMS, LEGITIMACY PERCEPTIONS, AND INSTITUTIONALIZED MISCONDUCT

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This theory-building analysis spotlights a dynamic that occurs between decoupling, legitimacy, and institutionalized misconduct. Using data gathered from a case study of widespread deceptive sales practices at a large financial services firm, we demonstrate the dangers of decoupling an organizational compliance program from the core business activities of an organization. We illustrate how decoupling created a "legitimacy facade" that enabled the institutionalization of misconduct and precipitated a loss of external legitimacy.

In recent years, the U.S. government has passed a plethora of laws and regulations in response to widespread organizational misconduct, most notably the Sarbanes-Oxley Act and the United States Sentencing Commission Guidelines. The guidelines have acted as "a virtual mandate for organizational investment in ethics and compliance programs" (Dalton & Metzger, 1994: 8), and they are largely responsible for the universality of organizational legal-ethical compliance programs at large U.S. corporations, 90 percent of which have some sort of formal compliance program (Trevino & Weaver, 2003).

The ubiquity of organizational compliance programs speaks to the extent to which they act to help organizations gain and/or maintain legitimacy in their institutional environment (Weaver, Trevino, & Cochran, 1999b). Although no doubt some organizations implement these programs in hopes of actually deterring misconduct, others decouple their compliance programs from their core business activities, deploying formal structures while avoiding integration of crucial elements of the compliance programs into the day-to-day, central, task-related processes of the organizations. This decoupling produces formal compliance programs that are a form of window dressing, symbolic gestures designed to give the appearance of satisfying regulatory requirements and enhance external audiences' perceptions of organizational legitimacy while still allowing for "business as usual" (Weaver et al., 1999b).

Research has demonstrated that external parties appear to be willing to grant legitimacy to organizations on the basis of such symbolic gestures (Ashforth & Gibbs, 1990; Elsbach, 2003; Suchman, 1995; Westphal & Zajac, 1994, 2001), but far less is known about how insiders—organization members—respond to decoupling of form and substance in their own organizations, and whether decoupling affects their legitimacy perceptions and related behavior.

In this article, we study this issue by analyzing how a decoupled formal compliance program affected internal and external legitimacy perceptions at a large financial services firm. We begin in the next section by describing formal compliance programs as legitimating structures and distinguishing between external organization-level legitimacy perceptions and internal program-level legitimacy perceptions. We then introduce our inductive, qualitative analysis of a case of widespread deceptive sales practices at a financial services organization. Subsequently, in our findings we demonstrate that efforts to enhance external organization-level legitimacy via decoupling the compliance program from core organizational activities negatively affected internal program-level legitimacy perceptions of the formal compliance program, enabling the institutionalization of misconduct and ultimately leading to a loss of external organizational legitimacy. Finally, we discuss the theoretical implications of this legitimacy dynamic for neoinstitutional and legitimacy theories as well as the implications it may have for both theory and practice

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related to the implementation of organizational ethics and compliance programs.

FORMAL COMPLIANCE PROGRAMS AS SYMBOLIC, LEGITIMATING STRUCTURES

Formal compliance programs have been conceptualized as organizational control systems (Weaver, Trevino, & Cochran, 1999a; Weaver et al., 1999b), the purpose of which is "standardizing employee behavior within the domains of ethics and legal compliance" (Weaver et al., 1999a: 42). Through various combinations of "carrot-and-stick approaches" as well as values-based efforts (Paine, 1994), formal compliance programs represent substantive organizational efforts to deter misconduct. These structures, however, also play an important symbolic role in organizations. Formal compliance programs are a vital means of managing organizational legitimacy, defined as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman, 1995: 574). It is a widely accepted theme in organization studies that legitimacy is necessary for organizational continuity and success (Ashforth & Gibbs, 1990; Dowling & Pfeffer, 1975; Scott, 1995; Suchman, 1995). Compliance programs act as legitimating structures in that they signal alignment with the normative expectations of external audiences, indicating that the organization's activities are the "right thing to do" and that they match taken-for-granted cultural assumptions about appropriate organizational structures, thus helping organizations gain or maintain external legitimacy (Metzger, Dalton, & Hill, 1993; Wartick & Cochran, 1985; Weaver et al., 1999b; Wood, 1991). Such programs are "presumed to enhance or maintain organizational legitimacy and thus contribute to financial performance by securing the support of key institutional actors" (Weaver et al., 1999b: 540).

Decoupling Compliance to Achieve Legitimacy

Managing compliance with externally imposed legal and regulatory requirements is a struggle for many organizations, especially when these requirements appear to conflict with or compromise profit-maximizing activities. Resolving this tension is critical, however, for organizations to acquire and/or maintain organizational legitimacy, especially from regulatory agencies and lawmakers.

Scholars have asserted that when expectations of their institutional environment appear to conflict with managerial interests, organizations may try to acquire legitimacy without necessarily changing business practices by deploying formal structures that meet institutional demands but are disconnected from actual practice (Meyer & Rowan, 1977; Oliver, 1991; Scott, 1995; Westphal & Zajac, 1994). Empirical evidence of decoupling being used to successfully gain or maintain legitimacy can be found in a variety of organizational contexts. For instance, Westphal and Zajac and their collaborators have demonstrated in a number of empirical studies how formal organizational initiatives such as long-term incentive programs, stock repurchase programs, changes of college curricula, total quality management (TQM) programs, or management of strategic change can be formally announced and, without actually being implemented, still help the organizations to maintain or gain legitimacy from external audiences (Fiss & Zajac, 2006; Kraatz & Zajac, 1996; Westphal, Gulati, & Shortell, 1997; Westphal & Zajac, 1994, 1998, 2001; Zajac & Westphal, 2004). Bowerman (2002) showed that local governments' implementation of the European Foundation for Quality Management's Business Excellence Model was being decoupled from practice and still allowed local governments to achieve a critical threshold in achieving legitimacy from the central British government, as measured by the distribution of grants. Trullen and Stevenson (2006) studied seven pharmaceutical companies and noted how they were able to decouple their formal announcements of price cuts of their AIDS medications from the substantive action of actually cutting prices and still maintain external legitimacy until generic manufacturers threatened their position.

In the context of compliance with regulatory expectations, neoinstitutional theory would predict that an organization may try to gain legitimacy from its external environment by creating visible, largely symbolic, compliance programs that signal fulfillment of legal requirements while simultaneously decoupling those structures from core processes. In practice, decoupling compliance means avoiding integration of crucial elements of the compliance program into the day-to-day, central, task-related processes of the organization. Compliance programs that are truly integrated into the "task-related core of an organization" are designed to "affect everyday decisions and actions; decisions are made in light of these policies, and people occupying these specialized structures have the confidence of and regular interaction with other departments and their managers" (Weaver et al., 1999b: 540). Hence, decoupled compliance structures may either manifest themselves as public claims of programs that do not exist in practice, or as programs that exist in practice but are disconnected from important, ongoing, line-related organizational functions.

This theoretical perspective explains how decoupling enhances perceptions of organization-level legitimacy held by external audiences without significantly changing informal organizational practices, yet it does not address how decoupling affects the legitimacy perceptions of organization insiders and how those internal legitimacy perceptions might shape organization members' behaviors. Indeed, most studies of legitimacy (including the ones cited previously) have framed legitimacy as something acquired from external audiences. It seems likely, however, that the view from the inside of a decoupled organizational program differs from the perspective held by external stakeholders. For instance, a formal organizational diversity training program instituted by British police services supported organizational legitimacy with external constituents, but members of the police force perceived it as "window dressing . . . the policies are not seen as helpful, nor even harmless, but as pernicious in that they contrive to give the appearance of progress, while actually achieving little" (Cashmore, 2002: 327). If formal compliance programs are an organizational facade (Nystrom & Starbuck, 1984) intended to promote positive external perceptions, working behind that façade is likely to affect insiders' perceptions of legitimacy, specifically, their program-level legitimacy perceptions (Ruef & Scott, 1998) of the formal compliance program.

Dissonant Legitimacy Perceptions: Internal Program Legitimacy versus External Organizational Legitimacy

Organizational legitimacy is a perception; acquiring and maintaining it is about organizational perception management (Elsbach, 2003). Most theorizing around legitimacy, however, has addressed only the impact that legitimacy management has on the perceptions of outsiders, constructing legitimacy as a commodity garnered exclusively from the outside world (e.g., Certo, 2003; Edelman, 1992; Elsbach, 1994; Elsbach & Sutton, 1992; Ruef & Scott, 1998; Suchman, 1995; Westphal & Zajac, 1998). Even in one of the most widely cited, seminal conceptualizations of organizational legitimacy, Suchman (1995) identified pragmatic, moral, and cognitive legitimacy as conferred upon organizations by external audiences. This stream of research has usefully identified many external sources of legitimacy, with the following being perhaps the most widely recognized: regulatory organizations, professional associations, the media, the financial markets, stockholders, consumers, analysts, and the general public.

Less has been said about internal legitimacy, or the extent to which internal audiences perceive, confer, or withhold legitimacy perceptions, despite Elsbach's (2003) explicitly categorizing legitimacy as an organizational image whose audiences include insiders as well outsiders and Wood's identifying employees as key stakeholders likely to "withhold loyalty and best efforts" (1991: 697) if they lose confidence in the firm and withdraw legitimacy. In this study, we were interested in legitimacy perceptions held by insiders, or *internal legitimacy perceptions*. Given our interest in formal compliance programs, we were specifically interested in insiders' legitimacy perceptions at the subunit or program level of analysis. Drawing on other research conceptualizing legitimacy as operating not only at the organization (Suchman, 1995) and the form levels (Dacin, 1997; Foreman & Whetten, 2002), but also at the level of subunit or function in an organization (Ruef & Scott, 1998), we define *internal program legitimacy* as organization members' perceptions of the appropriateness or acceptance of a particular function, subunit, or program of their organization and *internal compliance program legitimacy* as referring specifically to members' legitimacy perceptions of their organization's formal compliance program.

That decoupling is intended to promote external perceptions of legitimacy while protecting informal, business-as-usual activities raises a theoretical question with respect to internal and external legitimacy perceptions. Will external perceptions of organization-level legitimacy achieved through decoupling be dissonant with internal perceptions of compliance program legitimacy? Does that potential dissonance affect organization members' behaviors? Although we are unaware of any research that addresses this theoretical question directly, the literature on organizational image and identity offers insights into how insiders react to dissonant organizational images and affirms the importance of exploring perceptual dissonance in the context of legitimacy.

Organization Image, Identity, and Perceptual Dissonance

The organizational identity and image literature demonstrates that when insiders hold organizational perceptions that are dissonant with the perceptions that outsiders either hold or are construed to hold, it creates a tension that organization members are motivated to resolve. Dissonance between how insiders perceive what is central, distinct, and enduring about their organization (Albert & Whetten, 1985) and their beliefs about outsiders' impressions of their organization (Dutton, Dukerich, & Harquail, 1994) can lead to sense-making (Gioia, Schultz, & Corley, 2000) about how to respond to the gap and to organization members' actively trying to positively manage outsiders' perceptions of the organization's image (Dutton & Dukerich, 1991). Similarly, misalignment between organizational identity and reputation (Fombrun, 1996) can motivate insiders to act in ways to "protect both personal and external perceptions of their organization as well as their perceptions of themselves as individuals" (Elsbach & Kramer, 1996: 470). Dissonance between organizational identity and perceptions of ideal identity is theorized to be an engine driving managers to create change that aligns those discrepant perceptions (Reger, Gustafson, Demarie, & Mullane, 1994). This same dissonance has been empirically demonstrated to lead to identity ambiguity, conflict, and competition to more clearly define an organization's identity (Corley & Gioia, 2004) as well as decreases in employee cooperation, altruism, commitment, loyalty, and acceptance of change (Foreman & Whetten, 2002).

The identity and image literature demonstrates that dissonant internal and external organizational perceptions create tension for insiders and motivate them to reduce that stress in a variety of ways that may have both positive and negative outcomes for their organization. By extension, this literature highlights the significance of dissonant legitimacy perceptions and the importance of understanding the tensions these may create and the ways insiders may respond to them. However, the image and identity literature does not indicate a clear theoretical path to understanding the various ways insiders will react, as evidenced by the range of responses evoked by dissonance between organizational identity and its various "alters" (Kuhn, 1964).

To pursue our understanding of how decoupling formal compliance programs might affect dissonant legitimacy perceptions and shape insiders' behaviors, we conducted an inductive case analysis of Acme,[1] a financial services organization in which a decoupled sales practices compliance program created organizational dissonance (Duimering & Safayeni, 1998) between external organizational legitimacy and internal compliance program legitimacy. Analysis suggested that the legitimacy facade created by decoupling generated dissonant legitimacy perceptions and contributed to the institutionalization of deceptive sales practices, which eventually were detected by regulators and damaged Acme's external organizational legitimacy. A conceptual model of this phenomenon developed from the case data demonstrates how decoupling compliance from day-to-day operations can set in motion a process that creates external organizational legitimacy in the short term at the expense of internal compliance program legitimacy, contributing to (rather than constraining) noncompliance and precipitating a loss of external legitimacy.

The Case: Deceptive Sales Practices at Acme Insurance Company

Acme Insurance Company is a large mutual life insurance company operating primarily in North America. In the late 1990s, Acme was one of several large companies subject to regulatory investigations of their sales practices. National in scope, the investigation of Acme found that the use of deceptive sales practices had been widespread at Acme for over a decade; that individuals at all levels of management were aware of the practice; and that Acme had failed to appropriately supervise sales practices and discipline rogue agents and sales managers. The term "deceptive sales practices" relates to a variety of practices that have been lumped together by the media, class action lawyers, and the general public under the rubric "churning." Churning violates every state's fair trade practices as well as National Association of Securities Dealers (NASD) regulations, state insurance department regulations, and Acme's own internal sales practices compliance rules.

Churning involves using financing and/or replacement tactics to fund the purchase of new life insurance policies. "Financing" is defined as using dividends and/or loan values from an insured's existing insurance policy to purchase a new insurance policy. "Replacement" transactions are financed sales that specifically involve borrowing or planning to borrow more than 25 percent of the existing policy's cash value to fund the purchase of new life insurance. Financing and replacement transactions become churning violations when a

[1] "Acme" is a pseudonym. Because of the sensitive legal nature of this topic and promises of confidentiality made to interviewees, we go to great lengths to obscure the actual identity of this organization. We acknowledge that this results in some ambiguity around exact dates, such as when the deceptive sales practices were occurring, when investigations began and ended, when company ratings were downgraded, etc., but it is necessary to maintain the organization's anonymity.

sales agent does not disclose to an insured the potentially detrimental impact of financing on the values of the existing policy, or when the agent indicates that their existing policy will fund the new policy "forever" rather than disclosing that dividends from their existing life insurance policy are not guaranteed and thus may not be available in the future to pay premiums on the new policy. Victims of churning often do not know they have been victimized for years after the transaction, until values in the original policy have been significantly depleted.

METHODS

Data Sources

This study draws upon three separate data sources, all archival. Each is described below.[2]

The "State Investigators' Files." Files originally gathered by state investigators in the mid 1990s as part of a U.S. regional regulatory investigation into the sales practices at Acme served as one data source. This investigation was conducted jointly by one state's Department of Insurance and its Office of the Attorney General. These regulators investigated Acme's sales practices over 15 years, between the early 1980s and the mid 1990s, and reported that the firm's sales practices constituted violations of a variety of the state's R.I.C.O. statutes[3] with respect to the sale of securities and investor protection, theft, fraudulent practices, forgery, and offenses related to financial transactions. These investigative files contain detailed descriptions of the act of churning and how the mechanics of these practices worked, factors that influenced the occurrence and persistence of churning, and descriptions of the internal sales practices compliance program and auditing function. Types of files included a summary report of the investigators' findings,[4] internal audit reports, training materials, and personal correspondence and memos.

Interviews. The second data source was a set of 20 interviews conducted by the first author with former members of Acme's sales force on the topic of deceptive sales practices in 1997–98 (roughly three years after the churning scandal at Acme became public knowledge through the media). These interviews were conducted for an earlier research project designed to understand organizational misconduct from a process perspective.[5] Thus, the earlier project's goal differed from that of the present study, which is to illuminate the unintended consequences of decoupled compliance programs. We therefore consider these interviews archival in the sense that the interview protocol was not tailored to the themes emerging from this particular analysis. The goal of these semistructured interviews was to understand the organizational roles of the interviewees and how they were trained to do their jobs, obtain detailed explanations of deceptive sales practices, elicit opinions with respect to the causes of the churning scandal, and learn how the sales force at Acme framed or perceived sales practices compliance programs and rules. Samples of questions used in these interviews can be found in the Appendix.

The snowball technique (Cresswell, 1998) was used to create a sample of former employees that allowed access and insight into the issues and to provide greater assurance that interviewees would be less inclined to filter their comments for fear of organizational retribution and whistle-blowing. Adopting a loosely structured style of face-to-face interviewing enabled the first author to build the rapport and trust with interviewees that were necessary to evoke detailed discussions about their experiences with churning at Acme. The first author was also able to build rapport and minimize bias in the interviews by not asking the interviewees to describe their own sales practices, but rather to reflect on their observations of the sales practices of others they worked with at Acme. Each interview lasted between 45 and 90 minutes and was tape-recorded and professionally transcribed.

The interview sample reflected a diversity of geographically distributed sales offices. Most interviewees were from the New England region, representing seven different sales offices led by seven different general managers. The organizational tenure of interviewees ranged from 20 months to 32 years. All 20 participants worked for Acme be-

[2] The first author gathered and analyzed all data for the study.

[3] R.I.C.O. stands for Racketeer Influence Corrupt Organization Act.

[4] Although this report was publicly available at the time the first author was gathering data in 1998, our understanding is that the records were sealed by the state shortly thereafter. We do not cite this report here to shield Acme's true identity and to protect the identities of the interviewees.

[5] Publications based on these interviews include an article on the processes driving the persistence and proliferation of rule breaking in organizations (MacLean, 2001) and another taking a symbolic interactionist perspective on the causes of organizational misconduct (MacLean, 2008).

tween 1985 and 1995, when churning practices were reported to be at their height.

The "National Regulatory Investigation Summary Report."[6] The third data source for this project was the summary report of an in-depth national investigation into Acme's sales practices by a regulatory task force comprised of representatives of 30 states' departments of insurance, released in the late 1990s. The investigation was initiated to examine widespread customer complaints and state regulatory allegations of churning and misrepresentation in the sale of life insurance products between the mid 1980s and mid 1990s. The report summarizes themes from interviews with more than 250 agents and more than 25 marketing executives. The purpose of those interviews was to ascertain the extent of the sales force's knowledge of replacement activities and financed life insurance sales. The report also provides quantitative analysis of (1) replacement and financing activities and (2) monitoring and disciplinary actions at Acme during that time frame. The quantitative analysis in the report illustrates the task force's claims that illegal replacement activity was widespread throughout Acme over an extended period of years.

Data Analysis

Our original interest in this research built upon our curiosity both about how misconduct persisted and proliferated in organizations and in how insiders socially constructed compliance programs in the context of widespread rule breaking. This project was an inductive case analysis, relying on both content analysis of available data and utilizing grounded theory techniques (Glaser & Strauss, 1967; Strauss & Corbin, 1998) in order to situate theoretical insights induced from case data in the appropriate literatures. This approach involved moving back and forth between the data and the literature, in such a way that they mutually informed emergent theoretical insights. Analysis began with separating data into five different types of documentation based on similarity of form. Table 1 summarizes the data types used.

Breaking the data into categories made them more manageable to work with and provided the opportunity to triangulate, checking for support of concepts and categories both within type and across type. It is worth noting here that not all of the vast number of pages of documentation acquired through this research illuminated the dynamics of decoupling or perceptions of legitimacy and compliance. The data sources yielding the most insight were the interviews, the depositions of sales personnel and auditors found in the State Investigators' Files, and the personal correspondence found in those, as these documents spoke more directly to our research interests. The National Regulatory Investigation Summary Report was useful for the broad historical perspective it brought to the economic and regulatory environment facing Acme as well as for triangulation via the summary, which supported insights that emerged from the other data sources.

TABLE 1
Summary of Type and Volume of Data Collected and Analyzed

Type of Data	Number of Documents	Approximate Pages
Depositions	22	3,750
Audit reports/excerpts	20	350
Training materials	30	400
Correspondence and memos	50	200
Interviews	20	750

Coding. After sorting the data into type, the first author began a second reading of the documents, this time identifying "concepts" (Strauss & Corbin, 1998): key issues, themes, questions, frames, and ideas. Using a symbolic interactionist framework (Blumer, 1969; Fine, 1992; Prasad, 1993) conducive to her early interest in insiders' perceptions of the compliance program, she initially sought to identify shared "frames" related to rule breaking or rule compliance, in the context of deceptive sales practices. She then labeled each concept with a concise code and used a modified pile sort method (Bernard, 1995) to create provisional categories of frames. These were used to guide the final round of coding.

Evidence that insiders saw Acme's sales practices compliance program as symbolic in nature as well as powerless to control churning emerged through early analysis as an important theme. As a result, the first author adopted a neoinstitutional perspective and began looking for indications of decoupling of Acme's compliance program. This involved coding for the quality of the common core processes of compliance programs that Weaver et al. (1999b) identified in their study of integrated and decoupled corporate ethics programs: training, monitoring, and disciplinary processes. Data were analyzed with respect to how compliance training

[6] Although this report was publicly available at its release in 1996, we are not citing it here to shield Acme's true identity and to protect the identities of the interviewees.

was delivered: Did it occur in conjunction with and with similar frequency as sales training, or was it delivered less frequently and given less priority? Evidence was also sought regarding whether adherence to compliance was monitored regularly and to the same extent as sales were monitored and measured, and whether violations of compliance standards were addressed consistently and taken as seriously as poor sales performance issues were.

In view of the neoinstitutional perspective now being employed, evidence of both external organizational legitimacy and internal compliance program legitimacy was sought. Evidence of external legitimacy was found by researching Acme's history through A. M. Best (www.ambest.com),[7] an agency that rates life insurance companies on the basis of their ability to meet their financial obligations currently and in the future. A. M. Best's rating system is designed to "provide an opinion of an insurer's financial strength and ability to meet ongoing obligations to policyholders" (*Best's Insurance Reports*, 2000: vii). Ratings are derived through analysis of a company's balance sheet strength and operating performance compared to Best's standards. A. M. Best's ratings are reliable signals of external organizational legitimacy since "investors and lenders across the world have come to depend on ratings reports, largely because of their accuracy and integrity" and because the possession of a public rating by global ratings agencies such as A. M. Best is seen as "an essential prerequisite to any financial transaction between an insurer and its stakeholders" (*Post Magazine*, 2003: 18). The *New York Times* has referred to A. M. Best as the "company on which thousands of American corporations and consumers depend for evaluations of the financial health of insurance companies" (Berg, 1991: D1) and noted that "ratings and reports by Best and other such companies are widely followed by holders of life insurance policies, annuities and other pension investments, especially since the recent collapse and financial problems of several big insurance companies" (Berg, 1992: D1). A. M. Best provides detailed explanations of why ratings change from year to year, which was particularly important to this study because the explanations linked changes in Acme's rating directly to the institutionalized misconduct analyzed in this study. Acme's ratings, documented changes in those ratings, and rationales for those changes between 1985 and 1998 were analyzed.

In coding for internal compliance program legitimacy, we adapted Foreman and Whetten's (2002) measurement of form-level legitimacy to program-level legitimacy. Conceptualizing cognitive legitimacy as "the degree to which a form or practice is seen as being necessary or inevitable," Foreman and Whetten (2002: 623) utilized survey items that included questions probing the extent to which the form being studied was seen as valued, necessary, and useful. Conceptualizing pragmatic legitimacy as "the degree to which an entity represents its constituent's self-interests" (Foreman & Whetten, 2002: 623), they utilized survey items that included questions probing the extent to which the form being studied was seen as operating to the benefit of relevant stakeholders. We applied this measurement framework to internal compliance program legitimacy and analyzed the data for evidence of perceptions of the compliance program being valued, necessary, and useful (cognitive legitimacy) and/or operating to the benefit of the sales force (pragmatic legitimacy).

Evaluation of evidence. The rank assigned for the strength of evidence supporting a particular concept was a composite. We ranked the strength with which the concept was represented in the case in terms of the relative frequency of its occurrence both within and across data types and in terms of our judgment regarding the significance of the context in which the concept occurred in the data. This judgment was rooted in the theoretical sensitivity of the first author (Glaser & Strauss, 1967; Strauss & Corbin, 1998).

Evidence was rated as either "moderate" or "strong"; weak concepts were omitted. Strength of evidence was based primarily on indications found in the State Investigators' Files and the interview data; because the National Regulatory Investigation Summary Report provided quantitative support and summaries of narratives (rather than the actual interview data that their summaries were based on), it did not lend itself to extensive coding for perceptions of internal compliance program legitimacy. The system of evaluating support was adapted from Elsbach and Kramer (2003); footnotes to our tables describing concepts with examples report the specific ways the sources were weighted in evaluating the strength of evidence for each particular concept.

FINDINGS

The story that ultimately emerges from this case is one of how a compliance program that generates

[7] We can point readers to the A. M. Best website (www.ambest.com), but will not cite the specific volumes and pages accessed in order to ensure the anonymity of Acme.

compliance in name only can lead to a loss of legitimacy. At Acme, the decoupled compliance program created a legitimacy facade, creating dissonant legitimacy perceptions: though Acme's symbolic compliance program was sufficient to support positive legitimacy perceptions from external audiences, insiders at Acme held negative legitimacy perceptions of the decoupled compliance program. This perceptual dissonance contributed to the institutionalization of deceptive sales practices. Finally, as deceptive sales practices became institutionalized over time and throughout the organization, the risk of detection increased, which created a latent threat to external organizational legitimacy that was eventually realized. Figure 1 summarizes this process.

The Legitimacy Facade: The Substance and Symbolism of Acme's Compliance Program

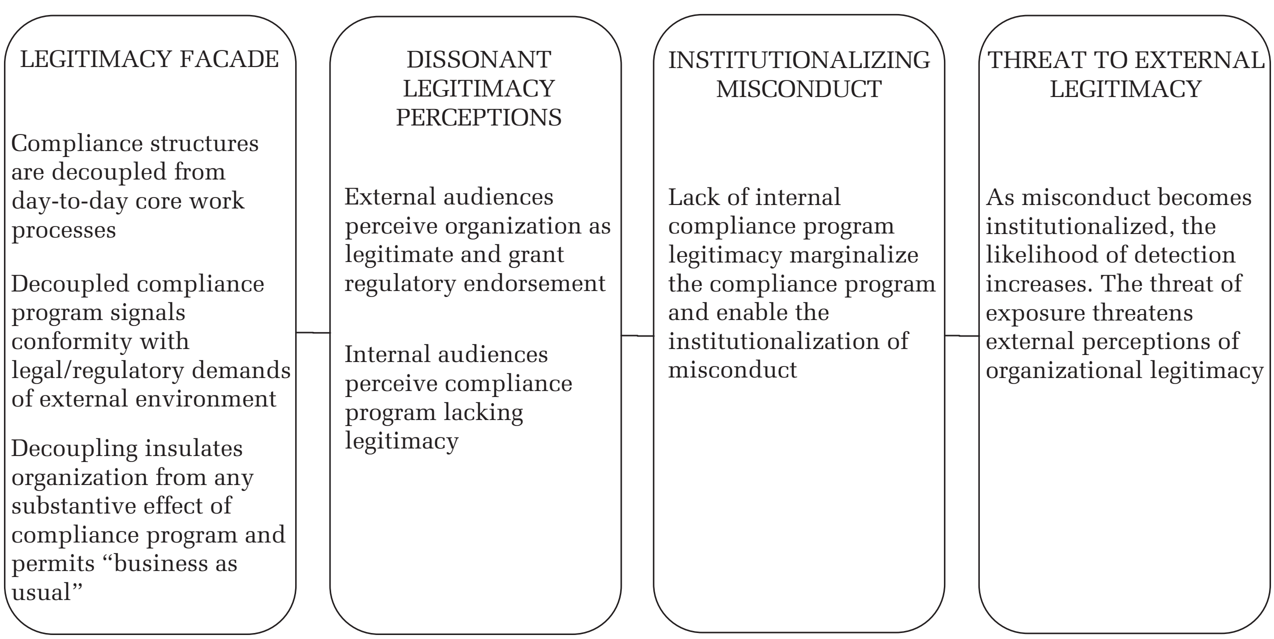
As noted earlier, decoupling involves the symbolic adoption of a particular policy or program without actual, substantive implementation of the policy or program. The archival data amassed for this study indicate a schism between the symbol and substance of Acme's sales practices compliance program that can be seen most clearly by comparing Acme's claim to adhere to regulatory requirements for replacement disclosure and Acme's system for identifying and monitoring replacement activity.

Acme's symbolic stance on replacement and churning. The National Regulatory Investigation Summary Report notes that Acme "reinforced repeatedly, in print and in written procedure, that it will not tolerate unethical behavior by any organization or any individual in the Acme family of companies." In 1984, the firm's senior vice president sent all members of the sales force a lengthy brochure outlining the company's stance on replacement activity and appropriate sales practices. The following excerpt illustrates the company's symbolic commitment to compliance:

> Many of you have probably heard how some of our major competitors have permitted—and in some instances even encouraged—their agents to churn their own books of business with new interest-sensitive products. . . . This move has helped foster a replacement-oriented environment in certain segments of our industry.
>
> I am firmly convinced this is not the path we should follow. I am certain our position is the right one. *Replacement is rarely, if ever, in the best interest of the client* . . . for all of these reasons, replacement should be discouraged. (memorandum, State Investigators' Files, emphasis in original)

Acme took a clear stand on replacement in the mid 1980s and communicated it to the sales force. However, Acme did not implement a system that would accurately identify replacement transactions and failed to maintain accurate record keeping. Replacement sales were implicitly encouraged by

FIGURE 1
The Legitimacy Facade: The Unintended Consequences of Decoupling Compliance



paying sales agents commission on sales that were in fact replacement transactions but not appropriately identified as such.

Acme's system for monitoring replacements. In conjunction with its symbolic stance on replacement activity, Acme instituted a monitoring system to identify replacement transactions. Sales identified as replacements triggered a record-keeping requirement for Acme and also resulted in the recapture of agents' commissions on the replacement policy. However, the Acme system did not identify replacements or recapture commissions if the withdrawal of money from the existing policy occurred more than 90 days after the sale of the new policy. This loophole in the system allowed the agents to first sell a new policy by accepting a quarterly premium from the insured, and then set up a withdrawal from the existing policy 91 days later to fund future premiums on the new policy. Doing so created a replacement sale that was not detected by the system and for which commissions were not recaptured from the selling agent. Strong evidence of this system and the 90-day loophole appears in all three data sources, and the following quote from an agent, taken from the interview summaries in the State Investigators' Files, describes the loophole:

> We were taught to borrow enough money to pay for three months on the old policy and to carry it for 91 days so we didn't get hit with a replacement. That [getting hit with a replacement] meant we didn't get our commission and the manager didn't get his bonus money."

The National Regulatory Investigation Summary Report further documents the weakness of the monitoring system at identifying replacement actions and summarizes its findings on this issue:

> Acme management developed a replacement detection system which failed to identify most transactions that regulations in many states would consider to be replacement transactions . . . many agents and managers found this system easy to circumvent.

The coexistence of strong symbolic statements against replacement activity and churning and monitoring systems that did not accurately identify replacement business provide strong evidence of the decoupling of compliance at Acme. Further evidence emerged from analysis of the integration (or lack thereof) of the training, monitoring, and disciplinary processes of the compliance program with sales processes.

Decoupled compliance at Acme: Lack of integration with sales processes. Formal ethics/compliance programs generally comprise training, monitoring, and disciplinary processes. We determined that the compliance program at Acme was decoupled from its core business function (selling life insurance) by examining the extent to which these three compliance processes were integrated with the core, ongoing, sales-related training, monitoring, and disciplinary processes, as well as by determining the regularity with which compliance training, monitoring, and discipline occurred vis-à-vis sales training, monitoring, and discipline. The case data indicate that during the 1985–95 time frame, the compliance program was poorly integrated into the day-to-day functions of the sales force and unsupported by other organizational policies. In the following sections we review how compliance training was infrequent at best, reiterate how compliance monitoring systems were ineffective, and show that discipline for violating compliance rules was not linked to conformity with existing rules. Table 2 presents a description of these dimensions of decoupling along with examples and an assessment of the strength of the evidence.

Training. Compliance training was infrequent at Acme relative to sales training, which occurred weekly. Each local agency administered ongoing sales training to new agents and delivered weekly sessions for all agents at which new and effective sales ideas were shared. Regional sales training meetings occurred quarterly both in the field and in regional headquarters. Annual sales conferences were devoted to recognizing top sales agents and to sharing effective sales techniques. Comparatively, compliance training was rare. Members of the sales force indicated that compliance training for the most part occurred annually. When questioned about the frequency of compliance training during interviews, former agents noted:

> Q: Did you have training on compliance? A: We had the compliance meeting once a year.
>
> Q: Was there time spent training on compliance rules? A: There was, yeah. If I think of it, I think there may have been maybe two meetings during the year.

The primary vehicle for compliance training was the once-per-year, one-hour-long "annual compliance meeting" that federal regulation explicitly requires. The heart of this annual training was the signing of a form, the "Acme Compliance Agreement." When asked if there was any compliance training at Acme, one former sales agent responded:

> Yeah. We had compliance meetings. They'd go over it, and you'd sign off. They had the yearly meeting. You'd sign off on that form.

TABLE 2
Decoupling Compliance Processes from Sales-Related Processes[a]

Dimension	Description	Example	Strength of Evidence
Lack of sales-practices compliance-related training	Extent to which the sales force received training on sales-practices compliance-related policies and rules	*National Regulatory Investigation Summary Report*: "There appeared to be little if any consistency in agent awareness of guidelines and agent training. A consistent training program encompassing all relevant areas of replacement compliance, including . . . and compliance training in general should be established." *Interviews*: Q: "Was there ongoing compliance training while you were there?" A: "No. I mean . . . no. I mean, there was, I guess? But I wouldn't say it was really ongoing. You had the once-a-year meetings." *State Investigators' Files*: "In the end, management did not properly monitor and train agents to ensure that sales practices were ethical and in the best interests of both the policyholder and the company."	Strong
Lack of sales-practices compliance-related monitoring	Extent to which the sales force was monitored for adherence to sales-practices compliance-related policies and rules	*National Regulatory Investigation Summary Report*: "It is apparent that Acme failed to responsibly monitor and discipline its agents for improper sales activities." *Interviews*: "Yeah, but it wasn't, you know, it's kind of like—it's like putting a security camera in your building without putting a videotape in, you know? It's there, it looks like it will work, but it's really not doing the job. There was a system, but with there was no follow through." *State Investigators' Files*: "I'm not going to be looking into it unless there is something seriously wrong in certain areas. It is like the old, the squeaky wheel gets the oil, and that is the way it works. And I don't think it is any different probably in many businesses, but that is just the way it is."	Strong
Lack of sales-practices compliance-related discipline	Extent to which the sales force was sanctioned for violation of sales-practices compliance-related policies and rules	*National Regulatory Investigation Summary Report*: "The examiners conducted a computer review of four separate databases. The results showed that Acme infrequently took disciplinary action against agents who had undisclosed replacements, and when action was taken it was lenient in nature." *Interviews*: Q: "Were there other things that Acme did that could be interpreted as giving the green light to these practices? A: Well, maybe not firing people who were obviously caught doing things? And maybe promoting them in order to save their jobs" *State Investigators' Files*: "There was no enforcement mechanism, and there was no mechanism to punish. In fact, I don't believe you'll find a single termination of an agent or member of management for financing insurance	Strong

[a] If a concept on Table 2 appears in two out of the three data sources, the evidence was considered "strong." If the concept is strongly indicated in only one of the data sources in a significant context, the evidence was considered moderate.

This form, which listed 20 statements, was passed out at the yearly meeting, and agents were required to check off either "Yes, I understand and comply" or "No" after reading the form, and then sign and submit the form to their agency manager.

Although the compliance agreement form and the annual meeting could have provided an opportunity to discuss compliance concerns and raise questions, agents described the treatment of compliance at the meeting as a rote formality. In an interview, one former agent said:

> We would go over it [the form]. "Does everybody understand? Make sure you answer 'yes' to everything on the back. If you say 'no,' there's a problem." So, who's going to say "no"? . . . and that would be the end of it.

As a result of decoupling training on compliance issues and rules from ongoing and regular sales training, sales agents and sales managers lacked awareness and understanding regarding compliance: some informants in interviews and depositions, as well as in the National Regulatory Investigation Summary Report, claimed not to know that practices associated with churning were violations of internal rules and external regulations. Rather, they were simply taken-for-granted ways of doing business. The National Regulatory Investigation Summary Report notes:

> Interviews with 283 agents revealed little if any consistency in agent training and agent awareness of company and regulatory guidelines. Communication from company management down to the agency force regarding Acme's policy on replacement compliance was weak and ineffective.

Monitoring. Decoupling of compliance monitoring systems could be seen in the infrequency of the monitoring reports, especially when compared with the frequency of sales results monitoring. The data indicate that sales results were reported and measured companywide twice per week. The system is described below by a former sales manager:

> As a sales manager, you wanted your people producing as much business as possible. That's how you got paid. And every Monday and every Thursday, they kept score. "Now, this is what you did, these were your sales from Monday to Thursday," and then every Monday, "from Thursday to Monday, this is what your sales were" . . . and the agency manager would answer every Monday and Thursday to the regional vice-president. And the regional vice-president would answer to the senior vice-president of the regional agencies, and right on up through. They were primarily, the ones that I was associated with, concerned with sales, period.

On the other hand, compliance monitoring reports were distributed monthly, according to the deposition of a confidential witness contained in the State Investigators' Files; thus, the ratio of reports of sales results to reports of compliance was 9:1. Problems and violations identified in the latter reports were not given priority, and the nature of the reports, as described earlier in this section, was such that they failed to identify many of the problematic transactions. Managers were held more accountable for the volume of sales than for the quality of sales and monitoring sales practices. All three data sources used in this study noted this, as well as evidence that Acme's sales practices monitoring was ineffective. A confidential witness whose deposition in the State Investigators' Files indicated he was a member of the top management team stated:

> Well, there was general consensus within the company that the agents were not being properly supervised.

A former sales manager noted the problems more colorfully:

> Have you ever heard the old saying "All good salesman have a little larceny in their hearts"? Salesmen, all of them, are hard-hitting, congenial, influential people who want something from you. Their job is to sell, first and foremost. No matter how you dress them up or educate them, they get paid for results. Acme didn't have a system of checks and balances that would monitor the quality of their sales.

Discipline. The compliance disciplinary function exhibited infrequent application and a lack of organizational support. Disciplinary actions with respect to churning took place infrequently and often amounted to the proverbial slap on the wrist. The National Regulatory Investigation Summary Report noted that:

> Acme infrequently disciplined agents for improper replacements and when it did discipline agents, the company normally only issued warning letters. In some cases, agents were promoted to sales managers and sales managers were promoted to general managers, without regard to significant complaint histories . . . agents were more consistently disciplined for misstatements about the applicant's smoking habits than about improper replacement activity.

Managers made light of violations of compliance rules and concomitant manipulations of the compensation system, and few suffered any significant consequences for such acts. Rule violators were routinely protected from adverse consequences if the violations resulted in sales. One agent being deposed explained:

> There were plenty of guys that did it, they were never chastised. Those were the guys at a Thursday meeting or the girls at a Thursday meeting that were put up on a pedestal and they'd say, hey, he's doing a great job or she's doing a great job.

Decoupling is also evidenced in the disciplinary process by the powerlessness of the departments outside of the sales channel responsible for monitoring sales practices (such as auditing, consumer affairs, and regulatory compliance). Although reports of deceptive sales practices had been written and evidence was in hand, these external departments lacked the organizational power to resolve the deceptive sales practices and discipline the guilty parties. For instance, one auditor explained in his deposition that in the middle of an investigation into widespread deceptive sales practices in a specific region of the company, he was told to back off a bit:

> I got a phone call in the middle of that from the Chief Audit Officer of the company who pretty

> much said in so many words you are doing a great job but maybe you better slow down. His words were "You don't want to bring the whole place down."

A former sales manager we interviewed described the same problem from his perspective:

> There were complaints that were being handled by the individual who was perpetrating the crime. The way Acme would handle a complaint from a policyholder is they give it back to the guy who did it and say "you fix this." It was self-policing. "You've robbed the store, now go back in there, we're going to trust that you're not going to steal anything else, and make this right, okay?"

The National Regulatory Investigation Summary Report summarizes its findings on Acme's disciplinary system as follows:

> The analysis of the company database also revealed that even when there were multiple instances of undisclosed replacements, the company seldom took any disciplinary action. When disciplinary action was taken, it was generally lax. . . . The company failed to research individual agents' records of wrong-doing. Acme's guidelines for progressive discipline often were ignored.

Decoupling the core compliance functions of training, monitoring, and discipline from central, day-to-day, sales-oriented activities robbed the compliance program of substantive organizational power and shielded the sales force from any significant impact compliance might have had on the sales process. Our data suggest that failure to integrate compliance processes with other core organizational processes sent an implicit—but apparently clear—message with respect to how compliance should be enacted in the organization and contributed to the dissonant legitimacy perceptions described in the next section.

Dissonant Legitimacy Perceptions

External organizational legitimacy. Acme's compliance program projected an image that was acceptable and appropriate to regulators and other external stakeholders, thus allowing Acme to maintain organizational legitimacy. This is reflected in the high ratings from A. M. Best that Acme maintained. From the mid 1980s to the mid 1990s, this premier life insurer rating organization assigned Acme its top-tier rating (www.ambest.com), even as deceptive sales practices were proliferating undetected throughout the company.

Although Acme's formal compliance program was sufficient to support external legitimacy, it failed to muster positive perceptions of legitimacy from organizational insiders. In the next section, we describe internal perceptions of compliance program legitimacy at Acme.

Internal compliance program legitimacy. Results of the analysis of insiders' legitimacy perceptions of the compliance program indicated that it was not seen as valued, necessary, or useful, and thus lacked cognitive legitimacy. Further, the compliance program was also seen as not operating in the best interest of insiders, but instead as a self-protection mechanism for senior executives, and thus as lacking pragmatic legitimacy. Table 3 presents an assessment of the strength of evidence, and further evidence is presented below.

One theme that emerged from both the interviews and the depositions concerns insiders' perceptions that the organization's compliance pro-

TABLE 3
Internal Compliance Program Legitimacy[a]

Description	Example	Strength of Evidence
Belief that the organizational compliance program is valued, necessary, or useful and/or that it operates to the benefit of the sales force.	*Interviews*: "It [compliance practices] wasn't taught. I mean, the annual compliance reviews in the agency were a joke. There was no form of formal tracking and that's the company's fault, because they never implemented the system. Which made it easy for people to abuse." *State Investigators' Files*: Investigator: "Would it be fair to say that from day one that the management did not want to change the [compliance monitoring] system, because they did not want a system that worked too well?" Witness: "I don't know if that is fair; but I don't think they want anything that would unduly interfere with sales."	Strong

[a] Strong evidence was inferred when the dimension was evident in both the state investigative files and the interviews. Moderate evidence was inferred when the evidence was strongly indicated in a single source. The National Regulatory Investigation Summary Report did not contain the type of data that would yield insights into internal compliance program legitimacy and thus was not used in determining strength of evidence for this concept.

gram and practices lacked substance and were merely empty rituals, versus being necessary and useful. In an interview, one former agent stated:

> Compliance meetings became a ritual; this isn't something we want to do, but we have to do it.

Similarly, a former senior Acme auditor being deposed by state regulators remarked that one of the senior compliance officers in Acme's legal department felt that his organizational role was a sham and that his attempts to enact his role substantively were problematic:

> Well, he indicated to me that he was essentially looked at as sort of window treatment, window dressing, and that he knew too much.

The lack of internal compliance program legitimacy is further demonstrated by the sales force's perceptions of the compliance program as being blatantly unimportant and a useless hindrance, as seen in quotes below by former agents who were asked during interviews to describe the sales force's attitudes toward Acme's compliance program:

I mean, the annual compliance reviews in the agency were a joke.

> Q: I'm interested in how the field felt—sales managers, general managers, and agents—how they viewed compliance. A: Well, as like a pain, you know?

> I think most people viewed compliance as a hassle.

Rather than viewing the compliance program as an important, necessary, and valued part of the sales process, sales agents and managers saw it as a system to beat in pursuit of sales and commission. One sales manager, when asked during his deposition by state regulators whether or not his general manager knew that another sales manager was allowing deceptive sales practices to persist, responded that all sales management in his office knew:

> Oh, yes, he knew. Believe me, they all knew what was going on. It was how much were they willing to tolerate was what it was.

The presumption held by the sales force that management at Acme knew churning was happening and looked the other way led to the cynical perception that top executives in the organization used compliance simply to protect themselves from the possible fall-out of the use of deceptive sales practices. One sales manager noted in his deposition that he felt the sales agents and sales managers were being unfairly blamed for the deceptive sales practices scandal in his region, and that top management took no responsibility:

> You know, they were being blamed for everything. See, the whole crux of this whole matter is that the field people are always going to be blamed for things, the agent, the line manager, all right. The executives always seem to be insulated for some reason. And that's very selfish on corporate's part and the regions' part, they want to protect the executives—and will always throw the blame to the field.

Similarly, a former agent described in an interview the pressure to produce high sales volume and how the vice presidents of sales sent mixed messages about being in compliance but made it clear that at the end of the day, the agent would be the one held responsible for his or her actions, regardless of the pressure he or she felt from management to produce results by any means possible:

> What you've got here is you've got—it's like bacteria. You give them an environment to grow in, and they're gonna grow. A company can't say "We need a hundred million dollars a month from your organization, Joe Jones." . . . So, what does Jones do? Jones comes to the Bob Smiths, and the Dick Murphys, and whoever, and says, "Look: I've got to have 50 million dollars out of your areas. I've got to have it. . . . Of course, we want to be in compliance, you know? Do what you have to." And it just works that way down on. I mean, and it's all passive—a tacit understanding. Whatever it takes to get the job done. You know, "Of course, if you do something screwed up, I'm not, I'm not a part of that. That's your ass. That's not mine."

Perhaps the most powerful and insightful example of the lack of legitimacy of the compliance program is seen in text from *Revisiting Compliance*, a video produced by sales agents and managers, parodying Acme's sales practices scandal and compliance efforts. The regional vice president of sales showed this video at a regional sales management meeting in 1995, as one of the regional regulatory investigations was winding down. It was subsequently shown at a variety of meetings in that region, to hundreds of sales agents. The State Investigators' Files included a transcription of this video, which is too lengthy to reproduce here. However, the excerpt below provides the flavor of the video and also illustrates insiders' negative legitimacy perceptions of the compliance program:

> Because of all of the attention the media has focused on the life insurance industry lately, we now see the need to publicly correct you for all of the practices we have privately trained you to do for years. We want all of our representatives to maintain our high ethical standards regardless of how we trained you in the past. . . . We want all our reps to get back to the basic need for life insurance, but as always, we

in management feel concerning your marketing practices, what we don't know won't kill us. . . . Any agent found to be out of compliance will find themselves in a three step disciplinary process. The first offense will result in a spanking. For the second offense, we will throw you off the roof of your local office. The third offense will result in termination. . . . We're taking some other steps to cover up, steps to make certain our offices, sales materials, and clerical staff are in compliance, so two weeks from now we will burn all of our local offices to the ground and exile your clerical staff to an uncharted island in the Pacific Ocean. Furthermore, we ask that you report to your manager immediately for an identity change, the cost of which will be paid entirely by the company. We're confident with everyone playing the same game by the same rules, with our new marketing materials and our new identities we can achieve top quartile performance once again. Good luck and good selling. Good grief.

Two sales managers who attended the meeting where the video was first shown noted that the tape was shown in another office with an additional video, which further demonstrates the negative legitimacy perceptions of the compliance program at Acme:

Actually, it was only about two weeks ago a manager with the company called me and said to me that at their meeting in Jonesburg that they preempted that tape with a little segment out of Burt Reynolds's movie *Best Little Whorehouse in Texas*. I don't know if you ever seen that movie where Charles Durning does a dance called the Steppin' Around or something like this where you're going around the truth. And they preempted that tape with that. . . . Q: You mean they added that as a lead-in? A: . . . to that Revisiting Compliance tape. That they stepped around everything, that they got around everything.

The *Revisiting Compliance* video embodies organization members' perceptions of the Acme compliance program as symbolic, as lacking substance and impact, and as being a cover for deceptive sales practices. Devoid of internal compliance program legitimacy, deceptive sales practices became routine at Acme.

Institutionalizing Misconduct

The prevailing theoretical explanation of organizational misconduct is that misconduct occurs when pressure to attain scarce resources coincides with opportunity to violate rules undetected (Baucus, 1994; Finney & Lesieur, 1982; Szwajkowski, 1985; Vaughan, 1983). The institutionalization of organizational misconduct, however, is a separate and distinct phenomenon (Ashforth & Anad, 2003). Institutionalized misconduct refers to an ongoing process: a pattern of interrelated activities, decisions, and routines that exists over time and is carried out by a changing cast of characters. Pressure and opportunity fall short in explaining how misconduct embeds into the routines of an organization, enduring in spite of old employees leaving and new ones filling their shoes and carrying on their rule breaking. It appears from this case that decoupling leads to dissonant legitimacy perceptions that marginalize formal compliance programs and facilitate institutionalization of misconduct.

The combination of structurally powerless rules and a lack of internal compliance program legitimacy attached to those rules worked together to create institutionalized misconduct at Acme. People utilized deceptive sales practices, sometimes unthinkingly and unreflectively with respect to ethics or legality, and passed them on from one group of employees to the next as the established modus operandi. Institutionalization of deceptive sales practices at Acme is evidenced in the data in a variety of ways. In the National Regulatory Investigation Summary Report, widespread deceptive sales practices were quantitatively documented; in the State Investigators' Files they were reported in depositions, and in the actual summary report, by the investigators. In the interviews, the use of shared terminology to name deceptive sales practices and common calculation methods for creating replacement policies using values from existing insurance provide evidence, as do accounts of shared understandings of how practices persisted and proliferated throughout the organization and of the extent to which practices were seen as routine and/or commonly accepted ways of doing business. Table 4 offers elements indicating institutionalization of misconduct, descriptions of each element, and an assessment of the strength of this evidence.

Common language and methodology. The use of common language and common calculation methods to replace policies can be seen in references to the physical process of using policyholder records to locate money in existing policies to fund new sales. Prior to computerization, policyholder records ("PRs") were distributed on index cards, and there are multiple references to using the PR cards to create new sales, evidencing the existence of informal, shared sets of sales practices.

An agent described the process of using PRs in his deposition:

We would circle the ones [the PRs] that had enough money in there to create at least a $5,000 policy because that's basically the minimum we were selling.

TABLE 4
Institutionalizing Misconduct[a]

Dimension	Description	Example	Strength of Evidence
Common language and methodology	Shared terminology used in multiple data sources to name deceptive sales practices; common calculation systems described acrosss multiple sources.	*State Investigators' Files*: That's when the four by four came up. In other words, they were taught the math, if you will. And it was called that. That was the description of it. It wasn't one person's description. It was many people's description. *Interviews*: Q: What is the rule of eight? Do you know? A: Oh, I absolutely know. There used to be a form, whether it came from Acme home office or whether it drifted from district to district, I don't really know. But the idea was that if you took a person's dividends, and divided it by eight, you came up with so much a year that they could spend. And if you increased it by a third to account for dividends and interest, that would be on a premium that could be supported by—by the dividends. *Interviews*: The Rule of Eight—the real Rule of Eight was pushing it, and that came about when you were having to hide dividends that the interest were paying, and stuff. The Rule of Ten was looking at the amount of dividends that were in a policy, dividing that dividend by 10, and adding the annual premium. And if that annual premium plus whatever was being generated from the division equaled the annual premium of the new policy, it was a safe bet.	Strong
Common diffusion mechanism	Shared pattern of diffusion of practices from sales management to sales agent existed across the organization.	*State Investigators' Files*: Due to the way that agents were previously educated by management in the sale of insurance . . . it appears that many, if not most, new agents were taught to sell insurance through financing mechanisms. *Interviews*: I think the company kind of used the agent as a conduit for sales, and gave them the tools to do it. And trained them to do it. So the agent felt that it was ok to do it. Again, an agent doesn't come into this business and know this stuff. It has to be learned.	Strong
Routinization	Extent to which the deceptive sales practices were routine and/or acceptable ways of doing business.	*State Investigators' Files*: Well, it was like a standard type of a procedure. *National Regulatory Investigation Summary Report*: There were widespread violations by Acme agents of various states' regulations regarding the replacement of life insurance. The violations were not isolated to any one region of the country.	Strong

[a] Strong evidence was inferred when the dimension was indicated in both the state investigative files and the interviews, or strongly indicated in either the files or the interviews and supported by the findings in the National Regulatory Investigation Summary Report.

Another agent also described the process similarly in response to a similar question in his deposition:

> Well, you were given by your sales manager, you were given PR cards, you were given the cards with clients' names, addresses, existing policies they had, cash values, dividends. You know, you knew everything about them, and you were told to pick out the ones that had the most money in them.

There are also references to common ways of calculating the amount of insurance a policyholder could afford using existing policy funds that indicate shared understanding and a set of informal practices that sales people worked within. The following quote is from an agent being deposed and responding to a question about prospecting for new sales:

> Basically, the sales manager showed us, as agents, the PRs, where the client might have three or four thousand dollars of money as far as cash and dividends in it goes. And he would say "Here is a client that has this much money. Let's take, and based on

> their age currently, divide that total figure by four, and see how much insurance they could get."

Common diffusion mechanism. Strong evidence also exists to argue the existence of formal and informal systems of diffusion of deceptive sales practices. Evidence from the interviews and from the depositions in the State Investigators' Files illustrates how sales managers were crucial informal and formal diffusers of deceptive sales practices. An agent being deposed describes his early training experiences at Acme:

> In 1985 when I first started with Acme, Joe Jones was my manager and they had quite an emphasis on writing life insurance and writing as many policies as I could, calculating the amount of insurance that we could write based on the amount of dividends and the cash value of either the policy or the cash value of the paid-up additional insurance.

Another deposed agent described the physical process of how the PR cards were used, and how both the agency manager and the sales manager played a role in teaching agents how to use them to finance new sales:

> The general manager, Steven Roberts, and our sales manager, Mr. Edwards, would review PR cards to find which customers had any cash value or dividends in them. The managers would then put paper clips on any card that had possibilities. They would call the agents into their offices and show us one at a time with a calculator how much more life insurance the customer could afford without increasing their annual premium.

A third agent describes formal training sessions he attended at which the manager taught churning as an opportunity to make sales:

> The manager would say at all the training sessions that each of us had policyholders with existing cash value just sitting there, in those policies, that we had a great opportunity.

Routinization. Institutionalization of a practice refers to the widespread adoption of that practice—to its routinization as an activity and to the degree to which it becomes an informal norm and accepted way of conducting business. Institutionalization of misconduct at Acme is also revealed through all three data sources indicating that deceptive sales practices were widespread and routine at the company. One former agent noted how embedded the practices were in the organization and how difficult it would be to change the system:

> They knew no other way! They really knew no other way . . . and by then, it was almost too late. It was ingrained in them. You know? I mean, almost too late in the sense that the system was ingrained in the old roots. Now, you're going to have to turn around a whale. And that isn't easy.

A regional vice president of sales noted when being deposed that in fact sales practices related to churning were seen as satisfactory and suitable:

> Q: So the information and the training that she was teaching other agents to use was considered acceptable at that time by corporate and by management and by everyone? A: It was acceptable, yes.

The state investigation also found widespread deceptive sales practices in the geographic region of the U.S. that it targeted, and its investigative summary report notes the widespread, commonplace, institutionalized nature of deceptive sales practices in this region of Acme:

> Acme trained its agents to commit fraud. Acme authorized its agents to use illegal sales materials. Acme failed to adequately supervise and discipline its agents and created an atmosphere that encouraged and allowed illegal activity.

With the routinization of misconduct, the probability of detection increased. The institutionalization of deceptive sales practices created a dormant threat to the external legitimacy of Acme in that public exposure of widespread churning would be likely to damage Acme's external legitimacy.

Threats to External Legitimacy

Churning at Acme persisted and proliferated for nearly a decade. The implementation of a formal compliance program maintained appearances and thus shored up external legitimacy until the early to mid 1990s, keeping regulators and auditors satisfied while churning continued. However, widespread deceptive sales practices at Acme were essentially a ticking bomb threatening external organizational legitimacy. The legitimacy facade crumbled when the economic conditions that hid churning from policyholders shifted and dividend rates paid on life insurance policies fell. Declining dividend rates meant that premiums on new policies being funded by values from older policies were no longer being paid. As dividends dried up, policyholders began receiving overdue notices on policies they had been told would never require payment, revealing the deception. This created a crisis of external legitimacy as the public began to complain—loudly and in large numbers. When dissatisfied customers' complaints to state regulators achieved a critical mass, a national investigation into Acme's sales practices was launched. This investigation determined that deceptive sales practices at Acme were widespread and that management was aware of these practices. The company was fined tens of millions of dollars for the use of deceptive sales practices and settled a class action suit that made over ten million policyholders eligible for restitution at a cost estimated to be in the hundreds of millions of dollars.

The regulatory investigation, class action suits, and dispute resolution generated tremendous amounts of negative publicity, one barometer of organizational legitimacy (Deephouse, 1996). A more concrete measure, however, manifested itself in a rating reduction by A. M. Best. As noted earlier, Acme received A. M. Best's highest available rating from the mid 1980s to the mid 1990s. However, as negative publicity increased and regulatory investigations picked up speed in the mid 1990s, Acme's rating was downgraded. It remained out of the top category for at least four years. The relationship between this rating downgrade and the sales practices scandal is made clear in the first A. M. Best annual report downgrading Acme's rating:

> This rating acknowledges the recent allegations and class action lawsuits concerning the "churning" of life insurance policies by Acme Agents.

The following two annual reports similarly stated that Acme's present rating "acknowledges the adverse financial as well as perceptual issues that have been encountered as a result of litigation associated with past sales practices of Acme Agents." In the fourth annual report in which Acme was downgraded, Best noted that the ultimate outcome of the class action lawsuit related to deceptive sales practices was still uncertain and that "Best will re-evaluate Acme's current rating if an adverse ruling materially affects the cost of the settlement process, if its competitive standing in the marketplace is further damaged, and/or its core business activities are materially disrupted."

Together, the rating reduction and acknowledgement by A. M. Best of the financial and perceptual damage done to Acme by the sales practices scandal, in conjunction with the findings of the national regulatory investigation and the negative publicity associated with the class action lawsuit, constituted damage to Acme's external organizational legitimacy: Evidence suggests that policyholders, regulators, and ratings agencies perceived Acme as having less legitimacy as a result of the widespread, institutionalized use of deceptive sales practices. This research does not track Acme's ratings beyond the late 1990s, so the longer-term impact of the misconduct on their organizational legitimacy is unknown.

DISCUSSION AND IMPLICATIONS

Implications for Legitimacy, Neoinstitutional Theory, and Decoupling

The story of widespread deceptive sales practices at Acme illuminates an important legitimacy dynamic that extends theorizing on legitimacy and compliance and should inform how organizations implement formal compliance programs. A previously unidentified process emerged from our focus on the underexplored conceptualization of legitimacy as being granted or withheld by insiders, and on the notion that legitimacy exists at a program level of analysis as well as at an organizational level. When organizations gain external legitimacy by decoupling compliance programs from core organizational processes, those compliance programs can lack legitimacy with organizational insiders, creating a legitimacy facade. This facade facilitates noncompliance or the institutionalization of misconduct, and it creates a latent threat to external legitimacy. This richer understanding of legitimacy and the dynamics of the legitimacy facade speaks to calls for increasing specificity and conceptual development of the legitimacy construct (Deephouse, 1996; Deephouse & Suchman, 2008; Suchman, 1995). It also creates a foundation for greater exploration of the dynamics associated with legitimacy facades that occur in other contexts. We found that a legitimacy facade around a sales practices compliance program contributed to widespread deceptive sales practices and ultimately led to a loss of external legitimacy. However, it is not clear that other legitimacy facades create equally problematic organizational outcomes. For instance, programs related to corporate social responsibility (CSR) have been hypothesized to be likely candidates for decoupling (Behnam & MacLean, 2009; Kalev, Dobbin, & Kelly, 2006; Weaver et al., 1999b). But it is unknown if, for example, decoupling an organizational diversity program would result in a legitimacy facade or if it would create a threat to external legitimacy. It may be that decoupling only threatens external organizational legitimacy if the program being decoupled involves some sort of regulatory or legal compliance. Further research is necessary to better understand in which contexts this dynamic occurs.

This case study also enriches neoinstitutional theory generally by making visible an important link between macrolevel changes that organizations enact in response to institutional pressures and individual-level responses to those changes. Understanding individual-level meanings of organization-level phenomena and the ways "organizational participants maintain or transform the institutional forces that guide daily practice" (Powell & Colyvas, 2008: 277) helps restore "the guts of institutions" (Stinchcombe, 1997: 17) to neoinstitutional theory. This study makes a unique contribution to understanding of this macro-micro link in that it focuses to a large extent on the perceptions of less powerful organizational members, those front-line managers and organization members who interact with customers, rather than on the perceptions of leaders. This focus addresses a need for a restoration of the microfoundations of institutional theory and responds to the call for "more attention to everyday processes than momentous events, [and] to less powerful members of organizations as opposed to only leaders or champions" (Powell & Colyvas, 2008: 277).

This study also contributes to neoinstitutional theory by addressing the need to go beyond current understanding of the predictors and mediators of decoupling and attend to "the unintended effects of decoupling, such as whether it affects morale and fosters cynicism within the organization" (Boxenbaum & Jonsson, 2008: 91). Our study does this by revealing the potential danger of decoupling form from function, demonstrating how decoupling may affect an organization's external legitimacy in unexpected and unwelcome ways, sounding a cautionary note, and adding to some of the known risks of manipulating legitimacy (Ashforth & Gibbs, 1990).

Neoinstitutional theory highlights the role of decoupling in securing legitimacy, yet recent scholarship has speculated that decoupling may lead insiders to act as a "subtle force toward reconciling external representation and internal workings" in organizations (Fiss & Zajac, 2006: 1188). For example, Edelman (1992) and her collaborators (Edelman, Petterson, Chambliss, & Erlanger, 1991) showed how insiders may work to eliminate the gap between symbol and substance by demonstrating how some equal employment opportunity (EEO) officers worked to enact substantive organizational policies and practices from an organizational program intended to be symbolic. Boxenbaum and Jonsson (2008) argued that decoupling may not be a sustainable strategy over time and may ultimately result in full implementation if the program being decoupled relies on the cooperation of organization members—as opposed to one that employs no people—because over time "individuals refuse to see themselves simply as ceremonial props" (Boxenbaum & Jonsson, 2008: 88). Our research illustrates yet another possible organization member reaction to decoupling: rather than subtly pressuring the organization toward full implementation of the compliance program, organization members adopted a cynical view of the decoupled program, and as a result of its internal illegitimacy, began to violate the formal compliance rules in a widespread fashion. This outline suggests that although organization members may be unwilling to be ceremonial props, their reaction may not be to lessen the gap between substance and symbolism, but instead to exploit the gap.

Implications for Theories of Ethics/Compliance Programs

An extensive summary of the effectiveness of legal-ethical compliance programs has stated that the scope and variety of elements in such programs are of less importance than organization members' perceptions of the programs (Trevino & Weaver, 2003). Organization members' perceptions are critical in determining how effectively a program generates important outcomes, such as willingness to report bad news, organizational commitment, ethical awareness, and observed unethical behavior (Weaver & Trevino, 1999). Programs perceived to be values-oriented generate positive outcomes such as those listed above, but programs perceived to be in place simply to protect management from legal problems have a negative relationship to those outcomes (Trevino, Weaver, Gibson, & Toffler, 1999). Our study advances this theoretical stream in two ways: by demonstrating that decoupling is one factor that determines how compliance programs come to be perceived in an organization, and by highlighting internal legitimacy perceptions as one determinant of conduct and misconduct.

Further, this research demonstrates the consequences of decoupling formal compliance programs from strategic, profit-enhancing, core organizational activities. Previous research conceptualizing compliance programs as being either decoupled or integrated has identified antecedents to decoupling (Weaver et al., 1999b). This work, importantly, identifies one consequence of decoupling by demonstrating how it can lead to the institutionalization of organizational misconduct. Future researchers should consider studying the decoupling of formal compliance programs in various contexts (for instance, social responsibility initiatives such as international accountability standards or diversity management programs) to determine whether decoupling has a similarly paradoxical effect of facilitating the types of misconduct it has been espoused to control.

These findings imply that it is insufficient to discuss how many or what types of formal elements characterize a compliance program, because programs are likely to be ineffective if decoupled, regardless of scope. Similarly, the effectiveness of a compliance program at deterring misconduct may be better explained by considering the extent to which the compliance program appears to be integrated into or decoupled from the daily work of the adopting organization.

Although this research indicates how decoupling can contribute to organizational misconduct, it does not indicate whether decoupling always leads to misconduct. Future researchers should explore those organizational factors that increase the likelihood that decoupling leads to misconduct. For example, decoupling may be more likely to lead to misconduct when existing organizational reward structures create a priori incentives for corner-cutting behaviors, and when mechanisms exist to easily facilitate the diffusion of shared perceptions and of system-beating practices (MacLean, 2001).

Implications for Managing Organizations

This research suggests that organizations can reduce misconduct by integrating compliance into their ongoing, day-to-day, core processes, such as training, monitoring, and discipline. This integration will not only concretely limit opportunities for misconduct, but will also positively impact the way the compliance function and its rules are perceived in the organizations and add to the positive perception of internal legitimacy, which influences the conduct of members.

A current context for considering the impact of these findings exists in the implementation of the new accounting rules and standards that have been passed in the wake of corporate scandals, such as those that brought down Enron and WorldCom. Organizational compliance programs designed in direct response to Sarbanes-Oxley and decoupled from the day-to-day central operations of an organization may mollify policy makers and the investing public, but if such standards have no teeth and are not fully integrated into the strategies and operations of corporations, they may offer a false sense of security while actually facilitating “business as usual.”

Exploring the Dark Side of Organizations

Finally, this work addresses a significant gap in organization studies research by spotlighting the negative outcomes of theoretical models. Recent research has suggested that organizational behavior theories in general tend to overemphasize the positive aspects and outcomes of organizational life, ignoring the fact that the same models that predict productivity and organizational citizenship behavior can also foretell organizational misbehavior (Vardi & Weitz, 2004; Vaughan, 1999). Demonstrating the negative effect of the legitimacy facade enriches and adds complexity and explanatory power to scholars’ theorizing. Future research that considers how organizational theories explain both positive and negative conduct will create the tools necessary to aid managers in understanding and eradicating dysfunctional behaviors that thwart their efforts to achieve organizational objectives.

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APPENDIX

Sample of Questions Used in Interviews

How was this [churning] going on in the face of the rules against it?

What I'd be interested in then, since you've been in all three jobs, is your perspective on the major responsibilities of an agent, a sales manager, and a general manager.

What methods were people in your agency using to sell insurance?

You just said that you felt that the company wasn't as concerned with how you got results. What made you believe that?

What types of sales practices training did you receive as an agent?

And does selling insurance using dividends violate any company rules, or any NASD or Department of Insurance rules?

So are you saying that even if the customers weren't quite sure exactly what happened, what they bought, agents were trying their best to take care of people?

How were they getting away with this?

Tell me about coming on board and learning how to sell insurance. Who taught you what you learned, what kind of techniques did you use?

What do you think that organization's goals were when you were working there? What were the values and the goals of that company, from your perspective?

I'm interested in, from your perspective, what this controversy over sales practices was really all about. Can you give me a thumbnail sketch as to what you think it was all about? And then maybe we can talk about how you feel it happened.

Ok. Tell me about financed insurance. Tell me what it is, and how it happens and why.

How were compliance rules implemented? How were they viewed by agents?

How do you think that the executives in your region viewed compliance?

You said people got around the rules. How did people learn how to get around the rules?

Were you aware of the compliance regulations that were in force at the company, that the regulators had in force?

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