Bargaining in Fraudulent Environments

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Abstract

The paper presents preliminary results of a series of economic experiments made in order to explore the effects of different frames and communication opportunities on observable bargaining behavior.

The „realistic“ frame seeks to involve test persons in certain value-laden roles. Especially, one group of test persons are induced to act as managers in a controlled business simulation game, in which they have the opportunity to eventually commit frauds (i.e. to overstate profits in order to increase compensation). The other group of test persons is induced to feel as owner/auditors, who (a) get the net profit of the business simulation played by the managers and (b) eventually discover the managers' frauds. The main focus is on the bargaining processes taking place: Managers may offer the owner/audiors a bribe in order to avoid punishment. The owner/audior may accept it and then not sanction the discovered fraud. If the manager and the owner/audior cannot find an agreement, the manager is fined. However, due to certain inefficiencies in the system (need of a costly system of justice, losses due to negative popularity etc.) the owner/auditor is assumed not to be able to recover the full amount withheld from him by the manager

In the „neutral“ frame the test persons' roles are intended to be value free. The bargaining takes place under the traditional circumstances, under which a given amount of money is to be divided between two bargainers. One difference to traditional bargaining experiments is that the outside opportunity of one bargainer is negative (in order to be able to mimic the manager’s fine in the „realistic“ frame).

All bargaining is analysed under two different communication conditions. In the no communication setting test persons are only able to anonymously exchange offers and counteroffers via a computerized facility. In the communication setting test persons are allowed to anonymously discuss the bargaining situation via email before entering the computerized bargaining facility.

First results indicate that the managers‘ reporting behavior in the business simulation game is pretty similar to those results achieved in tax avoidance experiments. I.e. there is almost always some misreporting going on and after an audit average misreporting increases. With respect to the bargaining stage, results indicate that fraudulent managers as well as owner auditors get a smaller part of the pie than predicted by formal bargaining theory.

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