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One bad apple, the saying goes, can ruin the bunch. So, too, with employees.

Our research on the contagiousness of employee fraud tells us that even your most honest employees become more likely to commit misconduct if they work alongside a dishonest individual. And while it would be nice to think that the honest employees would prompt the dishonest employees to better choices, that's rarely the case.

Among co-workers, it appears easier to learn bad behavior than good.

For managers, it is important to realize that the costs of a problematic employee go beyond the direct effects of that employee's actions — bad behaviors of one employee spill over into the behaviors of other employees through peer effects. By under-appreciating these spillover effects, a few malignant employees can infect an otherwise healthy corporate culture.

History — and current events — are littered with outbreaks of misconduct among co-workers: mortgage underwriters leading up to the financial crisis, stock brokers at boiler rooms such as Stratton Oakmont, and cross-selling by salespeople at Wells Fargo.

In our research, we wanted to understand just how contagious bad behavior is. To do so, we examined peer effects in misconduct by financial advisors, focusing on mergers between financial advisory firms that each have multiple branches. In these mergers, financial advisors meet new co-workers from one of the branches of the other firm, exposing them to new ideas and behaviors.

We collected an extensive data set using the detailed regulatory filings available for financial advisors. We defined misconduct as customer complaints for which the financial advisor either paid a settlement of at least $10,000 or lost an arbitration decision. We observed when complaints occurred for each financial advisor, as well as for the advisor's co-workers.

We found that financial advisors are 37% more likely to commit misconduct if they encounter a new co-worker with a history of misconduct. This result implies that misconduct has a social multiplier of 1.59 — meaning that, on average, each case of misconduct results in an additional 0.59 cases of misconduct through peer effects.

However, observing similar behavior among co-workers does not explain why this similarity occurs. Co-workers could behave similarly because of peer effects – in which workers learn behaviors or social norms from each other — but similar behavior could arise because co-workers face the same incentives or because individuals prone to making similar choices naturally choose to work together.

In our research, we wanted to understand how peer effects contribute to the spread of misconduct. We compared financial advisors across different branches of the same firm, because this allowed us to control for the effect of the incentive structure faced by all advisors in the firm. We also focused on changes in co-workers caused by mergers, because this allowed us to remove the effect of advisors choosing their co-workers. As a result, we were able to isolate peer effects.

We also ran tests that included only advisors who did not change supervisors during the merger, allowing us to attribute all changes in behavior to peer effects from co-workers with the same rank.

Within this restricted sample, we found strong evidence of peer effects just like in the main sample. These results show that, independent of any effects from managers, employee behavior is affected by the actions of peer co-workers.

Prior studies document that peer effects are stronger among individuals who share the same ethnicity. Accordingly, we use advisor ethnicity and show that peer effects in misconduct are stronger between advisors who share the same ethnicity; the contagion effect is nearly twice as large if an advisor meets a new co-worker with a history of misconduct and who shares the advisor's ethnicity. Thus, similar individuals, who likely interact more, have stronger effects on each other's behaviors.

Understanding why co-workers make similar choices about whether to commit misconduct can guide managers in preventing misconduct. Given its nature, knowledge and social norms related to misconduct must be transmitted through informal channels such as social interactions. More generally, understanding why co-workers behave in similar ways has important implications for understanding how corporate culture arises and how managers can shape it.

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