ABSTRACT

We propose and test a group-based mechanism, ingroup bias, as a source of regulatory failure. Extant research examining third-party regulation has mainly investigated threats to objectivity resulting from strategic motivations for regulatory leniency and dyadic exchanges between regulators and regulated entities. We argue that regulatory organizations can fall short of objectivity even when they do not intend to because ingroup favoritism is largely subconscious and ingroup identification is highly variable. Using proprietary data from a prominent firm in the marine survey industry, which regulates the maritime sector, we exploit a natural experiment based on a high-profile industry accident that dramatically heightened the risks of regulatory leniency. We find that while regulators are more lenient with their ingroup clients than outgroup clients, this difference converges in the aftermath of the accident. We further find that this leniency is driven by individuals who identify less with their regulatory profession and are thus more susceptible to ingroup bias, which clashes with the professional demand for strict impartiality. Our findings underscore the importance of categorical biases and identities in regulatory processes and how regulatory firms can inadvertently fail to maintain objectivity.