Enron Ethics (Or: Culture Matters More than Codes)

Ronald R. Sims
Johannes Brinkmann

ABSTRACT. This paper describes and discusses the Enron Corporation debacle. The paper presents the business ethics background and leadership mechanisms affecting Enron's collapse and eventual bankruptcy. Through a systematic analysis of the organizational culture at Enron (following Schein's frame of reference) the paper demonstrates how the company's culture had profound effects on the ethics of its employees.

Now, when most people hear the word "Enron" they think of corruption on a colossal scale – a company where a handful of highly paid executives were able to pocket millions of dollars while carelessly eroding the life-savings of thousands of unwitting employees. Not long ago, the same company had been heralded as a paragon of corporate responsibility and ethics – successful, driven, focused, philanthropic and environmentally responsible. Enron appeared to represent the best a 21st century organization had to offer, economically *and* ethically. The questions become, how did Enron lose both its economical and ethical status? Is it because of its very size and effects? Is it the direct harm to primary and secondary stakeholders? Or, is it the worldwide media coverage that the Enron demise has drawn? These questions make the Enron case interesting to us as business ethicists.

At first sight, Enron looks like a mega-size illustration of the bad apple and/or the bad barrel disease and, hence, looks like good marketing for the business ethics business (which almost has a vested interest in such scandals and other bad examples). The problem is, however, that Enron looked like an excellent corporate citizen, with all the corporate social responsibility (CSR) and business ethics tools and status symbols in place.

Enron Ethics (an ironic expression which is used now and then, see e.g. the headings of Tracinski, 2002 or Berenbeim in *Executive action* no. 15, Feb. 2002) reads like *the* new catchword for the ultimate contradiction between words and deeds, between a deceiving glossy facade and a rotten structure behind, like a definite good-bye to naive business ethics. Enron ethics means (still ironically) that business ethics is a question of organizational "deep" culture rather than of cultural artifacts like ethics codes, ethics officers and the like. With this as a backdrop, the paper will describe and discuss how executives at Enron in practice created an organizational culture that put the bottom line ahead of ethical behavior and doing what's right. More specifically, the paper first provides a brief background on Enron and its rise and fall. Next, the paper systematically uses Schein's (1985) five primary mechanisms available to leaders to create and reinforce aspects of culture (i.e., attention focusing, reaction to crises, role modeling, rewards allocation and criteria for hiring and firing) to analyze the company's culture and leadership that contributed to it's ethical demise and filing for bankruptcy. It is our contention, that with such a point of departure one will be better prepared for a necessary discussion in our field of how to prevent an "instrumentalization" of ethics and CSR for mere facade purposes (this theme deserves and requires a paper on its own, at least).

The culture history of Enron

The Enron case is not least a good illustration of continuously updated case presentation and case discussion in the Internet age (which could

Journal of Business Ethics **45**: 243–256, 2003.
© 2003 *Kluwer Academic Publishers. Printed in the Netherlands.*

deserve a paper on its own, too). Business school researchers, teachers and students alike can easily keep themselves busy for days just with sorting, structuring, checking and summarizing all the ingredients and pieces of the Enron story found on the Internet. One possible way of organizing and limiting such a task is departing from or even staying with the websites of traditional *mass media* such as CNN (see e.g. cnn.com/SPECIALS/2002/enron/), the *Wall Street Journal, Financial Times*, or of the *main stakeholders* such as the victims' enrongate.com or the remainders' enron.com. Most tempting for business ethicists is of course a closer look at the websites of the *business ethics business* (see e.g. http://www.msnbc.com/modules/enron/, businessethics.ca/enron/, caseplace.org, enronguide.com, all with lots of further links) and as the up-dated and earliest of all the academic articles and papers we can expect in the future Tonge et al., 2003; Petrick and Quinn, 2002; Cohan, 2002). In spite of (or because of) such an abundance of available information[1] we choose to tell the story once more, as a culture history in our own prose, as a background for the following illustration of how Schein's organization culture approach can lead to a better understanding of the Enron case.

Background

A company with humble beginnings, Enron began as a merger of two Houston pipeline companies in 1985. Although Enron faced a number of financially difficult years, the company managed to survive. In 1988, the deregulation of the electrical power markets took effect, and the company redefined its business from "energy delivery" to "energy broker" and Enron quickly changed from a surviving company to a thriving one. Deregulation allowed Enron to become a "matchmaker" in the power industry, bringing buyers and sellers together. Enron profited from the exchanges, generating revenue from the differences between the buying and selling prices. Deregulation allowed Enron to be creative – for the first time, a company that had been required to "operate within the lines" could innovate and test limits. Over time, Enron's contracts became increasingly diverse and significantly more complex. As Enron's products and services evolved, so did the company's culture.

In this newly deregulated and innovative forum, Enron embraced a culture that rewarded "cleverness". Deregulation opened the industry up to experimentation and the culture at Enron was one that expected employees to explore this new playing field to the utmost. Pushing the limits was considered a survival skill.

Enron's former President and Chief Executive Officer (CEO) Jeffry Skilling actively cultivated a culture that would push limits – "Do it right, do it now and do it better" was his motto. He encouraged employees to be independent, innovative and aggressive. The Harvard Business Review Case Study: *Enron's Transformation* (Bartlett and Glinska, 2001) contains employee quotations such as ". . . you were expected to perform to a standard that was continually being raised . . .", "the only thing that mattered was adding value", or ". . . it was all about an atmosphere of deliberately breaking the rules . . ." (Bartlett and Glinska, 2001). A culture that admires innovation and unchecked ambition and publicly punishes poor performance can produce tremendous returns in the short run. However, in the long run, achieving additional value by constantly "upping the ante" becomes harder and harder. Employees are forced to stretch the rules further and further until the limits of ethical conduct are easily overlooked in the pursuit of the next big success (Josephson, 1999; cf. also similarities found in the culture at Salomon Brothers in the early 1990s, see Sims, 2000; Sims and Brinkmann, 2002).

A lot of smoke and mirrors

Enron's spectacular success, and the positive scrutiny the company was receiving from the business press and the financial analysts, only added fuel to the company's competitive culture. The business community rewarded Enron for its cleverness (and even its ethicalness) and Enron's executives felt driven by this reputation to sustain the explosive growth of the late 1990s, even

when they logically knew that it was not possible. A negative earnings outlook would have been a red flag to investors, indicating Enron was not as successful as it appeared. If investors' concerns drove down the stock price due to excessive selling, credit agencies would be forced to downgrade Enron's credit rating. Trading partners would lose faith in the company, trade elsewhere, and Enron's ability to generate quality earnings and cash flows would suffer. In order to avoid such a scenario at all costs, Enron entered into a deceiving web of partnerships and employed increasingly questionable accounting methods to maintain its investment-grade status. Enron executives probably felt that they were doing the right thing for their organization.

Partnerships

Partnerships can be an easy and efficient way to raise money. However, in an effort to continue to push the value envelope Enron took partnerships to a new level by creating "special purpose vehicles" (SPVs), pseudo-partnerships that allowed the company to sell assets and "create" earnings that artificially enhanced its bottom line. Enron exaggerated earnings by recognizing gains on the sale of assets to SPVs. In some cases, the company booked revenues prior to a partnership generating significant revenues. Project Braveheart, a partnership Enron developed with Blockbuster was intended to provide movies to homes directly over phone lines. Just months after the partnership was formed, Enron recorded $110.9 million in profits prematurely, these profits were never realized as the partnership failed after only a 1,000-home pilot.

In a success culture like Enron's such behavior represented a way of least resistance. Enron employees with a self-image of being the best and the brightest and being extremely clever do not make business deals that fail. Therefore booking earnings before they are realized were rather "early" than wrong. The culture at Enron was quickly eroding the ethical boundaries of its employees.

Keeping debt off the balance sheet

The SPVs not only allowed Enron to boost earnings, but the SPV's also allowed the company to keep debt off its balance sheet. A highly leveraged balance sheet would jeopardize its credit rating as its debt-equity ratio would rise and increase its cost of capital. To avoid this, Enron parked some of its debt on the balance sheet of its SPVs and kept it hidden from analysts and investors. When the extent of its debt burden came to light, Enron's credit rating fell and lenders demanded immediate payment in the sum of hundreds of millions of dollars in debt.

This can be read as another example of ethical erosion. Enron's decision makers saw the shuffling of debt rather as a timing issue and not as an ethical one. Clever people would eventually make everything right, because the deals would all be successful in the long run. Moving debt was as easy as pre-dating a check, and would harm no one, and therefore was not an ethical issue.

Partnerships at "arm's length"

Each questionable partnership decision carried additional cleverness burdens. In order to keep information from the public, Enron had to guarantee that the Securities Exchange Commission (SEC) did not consider its partnerships as Enron subsidiaries. If the partnerships had been classified as such, in-depth disclosure and stricter accounting methods would have been required. In order to prevent potential SEC skepticism, Enron enlisted help from its outside accountants and its attorneys (Arthur Andersen, and Vinson & Elkins). The accountants and attorneys all referenced the Financial Accounting Standards Board (FASB) rule that holds that partnerships are not considered subsidiaries as long as 3% of their equity comes from outside investors and they are managed independently of their sponsors. This is commonly known as being at "arm's length". Enron crafted relationships that looked (legally) like partnerships, although they were (in practice) subsidiaries. A closer look at the partnerships would have revealed that the

outside investments came from companies (like SE Thunderbird LLC) that were owned by Enron.

Conflicts of interest

Although the partnerships were classified as partnerships according to the FASB rules, Enron officials obviously had close ties with them. This raised the question about conflicts of interest. Andrew Fastow, Enron's former Chief Financial Officer (CFO), ran or was partial owner of two of the most important partnerships: LJM Cayman LP and LJM2 Co-Investment LP. Michael Kopper, a former managing director at Enron, managed a third partnership, Chewco Investments LP.

The culture of cleverness at Enron started as a pursuit of excellence that devolved into the appearance of excellence as executives worked to develop clever ways of preserving Enron's infallible facade of success. Although Enron maintained that top officials in the company reviewed the dealings with potential conflicts of interest, Enron later claimed that Fastow earned over $30 million from Enron with his companies. At some point in the bending of ethical guidelines for the good of the company, Enron's executives also began to bend the rules for personal gain. Once a culture's ethical boundaries are breached thresholds of more extreme ethical compromises become lower.

The self-reinforcing decline of Enron

In the long run, Enron's executives could not "rob Peter to pay Paul". Even if the Enron culture permitted acts of insignificant rule bending, it was the sum of incremental ethical transgressions that produced the business catastrophe. Although Enron's executives had believed that everything would work successfully in the long run, the questionable partnerships left the company extremely vulnerable when financial troubles came to light. As partnerships began to fail with increasing regularity, Enron was liable for millions of dollars it had not anticipated losing. Promises began to come due and Enron did not have the ability to follow through on its financial obligations.[2]

The financial implosion

The partnerships that once boosted earnings and allowed Enron to prosper became the misplaced card that caused the Enron house to collapse. The stability of Enron's house of cards had been eroded by the very culture that had allowed it to be built. Enron was forced to renounce over $390 million in earnings from dealings with Chewco Investments and JEDI, another partnership. The company was also forced to restate earnings back to 1997, and the restated earnings totaled only $586 million, a mere 20% of the initially reported figures. The very results Enron had sought to prevent – falling stock prices, lack of consumer and financial market confidence – came about as a direct result of decisions that had been driven by Enron's culture.

The Enron case of ethical failure consists of more than a series of questionable business dealings. When strong company leadership would have been needed the most, Enron's leader left the company. In August of 2001, Jeffery Skilling resigned as President and CEO of Enron and sold shares of his company stock totaling $66 million dollars. Only two months later, Enron restated earnings, stock prices dropped and the company froze shares in an attempt to help stabilize the company. Enron employees, who had been encouraged to invest heavily in the company, found themselves unable to remove and salvage their investments. The company culture of individualism, innovation, and aggressive cleverness left Enron without compassionate, responsible leadership. Enron's Board of Directors was slow to step in to fill the void and individual Enron employees for the first time realized all of the ramifications of a culture with leaders that eschew the boundaries of ethical behavior.

What did the Enron executives do to mold a corporate culture that resulted in unethical behavior and the collapse of the company? The remainder of this paper drafts some answers to this question.

Leadership mechanisms and organizational culture at Enron

If corporate leaders encourage rule-breaking and foster an intimidating, aggressive environment, it is not surprising that the ethical boundaries at Enron eroded away to nothing. Schein (1985) has focused on leadership as *the* critical component of the organization's culture because leaders can create, reinforce, or change the organization's culture. This applies not the least to an organization's ethical climate (Sims, 2000; Trevino et al., 2000; Sims and Brinkmann, 2002). According to Schein (1985) there are five primary mechanisms that a leader can use to influence an organization's culture: attention, reaction to crises, role modeling, allocation of rewards, and criteria for selection and dismissal. Schein's assumption is that these five criteria reinforce and encourage behavioral and cultural norms within an organization. Our paper can be read as an illustration of Schein's assumptions. The Enron executives used the five mechanisms to reinforce a culture that was morally flexible opening the door to ethics degeneration, lying, cheating, and stealing.

Attention

The first of the mechanisms mentioned by Schein (1985) is attention. The issues that capture the attention of the leader (i.e. what is criticized, praised or asked about) will also capture the attention of the greater organization and will become the focus of the employees. If the leaders of the organization focus on the bottom line, employees believe that financial success is the leading value to consider. D. M. Wolfe, author of "Executive Integrity" even suggests that a focus on profit, "promotes an unrealistic belief that everything boils down to a monetary game" (1988). In such a context, rules or morality are merely obstacles, impediments along the way to bottom-line financial success (Sims, 2000).

One former executive of Enron has described Jeffrey Skilling as a leader driven by the almighty dollar. ". . . Skilling would say all that matters is money. You buy loyalty with money" (Zellner, 2002). Enron executives' attention was clearly focused on profits, power, greed and influence. They wanted their employees to focus on today's bottom line. Skilling communicated his priorities to his employees overtly, both in word and deed. Consistently clear signals told employees what was important to leadership – "Profits at all costs" (Tracinski, 2002). Or with another quote from a former Enron employee: ". . . there were no rules for people, even in our personal lives. Everything was about the company and everything was supposed to be on the edge – sex, money, all of it . . ." (Broughton, 2002). In her testimony before the House Subcommittee, Sherron Watkins described Enron as a ". . . very arrogant place, with a feeling of invincibility". Still another Enron employee noted about the company's environment that ". . . it was all about creating an atmosphere of deliberately breaking the rules. For example, our official vacation policy was that you could take as much as you wanted whenever you wanted as long as you delivered your results. It drove the human resource department crazy" (Bartlett and Glinska, 2001).

Another example of today's bottom line gain mentality is Andrew Fastow's, former Enron CFO, network of questionable partnerships. These partnerships provided profit for Fastow personally, as well as for some of his more favored employees, who were aware of his actions. Fastow demanded that Enron permit him to invest in and to personally profit from the partnerships (some of his earnings were passed to associates who aided him). Such actions sent a clear message that management's attention was focused on the bottom line for the company as well as personal gain, regardless of the means to get there. When it came to Fastow's special interest dealings the Board of Directors suspended the company's Code of Ethics at least twice. This made Fastow a wealthy man at the expense of Enron (Landers, 2002).

As Stern (1992) has suggested, if the organization's leaders seem to care only about the short-term bottom line, employees quickly get the message too. How else could employees read the Enron culture than being focused on

short-term when their CEO (Ken Lay) both blessed the relaxation of conflict-of-interest rules designed to protect Enron from the very self-dealings that brought the company down and participated in board meetings allowing the creation of the off-balance sheet partnerships that were part of those transactions. By late summer 2001 he was reassuring investors and employees that all was well (when he already had been informed that the company had problems with some investment vehicles that could cost it hundreds of millions of dollars, see Gruley and Smith, 2002).

Reaction to crises

The second leadership method mentioned by Schein (1985) refers to a leader's reaction to a crisis situation. Schein asserts, that a crisis tests what the leader values and brings these values to the surface. With each impending crisis, leaders have an opportunity to communicate throughout the organization what the company's values are. Enron was facing a crisis of how to sustain a phenomenal growth rate. Leaders reacted by defending a culture that valued profitability, even when it was at the expense of everything else. The off-balance sheet partnerships were tremendously risky. However, since normal growth of the stock price would have fallen short of expectations anyway, the only thing to do was to try to meet the unrealistic target profitability expectations. In such a case, an accident was waiting to happen.

Once the Enron situation came to light, the reaction from the Enron executives was telling. The executives were busy shifting the blame and pointing fingers. Jeffery Skilling even went as far as telling an incredulous Congress that despite his Harvard Business School degree and business experience he neither knew of, nor would understand the intricacies of the Enron accounting deals. (On the other hand, Skilling also was quoted on CNN saying ". . . if he knew then what he knows now – he *STILL* would not do anything differently.") Even before the issues came to light it appears that Skilling was willing to abandon the company to save his own skin as evidenced by his mysterious resignation in August 2001 and giving only the "personal reasons" explanation for his sudden departure (and he still sold significant amounts of company stock at a premium). Both Kenneth Lay and Sherron Watkins also sold stock before prices began to dramatically plummet (Kenneth Lay claiming that he had some personal debts to pay off, Sherron Watkins referring to the September 11th terrorist attacks. Watkins also sold stock at the same time when she was making allegations of deceptive accounting practices).

Enron began systematically firing those it could lay blame on before it declared bankruptcy (Brown and Sender, 2002). A self-serving exoneration committee was employed to explain (or excuse?) the current situation (Eichenwald, 2002). After Skilling resigned from his post, Kenneth Lay returned as CEO, promising that there were no "accounting issues, trading issues, or reserve issues" at Enron (McClean, 2001). Congressional testimony, news accounts and federal investigations have told us otherwise. Throughout October 2001, Lay insisted that Enron had access to cash and that the company was "performing very well," while he failed to disclose that Enron had written down shareholders' equity by $1.2 billion, or that Moody's was considering downgrading Enron's debt ("Explaining the Enron Bankruptcy", 2002). Company insiders also referred to Loretta Lynch as "an idiot" (the Yale-educated litigator who was among the first to question Enron's practices), Bethany McLean, the *Fortune* Magazine journalist who first broke the story, was called "a looker who doesn't know anything" (Dowd, 2002).

Another crisis consists in having to admit accounting irregularities. At first, the leaders of the company tried to deny there was a problem. They next tried to cover up any evidence of a problem or any wrongdoing. They even tried to seize computers of anyone they thought was trying to expose them as well as to destroy many files thought to be guilt-inducing (Daily Press, 2002). It transitioned into a blame game as many executives tried blaming each other, saying they didn't know what was going on, or it was someone else's responsibility to know about the

problems and do something about it. Both Kenneth Lay and his wife proclaimed his innocence. Lay claimed to have been unaware of the sweetheart deals, which were entirely the brainchild of Skilling and Fastow. Watkins also blamed them for the debacle, while shifting any blame from herself.

"I take the Fifth" (U.S. Congressional Hearing, 2002 – this was the response Kenneth Lay gave to the Senate Commerce Committee when asked to explain Enron's failure. Although all but one of Enron's officers (curiously Skilling) invoked the 5th Amendment right to not self-incriminate, the story has played out much like that of the Salomon Brothers and John Gutfreund fiasco in the early 1990s. Document shredding and lies, both overt and those of omission, have become the preferred strategy for Enron's management (Brown and Sender, 2002). These bold acts from Enron leadership show a poor reaction to crisis.

From anonymous whistleblowing to bankruptcy to document shredding, to suicide (Cliff Baxter) to hiding behind the 5th Amendment, the leaders at Enron have run the gamut of extremes in their reaction to the company's crisis. Willet and Always (2002) noted that "the mantra at Enron seems to be that ethical wrongdoing is to be hidden at any cost; deny, play the dupe, claim ignorance ("the ostrich instruction") lie, quit." It appears that the truth and its consequences have never been a part of the Enron culture.

Role modeling (how leaders behave)

Schein's third mechanism is the example leaders set for the acceptability of unethical behavior within an organization. Actions speak louder than words – therefore role-modeling behavior is a very powerful tool that leaders have to develop and influence corporate culture. Through role modeling, teaching, and coaching, leaders reinforce the values that support the organizational culture. Employees often emulate leaders' behavior and look to the leaders for cues to appropriate behavior. Many companies are encouraging employees to be more entrepreneurial – that is, to take more initiative and be more innovative in their jobs. The Scientific Foundation reports a study that showed that managers who want to change the organization's culture to a more entrepreneurial one must "walk the talk". In other words, they must demonstrate the entrepreneurial behaviors themselves (Pearce et al., 1997). This is the case with any cultural value. Employees observe the behavior of leaders to find out what is valued in the organization. Perhaps, this was the most significant shortcoming of Enron executives.

According to the values statement in Enron's Code of Ethics and its annual report, the company maintains strong commitments to communication, respect, integrity, and excellence. However, there is little evidence that supports management modeling of these values. For instance, while the first pillar of the values statement addresses an obligation to communicate, Sherron Watkins claims (quoted from the Hearing transcripts):

> I continued to ask questions and seek answers, primarily from former coworkers in the Global Finance Group or in the business units that had hedged assets with Raptor. I never heard reassuring explanations. I was not comfortable confronting either Mr. Skilling or Mr. Fastow with my concerns. To do so, I believe, would have been a job-terminating move (U.S. Congressional Hearings, 2002).

Enron's leaders' primary message about their values was sent through their own actions. They broke the law as they concentrated on financial measures and used of the creative partnerships described earlier in this paper. For example, Kenneth Lay announced to analysts on October 16, 2001 that Enron had eliminated $1.2 billion in shareholder equity by terminating a partnership created by former CFO Andrew Fastow. This arrangement allowed Enron to buy and sell assets without carrying the debt on its books, i.e. keeping Enron's credit clean and the stock price high. Such actions clearly show a self-serving attitude of Enron leadership. The executives not only condoned such unethical behavior, they initiated it and were rewarded for it. The partnerships were used to deceive investors about the

enormous debt Enron was incurring. It also sent a message to employees that full and complete disclosure is not a requirement, or even recommended. If the company achieved short-term benefits by hiding information, it was acceptable.

Enron's leaders also ignored, then denied serious problems with their business transactions and were more concerned about their personal financial rewards than those of the company. For example, when the company's stock price began to drop as the problems were becoming public, the company was transitioning from one investment program to another. While the employees were unable to sell their stock, the executives were quickly selling off many of their shares. Another example is the executives' lack of integrity in communicating to the employees and investors. They maintained that the company was financially stable and that many of their emerging problems really were not too serious, even though they knew the truth and were making financial decisions to protect their personal gains.

In retrospect, the leadership of Enron almost certainly dictated the company's outcome through their own actions by providing perfect conditions for unethical behavior. Michael Josephson, President of the Josephson Institute of Ethics, aptly described these conditions as they relate to the character of leadership: "People may produce spectacular results for a while, but it is inevitable that techniques depending so heavily on fear as a motivator generate survival strategies that include cheating, distortion, and an internal competitive ethos characterized by a look-out-for-number-one attitude. . . . Just as the destiny of individuals is determined by personal character, the destiny of an organization is determined by the character of its leadership. And when individuals are derailed because of a lack of character, the organization will also be harmed" (Josephson, 1999).

Allocation of rewards

The behavior of people rewarded with pay increases or promotions signals to others what is necessary to succeed in an organization – this is what Schein calls the "allocation of rewards"-mechanism. To ensure that values are accepted, leaders should reward behavior that is consistent with the values (and actual rewards count obviously more than promised rewards, cf. Sims and Brinkmann, 2002).

The reward system created by a leader indicates what is prized and expected in the organization. This view is in line with a basic management doctrine. When an instance of ethical achievement occurs – for instance, when someone acts with integrity and honor – the organization's leaders must reward it. Such an effort sends as clear a message to the rest of the organization as when an organization rewards an employee who acts unethically (see e.g. Larimer, 1997). Enron's reward system established a "win-at-all-costs" focus. The company's leadership promoted and retained only those employees that produced consistently, with little regard to ethics. Skilling singled out one of his vice presidents, Louise Kitchen, for her results-oriented approach to Enron's online business. Kitchen had started the company's Internet-based trading business even though Skilling repeatedly turned down her requests to begin such a program. Kitchen ignored the former CEO's decision and instead used already-allocated funds to pull the new network together. Or, as a former Enron vice president who attended the meeting described it best. "The moral of this story is break the rules, you can cheat, you can lie, but as long as you make money, it's all right" (quoted after Schwartz, 2002).

The company's compensation structure contributed to an unethical work culture, too – by promoting self-interest above any other interest. As a consequence, the team approach once used by Enron associates deteriorated. Performance reviews were public events and poor performance was ridiculed (or employees were fired through a "rank and yank" process). The strongest performing units even went as far as to "ignore" company policy – granting unlimited vacation time as noted earlier as long as the work got done, ignoring Human Resources' complaints (Bartlett and Glinska, 2001).

Extremely high bonuses were doled out to executives who behaved in desirable ways, e.g. in

the form of stock options) which in turn incited executives to keep the stock price up at any cost (Lardner, 2002). Annual bonuses were as high as $1 million for traders, and for executives they were even higher). Enron developed a reputation for both internal and external ruthlessness where employees attempted to crush any competition and was considered extremely aggressive for a non-investment bank (McClean et al., 2001). Additionally, the executives at Enron played favorites, inviting top performers to spend weekend vacations with the executive staff. The best workers (determined through day-to-day bottom line results) received staggering incentives and exorbitant bonuses. One example of this was Car Day. On this day, an array of lavish sports cars arrived for the most successful employees (Broughton, 2002).

Retention bonuses that were paid shortly before the company declared bankruptcy to about 500 executives ranged in value from $1,000 to $5 million (possibly as a reward for help with setting up the problematic financial partnerships that led to the company's downfall). Overall, Enron's reward system rewarded individuals who embraced Enron's aggressive, individualistic culture and were based on short-term profits and financial measures.

Criteria of selection and dismissal (how leaders hire and fire employees)

Schein's (1985) last mechanism by which a leader shapes a corporate culture, describes how a leader's decisions about whom to recruit or dismiss signals a leader's values to all of his employees. The selection of newcomers to an organization is a powerful way of how a leader reinforces culture. Leaders often unconsciously look for individuals who are similar to current organizational members in terms of values and assumptions. Some companies hire individuals on the recommendation of a current employee. This tends to perpetuate the culture because the new employees typically hold similar values. Promotion-from-within policies also serve to reinforce organizational culture.

Ken Lay placed an immediate focus on hiring the best and smartest people, those who would thrive in a competitive environment. Skilling shared Lay's philosophy. Skilling hired only Ivy-league graduates with a hunger for money that matched his. He hired people who considered themselves the best and the brightest and were out to forward their own causes. Stanford and Harvard graduates, who would have otherwise worked on Wall Street, these people were paid well to work in Texas and to build the Enron culture. Their reward for giving up the allure of Silicon Valley and Wall Street was a high salary and a large bonus opportunity.

Skilling perpetuated a focus on short-term transactional endeavors from the very beginning by hiring employees that embodied the beliefs that he was trying to instill: aggressiveness, greed, a will to win at all costs, and an appreciation for circumventing the rules. This was the same culture of greed that brought turmoil to Salomon Brothers on Wall Street in the early 1990s. Divorce rates among senior executives were sky-rocketing as well. Instant gratification, both personally and professionally, was part of the Enron culture and Skilling did everything he could to surround himself with individuals who had similar values and assumptions and fitted into the Enron culture.

The way a company fires an employee and the rationale behind the firing also communicates the culture. Some companies deal with poor performers by trying to find them a place within the organization where they can perform better and make a contribution. Other companies seem to operate under the philosophy that those who cannot perform are out quickly (Sims and Brinkmann, 2002).

Enron carried out an annual "rank and yank" policy where the bottom fifteen to twenty percent of producers were let go or fired after a formal evaluation process each year. Associates graded their peers, which caused a great amount of distrust and paranoia among employees. Enron's employee reviews added to the competition by reviewing job performance in a public forum and sending the bottom 5% to the redeployment office – dubbed the "office of shame" (Frey and Rosin, 2002). What better way to develop a distrustful work environment than to

pit employees against one another and as Larry Bossidy, former CEO of Allied Signal recently noted "forced ranking promotes bad employee morale" (2002), a win-at-all costs mentality, and a willingness to cross the ethical line (Wolfe, 1988; Sims and Brinkman, 2002).

The occurrence and handling of internal whistle-blowing also tells a lot about a corporate culture. At Enron, employees who tried to blow the whistle were punished, e.g. by career setbacks and hostility (cf. e.g. not least the enrongate website). The most well-known whistle-blower, Sherron Watkins, recounted how her fears about being fired for speaking out led her to reach out to Ken Lay through anonymous warnings. She even publicly stated that Andrew Fastow tried to have her fired once he found out that she was the author of the anonymous memo to Lay (Hamburger, 2002). Watkins reported that her computer was confiscated and she was moved to another office after she submitted her letter to Kenneth Lay. Another employee, Jeff McMahon, also spoke up against the conflicts of interest seen in the off book partnerships. As a reward for his actions, he was reassigned to a new job.

On the other hand, those who closed their eyes to the wrong doings were rewarded. Or with the words of a former Enron employee: "It was very clear what the measures were and how you got promoted at Enron. That absolutely drives behavior . . . getting the deal was paramount at Enron" (Hansell, 2002). A Houston headhunter described the freedom given by Skilling when he was Enron's CEO to loyal employees metaphorically: "Once you gained Jeff's trust, the leash became really long" (Zellner, 2002).

The selection and rewards system was consistent with the culture at Enron. It promoted greed, selfishness, and jealousy within the organization. Enron's executives selected those employees who shared their aggressive, win-at-all-costs mentality. Their short-term view may have prevented them from seeing what the long-term costs of this kind of personality could be on the organization as a whole.

Final comments and suggestions for future work

The story of Enron sounds smart and stupid at the same time. Deeply defective leadership from Lay and Skilling played a significant role in creating the company's culture that led to it's undoing, and we may never know whether it was hubris, greed, psychological shock or just plain stupidity that led them to behave in the way they did (Eavis, 2001). "Consequences of unethical or illegal actions are not usually realized until much later than when the act is committed" (Sims, 2000).

Enron's house of cards collapsed as a result of interacting decision processes. The culture at Enron eroded little by little, by the trespassing of ethical boundaries, allowing more and more questionable behavior to slip through the cracks. This deterioration did not go entirely unnoticed. Individual employees at Enron, auditors at Anderson and even some analysts who watch the financial markets, noticed aspects about the Enron situation that did not seem right, long before the public became aware of Enron's transgressions. There were whistle-blowers but the Enron leaders did not listen.

What existed in Enron's culture that kept individual employees from exposing the executive wrongdoers? And what about the Enron way permitted the executives to behave the way that they did? Enron's culture is a good example of groupthink (cf. eg. Janis, 1989; Moorehead, 1986) where individuals feel extreme pressure not to express any real strong arguments against any co-workers' actions. Although very individualistic, the culture at Enron was at the same time conformist, or quoting Glenn Dickson, a former Enron Risk Manager: "The pressure was – you just didn't have a choice but to approve the deals once everybody had their heart set on that deal closing" (ABC News, 2002). Employees were loyal in an ambiguous sense of the term, i.e., they wanted to be seen as part of the star team and to partake in the benefits that that honor entailed. Some former Enron employees commented that: "loyalty required a sort of groupthink. You had to 'keep drinking the Enron Water' . . ." (Stephens and Behr, 2002). John

Alarial, a former midlevel manager at Enron noted that: "Enron's aggressive business tactics were embraced by the rank and file, . . . even if (authors addition) . . . many suspected it was a house of cards" (ABC News, 2002). Employees were focused on the bottom line and "promoted short term solutions that were immediately financially sound despite the fact that they would cause problems for the organization as a whole . . . rules of ethical conduct were merely barriers to success" (Sims, 1992).

Enron's top executives set the tone for this culture. Personal ambition and greed seemed to overshadow much of their corporate and individual lives. They strove to maximize their individual wealth by initiating and participating in scandalous behaviors. Enron's culture created an atmosphere ripe for the unethical and illegal behavior that occurred.

Two of the most important lessons to learn from the Enron culture history is that bad top management morality can be a sufficient condition for creating a self-destructive ethical climate and that a well-filled CSR and business ethics toolbox can neither stop nor compensate for such processes.[3]

Enron's new CEO, turnaround-specialist Stephen Cooper could use (or should one rather say needs to use) the same five leader' influence mechanisms (Schein, 1985) used above for a turnaround of Enron's culture and ethical climate:

Attention – Cooper needs to focus attention on improving the moral climate of the organization by looking at the long-term implications of employee's actions instead of only the most recent bottom line profits.

Reaction to Crises – Cooper should swiftly react to the crisis facing the company by complying with authorities and firing ethical wrongdoers. The company must stop the lying, covering up ethical and legal transgressions, and trying to preserve those ethical wrongdoers at any cost.

Role Modeling – Cooper must convey the image of the moral manager (Trevino et al., 2002). He must set the example of honesty and integrity for the rest of the organization.

Allocation of Rewards – Using rewards and discipline effectively may be the most powerful way for Cooper to send signals about desirable and undesirable conduct. That means rewarding those who accomplish their goals by behaving in ways that are consistent with stated values and it must be assumed that a lack of commitment to ethical principles will ensure that employees will not be promoted.

Criteria for Selection and Dismissal – Cooper must bring employees into Enron who are committed to ethical principles and usher out all old employees connected to ethical misconduct. The company must have clear policies on the criteria for selection and dismissal that employees understand.

In other words, Enron's new CEO, Stephen Cooper, must take a proactive stance to promote an ethical climate and must be the *Chief Ethics Officer* of the organization (Trevino et al., 2000), creating a strong ethics message that gets employees' attention and influences their thoughts and behaviors. Executive commitment to ethical behavior is an important way of sustaining an ethical organizational culture (Weaver et al., 1999). Cooper must find ways to focus the organization's attention on ethics and values and to infuse the organization with principles that will guide the actions of all employees. New (and first of all credible) values could be the glue that holds things together at Enron, and these values must be communicated (by deeds) from the top of the organization. Employees must understand that any single employee who operates outside of the organizational value system can cost the organization dearly in legal fees and can have a tremendous, sometimes irreversible impact on the organization's image and culture. Employees must trust that whistleblowers will be protected, that procedures used to investigate ethical problems will be fair, and that management will take action to solve problems that are uncovered.

Our skeptical view regarding any compensatory use of the CSR and business ethics toolbox (i.e. as long as morally disputable leadership creates a bad moral climate) does not imply any radical rejection of CSR and ethics tools as such (Schein would have called such tools "secondary articulation and reinforcement mechanisms", such as "organizational systems and procedures" and "formal statements of organizational

philosophy, creeds and charters", see Schein, 1985, pp. 237–242). Once tools are understood as ("secondary") catalysts for ("primary") leadership influence, it is more fruitful to ask for conditions under which ethical tools such as codes could further and reinforce a given organization's ethical climate (cf. Brinkmann and Ims, 2003, esp. table #3) and how Schein's five mechanisms could be operationalized in terms of available tools.

In our introduction we mentioned briefly Enron's image of being an excellent corporate citizen, with all the corporate social responsibility (CSR) and business ethics tools and status symbols in place. It was suggested that this was a key aspect or dimension of the Enron case, as a case of deceiving corporate citizenship and of surface or facade ethics (which also has contributed to the creation of a new word, *Enron Ethics*). As an academic field we owe the general public and the business public a thorough documentation, analysis and discussion of how Enron and other companies with a similar record and reputation could "instrumentalize" (and thus discredit) ethics and CSR for mere facade purposes.

It has also been mentioned that such a focus deserves and requires a paper on its own, at least. As an open end to this paper we should like to draft briefly a typology with moral culture types and transitions which such a paper could address, as a prolongation of the present paper and as a bridge-building towards a more self-critical business ethics business and business ethics discipline. The typology is made up of two dimensions, ethicalness of an organization culture or what has been called ethical or moral climate, and presence of business ethical tools or artifacts, such as ethics officers, codes of ethics, value statements and the like. If one for practical purposes distinguishes dichotomously between low and high one ends up with a four-fold table as shown in Table I.[4]

As mentioned above, Enron looks at first sight like "type I", similar to what Kohlberg might have called moral "pre-conventionalism", like a classical business ethics case, with a typical mix of "amorality" and "immorality" (cf. for the distinction Carroll and Meeks, 1999). For headline-journalism and public opinion Enron and World.com are simply bad and rotten, one just didn't know before it was too late, and this shows once more an urgent need for more legislation and ethics. Our thesis is that Enron (and probably quite a number of other companies waiting to be discovered) is an at least as good illustration of "type II", of window-dressing ethics, with talking instead of walking, ethics as rhetoric. While "type II" looks modern or at least fashionable, "type III" looks like the old-fashioned type of moral business, from the days before the disciplines of business ethics, CSR, marketing and public relations were invented, with collective moral conscience (borrowing E. Durkheim's term) as consistent label and content, perhaps additionally communicating moral humbleness, with a touch of British understatement. The final "type IV" refers to a moral role-model business culture in the age of marketing and public relations, with walking the talk, with showing and confessing openly its collective moral conscience (call it self-reassurance, or more U.S.-style self-marketing, to put it stereotypically). In other words, a future paper should primarily deal with a documentation and criticism of "window-dressing ethics", of how to further processes towards collective moral conscience,

TABLE I
Typology of moral culture types and transitions

Presence and marketing of business ethical tools	Ethicalness of a given organization culture	
	Low	High
High	II: Window-Dressing Ethics	IV: Moral Role-Modeling
Low	I: Moral Preconventionalism (Without Disguise)	III: Collective Moral Conscience

with more or less marketing of the good examples, and of how to prevent degeneration towards "window-dressing ethics". We often wonder if we would prefer honest amorality and immorality to dishonest morality. But still, we choose to read the paper title of Tonge et al. (2003) optimistically: "The Enron story: you can fool some of the people some of the time . . .".

Notes

[1] Cf. in addition the Enron-story books for sale as of today by Amazon, see bookhttp://www.amazon.com/exec/obidos/ASIN/0471265748/millerriskadv-20/002-3887103-5927230.

[2] For example, Enron had promised CIBC World Markets the majority of the profits from Project Braveheart for ten years, or in the event of failure Enron would be obligated to repay CIBC its entire $115.2 million investment. Not only did Enron book the earnings prematurely, but it was also forced to repay CIBC its full investment.

[3] For a draft of possible "latent, negative functions" of ethical codes cf. Brinkmann and Ims, 2003, esp. table #2.

[4] Thanks to colleague Knut Ims from the Norwegian School of Business Administration for a discussion about this typology.

References

ABC News – World News Sunday: 2002, 'Profile: The Shadowy World of Enron's Corporate Culture' (January 27).

Bartlett, C. A. and M. Glinska: 2001, 'Enron's Transformation: From Gas Pipeline to New Economy Powerhouse' (Harvard Business School Press, Boston, MA).

Brinkmann, J. and K. Ims: 2003, 'Good Intentions Aside (Drafting a Functionalist Look at Codes of Ethics)', forthcoming Summer 2003 in *Business Ethics: A European Review*.

Broughton, P. D.: 2002, 'Enron Cocktail of Cash, Sex and Fast Living', *News*. Telegraph.co.uk (On-line journal) (February 13).

Brown, K. and H. Sender: 2002, Enron's Board Fires Arthur Andersen: Questions Arise About Auditor's Actions', *The Wall Street Journal* [On-line]. Available: http://wsjclassroomedition.com/tj 011802 enron.htm.

Carroll, A. B. and M. D. Meeks: 1999, 'Models of Management Morality: European Applications and Implications', *Business Ethics: A European Review* **8**, 108–116.

Cohan, J. A.: 2002, 'I Didn't Know and I was Only Doing My Job. Has Corporate Governance Careened Out of Control? A Case Study of Enron's Information Myopia', *Journal of Business Ethics* **40**, 275–299.

Daily Press: 2002, 'Troubles Widely Known, Exec Says' (February 15), p. A1.

Dowd, M.: 2002, 'Enron, Hollywood Version', *The Roanoke Times* (February 10), 1.

Eavis, P.: 2001, 'Enron Reaps What Its Cowboy Culture Sowed', TheStreet.com [On-line]. Available: http://www.thestreet.com/markets/detox/10004675.html.

Eichenwald, K.: 2002, 'Report Lays Out Troubles At Enron: Internal Investigation Finds Profits Overstated To Executive's Enrichment', *The New York Times* [On-line]. Available: http://www.austin360.com/aas/business/020302/3enrong.html.

'Explaining the Enron Bankruptcy': 2002, CNN.com (January 12). Available: http://www.cnn.com.html.

Frey, J. and H. Rosin: 2002, 'Enron's Green Acres', *The Washington Post* (February 25), 1.

Gruley, B. and R. Smith: 2002, 'Anatomy of a Fall: Keys to Success Left Kenneth Lay Open to Disaster', *The Wall Street Journal* (April 26), pp. A1, A5.

Hamburger, T.: 2002, 'Watkins Tells of 'Arrogant' Culture; Enron Stifled Staff Whistle-Blowing', *The Wall Street Journal* (February 15), pp. A3, C1.

Hansell, G.: 2002, 'The Fall of Enron Pressure Cooker Finally Exploded', *The Houston Chronicle* [On-line]. Available: http://www.russreyn.com/news/newsitem.asp?news=235.

Janis, I.: 1989, *Critical Decisions: Leadership in Policy Making and Crisis Management* (Free Press, New York).

Josephson, M.: 1999, 'Character: Linchpin of Leadership', *Executive Excellence* **16**(8), 13–14.

Landers, J.: 2002, 'Enron Exec' Silence Is No Shock Testimony Would Have Followed Hard-hitting Report On Activities. *The Dallas Morning News* [On-line], Available: http://www.kmsb.com/business/news/506152 enron.html.

Lardner, J.: 2002, 'Why Should Anyone Believe You? What Ruined Enron Wasn't Just Accounting. It Was a Culture that Valued Appealing Lies Over Inconvenient Truths. Are You Sure Your Company

Is All That Different?' *Business 2.0* [On-line]. Available: http://www.business2.com/articles/mag/0/1640.37748.FF.html.

Larimer, L. V.: 1997, 'Reflections on Ethics and Integrity', *HRFocus* (April), 5.

Lewis, M.: 1989, *Liar's Poker* (Norton, New York).

McClean, B., J. Sung Revell and A. Helyar: 2001, 'Why Enron went Bust: Start with Arrogance. Add Greed, Deceit, and Financial Chicanery. What Do You Get? A Company that Wasn't What it was Cracked Up to Be', *Business 2.0* [On-line]. Available: http://www.business2.com/articles/mag/print/0.1643.36124.FF.html.

Moorehead, G. and J. R. Montanari: 1986. 'An Empirical Investigation of the Groupthink Phenomenon', *Human Relations* **39**, 339–410.

New York Times: 2002, 'Profits At Enron Energy Services', [On-line] (February 14). Available: http://www.nytimes.com/learning/students/pop/articles.

Pearce, J. A., II, T. R. Kramer and D. K. Robbins: 1997, 'Effects of Managers' Entrepreneurial Behavior on Subordinates', *Journal of Business Venturing* **12**, 147–160.

Petrick, J. A. and J. F. Quinn: 2002, 'Management Integrity Capacity Neglect and Enron: Stakeholder Damages and Remedies', paper presented at the 9th International Conference Promoting Business Ethics, Niagara University, Niagara Falls, NY, Oct 23–25, 2002.

Schein, E.: 1985, *Organizational Culture and Leadership* (Jossey-Bass, San Francisco, CA).

Schwartz, J.: 2002, 'Darth Vader. Machiavelli. Skilling Set Intense Pace', *The New York Times* (February 7), 1–2.

Sims, R. R.: 1992, 'The Challenge to Unethical Behavior in Organizations', *Journal of Business Ethics* **11**, 505–513.

Sims, R. R.: 2002, 'Leadership, Organizational Culture and Ethics', *Teaching Note* (Graduate School of Business, College of William and Mary, Williamsburg, VA).

Sims, R. R.: 2000, 'Changing an Organization's Culture Under New Leadership', *Journal of Business Ethics* **25**, 65–78.

Sims, R. R. and J. Brinkmann: 2002, 'Leaders as Moral Role Models: The Case of John Gutfreund at Salomon Brothers', *Journal of Business Ethics* **35**, 327–339.

Stephens, J. and P. Behr: 2002, 'Enron's Culture Fed Its Demise: Groupthink Promoted Foolhardy Risks', *Washington Post* (January 27), A01.

Stern, G.: 1992, 'Audit Report Shows How Far Chambers Would Go For Profits', *The Wall Street Journal* (October 12), A1.

Tonge A., L. Greer and A. Lawton: 2003, 'The Enron Story: You Can Fool Some of the People Some of the Time . . .', *Business Ethics: A European Review* **12**, 4–22.

Tracinski, R.: 2002, 'Enron Ethics', *Capitalism Magazine* [On-line] (January 28). Available: http://www.capitalismagazine.com/2002/january/rwt.enron.htm.

Trevino, L. K., L. P. Hartman and M. Brown: 2000, 'Moral Person and Moral Manager: How Executives Develop a Reputation for Ethical Leadership', *California Management Review* **42**(4), 124–142.

Trevino, L. K. and K. A. Nelson: 1995, *Managing Business Ethics: Straight Talk about How to Do It Right* (John Wiley & Sons, New York).

U.S. Congressional Hearing: 2002 (February 6), Washington, DC.

Vogt, A. J.: 2002, 'Interview with Larry Bossidy: The Way It Is', *Across the Board* (May/June), 31–37.

Weaver, G. R., L. K. Trevino and P. L. Cochran: 1999, 'Corporate Ethics Programs as Control Systems: Influences of Executive Commitment and Environmental Factors', *Academy of Management Journal* **42**, 41–57.

Willet, B. and T. Always: 2002, 'For Investors, X Marks the Spot, Whether They Choose To See It Or Not', FallStreet.com [On-line]. Available: http://www/fallstreet.com/Spotlight/jan2502/htm.

Wolfe, D.: 1988, 'Is There Integrity in the Bottomline: Managing Obstacles to Executive Integrity', in S. Srivastva (ed.), *Executive Integrity: The Search for High Human Values in Organizational Life* (Jossey-Bass, San Francisco), pp. 140–171.

Zellner, W.: 2002, 'Jeff Skilling: Enron's Missing Man', *Business Week Online* (February 11).

Ronald R. Sims
Graduate School of Business,
College of William and Mary,
Williamsburg, VA 23187-8795,
U.S.A
E-mail: ronald.sims@business.wm.edu

Johannes Brinkmann
Norwegian School of Management BI,
PO Box 4676 Sofienberg,
N0506 Oslo Norway
E-mail: johannes.brinkmann@bi.no