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The blame game


A different slant on
the corporate
governance issue.




**EXCUSES AND ABUSES
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Playing the Blame Game:



The new corporate governance machinery simply allows investors and shareholders to pass the extortion buck to the easiest target without actually addressing underlying problems, argues **Carolyn Kaufman**.

Do Changes in Corporate Governance Laws Unfairly Target Directors?

Recent corporate scandals like the one around U.S. energy

giant Enron have raised questions throughout the global business industry regarding who is to blame and how to prevent future misconduct. The deterrent the

U.S. developed in the wake of Enron, called the Sarbanes-Oxley Act, has changed the rules for publicly traded companies more drastically than any

American reform in the past 70 years. Nonetheless, the responsibility that various governments, the media, and Sarbanes-Oxley have placed on company directors to dictate and enforce ethical business standards is, some believe, a scapegoating game that allows investors and shareholders to pass the extortion buck to the easiest target without actually addressing underlying problems.

In just over 15 years, Enron became the United States' seventh-largest company, employing 21,000 people in 40 countries. Touted before its fall as a paragon of corporate America, the company's success was eventually revealed to be a scam based on a complex web of partnerships, dubious accounting practices, and artificially inflated profits. Six months after Enron's house of cards collapsed, global communications company WorldCom filed the largest bankruptcy in U.S. history and confessed to over-

stating its profits and classifying billions of dollars in expenses as investments. The list of businesses implicated for shady bookkeeping goes on, both in the U.S. — including telecommunications firm Global Crossing, manufacturing and services company Tyco, and entertainment and communications provider Adelphia — and in Europe. One of the most famous scandals in the U.K. was the closing of the Bank of Credit and Commerce International (BCCI) in 1991 for fraud involving \$11 billion (about £6.5 billion), and as recently as 2002 charges of fraudulent accounting were levelled at corporations like Elan, an Irish-based biomedical group, and the French-based media giant Vivendi.

The new focus in the U.S. on requiring directors and auditors to be "independent" or autonomous from their businesses has encouraged U.K. Trade and Industry minister Patricia Hewitt to propose simi-

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lar restrictions to keep directors from appointing company auditors. In a keynote speech to the Cambridge faculty of law supporting the need for change, Hewitt commented, "the relationship [at Enron] between the company and the auditor was blurred, to put the point kindly."

Will court-ordered responsibility actually change anything?

The legal system is also emphasizing director accountability. In June of 2002, a U.S. federal appeals court reversed a lower court's decision that Abbott Laboratories' directors were not responsible for a breach in compliance with the Food and Drug Administration's mandates due to ignorance. The new ruling held that the directors were "grossly negligent in failing to inform themselves."

Pressure on directors to take increasing responsibility for the businesses they serve has in many cases doubled time and commitment expectations. In combination with the new "independence" statutes, and in some cases the limitations restricting the number of boards on which a director can serve, businesses are experiencing a shortage in qualified and amenable directors. Since directors typically work on a part-time basis for limited compensation, some crit-



ics argue that the pressure to micromanage and accept ultimate responsibility for ethical corporate conduct may encourage stringent focus on the letter of the law, to the extent that there is little time for decision-making relevant to the actual functioning of the rest of the organization.

The question remains whether the changes being considered and implemented across the globe will help prevent future misconduct, whether they will hinder lucrative business practices, or whether they are simply mollifications that keep us from exploring a larger problem.

For example, in 2000, *Chief Executive* magazine listed Enron's board as one of the top five in the United States. Among the 18 members of the Enron board were lawyers, former regulators, and a former dean of Stanford Business School, but only two insiders. In other words, Enron already met many of the requirements of the new laws, so even if these laws had been enacted before the Enron collapse, an informer would still most likely have been necessary to divulge the fraud. Directors are rarely involved in the day-to-day details of a company's operations, and even if they work 150 to 200 hours on board duties, there is virtually no way for them to monitor every potentially corrupt aspect of a business.

Ethics versus rules

Part of the problem is that ethics and rules do not always go hand in hand. While a business can be regulated by rules, ethics are values held by individuals and are, as a consequence, far more slippery. Lawrence Kohlberg's classic model of ethi-

cal stages, commonly taught in business schools, emphasizes that ethical behaviour varies based on the individual and the situation, and laws do not necessarily dictate ethics, and vice versa. In a survey of corporate ethics officers conducted by the Ethical Leadership group, only 18% said they fire great performers who don't live up to an organization's ethical values. Twenty-three percent said they simply tolerate these people, 30% coach them, and 8% said they promote them. The principles of capitalism are such that profits often retain more value than honest failures. In addition, the threats of bankruptcy and humiliation may be far more compelling than the seemingly remote likelihood that one will be caught exploiting a loophole in the rules.

In the end, regardless of how ethical a company tries to be or seems to be on the surface, the messages employees receive through managerial behaviours are more influential than anything else. Enron's ethical code—referred to by the acronym RICE: Respect, Integrity, Communication, and Excellence—was energetically promulgated throughout the firm. The company even made "RICE" t-shirts available at special events. At the same time, however, Enron enforced a strict personnel policy, internally nicknamed "Rank and Yank." Employees were rated on a six-level scale based on their productivity, and those at the bottom were routinely dismissed. Though Enron explicitly purported to prize respect, integrity, communication, and excellence, the "Rank and Yank" policy implicitly goaded a competitive environment that pitted employees against one another to keep their jobs by whatever means was

necessary—mirroring the game Enron was playing against the rest of the corporate world.

Governments and the media have emphasized the supposed importance of stricter rules to manage corporations like Enron, WorldCom, and BCCI, but the argument remains that loopholes can always be

“Pressure on directors to take increasing responsibility for the businesses they serve has in many cases doubled time and commitment expectations”

found in rulebooks. As Steve Priest of the Ethical Leadership Group acknowledges in *The Business Journal Online*, as long as money is more important in an organization than integrity, there will always be people looking for loopholes: “An absence of ethical leadership and a culture of ‘anything goes as long as it makes a buck’ will prevail over even the best training, code of conduct, or hotline, [which] emphasizes the critical importance of building integrity into the essence of the corporation.”

Stopping fraud in corporate business is not a job to be pinned on any one person or group. Despite arguments to the contrary, history has not shown that changes in legislation end crime, nor do punishments of corrupt businesspeople deter others from making the same mistakes. As Lord Acton wrote in a letter to Bishop Mandell Creighton in 1887, “Power tends to corrupt, and absolute power corrupts absolutely.” Maybe it's time to pass some of the responsibility around. 