The Myths that Led Us to Worldcom and Eron

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Are the Worldcom, Eron and other corporate ethical lapses just isolated examples of executive greed that can be fixed by tougher regulation and more severe penalties or are they symptomatic of something that goes much deeper? Is it just that a few CEOs, CFOs, and accountants have succumb to personal greed or were they just operationalizing beliefs that have become so pervasive in the business community they are no longer questioned. We think the latter. In fact, six widely accepted myths have led us to the current situation.

Myth # 1: Corporations Exist Primarily to Make Profits for Shareholders.

Wrong. The original purpose of corporations wasn't to make profits for shareholders but to serve the public interests. "Profits as primary purpose" is the result of an historical accident and represents a perversion of the original goal of incorporation. Ralph Estes, author of *Tyranny of the Bottom Line*, summarizes the history of corporations this way:

> In the beginning corporations were chartered by monarchs to serve the interests of the state...Democracies later adopted this tradition....
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> Investors were allowed a return as an inducement to fund the corporation, but providing a return to financial investors was secondary to the corporation's real purpose, which was to provide a *public* return, a public benefit....
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> The earliest corporations to deserve the name were ecclesiastical organizations, in a time when religion was very much a concern of the state. Next came municipalities, universities, guilds, and livery companies. These were followed by corporations chartered to exploit foreign lands—the Russia or Muscovy Company, the Levant (Turkey) Company, the Jamestown Company, the East India Trading Company.… America's colonization was accomplished largely through corporations: the Jamestown Company, the Massachusetts Bay Company, the Plymouth Company, the London Company....
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> As the colonizing corporations metamorphosed into colonies, the weak colonial governments in turn looked to chartered private corporations to

> meet public needs. These early American corporations mainly provided transport, water, insurance, library, and banking services.[1]

In each case, the purpose of the corporation was to serve a social function for the state. For example, when Massachusetts chartered a turnpike company it didn't do so to benefit the stockholders of the company but to benefit the citizens of the commonwealth. Later when the concept of incorporation was extended to other types of businesses such as manufacturing that didn't have such a clearly defined public purpose, state legislatures placed severe restrictions on corporate charters. Corporate charters had time limits (usually twenty years or less), stockholders were held responsible for the company's debts, and legislatures reserved the right to amend corporate charters at any time for any reason.

How then did profits become supreme? Estes ties what he calls the "loss of accountability" of corporations to two developments. First, in the early part of the nineteenth century states began competing with each other to attract corporations that would stimulate settlement and growth. "Soon," explains Estes, "states were prostrating themselves before corporations with inducements, benefits, and a general relaxation of restrictions. Populist concerns were swept aside; the corporation was king."[2]

The second phase in the conversion—or "perversion" as Estes describes it—of the corporate mission came in the years following the American Civil War. Business exploded in size and giant corporate empires like those of Cornelius Vanderbilt, John D. Rockefeller, Andrew Carnegie, J. Pierpont Morgan, and the other "Robber Barons" emerged. These robber barons were secretive, distrustful, and wanted to be held accountable to no one. They had no formal procedures or formal structures. They oversaw their business operations personally. Eventually, however, these enterprises simply became too big for a single person to oversee, and the tycoons were forced to bring in professional managers to help them. And, it was the professional managers that made profits king. They did so for a very simple reason as Estes explains:

> The simple structure of the early corporations...evolved into a complex entity organized into many divisions and branches, territories, and subsidiaries. These had to be monitored, evaluated, and scored. The tycoons, the owner-managers, may have disdained a formal scorekeeping system; the professional managers whom they hired to run their far-flung empires were more bureaucratic. They didn't manage by "gut" feel or the seat of their pants. They believed in numbers. They wanted performance reports. But there was no mechanism in place for scoring the corporation, for assessing and reporting its performance in fulfilling its chartered purpose.
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> There was, however, another mechanism already in place. This was the simple system that stockholders' agents had first set up to report to their principals on how well their investments were doing. It was never intended to show the performance of the corporation as a whole, in terms of chartered purpose. But it existed. It was on hand. And it looked reasonable. So the professional managers of these expanding corporations turned to this simplistic and inapplicable system as a measure of corporate performance.[3]

The inadequate mechanism that the early investors' agents had developed and that the professional managers turned to was profits—a simple count of what came in, what went out, and most importantly what was left on hand in the end. Managers came to serve the interests of stockholders, argues Estes, not because there were no other stakeholders but because of the historical accident that stockholders were the only stakeholders with a simple and readily available measure of performance.

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Myth #2: The Application of Moral Thinking in Business Decision-making Is an Abrogation of Fiduciary Responsibility.

Wrong again. When corporate executives ignore their social and ethical responsibilities, they often end up costing stockholders more than they gain them. John Dalla Costa, author of *The Ethical Imperative,* cites the case of Texaco as an example.

> The company had been embroiled for more than a year in a class action suit by black employees who felt victimized by an institutionalized prejudice. After first denying the charge and fighting the suit, Texaco was embarrassed into settlement by tapes, made pubic in 1996, in which senior executives uttered racial barbs while plotting to destroy incriminating documents relating to the suit. With apologies and promises of new training and promotional policies, Texaco promptly paid out $115 million. Ironically, the infamous tapes were made by a white manager, not out of concern about inequality toward fellow employees but as a negotiating lever to protect his job in a forthcoming reengineering. There is no doubt that this manager, arrested and prosecuted for his role in destroying evidence, did something illegal, something grossly self-serving and cynical. But it must also be acknowledged that he was behaving not unlike the way Texaco itself was behaving toward its own employees.[4]

Dalla Costa notes that Texaco's stock price dropped $3 per share in the first few days after its race-bias scandal, which he says amounted to "a neglect or omission of fiduciary obligations on the scale of $1 billion."[5] He adds that there are other costs of unethical and socially irresponsible behavior that never show up on the balance sheet.

> [T]he disloyalty of disgruntled employees, legal and public relations expenses to cover impropriety, and the general executive profligacy that tends to go in tandem with a self-serving corporate culture create millions of dollars in drag on potential earnings.…
> Business is complex and confusing...but what is clear is that seemingly straight-line relationships between self-interest and profit involve many other factors that often impede, diminish and destroy shareholder value. Rather than harming value, an ethical orientation often creates the conditions necessary for enhancing and preserving it.[6]

Stockholders of Worldcom, Enron and the other have paid a similar price for their executives 'ethical indiscretions.

Myth #3: Ethics and Social Responsibility Run Counter to the Pursuit of Self-interest Upon Which a Free Market is Based.

Wrong again. Dalla Costa notes that ethical behavior isn't an "either-or" proposition or a choice between one's self-interest and that of another. "Ethics essentially provide a framework for fairness that benefits both the individual pursuing self-interest and the community that must manage to stay functional.…We as individuals are not the opposite of our community, but its members, contributors and beneficiaries. Self and other, economy and community, competition and cooperation are not therefore antonyms but continuities of interdependent ebb and flow."[7]

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Robert O. Solomon, author of *A Better Way to Think About Business*, says this forced polarity between ethical behavior and self-interest "betrays a lack of vision, thought, and imagination."[8]

> [O]ur self-interest is intimately tied up with serving the interests of others. Thus the polarity between doing what is in our interest and doing the right thing—or doing things for other people—breaks down. In serving others, we serve ourselves. The language of "self-sacrifice" is misleading, at best. The conflict between our own interests and others' interest is rare.
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> When corporations struggle over the choice between self-interest (profitability) and doing right (treating the employees or customers fairly, paying attention to the surrounding community), it is almost always a symptom of unimaginative, nonstrategic, short-term thinking.[9]

Soloman cites Fred Reichheld, author of *The Loyalty Effect*. Reichheld believes that "it is foolish to think you can ignore employees' family demands and still get committed, energetic, long-term employees. That's fairyland."[10] Solomon adds that the choice between self-interest, whether corporate or personal, and doing right is usually an illusion and so is the image of the autonomous, self-sustaining, self-defining individual.

> The "self-made" man or woman is a social creature, and he or she "makes it" by being an essential part of society, however innovative or eccentric he or she may be. To say that we are communal creatures is to say that we have mutual interests, that even in the most competitive community, our self-interests are parasitic on and largely defined in terms of those vital interests we hold in common....
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> Princeton anthropologist Clifford Geertz once wrote that a human being all alone in nature would not be a noble, autonomous being but a pathetic, quivering creature with no identify and few defenses or means of support. Our heroic conception of "the individual"—often exemplified by the lone (usually male) hero—is a bit of bad but self-serving anthropology. There are exceptional individuals, to be sure, but they are social creations and become exceptional just because they serve the needs of their society, more often than not by exemplifying precisely those forms of excellence most essential to that society.[11]

Myth #4: The Corporation is an Autonomous Entity—Something Apart from the Community.

Nonsense. Rather than being an autonomous, independent entity, a corporation is part of the communities in which it operates—a "citizen"—whether it likes it or not. It is ludicrous to think otherwise. Peter Schwartz and Blair Gibb, co-authors of *When Good Companies Do Bad Things*, maintain that today's corporations can't choose whether to become involved in social issues like economic development, diversity and equal opportunity, human rights and so on. They simply are involved. "As soon as a company hires an employee or files a tax return or makes a capital investment, it has involved itself with social issues—it has just not made those involvements explicit. The company pays its employees what the market will bear—*or a little more or a little less*. It enforces certain health and safety practices—*to the minimum required by law or a little better*. It recruits and promotes employees—on the basis of merit, *with fewer or more exceptions for internal or external politics*."[12]

A corporation can't choose whether to be involved or not; it is involved. A corporation can only choose whether or not that involvement will be for the good or bad, whether it will be creative or destructive, and whether it will foster the interests of mankind or detract from it. And, by involvement in the community we mean more than just making charitable

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contributions or supporting a few good causes. Corporate executives must serve not just as corporate leaders but also as community leaders. They must be role models; standard bearers for values to which we should all strive for such as honesty, decency, fairness, and truthfulness.

Myth #5: Laws are Sufficient to Protect Those Who Cannot Protect Themselves.

Wrong again. Laws and ethics aren't the same thing, and one is not a substitute for the other. Dalla Costa explains the difference between laws and ethics this way.

> For thousands of years, as long as there have been laws, there has also been a set of ethics guiding the community's behavior. The two are complementary but not redundant. Laws emerge largely by precedent, whereas ethics derive from moral belief. Laws create authority by the threat of punishment, whereas ethics are usually an expression of principle that engages individuals at the deeper level of identity and belonging. The focus of laws is compliance, while the focus of ethics is human character and community development. History provides ample examples of widely followed, strictly enforced laws that clearly have been unethical: the laws enshrining slavery in the U.S. states; Nazi laws depriving Jewish citizens of their property; apartheid in South Africa. Nether the law nor ethics are ever perfect, since the examples just listed also involved a moral (immoral) complicity on the part of the majority. The point, however, is that justice may be served without satisfying moral right.[13]

It is not enough for a current or former CEO or board member to simply say: "We did nothing legally wrong."

Myth #6: Stakeholders Don't Pay for Their Stake. Shareholders Do!

Finally, we have the argument offered by some and accepted by too many that the be all and end all job of the CEO's job to drive stock price to his own and his stockholder's benefit regardless of how his actions impact other stakeholders. Once infamous CEO put this misguided reasoning this way: "The most ridiculous word you hear in boardrooms these days is 'stakeholders'. A stakeholder is anyone with a stake in a company's well-being. That includes its employees, suppliers, the communities in which it operates and so on. The current theory is that a chief executive has to take all these people into account in making decisions. Stakeholders! Whenever I hear that word, I ask: how much did they pay for their stake? Stakeholders don't pay for their stake. Shareholders do."[14]

Wrong, wrong, wrong. We like the response Peter Schwartz and Blair Gibb gave to such arguments. They recalled the disaster that occurred at Union Carbide's Bhopal, India, pesticide plant on the evening of Sunday, December 2, 1984. For reasons that were never fully determined, a deadly chemical used to make pesticides (methyl isocyanate or MIC) escaped from the plant and spread as a toxic cloud over Bhopal and surrounding communities. The accident killed 3,800 people. Most died when their lungs filled with fluid, the equivalent of drowning. Others died of heart attacks. In addition to the deaths, up to half a million people were injured. Some of the injured were blinded, others suffered concussions or paralysis. Many had serious lesions in their bronchial and nasal passages. The Bhopal disaster became the worst industrial accident in history.[15] Schwartz and Gibb's note "many thousands of Indians living around the Bhopal plant paid with their

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lives for their "stake" in Union Carbide."[16] That disaster should be a vivid reminder that it's not just stockholders that suffer when corporations do wrong.

We Must Manage (and Live) by an Ethical Code

The myths we cited above exist in part because we have allowed too many corporate executives and their apologizers to hide behind the excuse that the only decision rule managers need follow is that of returning the highest value to shareholders. We must demand adherence to a much broader and higher standards such as, for example the Minnesota Principles which were developed by a group of business leaders in Minnesota to encourage fairness and integrity in the global marketplace; or, the CAUX Principles that were created by a group of business leaders from Europe, Japan, and North America; or, SA8000, a voluntary international standard developed by the Council on Economic Priority Accreditation Agency (CEPAA) to ensure ethical sourcing of goods and services. There are many similarities in these codes and the instructions they provide to not just corporate executives but all of us: Be fair, respect life, be honest, strive for justice, honor the environment, and, most important, take personal responsibility. Welcome accountability. A little—no make that a lot—more adherence to such values would help us avoid future Worldcom's and Eron's. Who knows, we might just restore the public's faith in American business.

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NOTES

1 Ralph W. Estes, *Tyranny of the Bottom Line: Why Corporations Make Good People Do Bad Things* (San Francisco: Berrett-Koehler Publishers, 1996), pp. 22-24.

2 Ibid., p. 25.

3 Ibid., p. 28.

4John Dalla Costa, *The Ethical Imperative: Why Moral Leadership is Good Business* (Reading, MA: Addison-Wesley, 1998), p. 87.

5 Ibid., p. 101.

6 Ibid., p. 102.

7 Ibid., p. 103.

8 Robert C. Solomon, *A Better Way to Think About Business: How Personal Integrity Leads to Corporate Success* (New York: Oxford University Press, 1999), p. 32.

9 Ibid.

10 Ibid.

11 Ibid., pp. 43-45.

12 Schwartz and Gibb, *When Good Companies Do Bad Things*, p. 97.

13 Dalla Costa, *The Ethical Imperative*, pp. 107-108.

14 Schwartz and Gibb, *When Good Companies Do Bad Things*, p 105.

15 Rogene A. Buchholz and Sandra B. Rosenthal, *Business Ethics: The Pragmatic Path Beyond Principles to Process* (Upper Saddle River, NJ: Prentice Hall, 1998), pp. 211-215 and Schwartz and Gibb, *When Good Companies Do Bad Things*, pp. 48-51.

16 Schwartz and Gibb, *When Good Companies Do Bad Things*, p. 105. Schwartz and Gibb go on to say “to the extent that Dunlap is demanding more rigor in the discussion of stakeholder responsibility, raising the question of legitimacy is fair.”

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