Resisting Organizational-Level Corruption: An Interview With Sherron Watkins

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Enron is a prototypical example of organizational-level corruption. Our interview with Ms. Watkins focuses on the mechanisms that resulted in corruption becoming pervasive across the organization. It provides several illustrations of how these mechanisms can subtly ensnare even morally upstanding people in a web of corruption. Ms. Watkins’ insights can help us identify and resist corrupt practices, if and when they occur in any organization. Drawing on her insights and the corruption literature, we propose a 4P (perceive, probe, protest, persist) approach to help individuals prevent and resist organizational-level corruption.

Scholars have examined the “dark side” of organizations (e.g., mistakes, misconduct, and disasters) in order to understand the causes of catastrophic failures and prevent their recurrence (Vaughan, 1999). Events such as the Challenger Space Shuttle explosion (e.g., Vaughan, 1996), the Mann Gulch fire disaster (e.g., Weick, 1993), and the collapse of Barings Bank (e.g., Stein, 2000) have been analyzed thoroughly for insights on how to prevent similar failures. The fall of Enron also is an epic disaster that has been extensively covered in both the lay press and in academic publications (Conroy & Emerson, 2006; Healy & Palepu, 2003; Prentice, 2003; Swartz & Watkins, 2003; Watkins, 2003a,b). Our purpose here is to take a fresh look at the Enron story using a new organizational-level corruption lens (Pinto et al., 2008). This perspective is important because it highlights the often innocuous processes that over time can result in the emergence and spread of organizational corruption. As Ms. Watkins points out, “students need to learn the subtlety of how unethical behavior can take hold of you.”

A variety of perspectives have been offered on reasons for the recent crisis in business ethics, including a lack of moral grounding in management education (Ghoshal, 2005); the need for a more human-centered rather than organization-centered understanding of business (Giacalone & Thompson, 2006); poor leadership (Henle, 2006); and a failure to acknowledge individuals as the appropriate unit of moral analysis (Locke, 2006). We add to these perspectives an organizational-level view of corruption that can be manifested in two forms (Pinto et al., 2008): (1) the corrupt organization (CO) phenomenon, that draws from sociology, and (2) the organization of corrupt individuals (OCI) phenomenon, an extension of the economics perspective of corruption.

Corrupt organization (CO) is a top-down phenomenon in which a group of organizational members, typically a dominant coalition, organizational elites, or a top management team, undertake, directly or through their subordinates, collective and coordinated corrupt actions that mainly benefit the organization (Pinto et al., 2008). Organization of corrupt individuals (OCI) is an emergent, bottom-up phenomenon (Kozlowski & Klein, 2000) in which one or more mesolevel processes (House, Rousseau, & Thomas-Hunt, 1995) initiate or facilitate corrupt behaviors mainly for personal benefit. These corrupt behaviors cross a critical threshold (Andersson & Pearson, 1999) such that the organization can be characterized as cor-
rupt (Pinto et al., 2008). Enron manifested both phenomena and many of their concomitant processes. Arguably, if the corruption had not in Ms. Watkins’ words “spread like a sexually-transmitted disease,” the damage may have been contained to a particular subunit or a few individuals. Like Tyco or ImClone, Enron may have survived.

Sherron Watkins is the ideal person to describe the complex dynamics that led to Enron’s demise. She is the former Enron vice president of accounting, whose memo to late Chairman Ken Lay set in motion events that exposed Enron’s corrupt accounting practices. Ms. Watkins worked at Enron for 8 years, resigning in 2002 as vice president of corporate development in the mergers and acquisitions group. She reported to CFO Andy Fastow (1993–1997, and 2001–2002) and testified in the recent trials of former CEO Jeffrey Skilling and the late Chairman and founder Ken Lay. She is a CPA and former auditor with Arthur Andersen and completed master’s and undergraduate degrees in accounting at the University of Texas at Austin. Ms. Watkins’ position as a boundary spanner between the core and periphery (Borgatti & Everett, 1999; Pinto et al., 2008) of the Enron organization provided her firsthand knowledge of OCI and CO phenomena at Enron, and the role of collective behaviors and organizational systems in organizational-level corruption. In her words, she was “still close enough to the top to critique operations, but ... not in that inner circle” (Watkins, 2003b). She was thus in a unique position to discover Enron’s dodgy financial and accounting practices (CO) and widely adopted individual ethical failures (OCI).

The remainder of this paper contains three sections. First, we interview Ms. Watkins. Second, we highlight the antecedents and contagion mechanisms that contributed to organizational-level corruption at Enron. Third, we propose a 4P approach (perceive, probe, protest, persist) to identify and hopefully reverse, corrupt organizational practices.

**INTERVIEW**

People can engage in corrupt behaviors for a number of reasons, but two main motives may be either to benefit the organization they work for—though they may still get some secondary benefit—or to benefit themselves personally. Was one of these two motives more prevalent than the other at Enron?

I’ll answer that with information from the Association of Certified Fraud Examiners that I also heard at an FBI conference. Fraud occurs as a result of three conditions. The first condition is extreme pressure; for example, your finances are in shambles so you embezzle money. Enron was always under extreme pressure from Wall Street to achieve earnings goals. Though that benefited the organization, it still ends up benefiting people personally. If you can achieve the corporation’s earnings goals, you get stock options, the stock price goes up, and you get wealthy.

The second condition for fraud to occur is the opportunity to game the system, to skim a little bit off, like padding an expense report. That would be stealing for personal gain, and I have heard people’s rationalizations for doing that. In Enron’s case, the opportunity came in the form of twisting accounting rules in ways they were never meant to be twisted. Enron employees went beyond stretching the accounting rules and actually applied them in ways that violated underlying principles.

The third part of the fraud triangle is the most important—the necessary condition for fraud. That is, a rationalization that you are doing nothing wrong. With street crime, people know they risk going to prison if they get caught. White collar criminals are more likely to commit suicide because they had previously rationalized they did nothing wrong, so the shock of realizing they did do wrong can be overwhelming. Of course, many never come to that realization. I have heard the statistic at fraud conferences that over 50% of white collar criminals go to prison able to pass a lie detector test that they did nothing wrong. Hence, Jeff Skilling told the judge at his sentencing, “I believe I am innocent of these charges.”

White collar criminals rationalize their involvement and that happened to an incredible degree at Enron. I often heard, “What do we have accounting rules in this country for, if they are not meant to be used? The rules may be complex, but if you comply with them, then that is all you need to worry about.” Such rationalizations ignored underlying accounting principles that are intended to fairly represent your financial condition to the investing public; and in some cases actually violated other accounting rules on properly disclosing debt, related party transactions, or conflicts of interest. Wouldn’t shareholders care if they knew Enron had $38 billion of long-term debt instead of the 13 we had reported? Wouldn’t they care if they knew our CFO, Andy Fastow, was personally profiting from these confusing off balance sheet financing structures to the tune of $40 million? The underlying accounting principles were ignored, and people rationalized by focusing on unique applications of complex accounting rules. It was a study of the trees, but please no one look at the overall forest.
Part of what came out when Congress subpoenaed both Enron and Enron’s counsel, Vinson & Elkins, was that Ken Lay’s first reaction after I alerted him to accounting irregularities was to look into firing me. One of the reasons given by Enron’s counsel for not firing me was that if I sued for wrongful dismissal, in the discovery process the nature of the transactions with Andy Fastow, the CFO, might become public, which would damage the company. That indicates Vinson & Elkins and Enron’s top executives knew they were violating securities law principles, but their focus was on rationalizing what they were doing by showing they had attempted to follow certain disclosure rules, albeit weakly.

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Is this a situation in which both individuals and Enron were benefiting from corrupt practices?

Yes, and I think in the case of individuals benefiting, if Enron was not paying outlandish salaries, bonuses, stock grants and advisory fees, the fraud would not have happened. Enron paid each board member $350,000 for 6–8 meetings a year. The highest director pay in the U.S. is about $150,000. $350,000 bought a lot of rationalization. That made the board members think, “Enron’s management is the smartest ever, so creative, so innovative, they’re wonderful, can do no wrong.” I think Enron also was one of Vinson & Elkins’ largest clients, 7–8% of their revenue. It was Andersen’s largest client, $52 million a year; $10 million a year went to consulting giant, McKinsey. Pay and bonuses were above market, including clerical staff. If Enron paid peanuts, I doubt the fraud would have happened because people focused on their compensation, their big bonuses, getting the stock price up. Employees become aligned with misdirected corporate values because of what it does for you personally. If Enron would have “nickel and dimed” Vinson & Elkins, I don’t think the lawyers would have lost their ethical path.

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From your perspective, were corrupt behaviors that mainly benefited the organization concentrated in specific areas of the organization, such as specific business units, geographic regions, or among specific managers?

Yes, the primary “corruption” occurred in the use of structured finance arrangements. There was a distinct group that included finance professionals from the CFO’s department and special accountants and in-house lawyers. A trading company like Enron (which at one point handled a large percentage of this country’s energy trading business) usually implodes from a trading scandal, a large speculative trading bet so to speak. Enron’s financial fraud happened in a very unusual area—the department tasked with raising debt.

I had previously worked for Metallgesellschaft AG whose operations in New York, where I worked, focused on commodity finance and energy trading. After joining Enron in 1993, Metallgesellschaft’s U.S. operations imploded with a $1.3 billion oil-trading scandal. At that time, Jeff Skilling was very worried that the scandal could hurt his business because his newly formed Enron division was also in the same business. He held a meeting to discuss Metallgesellschaft, and I recall a moment of seeing into the soul of Jeff Skilling. He really wanted to know how oil traders had destroyed MG. When I told him they had bet the farm because their management was desperate, his response was, “that’s not a good answer,” because he said, “we could become desperate one day too.” It was as if he knew that if he was in a pickle, he also might pressure the traders to bet the farm. So to prevent rogue trading from happening, back in 1993 he set up an army of control people around the trading operation with tight reins. In 1994, a trader hid a position, and was walked out by security guards the next day. The news rippled through the organization. It happened again about 6 years later when a new crop of traders had to relearn the company was dead serious about these controls. They could manipulate the California energy market, but they could not hide an Enron trading position, they could not speculate, they could not bet the farm.

But with Andy Fastow, Skilling never put the right controls around him because he was raising debt. You normally do not think raising debt is risky like speculative trading, but it was where they were manipulating earnings. I am answering your question rather long-windedly, but Andy and his finance professionals along with some very sharp accountants who reported to him in a struc-
tured finance accounting group, not in the accounting department, was where corruption was happening. It spread like a sexually transmitted disease. They would get wind that a highly profitable deal had been closed, and come knocking on your door to see if they could fit that deal into one of their off balance sheet structures. For example, take David Cox, an Enron Broadband executive who closed a big on-line movie distribution deal with Blockbuster, a deal that later was in the news because Enron booked $50 million of revenues from a deal that was basically exploratory and never had any actual revenues. David Cox, the deal maker, was never targeted by the Department of Justice. The person indicted and convicted was Kevin Howard from the structured finance accounting group because he promised the bank who was lending money toward the Blockbuster deal that they'd get their money back. That is how the corruption would spread. The structured finance department would hear about a really big dollar deal, and then come knocking on your door to move it into one of these off balance sheet entities that Fastow's team had created and in some cases, profited from.

In terms of corrupt behaviors that mainly benefited individuals, were they concentrated in specific parts of the organization, such as certain business units, geographic regions, or managers?

That's hard to say. Deals that benefited Enron also benefited individuals, and vice versa. I do think that some of the finance and accounting people reaped some large bonuses when they closed something like the Blockbuster structure. So to that extent, the big bonuses motivated people to make those things happen, I guess those behaviors were concentrated in the same structured finance group. There were other large deals like that. For example, an electric barge deal in Nigeria was sold to Merrill Lynch through one of these heavily structured finance transactions. In that deal, I believe bonuses of over a million dollars were paid to a number of Enron folks involved. The Department of Justice indicted both Enron and Merrill Lynch executives involved in that deal very early on in their case against Enron. Fastow and his team structured a few deals that benefited themselves in unique ways, but once again, in complex transactions approved by many others within the company because it also benefited Enron. Only one transaction among dozens, involving the close out of a NatWest position, benefited individuals at NatWest and Enron at the expense of the companies.

Were there organizational processes, structures or systems that you think may have contributed to corruption at Enron? For example, variable pay systems, information systems, hiring and selection systems?

We had a performance review process we called “rank and yank” in which the bottom 10–15% performers would be fired each year, and those just above that threshold knew they were at risk of losing their jobs. That process contributed to corruption because it forced people to focus on what they did for Enron lately, and because of that focus, smart people stopped asking questions. They could not get to the bottom of things that bothered them because they just did not have time. They were too focused and preoccupied with their own performance. And of course, when people worked on these creative, aggressive, fraudulent structures and were well paid, they happily participated a second and third time. There also were examples of what happened to people like Vince Kaminski, the head of Enron’s research and “value at risk” measurement department, who protested some of the accounting applications and approaches. His group then lost responsibilities, and he was pushed to the side. So when other Enron people saw that protesting got you punishment, of course that shuts people up.

Do you think there are any characteristics of the business or the industries that Enron was in that made it more susceptible to corrupt practices?

Well look at Arthur Andersen. In the end they became just as corrupt and you cannot call public accounting an arena that should foster corruption. Some people say, “energy and Texas mean corrupt practices.” But you also have Tyco, Adelphia, WorldCom, HealthSouth. One thing I think is interesting is that most of the frauds share the characteristic of being the big fish in a smaller financial pond so to speak. HealthSouth was a top dog in Birmingham, Alabama, and its CEO, Richard Scrushy spread the wealth around. He hired young people, paid them more than they ever thought they would make, promoted them faster than they thought they would be promoted, and spread all this corporate largesse around Birmingham. So did people start looking the other way because they just loved Scrushy and HealthSouth? Adelphia contributed to that small town where they were located in Pennsylvania. The Rigas family was well regarded. WorldCom, in Jackson Mississippi, that was a huge deal in Mississippi. Enron was a big deal here, even though Houston is the fourth
largest city, we’re not known for large international corporations. But Enron was a big deal here in Houston; the Astros played in Enron field. The New York region had its share of scandals also. ImClone was insider trading, and Tyco was focused on abusive CEO pay packages, and the board going along, so those weren’t the same kind of large-scale corruption as the others. But when you look at the Enron, HealthSouth, and WorldCom’s of the scandal era, it was like the story of the Emperor’s New Clothes: The town’s people were saying, “Oh, yes the emperor’s clothes look great” probably because the emperor was spreading wealth around. I think it is unusual that more of these frauds seemed to occur in these lesser known corporate headquarter locations.

In your opinion, what were the main reasons Enron had such a pervasive corruption problem?

I think it was basic greed. They were throwing money around, so people were looking the other way. It was just a great client to have, so their accountants and lawyers and bankers would do what they wanted. And as I mentioned, they would pay such high bonuses, and stock options, that people would focus on what they could do to keep that going. I think Enron happened because of the money it was throwing around, and the way that fed people’s greed.

Another reason was Skilling’s leadership. He was charismatic and intimidating. He was very hypnotic, and convincing. He is sharp and could sell anything. If you were going to ask a bunch of questions, he would intimidate you and make you feel you were not smart enough to get it. You are either in our smart guy club or not. That is how he suckered people in. “Ah! You are smart like me.” That was the message. One thing I learned through all of this is that individual leadership matters more than I would have ever thought. I think if you take Skilling out of the picture, Enron would not have happened. Even if you leave Skilling in the picture, but you have Rich Kinder, Enron’s former COO, never leaving the company, the Enron fraud would not have happened. Kinder was an amazing COO, not charismatic in anyway. Incredibly sharp. He knew the right questions to ask to expose any potential wrong doing. I saw it happen over and over again in quarterly business reviews. If someone was putting fluff in their numbers, making promises that were not likely to come true, somehow he had an ability to decipher that and ask the right question to expose the fluff. He is an ethical person. I think he would have not allowed Fastow to do what he did. But without Skilling in the picture, I think it would have never happened, even with Fastow there. So I think Skilling’s leadership was key, and the whole mess probably boils down to the leadership of one or two people.

Let’s talk about Enron’s culture. A strong organizational culture can be described as one in which a core set of values are intensely held and widely shared by people in the organization. According to this definition would you say Enron had a strong culture, and if so can you describe it?

Enron certainly had a strong culture. But our stated values of respect, integrity, communication, and excellence (RICE) did not describe that culture. In a little book called Naming Elephants, Sue Hammond and Andrea Mayfield talk about the Columbia Shuttle explosion and the fall of Enron, and juxtapose NASA and Enron’s stated and real values. NASA’s stated value was “Safety first, anyone can kill a mission if they have a safety concern.” The real value, the elephant in the room, was “you better not bring up a safety concern unless you can prove it.” With Enron, they go through detailed stated values such as, “arrogance and ruthlessness have no place here,” then describe the real value, “smart people are expected to be arrogant and ruthless.” Also, “honesty and integrity is how we deal with all of our customers. When we say we do something, you know, we are going to do it.” But the real value is, “unless of course it is more profitable for us to change our mind and then we will.” What they say about Enron in their little book is accurate. This is a great question because once you have the wrong culture it is really hard to change it. NASA should have learned from the Challenger explosion, but did not because their unspoken culture, “you better not bring up safety concerns,” was firmly in place. At Enron, we had a firm culture in place that emphasized making earnings targets no matter what, and I don’t think any one person could have changed that culture.

Organizational cultures can be created or sustained by hiring the “right people” who already hold the organization’s values, or by formally or informally training people to adopt those values. You described some of Enron’s values. Do you think Enron relied more on hiring the “right people,” or on training people to adhere to their values?

I think the sad fact is that everyone thinks they are a good moral person and that they would do the
good moral thing, but as that classic Milgram shock experiment at Yale showed, we are all vulnerable to immoral behavior. It is the same with Phillip Zimbardo’s Stanford prison experiment. I have met him at some conferences. He points out we all think there are good people and evil people, but unfortunately, we can all do great evil. The Lord of the Flies gives a literary example where boys stranded on an island become brutal savages. That is what ends up happening. You get caught up in the heat of the moment, and before you know it, you have done immoral things.

At Enron I recall a woman named Cassandra who worked in the accounting department. Hers is one of those untold stories that happened probably more than I was aware of. She was told we had raised some debt on a Brazilian asset called Firefox, and that she needed to get all the Firefox documents and do the same thing for another asset. She finished the project and went to Rick Causey, the chief accounting officer, and told him we have to disclose this on the balance sheet. She says “it’s clear according to rules X, Y, and Z, and generally accepted accounting principles state this needs to be disclosed, and I am really surprised you did not disclose Firefox. It should be disclosed too.” So when it was made that black and white, Causey had to disclose both transactions. Within the next couple of months she is told, “Cassandra, we have been so impressed with your work, we would like to move you into the control and risk management arena. In fact, we would like for you to be in charge of A, B, and C.” So they describe the move like it’s a promotion out of accounting and into the control and risk department. Within 6 months she is getting less than satisfactory performance reviews and being told, “I am shocked you are a VP. You are not doing VP level work at all.” So she frantically begins searching for a job because all of a sudden it seems her future at Enron is in jeopardy. Now look how subtle that was. She never had a confrontation. No one ever said, “Oh, Cassandra don’t be so black and white, you know, about these rules.” She just spoke in such black and white terms that they had to disclose the transactions. But the next thing you know she is being shoved out. There were plenty of people who would just go along and not point out the rules. They would say, “OK, we didn’t disclose Firefox, so I’ll make sure we aren’t going to disclose this one too.” They ended up getting promotions and big bonuses, while Cassandra gets forced out. So I think that’s how values were sustained at Enron. Bad behavior was subtly rewarded, and good behavior was punished.

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What advice would you offer business students who may be thinking about the kind of organizational culture they may want to work in?

I try to help students realize they have got to be conscious about where they are now, and where they are heading because I know a lot of good people who are now felons. These people did not start their careers intending to become felons, but that’s where they ended up because they were slowly corrupted by their surroundings.

I was speaking to a large group of students at a university, and an accounting professor sharing the podium and panel discussion with me did an incredible demonstration. He asked the class, “How many of you would do what Ms. Watkins did, faced with the same situation?” All the hands in the room went up. I could tell this kind of ticked him off, so he asked, “Alright, we have an honor code policy here at this university. No cheating. How many of you, if you saw a fellow student cheating, would turn him or her in?” Two hands went up in a room of about 400. He then said, “These are the only two that would do what Ms. Watkins did. The rest of you would not.” You should have just seen the looks on their faces, but he was probably right. They viewed turning in cheating classmates as being a horrible tattle teller, but the point is that cheating hurts the university, and it hurts you. The context you’re in can be a powerful influence on whether you view something to be right or wrong.

That classic Milgram shock experiment is an

1 Experiments done by psychologist Stanley Milgram (1963) showed subjects can violate their own moral code in order to obey an authority figure. Under the guise of an experiment on learning, most subjects gave increasingly severe electric shocks to a “learner” who answered a question incorrectly, and when ordered to do so by a “scientist” who told them they would not be held responsible. The “learner” was actually a tape-recorded actor.

2 In 1971, psychologist Philip Zimbardo did an experiment at Stanford University to study the development of norms in a simulated prison environment. Normal, emotionally stable male college student subjects were randomly assigned as prisoners or guards in a makeshift prison in a laboratory basement. The 2-week experiment was cancelled after 6 days because “guards became sadistic” and “prisoners became depressed and showed signs of extreme stress” (http://www.stanfordprisonexperiment.org).
interesting example of this because it was done at Yale, with an authority figure in a lab coat, with lots of rules, disguised as something good—helping improve the person’s memory. It just shows you how we will follow rules, will follow authority, if it is cloaked with something good. It is very alarming. Evil becomes good, and good becomes evil. For students in particular, they do not understand that they are capable of doing things that are wrong. It’s critical for them to start their careers fully aware that they are capable of unethical behaviors, so they can safeguard against it.

You have mentioned some of Enron’s aggressive business practices, such as early recognition of revenue or finding loopholes that allowed them to violate principles without breaking rules. To what extent do you think employees more generally were aware of such practices?

Employees in the energy trading divisions, Enron Capital and Trade, Enron Wholesale and Enron Energy Services, were very aware of aggressive accounting techniques. I don’t think many employees of the regulated pipeline, electric utility, or international operations were aware of how risky Enron’s accounting was.

During the California energy crisis in 2000, there also were rumors we were manipulating the California energy market. So Enron went on a campaign. The head of our government regulatory group had a presentation he would give called, “California: Myths Versus Facts.” One of his points was California did not build enough power plants.

It is their problem because they are not deregulating appropriately. So the “myth” was California is being ripped off by Enron, but the “fact” was Enron’s name is being damaged, and we need to get our good name back. So as an employee you are wondering if we are doing something shady over there or not. There was so much spin going on internally, it was difficult for most people at Enron to know exactly what was happening.

I never looked at the financial statements in too much detail during the majority of my 8 years at Enron. I did not really look at footnotes until I suspected something, and then I began looking in detail. I do not think employees looked at their own division’s financial statements in great detail. Employees could be “spun” as much as investors at times.

One thing I wanted to mention is that most employees in Jeff Skilling’s world, the Enron Capital and Trade Group, saw enough aggressive accounting that they did not keep most or any of their 401(k) money in Enron stock. But the people who were in the traditional regulated gas and electric businesses, such as the gas pipeline business, or Portland General Electric, those poor folks thought they were working for a low-risk regulated business; hence, many had all their 401(k) money in Enron stock and lost it all. That is a shame because those employees had no idea Enron had adopted very risky accounting and finance practices. It’s the same with Arthur Andersen: The Houston office and some in the Standards Practice department of Andersen knew Enron, the firm’s largest client, was engaged in very risky accounting, but the vast majority of Andersen employees, partners, and retired partners had no idea the firm was involved with such shady accounting practices.

Other than yourself and the other few examples you mentioned, are you aware of any other examples of people, who quit, who were fired, or decided they would not take jobs with Enron because of how Enron was doing business?

Certainly the Cassandra and Vince Kaminski stories I mentioned. Also Jeff McMahon. His story is unique. He straddles the fence between ethical and unethical behavior. He protested to Skilling about the Andy Fastow off balance sheet financing deals. Skilling then moved him to be chief commercial officer of Enron Networks, which looked like he was being pushed out. McMahon ended up circling back and heading up a new group called Enron Industrial Markets. But I heard people say that was a Machiavellian move by Skilling. McMahon was a talented guy, you see him protest what Skilling is allowing Fastow to do. He then gets dangled over a cliff until he decides, “I don’t want to be fired, I give in,” then he can come back here to Enron Industrial Markets. I think McMahon was corrupted by that threat. It also sent people the message, “Don’t protest the Andy Fastow stuff, look what happened to Jeff McMahon.” So all Skilling or others had to do is punish a few key people and the rest of the employees realize, “Oh! Don’t raise objections.” It just takes one or two to silence everyone else. Not too many people are going to fall on their sword and take the fall because they have retirement coming up, or mortgages and so on.

What questions do you suggest business students ask when considering whether they should work for a potential employer?

There are two questions that I think are important for people to ask when deciding if they should work for a new employer or keep working for an employer. Fortune Magazine published one of the
questions in a 10/27/2003 article called, “Ten Questions Every Board Member Should Ask.” The first question is, “How does bad news get to the top?” I think that is very important, how does bad news get to the top and then how is it dealt with?

A second question is, “Does the company have a zero tolerance policy for internal control violators?” I cannot stress enough that internal control systems cannot be perfectly bulletproof. Perfect controls will not pass any cost–benefit analysis. Herb Kelleher, CEO of Southwest Airlines, once pointed out it makes no sense to install a $1 million information system to prevent $18,000 in annual ticket thefts. So internal controls are not meant to be bulletproof, but are meant to identify ethically challenged employees so you can get rid of them. I think if you are at a company where you see star performers can violate the system and are allowed to stay, you should get out. Bad stuff is going to happen. When the value system is that eroded, you know the company is going in the wrong direction.

In what ways can management education help minimize the possibility that another Enron will happen?

I do not think management education will change an unethical student. Students who get away with cheating and gaming the system will continue to do so until they have severe consequences. So I think universities ought to adopt a no tolerance policy on cheating. If it is discovered that someone accepted to the university lied on the application, they ought to be dismissed from the university. If they plagiarize, they ought to be kicked out of the university. Universities need a zero tolerance policy that says, “We don’t graduate an ethically challenged student.” I think that is very important, but that isn’t where most of the effort should go. I think the focus needs to be on the majority of students, who really want to be ethical. You need to provide them an expansive tool kit that helps them recognize the warning signs we’ve been discussing. For example, help them learn they are capable of rationalizing unethical behavior. Help them learn to discern if the top guy is ethical, and if he is not ethical, there is a problem. If star performers can violate the internal control system and get away with it, or are given a second chance, then that is a problem. You need to highlight the warning signs of how to recognize a potential Enron or WorldCom. You need to really stress that the stories of people who come out of scandals like Enron relatively unscathed, with millions in the bank, are a handful of people out of 8000 employees in the Houston office. People who believe, “I’ll be like John Arnold who made $8 million at Enron and now runs a multibillion dollar hedge fund,” will really end up being one of the 8000 left holding the bag.

I think they also need a tool kit to help them navigate through unethical situations. “Uh oh! I am in the middle of it now, what do I do? How can I develop and tap into helpful peer support? How do I decipher the right path, what do I do in an unethical situation?” The government accountability office has set up a website, www.whistleblower.org that provides guidelines and support for potential whistleblowers, and is a good educational resource for such situations. They have a set of questions you can use to assess if you should raise the alarm or not. I think students ought to become familiar with that resource. A college campus is such a safe haven, but the workplace is not like a college campus. Perhaps it would be helpful even to have a support hotline for people who have questions about ethics in their work settings. You are out there in the working world, really bothered by something, you know, here’s the office to call. I think students need to learn the subtlety of how unethical behavior can take hold of you. You are never asked to do something right or wrong. It is more subtle. Given a clear choice to cheat and lie or not, you don’t cheat and lie. It’s a slow process that can corrupt you over time. You’re working on creative financial structures, then aggressive structures, and finally fraudulent structures. Then you are too deep in it and people realize, “Oh my goodness, look at this and we just bought the big house. I can’t quit now.” People get sucked into fraudulent behaviors because they get into situations where they feel like they can’t quit.

For me personally, this is why I rely on my spiritual beliefs. My faith provides me a clear sense of what doing the right thing means and of the principles I need to follow. I think that helps a person make hard decisions that need to be made. People
can have different spiritual beliefs or even no spiritual beliefs, but it is important for people to know what they believe and why, and to have a clear set of principles that will guide them to do what's ethical. Enron showed you can always find loopholes no matter how detailed the rules are. Rules can always be broken because you can always find people smart enough to find the loopholes, like Enron did. But if you're driven by principles that guide your sense of right and wrong, you'll focus on the intent of the rules, and not on finding all the loopholes. I think students who understand this will have their moral compasses pointed in the right direction.

ORGANIZATIONAL-LEVEL CORRUPTION CONTAGION

Our interview with Ms. Watkins suggests Enron manifested both CO and OCI forms of organizational-level corruption, driven by three major factors: (1) extreme performance pressure, (2) leadership style, and (3) exploitation of structural opportunities for corruption.

First, the tight coupling of job security and compensation with financially reported results through the performance management system created a perfect storm of corruption at Enron. Extreme performance pressure is a key antecedent to organizational corruption (Pinto et al., 2008; Schweitzer, Ordonez, & Douma, 2004). According to Ms. Watkins, Enron's “rank and yank” performance review process created such extreme performance pressure, including an “ends justify the means” approach whereby perpetrators and innovators of corrupt practices were rewarded with large bonuses. Moreover, relative underperformers’ (those just above the acceptable performance threshold) focus was diverted toward keeping their own jobs, thereby reducing the likelihood that they would notice or question financial anomalies. Large bonuses in turn fueled personal greed and lifestyle pressure (e.g., “we just bought the big house”), which further encouraged corruption through a destructive feedback loop (Andersson & Pearson, 1999; Voyer, 1994).

Second, leadership style also contributed to the organizational-level corruption. In a classic example of the dark side of leadership (Conger, 1990), Ms. Watkins describes Skilling as charismatic, intimidating, hypnotic, and convincing, some of the very qualities that one might consider hallmarks of effective leadership. In her opinion, Skilling’s leadership facilitated corruption since, if former COO Rich Kinder had remained with the firm, the “Enron fraud would not have happened,” due to his ability to “ask the right question to expose the fluff” in financial results. In contrast, Skilling’s “leadership” produced a disastrous outcome for the organization. In our classes on leadership we would do well to stress the moral “boundary conditions” of leadership theories—effective leadership can build corrupt organizations when corrupt practices go unquestioned by leaders, or their followers.

Third, Ms. Watkins also described how Enron executives exploited both internal and external structural opportunities for corruption. Internally, the structured financial accounting department created opportunities for corruption through structural secrecy, which refers to the way division of labor, hierarchy, and specialization segregate knowledge about tasks and goals, facilitating the incidence of corrupt behavior (Vaughan, 1996). Members of this department possessed technical expertise that enabled them to find and exploit regulatory loopholes, while disregarding underlying accounting principles. Their expertise, combined with Enron’s extreme performance pressure motivated its department members to exploit internal structural opportunities for corruption.

Corrupt practices also were evident in Enron’s relationships with its external environment, including regulators (i.e., auditors); advisors (e.g., attorneys, consultants); and the regional community (i.e., the city of Houston). According to resource dependency theory, the power of one party over the other is contingent on the extent to which one party controls the resources needed by the other (Pfeffer & Salancik, 1978). External structural opportunities were exploited in an application of resource dependence theory: Enron “captured” its regulators and advisors by rendering them “dependent” on lucrative contracts (Szwajkowski, 1985; Pinto et al., 2008). As Ms. Watkins put it “if Enron would have nickled and dimed Vinson & Elkins, the lawyers would not have lost their ethical path.” Ms. Watkins also suggests “a big fish in a small pond” syndrome may have occurred with regard to geographical location whereby the surrounding community became so indebted to Enron’s corporate resources (e.g., employment, local philanthropy), that people may have “looked the other way.” Although Houston is a relatively large city, Enron played a highly visible role in the local economy (e.g., Enron Field was home of the Houston Astros). This type of constraint absorption (Casciaro & Pisikorski, 2005) has not been investigated in the academic literature and perhaps should be. Cases in which local communities are highly dependent on large corporations are common (e.g., PNC Bank in Pittsburgh, Procter & Gamble in Cincinnati, Walmart in Bentonville). Although such situations may not necessarily result in organizational corruption,
they may inure organizational and community members from noticing and resisting it.

Having illustrated some of the antecedents of corruption that have been well-documented in the literature (e.g., Finney & Lesieur, 1982; Hill, Kelley, Agle, Hitt, & Hoskisson, 1992), we now draw on Ms. Watkins’ insight to provide examples of recent theorizing on normalization (Ashforth & Anand, 2003) and institutionalization (Brief, Buttram, & Dukerich, 2001) of corruption actually played out.

Contagion Mechanisms

The mechanisms that lead to the contagion of corrupt behavior are a subset of general social influence mechanisms that have been studied from cognitive, emotional, social–psychological, and network perspectives (Pinto et al., 2008). These contagion mechanisms are key to the normalization and institutionalization of organizational corruption (Ashforth & Anand, 2003; Brief et al., 2001), as was the case in Enron.

Cognitive Mechanisms

Cognitive mechanisms include implicit sanctioning, sense-making, and selective attention (Brief et al., 2001; Gioia & Thomas, 1996; Pinto et al., 2008; Weick, 1993). As described by Ms. Watkins elsewhere (Watkins, 2003a,b), a form of implicit sanctioning (Brief et al., 2001; Pinto et al., 2008) appears to have been at work when Andy Fastow could justify his own corrupt behavior by taking a cue from Chairman Ken Lay who channeled millions of Enron travel dollars through his (Lay’s) sister’s subpar travel agency. Sense-making occurs in organizations when members confront events, issues, and actions that are somehow surprising or confusing (Gioia & Thomas, 1996; Pinto et al., 2008; Weick, 1993). Ms. Watkins offers two examples of how sense-making in response to organizational cues played out: (1) “Okay we didn’t disclose Fire-fox, so I’ll make sure we aren’t going to disclose this one too.” (2) When other Enron people saw that protesting got Vince Kaminski punished, they shut up. Selective attention is a cognitive bias that many employees collectively seemed to have experienced by focusing on unique applications of complex accounting rules—to the exclusion of fundamental accounting principles. In Ms. Watkins’ words, “study the trees, but please no one look at the overall forest.” Selective attention also appears to have been occurring as a result of the “rank and yank” system, which “forced people to focus on . . . their own performance,” to the point where they “stopped asking questions” about issues that may have “bothered” them from an ethical standpoint. These examples of cognitive contagion mechanisms can alert management educators and students to “the warning signs of rationalization and ethical anesthetica” (Hartman, 2006: 78).

Emotional Mechanisms

Scholars have theorized about the role of anger or resentment in reaction to injustice as emotional conduits for corruption to spread (Andersson & Pearson, 1999; DeGoey, 2000; Williams & Dutton, 1999). At Enron, fear appears to have been an emotion that may have generated and sustained corrupt practices. Some Enron employees may have been too afraid of Jeff Skilling’s intimidating leadership style to raise questions. In other cases, employees may have feared the fact that “protesting got you punishment” (e.g., Kaminski, McMahon). The “rank and yank” performance management system also provided impetus for managers to be in continual fear of losing their jobs. As we will argue later, the role of courage (e.g., Downs, 2000; Hornstein, 1986) in counteracting these syndromes is vital. Elsewhere, Ms. Watkins also suggests positive emotions may have contributed to the spread of corruption at Enron (Watkins, 2003a: 122). She likens corrupt corporate behavior to carnival time in Rio de Janeiro, where, once you put on your mask for the celebration, all sorts of racy behavior is acceptable.

Social–Psychological Mechanisms

According to Ms. Watkins, one was either in Skilling’s smart guy club, or not. This in-group/out-group distinction created social pressures to follow along with Skilling and Fastow’s aggressive accounting practices. Her observation corroborates with the psychological phenomenon of social identification described as “the perception of oneness with, or belongingness to some human aggregate” (Ashforth & Mael, 1989: 22; Williams & Dutton, 1999). Management educators should stress that “fitting in” may build group cohesion and commitment, but it can also trump individual values and moral discernment. Compromising one’s values should never be the ticket to in-group membership. It is up to the individual to decide whether he or she would like to belong to the in-group, be it the organization itself, or a corrupt subset of it.

Network Mechanisms

Prior to bankruptcy, Enron reported revenue of $111 billion in 2000 and employed about 21,000 people (McLean & Elkind, 2003) across divisions such as
electricity, natural gas, pulp and paper, and communications. In such a large, divisionalized organization, the role of intraorganizational networks in the spread of corruption would seem almost inevitable. Although Ms. Watkins did not describe network structures in detail, it is clear that the structured finance accounting group was a core of corrupt accounting practices. Deal makers in this group would identify opportunities for paper profits by tapping their internal relationships to “get wind that a highly profitable deal had been closed.” The interorganizational networks of organizational action sets (Baker & Faulkner, 1993) comprising Enron’s “accountants, and lawyers, and bankers” helped create a veneer of legitimacy for the corrupt practices. While management educators typically emphasize the positive aspects of social networks, the dark side of networks as mechanisms for carrying out and sustaining corrupt practices also should be highlighted.

A 4P APPROACH TO RESISTING CORRUPTION

Ms. Watkins suggests management educators should provide tools to help prepare students for the ethical challenges they inevitably will face in their organizations. Drawing on Ms. Watkins’ insights and our prior discussion we propose a “4P” approach that comprises four steps (perceive, probe, protest, persist), on a continuum of increasing resistance to corrupt practices. The continuum begins with developing one’s awareness of the possibilities for such practices, to verification that corruption actually is occurring, to actions aimed at resisting corrupt practice. This “4P” approach is intended to help equip management students and practitioners to resist or prevent organizational corruption.

Perceive

What managers and executives perceive influences their actions (Hambrick & Mason, 1984; Thomas, Clark, & Gioia, 1993; Waller, Huber, & Glick, 1995). In this context, the role of mindfulness is relevant. Langer (1989) defines mindfulness as a state of active awareness characterized by the continual creation and refinement of categories, an openness to new information, and a willingness to view contexts from multiple perspectives. Mindfulness requires two basic elements: attentiveness to one’s context, and the capacity to respond to unanticipated cues or signals from one’s context (Levinthal & Rerup, 2006). Being perceptive that corruption could occur in an organization is a function of the first element of mindfulness, that is attentiveness to one’s context.

While some employees may become aware of wrong-doing as part of their jobs, others may need to have their curiosity piqued. It is worrisome that “employees could be ‘spun’ as much as investors at times.” We should help our students explore the question, “When is suspicion of corruption warranted?” An obvious answer is “when something seems too good to be true, it probably is!” Our graduates have a responsibility to themselves and to the training they have received, to look askance at situations in which their organization appears to be prospering without a clear understanding of how or why. This is not easy. Some employees may have less access than others to important details of a business. Ms. Watkins provides the example of employees in Enron’s traditional regulated businesses who viewed their employer as a stable utility company. In her opinion, it may have been impossible for them to perceive what was occurring. Nonetheless, any employee could have asked, “how does Enron really make money?” Asking such questions in a state of mindfulness could be a useful tactic for perceiving whether corruption may be occurring in an organization.

Probe

Once a person perceives corruption might be occurring in an organization, the next step is to probe whether such corruption is actually occurring. Establishing for oneself that corrupt practices are being undertaken by one’s organization is the key basis for subsequent actions. The literature emphasizes the need for accuracy and fairness in judgment as prerequisites to whistle-blowing (e.g., Bok, 1980; Gundlach, Douglas, & Martinko, 2003). Individuals mentioned in the interview such as Cassandra, Kaminski, and McMahon, probed the situation sufficiently to ascertain that their suspicions were well-founded and that corrupt practices were almost certainly occurring. Most people would conduct such “due diligence” when they find themselves at the bad end of the deal. Yet sharing in the gains, as many Enron employees did, makes it more difficult to notice. Moreover, even perceptive employees who ask probing questions about the operating environment may not be able to establish for themselves whether fraud is being committed. Fastow and the structured financial accounting group perpetrated fraudulent practices by weaving an intricate web of legal structures. This created a veneer of legitimacy that...
concealed corruption from the cursory eye. The implication of this is that students and managers should have both a strong understanding of business fundamentals and accounting principles, and sharp analytical skills that can cut to the heart of business practices. Employees who become aware of a fraud being perpetrated can spread awareness of it, anonymously if necessary, throughout the organization. This would greatly increase the probability that someone with the ability and willingness to blow the whistle (i.e., protest and persist) would emerge.

Protest

Once the potential whistle-blower has probed the situation to confirm the prevalence of corrupt practices, the personal and organizational costs of protesting must be faced. A few inevitable moral questions with regard to protesting that should be addressed, include: (1) Is speaking out in the public interest? (2) Does the public interest outweigh one’s responsibility to colleagues and the organization? (3) To what extent will one’s personal life be unjustly impaired as a consequence? (Bok, 1980). This is consistent with Gundlach et al.’s (2003) theoretical model on whistle-blowing that addresses cognitive aspects (i.e., the cost–benefit analysis of blowing the whistle) and emotional aspects (anger, resentment, and fear). Whistle-blowers also may become unemployed, and/or stigmatized (Wiesenfeld, Wurthmann, & Hambrick, 2004).

Yet, despite the challenges of protesting, the alternatives could be worse. One may underestimate the personal costs of doing nothing, and overweight the financial benefits of participating. Doing nothing may result in organizational failure or even death since “you cannot fool all the people all of the time” (Tonge, Greer, & Lawton, 2003). Waiting too long to protest also has consequences. As Ms. Watkins has said elsewhere (2003b), “in hindsight, my efforts were probably too little too late.” Thus action needs to be taken in a timely fashion, and even if some individuals may be punished, other stakeholders should benefit. As Ms. Watkins’ notes, “in the long run, companies rarely get away with cooking the books” (Watkins, 2003b). Emphasizing long-term financial performance over short-term, quarterly earnings is an important source of perspective. Furthermore, firms that adhere to principles of ethical conduct in their financial reporting and dealings with stakeholders tend to have higher financial performance (Verschoor, 1998). In other words, good ethics can be good for business.

Persist

Considering the various barriers that impair one’s motivation to even raise the alarm, it is understandable if protesting has appeared to be unsuccessful, a person may decide to either quit the organization (Hirschman, 1970), or succumb to pressure by ignoring or conforming to corrupt practice. Ms. Watkins’ example of Jeff McMahon exemplifies someone who viewed the costs of being demoted as greater than the benefits of persisting in what he recognized as corrupt practice. Given that “can implies ought” (Koehn, 2005), how can people be motivated to persist in their resistance when the costs are so high? Three tactics should help energize individuals to persist in their resistance.

First, Ms. Watkins has stated elsewhere that “I should have found a few more people to go with me [to blow the whistle to Ken Lay] because then they could not have dismissed me as one lone person” (Erisman & Beenen, 2007). Building coalitions is a classic technique for mobilizing change (Kotter, 1996). Considering the individualistic orientation of business students, perhaps the power of forming coalitions is not sufficiently emphasized, particularly in delicate situations like these.

A second tactic to resist corruption is to exercise integrity by reflecting on and remaining true to one’s own ethical standards. Ms. Watkins credits her own spiritual beliefs as a moral beacon that provided her “a clear sense of what doing the right thing means,” regardless of the countervailing norms in her immediate environment. Recent research supports her position. A survey of 473 business students found a significant relationship between degree of religiousness and attitudes toward the economic and ethical components of corporate social responsibility (Angelides & Ibrahim, 2004). Nevertheless, simply having spiritual or moral beliefs is no guarantee that one will persist in resistance to corruption. Enron’s founder and former CEO, Ken Lay, an avid church member, spoke openly about how his own religious beliefs motivated him to make Enron a place where people were encouraged to fulfill their spiritual potentials (Novak, 1996). One must be aware of the potential for justifying unethical behavior with religious language.

Finally, courage has recently become a focus of some management scholars (e.g., Downs, 2000; Hornstein, 1986; Klein & Napier, 2003) as a tactic for enabling people to be true to their ethical values. Sanchez (2004) states that courage is in short supply in today’s workplace, with people tending to go with the flow, or going along to get along. Since most business students aspire to leadership positions, courage needs to be emphasized as an es-
sential component of leadership (Harle, 2005; Stefano & Wasylyshyn, 2005). In circumstances where forming a coalition is not feasible, courage is likely a necessary condition for protesting and persisting in one’s resistance to corrupt practices. As with the preceding three stages (perceive, probe, protest), exercising courage is not easy. Successful acts of managerial courage are not uniformly or frequently rewarded, and unsuccessful courageous acts are usually punished (Hornstein, 1986).

In sum, we have used a recent theoretical framework on organizational corruption (Pinto et al., 2008) as a basis for focusing our interview with Ms. Watkins. The interview explored some of the contagion mechanisms that may have facilitated the spread of corrupt practices at Enron. Drawing on Ms. Watkins’ insights and these mechanisms, we proposed a “4P” approach for resisting organizational corruption. Our hope is that this “4P” approach raises awareness of the seemingly innocuous mechanisms by which corruption can ensnare individuals and organizations, and with such awareness, a greater resolve to take corrective action.

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