Photograph by Steve Moors

Dirty and Clean Laundry

A new spate of books and reports puts corporate behavior on display — and enlivens the debate about business's purpose in society.

Knowledge Review
by Milton Moskowitz

Enron fooled a lot of people, including me. For two years in a row, 2000 and 2001, the former energy star made *Fortune* magazine's list of the "100 Best Companies to Work For." This list, which I codeveloped, is based on an annual survey of employees. Enron's employees were enthusiastic about working there, which is why the company made this list. I visited Enron shortly before it imploded, and I also failed to detect anything amiss.

Certainly, it is difficult for outsiders to understand the inner workings of a large corporation. Even astute insiders frequently don't see trouble coming, especially when the problems have to do with culture and behavior. Note that Enron's board of directors as the ship went under included Robert K. Jaedicke, former dean of the Stanford University business school, John A. Urquhart, former senior vice president of Industrial and Power Systems at General Electric, and Lord John Wakeham, former U.K. secretary of state for energy under Prime Minister Margaret Thatcher.

Today, nearly four years after Enron declared the largest bank-

Milton Moskowitz
(milton1996@aol.com) is senior editor of *Business and Society Review* and codeveloper of *Fortune* magazine's annual survey of the "100 Best Companies to Work For," produced with Robert Levering and the Great Place to Work Institute. He is the author of seven books, including *Everybody's Business* (Doubleday, 1990) and *The Global Marketplace* (Macmillan, 1987).

ruptcy in U.S. history, reverberations from this financial tremor are still being felt. We are being inundated with books, films, and essays dealing not just with ethical breaches and badly behaved executives but also with corporate social responsibility (CSR). Meanwhile, there has been a surge in comprehensive corporate reports on social performance from large, influential companies.

With corporate behavior increasingly on display, the rules of the game have changed. Corporations can't hide their actions or true natures, and some writers are using the dirty laundry of recent years to hold companies to a much higher ethical standard. Other books, chronicling the stories of implosion, suggest that human nature, as manifested in the character of the company's leaders, is the critical factor. And a few writers (including some who speak for companies) are articulating ethical standards for the private sector that could represent a significant change from the past.

Joel Bakan, author of *The Corporation: The Pathological Pursuit of Profit and Power* and an American on the faculty of the University of British Columbia's law school, believes he understands exactly what happened at Enron. He attributes the collapse to characteristics common to all corporations: "obsession with profits and share prices, greed, lack of concern for others, and a penchant for breaking legal rules." These characteristics, he says, are a direct result of the system in which corporations are legally bound to put profit ahead of all other goals.

In his book, published in 2004 simultaneously with the release of a documentary film (now available on DVD), Mr. Bakan argues that the corporation is constitutionally unable to act in the public interest. Only greatly expanded regulation by government can "[bring] corporations under democratic control and [ensure] that they respect the interests of citizens, communities, and the environment."

This is a viewpoint one might find compelling after dipping into three new books by seasoned investigative reporters that chronicle the travails of Enron and the Walt Disney Company. Two of them — *The Smartest Guys in the Room,* by *Fortune*'s Bethany McLean and Peter Elkind (there is also a movie of this one, available on DVD), and *Conspiracy of Fools: A True Story,* by Kurt Eichenwald of the *New York Times* — are blow-by-blow accounts of the Enron debacle. The third, *DisneyWar,* by James B. Stewart, charts the goings-on at Disney under the 20-year reign of CEO Michael D. Eisner. Mr. Stewart, who wrote *Den of Thieves, Blood Sport,* and *Heart of a Soldier,* is a former *Wall Street Journal* editor; he now holds the position of Bloomberg Professor of Business and Economic Journalism at Columbia University.

The authors interviewed hundreds of employees and ex-employees, and immersed themselves in massive numbers of documents disgorged as a result of regulatory actions, bankruptcy proceedings, criminal indictments, and — at Disney — ongoing litigation.

The stories, which are stupefying but not exaggerated, show the people running these companies behaving in mean, spiteful, petty, selfish, and childish ways. Although the egregious practices at Enron and the jealous infighting at Disney have been ventilated in the press, the devil is always in the details. These books are worth reading just to get the full force of the brazenness and cupidity that were allowed to grow like weeds in the corporate garden.

(Professor Bakan would say that these weeds are a natural growth.)

Andrew Fastow, the chief financial officer of Enron, set up off-the-books partnerships to do deals, primarily with Enron assets, hiding Enron's debts and making money for himself and his friends. He took home more than $60 million before he got caught! Jeffrey Skilling, an alumnus of Harvard Business School and of McKinsey, who joined Enron in 1990, was the brains behind the transformation of Enron from a natural gas pipeline operator into a company free of physical assets that traded natural gas future contracts the way Wall Street bankers traded bonds. The idea: Stop making things, do smart deals, and securitize everything not nailed down. In short order, Enron traders saw themselves as Masters of the Universe, as portrayed in Tom Wolfe's sendup of Wall Street, *Bonfire of the Vanities.*

Mr. Skilling once told a colleague: "I've thought about this a lot, and all that matters is money. You buy loyalty with money."

The blunt and arrogant Mr. Skilling was a hero to colleagues such as Lou Pai, a Chinese-born Enron trader with a typical take-no-prisoners attitude who indulged to excess. Married and the father of two, he was a devotee of strip clubs, invoicing his expenses from the clubs to Enron for years before Mr. Skilling told him to stop. Mr. Pai carted out so much money from Enron that he was able to buy a 77,500-acre ranch in southern Colorado.

Readers are likely to feel the same revulsion at corporations when they read *DisneyWar* as they did reading the Enron books. Mr. Stewart, who was a lawyer at the

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white-shoe New York–based law firm of Cravath, Swaine & Moore before becoming a writer, has a lawyerly way of marshaling facts and stories to make his narrative come alive. This is not an Enron-like story, though. Disney has a reputation to protect, built over decades, that Enron never had. Its customers and the public at large see everything it does: movies, television, publishing, or theme parks. And Disney's executives wrought destructive behaviors, which led not to the demise of the company, but rather to the ouster of the CEO, Mr. Eisner. Robert A. Iger, longtime head of the ABC network, which Disney owns, succeeds Mr. Eisner on October 1, 2005.

While chronicling Disney's growth and its achievements, Mr. Stewart takes us behind the scenes to describe how Mr. Eisner presided over a business rife with nasty arguments, backstabbing, politicking, spying, turf quarrels, lying, and belittling of co-workers. Mr. Stewart exposes a host of other brawls that are staggering in their frequency and ferocity. After reading this book, one comes away with the impression there isn't anyone Michael Eisner ever worked with to whom he did not first offer praise and promises, and, later, offense and insult. When Roy Disney, Walt's nephew, and his lawyer, Stanley Gold, brought Mr. Eisner to Disney, Mr. Eisner told his benefactors: "You got me this job. If I ever lose your confidence, let me know. I'll resign." Twenty years later, they were at loggerheads. Mr. Eisner booted Mr. Gold and Mr. Disney off the board. The two men retaliated with a successful campaign to get rid of Mr. Eisner. At the 2004 annual meeting, Mr. Eisner received a devastating no-confidence vote from 43 percent of shareholders and 73 percent of employees.

Mr. Eisner's ouster was never about financial performance, however. When he took over as CEO in 1984, Disney was close to being moribund, living on its past glory in animation and its two theme parks, Disneyland and Disney World. In 1983, the studio released only three films; annual revenue was $1.6 billion. In contrast, in 2004, Disney took in $30 billion. Its film library had grown from 158 titles to 900. The studio had won 140 Academy Awards. It owned ABC and cable channels like ESPN and the Disney Channel. It had Disney Resort Paris just outside the French capital. This book makes one wonder what Michael Eisner's behavior cost Disney shareholders, and how it constrained value creation opportunities.

Of course, the scandals and brazen behavior that rocked Wall Street and the business world globally in the first years of the 21st century hark back to the first stock market crash, in the 18th century, when the "South Sea bubble" marked the sudden rise and collapse of the artificially pumped-up stock price of a British trading company. Corruption and excess in business are recidivist. As a result, every generation has its watchdogs dedicated to exposing bad corporate behavior and thereby shaming companies into being better, and its regulations to keep wayward corporate behavior in check. (In the U.S., think Upton Sinclair, Ida Tarbell, Michael Moore, the Sherman Antitrust Act, and now Sarbanes-Oxley.)

That corporations can be forced, nudged, shamed, or pressured into being good and doing good has been a preoccupation of mine for 37 years. On the basis of my own experience, I agree with the arguments mounted in Steven

Lydenberg's *Corporations and the Public Interest* that suggest strategies for elevating corporate behavior through a mix of regulatory oversight and new voluntary standards and reporting systems.

In this slim book, Mr. Lydenberg traces the growth and impact of CSR and socially responsible investing (SRI) — both of which are inspired by the notion that public accountability leads to better corporate behavior. He also lays out a blueprint for a marketplace that rewards corporations for the pursuit of long-term wealth creation, which he describes as "the creation of value that will continue to benefit members of society even if the corporation was dissolved today."

In a variation of the Adam Smith dictum, Mr. Lydenberg calls his plan "guiding the invisible hand," meaning he does not advocate heavy government regulation, à la Joel Bakan. He calls for governments to set certain standards, such as requiring companies to disclose more data. He also expects stakeholders — consumers, investors, employees, and community groups — to play roles in making companies more accountable. Under his scenario, corporations would be compelled to:

- Address and minimize the public costs they incur before they declare private profits.
- Preserve and renew resources so that they remain available for future generations.
- Invest in stakeholder relations, including relations with stockholders.

Even though there are more opportunities today for companies to be both socially responsible and financially successful, social benefits are often manifest only in the long term — and may or may not be measurable in financial terms. Meanwhile, short-term financial measures are the ones that count in practice. I rarely see security analysts giving points to companies for their social responsibility initiatives.

But Mr. Lydenberg is hopeful that more analysts will start paying attention to nontraditional measures of performance, with longer time horizons. He himself has been responsible for the development of investment screens that evaluate a company's social performance. He has done this first as a founder of the research company Kinder, Lydenberg, Domini & Company, and now as chief investment officer of Domini Social Investments, manager of the Domini Social Index mutual fund.

Mr. Lydenberg's book gives thumbnail sketches of successful CSR initiatives, such as the Coalition for Environmentally Responsible Economies (CERES), a partnership of leading U.S. investment funds, public interest groups, and companies, and its offshoot, the Global Reporting Initiative (GRI), an international institution that promotes standards for corporate reporting of the environmental, social, and economic "triple bottom line." The author also presents compelling evidence that such standards are stimulating socially progressive and economically successful corporate actions.

As I was writing this review, two new examples of voluntary reporting surfaced — reinforcing Mr. Lydenberg's view (and my own) that public accountability is helping to change corporate behavior. For many years Nike has been the *bête noire* of activists who deplored the working conditions in contract plants, mostly in Asia, where virtually all Nike products are made. Nike at first stonewalled these protests, claiming that they were bringing badly needed jobs to developing countries. The company's 2004 "Corporate Responsibility Report" shows a complete about-face. Nike now has a strong code of conduct governing conditions in those plants, a comprehensive monitoring program, a grading system, and an internal compliance staff of 90 full-time employees who make spot-check visits. Detailed descriptions of noncompliance with Nike standards are presented in this year's report. For example, 25 to 50 percent of recent plant audits showed workers being paid below the legal minimum.

To create this report, Nike reached out to involve a committee of outsiders, including a labor union leader, the director of accountability at CERES, a labor rights consultant in the NGO field, and other social activists. At first, the company argued against releasing the names of specific factories because, it said, it would make operations too transparent to competitors, exposing sensitive information such as new product styles or production volume. But Nike now posts on its Web site the names and addresses of 731 contractors in 52 countries. Some 625,000 employees work in these factories — including 200,000 in 124 factories in China and 84,000 in 34 plants in Vietnam. (Rival Reebok already published a list of its footwear factories on its Web site.) In introducing the Nike report, founder and chairman Phil Knight even owns up to having made "a bumpy original response" to activists, "an error for which yours truly was responsible."

Corporate Behavior Resources

Works mentioned in this review.

Joel Bakan, *The Corporation: The Pathological Pursuit of Profit and Power* (Free Press, 2004), 240 pages, $25.00

Kurt Eichenwald, *Conspiracy of Fools: A True Story* (Broadway Books, 2005), 768 pages, $26.00

Steven Lydenberg, *Corporations and the Public Interest: Guiding the Invisible Hand* (Berrett-Koehler, 2005), 200 pages, $27.95

Bethany McLean and Peter Elkind, *The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron* (Portfolio, 2003), 464 pages, $26.95

James B. Stewart, *DisneyWar* (Simon & Schuster, 2005), 592 pages, $29.95

Great Place to Work Institute Inc.: www.greatplacetowork.com

2005 GE Corporate Citizenship Report: www.ge.com/en/citizenship/downloads/index.htm

Nike Corporate Responsibility Report FY '04: www.nike.com/nikebiz/nikebiz.jhtml?page=29&item=fy04

In May, General Electric — also considered a *bête noire* by many activists — issued the first citizenship report in its 127-year history. The report, called "Our Actions," runs 177 pages and discloses a wealth of information about GE activities related to governance, environment, health and safety, suppliers, community relations, customers, employees, compliance, globalization, investors, products, services, and the GRI.

Here are some things we learn: GE has a global network of 300 ombudspeople to whom employees can report integrity concerns without fear of retaliation; a total of 1,338 concerns were reported in 2004, resulting in 368 disciplinary actions, including 125 dismissals. Since 2002, GE has required that its suppliers "certify their compliance" with environmental, health, safety, and labor standards through on-site visits and audits. GE has terminated about 200 suppliers who failed to correct deficiencies. GE has decided not to pursue business opportunities in Myanmar because of a "history of human rights abuses."

It's stunning to see Nike pay attention to the wages being paid to workers in Chinese plants, and equally stunning to see GE concerned about a repressive regime in Myanmar. But these reports are not knee-jerk responses to activists. They set new standards for corporate social reporting and new benchmarks for performance. They are pragmatic management. GE's CEO, Jeffrey Immelt, talks about marrying "business opportunity with global need."

In the end, social responsibility reports are an attempt by large companies to take the high ground and persuade people that the harsh regulatory medicine prescribed by Joel Bakan is not necessary. Business leaders are certainly aware of how the recent scandals have undermined public confidence in corporations. They recognize that they have their company's reputation to protect and markets to grow, in a way that requires being accountable to more stakeholders. And there may also be personal motives. As a friend of mine says, "It's possible that Phil Knight and Jeffrey Immelt have decided that they don't want to look in the mirror every morning and see Fastow or Eisner looking back at them."

My own view is this: If General Electric can boycott Myanmar because of its human rights violations, then anything is possible. +

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