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The Enron/Andersen Collapse: Ongoing Implications for Executive M.B.A. Programs

David J. Springate

[This article is based on David Springate's presentation at the 2002 E.M.B.A. Council meeting in Keystone, Colorado, USA.]

Introduction

The premise of this article is that we can help develop leadership among the business men and women that are our executive students and, at the same time, serve society and the economy better if we move to modify Executive MBA programs given recent events. Given corporate and ethical lapses by some executives, our programs need some new emphasis, courses and exposures. Parts of our existing programs need tweaking. Further there is need for increased emphasis on judgment formation. I offer below some suggestions for doing this and, also, results of a quick look for changes recently instituted in Executive MBA programs.

The subject matter here relates to the failures of Enron and Andersen earlier last year. Both were large, well respected organizations. Both were the subjects of study and often pointed as role models in MBA programs. Enron was often portrayed as a high flying corporation that would lead others into the new economy while itself serving as a positive example of industrial transformation into a service provider and market maker. Andersen was a respected auditing firm

that had an illustrious history. It had served as an industry leader with the separation from Accenture. Its educational programs were widely known and emulated. The failure of these two firms, I believe, have unleashed a series of events that have serious implications for the programs we direct.

About a year ago, a second wave of corporate failures, bankruptcies, criminal charges and investigations occurred or were put into motion. The causes and specifics are often different but some examples include: the indictments for massive fraud at WorldCom, the bankruptcy of Global Crossing, the arrest of Dennis Kozlowsky and others at Tyco, the incident at Merrill Lynch that resulted in a \$100 million fine, the revelation that Citibank and other institutions made loans that arguably should not have been made to supposedly independent groups that were, in fact, controlled by Enron executives, and, finally, the charge, which was later substantiated, that some investment banks slanted their equity research recommendations to gain market share in banking. These are a selected sample, there were others. Some of these events have resulted in criminal prosecution. Others are under investigation.

Taken together the events of last year were, arguably, major reasons for the fall in the U.S. equities markets. Quite naturally, this value drop spread beyond this country. This economic setback lead to congressional investigations, the adoption of the Sarbanes-Oxley Act of 2002, and to increased penalties for proven criminal acts. It

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was especially hurtful to the stock markets and to parts of the economy that all the developments we speak of followed the dot com bust in 2000.

I have chosen to broaden my comments to reflect consequences of some of the above-mentioned events. Nevertheless, Enron and Andersen are at the center here. Without them the crisis of confidence would not have occurred.

Why Is This Important?

I believe that the issues now on the mind of the public will not easily go away. At the same time they offer an unparalleled opportunity for Executive MBA programs to better serve some of the many involved stakeholders. The issues are of major popular concern because circumstances in the USA, and indeed the world, have changed. Much of the country's population has a direct stake in the better functioning of capital markets in that over half of Americans directly own stock. Significantly there has been a rise in defined contribution plans as replacement for traditional pension plans. Defined contribution plans now cover approximately seventy percent of that part of the work force having a corporate pension plan. Just as importantly, we see a rapid rise in IRA plans, 529 plans for education, savings and the like. Social Security is projected to become proportionately less important over time in this country. The world, too, broadly speaking, has been moving toward increased reliance on equity markets to finance retirements and to serve as a development vehicle. As Americans, we have a real interest in keeping US markets attractive for inward bound private investment. Further, there have been substantial direct job losses at corporations as a result of executive actions that cannot be defended. Finally, the damage to our sense of living in an ethically directed country has been severe.

I believe these considerations mean the public has, and will continue to expect, indeed demand, a new standard of individual and

corporate conduct. I believe, we must be responsive to this and, in fact, can help lead it. MBA programs, it is often charged, have become too focused on bottom line results and have missed an opportunity to more useful educate their students to the legitimate needs of a community wider than shareholders. In this regard the name of Jeffrey Skilling, a graduate of the Harvard Business School and the ex-CEO of Enron, is often used make the point that executive values are sometimes not as high as they should be. The opportunity for us is to respond to these allegations by making sure our programs for executive students reflect a more complete inclusive agenda than personal aggrandizement or corporate value maximization at any cost. I would argue that if business schools and programs don't succeed in this we run the risk of being considered by many of the taxpayers, legislators and public actually as part of the problem, not part of the solution.

Not everyone would agree that the values we promote in our programs need change. Some finance professors and economists would insist economic value maximization is the only defensible corporate objective. This is arguable. Whatever our views, however, on the desirability of promoting change in the objective function of much university-taught finance, there are implications for action given the new laws and realities. It is these more general implications that I want to address. My issues fall into two categories. The first includes those subjects and topics that have no existing coverage in most programs and now need to be included. The second includes those areas where program modification may be called for.

Concerns Needing to Be Addressed in Most Executive M.B.A. Programs

As a first point, it seems clear that increased exposure is required to the importance of picking outside auditors and the importance of good audit trails. According to the new law

outside auditors of publicly held corporations will need to be rotated every five years. Given that auditing gets little coverage, a rebalancing of emphasis in our programs will be required. Sometimes choices of auditors should not be quickly made. How many more corporations using Andersen, if really motivated, could have found out that the Houston office seemed to push the partnership's policies around with impunity due to its importance in the revenue stream of Andersen? Increased comprehension of the internal procedures and workings of auditors would serve our students well. The same comment holds for the better understanding of audit trails and the importance of showing they are being properly constructed. Very few programs deal with these issues, yet every large board of director has an audit committee.

As a second point it seems obvious that corporate governance is now a hot issue and one that should be addressed in EMBA curricula. We traditionally do not include much coverage. Today's reality is that boards are both mandated and expected to become more involved with the companies they govern. Boards of directors have to be increasingly independent of the company's executive officers. Issues of interest to EMBA students include, first, the role and responsibilities of directors, and second how to fashion effective working relationships between active executives, the CEO and board members/committees. I suspect more responsive and responsible schools will soon modify their programs in these directions, if they haven't already.

Relatedly, it seems to me that the issue of setting executive compensation will move into EMBA programs of substance. The issue certainly cannot be said to be inconsequential if for no other reason than the publicity brought to the issue by Jack Welch of General Electric. Perceptions seem to count here. General Electric took back some compensation on the grounds that the accepted package seemed too

generous. What is proper? Can directors freely set the rate for top executives? Will stock options continue to be used given the movement to count their issue against income? Will European or Japanese standards of compensation (which are much less generous) become more widespread? I don't mean to presume the answers. I do mean to suggest, however, that the topic has moved beyond a simple "let the market decide" direction. At root, directors can be expected to become more acutely aware that they are dealing with an issue of tremendous importance. Employment contracts are likely to be increasingly visible and increasingly searched for evidence as to whether or not the board is responsibly carrying out its responsibilities. Our students need preparation for decisions they and the Compensation Committee are likely to make.

Finally, I believe that we have been remiss in the teaching of our programs to imply that those engaged in business administration are all admirable and honest folk. I believe that, collectively, we should make it more obvious that this is unlikely to be the case. I speak from experience. One of the major observations I made in the 80's while working in Switzerland and the USA on leaving academia was that individuals of questionable character do exist. An important question real to anyone in business is: With whom am I dealing? What are his/her standards? In all my years of teaching, case writing, and academic conferences, I have never seen this issue addressed or acknowledged. Perhaps there is a way to get such an issue raised in Executive MBA programs. Additionally, I feel that a reminder early in one's career of the importance of thinking about the later appearance of facts and decisions would be helpful. So would a reminder that many, not all, people later convicted believed, at the time of commission, that they were not doing anything wrong. Public hindsight can set higher standards of behavior than seemed required at the time.

Would first hand testimony on the part of convicted white collar felons help here?

Areas for Possible Modifications of Existing Curricula

I see five areas where modifications to existing programs might help achieve our new objectives. For the first, I return to the issue of stakeholder vs. shareholder focus. Although, as stated, it is often used as a guiding focus for finance texts and courses, I would suggest that a maximization of shareholder wealth focus is now insufficiently broad. Often shareholders can be ultimately hurt even if share values initially experience a great run-up in value. Global Crossing and Enron serve as cases in point. Further, the public has weighed-in here as a stakeholder. The recent doubling of criminal penalties for actions now defined as fraudulent clearly shows that higher-value-at-any-cost is a criterion unacceptable to the majority of our population. Gordon Gecko said in the film Wall Street, "Greed is good." The U.S. public does not agree. We should take heed and make sure this feeling is part of the exposure inherent in our EMBA programs.

I also believe ethics coverage in Executive MBA programs can be modified to include situations where decisions have to be made in the context of great pressures on earnings totals meeting expected levels. We know that executives have, increasingly, to deal with this issue. How do we help them become leaders in dealing responsibility with these pressures? I'm not sure I know. But I do feel that we could do more to bring ethical leadership on these points. If MBA programs have been responsible over the years, in some part, for the increased stature of business practitioners as professionals dealing in a vitally important arena, then I dare say our EMBA programs can successfully make the point that fully ethical decisions are required at certain times. By and large, we have made these points with respect to

employee safety, the environment, etc. But there is more to be done.

My third point, concerning the modification of most program curricula is that lobbying in Washington and elsewhere counts. Enron has shown this to be true beyond doubt. I believe we need courses on effective use of lobbyists at both federal and state levels. Further, our students need to fully understand how government works. Without such an understanding, relatively easily imparted, our students will not graduate as fully armed as they might be.

As a fourth point, I believe we can and should provide our students with better analytical, strategic and marketing skills. To cite a recent example, it seems a tragedy that so many telecom companies and equipment manufacturers mis-estimated the size of the final market for optical fiber and internet networks or felt that Global Crossing's stock values were justified. Literally billions of dollars in value and thousands of jobs have been lost. Might it have been possible for someone, somewhere to realize that an entire industry could continue to double in size every three months? Of course it would. To me, this proves my point for the need cited above. Its pedestrian but it's an implication that flows from recent experience. The lessons need to be captured in our programs.

Finally, I believe we need to help our classes realize that capital will become more expensive in the near future. It might be hard to believe this given recent low interest rates and low equity prices, but consider this: Bond ratings are more exacting, venture capital is much harder to get, and both international and domestic flows into equity markets are down. In fact lower stock prices imply a higher required rate of return. This is my point. Values are lower as a result and the required hurdle rate is higher.

Evidence from Surveys

I have argued that our Executive MBA programs should modify curriculum and should also address some implications of the events of Enron-Andersen and those that followed. Some cursory evidence is here presented. Apparently, there is a lot still to do but changes are underway and are increasingly noticeable.

Last September I looked at the website descriptions of leading fifty schools. I found that only two had addressed and described changes as a result of the issues here discussed. The changes were not in executive degree programs but in other programs. As a second measure in September, the one hundred twenty directors of Executive MBA programs belonging to the Executive MBA Council were surveyed by e-mail. None suggested modifications were underway.

In a more recent survey recently, I found that more significant changes are underway in MBA programs in about half the schools of management generally recognized as leaders. The changes noted go beyond curriculum into recruiting. Some schools are trying to attract degree candidates from non-traditional fields in the hopes of rounding each class with students more attuned to ethical considerations. Similarly, other schools are consciously trying to attract candidates who care as much about how they conduct themselves in the course of achieving success as they do about success itself. Still others perform background checks of verifying candidates' resumes or ask for submission of personal case studies detailing challenging ethical dilemmas faced.

With respect to curriculum and course structure, the most common change in MBA programs is to include more ethics coverage. This sometimes takes the form of workshops, games or orientation. Alternately, it might be in the form of leadership or ethics courses taught from an academic or professional center dealing

with ethics and corporate responsibility. Relatively few schools appear to have modified accounting or audit classes in response to the new needs, although without extensive syllabus checks it is not possible to make definitive statements in this regard.

What is significant is that while approximately half the fifty schools informally investigated have made modifications along the lines outlined above, it remains unclear (at least from website inspection) that EMBA programs have been differently treated. Specifically, my cursory inquiries found no evidence that EMBA programs are responding differently than conventional MBA programs and no apparent evidence that they are leading in the adoption of innovative responses. If true, this would be unfortunate. EMBA programs, generally speaking, have both the agility and the need to help lead management schools in making required structural and curricula changes in MBA programs. Certainly this holds in the case of corporate governance, ethics and leadership.

Conclusion

I believe we in executive education have the opportunity and responsibility to act now in response to the crisis of leadership, governance, and transparency that is upon our society and economy. If we do so in a responsible and collective manner we might achieve increased recognition as an industry. At a minimum, I urge individual leaders in executive education to consider how the programs they direct might be best changed. Our world really has changed in the last three years. To simply maintain that there will always be unfavorable events at times, and this is one such situation which will pass, is to ignore the clear necessity to act.