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The Demise of Arthur Andersen: Is Founder's Syndrome to Blame?

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What caused Andersen Company, a revered audit firm to fail? Most would argue that the Enron scandal caused the failure. However, this response is unsatisfactory as Enron only directly impacted one office of a worldwide firm. The paper posits that the seeds of the failure were planted long before 2000 in a little-studied phenomenon called "founders syndrome."

This paper proceeds as follows: we will next explore what is known about founder's syndrome and its symptoms. Next we will explore the outsized personality of Arthur E. Andersen and his influence on the firm that bore his name. We then look at the demise of the Accounting Firm renamed Andersen and, finally, examine the possible influence of founder's syndrome in the events that lead to the firm's ultimate failure.

FOUNDER'S SYNDROME

The literature on founder's syndrome is limited and often appears in books and practitioner publications. Ironically, the syndrome occurs most often as a result of success (Linsky, 2006). While it was originally reported in the nonprofit literature by Block and Rosenberg (2002), evidence of something like the syndrome can now be found in the for-profit literature (see for example Kelly, Athanassiou & Crittenden, 2000; Ogbonna & Harris, 2001: Nelson, 2003; Linsky, 2006; Donoher, 2009; Fern, Cardinal, & O'Neill, 2012).

Founders of any organization are special people. They deserve recognition because they not only had visionary ideas, but they were able to translate these ideas into organizational reality (Block & Rosenberg, 2002, Carver 1992). As Dym and Hutson (2005) discuss, the leadership style that is appropriate at the start of an organization's history may not be appropriate later in the life cycle of the organization. However, the "personal proclivities of founders compel them to retain high levels of control over organizational matters" (Miller & Simmons, 1992, p. 36). Founder-run organizations are often characterized by centralized decision-making processes. Sometimes these characteristics can outlive the actual founder of the organization. "Managerial references to a departed founder's legacy can still serve to focus, coalesce, and perhaps constrain the vision, objectives, and strategies of future generations" (Kelly, Athanassiou, & Crittenden, 2000, p. 29).

Not all founders or their organizations suffer from this syndrome. Many founders recognize that the traits that allowed them to bring their "baby" to life may not be what the organization needs if it is to develop to maturity. There is a problem only if the founder fails to change with the evolving needs of the organization (Gottlieb, 2003).

THE SYMPTOMS

Founders syndrome may be present to varying degrees in different organizations. Founder's relationships with the boards and executive leadership of the organization also vary. While there is no definitive list of the symptoms of founder's syndrome, there are some common, observable actions that are characteristic of the existence of the syndrome:

- Critical organizational decisions are not made collectively. Most of these decisions are simply made by the founder (Gottlieb, 2003, McNamara, 1998).
- Founders promote the removal of those who disagree (McNamara, 1998)
- There is no succession plan (Gottlieb, 2003, McNamara, 1998).
- The founder retains high levels of control over organizational matters (Miller & Simmons, 1992).
- Managerial references to the founder's legacy can still serve to focus, and perhaps, constrain the vision, objectives, and strategies of future generations (Kelly, Athanassiou, & Crittenden, 2000)

ARTHUR EDWARD ANDERSEN

By any measure, Arthur Edward Andersen had an exceptional life. The fourth son of John and Mary Andersen, Arthur was born on May 30, 1885, in Plano Illinois (Fisher.osu.edu, 2014). Arthur was just 11 years old when his mother died at age 38 and only 16 when his father died in 1901. The four younger Andersen children were left in the care of various relatives; the older four boys, including Arthur, were on their own. With only 8 years of schooling, Arthur secured a job as a mail boy at Fraser & Chalmers (later part of Allis-Chalmers). With the financial help of William Chalmers, Arthur was able to work during the day and attend Atheneum High School in Chicago nights. He graduated in 1903. By 1906, he had worked his way up from mail boy to assistant to the controller of Fraser & Chalmers. That same year he married Emma Barnes Arnold (Arthur Andersen & Co, 1988).

While working in the Controller's office, Andersen worked closely with the company's auditors. He became fascinated with the work of independent public accountants. By 1907, Andersen quit his job at Fraser and Chalmers and joined the Chicago office of Price Waterhouse & Co in a "temporary" staff position that paid $25/week. A determined young man he set out to earn his CPA certificate which he did in 1908, at the age of 23 he was the youngest CPA in Illinois, and one of only about 2,200 CPA's in the country (Arthur Andersen & Co, 1988).

Not fully satisfied with his new profession, Andersen decided to pursue a college education. Northwestern University had recently opened a School of Commerce and Andersen enrolled in the night school. Quickly distinguishing himself academically, Andersen was asked to teach some night school classes in 1909. In 1911, Andersen was offered the position of controller for the Uihlein family interests, including the Jos. Schlitz Brewing Company. Even though the position required a move to Milwaukee, WI, Andersen did not hesitate. He also did not hesitate to continue his teaching and his studies at Northwestern, a 180 mile round trip. In mid-1912, Northwestern University faced a crisis when the head of the accounting department and his assistant left to start their own accounting school. Northwestern offered the 27-year-old Andersen the position of assistant professor and head of the department of accounting. Again, Andersen did not hesitate to accept this new challenge (Arthur Andersen & Co, 1988).

Still restless and looking for a way to make his reputation, the 28-year-old Andersen resigned his position with the Uihlein family in 1913 and concentrated his energies on his academic position. Later that same year Arthur Andersen joined with Clarence M. DeLany and together they paid the estate of Clarence W. Knisely $4,000 for The Audit Company of Illinois, and on December 1, 1913 the accounting firm of Andersen, DeLany and Company of Illinois opened its doors for business. Andersen, DeLany and Co. and the Income Tax were both born the same year (Arthur Andersen & Co, 1988).

ANDERSEN, DELANEY & CO., 1913-1918

The original office of the firm was in Rooms 2002 and 2003 of the Harris Trust Building on West Monroe Street in Chicago. The original staff of the firm was inherited from the Audit Company of Illinois and consisted of three seniors, two semi-seniors, two juniors and a man who kept the books and did the typing for the firm. The total payroll for the half-month's operation of the firm (Dec 1-15, 1913) was $923.84. Fees billed for December 1913 totaled $1,039.50 and the largest client was the Jos. Schlitz Brewing Company. It was during these early years that Andersen set the tone for what would later become Arthur Andersen & Co. He demanded his staff write detailed and accurate audit reports. He also set the tone for the accuracy of these reports. In 1915 a Midwestern interurban railway company had distorted its earnings by deferring charges that should have been absorbed in current expenses. Andersen was adamant that the financial statements disclose the facts. The president of the company demanded that Andersen issue a report approving the company's procedure. Andersen refused and lost the client. A few months later railway company was forced to petition for bankruptcy. Similarly, a Great Lakes steamship company lost a new ship in a storm in February, 1915. The company and its underwriters had a bond issue coming due in 1915 and wanted to use the December 31, 1914 financial statements to support the bond and they wanted the statements to only reflect the situation on December 31, 1914. Andersen took the position that it would be misleading to issue a balance sheet that did not include this material loss which occurred between the dates of the balance sheet and the bond issue. In the fall of 1917, the firm issued a pamphlet, entitled "The Accounting Treatment of Overhead Construction Costs in Public Utilities." This was likely the first serious attempt to differentiate between overhead and direct costs of construction for public utilities (Arthur Andersen & Co, 1984). Andersen and DeLaney was also one of the earliest accounting firms to offer consulting services in addition to accounting, audit and tax. In 1918, Mr. DeLany resigned and the name of the firm was changed to Arthur Andersen & Co. Even before DeLaney resigned the firm was growing rapidly. By 1920 billings had reached $322,000 per year. The reasons for DeLaney's departure are not clear. One thing that is clear is that -Andersen did not develop trust easily. He was described by his contemporaries as a stern, demanding man who set high standards for himself and others. Today, we would call him a workaholic and he demanded the same dedication from the accountants who worked for him (Squires, Smith, McDougall, & Yeack, 2003).

ARTHUR ANDERSEN & CO.

Tax services proved to be an important hook to gain clients. Investigations and business advisory services proved to be an even bigger draw to clients. At the time, many established accounting firms were skeptical of providing consulting services. George May, the head of Price Waterhouse, advised that auditors should do audits and not get involved in other activities. Andersen believed that the right people with the right training in his techniques would be difference and he could trust them to do the right thing. Many of these right people came from the pool of students that Andersen taught. After DeLany's departure, Andersen turned to his younger brother, Walter, to oversee the Chicago office. He started in 1919. Andersen shifted his attention to growing Arthur Andersen & Co. As in everything else, Andersen was careful about growth. He did not want to sacrifice quality. He had already found five of the original staff wanting and replaced them. Andersen decided that the only staff he could trust were those he trained. The only offices that would be opened were offices Andersen himself would establish. In 1932 Walter resigned. According to some reports the brothers had an argument and Arthur ordered his brother out of the office. The two never spoke again. Similarly, Arthur Arnold Andersen, Arthur Edward's son joined the firm in 1940. He also left the firm after three years. Arthur E. Andersen was intelligent and ambitious, but he was also "blunt, domineering, and unforgiving (Squires, et al., 2008, p. 31).

When Andersen and DeLany founded the firm, the dominant form public accounting firms was the partnership and the firm was so organized. It retained this form after DeLany left. However, because Arthur E. Andersen owned a majority share of the firm he dominated every aspect of its operation. "The firm's organizational structure very much resembled a simple pyramid with Arthur E. Andersen at the very top" unforgiving (Squires, et al., 2008, p. 35). The partners who reported directly to Andersen were carefully selected. However, there was no doubt that while partners might run the local officers, Arthur E. Andersen ran the firm. In his later years, Andersen struggled to identify a successor. He had already run off his brother, Walter, and his son, Arthur Arnold. One early possibility was John Jirgal, a protégé of Arthur Edward. However, when Jingal began to build recognition in the accounting profession, "Arthur banished him to the New York office and reduced his authority. Arthur E. Andersen could not bring himself to share the limelight" (Squires, et al., 2008, p. 35).

Arthur E. Andersen died in January 1947 at the age of 61. After his death, he took on a mythical stature. Reminders of the founder's life were everywhere. It was clear even 50 years after his death that his values and self-discipline were embedded in the firm's methods and ways of doing things. Arthur E. Andersen provided the firm with legacies that enabled the firm to continue to grow and prosper after his death. These legacies included three significant positives: Integrity and honesty, the One-Firm One Voice partnership model, and his insistence on training to a shared method. Andersen also left his firm with one troubling legacy, consulting. Andersen ignored the warnings of more conservative accountants about a potential conflict of interest that could occur when an auditing firm also did consulting for the same client. Andersen believed that such conflicts could be avoided if consulting were contained. As it was while he lived (Squires, et al., 2008).

When Arthur E. Andersen died, his firm nearly died with him. Arthur E.'s son, Arthur A. was an obvious choice, but Arthur Arnold had walked away from the firm in 1943 and was not a partner. The remaining 25 partners had two choices. They could disband the firm or continue it as a partnership. After the 1929 crash, the SEC was born. One if the first actions of the SEC was to limit potential conflicts of interest in public accounting firms by prohibiting them from being corporations with investors. The discussion of what to do became quite heated. According to George Catlett, who joined the firm in 1940, the argument was really about who would run the firm (Wartzman, 2002). The initial vote of the partners was to dissolve the firm and each partner could go their independent way. Leonard Spacek and a few other partners developed a plan to save the firm. Their solution contained some significant changes to the firm's organization and financial structures. The firm would not be dominated by one man. Partners would have more real authority to run the local offices. All decisions in the new organization would be governed by the idea of one partner one vote. The firm would continue to speak with one voice, but that voice would be what the majority of partners wanted. Coordination of the local offices would be managed by a seven-man advisory committee and one partner designated as the administrative partner. The alternative was accepted by the partners and the vote to disband the firm was rescinded. This arrangement, a reaction to the way Arthur E. Andersen ran the firm, gave much more authority to the partners running local offices. This decision would have serious consequences later (Squires, et al., 2008).

THE DEMISE OF THE FIRM

Some will argue that the eventual demise of Arthur Andersen and Co. started with the election of Joseph Berardino as global CEO of professional services in 2001. Berardino announced the rebranding of the firm from Arthur Andersen to Andersen and a series of management changes. The overall result of the changes was a greater emphasis on legal advice and consulting than in the past (All change at Andersen, 2001).

Of course, the proximate cause of the firm was the Enron scandal. The warning signs that all was not well with Enron's accounting started to surface as early as February, 2001. This is when Andersen held its annual risk assessment of Enron. There was plenty of risk to discuss, starting with the off-balance-sheet transactions called LJM. These were special purpose entities that did not meet accounting requirement to assure independence from the parent company. Partners at this meeting discussed the conflicts of interest

Fastow faced as both the CFO of Enron and the LJM fund manager. Andersen proved itself adept at recognizing the risk inherent in this situation, but could not decide what to do about it. Ultimately, they decided to keep Enron as a client. After all, the fees could reach $100 million a year (Toffler, 2003).

The scandal began to break when Jeffrey Skilling, Enron CEO suddenly resigned. Shortly thereafter Sherron Watkins presented a comprehensive memo to Enron Chairman Ken Lay detailing a list of account problems she saw that could cause the company to implode. Watkins also called a friend and former colleague in Andersen's Houston office, James Hecker to express her concerns and ask for advice. After that, things started to speed up. On October 16, 2001, Enron announced its third-quarter results. The company lost $638 million and the reduction of shareholder's equity was $1.2 billion in connection with the termination of the special purpose entities. As a result, the stock price plummeted and six days later the Securities and Exchange Commission began an investigation (Toffler, 2003).

There have been many explanations for why Andersen did not do more to reign in the exceptionally aggressive accounting practices of Enron. One explanation is the structure of the firm that was developed in 1947 where the power is diffused among almighty partners (Cote, 2002). Another explanation is Andersen's unusually lax controls that allowed its Enron teams to call the shots (McNamee, Borrus, & Palmeri, 2002). This is a similar argument to the structure argument of Cote (2002). Another argument is that the Enron audit failures were a compromise of the ethics of Andersen (Wilson & Key, 2013). Probably the most popular argument is that this fall from grace is a sad tale of greed and miscues (Brown & Dugan, 2002).

DISCUSSION

Clearly, decisions made long after the Arthur E. Andersen's death were the proximate cause of the failure of Andersen. However, the argument here is that the seeds of the failure were planted long before 2000 in a little-studied phenomenon called "founders syndrome."

The first symptom identified above was that critical organizational decisions are not made collectively. Most of these decisions are simply made by the founder (Gottlieb, 2003, McNamara, 1998). This is certainly true of Arthur Andersen and his firm. Arthur Andersen was decisive in both his personal and organizational life. Probably the most momentous decision Andersen insisted upon was to combine consulting with auditing in a single practice.

The next two symptoms can be addressed together. The first is promote the removal of those who disagree (McNamara, 1998), and its partner is to not have a succession plan. As outlined above, Arthur Andersen removed his original partner, his brother, John Jirgal, and even his son from the organization when any one of them could have been perceived as a threat to Andersen's vision of "his" firm. The lack of a succession plan can be seen in the near closing of the firm when Andersen died in 1947. The lack of a succession plan can also be seen in the resulting organizational structure which probably contributed to the eventual death of the firm.

Andersen clearly retained a high levels of control over organizational matters (the next symptom). This is clear from the inability of the 25 remaining partners to figure out how to keep the firm going on Andersen's death in 1947. The partners were clearly not a group of equals when making decisions for the firm. Arthur Andersen made the decisions and everyone else followed.

Finally, it is clear that references to the founder's legacy still served to focus, and perhaps, constrain the vision, objectives, and strategies of future generations (Kelly, Athanassiou, & Crittenden, 2000). After his death, Arthur E. Andersen took on a mythical stature within the firm. Stories about his life were used to explain the Andersen culture and way of doing things. "Long hours, disciplined days, and a code of conduct that existed to the end of the 20th century were legacies attributed to the firm's founder at the beginning of that century" (Squires, et al, 2003, p. 37).

CONCLUSIONS

Did founder's syndrome cause Andersen to fail as an accounting firm? Probably not. However, there is an argument to be made that this syndrome set the stage for the eventual failure of the firm. The literature on founder's syndrome in for-profit companies is sparce and has generally been confined to small, family-owned firms. The lesson of Arthur E. Andersen and the firm he founded could be that founder's syndrome should be more carefully considered when organizations, especially closely-held companies like partnerships and family corporations are experiencing difficulties. It may be the legacy of founder.

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