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The Organizational Psychology of Hyper-Competition: *Corporate Irresponsibility* and the Lessons of Enron

Donald C. Langevoort*

I. Introduction

Were I not to know better, sadly, it might seem that the recent Enron fiasco was just a publicity stunt for Larry Mitchell's *Corporate Irresponsibility: America's Newest Export*.¹ So much of what the book says rings true with what we are learning about Enron's obsession with using short-term earnings numbers to prompt (with the aid of an elaborate set of smoke and mirrors) a grossly inflated stock price. And unfortunately, it was a mindset that produced severe social dislocation, especially for Enron's employees, its local community, and so many undiversified investors.

Corporate Irresponsibility is clearly right to ask whether there is something the law can and should do to counter the unhealthy effects of this kind of obsession, and there is much to admire in its set of proposals. I have to confess to being somewhat skeptical, however, about corporate law's capacity to change this kind of behavior if legal reform comes in the relatively mild tweaking the book advocates. Like its author, moreover, I am not confident that there is a more radical, efficacious strategy that would appeal within the rough constraints of capitalism as we know it. So what I want to do here is first explain my fears and then explore the Enron story from the standpoint of both social psychology and organizational behavior. My sense going in, at least, is that the social forces and selfish norms that emerge fairly naturally in highly competitive settings such as these dominate as behavioral influences over anything but high-powered legal controls.

The kind of firm that I want to concentrate on is the "new economy" sort that requires a high rate of creative productivity from a large number of key managers and employees. Thus, I will put to the side the few remaining monopolistic public utilities, as well as firms with high rates of free cash flow from entrenched market power. The paradigmatic examples that I am interested in are knowledge and service-based firms in markets with relatively low barriers to entry and high rewards for innovation. Enron clearly was one of these.

II. The Internal Structure of Hyper-Competitive Firms

The task faced by firms in these settings is to design a work structure that induces high-velocity productivity by key employees. This is absolutely

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¹ LAWRENCE E. MITCHELL, *CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT* (2001).

essential: should a critical mass of motivation and talent be lacking, the firm will not be competitive, and will fail. So what should this structure look like?

We begin with the selection of these employees at the entry-level (including employees who are at even more advanced stages of their careers). Based on the assumption, discussed more fully below, that monitoring will not be overly intense, the firm needs people with the personality characteristics associated with high productivity in lightly supervised settings. Here, we can go right to the human resources playbook—the common characteristics sought are things like “ambitious,” “competitive,” “a self-starter,” “persistent,” “positive,” and the favorite, “a team player.” At the entry-level, especially, those characteristics are imperfectly observable; hence, hiring decisions are heuristic at best.²

What kind of person meets these characteristics, and what is that person like? Most of these adjectives describe a person with a high need for recognition and achievement, and with a high degree of self-confidence. The latter, in particular, is associated with what psychologists call egocentric biases—an inflated sense of self-efficacy and ability to control. Such people are not necessarily realists, but optimists—a trait directly associated with persistence and risk-taking.³ The outlier in this cluster of personality traits is “team player.” The level of personal ambition has to be tempered by loyalty to the group—otherwise it poses a distinct threat to the organization’s interests. There is a balance here that is hard to achieve because loyalty is somewhat easy to fake, especially early on.

The people selected to work at the firm are then put into vigorous competition, both externally and with each other. In many firms, people tend to work in teams on projects, rather than alone. This permits some degree of monitoring and supervision by the team leader and other team members, although this is likely to be very imperfect monitoring. We know that too intense supervision over highly discretionary tasks tends to crowd out internal motivation, leading to reduced productivity.⁴ Key employees will thus tend to be given some autonomous “space” to conduct business without intense oversight.

With imperfect observation comes the tendency to base promotions and rewards on some combination of outputs, either individual or by team, and internal evaluations. As to the former, at least, quotas and targets emerge, and it is the *relative* performance of the key employees that counts. Where there is team-based organization, teams are frequently reconstituted so that individual productivity can be more easily teased out. As many people have pointed out, something of a tournament emerges in this environment. And

² For a very sophisticated approach to human resources, recognizing the economic and psychological constraints, see generally JAMES N. BARON & DAVID M. KREPS, *STRATEGIC HUMAN RESOURCES: FRAMEWORKS FOR GENERAL MANAGERS* (1999).

³ See MARTIN E.P. SELIGMAN, *LEARNED OPTIMISM* 100-12 (1991). I have elaborated on this, from a securities law perspective, in Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms)*, 146 U. PA. L. REV. 101 (1997).

⁴ E.g., Jennifer S. Lerner & Philip E. Tetlock, *Accounting for the Effects of Accountability*, 125 PSYCHOL. BULL. 255, 259 (1999).

the interesting question to me is whether there is some survivorship bias in terms of the personality characteristics of those who win in these highly competitive settings and move up the corporate ladder. I suspect so, and am troubled by this.

To some extent, the winners will tend to be those who (natural skills aside) are most ambitious, hard-working, persistent, etc.—exactly what the firm was looking for. They will get a sense of the prevailing metric and outperform their peers on it. Where teamwork is valued, however, they will have to restrain their personal ambition, or at least appear to do so in the eyes of higher powers. This is an important point. As noted earlier, from the standpoint of the superiors making the promotion decision, it is essential *not* to promote the purely self-centered, for he or she will not be other-regarding enough (as to their interests, if nothing else) once given substantial autonomous power. Thus, there is a great deal of emphasis placed on innate loyalty, while at the same time recognizing how easily it can be faked.

Who, then, is the person who can simultaneously be so competitive and yet loyal? I think that the answer is those people who bond quickly to their team—both expressing and feeling intense loyalty—while at the same time behaving very aggressively vis-à-vis outsiders.⁵ This kind of person needs to be adept at rationalizing a shift in loyalties as conditions dictate. Sadly, researchers have put two apt labels on the kinds of people who do this well time and time again. One is “Machiavellian”—a standard psychological measure. This is characterized by an astuteness regarding alliances to make, people to impress, and how to manipulate. “High-Mach” scores correlate with organizational success, especially in discretionary fields such as sales and management.⁶ This label connotes deliberate cunning and opportunism, but it need not be like this—recall that organizations are threatened by blatant egoism. It is the behavior, not the state of mind, that is important. Hence, there is a second label that I like: ethical plasticity, inspired by Robert Jackall’s work on business ethics.⁷ In tournament structures, successful executives have an ability—born in what psychologists term self-serving inference—to construe what is self-serving to be reasonable, so that moral anxiety is buffered. They convincingly appear as highly loyal team players because—via the magic of self-deception—that is how they see themselves. But they find ready excuses to shift loyalties, without guilt, as the local competitive conditions change. This lets them stay “focused” and able “to take care of business”—other popular words and phrases from the human resources playbook. They are grease, rather than grit, in a high-velocity setting. Unburdened by moral anxiety, they are valued and rewarded.

⁵ The training grounds that model these traits in pure form are athletic teams and the military, and rhetoric from these settings is commonly imported into business cultures.

⁶ Samuel Bowles et al., *The Determinants of Earnings: A Behavioral Approach*, 39 J. ECON. LIT. 1137, 1161-62 (2001); Myron Gable & Frank Dangelo, *Locus of Control, Machiavellianism and Managerial Job Performance*, J. PSYCHOL. 599 (1994).

⁷ See ROBERT JACKALL, *MORAL MAZES: THE WORLD OF CORPORATE MANAGERS* 203 (1988) (“Only those with an inexhaustible capacity for self-rationalization, fueled by boundless ambition, can escape the discomfort such compromises produce.”). Jackall’s emphasis is on the need for flexibility if one is to be a survivor in a series of “probationary crucibles.” *Id.* at 192.

On average, then, survivors in highly competitive organizations are those who best exhibit these traits. But I do not want to pretend that personalities within organizations are static over time. Especially when organizations have sought people with high self-esteem going in, egocentric biases are enhanced at each step up the organizational ladder. Whatever may have been the reasons for success (luck, perhaps, or good social skills), managers are likely to self-interpret their success in terms of talent, skill, and just dessert. Self-esteem grows, with the predictable increase in resistance to information that is inconsistent with inflated self-image. At the very top of the organization, we see a rarefied group of survivors very adept at producing, but with diminished capacity to see things as they really are. Indeed, the noted organizational psychologist Michael Macoby has claimed that the ultimate tournament survivors in high-growth “intangible”-based firms is often the hard core narcissist—a personality trait (disorder in severe instances) that often produces highly charismatic leadership coupled with a strong disinclination to accept or admit the truth.⁸

So far, I have focused on personality, which is inherently individual. But culture is also important as it sets the normative ground rules for both belief and action within the firm.⁹ Without revisiting the extensive literature on corporate cultures, I will simply suggest that these cultures are often the reflection of the internal reward system over time. Those who succeed within the system determine, indirectly at least, what is valued. Their behaviors that gave rise to success will be imitated, and over many iterations, replicated. The most adaptive corporate cultures are ones that reflect the key personality traits—optimism, persistence, and competitiveness. The most powerful consequence, when a functional corporate culture emerges, is that it helps build an identity—a sense of manifest destiny that with luck can turn into a self-fulfilling prophecy—within the organization. That has mainly positive consequences (higher levels of internal motivation and trust) but the potential for negative ones (in-group biases that brand outsiders as inferior¹⁰ and silencing of dissenting voices) as well.

What I am suggesting, in sum, is that success in highly competitive business organizations is skewed in the direction of rewarding those who are highly focused at the business of competing, which of necessity means the cognitive ability to block out concerns—like difficult ethical problems—that are likely to be distracting.¹¹ Jackall puts it well: “Only those with an inexhaustible capacity for self-rationalization, fueled by boundless ambition, can escape the discomfort such compromises produce.”¹² As to the prevailing competitive metric, I suspect that it is two-fold: whatever the definition is

⁸ See Michael Macoby, *Narcissistic Leaders: The Incredible Pros, the Inevitable Cons*, HARV. BUS. REV., Jan.-Feb. 2000, at 69-70.

⁹ For a useful perspective on the person-culture nexus, see generally Barry Staw & Robert Sutton, *Macro Organizational Psychology*, in SOCIAL PSYCHOLOGY IN ORGANIZATIONS 350 (J. Keith Murnighan ed., 1993).

¹⁰ See Paul F. Levy, *The Nut Island Effect: When Good Teams Go Wrong*, HARV. BUS. REV., March 2001, at 52.

¹¹ See David M. Messick & Max H. Bazerman, *Ethical Leadership and the Psychology of Decision Making*, 37 SLOAN MGMT. REV. 9, 20 (1996).

¹² JACKALL, *supra* note 7, at 203.

with respect to competitive success (something to do with profitability, at least), tested by some combination of performance data with respect to the team in question and a style that bespeaks efficiency—a style that is politically nimble, decisive, action-oriented, and confident. Here we see something important. On average, upper echelons of organizations like these will be less and less likely to have people whose inclination is to worry, or to doubt, especially about things that go to the heart of the organization's self-identity. Worries and doubts appear at these levels, of course, but only when presented starkly, which often is too late.

If I am right about this, then the seeds of corporate irresponsibility are endogenous ones, not the product of external norms such as law or shareholder primacy. But haven't I proved too much? If the account is as bleak as I seem to be suggesting, what explains the presence of at least some seemingly functional, socially sensitive organizations out there? The answer—which *Corporate Irresponsibility* occasionally hints at—is that, most of the time, a high degree of attention to groups such as the company's workforce, creditors, supplier base, etc. is smart. All other things being equal, "high-Mach" senior management teams will bargain with these other constituencies in a savvy way, recognizing that many of the relationships are for the long-term and thus cheating opportunities are diminished. And, as I have argued elsewhere, this inclination to share will be strongest when the control group is optimistic about the future, and sees much left over for itself even after being generous with others (precisely why optimistic, "can-do" corporate cultures are so adaptive).¹³ The stress point comes only when bad times threaten and the management team senses the coming of a "last period." That is when its darker, Machiavellian instincts take hold.

I have gotten to this point while saying relatively little about something that is central both to *Corporate Irresponsibility* and the Enron story: stock-price obsession. Nothing in what I have said necessarily explains why the control group would find stock price maximization so profoundly compelling; all I have said is that I think the motivations in these kinds of organizations are largely endogenous and self-serving. Let me offer three explanations, one of which is obvious (and one of the chief culprits offered by the book). That obvious one is stock-based compensation plans, which tie the executives' interests to a high stock price whenever sales or hedging activity is permitted. I share the view that, as typically designed, these are often troublesome, encouraging near-term stock price inflation by whatever means practicable.

But there are others. As Enron shows, a high stock price has an independent competitive purpose—it provides an acquisition currency and a source of collateral that can be used to facilitate substantial (often hidden) leveraging. To a growth-oriented firm, this is crucially important. Also, and perhaps more subtly, stock price is a metric by which to test the success of the control group currently in power in a firm with much hard-to-measure value, and hence goes deeply to their sense of identity. We have to remember that executive job turnover in these kinds of organizations is increasingly fre-

¹³ See Langevoort, *supra* note 3, at 155.

quent; many at the top doubt that they can count on being there for the long run. For all these reasons, I fear that near-term stock-price obsession in aggressive knowledge-based organizations is naturally embedded, and not easily overcome.

III. *Enron's Story*

In this light, let me speculate—and I emphasize that word—in very general terms on what may have occurred at Enron to lead to the company's sudden implosion and the consequential social damage. To do this, of course, we have to identify the cause(s) of the implosion, which is not an easy task. Here, I will build on Bill Bratton's account,¹⁴ which suggests that the stock market too easily trusted Enron's cosmetically enhanced earnings and failed to identify the risks associated with the derivatives activity. Upon discovering the truth, investors and lenders exacted a heavy toll. Particularly significant was the use of Enron stock as an inducement for third parties to provide capital to the equity affiliates and special purpose entities in the late stages of the company's expansion, which in turn helped disguise the deteriorating economic condition of the company. Although the self-dealing nature of these transactions was troubling, they were probably not a proximate cause of the implosion. And we should at least note that the six million dollar shortfall in outside capital, which is what it would have taken to justify treating the Jedi and Chewco partnerships as independent, was probably trivial in and of itself—the harm would have come upon discovery of the nature of the risks hidden within the company whether or not this accounting convention had been followed.

I will also assume that, initially, Enron's business model of being a dominating market-maker was a sound one on which to build a business, and produced a round of initial success within the company's core product competence, the energy business. Indeed, this initial success was the root cause of the later demise. Enron was filled with people who met the job description set out in the previous section: optimistic, aggressive, and focused. The culture quickly identified itself as special and uniquely competent, believing that special skill rather than luck (or just being first) was responsible for the early victories. That self-definition then set a standard for how up-and-coming people acted out their roles: Enron was a place for winners. With this—and the stock market's positive feedback—the company's aspiration level rose.¹⁵

This aspiration level required a high level of risk-taking by the firm, though like many egocentric people, key decision-makers were probably overconfident in their ability to manage these risks, and thus underestimated them. Here, we should pause to take note of the compensation and promotion structure at Enron, which resembled many other hyper-competitive

¹⁴ William Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275 (2002). My account here is derived from Bratton's article, press reports, and the February 1, 2002 Powers Committee report to the Enron board.

¹⁵ On managerial aspiration levels, see generally James G. March & Zur Shapira, *Managerial Perspectives on Risk and Risk Taking*, 33 MGMT. SCI. 1404 (1987).

firms in this regard. Enron harshly penalized the laggards at the firm, which, on average, tends to lead to herding behavior (risk *aversion*). To counteract this, the company had to magnify the reward structure considerably for those who ended up as stellar performers—a winner-take-all kind of tournament.

Presumably this worked, and key people gradually placed more and more risky bets in a variety of fields, increasingly outside of the firm's core competence. And predictably, many of these turned bad. Here is where some basic principles of social cognition come into play, perniciously. High ego people are slow to recognize problems as attributable to their mistakes; rather, they minimize them as controllable and seek to correct them through an increase in persistence and aggression. Although this is an adaptive strategy on average, it can easily compound the risk (essentially, the phenomenon of throwing good money after bad). With a streak of bad luck, the person finds himself deeper and deeper in trouble. By the time people face up to the facts, they are in a loss frame, and the organizational structure and culture leaves little choice except a cover-up and even more risk-taking as the only means of escaping the bad situation. In sum—and in previous work I've called this the "optimism-commitment whipsaw"¹⁶—their overconfidence commits them to a high-risk strategy; once committed to it, they are trapped.

I suspect that at multiple, overlapping levels in Enron, this happened. Individual traders probably fell prey to it, and the key principals in the organizational structures (Fastow and his close confederates, and perhaps Skilling) probably did too. I would guess, then, that the SPE's were initially thought of as legitimate devices for moving assets off the company's books to keep earnings up and the stock price high—legitimate, at least, within the accounting conventions that apparently permitted so much make-up. The self-dealing was rationalized, perhaps rightly, as offering speed and efficiency, and the key players had no conscious intention of disloyalty. But as the bets moved in the wrong direction, their natural response was simply to bolster their initial choices, thereby gradually sinking deeper into the "big Muddy" of cover-up and deception when good luck failed to come their way.¹⁷ Early on in the bolstering, concealment was rationalized as buying time to solve the problem, which they believed they surely would. Later, they may have simply felt trapped.

Whatever deception there was no doubt included a large amount of *self*-deception, perhaps until the very end. This is important, for among other things it goes to the level of "intentionality" underlying whatever was wrong at Enron. Objectively, in hindsight, it is hard to imagine how someone could be responsible for risky choices that go bad and be anything other than corrupt for failing to reveal the problems promptly. Psychologically, however, that is hardly surprising. I have no idea when, if ever, the key insiders at Enron lay awake one night and realized that they were responsible for a very

¹⁶ Langevoort, *supra* note 3, at 167; see also John M. Darley, *How Organizations Socialize Individuals into Evildoing*, in *CODES OF CONDUCT: BEHAVIORAL RESEARCH INTO BUSINESS ETHICS* 13, 16-25 (David M. Messick & Ann E. Tenbrunsel eds., 1996).

¹⁷ For an interesting account of a team gradually redefining itself based on the need to deceive others whose response would, they rationalize, be disruptive and foolish (and hence unworthy of respect), see generally Levy, *supra* note 10.

big mess and simply lacked the ability to clean it up. That is an admission few high-ego, high-Mach people make easily, even to themselves. The familiar term for this response is denial.¹⁸

As we go higher in the company and farther away from the SPE transactions, to Ken Lay and the board of directors, particularly, we see similar social and cognitive forces at work. First, this is a company culture that discourages the reporting of bad news to superiors—"don't bring me problems, bring me solutions!" And it is only, like nearly all, companies heavily built on trust rather than aggressive monitoring. Again, in hindsight, it is hard to imagine, given the conflict of interest, how so much discretion could have been given to Fastow regarding the workings of the SPE's. The answer is that he was trusted, by and large. Nor was it necessarily an unreasonable trust, early on. High-Mach people are very loyal when times are good (the optimism link, again) and there is gain to be had from cooperation. He could thus have laid ample groundwork to justify the trust Lay and the board had. But this was the cognitive trap. Having committed so strongly to Fastow, Skilling, and their vision, the higher-ups were resistant to disconfirming data as it began to trickle in, because it was threatening to them too. If so, whatever disloyalty there might have been down below was harder to spot at the time than we now might think.

IV. Conclusion

My concern, then, is that what I have described above is natural within hyper-competitive organizations. To be sure, Enron-like harm is rare, but that may be simply a function of its rarefied situation: a first-mover in the suddenly important world of energy resources with an immense initial streak of good fortune, later hit just as quickly by a streak of bad. No doubt there was a "cowboy-culture" there that may have been more stark than most, which contributed to the overreaching. But I suspect that we would find Enron-like tendencies in many firms, for the reasons I've given.

If that is the case, then I am more skeptical than Larry Mitchell that we should give tournament survivors in these kinds of firms more freedom to manage, on the assumption that the resulting moral autonomy will cause them to gravitate toward the benign. As I've said, I think stock price obsession is more a symptom than a disease, and any remedies for the resulting externalities will have to be more heavy-handed than simply enhancing managerial freedom from investor pressure. Again, I applaud many of the book's specifics. But I won't hold my breath waiting for spontaneous enlightenment from corporate cultures and hierarchies formed in the nasty world of business competition.

¹⁸ See Patricia Sellers, *CEOs in Denial*, FORTUNE, June 21, 1999, at 80. More formally, from an organizational perspective, see Andrew Brown & Ken Starkey, *Organizational Identity and Learning: A Psychodynamic Perspective*, 25 ACAD. MGMT. REV. 102, 105-06 (2000).