



GUY: Ethical collapses offer many lessons

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VIEWPOINT

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“The Seven Signs of Ethical Collapse,” by Marianne M. Jennings, caused me to wonder whether investors could have avoided various corporate disasters in Indiana.

Jennings suggests that observers can “spot moral meltdowns in companies ... before it’s too late,” by paying attention to seven signs:

- “Pressure to maintain those numbers,” which is the desire to keep earnings growing when fundamental factors, such as competition, squeeze margins. Two techniques for manufacturing earnings are accounting manipulations and aggressive acquisitions, both bound to fall of their own weight.

Locally, I believe AES Corp., owner of IPALCO Enterprises Inc., tried the acquisition route from roughly 1990 to 2002, when the weight of debt became too much, and the stock declined more than 80 percent. Another was locally based Crime Control, believed to have booked earnings at the time of sale, instead of on receipt of payment.

- “Fear and Silence” refers to corporate cultures in which dissent is stifled and employees fear to ask substantive questions. Houston-based Enron is a prominent example.
- “Young ’uns and a bigger-than-life CEO” is a circumstance exemplified by Charles Keating, who purchased California-based Lincoln Savings & Loan with junk-bond funds raised by Michael Milken. Keating screamed and intimidated employees, many of whom were relatives. Before its sale, Indianapolis-based Marsh Supermarkets had similar circumstances, on a much smaller scale, and with relatively minor consequences, primarily a poorly performing common stock.
- “Weak board” is another sign, but difficult to see, except by hindsight. Nevertheless, unusually high board compensation is a red flag, because directors fear losing their positions by offending the CEO. Another signal is when a company maintains a lucrative contract with a board member, such as for consulting. Today in Indianapolis, three companies pay more than \$300,000 a year to board members.
- “Conflicts” can be as simple as a political figure’s wife on the board of a company, or complex, such as auditors who receive non-audit fees from client companies, making auditors fearful of dismissal. The auditors of Michigan-based Delphi Corp., for example, which has a large plant in Kokomo, received eight times more non-audit fees than audit fees. Delphi admitted overstating revenue, and filed for bankruptcy.

Marsh was controlled by family members who built a fancy headquarters and acquired a jet. New owners are challenging sellers for at least one plane-related tax deduction denied by the Internal Revenue Service.

- “Innovation like no other” is projecting an image of unique capability, such as claimed by Enron, Tyco and Worldcom. An indirectly related phenomenon is that such companies frequently provide elaborate perks to employees. Carmel-based Conesco Inc. paid big benefits to top officers while claiming an unusual capability to improve earnings by imagined superior management of acquired companies.
- “Goodness in some areas atones for evil in others.” According to Jennings, officers of many fallen companies view themselves positively for having made large contributions. I recall one who became honorary chairman of a local telethon, and another who endowed a theater, both only a few months before their companies headed south.

Ethical challenges sometimes appear due to inattention or a misguided attempt to market a product. Cheerios, for example, suffered a hand slap for claiming it reduced cholesterol and Disney is offering to refund purchases of Baby Einstein, which does not, as promised, improve infant IQs. Such incidents do not forecast disaster, because they are aberrations in long histories. Furthermore, on questioning, these companies stood up and did the right thing. Hence, signs of ethical collapse must be viewed in context.

I hope Indiana graduate business schools pick up the banner of ethics, teach it in classes, and ask students to research failed companies. The opportunities for learning are ample, and the effect will be to make students better investors, and better leaders when called upon to direct the affairs of companies. •

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