

Keep Your SOX On: Taking the Ethical Pulse in the Corporate Suite

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The continuing parade of companies caught up in the nets of State Attorneys General, the U.S. Justice Department and jurisdictions abroad forces us to reflect on how much impact all the talk and legislation about business ethics and related subjects is truly having. For those who have already been caught or are in the process of being nabbed and punished, the impact will be beyond dramatic. On the other hand, it seems evident that all the visibility about punishments, humiliations and negative exposures has had little impact on companies not immediately in a prosecutor's kill zone.

As I work in the various executive suites across America and abroad, among the first things almost all CEOs want to discuss is their frustration about the loss of public, shareholder, even employee trust and respect for those who lead business. The excuses and self-forgiveness are almost immediate. CEOs rail and rant at the cost, the inconvenience and overkill of the Sarbanes-Oxley (SOX) laws: "Why attack the many when so few are at fault?" "These are all isolated incidents." "How does all this costly disclosure prevent that behavior?" "Can any organization really comply?"

It's all charmingly naïve. On an individual basis, it's probably strongly



A source of irritation and concern?: New York State Attorney General Eliot Spitzer.

felt. Optimism combined with an excessive willingness to forgive themselves and their peers for "minor infractions" or for the "misinterpretations" or overzealousness of the uninformed (some, of course, with "antibusiness," "antimanagement" or their personal political agendas) are common operating executive perspectives.

It's a kind of ethical delusion that because 98 percent of organizations and operations follow the rules, are compliant and at least talk a fairly good game of ethics, executives or industries should get credit for their overwhelmingly harmless, even helpful behavior rather than the perpetra-

tor treatment they currently experience when problem areas are uncovered. American companies have now bred generations of top managers who tolerate their own infractions in the name of entrepreneurialism. The American tradition has been one of extraordinary latitude for those who achieve exceptional results.

Executive resentment of SOX continues to grow. Corporate leaders and their surrogates are becoming more vocal. The indictment is that SOX goes way too far and moves in unnecessarily rigid, tough and expensive directions with little tangible benefit. Some executives and critics claim:

- They are unable to be as creative

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as they used to be because boundaries are far less clear and penalties are incredibly severe.

- The emphasis on the examination of company structures and reporting requirements is too onerous and presents too much risk to a company used to developing new ideas and concepts and moving forward aggressively.

- SOX-regulated companies are going to find it increasingly difficult to entice the kinds of qualified directors they need, especially in light of the recent Enron and WorldCom types of settlements where directors were forced to pay money from their own pockets, even though companies had applicable insurance coverage. This is the Department of Justice's way of sending messages to other would-be sloppy or lazy directors.

- SOX Section 404 procedures to audit a corporation's internal controls do little to prevent high-level fraud. These 404 audits are almost entirely focused on the micro-operational details and are likely to miss the kind of financial activities orchestrated at the top that led to the scandals and bankruptcies we've been reading about. And they really whack smaller businesses.

The American Electronics Association recently forecast that SOX would levy \$35 billion of additional costs on corporate America by the end of 2005 — 20 times more than the Securities and Exchange Commission originally estimated.

New York State Attorney General Eliot Spitzer's prophylactic humiliation approach is another source of concern and irritation. Executives point to Marsh McLellan and AIG as the latest examples of the Spitzer method. The CEO and other top officials were gone before Spitzer

even got to the company. Never mind that these sacked executives were allowed to keep their platinum bonuses and parachutes while several thousand employees lost their jobs and the government assessed \$1 billion in fines.

While it now appears that many executives will go to jail, one has to wonder, What does that matter if, in

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the process, the little people — those who get a paycheck every couple of weeks and were just doing their jobs — are the ones who pay the price? The impact of SOX is, in management's judgment, incredibly disproportionate to the good generated and provides little deterrent. When used to punish, the process involves embarrassing a handful of wealthy individuals who will remain wealthy and above the fray, even if they go to prison. Meanwhile, hundreds — in some cases thousands — of employees will lose their jobs in a job market where they're likely to have great difficulty recovering emotionally and financially, perhaps ever.

There is an alarming absence of top executives who aggressively advocate ethical behavior or SOX awareness. Many of those who do are meeting the provisions of their plea agreements following a prosecution or

sanction proceeding. Some, thanks to zealous PR counsel, confuse corporate social responsibility (CSR) activities with ethical behavior. CSR, in America especially, is far more a PR exercise than demonstrating fundamentally ethical behavior. American public relations overvalues good will as a buffer to bad behavior.

Yes, many of the punishers are political or legal figures with all-consuming political ambitions. The American business community despises politicians in general, even while loving to hobnob with them in front of television cameras and in other highly visible circumstances. There is a lack of respect, almost a smug superciliousness, among business people toward politicians and much of government.

Loss in foreign investment

The prospect of punishment is also having a negative impact on foreign investment in the United States. A recent *Wall Street Journal* article, "Goodbye, Farewell, Aufwiedersehn, Adieu . . ." by Daniel Epstein, a partner in the London law firm of Allan & Overy LLP, describes the rush of European companies to exit the U.S. securities environment. Citing SOX as an enormous burden imposed by U.S. federal law and using several leading European companies as examples, he describes the way European business is beginning to organize against SOX. With the decline in the need and utility for American depositary receipts (ADRs) and with preference for direct ownership of stock in companies outside the United States by Americans, says Epstein, the need to remain listed in the United States is more a prestige factor than a business necessity.

Coupled with the risk, which

some estimate to be between 4 and 11 million euros per year as a cost of maintaining, providing and participating in SOX requirements, even for large companies these are serious bottom-line dollars they prefer to keep for shareholders and for the company itself. One Swiss-based company recently spent more than \$100 million in two years, and the process yielded nothing. They put out a news release saying as much.

The Securities and Exchange Commission does seem concerned.

Any improvement?

The big question about SOX and other recently imposed regulatory structures is what measurable improvement has occurred in the overall ethical behavior of companies. In fact, we are only now beginning to hear about measuring the effect of SOX. The negative indicators are the continuing prosecution of more companies rather than fewer, and that more companies are paying more fines. It's hard to extrapolate in either direction other than to assume that many companies are being caught doing things they used to get away with, and that others are doing the minimum required to stay out of trouble and placate their own managers and stockholders rather than maximizing good behaviors and instilling the spirit these rules and regulations were meant to foster.

Employees take note

Employees are noticing. Emotional and credibility gaps continue to widen. Employee agitation grows, too, because of the differences between workers, senior managers and leadership, especially enormous financial disparities caused by ever-rising executive compensation and bonus packages, even at failing companies.

When an executive receives a bonus that is several thousand times the salary of the lowest paid employee in the organization, irritation, resentment and aggressively negative feelings are bound to surface. Insults happen regularly. Harry Stonecipher, the Boeing CEO fired in March for having an affair with a co-worker, received a multimillion-dollar bonus just days before his humiliating departure.

Employee expectations are predictable and pretty reasonable:

- Job security
- Company survivability
- Fair and just treatment
- Rules everybody can play by and win with
- Fairly evaluated and appropriately justified compensation with no special treatment
- Compensation based on a rational relationship to executive achievement and pay

Employees see management that is increasingly and onerously amoral, arrogantly unemotional, even mean — all the while demanding increasing performance and loyalty, “hyperperformance,” while offering a “no guarantees” future.

“What gets measured matters.” I have no idea who originally said this, but measurability is the operative concept and daily driving force in business among those coming out of American business schools. If it's too difficult to count or inherently immeasurable, it should either be eliminated or severely curtailed. Many business schools and business school graduates seem to be quite proud of how post-graduate business education in America has taken on the issue of ethics. Reality may be quite different.

A recent headline in *Business*

Ethics Magazine read, “It's a Heck of a Time to Be Dropping Business Ethics Courses.” The subtitle was, “MBA Programs Are Downsizing Ethics Requirements at Precisely the Wrong Time.”

A surprisingly insightful view comes from an unexpected source — *The Harvard Business Review*. In its May/June 2005 issue, Warren G. Bennis and James O'Toole wrote “How Business Schools Lost Their Way.” They make the following indictment: “During the past several decades, many leading B-schools have quietly adopted an inappropriate — and ultimately self-defeating — model of academic excellence.” These two leading academics argue that business is a profession “akin to medicine and the law . . .” and that “business schools are professional schools — or should be.” They agree that the error in business education is that it is now fundamentally science driven.

According to the authors, “Today it's possible to find tenured professors of management who have never set foot inside a real business, except as customers,” . . . or consultants.

The problem, according to Bennis and O'Toole, is that the strict adherence to the values of science and its rigor crowds out the kinds of values education, attitudes and human experiences, such as moral decision-making, that seem so lacking in today's business-school product and among executives you find on the point of the prosecutor's spear.

The bottom line remains supreme

What may be happening to ethics in academia is what is happening to ethics in corporate America. Rather than the longer-term beneficial prospects of running ethical organiza-

tions, the bottom line remains supreme and neither wimps nor whining moralists need argue or apply.

My view is that American management education and training has become systematically de-emotionalized and amoral — every aspect of business operations is treated as a capital, resource-based element of production. Employees (often called “human assets” by operations) have become just a part of the machine that is constantly being tweaked, picked apart, rebuilt and added on to — all in the name of ever-increasing production, productivity and competition.

It may be that management and those who educate them are afraid of the people who work for them. It is easier to quantify everything, or severely restrict the soft stuff and then turn over the achieving of these hard objectives to “those people.”

Shareholders don't seem to care about workers either. It's a rather disappointingly frequent occurrence that when a business announces a work force reduction of almost any size in a public company, there's an uptick in the market for the day. If there is a substantial reorganization or downsizing, there may be a sustained increase in share price over time. When the CEO is replaced, quite often the share price also rises. The emotional, institutional and cultural damage done by these acts never seems to be accounted for by management or ownership and is rarely acknowledged by shareholders.

The growing business irritation and frustration with criminalizing business actions will continue. My sense is that we have yet to reach a peak level of persecution and prosecution, which is the impact, if not the actual intent of SOX. If businesses and executives want to begin reigning

in these governmental activities, they will have to take strong measures to rebuild public confidence and trust by running businesses that are openly and aggressively compliant, ethical and efficient in fixing what's wrong inside first. Given the public support for prosecuting business leaders or simply making their lives miserable as a way of punishing them, we're head-

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ing down a long, rough road.

If executives want ethical corporations and employees, they're going to have to set the example, market that example throughout the organization, and hold everyone to the standard of their own personal and business behavior. But even this lofty bit of thinking will fail until boards of directors find ways in the normal course of business to measure, expect and compensate executives on their success in building organizational integrity.

The lesson for communicators is that they better learn about how SOX applies to their organization and how it touches every operation and activity, and potentially every individual in the organization in some way. SOX will be around for some time. But wait, it gets better.

BusinessWeek's “SmallBiz” Summer 2005 issue notes that “New

York and California are considering asking private companies and significant nonprofit organizations to comply with SOX-type regulations. Last January, California began requiring nonprofits with more than \$2 million in annual gross receipts to complete audits and upgrade their accounting.” Many forecast that it's just a matter of time before Congress applies these rules and regulations to all tax-subsidized organizations, such as foundations, political parties, chambers of commerce, and trade and professional associations. Soon we'll be reading about scandals at major nonprofit associations.

How do we recognize the ethical company? It's a company where people are properly honored for their part in the process of achieving results, and where employees participate daily in the prevention, detection and deterrence of the potential for unethical behavior. It's a company where management willingly acts on the employees' reports, suggestions and observations, and then celebrates the result.

All too often today, business behavior reflects the famous quote by Winston Churchill in which he said, “One of the most exhilarating experiences in life is to be shot at . . . and missed.”

How many of you have that down-range feeling at your company? ■

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