

## CHAPTER 11

# Reasons of Systemic Collapse in Enron

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*This article studies the moral development at Enron from the perspective of its long-term CEO and chairman Ken Lay. I focus on some critical decisions in the early years of Enron and speculate why Lay chose in favour of non-systems intelligent solutions in leading morale. According to the outlook developed it is plausible to think that immoral behaviour at Enron stemmed not so much from Lay's immoral character but from his Christian values. Neglecting opportunities to change his value structure Lay avoided tough decisions that marked loss for others. Consequently, unable to make decisions objectively based on systemic rather than individual motives, he lost his opportunity in creating coherent corporate values promoting moral integrity. If the suggested causality is true, it underlines the importance of conscious moral leadership as an everyday discipline.*

### Introduction

This article discusses the story of Enron, the infamous American energy company that December 2, 2001 filed the largest bankruptcy case in US history, totalling losses around 66 billion US dollars,<sup>1</sup> forcing 4,000 unemployed,<sup>2</sup> and bringing down Arthur Andersen,<sup>3</sup> its auditing company. For many of the “bad” and publicly convicted Enron executives it has been the worst nightmare come true, a personal travesty. Cliff Baxter, an Enron executive, has committed suicide and Ken Lay, after being found guilty of conspiracy and fraud, died of heart attack. We might ask, why did these people choose to risk so much? Did they not consider personal responsibility? Did they not consider the possibility of prosecution and consequences of public hate? Did they not consider the pain and anguish their relatives and family would have to bear?

From a systems analytic perspective the case of Enron is intriguing. It provokes us to ask what made people behave the way they did? What was it in Enron that made some of the worst in human nature prosper over the good, and why did nobody intervene until it was too late?

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<sup>1</sup> <http://www.geocities.com/ritholtz/writing/fiasco.html>

<sup>2</sup> [http://money.cnn.com/2006/05/25/news/newsmakers/enron\\_verdict/index.htm](http://money.cnn.com/2006/05/25/news/newsmakers/enron_verdict/index.htm)

<sup>3</sup> June 15, 2002 Arthur Andersen was convicted of obstruction of justice in the Enron case, resulting in loss of its licenses and right to audit public companies.

History knows many similar incidents where a system takes over, where people in disdain look in retrospect, saying, how could something like that have happened? In this respect Enron is no different; it is a testament to human nature, of the frail nature of human morale. At the same time it is a case about the system, about the social, and the affect that the system has on the individual.

My objective here is to suggest some reasons why immoral and irrational behaviour came to be in Enron. I focus on Ken Lay's leadership and speculate why he chose in favour of decisions that were non-systems intelligent in terms of the company's long-term moral development. But rather than assuming immoral behaviour at Enron having roots in the immoral character of the leader, I develop an outlook that attributes some of the problems in moral development to Lay's emotional life. I discuss the possibility of a conflict between his Christian values and those required in moral leadership and suggest how this conflict, when repressed, may have undermined his moral integrity and motivated immoral behaviour in his followers.

The article is structured as three stories that focus on the early years of Ken Lay's leadership in Enron. I have intentionally left the later years unexamined and concentrate on how the moral decline in Enron may have started. The narrative structure of the inquiry is hoped to take the reader into Enron – into Lay's world – and help see situations from the inside, in order to appreciate the conflicting demands (or tensions) on values leaders have to respond to. Here the article is similar to the Systems Stories of Oshry (1999).

*Having created a morally downwards driven system in Enron need not imply Ken Lay having lacked moral motivation. There may have been more systemic reasons.*

The three Systems Stories and their analysis are followed by a section on causality and morale at Enron. This part draws some analogy to the work of Senge (1990), who has identified causal patterns typical to organizations. But here I discuss causality primarily from the viewpoint of the individual and illustrate how Lay's leadership may have motivated undesirable patterns of causality in the overall organization and how his values might have been ultimately responsible.

## Story I: Values and Experience Compromising Decision-Making

Ken Lay was the man that created Enron. He was the son of a Baptist preacher, spoke openly about corporate values and was openly religious. "Everyone knows that I have a very strict code of personal conduct that I live by", he once told an interviewer for a religious magazine *The Doors*. "This code is based on Christian values" (McLean and Elkind 2003, p. 3). He was also a hard man not to like. He built a reservoir of goodwill among those that worked for him, and made a point by serving drinks for subordinates along for the ride on Enron's flagship jet. He remembered names, listened earnestly, and seemed to care about what others thought (McLean and Elkind 2003, p. 3). In terms of conventional *virtue ethics* he resembled a good man.

But in addition to being a man of virtues Lay was intelligent – both analytically and socially. He earned a Ph.D. in economics, during the Vietnam War worked at the Pentagon, and in 1972, thanks to influence of his professor, joined the Nixon White House as undersecretary of energy. Lay was only 30 years old at the time. It was the year of the Arab oil embargo, electric brownouts were common and the country suffered shortage in natural gas – a spectacular moment in history to be working on energy policy. But Lay was more a businessman than politician at heart and soon quit realizing the opportunities policy changes were about to bring to the industry. He rose fast through the ranks and eventually in 1984 was hired to head Houston Natural Gas. The following year the company merged with InterNorth and was named Enron.

What helped Lay's fast ascent was probably the combination of systems thinking and respect for others. As an economist of Washington experience he understood how the market was about to change. But his vision alone was not power. What made Lay powerful was his ability to build an extensive network of relationships over the years. And it was his way to treat people that made him so good at it. He respected others by listening to them, he treated others as he would have treated himself and did favours without asking anything directly in return.<sup>4</sup> Indeed, it seems that at least in the early years Lay genuinely believed in Christian values, acted altruistic and represented age-old virtues of good life that are supposed to bring good to the whole system.<sup>5</sup> So, why did the virtues not take seed in Enron? And why did something so bad get created instead?

### **A decisive weakness**

Indeed, despite the good virtues – or due to them – Ken Lay did have a decisive weakness. Although he was generally strong on interpersonal skills, especially in soothing conflicts, he avoided tough decisions that were certain to make people mad (McLean and Elkind 2003, p. 3). He would rather throw money at a problem or let the subordinates work out the conflict themselves.

This problem is particularly clear in the case of the emerging markets where both Enron consultant John Wing and head of Enron Development Rebecca Mark were continuously competing for the same deals during the mid-90s. Instead of drawing clear boundaries Lay created complex arrangements that confused people. When the board fired John Wing in 1991, Lay offered his former star dealmaker a lucrative consulting contract to keep him onboard. Although the contract did make financial sense in isolation, overall it confused and held back development at Enron.

This illustrates an important point. Altruistic behaviour is not the same as systems intelligent behaviour. Clearly, Lay was constantly drawn in conflict with his beliefs when confronted with situations that required drawing a line and letting go of something in favour of something else. Lay did not seem to internalize that letting go had value in simplifying the system, that what was left could in fact be greater than what previously was. Lay seemed to think only about the part of the system that was being let go of, not the whole. This thinking represents transactional leadership (Burns 1978) where letting something go only makes sense if the part let go cannot deliver more than it asks. This of course is a simplistic view on systems. In reality, cutting a "bad branch", although productive, may improve performance overall.

### **Roots of the weakness**

It is most interesting to consider the reasons for Lay's line of systems thinking. In order to understand it we have to pay a visit to his past, looking at experiences that could have invoked the skewed outlook on systems logic. I start by discussing Lay's divorce from his first wife Judie in 1981. At the time Ken was 39 and about to become president of Transco, a Texan natural gas company. Judie was his high-school sweetheart, but Ken had fallen in love with Linda, his secretary, a divorced mother of three, whom he quickly married just one month after the divorce became finalized. Although after the divorce Ken established a "remarkably cordial relationship"

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<sup>4</sup> An example of not asking favors in return is Lay's Transco in 1984 offering to act as white knight, repelling a takeover attempt over Houston Natural Gas.

<sup>5</sup> Aristotle, *Nicomachean Ethics*, Book I Chapter 2 (Aristotle 1996, pp. 3–4).

with Judie – a further testament to Ken Lay’s ability to smooth over any conflicts – the divorce itself was anything but smooth (McLean and Elkind 2003, p. 7).

It was in late April 1981 that Ken Lay filed for divorce, requesting custody of his two children. Judie responded in court papers that Ken was unfit to have custody. A few weeks later she suffered what doctors called a “psychotic episode” resulting from “manic-depressive illness.” The psychiatrists treating Judie concluded that the episode was triggered by the couple’s impending divorce. As one psychiatrist later testified in deposition: “The divorce or the thought of a divorce hit her very hard. ‘It was like dying,’ as she put it.” (McLean and Elkind 2003, pp. 7–8)

This appears as a very traumatic experience also for Ken Lay. It is likely that Judie’s unexpected condition triggered a sense of insecurity in him. His thinking had missed something important. As he was preparing to let go of Judie in exchange for Linda he had unexpectedly come in conflict with himself – his Christian values. By divorcing Judie he may have realized having inflicted harm on someone who had responded to his values – returned his love, return of love being the systemic response for his altruistic behaviour of giving love. So, what seemed at first a rational choice between two alternatives brought to surface a deep conflict with his decision-making and value structure. He could have internalized on an unconscious level the dual nature of altruism as follows: What made possible for him to bond so closely with others also avoided them from being separated of him. In other words, there was no undoing of “social contracts” for the missionary of Christian values! Building of social was the imperative, not the pruning. What was once built was meant to be.

*Had Lay admitted sadness and taken a reflective retreat he could have questioned the appropriateness of his values in this new world of his where “letting go” was becoming as important as “holding on.”*

It is important here to understand that the logic that derives from such deep Christian values most likely has limitations to applicability. In Lay’s case it worked well for winning other peoples’ trust and fellowship critical for his climb to the top, but worked against him once there. The burning question is, could Lay have learnt to overcome his disposition toward making hard decisions that marked loss for someone. Saarinen and Hämäläinen (2004, p. 18) assume that critical to such circumstances is “thinking about thinking, a meta-level capability fundamental to man as a self-corrective system”. According to Goleman (1995) human emotions have a critical role to play in managing self-corrective action.

### **Emotions and self-corrective action**

In 1981, at the time of the divorce trial, what possibly took place in Lay’s mind was a denial of own emotions. The three-minute hearing, leaving directly for the airport from court after setting the divorce and remarrying within a month are behaviours supporting the tuning-out of emotions such as sadness that bring into the mind’s focus what has been lost and what there is to learn. In short, Lay, no matter for what reasons, seemed to neglect the opportunity to learn by taking a “reflective retreat from the life’s busy pursuits” by admitting sadness (Goleman 1995, p. 70). Had he taken this retreat, slowed down and reflected upon what he had lost, he could have learnt to master his mind and question the appropriateness of his values in this new world of his where “letting go” was becoming as important as “holding on.”

## Story II: Deceiving the Self and the System

The post merger years were hard on Enron. The company was under crushing debt and to honour its loan agreements it needed to report earnings at least 1.2 times interest each quarter. As the company struggled making profit altogether profits exceeding earnings requirements on one quarter were little use if falling behind on the next. In addition Wall Street awarded for steady earnings. McLean and Elkind (2003, pp. 18–19) suggest it was for these reasons Enron committed to profit shifting deals, moving excess profit from one quarter to the next through entities operating outside the Enron books. One of the business units that did profit shifting was Enron Oil.

Enron Oil was unlike Enron's other businesses. It was not capital intensive like the infrastructure projects and it was highly profitable, at least in 1986 when Enron overall was loosing money. But Enron Oil was also isolated, operating close to Wall Street, distant from Enron headquarters in Houston, Texas. It was probably the combination of profit shifting responsibility and isolation that made Enron Oil ripe for abuse. A critical instrument in this were the double books maintained by Enron Oil. This arrangement allowed Enron Oil awarding its traders for the profit shifting deals while keeping the details hidden from the rest of the company. The concealment of true financial activity also made proper auditing and risk management impossible.

*"...I have complete confidence in your business judgment and your ability and your personal integrity. Please keep making us millions..."*

Although in early 1987 Enron senior executives were onto the true nature of activity in Enron Oil, they were terrified of the effects their sanctions could have

on the business. A fax sent by Enron's number two executive to Enron Oil's head Louis Borget after an Arthur Andersen investigation illustrates this particularly well. It said, "...I have complete confidence in your business judgment and your ability and your personal integrity. Please keep making us millions..." (McLean and Elkind 2003, p. 20). Later at a board meeting when the conduct of the traders was called upon for discussion Lay openly said the traders made too much money to be let go of (McLean and Elkind 2003, p. 21).

However, the house of cards eventually collapsed in October 1987. Louis Borget disclosed Enron Oil trading losses amounting to well over \$1 billion, risking bankruptcy for the entire company. Though positions could finally be closed at a much smaller loss, Enron was forced to take an \$85 million after-tax charge to its earnings that year. The loss upset banks and investors. In response Enron pressed charges against Borget and the traders; meanwhile the executives appeared shocked at what had happened. At an all-employee meeting Ken Lay told he had been blindsided by Borget. "If anyone could say that I knew, let them stand up", he said (McLean and Elkind 2003, p. 23). In reality Lay had approved it all. In a mid-August 1987 board he had even approved to increase Borget's trading limits by 50 percent.

### Potential for miscommunication in values

Looking at the scandal from the outside it appears that Ken Lay chose to shortchange profit for values, turning the blind eye to fraud in exchange for money Enron desperate needed. This view represents transactional leadership (Burns 1978) where the leader bargains with extrinsic motivators, such as money, in exchange for favours and work done. The problem with this genre of leadership is its low regard for intrinsic motivation, such as pride in work. In the case of Enron Oil as the management did not commit to managing intrinsic motivations they left them defined by the employees. Interpreting the communication with Enron executives Borget along with his traders sought to define their own structures for motivation the Enron management seemed to

support. Had the communication been more in nature of transformational leadership (Burns 1978) that seeks transformation by managing the motivational structure, the outcome could have been altogether different.

We should however develop this view on leadership further by examining the causes for the behaviours that appear here as transactional. To the outside (especially if we think in transactional terms ourselves) the communication among Lay and the traders may *seem* like a transaction, and even in Lay's words it *was*, but what drove Lay to pursue the transaction in the first place could have been his disposition to "hold on." And considering the likely roots of this disposition it is most troubling to notice how Lay's Christian values might have worked against him by supporting the traders in applying their own, less moral motivational structures.

*Although Lay seemed to practice transactional leadership, it was his disposition to "hold on" that motivated the transactions, not his outlook on leadership.*

It would thus be somewhat incorrect to say Lay motivated by transactions although on the surface the communication between Lay and the traders assumed such nature. It is here important to understand that dispositions for behaviour, especially if unconscious, can be deceiving and that the problem of morale can be attributed to miscommunication. Considering the communication Lay could have assumed his Christian values non-compromised by the situation whereas the traders may have only observed the transactional values. The traders could equally have assumed their cover exposed and interpreted lack of sanctioning as approval of immoral conduct, whereas Lay might have assumed the traders taking self-corrective action.

Overall, the miscommunication in values, if we were to interpret it as such, is related to the "masking" problem where on the surface a dispositional attribution looks true, but is accompanied by competing or complementing ones that may be masked by the first one (Doris 2002, p. 16). For example shyness may mask friendliness, and depending on the nature of the circumstances this may leave an undesired impression. In similar fashion it is possible the communication between Lay and the Enron Oil traders invoked an undesired impression by masking the true values.

### **Reactive moral leadership**

Enron Oil having failed let's examine where the system was headed and assess Lay's role and influence on the moral development of the organization. I will begin by considering Burns (1978, p. 36) on conflict and consciousness:

... only the followers themselves can ultimately define their own true needs. And they do so only when they have been exposed to the competing diagnoses, claims, and values of would-be leaders, only when the followers can make an informed choice among competing "prescriptions," only when – in the political arena at least – followers have had opportunity to perceive, evaluate, and finally experience alternatives offered by those professing to be their "true" representatives. Ultimately the moral legitimacy of transformational leadership, and to the lesser degree transactional leadership, is grounded in *conscious choice among real alternatives*.

Burns argues that people are not always aware of their true needs, and awareness emerges through conflict that the leaders need to properly facilitate. His argument is congruent with Freudian theory on the development of morale through the resolution of Oedipal conflicts and instruction (Burns 1978, p. 35). But whereas Burns argues for conscious leadership the case of

Enron Oil demonstrates very clearly how leaders are inadvertently caught up in situations in which the followers are exposed to “prescriptions” that were never intended by their leaders. Put differently, Freudian theory on conflict resolution argues for the importance of conscious moral leadership whereas Enron demonstrates the emergent nature of demands imposed *on* leadership that significantly narrow down the leader’s alternatives.

My argument here is that the Enron Oil scandal worked much like a “prescription” that made employees of Enron conscious of their own good moral values by demonstrating the connection between immorality and disaster. Conversely, given the evidence it would have been illogical for them to choose in favour of the immoral as its outcome was now in clear conflict with their need to succeed. The scandal thus forged and hardened the good values of the system (similar to development of Freud’s superego), although the act of offering alternatives was not a conscious act of leadership in the sense of Burns.

*In protecting the moral integrity of Enron Lay discredited critics such as Muckleroy and the auditors by demanding their allegiance in a secret.*

Although the developments in value structure were good news for the system, they were bad news for Lay as they drew him in conflict with his past involvement and Enron’s developing good values. In addition, he was further confronted by demands from the outside (from institutions such as banks, investors, regulatory authorities, the IRS and the SEC) that were now congruent with the value demands from inside of Enron. This limited Lay’s alternatives further and ushered Lay into a “discrepant role” (Goffman 1959, p. 141) in which he was persuaded to downplay his past involvement in order to respond to the demands for good values. However, such concealment of “destructive information” risked disgrace in front of those that knew about the conflict with the past and the future.

### **Systems consequences of Lay’s response**

By choosing to give a performance at the all-employee meeting that denied personal responsibility for the Enron Oil scandal Lay created two groups in his audience: those that interpreted his performance as the truth and those interpreting it as a lie. Of course those that had been closely involved in Enron Oil and had access to “backstage” information saw the disturbed coherence in Lay’s performance and were inclined to interpret the performance as a lie. The lie was arguably given to conceal evidence of a lower moral ground practiced by the executives than now demanded by the employees. The lie therefore was given to protect what Goffman calls a “dark secret” that contains “facts about a team which it knows and conceals and which are incompatible with the image of self that the team attempts to maintain before its audience” (Goffman 1959, pp. 141–142). However, in saving face Lay created further change.

For people such as the auditors and self-motivated critical thinkers who had in vein tried to intervene in Enron Oil Lay’s secret was a “free secret”, one that if disclosed would not discredit their own image (Goffman 1959, p. 143). But as often is with free secrets, it was presented in a way that persuaded these groups to entrust it. For example Mike Muckleroy who had on several occasions pushed Lay to see the risks in Enron Oil was furious on hearing these demands (McLean and Elkind 2003, p. 23). Clearly, with his behaviour Lay discredited critics such as Muckleroy and the auditors by demanding their allegiance in a secret that ultimately contradicted with their original righteous motivations. Lay thus fundamentally undermined motivation for further constructive critique and organizational learning from their part.

But Lay’s performance could be argued having other consequences as well. Those entrusted to the secret were now caught up in a reality of double standards where on one hand they knew truth

was no longer objective and on the other they needed to preserve the sense that it still was. Such a state of mind in which multiple conflicting thoughts or realities are held true at the same time is extremely stressful for the individual and is known in psychology as *cognitive dissonance*. In a classical experiment Festinger and Carlsmith (1959) discovered that some subjects sought to offload part of the tension arriving from conflicting thoughts through disregard for their private opinion. In this respect, Lay's demands for maintaining the conflicting truths may have caused lack of freethinking for those entrusted to the secret.

### A systems intelligent intervention

Overall, although taking place in the 1980s, I consider the Enron Oil scandal critical for Enron. The company had been brought to the brink of bankruptcy and these early incidents were conspicuously similar to events unfolding later leading to final collapse in 2001. We should thus ask, why the management did not learn and create appropriate change? The problem, I argue, was the management's reactive role in moral leadership. They were constantly reacting to demands of the system, not consciously leading it. In addition, as we realize, the management created situations in which it contradicted itself, discrediting themselves and undermining faith in their moral responsibility.

*Had Lay admitted responsibility and advocated for one objective truth he would have made useless the complexity now motivating immoral behavior and holding back further honesty.*

I will now inspect opportunity for change in Enron, exploring how the management could have broken out of this reactive loop and assumed leadership of morale. I will discuss this through the looking glass of Systems Intelligence, a discipline marked by optimism for change (Saarinen and Hämäläinen 2004, pp. 22–31). The instrument for change is the systems intervention, an action, performance, or behaviour that succeeds in harnessing the demands of the system with human alertness for detail. Fundamental to such interventions is appreciating that small things matter as much as the whole. History knows many incidents where a seemingly minor event starts a cascade of events propagating through entire systems, resulting in permanent change.<sup>6</sup> Lay's performance in front of the all-employee meeting had such potential. The question is, what should the intervention have been and what was holding it back?

Instead of creating more complexity and hard to manage feedback systems Lay could have sought to simplify the system, giving it a fresh start. Had Lay admitted responsibility and advocated for one objective truth he would have made useless the complexity now motivating immoral behaviour and holding back further honesty. This intervention would have nevertheless made Lay vulnerable, throwing his and his allies' faith in the hands of the system. But honesty is a very positive mechanism for it insists forgiveness (see further Seppä 2007 on forgiveness). Had the Enron system not forgiven,<sup>7</sup> it would have committed self-deception, making useless any further attempts to divert to righteousness. I will now examine why such a systems intelligent response

<sup>6</sup> Consider for example the incident of Ms Rosa Parks refusing to give her seat to a white man on the Montgomery city bus in 1955. Given the seemingly minor nature of the incident, it however sparked a cascade of events, reaching epic proportions, influencing the civil rights movement in the US.

<sup>7</sup> It should be remembered that forgiveness is many times coupled with sanctioning. It is done in order to promote moral development by assuring that those that do not regret do not make the system of forgiveness useless. Thus it is fair to assume Lay nevertheless sanctioned although forgiven.

proved so difficult for Lay. The discussion that follows shows how important the self-system is in systems intelligent behaviour.

### Systems of holding back

If we accept the earlier argument for miscommunication of values taking place between Lay and the traders, it is quite possible that Lay did in fact not feel responsible for the immoral conduct in Enron Oil. If this is the case, it is logical to assume Lay trying to distance himself from the scandal. Would not it have been non-systems intelligent in itself for Lay to take blame for something not responsible for? In other words, from where Lay was standing the performance he gave at the all-employee meeting was not necessarily a lie but his subjective truth. The distinction between these two interpretations is both important and troubling; in one Lay is the victim, in the other he is the oppressor. As we now realize, fostering a performance of truth could have been far more challenging than we are inclined to understand as it may have demanded Lay contradicting his own beliefs.

Another system holding Lay back from committing to systems intelligent change could have been his unconscious. The Enron Oil scandal quite realistically risked disgrace for Lay. Such primal fear may have been interpreted by Lay's unconscious as an attack on his self-esteem. In such circumstances the self-system works to ward off threat by applying different types of schemas that hamper objective thinking (Goleman 1997). It is worthwhile noticing that Lay's Christian values may have made matters worse as the claims being made concerned morale, claims a religious man might not take lightly. Lay's mind could thus have been particularly weak under the circumstances. He may have experienced what Sullivan (1953, p. 160) refers to as "uncanny emotions," feelings of such severe anxiety that practically prohibit any clear understanding of the immediate situation. It is thus no wonder Lay's opportunity for systems interventions never realized as his mind may have been preoccupied with protecting the self-system.

*A religious man like Lay might not have taken the moral accusations lightly. In response he might have over-performed in denying responsibility for the Enron Oil scandal.*

### Story III: A Critical Intervention Fails and Immorality Takes Seed

Somewhat a paradox, the trouble with Enron Oil marked the rise of Rich Kinder as the company's number two executive. He was a practical man that did not avoid hard decisions like Lay did. He understood what Lay's indecisiveness was doing: Backbiting had become part of Enron culture, and since executives felt they could always get Lay to reverse a management decision, it had become impossible for the company to act decisively (McLean and Elkind 2003, p. 26).

Change for better – and worse – got eventually under way at mythical meeting in 1988 during which Rich Kinder declared "Enough of this!" The company's problems were like alligators he growled. "There are alligators in the swamp", he said. "We are going to get in that fucking swamp, and we're going to kick out all the fucking alligators, one by one, and we are going to kill them, one by one" (McLean and Elkind 2003, p. 26). And Kinder delivered his promise: He made tough decisions that changed the climate; he cut down debt and paired costs relieving pressure.

#### Rich Kinder's influence on values

Although Kinder was the leader Enron desperately needed in bringing order to chaos he was also the one to pioneer the boundaries of morale. He worked to reduce complexity, which Lay's

indecisiveness had motivated, but at the same time he created complexity of a moral nature by installing questionable accounting practices. In this respect Kinder was never motivated by values in the sense Lay was. He was rather driven by financial objectives. For him it was the end, not the

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means that mattered. Lay on the other hand was a more complex character caught in the middle of conflict between his Christian values and financial objectives.

Although questionable, the accounting tricks Enron pulled during these early years were not illegal (McLean and Elkind 2003, p. 92). They did however push people's morale into the gray zone. Possibly realizing this Lay chose not to promote Kinder as CEO, something the two had agreed taking place in 1996. But Lay's intervention was problematic. Considering Kinder's influence on morale at Enron it would have made more sense letting him go as early on as 1987 when he clearly stood in support of the profit shifting deals in Enron Oil (McLean and Elkind 2003, p. 21). Alternatively, Lay could have kept him onboard to "control the damage". Now, instead, Lay seemed to compromise between two plausible alternatives. At first look it seems the only advantage in delaying the decision until 1996 was in not having to take personal responsibility.

### **A systems intervention and the complex dynamics of moral behaviour**

I will now examine from a systems analytic perspective how intelligent Lay's systems intervention really was. I will also explore more in depth Lay's rationale in his fight against the immoral and discuss possible roots for his strategy. The objective is to try to uncover how his mind might have been misled into thinking certain strategies as more effective than they really were. I begin by discussing the systems dynamics of moral behaviour.

Aristotle (1996, p. 38) writes in chapter four of Book Two of Nicomachean Ethics: "a man becomes just by doing just action and temperate by doing temperate actions". In other words, moral virtue as a habit of right action is formed by acting rightly. Fundamental to this formation is the human mind's urge to explain behaviour and justify it in retrospect. And this mechanism works just as well for immoral as it does for moral behaviour. Moreover, in examining immoral behaviour the mind looks for reasons for having acted immoral, and if it succeeds, it may adopt these reasons as justified causes for further immoral behaviour.

In social systems this mechanism is further influenced by the examples set by others. In other words, people look for reasons in other's behaviour, and adopt the behaviours if applicable and justifiable. For this reason minor immoral action may be deceptively dangerous. Under favourable, or rather, unfortunate conditions immoral action may invoke a cascade where more and more people become influenced by an ever-expanding network of individuals realizing rationale in the immoral. In this respect, mechanisms of immoral action are no different to contagious disease (Watts 2003), diffusion of innovations (Rogers 2003) or cultural change (Gladwell 2000).

*The two leaders focused on different parts of the Enron value system: While Lay promoted the good Kinder controlled the bad. With Kinder gone bad growth was let loose.*

Now let's look at what went wrong in Lay's systems intervention. Once Kinder left Enron the controls maintaining the delicate balance between the moral and immoral changed. Lay's attention to details was nowhere near that of Kinder, and in the absence of decisive and regular management of the immoral (such as rules limiting accounting tricks, supervision and

intervention) the immoral behaviours were let loose. However, the logic in Lay's system intervention may not have been as flawed as we are inclined to think. The strategy Lay apparently applied sought change by promoting the "good" moral values, whereas Kinder's strategy was practically about control of the immoral. In other words, the two leaders focused on different parts of the value system.

This difference in strategy is perfectly congruent with the earlier view developed on the two leaders' positions regarding values. If we accept Lay as altruistic it is also logical to assume his strategy regarding corporate values reflecting altruism. However, in a system where the processes of immoral behaviour had already taken seed Lay's altruistic strategy that sought to lift the good instead of suppressing the bad was arguably insufficient. Had Lay assumed a different strategy, shown decisiveness in pruning of bad growth, and taken everyday management responsibility seriously the intervention may have worked out. The inadequate attention to the execution of the intervention seems to speak for lack of understanding on dynamics of immoral behaviour. I will now turn my attention to understanding why Lay might have fallen for such thinking.

### **Possible roots of Lay's intervention: Fighting bad with good**

Considering Lay's Baptist upbringing it is possible that he had internalized a strategy of virtues for fighting back the immoral, in other words, fighting back by forgiving and showing a good example. It is in the Christian tradition that man should display courage in front of evil and fight it off with good.<sup>8</sup> Also Christianity externalizes the man's right to judge to God, insisting the first and foremost task of man being the promotion of good.<sup>9</sup> Therefore it is plausible to assume that someone religious like Lay may have steered away from condemnation and sanctioning. However, it should be remembered that Christianity, as any religion, essentially teaches microbehaviour for the masses, and the lessons from religion are never applicable universally to all life situations. Especially in circumstances of escalated immoral development – such as the

*Although the escalated moral decline in Enron called for direct intervention in the immoral, Lay's idea of fighting bad with good may have held him back from such response.*

phase in Enron following Kinder's departure – sanctioning and condemnation may be necessary to properly control immoral growth.

We realize that Lay's thinking may have been biased in selection of strategies in the fight against immoral, compromising his ability to lead through conflict. In Lay's defence we should also remember that virtue should be undisputed. It could be argued that the

whole idea of virtue is that their power is universal. Therefore, it is somewhat unreasonable to judge Lay for not having complemented altruism with sanctioning if it essentially would have contradicted with the idea of the virtue. Also, we should remember that for a devoted Christian like Lay religious values are most likely deeply rooted and somewhat unconscious. Therefore, the inspection of their appropriateness might be difficult. We could in fact argue that part of the power of religion arises from the very fact that the mind leaves some fundamentals unexamined

<sup>8</sup> Rom 12:21: "Be not overcome of evil, but overcome evil with good." Consider also the epic poem *Psychomachia* (Contest of the Soul) written by Prudentius in the 6<sup>th</sup> century insisting the seven good virtues (chastity, abstinence, liberality, diligence, patience, kindness, and humility) being powerful enough to fight even the seven deadly sins (lust, gluttony, greed, sloth, wrath, jealousy, and pride).

<sup>9</sup> Rom 12:19: "Avenge not yourselves, beloved, but give place unto the wrath of God: for it is written, Vengeance belongeth unto me; I will recompense, saith the Lord."

and undisputed. However, the Enron case seems to demonstrate that this can have very negative effects as well.

### Causality and Morale in the Enron System

According to Senge (1990) fundamental for learning organizations is becoming aware of the causal pattern for events in the system. The risk according to Senge is that unless an organization is aware of its causality it becomes a prisoner of its own system. To effectively manage is thus to think about the system of events and responses and ask whether the system is creating appropriate behaviour as a whole. But as expected, the task is far from trivial. The Enron case only too elaborately demonstrates the many things that can go wrong.

We will now look at the causal patterns in Enron based on the three Systems Stories and discuss how aware the prime decision maker Ken Lay must have been of the Enron system. We will then proceed to discussing the question of morale. As we know, morality and causality are connected; for it is difficult to hold someone responsible who does not see the (systems) consequences of their actions or is otherwise incapable to properly regulate their own action (in the system).

### Causality in Enron

The causality pattern created based on the three Systems Stories is illustrated in FIGURE 1. It is composed of three interconnected systems: The Enron system of secrecy and bad growth, Lay's system of forgiveness and Lay's system of condemnation. I have drawn three conditions that regulate and couple the three systems. These conditions are Lay's values that drive the systems of forgiveness and condemnation, and the feedback mechanisms between the Enron system and Lay's systems of forgiveness and condemnation.

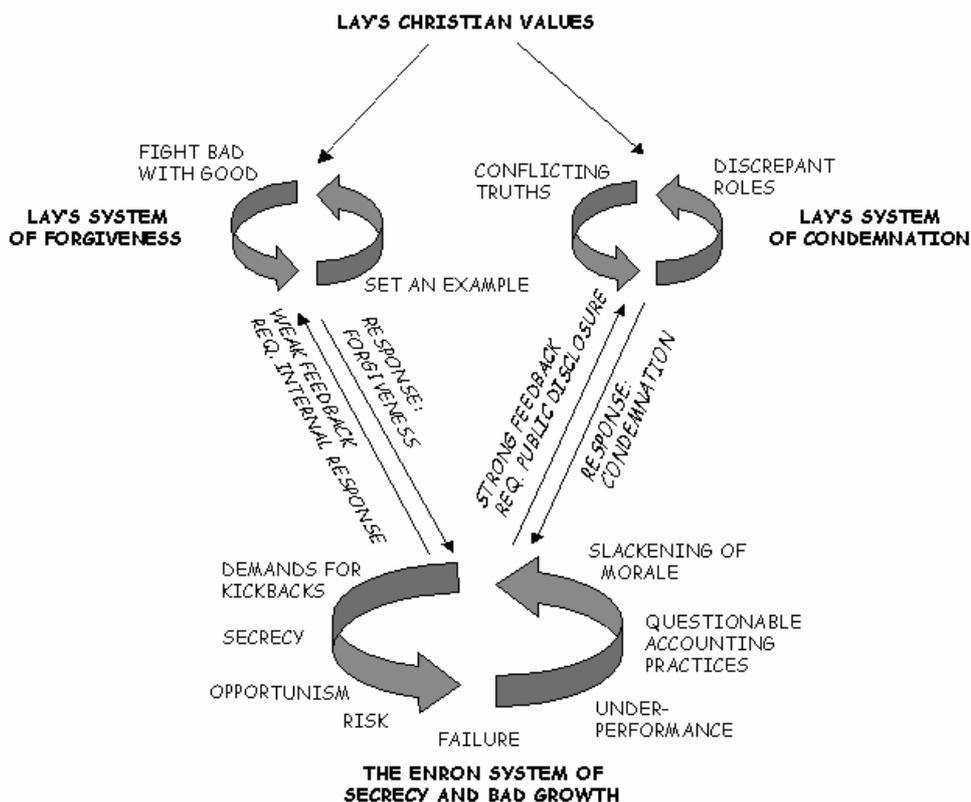


FIGURE 1. The Enron system of feedback and response.

Let's start by examining the Enron system of secrecy and bad growth. Its starting condition is the financial underperformance, which motivates accounting tricks, legal at first, although in the gray zone, illegal later on. The use of questionable accounting practices slackens morale, and in the case of Enron Oil and later under Jeff Skilling's leadership employees demand kickbacks for their questionable methods. Kickbacks, then, especially if not legitimate (consider the double books of Enron Oil), motivate secrecy and opportunism. Secrecy, opportunism and kickbacks in turn promote an atmosphere of risk as kickbacks become installed as prime motivation and internal auditing and risk management are avoided through secrecy. This results in failure as employees take more and more unaccounted, uncontrolled and self-motivated risk.

Depending on the nature of feedback from the Enron system Lay either responds by forgiving or condemning (see FIGURE 1 for the two feedback systems). When there is no need for immediate action – and for Lay there rarely is – Lay is inclined to “hold on” and let things continue as they were, signaling acceptance or forgiveness. Lay's primary leadership style could thus be summarized as *laissez-faire*<sup>10</sup> where only the most adverse situations call for management intervention (see strong feedback requiring public disclosure in FIGURE 1). Notice here how the *laissez-faire* leadership style is psychologically motivated, driven by the Christian mind's urge to “hold on” and fight bad with good example.

Lay's two response systems have the following effect on the Enron system of secrecy and bad growth: Forgiveness and good example demonstrate the model behaviours, whereas condemnation prunes bad growth and sets an example on undesired behaviour. Thus the system of forgiveness and good example when combined with appropriate measures of sanctioning (condemnation) seems to create a functional strategy. However, Lay assumes a reactive role in the pruning of bad growth. Consequently, what is taking place is the emergence of situations in which Lay's forgiveness and condemnation conflict in the eyes of others. He appears to condemn those whose actions he earlier forgave. And to make matters worse he seems to deny responsibility by being untruthful about his own involvement.

In response to this conflict, those interpreting Lay as inconsistent in managing the system and untruthful of his own involvement are inclined to act on their beliefs. For example, the auditors and critical thinkers lose motivation in their moral task while the scam artists are motivated by both Lay's untruthfulness and inconsistency in creating systems to protect themselves from sanctioning. Also, the conflicting truths and the demands made to maintain it cause stress, motivate repression of feelings and thought, and possibly create loss of sentiment and critical thinking among those entrusted to the secrets. Such subjective interpretation of Lay's response may have fed Enron's vicious circle of secrecy and bad growth. In leading systems Lay's thinking therefore seemed to miss a note on causality and subjectivity.

### **The challenge of moral leadership**

As we realize the problem with Enron was not necessarily so much an ethical one, but one concerned with systems feedback and response. I think Burns (1978, p. 46) provides one of the best perspectives to take us forward:

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<sup>10</sup> Leadership can be characterized in terms of group involvement in decision-making. White and Lipitt (1960) performed a classical study on three scenarios regarding decision-making: autocracy, democracy, and *laissez-faire*. Whereas in autocracy the leader assumed all responsibility, in *laissez-faire* the group was given total freedom, the leader merely assisting. Results of the experiment indicated democracy being most satisfying for group members, *laissez-faire* being let down by behaviours such as irresponsibility, uncertainty and conflict.

The great bulk of leadership activity consists of the day-to-day interaction of the leader and followers... But the ultimate test of moral leadership is its capacity to transcend the claims of the multiplicity of everyday wants and needs and expectations, to respond to the higher levels of moral development, and to relate leadership behaviour – its roles, choices, style, commitments – to a set of reasoned, relatively explicit, conscious values.

Burns recognizes that what ultimately counts in moral leadership is the ability of leaders to respond coherently to the (conflicting and sometimes seemingly minor) everyday demands that have consequences on the moral development of the enterprise. Burns also insists that leaders have to be very explicit in translating these demands into values recognized by their followers. If we consider Enron, we can say Lay having failed in both. He failed in responding to the claims of his followers in a way that would promote coherence. Instead, his leadership created conflict in which, worst of all, he was challenged personally. And it was in these circumstances that he undermined his chances of developing “a set of reasoned, relatively explicit, conscious values”.

According to Doris (2002, p. 133) the “powers of reflection” and “powers of self-control” can be assumed requisite for responsibility. In leading systems Lay was apparently compromised in both. He did not seem to understand the complex nature of feedback and response in the Enron system. And it was his lack of self-control – his disposition to “hold on” – that created that very system he failed to understand. Also, the discrepancy in values between him and some of his more “practical” and less moral executives undoubtedly contributed to the overall problem. It is somewhat ironic even to understand that a less righteous leader might have been better for Enron. With less chance for miscommunication and self-deception the immoral behaviour might have stayed within “proper” limits. Now, however, Lay’s inadequate powers of self-control and reflection combined with potential miscommunication may have inspired a morally downwards driven system.

## Conclusions

From a systems perspective the article brings into focus the problem of holistic thinking. Considering Lay’s leadership, it is rather clear that Lay did not think holistically, but made decisions locally. This was particularly evident in his tendency to “hold on” when “letting go” was more appropriate for the overall moral development of the system. However, although we can assume Lay lacking in systems thinking, the roots of the problem I argue were located in his value structure rather than his conscious mind. I suggest that what may have caused Lay to surrender his systems thinking were his Christian values that had fared him well during his climb to the top and are widely recognized as a source of good in systems. This leads me to making the following conclusion.

Moral leadership seems primarily a *conscious* task in which the leader needs to consider the emerging situations and decide on a response that best caters toward overall moral development. Unconscious strategies – such as Lay’s dispositions to behaviour originating from his religious values – may hold back the leader from such conscious thinking. Consequently, systems thinking may become replaced with behaviour that does not necessarily promote coherence in overall moral values. Therefore, in order for leaders to develop their moral leadership they need to learn to identify mental models that are holding them back from systems thinking. For example for Lay it would have been necessary to realize how his local interest in the well being of his followers was creating chaos overall. In this respect, it seems important for leaders to actively develop strategies that identify values and experience that keep them from committing to systemic objectives.

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