

**LEADERSHIP AND  
GOVERNANCE  
FROM THE INSIDE OUT**

**ROBERT GANDOSSY  
JEFFREY SONNENFELD**

**EDITORS**



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people's capital. This behavioral problem is one that must be addressed to keep capitalism functioning efficiently; everyone who reads this work will come away with a strong sense of the work left to be done and the direction in which we need to go.

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"At a time when corporate governance is preoccupied by legal liability and forensic accounting, Gandossy and Sonnenfeld's insightful anthology correctly places good governance and effective leadership as twin top priorities. Those who lead, or hope to lead, need to read these essays and learn their lessons."

**Richard E. Cavanagh, president and CEO, The Conference Board, Inc.**

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The authors dedicate this book to their loving families,  
where all good governance originates.

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## PREFACE

Over the centuries, social commentators have complained that “laws are like spider webs, which may catch small flies but let the wasps and hornets break through.” In fact, before the writing of criminologist Edwin Sutherland in 1939, theft was widely seen as a pathological reaction to poverty. Sutherland is credited with coining the term *white-collar crime*, which refers to respected, affluent members of society who broke laws as often as did those less fortunate although their deeds often did not label them as criminals. The outrage of the financial scandals of the 1930s led to the Pecora hearings in Congress, from which new securities legislation resulted. Some financiers were even imprisoned. Nonetheless, white-collar criminals were rarely treated as genuine felons. For example, criminal violations of the Sherman Anti-Trust Act of 1890 did not lead to a single imprisonment until 1961.<sup>1</sup>

That all began to change in the United States in the late 1970s and early 1980s as chief executive officers (CEOs) and other top leaders became ensnarled in both the crimes and the punishment. The seeds of this book were planted at that time when our paths first crossed. Jeffrey Sonnenfeld was then teaching as a professor at the Harvard Business School and Robert Gandossy had just completed his graduate work at Yale and had begun his consulting career in Cambridge, Massachusetts. Interestingly enough, the hot topic then, as now, revolved around corporate wrongdoing and governance. Thus, a quarter century before breakdowns in corporate governance became so salient, Jeff was researching corporate scandals and price fixing beginning with the 1976 punishment of 48 executives from 22 companies in the forest products industry where 15, including CEOs, were sentenced to prison terms with the others facing stiff fines and civil penalties.<sup>2</sup> Meanwhile, Bob examined what was—up to that point anyway—the largest fraud ever committed in the United States, the OPM Leasing Scandal. Over a period of 10 years, OPM’s principal owners perpetrated a fraud amounting to more than \$200 million.<sup>3</sup> OPM, by the way, blatantly presaged what they were to become—OPM stood for *Other People’s Money*. We recognized a shared

interest, not only in subject matter, but in the whole process of research and writing; it wasn't long before we bonded, forging a professional and personal relationship, based on a common cause, not to mention mutual admiration and respect.

Over the next two decades, we came to recognize that corporate scandals come in waves. During the late 1970s and early 1980s, for example, we saw The Penn Square Bank, E.F. Hutton, The Bank of Boston, Drysdale Government Securities, Lincoln Savings, and The Bank of Credit and Commerce International (BCCI) among the financial services scandals and other revenue recognition fraud at firms like Sunbeam and Cendant. In each case—despite the number of fiduciaries involved—“no one knew” about the wrongdoing for long periods of time. Or so it seemed.

The Penn Square Bank, a small, windowless shopping mall bank in Oklahoma City, sold questionable oil and gas loans upstream to several of the largest and most prestigious banks in the country, including Chase Manhattan, Continental Illinois, and Seattle First National Bank. The person who headed the oil and gas loan department at Penn Square was Bill “Monkey Brains” Patterson who was known to drink beer from his boot and wear Mickey Mouse ears, a Batman hat, or a Nazi storm trooper helmet to work. He was also known to engage in food fights in fancy restaurants.

But for years, no one knew that the Penn Square loans were not collateralized properly. No one knew that many of Penn Square's credits were not creditworthy. No one knew about Patterson either. Not Continental Illinois, which lost several hundred million dollars on Penn Square. Not Chase Manhattan. Not SeaFirst. Not the comptroller of the currency. And not Penn Square's auditors, Peat, Marwick, Mitchell & Company.

The Bank of Boston was accused of failing to report \$2 billion worth of international currency transactions. For over four years, the bank's compliance officers were apparently unaware that they were required by law to report those transactions. The bank's auditors claimed they did not know; the bank's management claimed they did not know; and the comptroller of the currency also claimed ignorance.

E.F. Hutton, at the time, the nation's fifth-largest brokerage house, engaged in a complicated check-kiting scam that involved over 400 banks and allowed Hutton the use of millions of dollars of the bank's money without ever paying interest. Again, no one knew. Not E.F. Hutton's management, not the victim banks, not Hutton's auditors, not the SEC. Everyone seemed

to be so distracted by succession politics and internal political sabotage, no one seemed to know about the complicated top-level scheme, and outside legal investigator Griffin Bell failed to locate those responsible.<sup>4</sup>

And then there was OPM. Over the course of a decade, OPM committed its multimillion-dollar fraud against 19 financial institutions. American Express and Rockwell International were among its customers; Goldman Sachs and Lehman Brothers were its investment bankers; and Fox & Company—one of the nation's largest accounting firms—were its outside auditors. But no one knew. Not Lehman. Not American Express. Not Rockwell and not OPM's lawyers, accountants, or their own employees. At least this is what they would have us believe. In fact, many people knew about OPM's crimes or had strong reasons to suspect them, but failed to take adequate steps to put an end to the misconduct.

Later in this decade, the BCCI banking scandal revealed a massive financial criminal network involving many prominent political leaders from 73 countries where the funds of central banks were used to create shell corporations hidden by bank privacy laws. The network was also responsible for hiding tax evasion, bribery, smuggling, arms trading, and terrorist activities.<sup>5</sup> Arizona's Lincoln Savings scandal led by Charles Keating had links to BCCI which was later accused of political influence peddling, misrepresenting risk, fabricating earnings of over \$500 million, and leading to the eventual collapse, which cost the public \$3.4 billion.<sup>6</sup> Several other savings and loan disasters, including Neil Bush's ill-fated Silverado Savings,<sup>7</sup> added to the public bill. Many prominent legislators, regulators, and investment banks were deeply immersed in these S&L scandals, yet all claimed to have been surprised.

Similarly, darlings of Wall Street came crashing down to earth in the next wave, which included such firms as Al Dunlap's out-of-control Sunbeam Corporation with one-third of its earnings fabricated, misleading revenue figures from channel-stuffing manipulations, and which incurred \$15 million in fines against former CEO Al Dunlap, among other penalties. Here again, a win-at-all costs, profit-at-any-price mindset led to a celebrity beyond Wall Street before the accumulated fraud brought down the enterprise.<sup>8</sup> After a first decade of brilliant revival, Michael Eisner's Walt Disney Company, the beacon of family entertainment, suffered high-level staff defections and political intrigue that began to engulf the enterprise. The scandal erupted when it was discovered that CEO Michael Eisner had promised

his friend and right-hand man Michael Ovitz \$100 million in the instance he should be fired. After just 14 months on the job, Eisner did indeed terminate Ovitz but awarded him an astounding lush severance package that paid him \$7 million for each failing month on the job. Stockholder litigation in Delaware courts—challenging the *business judgment rule* protection of board members from liability—helped bring several alarming facts to light, including the fact that the Disney compensation committee had never reviewed Ovitz’s final severance package and that he was, in fact, terminated for cause, having been given a harsh performance assessment by Eisner.

In the immediate aftermath of the anticipated Y2K database systems crisis and the 2000 Presidential election debacle came the most recent wave, fed by the scandal-hungry, 24-hour news networks and anger at the collapse of the technology bubble that had emerged from the greatest economic expansion in the history of the United States—but this wave of scandals seemed bolder, brasher, and more brazen. To be sure, leaders in most corporations are trustworthy, have integrity, and operate with strong ethical standards. But the minority charged with wrongdoing in this latest wave—these residents of the C-suite appeared not to give a damn about their employees, shareholders, or any of the other constituencies whose best interests they were charged with looking out for.

This most recent spate of corporate scandals began just one month after the terrorist attacks on New York City and Washington D.C., when the most infamous of the scandals first broke. That was when the public became aware that one of the world’s most highly regarded energy companies, Texas-based Enron, had been hiding more than \$1 billion worth of accounting indiscretions by improperly using off-the-books partnerships, manipulating the Texas power market, bribing foreign governments to win overseas contracts, and manipulating the California energy market. The leadership became intoxicated with a shared hubris and flagrantly violated basic accounting practices.

In a flash, the \$70 billion company declared bankruptcy, and thousands of employees found themselves not only out of a job but also without any retirement savings. At the top, heads rolled, as executives faced literally dozens of criminal charges, including fraud, obstruction of justice, insider trading, money laundering, and filing false income tax returns. Fines of up to \$1 million were levied, and once-revered leaders found themselves facing the real possibility of trading the corner office for the corner cell.

The Enron story struck a nerve among the American public, not to mention Wall Street. Granted, as the first major scandal of a fresh wave of corporate misgovernance, it received more than its fair share of attention. Then there were the purported ties to the White House and the reams upon reams of documents that Enron executives supposedly ordered shredded to cover their misdeeds. Perhaps more than anything else, people were struck by the fact that Enron had been, by all accounts, a highly admired company, right up until the scandal broke. No less a magazine than *Fortune* had branded Enron the most innovative company in America for six years running. Once again, for years, no one knew the real Enron. Even its chairman—the paternalistic but detached Ken Lay, who surreptitiously sold \$80 million of stock during the secret unraveling—claims to have been in the dark.<sup>9</sup>

The nightmare didn't end with Enron, of course. In short order, there were Arthur Andersen; Global Crossing; Tyco; AOL Time-Warner; Adelphia Communications; and WorldCom, which declared bankruptcy on July 21, 2002 after admitting to an \$11 billion accounting fraud, beating the record for the largest insolvency in U.S. history, which had been set by Enron less than eight months earlier. Andersen, once the beacon of integrity for its profession, came crashing down on charges of obstruction of justice.<sup>10</sup> In each of the others, there were hundreds of millions of dollars misdirected to top leadership.

In every corner of corporate America, allegations were flying as executives were accused of cooking the books, overstating earnings, establishing off-the-book partnerships, profiteering from Initial Public Offerings (IPOs) and phony or inflated stock ratings, and participating in trading misconduct in the form of market timing and late trading. Personal indiscretions, such as the filing of false tax claims, money laundering, wire fraud, inside trading, and elaborate and outrageous perquisites, made household names out of the likes of such former leaders as Enron chairman Kenneth Lay and its CFO, Andrew Fastow; Imclone founder Samuel Waksal; and Tyco CEO Dennis Kozlowski. From mid-2003 to mid-2004, dozens of top executives from such firms as Enron, Worldcom, HealthSouth, and Imclone were convicted of massive frauds and imprisoned. These were followed by the mutual fund scandal and conviction of none other than Martha Stewart.

For a country already in the throes of recession, facing high unemployment and a weak stock market—not to mention national security fears—these scandals cast a permanent shadow on corporate America. What's more,

they brought into question the validity of the stock market boom of the 1990s—to what extent was some of it built on scandal, deception, and illegal practices?

As employees, shareholders, consumers, and citizens, we are comforted by the integrity of leaders. Whether one of the leaders of this nation or one of the leaders of a corporation, we expect those entrusted with *the keys to the store* to exhibit high integrity, to keep their promises, and, above all, to operate within the bounds of the law. Trust and integrity are important foundations for leaders everywhere. Yet there's been a decline in confidence in the integrity of leaders in recent years. While employees generally trust their own bosses, Gallup surveys show that CEOs in general have fallen, with roughly 75 percent of the nation believing that corporate fraud is widespread in high office. From the shenanigans of corporate leaders already discussed herein, to questions about misleading weapons of mass destruction, to intelligence evidence to justify President Bush's push for war in Iraq, to President Clinton's denial of sexual escapades in the Oval Office, the integrity of leaders—or lack thereof—is a hot-button issue that isn't going away anytime soon. High degrees of trust and integrity take years to build, yet—as we've seen numerous times in recent years—they can be destroyed in mere moments.

Executive indiscretions have a major impact on how employees, shareholders, and the public view corporate America and the people who lead it. What's more, the scandals that arise from misconduct in the C-suite are problematic not just for the wrongdoers but also for everyone associated with the organization as they find themselves tainted by the deeds of a relatively small number of people. Consider what it's like to be a former employee of Enron or Arthur Andersen. Particularly in the early postbankruptcy days, going in for a job interview with a potential employer had to feel like a scene out of *The Scarlet Letter*. Instead of wearing their stigma on their clothing, however, they wore theirs on their resume.

Recognizing that it's impossible to create vibrant, growing, dynamic businesses when trust and integrity are not present, we set out to give a complete and accurate picture of the problem in the hopes of breaking the cycle so that we're not constantly having this recurring theme. Granted, there are many ways to look at corporate wrongdoing—through the findings of academicians and through the sound bites of talking heads, who regularly pop up on broadcast news programs, expounding on the subject.

In reviewing the shifting landscape of corporate misconduct, three key elements stand out that guide this book. First, the problems are not isolated in any sector—corporate, consulting, banking, governmental, and even nonprofit leadership complicity is involved. While each professional has raced to seize moral high ground and point the fingers elsewhere, the truth is that there is no purely virtuous ground. In fact, this is not even a set of problems unique to U.S. soil as continuing scandals in Europe remind us, afflicting such global titans as Royal Dutch/Shell, Parmalat, Royal Ahold, Adecco, Vivendi, SwissAir, and Asea Brown Boveri Ltd. (ABB).

Second, there has been a sad democratization of this misconduct. WorldCom founder Bernard Ebbers was a former high school basketball coach and barroom bouncer. Enron's Kenneth Lay was the son of a part-time tracker salesman—part-time preacher. Adelpia's John Rigas was the son of a Greek immigrant street vendor. Tyco's Dennis Kozlowski was the son of a New Jersey Transit cop. Where once the thieves were misguided aristocrats who had abused their positions of wealth and privilege, the current crop of corporate criminals is largely populated by upwardly mobile strivers. They had distorted the American Dream into a nightmare.

Third, the knowledge required for improving the leadership and governance is not in the exclusive domain of any profession or academic discipline. These most recent governance scandals had a wide array of relevant embedded problems cutting across fields, such as corrupt leaders, overhyped markets, short-term pressures, intentionally ambiguous accounting practices, dishonest financial analysts, weak internal audits, unscrupulous financiers and consultants, conflicted interests among board members, skill deficiencies, lax regulation, careless board supervision, improper board structure, perfunctory board processes, inadequate disclosure, misguided financial incentives, insufficient whistle-blower protection, autocratic imperial CEOs, unethical cultures, and inadequate character assessment in leadership searches. Thus, this book has solicited a broad slice of experts.

In assembling this book, we felt it was important to bring together some of the best minds from a number of different constituencies to reflect on the challenges, the problems, and yes, the potential solutions. Among them, you will find academicians and consultants, presidents and CEOs, representatives of corporate boards and regulatory bodies, accountants and psychologists, even one well-known whistle-blower, whose historic actions helped heighten the awareness of this entire issue. Brought together, their voices

form a coherent picture—from the boards and regulators who bear the responsibility for protecting shareholder interests to the employees who don't know where to turn when they observe wrongdoing by occupants of the C-suite. The wide array of contributor perspectives has a common theme, but it is, nonetheless, one that encourages examination of governance failures. Through the scandals of the last three decades, there was no absence of regulation with clear purpose, no lack of accounting rules with overintentions, no lack of corporate codes of conduct, no lack of board member financial literacy, and no shortage of many of the other governance remedies that abound as panaceas. Sadly, major accounting firms, investment banks, executive suites, and corporate board rooms were filled with professionals who knew they saw wrongdoing, but failed to act. Worse, some even participated in fraud and other forms of misconduct. The original contribution of this book then is to utilize various disciplines to gain greater insight into the behavioral failings that facilitated these scandals.

Each author is also a national if not globally renowned, expert in their field. They each bring their own unique commentary and tone to this critical issue and address what can be done to possibly reroute the next wave of corporate scandals that is inevitably already positioning itself to come crashing to the shore. They have a wealth of wisdom to share. We laud their efforts and encourage you to take their candid, insightful words to heart.

—Robert Gandossy and Jeffrey Sonnenfeld

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## NOTES

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## ACKNOWLEDGMENTS

Sitting at lunch at the New Haven Lawn Club one day in the spring of 2003, we began drawing parallels between the many recent business scandals and those that broke 20 years ago when we first met in Cambridge, Massachusetts. In the early 1980s, we were independently working on the rash of fraud and corporate misconduct occurring during that time. And, as is so often the case, what goes around comes around—here we are again.

We debated how these events come in waves, yet there seems to be little that is learned from one wave to the next. We wondered whether current proposals for reform would have impact or whether they would miss the mark as had earlier attempts.

These are challenging, difficult, and complicated issues. We decided it would be useful to bring together a variety of perspectives to shed light on the topic of leadership and governance. We made a list of friends and colleagues that have influenced our thinking over the years. The list included academics, CEOs, board members, and heads of regulatory commissions. We were delighted when nearly everyone we asked to contribute to this book eagerly accepted. We'd like to thank all of these exceptional contributors for exactly what we had hoped for—bold insight, clarity, and direction.

We'd also like to thank the vast majority of leaders who struggle everyday with difficult and competing demands but do so with strong values and integrity. We hope you find these pages a source of inspiration and a source of ideas to do more.

We'd also like to thank Matt Holt and his team at Wiley. We'd especially like to acknowledge Julie Offord of Hewitt. Julie kept the contributors informed and on track and maintained her sense of humor in the process. We'd like to thank Tina Kao and Shelli Greenslade for the background research and for keeping other things afloat—with Julie—while we were working on this book. Joe Micucci, Jon Hay, Kyra Ramsey, and Don Minner have always been there for us and have often been one step ahead. Thanks. We'd also like to thank Julie Cook for editing assistance under some very tight schedules.

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A portion of the royalties for this book will go to City Year, and we'd like to thank them for the good they do for so many.

BG

JS

# **PART I**

## FUELING THE CRISIS

### CORPORATE SCANDAL AND WRONGDOING

Forever epitomized by the megameltdown of Texas-based energy giant Enron, a series of grand-scale scandals rocked the business world from 2001 to 2003. In addition to Enron, there was WorldCom, Adelphia, HealthSouth, Global Crossing, Arthur Andersen, and numerous others. As if that wasn't enough, news also broke regarding outrageous compensation levels at the top rungs of the corporate ladder as well as rampant market timing and fee-gouging activities in the mutual fund industry. If the wrongdoers had any fear of being caught or reprimanded, it was trumped by their desire to boost their own personal fortunes, with absolutely no regard for others. Across the country, employees, shareholders, and consumers rightfully felt duped and cried out angrily for retribution, all the while uneasy that it could happen again.

The chapters in this section set the stage for the rest of the book, exploring the recent wave of corporate governance scandals. Included is the ultimate insider's view of the Enron implosion, from the point of view of the woman who blew the whistle on the company's questionable accounting practices, off-the-books activities, and excessive executive compensation packages. She argues that corporate America's current board system is seriously in need of revamping. Granted, the recently enacted Sarbanes-Oxley Act and the newly formed Public Company Accounting Oversight Board are a step in the right direction, but old habits die hard, leading her to question whether such legislation will be effective in preventing unethical business among corporate leaders.



# CHAPTER 1

## “I SEE NOTHING, I HEAR NOTHING”

### CULTURE, CORRUPTION, AND APATHY

ROBERT GANDOSSY AND JEFFREY SONNENFELD

IN HIS testimony before the House and Senate investigation of widespread corruption at Enron, former CEO Jeffrey Skilling insisted he had no knowledge of any serious problems in the company before his abrupt resignation six months into his term and six months before the firm’s collapse. Similar testimony by board members who chaired the finance and audit committees at Enron led U.S. Congressman Edward Markey to label this response the “Sergeant Schultz” defense. Sergeant Schultz was a fictional character on the 1960s TV comedy series “Hogan’s Heroes,” a sympathetic prison guard who routinely looked the other way when he observed rule infractions by prisoners.<sup>1</sup> His refrain “I see nothing, I hear nothing!” is widely used by both white-collar criminals and their compliant colleagues who are aware of the corruption but look the other way.

“If only one of the scores of lawyers, accountants, or managers had spoken up, this whole scheme would have unraveled. I just cannot understand how they could stay silent.” These were the remarks made to us by a decorated veteran of Silicon Valley tech start-ups, who was recruited in the mid-1990s as the new CEO in an attempt to salvage Informix, once a close rival of Oracle. Despite its path-breaking, often superior multimedia software, Informix was felled by a greedy revenue recognition scheme that deceptively propped up international sales. The turnaround CEO was horrified by

the apathy of those who knew and the timidity of the board to rout out the villains once the fraud was public.

“Either these people are just plain stupid or they don’t listen,” a CEO cried out to us decades ago at International Paper after the company was embroiled in a large price-fixing conspiracy. Several executives at International Paper were convicted, along with over 40 top leaders from 22 firms, who moved from Babbitt-like middle-class respectability to the stigma of being convicted felons. “We have clear codes of conduct and ethics statements,” the CEO continued. “Is it fair to hold the high school principal responsible because some students misbehaved?” Somehow the formal incentive systems, the intended role modeling from top executives, and the overt codes of conduct were inadequate in combating the informal culture that had taken root in this industry. But the patterns we observed in the paper industry decades ago—and the excuses, justifications, and calls for reform—are vaguely familiar today.

Whenever we enter the economic market, whether it is to seek employment, to purchase a product, or to strike a business deal, we are confident that the terms of the transaction—the promise, as it were—are exactly as they appear. It is easy to cheat if we want. Most diners can flee a restaurant, or taxi cab passengers can race into a crowded street, to skip paying—but few operate this way. In business, we rely on the words and actions of the others involved. What people say and do are moral and legal assurances to us that they are as they appear: that is, devoid of fraud and material misrepresentation. We have trust that our laws and regulations protect us against illegal business practices, and we believe violators will be discovered quickly and dealt with appropriately. We’re also comforted by the trust and integrity of leaders. We expect our leaders to have high integrity, to do what they say, and to operate within the bounds of the law. We have confidence that commercial activity operates this way. Without such confidence, the economy could never have evolved as it has.

This confidence—or trust—is not always well placed, as the recent series of highly visible cases of corporate wrongdoing and malfeasance tells us. It is sometimes difficult to determine who can be trusted and who cannot. We are not omnipresent. We cannot be sure their business associates have remained within the bounds of the law. We trust that they have. In part, this trust is derived from reliance on others—auditors, lawyers, the board of di-

rectors, internal staff, and the government—to monitor and police commercial activity.

During fiscal year 2002, the Security and Exchange Commission (SEC) filed a record 163 actions for financial reporting and disclosure violations—46 percent higher than the previous year. The Commission attempted to permanently ban 126 unfit officers and directors from corporate boardrooms—a 147 percent increase over the previous year. They filed 48 temporary restraining orders, up 55 percent from 2001, and they filed more subpoena enforcement actions than in previous years, supporting an extraordinary number of criminal prosecutions. Although the SEC cannot bring criminal charges itself, it worked in collaboration with the Corporate Fraud Task Force, established by President Bush, to bring 259 criminal actions by 30 different U.S. Attorney’s offices.

A number of well-known companies were implicated in these actions, and several were once the darlings of Wall Street or revered as models of innovation and entrepreneurship. And in many cases, their wrongdoing was conducted over a period of years, under the collective noses of a bevy of outside advisors and internal staff.

The examples of missed opportunities are staggering. On January 9, 2004, the venerable Royal Dutch/Shell Group admitted to the public that its senior management had known for over two years that its petroleum reserves were overstated in excess of 20 percent. In the aftermath a tumble in market value, a shattered corporate reputation, and the ousting of the chairman and other top officers, investors and regulators wondered how this massive fraud was kept secret.<sup>2</sup> In the trial of John Rigas and his sons at Adelphia Communications, prosecutors charged that the family took personal trips on company jets, spent millions of dollars of shareholder money on personal real estate, hid billions of dollars of debt, stole \$100 million, lied about revenue, and “borrowed” more than \$1 billion to buy Adelphia securities. A decade earlier, one finance vice president questioned extravagant personal expenses, only to be demoted and let go.<sup>3</sup> *Where were the other voices of outrage?* At HealthSouth, five former Chief Financial Officers (CFOs) were convicted after admitting to a \$2.5 billion accounting fraud that involved 11 other top executives. Reports show that auditors were tipped off five years earlier, but no investigations followed.<sup>4</sup> Tyco’s brazen CEO, Dennis Kozlowski, and CFO Mark Swartz were charged with looting \$600 million of corporate funds to

support extravagant lifestyles. Questionable purchases included properties in Manhattan, Florida, and Massachusetts; multimillion-dollar relocation payments; paintings by masters of western art, like a \$3.95 million Monet and a \$4.7 million Renoir; a now-infamous \$6,000 shower curtain; \$40,000 draperies; a \$2 million birthday party for Kozlowski's wife on the island of Sardinia; and other such waste, all while claiming legendary corporate frugality to investors and the media.<sup>5</sup> It has now been revealed that before Enron's collapse, senior executives at the nation's most prestigious financial institutions joined scams that helped hide debt and inflate earnings through fictional offshore special-purpose entities.<sup>6</sup>

No one knew. *Or did they?* Few if any took action. No one blew the whistle to put an end to the wrongdoing. How can it have been possible for some of the nation's leading institutions to have remained blind to such massive misconduct for so long? There are many shades of awareness and action. We might think of the state of awareness as a continuum ranging from individuals in the know—the criminals themselves, for example—to those in the dark—victims, for instance. In between the states of being fully aware and unaware are situations in which individuals have partial knowledge, a vague understanding or suspicion about the criminal activity happening around them. But what prevents people from seeing criminal acts for what they really are? What prevents people who suspect from learning more? What factors inhibit them from digging deeper?

There is no single answer to these questions, but there are several factors we've observed that interactively create situations in which individuals genuinely do not know enough to take action. In situations where they do know, there are circumstances that allow individuals to easily shift responsibility for taking action to others. First is the diffusion of responsibility for seeing and acting. Bystander apathy, the division of responsibility between specialists and organizations, obedience to the authority, and professional codes of conduct all contribute to this diffusion. These circumstances make it easy for information about and accountability for wrongdoing to slip through the cracks. The second factor is what we call *golden shackles*—a euphemism for the strong financial incentives to look the other way. These are often not explicit payments for complicity but rather a risk to a lucrative business partnership or job if too many questions are raised. Third is the lack of options for individuals who suspect wrongdoing. Where do you turn if you *suspect* but *don't really know*? Finally, there is a widespread tolerance for