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WHY VALUES ARE PRECIOUS?

There is a long-standing superstition that values calls for sacrifices in real life to be compensated by God in the eternal one. Consequently the picture of an honest follower of certain moral rules has been strongly associated with poverty, while success in creation of business and wealth has had to be based on a cynical approach to life. This idea refers much more to corporations than to individual people, since the former are often viewed to a greater extent as mechanical constructions rather than groups of people. Even if business founders, like John D. Rockefeller, Andrew Carnegie or Andrew Mellon, claimed to follow clear moral guidelines, they faced an outcry from their critics, who insisted that such declarations were nothing but a mocking attempt to cover the reality of an undisturbed drive for money and power. Now, when some corporations, however changed, have existed and succeeded for more than 100 years, researchers can analyse in depth the foundations of their development, looking at the factors holding such organisations together and stimulating their development. This article attempts to show how the business sciences have evolved, starting from a completely technical approach to corporate structures and functioning, gradually recognising the importance of more tacit factors, and finally getting to the point at which values are considered to create the fabric of modern firms.

Chandler's influence on business conduct

With the creation of the first big corporations there was little scientific explanation as to what the factors were holding them together as entities and unifying all stakeholders in their efforts. The simplistic answer which came always pointed to a hunt for accumulation of wealth at the expense of others who happened not to function within a corporate influence as a foundation of their existence. Alfred D. Chandler's remarkable work *Strategy and Structure*, based on extensive research on several leading US corporations including General Motors and DuPont, gave a more sophisticated explanation of the issue in consideration. He, of course, did not question a profit-based motivation, but rightly pointed out that such desire had to be converted into a tangible, long-term plan of actions and supported by a complementary division of roles and responsibilities. A paradigm of congruence in between strategy and structure as a cornerstone of each company's existence was born. While Chandler focused on structures and was rather an administrator than a strategist, generations of business leaders and scholars treated his book as a guideline for strategy formulations. The right strategy was to be set, then followed and supported by carefully tailored structures filled with precisely selected people. The logic of perfect correspondence in between goals and resources had an intellectual appeal and tremendous impact.

The congruence introduced above had been understood as a necessary product of top-bottom strategy formulation and implementation. The idea that execution is distinct from formulation had become firmly ensconced in management thinking. Formulation was to be separated from implementation as totally independent processes run by two separate groups of corporate employees: managers and workers. Managers were expected to craft a strategy, design the necessary tools, teach subordinates what they were expected to do and, finally, control results. The last of these duties constituted almost the only acceptable source of internal feedback for strategy change. Recommendations from operations were not forbidden of course, they were just not expected[1]. Basically the only group allowed to participate at the forming stage was external consultants.

Such a mechanistic[2] approach to organisations originated from the pioneering concepts of Taylor and Ford, who revolutionised production and operations, converting the chaotic efforts of numerous independent people into a system in which everybody had a precisely pre-designated role to fulfil. Any departure from established procedures was an oddity, posting risks and/or creating losses to an organisation. Companies were essentially to compete in two areas: efficiency of established rules, and ability to reinforce them into operations.

[1] A. C. Hax, N. S. Majluf, *Strategic Management. An Integrative Perspective*, New Jersey 1984; R. L. Martin, *The Execution Trap*, "Harvard Business Review", July–August 2010, p. 66–67.

[2] The term "mechanistic" was introduced by Burns and Stalker in 1961 as opposed to "organic". See A. C. Hax, N. S. Majluf, *Strategic Management*, p. 404–406.

Any failure had to be attributed either to bad strategy formulation or to its inefficient execution. Statements like "I'd rather have a first-rate execution and second-rate strategy any time than a brilliant idea and mediocre management" were accompanied by one stressing the key importance of a clear and appropriate strategy which could be almost automatically implemented[3].

A corporation was nothing more than a set of procedures linking all the staff. And nothing else but "efficient" procedures was deemed necessary to develop and prosper. As summarised by Peter Drucker, traditional (or in another, more accurate word, mechanistic) corporations can be characterised by the following five basic points[4] (expanded a little by the author):

– In almost all key relations a corporation had an unmatchable bargaining power: with employees, suppliers and even clients (especially in the case of Business-to-Customer industries), based on almost fully controlled infrastructure, production capacities and product development.

– In the great majority of employees the pay they got for the job constituted their only source of income. This referred to some extent to suppliers. In certain cases also customers had become strongly dependent if not on one, then at least on very few corporations.

– The most efficient way to produce anything was to consolidate internally as many activities needed to turn out the product as possible in order to lower the transactional costs.

– Customers were deficient in product expertise so they had to rely almost solely on the suppliers' brand and renown.

– Key technologies were exclusive to those industries which they served.

The properties described above created a perfect environment for creating knowledge and power pyramids, with executives on top, specialists in the middle and finally customers, suppliers and other stakeholders at the bottom.

From 1970 onwards, however – and this date can be established quite precisely – the environment turned upside down:

– Knowledge-based industries have become dependent more on the competences of employees and suppliers than on physical assets strengthening their bargaining power against corporations.

– An increasingly large part of the workforce has been made up not by full-time employees but by part-timers, temporary consultants and contractors whose dependence on the income coming from a given corporation constitutes a diminishing part of their total income.

– Knowledge has become both expensive and highly specialised, making it very difficult for one, even very sizable, corporation to support its development in all areas needed for the business. In addition communication channels have become significantly cheaper, leading to a decline in transactional costs. Both factors men-

[3] R. L. Martin, *The Execution Trap*, p. 66.

[4] P. F. Drucker, *Managing in the Next Society*, New York 2002, p. 271–277.

tioned above acted as a triggering cause for promoting disintegrating programmes such as lean management, outsourcing and so on.
– The internet and other communication tools have closed, at least partially, the information gap between corporations and their partners. The periods within which each single piece of information or product becomes widely available have shrunk so dramatically that the competitive advantage is built by an ability to effectively use rather than having access to them.
– Key technologies for many industries have been developed outside internal cycles of their leaders. Both telecommunication software and fibreglass cables were not created by telecom companies, but by those from related businesses.

In view of the above, managers learnt that the search for ideal procedures recalled the famous proverb about a dog attempting to catch its own tail. Given the time needed to develop, consult, approve and implement whatever procedure or other similar regulation it is almost certain that in the meantime the environment is going to change enough that at least some of the factors underpinning the carefully prescribed schemes and solutions deviate very much from the base, making at least part of it ineffective or even not applicable. Therefore every manager with some experience knows that there is no one top-bottom direction in such complicated processes as managing companies. Instead there is an intensive exchange of signals going both down and up as well as a massive amount of decisions and actions taken without any instruction from headquarters, based on "common sense", "practical approach" and "case-by-case judgement" to name the explanations given most frequently where a formal cause for them is asked for.

Over the years people in business organisations, acting as described above, develop competences in both a planned and an unstructured way, consequently creating a unique intellectual and emotional capital. Moreover, this capital is based not only on themselves but also on relations formed with colleagues, customers, suppliers and other stakeholders. Collaborative, complex problem-solving constitutes its essence. These "tacit" competences – exchange of unstructured information, making quasi-intuitive fast judgements in exchanges with fellow workers, suppliers, and customers – have become a standard model for leading companies in various industries (see the results of research conducted by McKinsey: Fig. 1)[5].

Interestingly, the percentage of "tacit" workers has a very strong impact on financial performance, widening tremendously the span of financial results. In industries characterised by the dominance of routine tasks the discrepancy between the best and worst companies tends to be relatively narrow. The McKinsey study showed that in the case of freight companies the EBITDA (earnings before interests, taxes and depreciation – a commonly used indicator of operational efficiency) per employee varied from $7,000 to $90,000.

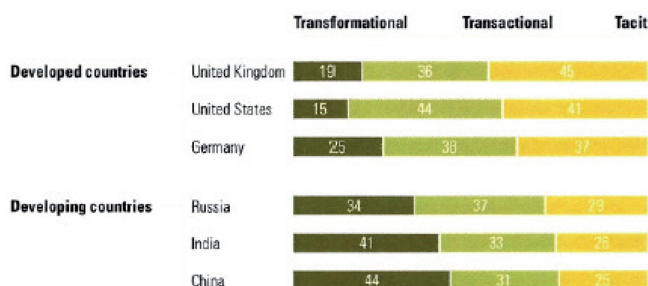
[5] S. C. Beardsley, B. C. Johnson, J. M. Manyika, *Competitive Advantage from Better Interactions*, "McKinsey Quarterly" 2006, No. 2.

On the opposite side, in the case of one of the mostly interactions-based businesses – private banking – the same index spanned from minus $82,000 up to plus $805,000, eleven times more.

Figure1. Structure of positions in corporations regarding complexity of problem-solving

More jobs require tacit interactions

Composition of economies, 2004, % of workforce by job type[1]



[1]Categorized by predominant job activity: tacit = complex interactions; transactional = routine interactions; transformational = extraction or conversion of raw materials; 800 occupations studied.

While transactional or transformational jobs have to be administered quite precisely based on some sort of formally reinforced instructions and structures, "tacit" ones would lose their nature if managed this way. By definition "tacit" means something implicit and unspoken. Therefore "tacit" employees cannot be organised by any formal ruling, neither procedures nor structures. They require other type of drivers keeping them together and coordinating their efforts if a corporation is not to fall into total chaos and eventually break up. With all its cloudiness and apparent elasticity they have to be somehow organised around any kind of stable denominator which would simply keep a given company united.

Porras and Collins's contribution

Jerry Porras and James Collins coined the terms: "visionary companies" and "visionary leaders" in their famous book *Built to Last*, first published in 1994. This outstanding work identified a set of corporations which had:

– managed to achieve a "crown jewels" status in their industries, being admired by both peers and stakeholders and significantly influencing their behaviour;

– prospered over a long period of time, through multiple product and economic cycles, generations of leaders (indeed some of them managed to survive the extinction of their once key markets);
– brought a return on investment, in a long-term perspective, significantly higher than even their closest competitors, not to mention the market average[6].

Porras and Collins underlined that the key point for the visionary companies' success was that they were organisations (institutions) capable of surviving the passage of their most able leaders, greatest products and services, most widely admired business concept, somehow fulfilling Chandler's idea of the "perfect" business structure. Yet, their understanding of corporate basics was almost totally different from that of the respected author of *Strategy and Structure*. In the whole book it is in fact very difficult to find any reference to organisational charts as well as to communication and reporting lines. If these are irrelevant, what could hold these crown jewels together and make them so successful? The answer comes with a piece of advice to young leaders wanting to convert their company into a visionary one. They posted a question, simple but the most important: where should they begin? Here is the reply: "First and above all else, pin down your core ideology. Start by articulating your organisation's core values. And we mean ***core*** values"[7] Then we can find a list of simple testing questions verifying whether the values being considered merit a status of core ones. Reading it through, one can compare such requirements to the attributes of the Ten Commandments that make them a cornerstone of Christian values.

The first criterion to be met is about upholding candidate values, even if obeying them causes a loss, financial or otherwise difficult to sustain. This requirement links value to sacrificing through expressing the very basic concept that values cannot be available for free, otherwise nobody would consider them valuable. The same applies to the Commandments. One very simple example shows how difficult it is for companies to meet this fundamental requirement. Corporate leaflets and reports are packed with declarations about honesty in dealing with customers. Yet how many companies compensate clients for the time lost while dealing with their defective products? In many cases a mere substitution with a new item is meaningless. For somebody who, say, paid 10 dollars for a CD to be played during his daughter's anniversary, which then turned out to be damaged, sending a new one a month later creates only trouble.

Or, more commonly, which bank is willing to return not only the value of a fake transaction but also pays interests on money mistakenly charged, not to mention other costs incurred? Of course one may argue that the acceptance of such

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[6] In fact a return on one US dollar invested in the twenty visionary companies' shares brought 6,356 dollars between Jan. 1st, 1926 and Dec. 31st, 1990, so over 65 years, while investing the same one dollar in shares of the twenty closest competitors gave only 955 dollars. In the same period of time General Market rose from one to 416 dollars only. See: J. C. Collins, J. I. Porras , *Built to Last. Successful Habits of Visionary Companies*, New York 1994, p. 1–7.

[7] *Ibidem*, p. 219.

costs would have affected profits. And precisely this is why honesty is valuable and so few can really be named honest.

The second criterion core values are to meet refers to their usefulness for stakeholders. The best way to check this is to ask the following question: "Suppose the corporation shut down, duly paying out all financial obligations, would the stakeholders be adversely affected? And if it does so 100 years from now will this also be true?" There are two components of this requirement. First, the core values have to be both valuable and unique, so stakeholders would not only regard their disappearance as substantially negative, but they would also not be able to easily find them, e.g. among the corporation's competitors. Second, the core values have to stand the test of time. This is especially important if a candidate value is linked to a product or service. The ability always to provide the fastest microprocessors available on the market might make sense. But what if microprocessors are replaced with other type of devices designed for the same purpose? It took humanity around 50 years to replace mechanical calculating machines with silicon based ones. This is two generations only.

Can the concept of core values work in business practice? Let us take a short look at American Express. This is in a way a strange company. It is most commonly known as one of the biggest credit card issuers in the world. Yet it is not a bank. And it does not even want to become a financial institution. It began life in 1850 as a regional freight express business. Thirty years later, facing a declining demand for cash shipping services due to the increasing popularity of postal money orders, American Express created its own money order named "American Express Order", which was made available not only at the company's premises but also at railroad stations and retail outlets. A decade later, the company was inspired by the difficulties faced by its own president during vacations in Europe who found it troublesome to cash his letter of credits. As a response to the boss's fatigue an American Express employee created the "American Express Travel Cheque", based on the simple principle of checking the congruence between two traveller's signatures, one made upon purchase and the second upon redemption. By chance a float was created, a source of additional income for the company, since in 1990 the outstanding balance of unrecalled cheques topped $4 billion, generating interest of around $200 million. Simultaneously, in serving mostly American travellers around the world it has developed another business area: travellers' assistance. Crowds of Americans have crammed American Express offices, primarily for checking cash, but considering it the almost only trustworthy institution in the otherwise unfamiliar environment, which led to it starting to share all sorts of other problems: mail service delays, ticket availability, scarcity of medical care and so on. To some extent American Express has also become a travel agency. Surprisingly the last evolution occurred against the explicitly announced will of the company CEO, who once said: "This company is not and does not intend going into touring business".

What may look like opportunistic exploration of business opportunities available by chance has in fact been a constant and long-term development and application of three core ideologies: heroic customer service, worldwide reliability of services and encouragement of individual initiative[8] oriented towards serving travellers' needs. That is why American Express has not entered the mortgage business, although it has accumulated a lot of strengths almost warranting success if such a move occurs. Who else has obtained such a network of contacts with potential customers, detailed knowledge of their needs as well as experience in financial services? There was only one obstacle, albeit a decisive one. American Express's core values are not attractive in the mortgage business. Rather than the customer service being heroic, one expects it to be predictable, since decisions are taken after thorough evaluation usually within clients' own home premises. Worldwide reliability is usually not a need, since even wealthy families own no more than two or three properties. Individual initiative, in case of mortgages, is definitely not welcomed, since this business has to be, by its nature, highly regulated and based on clear and rigidly imposed procedures. Individual initiative here recalls much more fraud than heroism.

Core values have to be preserved and protected vigorously over time. There are many ways of doing this, but a cornerstone of all effort is created by translating ideologies into tangible mechanisms aligned to send a consistent set of various reinforcing signals such as:

– extensive in-house training programmes, often structured in the form of "universities" or official training centres (for example the McDonald's Academy, which was run in cooperation with the University of Indiana and granted regular credits);

– social events, celebrations and contests underlining the importance of common values;

– unique language, songs, cheers and affirmations promoting psychological commitment;

– incentive, advancement and promoting criteria explicitly linked to a given corporate ideology with strong preference for internal promotions[9].

If successful, these efforts lead to the creation of a religious order – a kind of uniformity among employees and even partners. Joining IBM was presented as on a par with joining a religious order[10], to such an extent that when, in 1979, the corporation created a spacious "Management Development Centre", one of its employees said that it "might pass for a monastic retreat", and continued by stating that the company had institutionalised its beliefs the way a Church did, converting employees into ardent believers.[11]

[8] *Ibidem*, p. 88 and 142–143.

[9] *Ibidem*, p. 88 and 134–136.

[10] *Ibidem*, p. 125.

[11] R. Levering, M. Moskowitz, M. Katz, *The 100 Best Companies to Work for in America*, New York 1985, p. 163–168.

It is worth noting that even such a utilitarian and goal-oriented thinker as Machiavelli recognised that it is difficult to lay the foundations for long-term ruling without the support of religion, either adopted or self-created[12].

However, Porras and Collins pointed out one, in their view, fundamental difference between cult-like corporations and religious faiths and sects. They claim that the former are constructed around ideologies, not around cult leaders. This dissimilarity is much smaller if analysed in depth. Of course all major religions are attached somehow to their more or less historical founders. But this is so also in the case of corporations. Each of them was founded by a visionary, but no fictional leader. In both cases their real appeal in followers' eyes has been linked to the ideas they advocated and pursued. The only difference – but a crucial one – is that prophets claimed eternal support and origins of their teaching while corporate founders had no such privilege, at least directly. This is not to say that visionary leaders were not religious. On the contrary, most of them were active members of various Christian Churches, believing that their business efforts comply with God's expectations. What is often not told in the history of entrepreneurship is how many companies started with a vision that was informed by the religious faith of their founders, companies like Cadbury (Quaker), Herman Miller (Calvinist), Service Master (Evangelical), Dayton Hudson (Presbyterian), Cummings Engine (Disciples of Christ) to name a few of the most famous[13]. However, as regards corporate values, God was usually not claimed to be an original author.

Amazingly, strong ideological control is not an obstacle to, but creates an excellent environment for operational autonomy. It was its strong culture which allowed Nordstrom, a company renowned for excellent customer service, to write in its employees' manual the following instructions: "Rule #1: Use your good judgment in all situations. There will be no additional rules."[14] Such brevity in approach may come as a shocking surprise to many employees of banks, telecoms and other service companies with voluminous "customer relationship management procedures" describing everything from a unified pattern of male staff ties up to a standardised size of welcoming smile, not to mention long reports filled in after each interaction with a customer. According to this approach's logic, customers should have encountered disorder and incompetence in Nordstrom shops and would have escaped from them disgustedly running to competitors' premises. Yet nothing like that happened. Clients actually took almost exactly the opposite direction, praising Nordstrom's level of customer attention and service. The secret of Nordstrom's success lies in two mutually supporting factors: Sale Per Hour (SPH) based performance indicator and secret shopper control. The former takes care of current

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[12] See: H. C. Mansfield [in:] N. Machiavelli, *The Prince. Translated and with an Introduction by Harvey C. Mansfield*, Chicago–London 1998, p. xxi–xxii.

[13] M. Naughton, J. R. Cornwall, *Culture as the Basis of The Good Entrepreneur*, "Journal of Religion and Business Ethics" 2009, Vol. 1.

[14] J. C. Collins, J. I. Porras, *Built to Last*, p. 117.

financial results, while the latter takes responsibility for making sure that customers are served in a way which guarantees their return. The rest is left up to employees, as they are supposed to be much better at addressing individual customers' needs than any bureaucrat sitting in an "ivory tower". Nordstrom correctly recognised that each time a front-line employee responded to a customer request it was up to him to choose how to represent the company and his choice was directly related to the fundamental value proposition Nordstrom was offering[15].

Values cannot be induced by any formal training. They do not resemble IT systems or re-engineered processes and cannot be copied easily, if at all. To be developed they require above all time spent in a given company, since almost always they are specific to a particular business context. Therefore they cannot easily, if at all, be purchased directly on the market. As a consequence, value-based corporations cannot afford to maintain Chandler's congruence between strategy and structures adjusting employees' tasks and benefits to a current set of goals. One of the most successful corporations named people who in other firms would hold executive titles "advisors". This bold step expresses the idea that it is not employees, but processes that are managed. The real interdependences in modern companies are not kind of master-servant relations but strongly competence based. A leading role is usually naturally assigned to a person with the highest intellectual and psychological ability to make the right decisions, which sometimes acquires formal confirmation in the form of "project leader" or "process leader" assignments. Asking experienced people to subordinate to any "most efficient" formal structure would then have a tremendously negative effect. They would either leave a company or intellectually withdraw themselves from activities they would otherwise contribute to. On the other hand, it would take new people, even technically very well prepared for assigned responsibilities, years to develop the "tacit" skills necessary to take effective actions in a complex and interrelated environment.

Now, at the beginning of the 21st century, we are overwhelmed by the speed and profoundness of alternations. The notions of turbulent times and rapidly changing environment have become the new paradigm. Thinkers claiming that managers can either change or die are followed by crowds of believers. Is there any place for stable values now? Surprisingly it looks as though they have become not only obsolete, but even more necessary. With the accelerating pace of technological change, dramatically shorter product and market cycles the lifespan of any single business idea will only decline. The same applies to structures and procedures. The former become flatter, more decentralised and geographically dispersed, accepting much wider areas of individual autonomy and dependent on their knowledge. Homework also pays tribute to that, destroying the external attributes of hierarchies. The latter are challenged by the diminished role of formal powers, budgets and reporting lines. So what, then, is to keep corporations together? It looks like only core ideologies can do the job. They possess, if properly applied, several

[15] R. L. Martin, *The Execution Trap*, p. 68.

unique features:Ideologies tend to be flexible enough to adapt to various technologies as they speak to basic and universal needs. Diseases have long accompanied humankind, as well as the means to cure them. Challenging them is an always valid mission, regardless of the means applied.

Surprisingly, in view of the above, ideologies can be precisely defined. Enough to be understood in pretty much the same manner over ages. The distinction between treatment of a disease and cosmetology, however heavily challenged, is clear to most of us, as well as for the ancient Egyptians. Even so, if the tools used in both areas have changed so much.

Ideologies rather catalyse than disturb innovations, since a changing environment faced with stable values creates unbalances which have to be checked by new business ideas and product lines. Such innovations are self-generated and continuous, building on previously developed strengths and upgrading them to a new level. In such a way an innovation becomes more a process than a case, upholding, not destroying, the basis of a corporation[16].

Paul Polman, CEO of Unilever, after serving on the Management Boards of Procter & Gamble and Nestlé – all three of them operating in FMCG, definitely a rapidly changing business facing enormous challenges – made it clear that what made them great were strong values. The companies he has worked for are increasingly more appreciated for what they did to the economy. In Polman's opinion values permitted these companies to do the right thing in the long term, to operate with a high level of integrity and trust, to invest in their people, always wanting the communities where they operate to be as successful as the companies themselves.[17] The opposite can be said about Enron, which went bankrupt in 2002 in a way which shocked America. It fostered innovation in an unprecedented way in otherwise mature and "boring" industries: electricity and gas supply, basically creating totally new markets. It lacked two other, as it eventually turned out, much more important features: focus and direction, proper values. And in this deficit the real reasons for its collapse can be found[18].

Certainly, even companies based on strong ideologies can face troubles and fall into crises. No one is immune to them. And there is a strong temptation to depart from the core values when difficulties accumulate and old products and business practices become obsolete. But as recent interviews with 15 CEOs and chairmen of boards showed, a healthy company enjoys not only strong financials but also a culture and values that bind it together. The CEO of AutoNation, a car dealer network especially strongly affected by the troubles of the Detroit-based car makers, admitted that the most critical battle he waged when he arrived was destroying the "growth at any cost" culture and replacing it with entrepreneurialism paired with

[16] J. C. Collins, J. I. Porras, *Built to Last*, p. 227–229.

[17] A. Bird, *McKinsey Conversations with Global Leaders: Paul Polman of Unilever*, "McKinsey Quarterly", October 2009.

[18] P. C. Fusaro, R. M. Miller, *What Went Wrong at Enron*, New Jersey 2002.

the highest standards of integrity. Over three years following his appointment he worked hard to nurture and recruit the right people for the company's top 350 positions and to purge the "high-performing money-makers whose risk profile would keep you awake at night." This amounted to a cultural revolution that has delivered a sustainable competitive advantage[19].

The strength of visionary companies lies in the way they deal with adversities: by turning to their core ideologies. Let us review in brief IBM's recent history. "Big Blue", as it is also known, had for a long time been associated with PCs. In many countries IBM had become a synonym for a personal computer. Increasing competition from low-cost and sometimes more capable producers alongside the dominance of Microsoft on the software market brought this icon of the US computer industry almost to bankruptcy. Various attempts, for example based on taking over Lotus, the office software manufacturer second only to Microsoft, not only failed to return leadership but increased financial stress and operating problems. Then IBM decided to get rid of the PC business altogether (selling it to Lenovo) and focus on analysing and streamlining customers' processes, offering a wide range of outsourcing and consulting services. Now, in 2010, "Big Blue" is again a respected and profitable company, the number 2 software provider globally. But this shift meant no less than going back to the company's roots. After all IBM had started with offering calculating services aiming at simplification and cost effectiveness of customers' processes related to a huge accumulation of simple algebraic calculations, such as payrolls, to name one of the most popular examples.[20] Here, once again, "Big Blue" found the source not only of business competitiveness but also of advanced product development. The once innovative machine called the PC is passing by now, but process effectiveness is even more desired. So the IBM core ideology is separated from temporary slavery in a plastic box, which for a few years exemplified it.

As Chantal Delsol rightly pointed out, common values are in fact a language which serves two purposes: to bridge differences and to determine common meaning[21]. The latter expresses an everlasting dynamic impulse for constant change, yet preserving a certain call that every member of a corporate family can refer to in order to assure that his/her efforts are consistent with the actions of others.

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[19] D. Carey, M. Patsalos-Fox, M. Useem, *Leadership Lessons for Hard Times*, "McKinsey Quarterly", July 2009.

[20] R. Waters, *Big Blueprint for IBM Services*, "Financial Times" 2009, 3 March, p. 12.

[21] C. Delsol, *The Unlearned Lessons of the Twentieth Century*, Wilmington 2006, p. 134–135.

Deficiencies of the financial approach to business: the cases of Enron and Lehman Bros

Chandler's well-known conclusions about the necessity of gathering meaningful data processed via clear-cut communication lines and authority leading to optimal allocation of resources[22] not only guided them, but also drew a borderline of managerial sciences. Hence a business equalled business administration run by masters in business administration – cold technocrats able to solve problems and calculate risks. And the long-lasting search for hard evidence resulting from even harder data, creating the basis for right decisions, became a necessary foundation of any "strategic" decision.

Finally, McKinsey summarised this approach to business by stating that the managers' ultimate goal was to "gather appropriate information, evaluate it thoughtfully, and make choices that provide the best chances for the company to succeed, all the while recognising the fundamental nature of business uncertainty"[23]. And among all business sciences there is no other more thoroughly based on hard data than financial accounting. Accountants have successfully claimed that the only universal language valid in the business word is their language: profits, costs, investments, equity are "hard", "objective", delivered by application of an array of specific rules to all businesses.

The two astonishing and gigantic failures of Enron (2002) and Lehman Brothers (2007) posed fundamental questions about not only the efficiency and limitations of financial reporting and audits but also the real value of technical, "hard" skills. In both cases we are talking about highly respected and supposedly successful corporations – stars of corporate America. The former won a string of prizes for being extremely innovative, creating new industry standards and even new industries. In fact it surpassed competitors tremendously in this area – for all its flaws, Enron was an important trading academy for the industry. Eight years after its collapse commodity markets still suffer from a tiny supply of skilled professionals[24]. Enron's CFO, Jeff Skilling, came from McKinsey, known "the Firm" and recognised as the leading "strategy house". The financial statements had been audited by the biggest and widely renowned accounting giant: Arthur Andersen. Moreover it would be unjust to state that these people deliberately caused Enron's collapse. After all they all paid a high price too[25]. The latter earned credit for capital efficiency. In both cases they were believed to be run by highly professional

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[22] A. D. Chandler, *Strategy and Structure: Chapters in the History of American Industrial Enterprises*, Boston 1962, p. 396.

[23] P. Rosenzweig, *The Halo Effect, and Other Managerial Delusions*, "McKinsey Quarterly" 2007, No. 1, p. 8–9.

[24] I. Kamińska, *Market for Traders is Hottest One of All*, "Financial Times" 2010, June 1st.

[25] Arthur Andersen lost almost all its customers and had to withdraw from the audit business as a whole. Its consulting branch underwent a thorough reorganisation and came back as Accenture. Several of Enron's top executives were sentenced to prison. At least one of them committed suicide.

management teams fenced by the most advanced combinations of regulations and audits. The financials, as presented in official filings, looked very strong. Months before their defaults anybody questioning credibility of these institutions would have become a good target for satirists. Yet both of them failed miserably.

First of all, they failed to recognise four reasons noted by Henry Mintzberg, which undermined the belief in deliberate strategy formulating based on hard data. These deficiencies were as follows[26]:
– the hard information was limited in scope and often failed to encompass important non-economic and non-quantitative factors;
– much hard information is too aggregated for effective use in strategy-making;
– much hard information arrives too late to be of use in strategy-making;
– a surprising amount of hard information is unreliable.

At the end it turned out that Enron's operations were composed of a wide array of independent deals, each of them taken on the grounds of some research, but there was no research supporting decision-making and control at the corporate level. The process of creating financials reflected this problem very well. The CFO had no vision as to what to expect from reports in terms of at least a range of values. When they arrived a "dressing" process usually started, aimed at covering big problems. Surprisingly, at the first stage, the biggest negative impact had been coming from operations remotely related to the core business, for example from water deals in India[27]. Only later, when problems mounted, did core activities follow.

Experienced managers know very well that making a good decision takes much more than data-gathering and analysing. It requires a subjective judgment based on previous experience and intuition. However, these tacit factors may play both in favour of and against corporate interests. If properly used they were a spur to excellence. But if flowed by bad will and desire to accumulate wealth at the quickest pace possible they led to disasters. Therefore the challenge lay in creating a controlling mechanism capable of identifying these two groups properly.

Traditional control and audit relies heavily on exactly the same principles Henry Mintzberg successfully questioned. They recognise two sources of managerial failures:
– either managers failed to collect enough hard data,
– or managers failed to process the collected data properly.

Consequently all decisions based on "tacit" factors must have been questioned on the grounds that they by definition must not be supported by objective evidences.

What, then, was the real reason of Enron and Lehman Bros' bankruptcies? Henry Poulson, a former US Treasury Secretary, noted in an interview given to the Financial Times that "*the key test of accurate financial reporting is trust*"[28]. But

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[26] H. Mintzberg, *The Rise and Fall of Strategic Planning*, New York 1994, p. 257–266.

[27] P. C. Fusaro, R. M. Miller, *What Went Wrong at Enron*.

[28] "The Financial Times" 2007, May 17, p. 11.

how is this trust to be built if, as shown above, old-fashioned control and audit systems are more and more deficient in the modern world? In their attempt to construct new credible reporting standards Samuel DiPiazza and Robert Eccles[29] named the three necessary pillars on which the new trustworthy accounting system should be based. Anyone who expects them to be a new set of sophisticated financial indicators, cold computer-based algorithms and Monte Carlo simulations or something similar is profoundly wrong. DiPiazza and Eccles indicated:

– a spirit of transparency,
– a culture of accountability,
– people of integrity.

Corporations are simply the people who work in and manage them. When they, for various reasons, decide to hide something in practice the list of possible options to do so turns out to be almost unlimited. Nobody else but employees know best what is really going in a company, which decision or change in an environment has an important impact on corporate market value and which not. The growing complexity and volatility of modern business increases the information gap between insiders and outsiders. Therefore nobody, even the smartest supervisory board member or auditor, can quickly recognise an intentional fraud. The real protection must come from an ethos of responsibility, this internal controlling lamp which says independently from all procedures and regulations that a given behaviour is just wrong. Managers with such a lamp are best controlled and audited. Their whole complex business knowledge protects them better against possible misbehaviour or even fraud. Rules, regulations, laws, concepts, structures, processes, best practices and the most progressive use of technology cannot ensure transparency and accountability. This can only come about when it is based on people of integrity. Doing the right thing can never be compromised. Actions that purport to increase a return for shareholders at the expense of integrity ultimately betray both. Pointing out various roots of Enron's collapse Peter Fusaro and Ross Miller came to ethics and noticed: "many students are believed to view ethics as being about not getting caught rather than how to do the right things in the first place".[30]

Integrity, as mentioned above, is about doing the right things. There is no other existing way to define what is right and what is wrong than turning to values. In his classic book about law John Finnis elaborated profoundly and convincingly on the necessary existence of natural law – commonly recognised values which need not be spelled out in any formal way but enable any practical and congruent execution of all prescribed rules[31]. Consequently only people sharing common values can communicate efficiently beyond formal regulations. And only common values can keep mutual understanding, the prerequisite for trust, existing

[29] S. A. Di Piazza, R. G. Eccles, *Building Public Trust. The Future of Corporate Reporting*, New York 2002, p. 3–7.

[30] P. C. Fusaro, R. M. Miller, *What Went Wrong at Enron*, p. 148.

[31] J. Finnis, *Natural Law and Natural Rights*, New York 1980.

regardless of any turbulent environment and the increased complexity of business information. So financial reports are not based on values reported – they are based on values shared by those who make reports and those who take actions resulting from analysing financials.

Therefore, to cut a potentially extremely long argument short, the real reason for Enron and Lehman Bros' defaults was the lack of commonly recognised and followed values by their key stakeholders.

Conclusion

The turbulent years 1990-2010 surprisingly showed the importance of values in business as a foundation of keeping corporations on the floor. They possess two key characteristics necessary for operating successfully: on the one hand they are flexible, allowing or even forcing adjustments of products, services and operations to constant changes, yet holding big organisations together around a certain common mission and vision. Organisational structures, formal allocation of power and resources are necessary, but if they are to be efficient it is crucial to develop them as a consequence of application of long-standing values to the current market situation. The decreasing ability of formal power and control systems to deal with risks resulting from a rapidly changing environment showed clearly how much modern corporations are dependent on very simple but extremely powerful factors: the honesty and devotion of their employees and partners. Both of them cannot be ruled out and controlled in any formal way. Honesty has always been based on a commonly shared belief regarding what is "good" and "bad". People with substantially different views on this issue cannot cooperate differently than with use of formal power because somehow these discrepancies have to be checked within the organisation. A similar requirement is posted by devotion. One can devote part of one's life to something deemed valuable in more than a mere monetary way. When one finds other people with a similar purpose an organisation gets created almost naturally and continues its existence even if the founding generation passes by. When such a unifying purpose is missing all other tools and efforts utilised to keep corporations going bring only temporary results and rarely prevent them from a final break-up or collapse.

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