National Medical Enterprises moves swiftly on ethics training

By Andrew W. Singer

Scandal is the great road leveler when it comes to ethics training programs. It can overcome a thicket of corporate resistance. Has the company been accused of wrongdoing by its chief regulatory agency? It may prompt a two-lane ethics building effort. A really big scandal? The company’s ethics trainers will soon be rolling along a four-lane highway.

In the early 1990s, National Medical Enterprises (NME) had an eight-lane scandal on its hands.

Ten large insurance companies sued the Southern California health care provider in 1992, alleging $740 million in fraudulent psychiatric claims at NME’s psychiatric hospitals. Later, 600 federal agents raided company headquarters, seizing papers related to the suspected fraud. Among the abuses with which the Santa Monica-based company was charged: Overbilling. Fraudulent diagnoses to extend patients’ hospital stays. Illegal payments for referrals to the company’s psychiatric and substance abuse facilities.

Eventually, NME paid out $375 million in a settlement that followed a three-year federal criminal and civil investigation. This was on top of another $200 million settlement with private insurers over fraud charges and the settlement of charges by the SEC.

Now under new management, National Medical Enterprises has responded with one of industry’s most swiftly executed large-scale business ethics training efforts. In less than eight months—from November 1993 to July 1, 1994—it put more than 80 percent of its 30,000 employees through a two-hour ethics training regimen. By the end of 1994, it had trained 90 percent of its employee population, including the firm’s chairman and its president.

A demonstration of commitment

This, by most measures, is an unusually fast training rate. “We were very interested in demonstrating to the government that we were serious, that senior management was..."
committed,” recalls Neil B. Hadley, Vice President, Corporate Compliance and Ethics Program.

Hadley, appointed to his post in mid 1993, has been with the company since 1984 in a variety of positions, including operational posts in Saudi Arabia and Asia, and a stint as associate administrator at one of NME’s California hospitals. Before that he spent 29 years in the U.S. Air Force where he held the rank of Colonel and was Air Force Medical Service Comptroller.

Three main components

Working with a consultant, Mark Pastin of Virginia-based Strategic Management Systems, Hadley quickly sought to develop those key elements that a large corporate ethics program should have if it is to pass muster under the federal Organizational Sentencing Guidelines. The three primary components, in his view, were a Standards of Conduct booklet, an ethics hotline, and ethics training for company employees.

The Standards of Conduct booklet was published in September 1993. Its writing and dissemination followed interviews and focus group sessions with some 100 employees. The hotline, or Ethics Action Line, was in place by October 1, 1993. Ethics training began in November 1993.

The training was designed to be comprehensive. “Every person in the company had a face-to-face encounter.” (After the scandal, the company divested many of its psychiatric hospitals; its 55,000-person payroll shrunk to about 30,000. The company has since focused on its acute care medical facilities, its traditional business.)

The effort began with 15 of the company’s most senior executives, including the chairman, president, chief financial officer, and general counsel. These were four-hour sessions—not all 15 could attend on the same day—led by consultant Pastin.

Training for the next-most-senior executives began in March 1994 and continued until July 1, 1994. This involved 400 executives, including the CEOs of NME’s various hospitals. Training groups were no larger than 20 individuals.

The remaining workforce underwent two-hour sessions in groups of 40 to 45 individuals. By the end of 1994—after a second sweep of the hospitals to provide additional sessions for those who had missed the training on the first wave—90 percent of the workforce had been trained.

Why full-day sessions?

Hadley was asked why the company opted for full-day training sessions for the hospital CEOs and other senior staff in the operating units. The aim was to “really immerse the [hospital] CEOs” to impress on them, and their subordinates, “that this was something different. If they went through a full-day session, we thought this would be more meaningful.”

The first two to two-and-a half hours of these sessions dealt with some of the history of ethics programs—how and why they began in the defense industry, for instance, after the contracting scandals of the 1980s. They included a review of the Standards of Conduct booklet.

The afternoon sessions were dedicated to 20 or so ethics case studies. The 12 to 14 executives spent the time

Ninety percent of the employee population underwent ethics training within a fourteen month period.
discussing the cases, with role playing. The question often asked: “If you were in this situation, what would you do?”

**An appropriate bid?**

One case used in NME’s training sessions focused on a hospital purchasing officer who needed to buy a new piece of equipment. He had three potential vendors. One happened to be his brother-in-law. He received the three bids. All were roughly similar. If anything, the brother-in-law’s bid may have been the better of the three.

The purchasing officer awarded the contract to his brother-in-law. Now say you’re a clerk in the purchasing department. Does this bother you? Even if the brother-in-law’s is the best bid?

If it does bother you, what should you do? Go to your boss’s boss? Call the 800 ethics number? Or do nothing?

Hadley points out that such a conflict is addressed in the company’s Standards of Conduct booklet. (“We should avoid placing business with any firm in which we, our families, or our close business and personal associates have a direct or indirect interest.”) And because the booklet is reviewed before the scenarios are presented, employees may already be sensitized to some of the issues.

Overall, some 25-30 cases have been presented at the training sessions. Most are from real life situations. Textbook solutions are generally avoided.

**Establishing a hotline**

As mentioned, the company’s ethics hotline was established quickly—several months after Hadley took over the ethics office, on October 1, 1993. Hadley notes that while the federal Organizational Sentencing Guidelines do not actually make hotlines mandatory, “they make it close” to mandatory if a company wants to be judged to have an “effective” ethics and compliance program. And since NME had been in trouble with the government it was seen as a virtual certainty that the company would have a hotline.

Still, the action was not without some contention. Referring to the various hospital units, Hadley recalls that “some CEOs weren’t too happy about it.” The initial attitude was something on the order of: “You mean that someone in my hospital can call [the] corporate [ethics office] and not come to me first?” That was contrary to that which most of the hospital CEOs were accustomed. The company, notes Hadley, has traditionally been quite decentralized.

**‘We were very interested in demonstrating to the government that we were serious, that senior management was committed.’**

In time, though, they were able to demonstrate that the ethics office was not promoting hotline calls, says Hadley. It was encouraging employees to attempt to first work things out with their managers, or go to others in their operating units, like the human resources department. Indeed, in the brother-in-law scenario described above, ethics trainers encourage employees to do other things before calling the Ethics Action Line. Eventually it may come down to what an employee feels most comfortable doing. Many may feel that they may lose their job if they blow the whistle on their boss; in such cases, the anonymity of the hotline may be the preferred course.

In any event, “We leaned over backward to show we would not promote calling the hotline, initially.”

**What is the ‘right’ number of contacts?**

The hotline has been drawing about 60 callers a month. Is that an appropriate number? Hadley was initially told that if a company has 50,000 employees, it should expect about 1,200 to 1,500 calls a year. With 30,000 employees, that number is obviously lower. If a company does not get many callers on its hotline, however, “that is not a good sign,” says Hadley. It may indicate that callers believe that they will encounter retribution if they use the line.

NME’s calls peaked when the program was first established. Later they tapered off, perhaps because the company was selling off many of its hospitals and had fewer employees as a result.

More recently, calls were averaging 45 a month, then rose to 55. They are now averaging 60. Hadley attributes this to the fact that most employees have completed their ethics training, which makes them more sensitive to such issues—and likely to call the hotline. Another explanation may be that the CEOs of the hospitals and business units are less likely to discourage employees from calling. (They weren’t overtly discouraging calls, but may have indicated their lack of enthusiasm in other ways.) Hadley has sent wallet cards with the Ethics Action Line 800 number to all employees at their home address.
Human resources contacts predominate

About two-thirds of the calls to the ethics hotline deal with human resources issues. Employees have problems with their supervisors; if they are part-time employees, they may be upset that their hours have been cut back. The company has also had some layoffs recently; that prompted some calls.

The role of the hotline operator is often one of listening and reassuring, notes Hadley. He takes many calls himself, along with two other trained operators.

About 70 percent of callers choose to remain anonymous, which may be a higher percentage than that found at some other companies. (See story on Jostens in the January/February 1995 issue of Ethikos.) Hadley says that only 1 percent of calls are “serious” in the sense that they involve significant allegations of waste, fraud or abuse.

Because so many callers elect to remain anonymous, investigations can be difficult. “Investigations are one of the biggest challenges.” Some callers will indicate only the place where they work. When they work in smaller units, with only a handful of people, a supervisor may be able to identify the complainer if Hadley contacts him—particularly if that individual has made his or her concerns known locally. This remains a problem, he concedes, but one that is common to many ethics hotlines.

Providing direction

Has the company averted any major problems because of the hotline—the sort that plagued National Medical Enterprises in the early 1990s? “A lot of people have given us direction—pointing out things we ought to look at.” If there is an increase in calls alleging sexual harassment, for instance, this says to management that there may be problems that need to be addressed.

When a company has had problems of the sort that NME has experienced, employees sometimes see a new ethics program with a jaundiced eye. Was that the case here?

“That may have been the case prior to the training,” comments Diana Takvam, vice president for communications. “But as one who went through the training, I can say that wasn’t the case afterwards. The scenarios are so close to those encountered in the workplace.”

Hadley recalls that employees came up to him and asked: Why are you spending all this money on ethics training? “We in acute care [as opposed to those in the psychiatric hospitals] didn’t do anything wrong.” The clear implication is that they would rather see that money put into their paychecks.

Hadley thinks that employees in this instance may be failing to grasp the larger picture or appreciate the sheer financial costs that a scandal can visit upon a company, to say nothing about morale. After actually undergoing the ethics training they are often “surprised in a positive way.”

Top management support is crucial

What is the key to making such a program work? One element in a successful ethics program, in Hadley’s view, is to have interactive, face-to-face training. That human element is important. It works better, in his view, than interactive, computer-based training.

Still, “The key, first and foremost, is to have buy-in from the people at the top.” Before the ethics training began, the company’s chairman and president both met with the CEOs of the various units to explain the training that would take place. Three such meetings—each of about two hours—took place, at Tampa, Dallas, and Santa Monica locations.

Even the company’s board of directors have experienced ethics training, albeit in abbreviated form. They participated in a one-hour session during one of NME’s regular board meetings.

The company is now running ethics training sessions for the governing boards of its various hospitals. Participants include some of the doctors who serve on these governing boards.

This has a positive impact on National Medical Enterprise employees, since they have been known to ask if doctors are getting the same training as themselves. (NME often has to answer no: “We haven’t trained them all because they’re not hospital employees.”)

Not all doctors are warm to the concept at first. The attitude is often: “Why give me ethics training? I’m a doctor.” But “we’ve had excellent feedback from doctors” after they’ve taken the modified 45 minute training sessions, says Hadley.
Traditionally, a corporate internal auditor conducts operational audits. How well is a given sector performing its job? He or she may look at internal control standards. What controls are in place, for instance, to prevent unauthorized access to the company’s mainframe computer?

But there are now indications that the internal auditor’s role at some companies is expanding, and that auditors are playing an increasing part in the management of the ethics function.

“I’m surprised at how much we’ve gotten into the ethics role,” says Harry W. Britt, Manager, Operational Audit & Government Compliance, Bath Iron Works Corporation, Bath, Maine.

At Bath Iron Works, auditors work closely with the ethics office in dealing with hotline complaints. When wrongdoing is reported on the hotline, “We do the vast number of investigations,” says Britt. And when the company’s ethics officer is out of town, auditors answer the hotline. Indeed, one senior auditor has been assigned to work exclusively on ethics issues.

**More than 170 calls in 1994**

The number of calls to the hotline “have been going up steadily over the last four or five years as more people learn about it,” notes Britt. The company had 170 calls in 1994—it has 9,000 employees—as of early December, and while that may not be an enormous number compared with the thousands of hotline calls logged at some companies, “it certainly keeps us busy.

“We take all those calls very seriously,” comments Britt. “It’s different every time the phone rings.”

Why have the internal audit department handle such calls? “Auditors are trained in investigative-type work,” observes Britt. “At Bath Iron Works, it seemed a natural-type process. The ethics officer doesn’t have a separate staff. He needs assistance.”

Also, Bath Iron Works doesn’t have an in-house legal department—unlike many large companies where investigations are often the responsibility of the in-house corporate counsel.

**Some unintended benefits**

It is no secret that many corporations establish ethics hotlines because they think they have to. The government may be pressuring the company after it has become embroiled in scandal, for instance. But companies sometimes find that hotlines, which allow employees to report instances of waste, fraud and abuse—anonymously, if necessary—bring unintended, positive consequences. Hotlines can support a company’s total quality management effort, for instance.
Britt offers two examples from Bath, which builds warships for the United States Navy, that “indicate the benefit to a company by having an active/successful hotline program”:

“Many of the production processes involved in building a destroyer are very detailed and labor intensive. An employee called the corporate hotline and said he was concerned about recurring deficiencies in a process used to coat surfaces. Along with Quality Control, we checked the process and examined the area mentioned by the caller. We found that, in fact, there had been problems. The thickness of the coating had varied too much.

“‘To resolve the process problem, we worked with the appropriate production managers to obtain additional training for personnel applying coating. The direct supervisor received additional training on how to test the completed/coated areas. Quality control personnel implemented new inspection procedures.

‘As a result, the number of defects decreased significantly, and the Government commended the company for a dramatic improvement in the coating process.’

Another hotline call dealt with a personnel matter:

“An employee called the hotline to complain that he had been moved from job to job within the company. As a result, his personnel evaluation had been delayed, and he had not been considered for a merit increase. We discussed the problem with the current supervisor and with Human Resources personnel. Given the circumstances, the supervisor agreed the employee was doing a good job and that an interim evaluation and merit increase would be possible. The supervisor told us that as a result of the ‘hotline’ process, there was a change of attitude and a significant improvement in the employee’s job performance.”

Fielding questions

“One reason for the hotline is for people to ask questions,” observes Britt. Bath Iron Works signed a new labor contract in August, to cite one example, and some employees were concerned how some things should be handled under the new contract. Several called the hotline. “We’ll get an answer for someone, or we’ll direct them to the right person.”

During the Christmas holiday season, vendors will send gifts to Bath employees. These may be as seemingly trifling as a box of chocolates. People call the hotline asking about what they can or cannot accept.

Other calls might focus on a minor charge that may have been tagged to the wrong account. How can that be made right?

Most hotline contacts do not touch on issues of fraud or abuse, notes Britt. A large portion deal with employee relationships. There may be questions about time cards, business expenses, travel reports, or environmental issues.

“Someone believes that someone mischarged something on a travel voucher. In such a case we’d look at the vouchers, talk to the travel people,” and so on.

Some issues are referred to other departments, of course. Diversity issues are often referred to the corporate affirmative action department.

Trained in investigations

As mentioned, Bath has appointed a senior auditor to deal with ethics matters on a full-time basis. Originally, the company rotated its investigators, assigning cases to the auditor who happened to be closest to the phone when the call came in. But that proved too disruptive. Auditors often had to interrupt current projects to deal with hotline matters. Responsibility was therefore given to a single auditor who has been specializing in this area for about a year.

Britt, who has four auditors on his staff, can get additional legal assistance in an ethics investigation. But this involves calling on the company’s outside legal firm. That does happen on occasion, but more often audit handles the task.

How does Britt feel about the expanded role of the auditor at Bath? “It’s crucial to have someone trained in investigations and audit techniques. One can’t have just anyone in the company do this. It’s a crucial area. We’re strong supporters of the ethics function. We see it as a benefit to employees to be able to call the hotline. It’s an outlet, a place to which people can go.

“Also, it’s an important function under the Sentencing Guidelines. Companies need to have this [hotline] function.”

For the audit staff, the work offers some interesting diversity. Calls run the gamut. An auditor “has the advantage of being able to learn the company more quickly.” Hotline calls tend to involve short, quick projects, sending auditors into “areas of the company that they would have otherwise taken more time to get into.”

Continued on page 9
At KPMG: The forensic approach to fraud prevention

“I’ve seen cases where a senior manager, or CEO, let it be known that he was perfectly willing to fiddle with his tax returns,” recounts Michael D. Carey, Principal, KPMG Peat Marwick, New York. “How can you then be surprised if employees steal from you.”

In other instances, a CEO or senior manager has accepted expensive trips from vendors. That individual “is not sending the right message,” says Carey, who heads the accounting firm’s Forensic & Investigative Accounting Services Practice. Corporate fraud prevention programs just don’t happen. Senior management support is critical.

Codes of conduct

A company cannot have a prevention campaign without first making clear what it regards as proper business conduct, i.e., what the rules are. In this regard, a code of conduct is important.

It helps if senior managers talk to employees or present the code of conduct themselves. “That’s important. Some codes are distributed in an anonymous way and that’s the first and last time that employees ever hear of them.”

Is a code of conduct really an important element in fraud prevention? “I take the view that they are important,” says Carey of codes, “but they can’t be the full answer. They’re just a start.”

Carey has reviewed the codes of both profit and non-profit organizations. They run the gamut. Some are only three pages long. Others may run eighty-five pages.

Should one opt for the brief or comprehensive code? “I personally believe in a combination of the two.” A code should have a brief summary of principles, he says, but it should also carry a series of guidance notes, i.e., what exactly is an acceptable gift.

According to Joseph A. Spinelli, Managing Director in KPMG Peat Marwick’s Forensic & Investigative Services Practice, a code has to focus to some extent on those business activities in which the company is most vulnerable. An employee handbook can further state those policies.

Checking references

There are other steps that should be taken to minimize corporate fraud. One has to check references of new employees. In a recent KPMG survey (“1994 Fraud Survey”), 70 percent of companies said they perform reference checks on new employees; this was the second most common fraud prevention effort, after establishment of a corporate code of conduct (79 percent of 501 responding companies said they had established a code of conduct.). “This is not easy, but not to do it simply because it isn’t easy is not the solution,” says Carey. One can conduct background checks of public records, among other things.

When Spinelli worked in government, as New York State’s First Inspector General,
‘I’ve seen cases where a senior manager, or CEO, let it be known that he was perfectly willing to fiddle with his tax returns. How can you then be surprised if employees steal from you.’

he recalls interviewing a high-ranking individual in the state’s Human Rights division. Something about that individual just didn’t seem right, Spinelli recalls, so afterwards he did some further checking. He found that the individual had been arrested for six felonies.

In this case, he was able to check criminal records through the police department. He acknowledges that conducting checks of this sort isn’t as easy in the private sector, but in many cases companies are not even verifying employees’ previous employment. “If they lie about their education or past experience, that is the basis for termination in itself.”

Taking disciplinary action

Spinelli recommends that companies send out employee bulletins that incorporate compliance policy statements in an attempt to make all employees aware of the rules. “And if the rules are violated, take decisive action.”

When disciplinary action is taken, Carey advises companies to publicize it, although he readily admits that some companies may shy away from this. Many are afraid of defamation suits. “Of course, you have to be very careful, and you may not want to name names,” but it is an important part of preventing fraud, in his view.

Spinelli has seen instances in which the CEO of a major corporation has gotten on the company PA system to announce that an investigation was underway, and said he expected all employees to cooperate. He encouraged them to forward any information that they might have about the matter to the FBI. As a result, not only was more information brought forth about the person under investigation, but four other individuals as well.

Reviewing internal controls

Companies that want to prevent fraud should seek to review and improve their internal controls. In the KPMG survey, 47 percent of companies said they are doing this, and another 34 percent said they are currently exploring improving their internal controls in order to help reduce fraud.

New York State has an internal controls act, notes Spinelli, which requires the heads of state agencies to conduct an appraisal of those areas that are most vulnerable to fraud every six months. He urges companies to conduct such assessments as well.

“It needs to be done on a regular basis,” adds Carey, although it may be difficult to convince companies to do it every six months. Still, “just the exercise of thinking about it is useful.”

Risk areas

What are the sorts of risks that typically arise in corporations? They differ dramatically by company and industry, says Carey, but there are some areas that are more problematic than others. Procurement and purchasing is one such area. “It is very difficult to be sure that the company is not subject to loss through collusion of a vendor and the company’s buyer.”

Research and development is another area subject to fraud. “A lot of money is spent but often few people know what’s going on.” Carey recalls a case in which a senior scientist who was responsible for obtaining various pieces of research from third parties spent millions of the company’s dollars. Some of the purchased research proved to be “non-existent, paid to companies he owned.”

Payroll can be another high risk area, particularly if there is no segregation of duties among employees. Spinelli recalls a municipality in which a single individual was responsible for the paychecks of 260,000 employees. He had no replacement. When he wasn’t present, people didn’t get paid.

Later, it was shown that the municipality’s payroll had been filled with no-show employees and also friends of the payroll chief who were getting more money than they should have been receiving. That fraud would have probably been discovered earlier, or not occurred at all, if someone else in the company were occasionally handling the payroll.

It can also be dangerous to have one senior person with the authority to override the controls that are in place, says Carey. It is better to require two senior people to sign off on big-dollar items.

Consultancy agreements can be risky too because
employee believes that his supervisor did the wrong thing.

The company is doing more compliance audits, examining procedures in various parts of the company regarding procurement standards, antitrust issues, customer relationships, travel, and so on.

Britt’s department also audits the Defense Industry Initiative (DII) questionnaire that is required for DII signatories. “We validate what the assistant to the president is doing as ethics officer.”

The company expects to do more in the way of ethics audits, i.e., surveying the ethics program to see how it is doing, interviewing employees, conducting surveys about what employees know about the ethics program, etc.

Bath Iron Works . . .  Continued from page 6

Prioritizing calls

Hotline investigations do bear some resemblance to the ordinary audit process, notes Britt. A call arrives and the auditor is obliged to get “to the bottom of this thing: why the problem occurred.” The process is “somewhat similar” to an operational audit.

Since everything can’t be resolved immediately, Britt and his staff have had to develop a system for prioritizing calls. Most cases are resolved in a few days. If a call suggests the potential for fraud or abuse, that call will go to the top of the priority list. In a big government contracting business, such as Bath’s, time-card charging issues fit this category. The government takes such issues seriously.

What are the most difficult cases? “Problems between employees are often the most difficult,” says Britt, or a contract issue in which an investigation is over to remove the uncertainty.” The company might describe what action was taken after speaking with its lawyers. By implication, those who are still at their jobs are cleared.

Follow the money

Is there any one key to preventing fraud in the corporation? “Follow the money,” says Spinelli, who observes that “you can have all the internal controls in the world, but if people aren’t cognizant of what is expected, if the tone isn’t what it should be, if people don’t expect that if they do something wrong they’ll not only be terminated but prosecuted,” then a program will founder.

“No one individual action is enough,” adds Carey. “You need to train people, so they know what is or what is not a red flag where fraud is concerned.”

“One word sums it up,” says Carey. “Awareness.”

When an investigation is conducted, there is a presumption that someone is guilty. If one is not discreet, the word may get around.
In no other industry that I can name have so many major firms failed over the last decade because of problems that initially were rooted in ethical shortcomings,” notes Columbia University Law School Professor John C. Coffee, Jr. “The roster of the deceased includes Drexel, E.F. Hutton, and Kidder Peabody. Both Salomon and Prudential were near misses that recently experienced close encounters of the worst kind.”

He was speaking of the U.S. securities industry, of course, and perhaps that was as good a reason as any to explain the first New York Stock Exchange (NYSE) Ethics Conference, which was held February 9 in New York. About 150 industry representatives attended, according to NYSE spokesman Raymond Pellechia. They heard, among other things, a presentation by Prudential Securities’ John F. Settel on the role of the corporate ethics officer (see ethikos, January/February 1995), and from Kidder, Peabody general counsel John M. Liftin on the role of the brokerage firm audit. Coffee, who holds the Adolf A. Berle Professor of Law chair at Columbia, delivered the keynote address.

In his speech, Coffee made clear that he was talking about “securities ethics” and not “business ethics” because the former is, in his view, more “rooted in specific contexts that grow out of experience more than logic.” In other words, this was to be a “hands-on” conference, dealing with real issues that were bedeviling the securities industry, not some theoretical confabulation.

Nor did Coffee shy away from discussing some of those “specific contexts” in his keynote address. He referred to a recent enforcement action taken against Bankers Trust, the bank holding company, and its broker/dealer subsidiary, BT Securities. Bankers Trust has been one of the larger players in the controversial derivatives market:

“Many of you are familiar with the tape-recorded statements in the SEC and CFTC opinions in which a managing director of BT Securities relates to a superior that a substantial difference exists between the value that the client (Gibson Greetings) has been told was the current value of its derivative investments and what BT’s own computer model showed that actual value to be. In this conversation, the managing director suggests that they should exploit future market movements to close the gap before the client tried to unwind. The SEC and CFTC opinions do not relate the superior’s response, but clearly it was deficient.

“It’s easy enough to call this behavior unethical, but, because it was also found to be fraudulent by the SEC, we gain little by adding the phrase ‘unethical.’ The true ethical issues in this field involve not misrepresentations, but omissions. Should the broker-dealer have the obligation to provide on a continuing basis its model’s estimates of value when it knows the client lacks the expertise and computer technology to value these transactions for itself? Essentially, the Federal Reserve Board imposed such an obligation on Bankers Trust, but the ethical issue for the securities industry (which is not within the Federal Reserve Board’s jurisdiction) is whether its own self-regulation should reach a parallel position. Short of any industry-wide initiative at self-regulation, this is also an issue for individual firms.

“I suggest to you that a policy of full disclosure by dealers to their customers of the estimates generated by their proprietary computer models is not only ethical, but good business as well.”

In his summary, Coffee noted that “My role this morning has been to be something of an agent provocateur and take exactly the opposite perspective that the general counsel normally takes. I have not asked ‘How does one protect the firm?’ But instead: ‘What more should be expected of the firm.’”

After noting the aforementioned corporate failures in the industry in recent years, Coffee concluded: “You need a margin of safety, and codes of ethical practice provide it.”

In an ironic twist, the company whose payoffs to foreign officials was a major impetus behind passage of the Foreign Corrupt Practices Act (FCPA) eighteen years ago has pleaded guilty to a violation of the FCPA.

In January, The Lockheed Corporation pleaded guilty to a felony count of conspiracy in the hiring of a member of the Egyptian parliament to help it secure the sale of three transport planes. The Calabasas, California-based company agreed to pay a $24.8 million penalty.

In the mid 1970s, Lockheed paid more than $7 million in bribes to Japanese politicians in order to win aircraft orders. In the wake of public indignation over this act, and those by other companies, Congress passed the Foreign Corrupt Practices Act. The FCPA makes it a felony to bribe a foreign government official in order to obtain business. To date, no other country has anything like the FCPA, and the law remains controversial. Some companies argue that
the act puts U.S. firms at a disadvantage in an increasingly competitive global marketplace.

In the current case, “Prosecutors contended that Lockheed had agreed in 1988 to pay a commission of $600,000 per plane to a consulting company owned by Leila Takla, a member of the Egyptian Parliament, and her husband,” reported the New York Times.

“After auditors found evidence of the fee agreement in 1989, Lockheed told the Pentagon that no fee would be paid. But it had agreed in 1990 to pay a $1 million ‘termination’ fee to Mrs. Takla in lieu of a commission after the sale.

“The indictment said the payment to Mrs. Takla had been made ‘for the purpose of inducing Takla to use her influence with the Egyptian Government to direct business to defendant Lockheed.’”

Apropos of bribery and government officials, corruption in Russia appears to be going from bad to worse. And in no place may things be more extreme than in Moscow.

This recent story from the Wall Street Journal (February 13, 1995) states:

“Judging from accounts of residents, most Moscow officials seem to be on the take, from traffic cops to top bureaucrats. And at the uppermost reaches the costs are staggering.

“Consider the experience of Viktor Anatolievich, an upstart Russian trader who quickly learned the cost of doing business with the city. Last year, Viktor (who won’t let his surname be used) vied for a contract to supply $2.3 million in sophisticated equipment to a Moscow city medical establishment. He eventually won, but, he says, only after meeting a demand to pay 10 percent of the contract’s value—in cash—to a bureaucrat approving the deal. That works out to a cool $230,000 for a signature.

“‘At the end of the day, I made less profit than the bureaucrat,’ says Viktor, an international affairs expert who ventured into business two years ago pledging to keep clean. Now he says he finds himself traveling from abroad into Russia with suitcases full of dollars for just such payments. ‘It’s the only way you can do business in this city,’ he says.”

Bath Iron Works . . . Continued from page 9

company received adverse publicity when its then-chairman ordered the photocopying of a “business sensitive” docu-

‘We take all those calls very seriously. It’s different every time the phone rings.’

ment inadvertently left behind by Navy officials after a quarterly meeting. The chairman resigned.

Are ethics issues more important since the company got into trouble? “Probably, yes. There’s no question [the case] got a lot of people’s attention. We would have done it [i.e., developed a comprehensive ethics program] anyway. We had an active program at the time of the problem in 1991. But the incident has given us an impetus to look at a broader spectrum of ethics issues,” like diversity and sexual harassment.

It’s also his perception that other companies, that were not doing anything in this area, “have been woken up by the [federal Organizational] Sentencing Guidelines,” which put a premium on ethics and compliance programs.

Is the ethics function an appropriate role for an internal auditor? “It’s certainly appropriate at Bath that we be doing this. It is people who are trained as certified fraud examiners who are looking at hotline calls. There are definitely some pluses at Bath Iron Works for auditors to be doing this.” Even though the company has 9,000 employees, and is the largest employer in Maine, it has a smaller corporate staff than many large companies. “So it is probably a good way to handle it.”

Britt notes that the scope of internal auditing in the defense industry has broadened generally. “Auditors face new ethics and compliance roles that go beyond traditional internal audit roles.”
The Network: Managing hotlines for corporations

Once a company decides to establish an ethics hotline, a basic question to be answered is whether to manage the hotline in-house—or contract the line management to an outside firm.

Why an outside-managed hotline? “The primary reason is that the people who call a third party know it’s a third party,” says Paige Grisette, Director of Marketing, The Network, Norcross, Georgia. “The fear of reprisal is lessened. As a result, they disclose more information.”

The Network, founded in 1983 to help retailers minimize “shrinkage,” or theft, is one of several companies that is now prepared to help corporations set up and manage an ethics hotline. Such firms have seen increased business since enactment of the federal Organizational Sentencing Guidelines which encourage companies to establish hotlines.

Costs may favor contracting out hotline management, continues Grisette. Operating a 24-hour, 365-day-a-year hotline can be relatively expensive. And if a company sets up a hotline just for business hours, what happens if employees call during off hours? They will reach an answering machine. Employees then face a quandary: If they leave a message, will they be identified by their voices? “The whole agenda is subject to doubts in their minds,” says Grisette.

Are employees right to harbor such doubts? The paranoia may be more perceived than real. “I know of no company with an internal number that has taken action against someone because they recognized that person’s voice” on an answering machine, says Grisette. Still, perceptions may be important in such matters—whether ultimately justified or not.

When normal channels won’t suffice

Grisette says that a hotline should not be seen as a substitute for a company’s own internal chain of communications. Employees should be able to talk to their managers or supervisors about problems first. “But there are many times that employees feel that they can’t talk to their managers—it’s impossible in their minds. This outlet can be quite critical.”

It is a factor in workplace violence, suggests Grisette, i.e., employees who keep their concerns bottled up. “It’s a tremendous source of frustration. I’ve seen indications that just the availability of an 800 number brings satisfaction to employees, whether or not they ever use it.

“Many companies are open 24 hours. A lot of people want to get off their shift,” seeking more privacy before calling the hotline.

Most calls are in the afternoon

The Network has eighteen interview specialists. The staffing will fluctuate by call activity. In the wee hours of the night, they have fewer specialists. The highest percentage of calls—forty percent—are received between one p.m. and six p.m., according to the Network’s statistical database. The second busiest period is between 9 a.m. and 1 p.m., when 26 percent of the calls are received. About 18 percent fall between 6 p.m. and 1 a.m.
Interviewers use an “active listening technique” as opposed to an interrogative style. When the caller begins his or her story, interviewers are encouraged to “let them go,” although they will prompt them with “who” and “when” and “how long was it going on,” and other questions designed to elicit information.

Once the interviewer is confident that he or she has captured all the information that can be obtained, the incident is reported to a designated person within the client company. This is done within twenty-four hours.

The report can be transmitted via electronic mail, facsimile machine, or regular mail. E-Mail is the fastest mode, and it is more secure than a faxed report.

In addition to name, address, and time, reports typically present a synopsis, e.g., “The caller, name refused, stated that Store Manager John Smith is sexually harassing female employees.” This will be followed by a narrative, that might begin: “Caller stated the following: For approximately the last six months (exact dates unknown), Smith has been putting his arm around and touching female employees without their permission . . . .” The report would also contain any information sources provided by the caller as well as notes, e.g., “Caller has not spoken to anyone in management about this because the caller wishes to remain anonymous.”

Even though some interviewers have worked in large companies in loss prevention or human resources, previous experience isn’t so critical in recruiting interviewers, Grisette emphasizes, because the company conducts extensive training itself. What they want above all are bright, sensitive, educated individuals. Interviewers work out of quiet, private stations that “enable them to focus and work more effectively.”

Preventing problems

The company was founded by Ralph Childs, a former FBI man. Its president, Ed Stamper, was previously manager of retail advertising for the Atlanta Journal-Constitution. When the company was founded in 1983, the hotline function was its leading service. After two years, the company realized that its clients, while finding the service useful, wished above all that they didn’t have these sorts of problems in the first place, so the firm developed a sort of preventive maintenance business. The Network’s publishing unit publishes newsletters and places posters around client companies to suggest ways to thwart problems like internal theft or business abuse. Companies can focus each month on an issue that is endemic at the company. One month it might be harassment, another month worker safety, a third month workers compensation insurance issues. With regard to workers compensation, for instance, a promotional campaign might emphasize that workers compensation insurance is a privilege; to take advantage of it is little more than theft. Widespread fraud and abuse where workers compensation is concerned can drive a company out of business in the long run.

If a company has been experiencing harassment problems, the posters and written materials can emphasize: “Here’s a number to call if you’re dealing with harassment problems.”

About 65 percent of The Network’s clients are retail businesses, many of which are typically concerned about employee theft. To some extent, though, “that’s been changing as we’ve grown.” They have more programs that have applications beyond the retail industry, like preventing harassment or workplace violence.

In addition to retailers, The Network works with airlines, banks, health care companies, and insurance firms.

The price charged to clients for the basic hotline service will vary from $1 per employee down to 10 cents per employee, based on the size of the company. The largest companies will pay the 10 cents-per-employee rate.

More harassment complaints

Has The Network had more business since the implementation of the federal Organizational Sentencing Guidelines? “We get a lot of calls where the initial concern is complying with the Sentencing Guidelines,” says Grisette.

Have any new trends been apparent in recent years? “Only harassment, which has really jumped off the page.” Why harassment? “It’s a social phenomenon. Ever since Anita Hill, it’s out of the closet. A lot of people are saying, ‘I’m not going to take it anymore.’”

Harassment is not focused wholly on sexual harassment, either; programs have been expanded to address other kinds of harassment, such as racial harassment. “As everyone becomes more educated, they realize that sexual harassment is only one aspect of it.”

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Harassment complaints have ‘really jumped off the page . . . . A lot of people are saying, “I’m not going to take it anymore.”’
Visionary companies without visionaries

By Loren Singer


BHAG is an acronym for “Big Hairy Audacious Goals.” The presence of the BHAG is one characteristic common to the 18 visionary companies the authors discuss at length and in detail in this book. It might also be applied to the work’s concept: to demonstrate the practices that all shared, and account for their success, in some cases for more than a century. While other books have attempted this over a shorter time span and a wider spectrum, Collins and Porras chose to apply their efforts in what they believe to be a unique approach.

Theirs is a kind of alchemist’s effort like the search for the philosopher’s stone. Thus they have referred to symbols and thought patterns from even more distant eras. The Yin Yang symbol of dual states and inter-relationships that is a part of Chinese cosmology appears in most chapter headings and demonstrates certain required qualities that must be paired. Flexibility and adaptability include a digression into Charles Darwin’s theorizing on the genetic changes among some species of tortoise over millennia; the need to build an institution that will endure discusses the intentions of the authors of the U.S. Constitution.

Identifying ‘visionary’ companies

In 1989 the authors surveyed 700 CEOs from Fortune’s lists of 500 industrial companies and 500 service companies, and from the Inc. list of 500 private companies and 100 public companies, asking each participant to name up to 5 companies that they considered as “highly visionary.” 23.5 percent responded, and from that source the authors identified 20 companies. All of the companies included were founded before 1950 in order to eliminate those that were not simply beneficiaries of a single leader or one great idea. The average age of those selected was 92 years; eighteen were eventually listed herein.

In order to demonstrate the qualities that set apart those chosen as visionary, the authors found it necessary to seek a comparative for each—a company that was founded in the same era, and had similar products, markets and/or services. These latter firms were by no means abysmal failures although some were; the authors wanted comparison at a more complex level. They liken this degree of difference to the placement in an Olympic event—the gap between gold, silver and bronze medalists. This is not a very satisfying analogy, since, in a table of cumulative stock returns between 1926 and 1990 the “visionaries” look to be lunging for the tape while the lead-footed comparatives are just emerging from the starting blocks. Nonetheless, all units were now sited in the study, and

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Edison, Ford, and even Walt Disney were not as important as ideologues and company leaders as they were as ‘clock builders.’

The reasons for this have to do with the great number of imponderables that remain almost constant in this fluid corporate society—economic, social, and political factors that cannot be foreseen by the most prescient, the most experienced, the best educated leaders. *Built to Last* has a case to present, and some of its points are both interesting and valid. But in supporting them, scientific analysis and philosophic tenet give way to anecdote and vignette—often repeated—and these sometimes refute the very points the authors wish to make.

Early on Collins and Porras prise away some long-held and treasured beliefs from their readers—that one does not need a great idea, and two, an exceptionally gifted leader to build a visionary company. That might be swallowed, but it becomes a kind of indigestible lump that lies uncomfortably on the mental processes, and inspires some sullen inclinations to disagree, no matter how sound and rational their proof that this is so. It’s a bit like removing a cherished bit of bigotry from an ignoramus—when cogent argument has shredded this it may become latent for a time, but it remains.

Herein, Edison, Ford, and even Walt Disney are not as important as ideologues and company leaders as they are as “clock builders”—the authors’ term for executives who construct impregnable business structures that remain functional for generations. But where would GE, Ford, and Disney be today without the light bulb, the Model T, and the ubiquitous Mouse, let alone the powerful personalities of those “visionaries”?  

Other major points that the book puts forward are less arguable, but still debatable. Surely a company should try to combine profitability with purpose; change and a fixed core ideology; long-term investment and short-term performance; superb execution with futuristic planning. Research and development is a necessity, internal competition between divisions is important, exploring new products and a proper selection process for deciding which ones to develop is a priority. Promoting from inside the firm is a more stable approach to management than outsider recruitment, and a commitment to constant improvement of products and services is a most worthy goal, no matter how high the profits or size of market share.

However, in an economy as vast and encompassing as this contemporary one that presently includes global corporate competitors with access to great amounts of capital, paradox and anomaly abound; no schematic for a hundred-year survival can be much more than generally instructive.
One does not need a great idea or an exceptionally gifted leader to build a visionary company, say the authors.

Offering up straw men?

There are other weaknesses apparent in the thesis as presented in Built to Last. Some of the companies that run second to the visionaries are completely outclassed. Disney is compared with Columbia Pictures which should have lost out in the qualifying heat; any competition between American Express and Wells Fargo (the express company, not the bank) probably ended late in the 19th century when the American Express traveler’s checks and the hugely profitable “float” appeared; by 1990 that generated $200 million annually in revenue.

Generalizing about some narrow escapes from failure which plagued a number of the visionaries early in their corporate histories may have some value in teaching persistence and overcoming reversals, but it is simply a common setback in the life of a company, and hardly a positive factor. Also, in recounting turn-arounds and great leaps forward by a number of visionaries—3M when it developed wet or dry sandpaper, Marriott putting up box lunches for airline passengers at a Hot Shoppe in Washington, and Johnson & Johnson developing its Band-Aids—it is apparent that chance had at least some influence on success.

No consideration of government role

There is also little consideration of the role that many billions of government dollars played in the financial support of companies like Boeing, Hewlett Packard, GE, and Motorola. Half a century of intermittent warfare and the funding of an immense international defensive coalition assured a substantial amount of business, and the customers could be relied upon to meet their obligations—even if sometimes they did so with American money. Another item to ponder is the reason why the original panel of CEOs selected some of the companies included as visionaries. Why Philip Morris, for one, or Marriott, or Nordstrom, or even 3M for example? Whatever their qualifications as visionaries, they are hardly exemplars as industrial giants.

There are some pleasures in among the rubrics, the flow-charts and the feedback diagrams in Built to Last: the foreknowledge of great success after a perilous decision as when Boeing committed itself to building the 747. There was the humble aim of Sam Walton in 1945 to “make my little Newport store the best, most profitable variety store in Arkansas within five years.” There is the account of Sony’s recovery from its early failures—its one product, a simple rice cooker, “failed to work properly,” and its first significant product, a tape recorder, “failed in the marketplace.” Fortunately or unfortunately they soldiered on to the Walkman and other achievements.

Cult-like cultures

The chapter that considers cult-like cultures is informative and even amusing, if Orwellian, as when a Nordstrom neophyte hears about “secret shoppers” for the first time: “That’s a Nordstrom employee who pretends to be a customer—secretly—and checks on your demeanor and service. . . I think you did fine, but watch the frown. . . A frown can be a black mark in your file.”

At Disney, “Potential recruits—even those being hired to sweep the floor—must pass at least two screenings by different interviewers.” Sam Walton speaking to over 100,000 associates via satellite TV asked them to raise their right hands and . . . “solemnly promise and declare that every time a customer comes within ten feet of me, I will smile, look him in the eye, and greet him. So help me Sam.”

The quotes, narratives and vignettes from and about executives of visionary companies that are meant to buttress the book’s thesis actually weaken it. These are men with powerful personalities. They are individualistic, assured, confident and dedicated, and they manage their businesses accordingly. None is a product or an amalgam of specific attitudes and thought patterns. Despite the panegyric to Jack Welch one cannot imagine him directing Walt Disney, nor the CEO of Motorola taking over at Wal-Mart.

The authors of Built to Last may have separated out the elements necessary to build a business that would function like their clock mechanism for a century or two, but installing those who can keep it ticking is another matter. Perhaps another volume is necessary in order to resolve a major question, as yet unsettled: Do men make corporate history or does corporate history make men.

Footnote: The type face used in the sub-heads and especially in pagination is almost unreadable.