

Cook & Company Commentary

Spring 2002

Thoughts on Enron...

It is interesting to speculate on the Enron situation, and in this, the first in a series of periodic newsletters, we'll do just that. But before we do, some cautionary thoughts regarding recently reported conclusions about the Enron failure. First, the conclusions:

- "... a shocking absence of the usual corporate checks and balances . . ." – *Business Week*, February 25, 2002
- "This was a company which simply placed a lot of bad bets on businesses that weren't so promising to begin with." – *Business Week*, February 25, 2002
- "Enron was engaged in a series of high risk transactions . . . (including) hedging . . ." – from an Audit Committee-sanctioned report of another Board of Directors.

Before we fully embrace these conclusions, we might want to consider the following:

Appearances, as they say, can be deceiving – as one who has gone through an Enron-type debacle at the board level, and who found that he and his fellow outside board members were skillfully lied to by insiders, I strongly urge all of us to reserve judgment in the Enron case until we have more of the facts.

We are undoubtedly going to learn (or re-learn, as the case may be) some good lessons from Enron, but we don't want to over-learn. For example, to generalize that hedging as an activity is wildly speculative is highly questionable. Indeed, an oil or gas producer who *doesn't* take advantage of hedges today is probably engaging in more speculative activity than one who does. The question is,

is it speculation or "covering" that one is engaged in, and how well-matched is the hedge to the risk and time profile of the underlying revenue stream?

But there is clearly something amiss. In a report cited in the February 18, 2002 issue of *Fortune*, "some two-thirds (of large company CFOs) said they had been pressured by their bosses to misrepresent financial statements. Only 55% said they had successfully resisted."

At Enron, did a sound strategy collide with questionable leadership and a questionable organizational culture?

The strategy: Build an energy-trading company with minimum energy "hard-asset" exposure and maximum reliance on matching supply and demand risks to maximize return.

The leadership: Was it overly driven by quarterly earnings to engage in increasingly questionable transactions with special purpose entities and its own employees, all in the pursuit of driving higher short-term earnings growth? This leadership group apparently forgot a key principle – you must identify and be responsive to all stakeholders, including employees and regulators – not just yourselves.

The organizational culture: By all appearances, an initial culture with strong values was subverted rapidly over the last couple of years by a senior management and compensation system powerfully directed toward near-term earnings growth and intolerant of dissonant views.

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What are some lessons we might take away from Enron that are likely to survive any reasonable disclosures about additional relevant facts?*

- Strategy is what drives the organizational effectiveness of any organization – even good leaders and a sound culture probably won't lead to success without a sound strategy.
- Conversely, a sound strategy can be corrupted by poor/questionable leadership and/or a questionable culture.
- It is amazing how quickly a few questionable leaders can corrupt an otherwise sound culture – and compensation can be the key tool causing that decay, as Enron suggests.
- Competence cultures, like Enron's, are not in and of themselves "bad," (just as control cultures are not bad). It is when they get "out of balance," as appears to have been the case at Enron, that the

trouble begins.

**How does one deal with these issues?
Start by asking:**

- Is the strategy sound, as it applies to all stakeholders (shareholders, employees, officers, customers, vendors, etc.)?
- Do the CEO and management team possess appropriate values, and align themselves with the strategy and with these values?
- Are the levers of management (recruiting, training, compensation, etc.) aligned to achieve the strategy, meet the values, and reinforce the appropriate culture?

*I'm indebted to Dr. William Schneider and his book, The Reengineering Alternative, for the organizational culture concepts discussed here.

- Gary M. Cook

WHAT IS AN INFLECTION POINT AND WHY DOES COACHING AT THAT MOMENT MAKE SENSE?

We often use our trademarked phrase, *Coaching at the Inflection Point*,TM when talking about when coaching can be most effective. What exactly is an *Inflection Point*? Here is an excellent example. A cardiologist I know always has a session with his patients after he has installed a pacemaker. As you might imagine, after what has often been a near-death experience, patients are generally *very* attentive to suggestions about improving their lifestyle so they might live longer – and they also seem more committed to the change!

The combination of the proximity to death, plus the reprieve given by the pacemaker, creates the classic *Teachable Moment*.TM It is that moment, or what we at Cook & Company call the *Inflection Point*, that offers perhaps the most profound opportunity to create behavioral change.

Here is an example from the business world:

Marie, a senior manager in a technology firm, receives total compensation in excess of \$1 million per year for her contribution to the firm, by far the highest in her organization, except for the two managing partners. However, her abusive behavior was having a materially negative impact on the firm's effectiveness. When the managing partners explained that her way to ownership was blocked unless she was able to change her behavior, Marie truly came to a *Coaching at the Inflection Point*TM moment in her career.

With coaching, she was able to receive honest feedback from her superiors, peers, and subordinates about those behaviors that truly bothered them, and is now well on her way to changing those behaviors and to a potential partnership in the firm.

We'll explore more about what causes such moments and how to take advantage of them in future issues.