# Enron: The organizational culture of stress and fraud

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**Major players & issues**

The Enron Corporation had a highly competitive and cutthroat organizational culture. The company maintained a very stressful and challenging system for evaluating its employees, called the Performance Review Committee. The system was twice a year, which is more frequent than the standard one-year review. This evaluation cycle creates more stress on employees by creating paranoia in these individuals. Secondly, the evaluation takes data from not just supervisors but also peers and customers to evaluate each employee. This kind of extensive evaluation contributes to the already heightened stress level by essentially expecting employees to perform 150% all day, every day. Lastly, Enron would typically fire those employees that were at the bottom 20% based on reviews. This organizational framework forced employees to prove themselves consistently and show that they are adding value to the organization. All three of these factors enforced high levels of stress within everyone. (Healy & Palepu, 2019, p. 4) These structures forced Enron employees to take risks due to the fear of losing their job. Enron employees ended up trying to bend the rules as much as possible and were always on the edge of breaking the law.

Enron also used a unique compensation structure that exacerbated the fear and stress culture by using a unique reward structure. Firstly, Enron heavily rewarded those that originated new business. They also paid the bonus commission based on the present value of the deal. This essentially makes employees take more risk because the bigger the deal size, the more compensation. Third, senior executives were paid based on "phantom equity" which means that they would get paid based on the company's stock value reaching certain prices. This created a culture of engaging in risky behavior because stocks are volatile and contain a significant risk of loss. Finally, employees were encouraged to take their compensation in the form of stock or stock options, rather than a tangible paycheck. (Healy & Palepu, 2019, p. 4) These unique compensation structures created a culture that rewarded high risk-taking and made Enron employees take significant risks with their savings, health, and business interests.

Notably, the governing board of Enron failed at their job. We see that the board directors of Enron met five times in the year 2000 and were awarded total compensation of $300,000 per member. That is a significant amount of compensation, and these individuals should have worked collectively to create internal control for the organization, but they failed. Furthermore, we see that the board made exceptions and allowed some senior leaders not to comply with the code of ethics. We see this with the LJM Special Purpose Entity, which Andy Fastow owned and made a significant amount of monetary profit for himself. As the CFO of Enron being the general partner of LJM was clearly a conflict of interest, and by the governing board signing off on it, it shows an organizational culture in which the code of ethics is not implemented at any level. (Healy & Palepu, 2019, p. 7) The lack of accountability and responsibility bolstered the already risk positive culture. The board clearly failed to create and maintain systems that protected the company and its employees.

Because of the culture of high stress, fear, and high-risk culture at Enron, it is not surprising that employees and executives at Enron engaged in activities that were deceptive and illegal in some instances. According to Sherron Watkin's memo, Enron engaged in "very aggressive" accounting practices. These practices were very creative and legal but deceptive to investors. Throughout the case, we see instances where Enron spent an extensive amount of money lobbying and advocating for no regulation and more favorable terms for the company. These accounting rules allowed Enron to mislead investors by showing them profits that were not real but based on new rules that Enron used creatively to deceive investors.

**Analysis of issues:**

As identified earlier, a major issue with Enron was its level of stress and fear within the organizational environment. It seems that the organization was not considering its employees as a form of human capital but rather as a revenue-generating machine. Human capital is built over time and requires employers to take a more accepting approach to how employees learn and develop. A clear example of Enron's treatment of employees is the use of the PRC system, which is very detrimental to human capital.

A major issue with the PRC system is its similarity to the Rank and Yank system that is used in competitive companies. These policies harm organizational performance in the long run and cause a significant amount of stress for the entire organization. The 20% of employees being fired is a large part of Enron's structure and is detrimental because organizations should be minimizing their employee turnover. First, as a general rule, the lower the turnover rate the better because it a sign that the organization is growing and building a collective human capital. Second, terminating employees has a detrimental effect on those that stay in the company because it creates panic and stress induced by losing co-workers. Lastly, those that stay go through survivorship bias and also fear getting fired, which leads to poor performance and higher stress. It can also lead to distrust of organizational leadership.

**Application to theory:**

*Stress*:

According to chapter 7 of Hitt et al., stress has significant effects on employees. These include the following negative emotional effects that can affect employee performance. Stress makes employees more anxious, worried, unmotivated, depressed, irritable, and unfocused. (Hitt, Miller, & Colella, 2011, p. 236) We see that at Enron, all that pressure to perform and the fear of losing one's livelihood can lead employees to have a significant amount of stress that will affect the overall performance of the organization. In addition to emotional effects, the theory also suggests that there are negative behavioral effects of stress. These are employees overreacting, being angry & aggressive, increased drug abuse, social withdrawal, and diminished productivity. (Hitt, Miller, & Colella, 2011, p. 236) These negative behavioral and emotional effects also create chain reactions that enforce a cyclical system of environmental problems. Individuals may have stress that is caused by external circumstances such as personal or financial issues, which, when added to the work stress, can create an even worse environment for the organization.

All of these negative consequences of stress can have severe consequences on the organization. For one, increased turnover will reduce organizational performance. Second, lower quality of relationships will reduce job satisfaction and, in turn, lead to higher stress, which will also increase employee turnover. These can also cause more problems related to communication breakdown, which can be catastrophic for the organization.

As suggested by Hitt et al.'s stress theory, Enron should have incorporated the following into its corporate strategy to reduce stress:

1. Enron employees should have been given a set of demands and requirements that are considered healthy. These would have allowed employees to have a healthy work/life balance.
2. Enron should have trained and developed its employees. They should have specifically targeted those at the bottom 20% (PRC evaluation) and developed their skill levels.
3. Enron should have invested heavily in providing job security and career development. These could have been in the form of educational opportunities to help associates improve their skills. They should also allow associates to rotate and expand on skills.
4. Enron should have maintained a healthy work schedule that is consistent and allow for flextime and other alternative work schedules.
5. Enron would have benefited significantly from wellness programs that train employees on how to manage stress.

All of these tactical tools will help improve the culture of Enron based on the theory. (Hitt, Miller, & Colella, 2011, p. 237).

**Recommendations to strategic leaders:**

*Stress management:*

1. Appoint a human resource professional as a board-level position.
2. Have a number of industrial psychologists on board of directors or advisory boards.
3. Consider changing the view of employee’s purpose in the organization. Leadership should view employees as human capital that needs to be built and invested in.
4. Actively invest in stress reduction programs.
5. Reduce employee turnover rate as much as possible. Make it a goal to hire the right people and build them up within the organization.

*General advice:*

1. Have a board of directors that is diverse. Appoint human resource leaders as well as individuals that are experts in ethics and culture.
2. Consider the tradeoffs associated with creating such a competitive culture. There should ideally be a balance between competitiveness and a caring environment in your company's environment.
3. Consider changing the compensation structure to create an environment that manages risk well.
4. Invest heavily in hiring organizational culture consultants to ensure the organization's culture is aligned with its strategy.
5. Create an independent ethics board to review the company's business practices on an annual basis.

# References

Healy, P., & Palepu, K. (2019). The Fall of Enron. *Harvard Business School Publishing*. Retrieved December 7, 2020.

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