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How Ernst & Young is training its Brazilian team

by Adam Turteltaub

Vice President of Membership Development at SCCE

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The dominant CEO: Great for business and terrible for compliance?

» The personality of the CEO has a significant impact on compliance.

» A red flag is the CEO who follows only his/her own rules, as opposed to company polices. *"La compagnie, c'est moi."*

» Another red flag is the CEO who doesn't believe in any sort of corporate governance or compliance structure. Trust can be overdone.

» Chief compliance officers must understand the CEO's personality, as well as the corporate culture, in order to design an effective compliance program.

» The business may be successful in the absence of an effective compliance program, but eventually, it will suffer.

Is there a correlation between ethics and business success? The Compliance and Ethics community, of course, loudly proclaims this fact. There may be such a correlation for several reasons. Your company makes more money if you aren't paying huge fines and legal fees. Management can pay more attention to the business if they aren't preoccupied with litigation—or in jail. Business partners, including consumers, may well shun a company that is constantly in legal trouble ranging up to formal debarment for government contractors convicted of (or, in some circumstances, merely suspected of) wrongdoing.

Banks

But even if there is a correlation, the sad fact is that ethical business operations may not be a necessary precondition for business success. Wall Street may punish companies after they have been caught in an ethical violation, but it does not seem to reward companies for their ethics, only for their profit and loss (P&L) statements or balance sheets. CEOs see this, and direct their attention accordingly. This focus is reinforced by the media attention paid to the "strong" CEO who imposes his (or, occasionally, her) vision on the company. That vision rarely, if ever, includes an ethical component. Yet the strong CEO, through some combination of business acumen, luck, and a media-friendly personality, becomes a darling of the business press, investors, and b-school case studies.

Is Warren Buffett the right model for Compliance?

It is interesting to compare two examples of "rock-star" CEOs: Warren Buffett and Steve Jobs. Buffett's firm, Berkshire Hathaway, has been very successful, and he has become a cult figure, although with a decidedly modest life style. He has also made a point of stressing the importance of ethical values in his activities. When Buffett testified before the

House Committee on Energy & Commerce in 1991 about the problems at Salomon Brothers, he said, "Huge markets attract people who measure themselves by money… sooner or later they're going to end up in trouble… Lose money for the firm, and I will be understanding. Lose a shred of reputation for the firm, and I will be ruthless." Buffett had earlier directed the company to cooperate with the government investigation, including waiving the attorney-client privilege. He also directed that the public relations consultants be discharged. "It isn't that we're misunderstood…. We don't have a public-relations problem. We have a problem with what we did."[1]

But Buffett, of course, is not perfect. When a close associate of Buffet's, David Sokol, apparently engaged in insider trading, Buffett initially defended his colleague, who was rumored to be Buffett's successor. Later, as more facts were revealed, Buffett stated that Sokol's trades violated company policy, and his actions were "inexplicable and inexcusable."[2]

Buffett and Charlie Munger, vice chairman of Berkshire Hathaway, take an extreme approach to compliance—they "overtrust."[3] The company has a tiny headquarters staff, without a general counsel or Human Resources department. Their stated policy is to hire people they trust, and then get out of their way. By establishing principles that everyone is expected to follow, rather than rules that people might try to evade, there is a relatively powerful dynamic for people to do the right thing. But is this enough?

Munger and Buffett do understand that with 300,000 employees, there are going to be problems. The no-staff-at-headquarters system that Berkshire has established has sometimes resulted in problems, such as a recent fine from the FTC for a repeat violation of the Hart-Scott-Rodino reporting requirements. The company agreed to pay $896,000 to settle the case, after having violated the same rules in 2013, and giving the FTC assurances that it would implement a compliance program.[4] This "technical" violation of the rules perhaps could have been avoided had there been sufficient staff to ensure that commitments made to establish a compliance program were actually followed.

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Buffett's personal honesty seems to be above reproach, but just setting an example is not enough to ensure a good compliance program. It may be necessary, but it is not sufficient. The same principle holds true for corporate governance. While Buffett's stated aversion to investing in businesses he doesn't understand and his modest annual salary are held up as examples of good governance, sometimes there is a lack of fundamental due diligence in business decisions, due to his reliance on gut instinct that may result in questionable business decisions.[5] This kind of decision-making obviously can lead to bad investment decisions. It can also lead to problems in overall management of the people in a company. When decisions are made based on the instincts of a leader rather than transparent principles (such as corporate policies), there is risk that the ability of employees to conduct business without fear of reprisal can be compromised. For example, right after Benjamin Moore & Co. had its first profitable quarter in five years, the CEO was fired abruptly for an "ineffective corporate strategy." A lavish Bermuda cruise for the subsidiary's top management to celebrate the company's success may have contributed to the termination, but, if true, that runs counter to the stated philosophy of allowing business managers to manage as they see fit. This may be consistent with Buffett's insistence on a modest lifestyle, but were employees aware of actual corporate limits? Were there any rules in place? The successor to the discharged CEO was also terminated in response to allegations that he has sexually harassed female employees.

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If those instincts lead to hiring friends because you trust them, that may work—but it may also lead to the hiring of people who, while trustworthy, lack the business skills the job requires. Many people who are found to have defrauded businesses were perceived as loyal, hardworking, and, of course, honest employees. Relying on setting an ethical example, and trusting your instinct on who to hire, are just not enough to ensure compliance.

Notwithstanding the occasional misstep, it is clear that Buffett sets a tone of ethical behavior that resonates throughout the companies that make up Berkshire Hathaway. But the question remains as to whether the market rewards Berkshire Hathaway for anything other than business performance. The Buffett/Munger formula requires the "right basic controls." Even with the tone of ethical behavior firmly in place, removing the infrastructure necessary to accomplish a culture of compliance can make it impossible to fully comply with all of the rules our legal system imposes. It certainly would not look like an "effective" compliance program under the Federal Sentencing Guidelines.

The Steve Jobs CEO model

In contrast, perhaps, is the example of Steve Jobs and Apple. Jobs resurrected a struggling Apple after he returned to the company he helped found. A series of innovative products followed, reflecting his passion for elegant design and an understanding of how humans function (or could function). He intensely cared about his products, but in his quest to achieve the vision of what he thought was right, nothing else seemed to matter. According to his biographer Walter Isaacson,[6] Jobs' relentless pursuit of his vision of what should be in his products, and his absolute conviction that he was right about any subject, led him to great product success but also product failures, ethical lapses, and, ultimately, his early death as Jobs ignored medical advice that conflicted with his own ideas. In spite of legal problems over the years, evidence appears that the Jobs approach to ignoring inconvenient legalities may have continued at Apple after Jobs' death. Nevertheless, the business continues to be hugely profitable and the company's stock continues to trade at stratospheric levels.

However, it is fair to ask whether Apple's legal problems over the years represented "routine" legal problems that might encountered by any large company, or were a reflection of the values of the CEO. Apple was one of several hi-tech companies that participated in the Silicon Valley "anti-poaching" conspiracy where each agreed not to hire the employees of the other. Steve Jobs appeared to be the central figure in this arrangement. All of this was clearly illegal under the antitrust laws. The insistence of Jobs in getting his own way was reflected in the way he brow-beat other Silicon Valley executives. For example, according to an email produced in the litigation, Jobs called Sergei Brin at Google and told him that if he hired a "single one" of the people from Apple, "that means war." Such was his power that no other company, including giants such as Intel and Google, wanted to anger Jobs.

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Additionally, although appeals are ongoing, Apple has been found guilty of facilitating a price-fixing conspiracy for the sale of e-books. The agreements between Apple and five large publishers resulted in a significant increase in the prices that consumers paid. The prosecution by the Department of Justice for violation of the antitrust laws was followed by civil actions by a number of parties who alleged that they were injured by the conspiracy and resulting price increase.

In the e-books case, the evidence showed that Jobs pushed to have an arrangement with publishers in place at the time the iPad was released. The proposed agreement would shift the sale model used by Amazon (i.e., the book was sold to Amazon, and Amazon re-sold it at whatever price it wished to charge) to an agency model (i.e., Apple would receive a 30% commission on the sale of books at whatever price the publisher wished to charge). The publishers thought that Amazon's prices were too low and adversely impacted the sale of hardbound books. If they responded by raising their prices to Amazon, Amazon often failed to respond by raising its prices and simply took a loss on the sale of the e-book. Jobs (and, presumably, his lawyers) understood this, and offered the publishers a way to make more money on the sale of e-books by switching to the agency model. But the system would only work if all of the major publishers were on board, and emails from Jobs showed that he personally pushed for the agreement. Although others were involved, including company lawyers, this was clearly an idea that was fixed in Jobs' head. According to the government case, this was an illegal conspiracy orchestrated by Apple, which violated the Sherman Act. The publishers all settled the charges that had been brought against them. Apple refused to settle, went to trial, and lost. The judge agreed with the government that Apple solicited and facilitated an illegal agreement that restrained competition among competitors (the publishers).

Jobs also had a well-documented obsession with music. This is reflected in his push to develop the iPod and control the music that was played on it. In yet another major lawsuit, Apple was accused of violating the antitrust laws by forcing iPod users to purchase higher-priced music, since technological tools were used to prevent other music files from being played on the Apple devices. Jobs and Apple defended the practice as a way to prevent liability for copyright violations, but it can also be seen as a relentless drive to accomplish a business goal without concern for legal consequences (or smaller competitors).

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It is somewhat difficult to speculate as to what goes on behind closed doors in a business, but we get hints of internal conduct and misconduct at Apple from the Isaacson biography, and from the evidence presented at the price-fixing trial. These bits of evidence paint a picture of the type of culture that Jobs created at Apple. Jobs had a reputation for being totally focused on his vision of what an Apple product should be. Other considerations—such as legal requirements—were just not part of his concerns. Although it may be unfair to extrapolate from "little" things, like ignoring license plate requirements or parking restrictions, these do paint a picture of a person who felt that normal rules—such as laws—did not apply to him.

Our society seems to reward risk-takers—when they are successful. It is one of the mantras of innovation that you really need to fail before you understand how to succeed. But what seems to be forgotten is that there is an important difference between taking a risk with a business idea versus taking a risk involving questionable ethics or legal compliance. Here, it seems that Steve Jobs simply had no perception that there was a difference. In a *New York Times* article,[7] James B. Stewart asked the interesting question, "If Steve Jobs were alive today, would he be in jail?" As noted above, Jobs was at the center of several legal controversies over the past few years, involving antitrust (e.g., e-book price fixing, anti–job-poaching conspiracy) and securities laws (e.g., options backdating involving both Apple and Pixar, where he was CEO). The defense of Jobs in the options backdating case basically was that he didn't know what he was doing, yet the evidence showed that minutes were fabricated for a board meeting that never occurred.

In the Isaacson biography, Jobs' use of the "reality distortion field" was common. For some, this was just another way of saying that Jobs tended to lie. But it also represented a desire to bend reality to his vision and his forceful personality to get other people to believe his vision, because Jobs had internalized it. This ability and willingness to push people to do things they didn't think were possible is one of the signs of the exceptional leader who can accomplish things that others could not. Jobs' single-mindedness apparently was not constrained by other considerations, and this seems to be where the compliance problems arose. As Isaacson said, Jobs believed that the rules that applied to ordinary people didn't apply to him.

But it would be unfair to limit the characterization of Jobs as someone who simply ignored reality. Colleagues report that he had an amazing talent at solving problems, and his visionary side deserves the respect it has been given. While Jobs had a reputation for treating employees harshly, there were many instances where people stood up to Jobs when they believed they were right, and he respected them for that. The problem was that it took a certain type of strength to resist Jobs' personality, and the normal tendency was for people to allow themselves to be pushed. The stubbornness of Jobs didn't just extend to an insistence on following his design vision for products, but included the exclusion of other considerations when they may have had nothing to do with product design.[8] People were either unable or unwilling to convince Jobs to do something different when it came to options backdating, employee poaching, or e-book pricing. With one exception, Jobs' personality (and the tacit economic threat that Apple could pose) forced other Silicon Valley companies to go along with his no-poaching conspiracy. The one exception? Sheryl Sandberg, who left Google to work as COO at Facebook. Facebook was not named as a defendant in the employee poaching case.

Jobs' business success seems to have come without any particular recognition that ethics were a necessary part of doing business. When he was asked about the ethical complications of genetic research and cloning in an interview, Jobs famously replied, "You know - I'd rather just talk about music. These big-picture questions are just - zzzzzz."[9] Part of Jobs' fixation on his vision also included a bit of paranoia about employees who might not have had his same single-mindedness. It was reported that Apple had a group of employees known as the "Worldwide Loyalty Team" (also referred to as the "Apple Gestapo") whose job was to vigorously pursue any suspected leak of information. They would descend upon a department, collect cell phones and require employees to unlock them so they could be examined. They were told not to communicate with anyone while a department examination was occurring, and if they didn't like it, they could leave. It was earlier reported that the intense efforts to track down the disappearance of an i-Phone prototype at Foxconn, the Chinese company that makes the device, resulted in the suicide of one of the employees who was interrogated. For Jobs, secrecy and loyalty were of paramount concern, not because it was a matter of ethics, but because it was a matter of business.

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Now that Steve Jobs is no longer with Apple, the question is whether the company is committed to following all of the Jobs management traits—including the minimization of the importance of compliance. After Apple lost the e-books price-fixing case brought by the Justice Department, the first report from the compliance monitor painted a picture of a company determined not to admit that it had done anything wrong and determined to resist the attempts by the monitor to guide the implantation of a compliance program. Requests that are common in implementing a compliance program, such as interviewing senior managers and directors, were characterized by Apple as grossly intrusive.[10] In this case, Apple was not just resisting the suggestions of a monitor, but it was resisting the orders from the sentencing judge regarding a compliance program. There may have been legitimate disagreement over whether the conduct of Jobs was actionable price-fixing, but once the case was lost, it seemed incredible to most observers that the company would continue to fight the establishment of a compliance program. Why would any company take the position of resisting what appeared to be the objectively reasonable requests of a court-appointed monitor? One might speculate that it was the attempt by the company to assimilate the obstinate personality of Jobs, even after his death. But things improved somewhat six months later, and the second report of the monitor indicated that Apple had implemented a revised antitrust compliance program.

Compliance professionals understand the importance of corporate culture and its effect on behavior. The psychology that exists within a company can have a significant impact on decisions that employees make. Jobs commanded tremendous respect within Apple, based on his intelligence and his forceful personality. Jobs fostered a culture of moving forward without much thought to consequences, ethical or otherwise. This resulted in a number of significant product innovations, and some legal stumbles.

The role of the CEO in compliance

Moving beyond Apple and Berkshire Hathaway, it is clear that in many companies, on Wall Street, and in business schools, there is almost a "cult" approach to the CEO. The media and investment community love to have a CEO they can talk about, and this may result in a situation where the company becomes so identified with the CEO that his/her word becomes law and nothing else matters. In the business community, the appointment of the charismatic CEO is often rewarded by a rise in the stock price, but it is often followed by a breakdown in sound management and governance principles that will eventually lead to disaster. The role of the leader in setting the ethical tone for a company is key. Sometimes the problems arise when a founder of a company, who had a key role in making the corporation work, will stay too long as business and ethical problems mount. Dov Charney, the founder and CEO of American Apparel, was the subject of a number of allegations regarding sexual harassment, and he was finally fired in 2014, after he apparently released personal photos of a woman who was suing him. There is also a recognition that in the scientific community, the traits that describe a psychopathic personality (e.g., calmness under stress, egocentricity) may also be ones that enable a CEO to succeed.

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It doesn't seem that Jobs' inattention to ethical considerations fit into any of the standard models used to examine business ethics. As Evgeny Morozov noted, in Jobs' world, "there were only two kinds of people to be reckoned with: producers and consumers. Norms, laws, institutions, politics—none of that larger context matters."[11] Jobs wasn't necessarily *immoral*; his behavior suggested that he was *amoral*. Morals were not an issue. In fact, it may well be that in order to achieve great results, a certain irrationality is required. The only way to do the impossible is to press ahead and insist on doing it.

Many lessons about Jobs as manager can be gleaned from reading about his life at Apple. Stubbornness and commitment can be very powerful. Simplification of messages and products is important. Demanding top performance from employees is important to establish excellence. But when other managers start to emulate Jobs as manager, it is scary to think that they will also assume that in the drive to push out a product, nothing else matters.

In the *Harvard Business Review* discussion of the best performing CEOs, Steve Jobs was ranked #1. The criteria for such judgments were financial: returns adjusted for countries and industries, and market capitalization changes. After going through the rankings, the authors noted that there was zero correlation between the financial performance of the executives they ranked, and the social and environmental performance of their companies.[12] Unfortunately, the authors focused on indicators of corporate social responsibility (CSR), and not ethics or compliance. CSR is not an accurate proxy for compliance and ethics, because the components differ widely from country to country. But the authors made no mention of other ethical considerations or a company's history of litigation, which might be an indicator worth considering.

It wasn't just that Steve Jobs was a difficult individual, or that he was inconsistent, or that he valued product design above all else. It was just that he would not allow ethics to enter into his thought process—and for that, the company, its employees, and its shareholders, suffered. The "insanely great" company could have been even greater.

But is the Buffett model preferable? The strong emphasis on ethics of Warren Buffett is clearly something to be admired, and every CEO should demonstrate the same commitment. But along with that commitment came a tendency to make business decisions based on instinct rather than analysis. The idiosyncratic aversion to staff positions and technology resulted in legal violations and business problems that could have been avoided had there been a more conventional structure available to implement the Buffett ethical vision as well as his business vision. The immense power vested in Buffett, together with the lack of structure, appears to have resulted in some confusion as to actual policy.

Structure alone is not an answer. Compliance can get buried in an elaborate internal structure, with the result that nothing gets done. This may be a reflection of an entrenched corporate culture. The CEO may be unable to alter the culture, or be unaware of certain aspects of the culture that can undermine the company. The result is like the "paper" compliance program: on paper, the corporate process looks thorough and reasonable, yet nothing gets done. This can be the result of an intentional strategy to avoid compliance, as at Enron, or it may be an unintentional result of a corporate bureaucracy. This has been widely discussed in the case of the General Motors ignition switches. A report by an outside lawyer revealed that GM knew about a defect in ignition switches for many years, but did nothing about it. The culture in the company was such that, while there were many meetings and discussions about the problem (i.e., there was a structure to address the problem), nobody would take responsibility for fixing the switch, nor would they do anything that might publicly embarrass the company or lead to liability. The general counsel and CEO seemed to be unaware of the situation. Needless to say, the lawsuits followed soon thereafter.

One way to think about this tension between the value of the strong leader and the need for objective compliance and ethics standards was suggested back in the 1982 book by Thomas Peters and Robert Waterman, *In Search of Excellence*. One of their attributes of excellence was "loose-tight" management. There are certain areas where tight management is necessary (e.g., finance); other areas benefit from autonomy (e.g., shop-floor activities). This principle applies to compliance and business ethics, too. There need to be the cultural signals within the company, starting with the CEO, that might be thought of as "loose," or subjective. But there also needs to be a structure to implement those things that make up the company's values that can't be left to examples or signals, and these would be the tight or objective part of the compliance program. Both are necessary.

Conclusion

Media stories about famous CEOs paint an incomplete picture, of course, but there are some things that compliance officers can learn:

- The personality of a CEO is a major factor in compliance. In addition to sending a message that compliance and ethics are important, the CEO must also support a structure for compliance where it is necessary.
- If the CEO does not automatically send a message that ethics are important, the compliance officer will need to do it for him/her—if possible. If not possible, or only partially possible, then there is a strong possibility that ethical problems may be on the horizon.
- A risk assessment of a company should also include a section on the CEO's personality. Legal violations at Apple and Berkshire Hathaway (and other companies) occurred, to a certain extent, because of the CEO's personality. In one, the CEO didn't care; in the other, the CEO cared, but didn't do much to implement his cares. The risk would be in proportion to the dominance of the CEO and the nature of the personality.
- Perversely, the more successful a CEO is perceived to be, the more difficult it may be to implement an effective compliance program. Chief compliance officers (CCOs) should take advantage of business success to bolster their program, and not allow management to adopt a complacent policy that nothing more needs to be done. But the CCO should recognize when the dominance of a CEO threatens the ethics of the organization. ✳

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