

More Scandal, Less Appetite for 'Reform'

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It's not necessary to draw a connection between Dennis Kozlowski's private penny pinching and how he ran Tyco, but it's nonetheless tempting. It certainly doesn't offer much fuel for the debate over corporate "reform."

Tyco makes everything from fire alarms to hospital supplies, but these are mere details. Its business model was an endless series of acquisitions combined with rich incentives for field managers to rip out costs and boost profits, creating wealth for themselves and Tyco's onlooking shareholders. Mr. Kozlowski once said that he seeks managers like himself: "Smart, poor and wants to be rich."

He treated tax efficiency the same way he did industrial efficiency, as a quantum to maximized un sentimentally. Hence Tyco's Bermuda corporate address. Now it appears he also used the company's New Hampshire post box to illegally evade sales tax on his own personal art purchases and who knows what else.

Such penny-foolishness in a man who made \$300 million in recent years is a mystery best left to the psychology department. Still, what gave the past two decades much of their flavor was a frankness with which we treated money as a carrot for executive decision-making, which it surely was at Tyco.

Nobody in his right mind doubts that, overall, these incentives have had a major effect, if only because they help overcome resistance to the unpleasant ways companies can create wealth, such as closing down a modestly profitable factory because it isn't profitable enough.

This may not be everyone's idea of how to run an economy, but political tolerance for big-money corporate incentives has been tested before. In the 1996 presidential primaries, Bob Dole, Pat Buchanan and a host of Democrats decried mass layoffs engineered by CEOs enriched with stock options. Remember Newsweek's "Corporate Killers" cover?

Then it was a question of whether we were willing to pay the price in creative destruction for these intoxicating management incentives. Many Americans who shared in the CEO's windfall through their 401(k)s proved decidedly ambivalent about hoisting the red banner.

Now the furor is over Enron and a handful of other companies accused of accounting fraud, raising a question of whether financial reporting has been systematically distorted by having so many managers and employees obsessing daily about the stock price. Is corporate performance all shadow play, orchestrated by management to make shares go up?

Not likely. A better explanation for why a delirium that exhausted itself quickly in the mid-1990s burns so hotly today is the performance of the stock market itself. This time around Americans are hurting in their portfolios and looking for someone to blame.

Every generation seems to have to learn the same lessons. Brokers have always pushed the hot stock du jour. Speculative companies have always engaged in aggressive accounting, with egg on their faces if they fail (and sins quickly forgiven if the business succeeds).

In its chronicle of Andersen's fall from grace last week, the Journal quoted accounting conscience Leonard Spacek on an alarming "retrogression in the quality of accounting." Mr.

Spacek is long dead; he was speaking in the early 1960s, upbraiding Bethlehem Steel for supposedly overstating its profits by 60%.

Since then, of course, American capitalism won the Cold War, created a \$10 billion economy and invented the Internet, SUVs and Viagra. In the markets, the most visible trend has been toward more and better information, analyzed more intelligently, with a resultant decline in the volatility of stock prices.

Still, there's a market for disgruntlement with recent setbacks, not to mention ambulance chasers galore. Yet a curious fact is that most ideas for "reform" seem to have already worn themselves out with talking.

Accountants were in the crosshairs for a while -- until we realized that a weakened accounting industry wouldn't be able to service the growing demand of companies for more rigorous auditing to win back investor trust.

Likewise, what became most clear in the debate over management's stock options was the presence of loons on both sides, insisting the sky would fall if we did or didn't require a purely fictitious ding to earnings. In the words of Dennis Beresford, former head of FASB, the nation's accounting rulemaker: "Accounting principles don't lead to falling skies."

As one reform proposal after another has finally bored its proponents, the most lasting casualty of Enron may be our infatuation with minutely prescribed "accounting standards" themselves. In his speech last week, Goldman Sachs's Henry Paulson called this the "most critical area" where change is needed.

A year ago nobody was touting Europe's approach to accounting, heavy on broad principles but notably light on detail. Now everybody is. We've begun to realize the battle was already half-lost when Enron executives could look to a shelf-long accounting bible for ways to conceal what they felt like concealing. Worse, investors were led to believe it was somebody else's job -- i.e., the accountants' -- to worry about whether management was telling the truth.

The Europeans haven't had our recent history of mass participation in the stock markets, and neither have they suffered our urge to treat the average investor as needy of protection. Maybe that's why they have a realistic view of accounting's limits.

No amount of rule tinkering will prevent a Kozlowski or Enron from discovering new ways to blow themselves up. Investors who find this thought unduly scary haven't figured out the oldest rule in the book: You can never be too skeptical or too diversified.