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Summer June 25, 2013

An Exploratory Study of Investment Compliance Management in the Enron Collapse

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Presented to

Dr. Robert Munro
Thesis
Thomas Jefferson School of Law

July 24, 2013

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I. Abstract

At the turn of the 21st century, the Enron scandal played a major role in shaking investors' and stakeholders' confidence, in part because the corporation's administrators were able to conceal its losses for nearly five years. This thesis examines the history of Enron and describes the circumstances leading up to its collapse in 2001, paying particular attention to the violation of corporate governance laws on the part of the firm's high-ranking officers. The national scandal that Enron engendered gave rise to specific regulatory changes on the part of the U. S. government, which are outlined and discussed. The central part of the thesis focuses on organizational leadership, particularly as it relates to financial institutions such as Enron, and delineates a new leadership paradigm designed for effective communication at all levels of a corporation. The final section of the thesis assesses financial industry trends that bankers and consumers can expect during the next ten years, such as improvements in technology, increased government regulations to protect security and privacy, and greater use of electronic banking.

II. Introduction

The economy is a financial system that is structured and conditioned on the basis of everyday life, such as: trade, labor, capital, land resources, manufacturing, production, distribution, and consumption of goods and/or services. . . A *financial crisis* is a structure of financial resources that rapidly depletes due to the supply and demand of the economy. . . . A *scandal* is “a circumstance or action that offends propriety or established moral conceptions or disgraces those associated with it.” (Merriam-Webster, 2013)

At the turn of the 21st century, the Enron scandal played a major role in shaking investors’ and stakeholders’ confidence, in part because the corporation’s administrators were able to conceal its losses for nearly five years. The Enron Corporation’s administrators failed to notify investors, credit-rating businesses, stock market analysts and accounting firms about the decline of business within the corporation. The Enron Board of Directors, audit committee and marketing analysis group apparently did not understand the severity of the financial activities that were taking place, and did not provide adequate oversight for the corporation’s financial obligations to American businesses. This thesis will examine the financial development and leadership behavior among financial institutions, evaluating Enron’s collapse and other major factors that have impacted and corrupted the world of business and investments.

The thesis also examines current research from various theorist perspectives about financial institutions, leadership, and accounting strategies that would shed light on today’s businesses on the verge of collapse (such as AIG and Citi-Group). It addresses various changes in financial corporations and their performance in providing quality services to their shareholders, investors and American businesses, with particular attention to leadership and ethical behavior.

The first part of this thesis examines the history of Enron and describes the circumstances leading up to its collapse in 2001, paying particular attention to the violation of corporate governance laws on the part of the firm’s high-ranking officers. The national scandal that Enron engendered gave rise to specific regulatory changes on the part of the U. S. government, which are outlined and discussed.

The central part of the thesis focuses on organizational leadership, particularly as it relates to financial institutions such as Enron, and delineates a new leadership paradigm

designed for effective communication at all levels of a corporation. The final section assesses financial industry trends that bankers and consumers can expect during the next ten years, such as improvements in technology, increased government regulations to protect security and privacy, and greater use of electronic banking.

III. The Rise and Fall of Enron

The Enron Corporation (former NYSE symbol: ENE) was a Houston-based energy, commodities and services company. At one time it earned revenues of over \$100 billion, employed over 20,000 people, and was considered one of the world's major suppliers of natural gas, communications, electricity, and paper/pulp. The corporation went bankrupt in 2001 following a scandal that exposed financial wrongdoing on the part of Enron's top-ranking officers and headlined the national news for months.

A. Enron's History

Enron was founded in 1985 from the merger of two natural gas companies: Houston Natural Gas and Omaha-based Inter-North. In 1989, it began a global trading business in natural gas that grew rapidly once government price regulations were lifted in the 1990s. In the mid-90s it traded electricity in North America then expanded into Europe. Enron also pioneered the market in weather derivatives beginning in 1997.¹

The Securities Litigation Uniform Standards Act (SLUSA), 15 U.S.C. § 77p (b) (1) and § 78bb (f)(1) allowed Enron to expand into new fields such as pulp and paper as well as broadband telecommunications. In the fifteen years between 1985 and 2000, its revenues increased tenfold (from \$10.25 billion to over \$100 billion), as did its net income (from \$125 million to nearly \$1 billion), with the energy trading portion accounting for almost three-quarters of its profits.”² Ranked in *Fortune 500* magazine for its remarkable revenues in energy trading and investments, Enron was lauded for its diversification and global energy expansion, and the corporation appeared to be an international success.

¹ Altman, E. I. (1968), Financial ratios, discriminant analysis and the prediction of corporate bankruptcy, *Journal of Finance*, 23(4):589-609; Mizrach, B (2006), The Enron bankruptcy: When did the options market in Enron lose its smirk? *Review of Quantitative Finance and Accounting*, 89: 404-408.

² Securities Litigation Uniform Standards Act (SLUSA), 15 U.S.C. § 77p (b) (1) and § 78bb (f)(1).

B. Enron's Violation of Corporate Governance Laws

As noted above, Enron began in the mid-1980s by merging with two of Houston's pipelines. Even though the company faced economic challenges, it managed to survive. In 1988, the company was redefined from "energy delivery" to "energy broker." Enron started to bring energy buyers and sellers together, thereby creating a powerful energy industry. However, Enron, WorldCom and others failed to operate within the lines of maintaining profit exchanges and generating consistent revenues of buying and selling.

Enron and other corporations deregulated financial limits without consulting the Chief Financial Officer, Securities and Exchange Commission, and Congress. Enron contract agreements became increasingly complex and engendered a diverse company culture. Employees were rewarded for their exceptional performance in cultivating financial exchange agreements among shareholders, stakeholders, clients and investors. Jeffrey Skilling, Enron's former President and Chief Executive Officer, increased major changes in the corporation through shared values of culture and diversity. Skilling promoted innovation, aggression, and independence in Enron employees along with high-quality services and level of expectations for their shareholders, stakeholders and clients.³

In the late 1990s, Enron had a "red flag" against it for negative earnings and profits, which forced its value on the stock market to decline and raised concerns with investors. However, Enron continued in its pattern of excessive selling, which resulted in a decrease of its credit rating, along with the loss of trading partnerships; these actions had a major effect on the cash flow and earnings that had already suffered over the past years.

Initially, global executives and partnerships were secure in allowing Enron to use their assets to sell and create earnings by special purpose vehicles (SPV). But over time, Enron entered into what Sims and Brinkman (2003) called "a deceiving web of partnerships" across the global economy that prompted questions regarding its accounting methods and procedures.⁴ According to Sims (2000), Enron over-exaggerated earnings

³ *Newby v. Enron Corp.*, (In re Enron Corp. sec. Litig.), 2002 U.S. Dist. LEXIS 25309 (S.D. Tex., Dec. 18, 2002).

⁴ Sims, R. R. & Brinkmann, J. (2003), Enron ethics (or, culture matters more than codes), *Journal of Business Ethics*, 45(3), 243-256.

and profits by recognizing gains and sales assets to SPV, sometimes claiming income before a sale or partnership had actually been executed.⁵

For example, Enron had developed a profit-generating plan with Blockbuster to make movies directly available to customers over the phone lines. Enron recorded \$100.9 million in premature profit and never realized that the partnership failed after 1,000 home pilots.⁶ Enron failed to consult their Chief Financial Officer and external auditors for making business deals prior to receiving earnings and investments, which was a violation of corporate governance laws and federal government laws by the Securities and Exchange Commission (SEC). Enron continued to increase earnings prematurely, along with falsifying and leaving earnings and debt income of the corporation off of its balance sheets.

C. Enron's Collapse

Enron's credit rating declined and lenders demanded payment in sums of millions of dollars in debt collections. Inconsistencies on Enron's balance sheets had jeopardized their credit rating with lenders, which resulted in collections of payments by the lenders immediately. Enron was predating checks and moving accounts around to satisfy their debt, which made it easy for the corporation to stay in business. Because certain partnerships had not actually been formed, they could not be considered subsidiaries; in this way, Enron's accountants cleverly tried to avoid notice by the SEC, as such partnerships would have involved stricter accounting laws, methods and procedures.⁷

To get the SEC out of the way, Enron hired external accountants and attorneys, including Arthur Andersen and Vinson & Elkins. The accountants allegedly referenced the Financial Accounting Standards Board rules (FASB) that did not consider subsidiaries as long as their equity is 3% and comes from independent investors and sponsors. Enron had partnerships that were not legal, but that appeared legal to the

⁵ *Ernst & Young, LLP v. Pacific Mutual Life Ins. Co.*, 51 S.W.3d 573, 583 n.7, 44Tex.Sup. Ct. J. 955 (2001), (not reaching issue of whether Texas law recognizes a cause of action for aiding and abetting fraud separate and apart from a conspiracy claim); Sims, R. R. (2000), Changing an organization's culture under new leadership, *Journal of Business Ethics*, 25, 65-78.

⁶ Savidge, J. (2008). Financial aspects of technology management. *The CPA Journal*, 78(5), 155-202.

⁷ *SEC v. Dresser Indus., Inc.*, 202 U.S. App. D.C. 345, 628 F.2d 1368, 1374 (D.C. Cir.), cert. denied, 499 U.S. 993, 101 S.Ct. 529, 66 L. Ed.2d 289 (1980).

Securities and Exchange Commission (SEC). One example of these external partnerships was the SE Thunderbird LLC.⁸ Also, Enron's Chief Financial Officer (CFO) Andrew Fastow owned a partnership with LJM Cayman LP and LJM2 Co-Investment LP. And a former director at Enron owned a share of partnership with Chewco Investment LP.

Enron's top officials made over \$30 million dollars and redeveloped ethical guidelines and standards, manipulating rules for their personal gain and to keep the corporation afloat. When ethical boundaries are breached, then the creditability of a financial corporation is compromised.⁹ Very large defaults in Enron, WorldCom and other companies made an impact on credit derivatives in the banking and financial sectors.¹⁰

Credit derivatives would help the stability of the financial market but could also lead to financial disaster among lenders.¹¹ Since banks have no obligation to disclose financial and credit dealings with their clients, it could be noted that the banks are not the ones that are taking the risk; rather, it is the clients and corporations that are taking the risk by having to pay back more than they originally borrowed.¹²

As Enron partnerships began to fail, Enron's debt continued to increase and the corporation was liable for millions of dollars in unpaid debt. The partnerships that had once allowed Enron to increase earnings and revenues began to collapse. Enron was forced to announce an earnings decline of \$390 million dollars from partnerships with Chewco Investments, JEDI, and others. Companies that unethically promote partnerships without reinstating earnings from other corporations will fall in capital budgeting and loss of revenues over a period of years.¹³

Enron was forced to restate earnings from 1997 which totaled over \$586 million dollars, which was 20% of revenues. In August 2001, Enron CEO Jeffrey Skilling

⁸ §§ 11 and 15 of the Securities Act of 1933; §§ 10(b), 20(a), and 20A of the Securities Exchange Act of 1934; and the Texas Securities Act.

⁹ Zhang, M. & Yu, T. (1999). An international analysis of business strategies: The case of the auto industry. *Journal of Accounting and Finance Research*, 7(3), 454-525.

¹⁰ Fajardo, C. L. (2007). The move towards convergence of accounting standards worldwide, *Journal of the American Academy of Business*, 12(1), 458-490.

¹¹ Peslak, A. R. (2008). Organizational information systems; Rate of return and influencing variables as viewed by top financial executives, *Industrial Management Data Systems*, 108(1), 232-263.

¹² Arthur Andersen LLP v. United States, 544 U.S. 696 (2005).

¹³ Eriotis, N., Vasiliou, D. & Ventoura-Neokosmidi, Z. (2007), How firm characteristics affect capital structure: An empirical study, *Managerial Finance*, 33(5), 321-331.

resigned and sold shares in the amount of \$66 million dollars. Two months later, Enron started to decline and could not be stabilized. Employees were asked to invest in the company but when some of them did, they found themselves unable to retrieve their investments. Due to Enron's unethical behavior in the financial system, the corporation was forced to file bankruptcy and begin a battle on Capitol Hill that ended in the worst financial crisis in history and led to changes in financial laws.¹⁴

IV. Understanding Financial Corporations and Financial Crisis

Financial corporations always need profit and revenues to increase for each yearly cycle. The profit that financial corporations need to stay in business comes from sole proprietors, investors, partnerships, and banking institutions (stocks and bonds). Failing corporations tend to seek financial assistance from other corporations or financial lenders. Most lenders want to increase percentages and profits on their loans, and other corporations may want the company to merge as a partnership.

Equity and debt financing is based upon future revenues and investments, such that lenders are compensated at a predetermined rate and the corporations divide the profits at varying ranges. In addition to loans, corporations may borrow from banking institutions and/or government entities for debt financing. The corporations pay a significant amount of money to the lenders and government at a fixed rate.¹⁵

To avoid a future financial crisis, corporations and lenders set aside reserve funds for their capital and profit losses that other financial corporations may face with the economy. When banks face losses of funds, banks (lenders) tend to put restrictions and requirements on shareholders, corporations, consumers and investors on how much money can be borrowed. The U.S. government also creates regulations in order to protect investors; one such regulation was the Glass-Steagall Act of 1933, which created federal deposit insurance. Additional regulations may create new oversight of banks with higher capital requirements and strict guidelines for lending to corporations.¹⁶

¹⁴ Sarbanes-Oxley Act of 2002 (Pub.L. 107-204, 116 Stat. 745, enacted July 30, 2002).

¹⁵ In re WorldCom, Inc. Sec. Litig. (*Bell v. Ebberts*), 308 F.Supp.2d 236 (S.D.N.Y. 2004).

¹⁶ WorldCom, 308 F.Supp.2d at 240.

V. A Brief Analysis

As described above, Enron's energy sales and net revenues conflicted with the auditors' report and financial statements. Enron reported less than the revenue and sales from energy trading and stockholders on Wall Street. There was a profit of \$1 million contract sales in revenues and not gross net revenues. Enron made over \$500 million transfers in revenues and sales costs. But Enron officials had no set accounting standards for its corporation and no governance and ethics accountability for its revenue and profits.¹⁷ Furthermore, Enron failed to demonstrate responsibility, merit and accountability towards checks and balances of financial activities within the corporation's performance.

Enron management did not clearly acknowledge generally accepted accounting practices (GAAPs). Management did not report various revenues, cost, assets and profits from shareholders. Enron failed to report the energy sales contract investments from shareholders' profit, which was in the amount of \$1 million contracts that included the electricity and gross revenues for foreign and domestic deliveries. Enron revenues made a sudden increase from \$13.3 to \$138.7 billion in 4 to 9 months, which raised a red flag to shareholders.¹⁸ Enron officials refused to disclose the corporation's financial activities and lied to shareholders and stockholders about its financial schemes. Enron auditors failed to retrieve missing information about the company's finances, which resulted in an external audit by Congress.¹⁹

Enron's demise was succinctly summed up by Mizrach (2006, p. 365), who said, "Enron's collapse was due to excessive debt, disguised from the public through off-balance sheet entities. Wall Street buy side analysts were either deceived or dishonest. Many maintained strong buy ratings until Enron was delisted."

¹⁷ Sarbanes-Oxley Act of 2002 (Pub.L. 107-204, 116 Stat. 745, enacted July 20, 2002).

¹⁸ Stanley-Oxley Act of 2002 (Pub.L. 107-204, 116 Stat. 745, enacted July 30, 2002)

¹⁹ *Newby v. Enron Corp.*, (In re Enron Corp. Sec. Litig.), 2002 U.S. Dist. LEXIS 25309 (S.D. Tex., Dec. 18, 2002).

VI. Regulatory Changes Following the Enron Crisis

A. A Breach of Trust

During the Enron investigation, many analysts and investors suspected that major accounting errors, inconsistencies and critical documents were not revealed to the external auditors from the U.S. government and the Securities and Exchange Commission in order to protect the company's capital, investments, profits, and revenues. Despite the auditors' efforts at last-minute cleanup in the Enron scandal, however, many employees lost their jobs due to the misappropriation of funds and breach of accountability of leadership within the corporation. The corporation therefore failed in its responsibility to the shareholders and employees. Initially, Enron had been rewarded for its high performance in meeting the goals of the economy and its energy investors.²⁰ But Enron later received scrutiny from the business media and financial analysts about how the corporation's leaders conducted themselves unethically with regard to financial laws and negative earnings.²¹

The post-Enron economic crisis has continued to spark a global change in financial laws.²² The collapse of Enron, WorldCom and a growing list of other companies that have inflated revenues and net income due to the misappropriation of earnings and falsified accounting figures has prompted major changes in how financial institutions conduct business. Such changes were necessary because the public's trust has been damaged due to the Enron scandal and other similar events that occurred during the first decade of the twenty-first century. The blame starts with the lack of leadership accountability and attempts to undermine the financial system.²³

The heads of Enron, WorldCom and other companies failed to provide transformational leadership results and envision future roadmaps of the corporation and also did not achieve positive results among the employees, shareholders, stakeholders and clients. Furthermore, they did not provide or disclose all documentation that was instead

²⁰ Bartlett, C. A. and Glinska, M. (2001), *Enron's transformation: From gas pipeline to new economy powerhouse*, Boston, MA: Harvard Business School Press.

²¹ Sims, R. R. (2000), Changing an organization's culture under new leadership, *Journal of Business Ethics*, 25, 65-78.

²² §§ 11 and 15 of the Securities Act of 1933; §§ 10(b), 20(a), and 20A of the Securities Exchange Act of 1934; and the Texas Securities Act.

²³ Sarbanes-Oxley Act of 2002 (Pub.L. 107-204, 116 Stat. 745, enacted July 30, 2002).

hidden by the Chief Financial Officer (CFO) and the Chief Executive Officer. While directors of financial corporations need to understand the basis of regulating and following financial requirements set forth by the U.S. government and to conduct further research on how to prevent profit losses, crisis or financial collapse from happening in their corporation, it is essential that today's organizational leaders demonstrate honesty, integrity, morality and values, which will lead to achieving effective results.

“The economic recovery in the United States and abroad weakened in 2002 as financial markets reflected the uncertain environments of declining stock market prices resulting from corporate and accounting scandals like Enron, WorldCom or others. This demonstrated the vulnerability of financial markets and the need to restore integrity to the reporting system and to address issues associated with corporate accountability (Kean, 2002).” According to Kean (2002), “earnings manipulations are prevalent; but except for specific cases, it is hard to detect and prosecute them.”

Trying to regulate earnings manipulations out of existence with more detailed rules seems unlikely. The key to sustainable economic growth lies in corporate reforms that strengthen corporate governance and restore confidence to the financial system (Fromlet, 2001). The Securities and Exchange Commission (SEC) and Congress initiated a major audit on Enron's financial activities, which contained unreported assets, revenues, and profits. The SEC and Congress have created new financial laws such as the Sarbanes-Oxley Act. The Sarbanes-Oxley Act (described below) holds financial corporations accountable for their rulemaking and financial decisions.

The new regulatory framework was created to protect the shareholders', clients', and stakeholders' profits, investments, savings, and revenues. Although Enron had as its base a very valuable set of assets and cash flow streams, its value was ultimately offset by the huge liability and capital cost incurred when investors could not trust the company's financial management. “One potentially positive outcome of Enron's failures will be a clear and improved process by which auditors are selected, retained and compensated. Directors, accountants and auditing companies need to be sensitive and responsive to the new levels of scrutiny and exposure caused by the Enron bankruptcy, the WorldCom debacle, and other recent corporate scandals. The new emerging auditing and reporting standards along with companies' ethical decision making should be the

basis for leading corporate practices in the future.²⁴ Already, large financial corporations such as J.P. Morgan Chase, Morgan Stanley, and Salomon Smith Barney publish the share values of sold revenues and share offerings and have therefore made a significant change in how shareholdings and balance sheets are reported to the trading market.”²⁵

B. The Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 (*Pub.L. 107-204, 116 Stat. 745*, enacted July 30, 2002), is also known as the Public Company Accounting Reform and Investor Protection Act.²⁶ The Sarbanes-Oxley Act is a United States federal law that sets requirements for public companies, board management and organizations to follow in accordance with federal and state laws of the United States of America. The Act was named for two United States congressmen: Senator Paul Sarbanes (D-MD) and House Representative Michael G. Oxley (R-OH). The Sarbanes-Oxley Act contains eleven titles, or sections, that range from the setup of a Public Company Accounting Oversight Board (PCAOB) to descriptions of criminal penalties and financial accountabilities pertaining to analysts, auditors, and corporation executives. The law helps to protect our financial infrastructure from fraud, criminals, terrorists, and other financial offenders who wish to use public funds for their personal or financial gain.²⁷

The Act consists of the following sections:

Title I- Public Company Accounting Oversight Board (PCAOB)

Title II- Auditor Independence

Title III- Corporate Responsibility

Title IV- Enhanced Financial Disclosures

Title V- Analyst Conflicts of Interest

Title VI- Commission Resources and Authority

Title VII- Studies and Reports

Title VIII- Corporate and Criminal Fraud Accountability

²⁴ Livingston, P. (2002), Financial management after Enron, *Bank Accounting & Finance*, 15(3): 27-28.

²⁵ §§ 11 and 15 of the Securities Act of 1933; §§ 10(b), 20(a), and 20A of the Securities Exchange Act of 1934; and the Texas Securities Act.

²⁶ *Newby v. Enron Corp.*, (In re Enron Corp. Sec. Litig.), 2002 U.S. Dist. LEXIS 25309 (S.D. Tex., Dec. 18, 2002).

²⁷ Sarbanes-Oxley Act of 2002 (*Pub.L. 107-204, 116 Stat. 745, enacted July 30, 2002*).

Title IX- White Collar Crime Penalty Enhancement

Title X- Corporate Tax Returns

Title XI- Corporate Fraud Accountability

VII. Effective Organizational Leadership

A. Strategic Planning and Communication

Organizational leaders play a pivotal role in helping their organization create and execute a plan for achieving and maintaining organizational effectiveness. According to Crum, Laughhunn and Payne (1981), corporate planning stresses the setting of goals and the tailoring of actions to achieve the goals.²⁸ Wall, Solum, and Sobol (1992) theorized that leaders have two primary roles: one is to have an organizational vision and implement it, and the other is to prepare people for greater levels of responsibility for financial investments and liquidation. They also observed that during conversations with many business leaders across the country it was noted that many have not developed a strong vision for their respective organization.²⁹

Effective communication on the part of organizational leaders will ensure congruency among the workforce, financial investments, and quality assurance accountability (audits). Organizational effectiveness in the Enron collapse was undermined through bad investment decisions to offset the revenue and cash flow from stakeholders, shareholders, and companies, which caused a major decline and led to a federal government investigation. A focus on organizational performance and effectiveness at a company like Enron would lead to both internal and external customer satisfaction; this would also supply chain management as seamless coordinated functions. Lack of communication at nearly all levels of operations was also a problem at Enron. As Cohan (2002) pointed out, “We can understand the dissemination of information

²⁸ *Newby v. Enron Corp.*, (In re Enron Corp. Secs, Derivative & ERISA Litig.) 2003 U.S. Dist. LEXIS 1668 (S.D. Tex., Jan. 28, 2003); Crum, R. L, Laughhunn, D. J & Payne, J. W. (1981, Winter), Risk-seeking behavior and its implications for financial models, *Financial Management*, 10(5): 20-27.

²⁹ Wall, B., Solum, R. S., & Sobol, M. R. (1992). *The visionary leader*. Rocklin, CA: Prima Publishing.

within a corporation only if we can understand the realities of behavior within [it].”³⁰

The “web of deception” existed not only outside the corporation, but within it as well.

The ability to successfully plan for growth, development and continuous financial improvement would assist in organizational goal achievement by maintaining sustainable investments from financial collapse (Walton, 1986). Also, the ability to visualize the organization’s future would provide the direction and focus to achieve effectiveness (Wall et al., 1992). Leadership has to understand the organization, and the general (potential) environmental landscape that the organization must operate in. Figure 1 shows both internal and external landscape factors that influence organizational effectiveness for corporations like Enron (and, more than likely, most energy and investment organizations).³¹

While creation of strategic direction is essential, corporate leaders must also take the next step by communicating that strategic direction throughout the organization. This is validated by Cohen’s (1990) belief that a leader’s ability to influence others toward maximum performance is based on their ability to communicate effectively.³² Effective communication is an essential element that organizations must embrace in order to enhance the organization’s performance. In addition to communication, organizational members at Enron must know where they fit into the organizational structure and understand the importance of what and how they contribute to the success of the organization. Similarly, Bennis and Nanus (1985) cite that effective communication, trust, and positive self-regard are essential elements of organizational success. Leaders must show their employees and other stakeholders the vision its leadership has laid out for the organization, and discuss the communication of that vision and implications for the future in order to foster belief and trust in the vision.³³

³⁰ Andersen, L. & Brotherton-Ratcliffe, R. (1998) The equity option volatility smile: An implicit finite difference approach, *The Journal of Computational Finance*, 1, 5-32; Mizrach, B. (2006), The Enron bankruptcy: When did the options market in Enron lose its smirk? *Review of Quantitative Finance and Accounting*, 27: 365-382; Cohan, J. A. (2002), "I didn't know" and "I was only doing my job": Has corporate governance careened out of control: A case study of Enron's information myopia, *Journal of Business Ethics*, 40(3): 275-300.

³¹ Wall, B., Solum, R. S., & Sobol, M. R. (1992). *The visionary leader*. Rocklin, CA: Prima Publishing.

³² Cohen, W. A. (1990). *The art of the leader*. Englewood Cliffs, NJ: Prentice Hall.

³³ Bennis, W. & Nanus, B. (1985). *Leaders: The strategies for taking charge*. New York: Harper & Row.

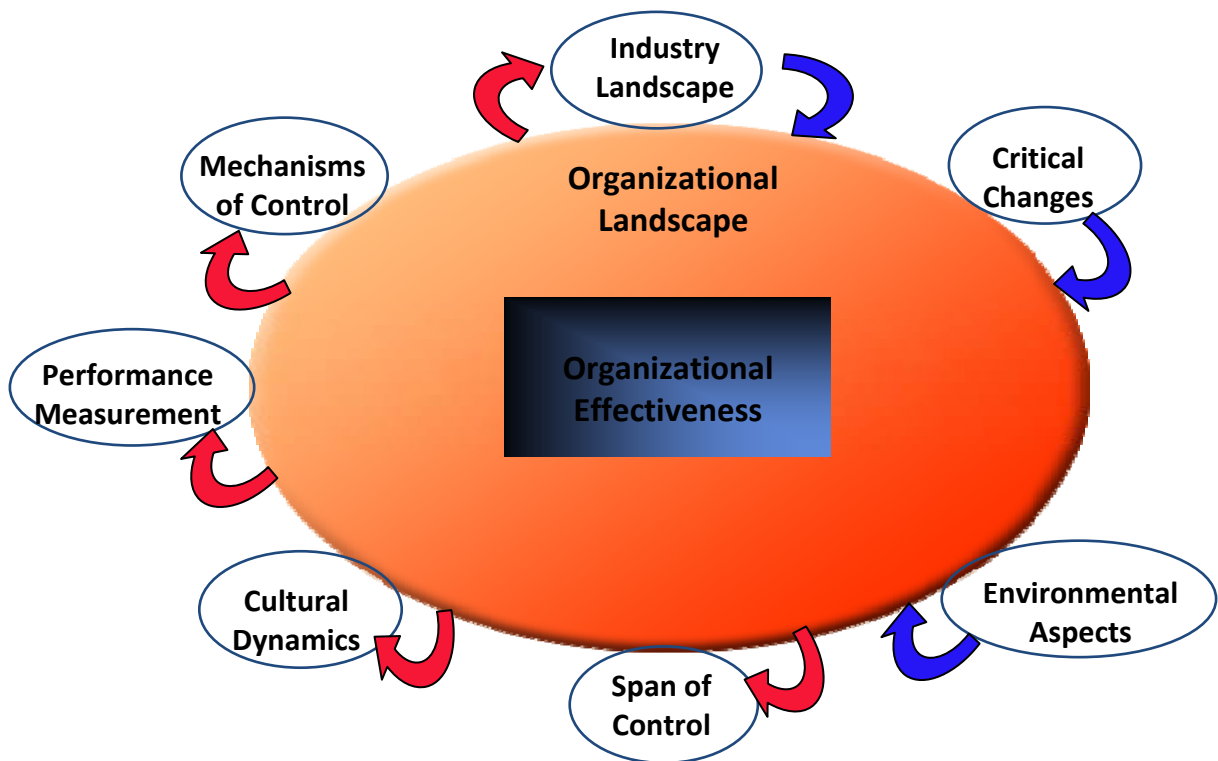


Figure 1. Factors Influencing Organizational Effectiveness.

B. Mechanisms Governing Leadership Efficiency and Effectiveness

To understand some of the underlying mechanisms that move or shape organization operations—such as those of Enron—for efficiency and effectiveness, it will be helpful to discuss some of the critical aspects that govern these areas, including: (1) Span of Control, (2) Scope of Control, and (3) Boundary Setting.³⁴

Span of Control

In an organization, span of control is defined as the number of employees reporting directly to the supervisor, traditionally between four and seven under one manager. As technology has improved and employees are being empowered with decision making, some organization specialists now argue in favor of 20,000 employees

³⁴ Perotin, M. (6/28/08). Retrieved on 6/28/08 from <http://www.star-telegram.com/business/story/728959.html>

reporting to the Board of Directors. However, span of control needs to be set at an optimum value so that the organization can adapt to rapidly changing markets and a drive to reduce costs. The original “span of control” belongs to a school of management thought rooted in classical traditions from the 1930s, in which employees had to be controlled because they couldn't be trusted--a very “Theory X” approach. Today, spans of control are generally wider than in the past, reflecting the changing nature of management (Harrison, 2004).³⁵

Scope of Control

Scope of control is defined as the level of involvement an employee at every level has with the overall working of the organization. In a traditionally aligned organization, each level has a defined span of control and each employee reporting to the manager is assigned predetermined roles and responsibilities. Scope of control within an organization is partly defined by the level of empowerment an employee is endowed with in regard to decision making.

A highly bureaucratic organization has specialization of skills within each unit and the overall scope of control is high. Within an innovative or growth organization, scope of control is relatively low and an employee is empowered to put on multiple hats and be actively involved in decision making across domains. An example of relatively low scope of control is Saturn, whose employee handbook contains only one rule: “Use your good judgment in all situations” (Bolman & Deal, 2003). As cited in Bolman and Deal (2003), Nadler states, “How a firm organizes its efforts can be a source of tremendous competitive advantage, particularly in times where premiums are placed on flexibility, adaptation, and the management of change.”³⁶

Boundary Setting

³⁵ Harrison, S. (2004, Feb.), *Is there a right span of control? Simon Harrison assesses the relevance of the concept of span of control to modern businesses*, *Business Review*, 10(3): 10-14. Retrieved June 28, 2008 from General OneFile database.

³⁶ Bolman, L.G. & Deal, T.E. (2003). *Reframing organizations: Artistry, choice, and leadership* (3rd ed.), San Francisco, CA; Jossey-Bass.

Many of the traditional boundaries in an organization are being removed and replaced with different types of boundaries: namely, ones that are more psychological than organizational. These boundaries exist in the minds of managers and employees and are reflected in the relationships that managers have with their peers, employees and bosses (Hirschhorn, 1992). The electricity, natural gas, communications, and pulp and paper industries have experienced many different changes over the years; as a result, the traditional concept of work has changed, and in some cases, once-clearly-established boundaries have become blurred. Corporations similar to Enron have gone through many changes over the years. They are learning what areas they are able to excel in and have set out to develop those areas to the fullest. For example, Enron recognized how heavily customers rely on their cellular phones, which resulted in their cellular service division greatly expanding.³⁷

Boundary setting can be a complex process. Huge organizations (such as Enron was) must be careful in setting boundaries so as to not exclude all communication, but instead to allow constructive and disallow other communication. Scott and Davis (2007, p. 185) stated, “Given the essence of organizations as open systems, their boundaries must necessarily be sieves, not shells, admitting the desirable flows and excluding the inappropriate or deleterious elements.” Scott and Davis also asserted that boundary setting is based on several factors such as the proximity to an organization’s vendors and its operations, behavioral criteria, frequency of contact, relationship between the entities, and other factors.

A large corporation’s organizational marketing, boundary-spanning, and management must encompass three key dimensions of customer-linking behaviors that contribute to the development of market-driven organizational capabilities and resources. First, corporate leaders must place importance on accurately representing the organization to outsiders (including customers) and enhancing the firm's image and legitimacy through their advocacy of the firm and its products and services. Second, as part of their boundary-spanning, leaders must provide many opportunities for employees to share information internally about evolving customer needs and possible

³⁷ Hirschhorn, L., & Gilmore, T. (1992, May/June), *The new boundaries of the “boundaryless” company*. *Harvard Business Review*, 70(3), 104-115.

improvements in service delivery. Third, because service quality perceptions and customer satisfaction are largely dependent on frontline employee service delivery behaviors such as courtesy, personal attentiveness, responsiveness, and promise-keeping, these behaviors must be emphasized in training sessions.

C. The New Leadership Paradigm

Leaders today in the financial system are encouraged to have much more of a hands-on approach in the aim of inspiring and developing others; this is at the core of the new leadership paradigm.³⁸ This new model of leadership involves leaders taking the time to consider and understand the relational aspects that bind an organization together. Additionally, those in leadership positions need to promote the concept of teamwork and shared governance, and this requires that they develop the potential leadership abilities within the organization.

Although there are many existing methodologies that identify how all of this can be achieved, the coaching and mentoring component of leadership is considered to be one of the most effective ways to accomplish this.³⁹ The process of successfully coaching and mentoring others under the new leadership paradigm requires that a leader develop empathy and be able to feel a certain degree of compassion for those that he or she is coaching and mentoring. Not only does this have the capacity to potentiate the coaching effect, which in itself has beneficial outcomes to the organization through individual development, but there is evidence that the singular physiological effects of a leader experiencing empathy can act as an antidote for his or her own stress.⁴⁰

This raises the tantalizing possibility that new paradigm leaders may be able to compensate for the stresses they experience by developing an empathic approach to the development of others within the organization and because of this, be able to sustain and protect their leadership effectiveness. Leadership in the financial world has a vision to

³⁸ Green, J. W. and Zavada, D. M. (2008). Accountability and oversight: Who's minding the store? *The Journal of Government Financial Management*, 57(3): 6-10.

³⁹ Daniels, D. M. (2007). Follower readiness - Situational Leadership Theory and Transformational Leadership Theory: An interpretation of the commonalities, *Proceedings of the Academy of Strategic Management*, 6(1): 11.

⁴⁰ Xenikou, A. and Simosi, M. (2006), Organizational culture and transformational leadership as predictors of business unit performance, *Journal of Managerial Psychology*, 21(6): 566-579.

lead and market the organization. Leaders have always had the capability to influence others and be able to follow strategic goals in meeting stakeholders', employees' and subordinates' needs and values. Leaders tend to have the courage and the willingness to display appropriate reactions, particularly in crisis situations.⁴¹

Chief Financial Officers (CFO) help to drive a company through financial crisis and solve problems to help stabilize the organization. CFOs tend to investigate future expectations of the organization's stability in the corporate world. The CFO's position involves strategic planning and integration of continuous process improvement that deals with negotiations, collaboration, and change management. CFOs are responsible for providing the highest level of professionalism, ethics and integrity in the organization, and without the CFO the organization will be unstable. Financial leaders must have self-confidence in communicating and coordinating management accounting by formulating financial reports, performance management, internal control, and cost management.⁴²

Financial leaders' performance is based upon external satisfaction and meeting the demands of the stakeholders, employees and subordinates, and by maintaining process control and benefit exchange through organizational stability. Leaders must have the ability to understand business and maintain the same level of effectiveness for the organization and its funds. Financial leadership sets goals and objectives to support their effectiveness in satisfying relevant demands and commit to understanding subordinates and their behaviors, by self-enhancement through organizational goals and personal achievements.⁴³

Leadership exists on a continuum, and leaders must seek out professional opportunities and development by effectively communicating and understanding issues that face the organization.⁴⁴ It is expected that leadership-fostering goals will improve

⁴¹ Chang, S. and Lee, M. (2007), A study on relationship among leadership, organizational culture, the operation of learning organization and employees' job satisfaction, *The Learning Organization*, 14(2): 155-185.

⁴² Boerner, S., Eisenbeiss, S. A., and Griesser, D. (2007), Follower behavior and organizational performance: The impact of transformational leaders; *Journal of Leadership & Organizational Studies*, 13(3): 15-27.

⁴³ Daniels, D. M. (2007). Follower readiness - Situational Leadership Theory and Transformational Leadership Theory: An interpretation of the commonalities, *Proceedings of the Academy of Strategic Management*, 6(1): 11.

⁴⁴ Green, J. W. and Zavada, D. M. (2008). Accountability and oversight: Who's minding the store? *The Journal of Government Financial Management*, 57(3): 6-10.

organizational performance. Financial organizations with successful performance tend to have significantly higher levels of intellectual stimulation than other financial organizations. Financial leaders should be aware of the requirements for improving organizations and be more alert to signs of mismanaged funds or instability within organizational management.⁴⁵⁴⁶

Employees have been the main resource that allows the organization to thrive. The financial industry needs to consider the lifelong learning opportunities for creating knowledge and talent within an organization. Leaders must be able to consider the improvement levels in an employee's academic background and expectations of the employee's performance to improve job satisfaction. Also, leaders must encourage a flexible work environment for all employees and honor employees for achieving the goals and objectives as outlined in the organizational mission statement.⁴⁷

Leadership cultivates organizational culture and has an impact on the influences of productivity, resignations, unreported job absences, job satisfaction, and personnel resources. Leaders need to aim at examining job satisfaction and fostering learning organizations that would help to improve operational models and theoretical concepts in leadership management.⁴⁸

D. Leadership in Banking Institutions

Leadership styles in banking are based on bureaucratic authority and legitimacy with the financial institutions. Leaders emphasize work ethics, assignments, goals, and standards for the institution. Leadership in banking tends to focus on compliance and tasks that need to be completed. Most leaders in banking rely on rewarding and punishing to influence employee behavior and performance. Banking leadership styles help motivate followers by appealing to employees' morals and values.

⁴⁵ *Wimm v. Jack Eckerd Corp.*, 3 F.3d 137, 139 (5th Cir. 1993).

⁴⁶ *SEC v. Dresser Indus., Inc.*, 202 U.S. App. D.C. 345, 628 F.2d 1368, 1374 (D.C. Cir.), cert. denied, 449 U.S. 993, 101 S. Ct. 529, 66 L. Ed. 2d 289 (1980).

⁴⁷ Daniels, D. M. (2007). Follower readiness - Situational Leadership Theory and Transformational Leadership Theory: An interpretation of the commonalities, *Proceedings of the Academy of Strategic Management*, 6(1): 11.

⁴⁸ Chang, S. and Lee, M. (2007), A study on relationship among leadership, organizational culture, the operation of learning organization and employees' job satisfaction, *The Learning Organization*, 14(2): 155-185.

There are various people-oriented leadership styles in banking that garner the commitment of employees and customers. Specifically, *transformational* and *transactional* leadership styles play an important role in the performance of banking leadership within the financial system. Transactional leaders are concerned about maintaining the normal flow of an operation, while transformational leaders go beyond the transactional scope and are concerned about taking the organization to a higher performance and success level. Three banking dimensions are as follows: “(a) a strong belief in and acceptance of the organization's goals and values; (b) a willingness to exert considerable effort on behalf of the organization; and (c) a strong desire to maintain membership in the organization.”⁴⁹

Banking leaders must also be able to articulate a vision for the institution and the employees must be able to accept the credibility and integrity of the financial institution by working in the best interest of the customers and the strategic goals of the financial system and bank. Bank leaders can motivate employees to work beyond the financial institution's expectations.⁵⁰ In the continuing efforts to improve work ethics, bank tellers and bank personnel have been identified as having a strong correlate in maintaining customer satisfaction. Employee satisfaction in banking has often been conceptualized as containing supervisory relationships, future growth and opportunities, positive work environment, and benefits and rewards for positive work performance.⁵¹

Leadership in banking places a great deal of trust on leaders and managers' judgment of supporting the values and mission of the institution. Leaders and managers must be able to resolve financial matters and problems among customers that relate to employees, and also be able to encourage the employee and be willing to stand for the rights of both the employee and in the best interest of the customer.

Banking leaders intrinsically foster job satisfaction through goals and values of the customers, employees and institution. Banking leaders help encourage their followers

⁴⁹ *Marian Bank v. Electronic Payment Servs. Inc.*, 1997 U.S. Dist. LEXIS 21021, 1998-1 Trade Cas. (CCH) P72, 131, 1997 WL 811552 (D. Del. Dec. 30, 1997).

⁵⁰ *Shands v. Texas State Bank*, 2001 Tex. App. LEXIS 109, 2001 WL 21490 (Tex. App. San Antonio Jan. 10, 2001).

⁵¹ *August v. U.S. Bancorp*, 146 Wn. App. 328, 190 P.3d 86, 2008 Wash. App. LEXIS 1927 (Wash. Ct. App. 2008).

to accept responsibility and autonomy through increasing levels of satisfaction and accomplishment.

To maintain quality service to customers, bank personnel must be able to understand the customers, show respect, and resolve problems in a timely manner. Leaders in banking also provide customer surveys and monitor calls for quality assurance purposes. This is an exceptional banking method of understanding the problems and resolving issues before they escalate into more serious problems in banking competition.

VIII. Assessing the Past and Present, and Anticipating the Future

Managers in both nonprofit and investor-owned organizations acquire capital and make investment decisions under uncertainty. Ideally, these managers seek to maximize the benefit of this capital based on their financial management goals. In attempting to maximize benefits from investing capital, management must decide what long-term investments to take on (i.e., what lines of business will you be in and what sorts of buildings, machinery and equipment will you need?).

Consistent among all types of organizations, the financial manager tries to identify investment opportunities that are worth more to the organization than they cost to acquire. Consequently, the only difference between nonprofit and investor-owned organizations is how the worth of the investment opportunity is valued, whether in terms of shareholder worth or in terms of societal value.⁵² An investment is worth undertaking if, in the case of for-profit firms, it creates value for its owner or, in the case of nonprofits, if it moves the organization closer to achieving its mission.

The problem is determining which investments meet the criterion of being worth more than they cost to acquire. Typically, for-profit managers look for investments where the present value of future cash flows is greater than the investment's cost. The same methodology works for nonprofit organizations, with the added difficulty of quantifying non-cash benefits (such as providing social value) into the future cash flows.⁵³

Sartoris and Spruill (1974) said,

⁵² See 15 U.S.C. § 77p (f) (2) (D).

⁵³ See 544 U.S. 696 125 S.Ct. 2129; 161 L.Ed.2d 1008; 2005 U.S. LEXIS 4348; 73 u.s.l.w. 4393; Fed Sec. L. Rep. (CCH) P93, 266; 18 Fla. L. Weekly Fed. S324.

“Financial corporations tend to inappropriately examine the optimal level of assets and investments. The investments in these assets are viewed jointly and the decision must become one of satisfying rather than optimizing.”⁵⁴

The Riegle-Neal Act of 1994 allowed financial institutions to change dramatically due to the reduction of barriers to intrastate banking. During the 1990s, financial institutions led all other institutions in terms of banking mergers. Consolidation within the financial industry greatly reduced the number of financial holding institutions in the United States. Interstate banking restrictions allowed domestic banks to acquire other banks throughout the United States to process transactions across state lines.⁵⁵

The theory was that merging banks across states would minimize processing expenses and reduce operating inefficiencies. However, in the 1990s, banking institutions were never this dynamic. In the 1980s, some states allowed banks to expand throughout state regions (but not as new entries). These banks expanded until the 1990s, when national agreements superseded most banking laws and institutional guidelines. By 2009, banks’ entry into a new market was heavily dictated by the prospects of future capital and profits. Therefore, new banks attract high profits, market size and growth better than existing banks; however, acquisitions and mergers continue to make headlines, with national banks acquiring smaller banks in order to penetrate existing gains and market shares.

Bank and financial institution leaders should expand their understanding about the competitive market of products and services. With the financial banking industry growing rapidly and competitive markets at stake, banks need to look at the rates that are being offered to consumers and businesses, along with profits and revenues needed to stay afloat in the financial industry.

⁵⁴ Sartoris, W. L., & Spruill, M. L. (1974), Goal programming and working capital management, *Introduction to Financial Management* (pre-1986), 3(1): 67-75.

⁵⁵ Riegle-Neal Act of 1994 (P.L. 103-328, 108 STAT. 2338)

A. The Growth of Foreign Banking and Investment in the United States

According to O’Uallachain (1994), there has been a high concentration of foreign banking and investment patterns among domestic banks. In fact, the U.S. has become highly dependent upon foreign resources of capital investment.⁵⁶ For over 30 years, Japanese banks have made a tremendous contribution to most of the U.S. capital, but other countries such as China are becoming important investors in U.S. banking enterprises.

OhUallachain suggested that area size, population, and personal income are not good predictors of foreign banking activities. For the most part, though, foreign banks have relied heavily on analysis of major metropolitan centers, where business is conducted on a constant basis. Miami, New York, Los Angeles, San Francisco, Chicago, and Atlanta are the U.S. hubs that connect domestic and international financial systems.

Most skilled professionals in banks accumulate a better understanding of the services their organization can provide and the financial requirements of its customers. When engaging in foreign investment, banks decide what is preferably good to produce certain services in the economy to satisfy customers, businesses, and investors.

There are many reasons why foreign banks have widened their interest. Most U.S. banks are currently owned by foreign nationals. Most banks give better reception to banks of the financial world. Therefore, the U.S. economy is regarded as a good place to invest. The banking returns in U.S. dollars often compare favorably with those in other currencies.⁵⁷

With the banking industry moving at an accelerated pace, there are various differences between the U.S. and international banking systems in that the government has different approaches to capitalization and laws. Bank officials continue to learn more about the global capital market and what it takes to be successful in the future. At Wachovia Bank, for instance, there have been positive relationships and commitment to

⁵⁶ *Ernst & Young, L.L.P. v. Pacific Mutual Life Ins. Co.*, 51 S.W.3d 573, 583 n.7, 44 Tex. Sup. Ct. J. 955 (2001).

⁵⁷ Hagaman, T. C. (1990). Foreign banking in the U.S. *Management Accounting*, 72(2): 15.

improving the banking system, along with organizational efforts at providing quality assurance and superior customer service.⁵⁸

B. Market Power

It is important to note that market power has an effect on bank loans. Banks control the endogeneity that measures the market power of bank loans.⁵⁹ Endogeneity depends on the overall bank risk, loans and capitalization. With the high rates in market power, the banks steadily increase loan rates for customers to ensure profit and risk liability. With the bank rates' increase and decrease, the stability of market competition for customers will result in banking failures and risk destabilizing the monopolistic system.⁶⁰

Berger, Klapper and Turk-Ariss (2009, p. 215) commented,

“As banks continue to gain market power, their values and profits continue to increase. Because values and profits represent intangible capital that will only be captured if the banks continue to remain in business, such banks face high opportunity costs of going bankrupt and they become more reluctant to engage in activities. . . . Banks tend to behave prudently by holding assets on to more capital by lessening risky portfolios. Alternatively, when banks gain market power, it is also possible that their risk of exposure increases dramatically. The banks' competition of stability contends that financial stability increases as the degree of competitiveness is lessened. Banks with market power will earn more profit by charging customers and businesses higher interest rates on consumer and business loans.”

An additional consideration here is a bank's ability to woo and retain customers to insure that the financial institution stays in business. Customers report favorable and unfavorable views of service quality and performance about banks, along with the perception of respect, honesty and integrity among employees and their managers. In light of these views, the Bank of America has become a competitor among banks that focus on customer satisfaction. Bank employees are a major determinant of customer attitudes and behavior among the institution. Another example is that of Wells Fargo,

⁵⁸ Blount, E. (2008), Keep functional regulation. American Bankers Association. *ABA Banking Journal*. 100(10): 42-43.

⁵⁹ Berger A.N., Klapper, L.F. and Turk-Ariss R. (2009), Bank competition and financial stability, *Journal of Financial Services Research*, 35, 99-118.

⁶⁰ *Anchor Sav. Bank, FSB v. United States*, 81 Fed. Cl. 1, 2008 U.S. Claims LEXIS (Fed. Cl. 2008).

where customer satisfaction and cultural diversity represent the highest commitment to the banking industry.

C. Corporate Governance, Ethics, and Trust

A financial corporation's governance rating has a strong influence on practices and management behavior. The rating criteria and rating practices have a major impact on the corporation's performance and enhancement of assessing management goals in meeting the demands of shareholders, stakeholders and clients. The corporate governance in financial management holds leaders and officers accountable for oversight responsibilities of the corporation. When a corporation such as Enron, WorldCom or other financial institutions fails to comply with corporate governance laws, this demonstrates a lack of integrity, ethics and management behavior that may lead to the demise of the corporation due to violation of laws in management ethics standards.⁶¹

As we continue to observe notable corporate events that sparked the global economy due to poor managerial leadership, ethics and behavior, it is quite clear that, in many cases, corporate governance has not being utilized and followed within corporations. When ethical boundaries are breached, then the creditability of a financial corporation is compromised.⁶² If financial corporations follow governance laws and ethics, however, then the corporation will be able to provide quality services to their shareholders, stakeholders and clients, and also should be able to enhance financial performance among other companies and investors. Every corporation should have high ethical standards and promote best business practices among the corporation and the financial entity. Financial leaders will need to utilize their corporate governance, because without it the company will fail.⁶³

⁶¹ SLUSA, 15 U.S.C. §§ 77p (b) (applicable to remedies under the Securities Act of 1933) and 78bb (f) (1-2) (applicable to remedies under the Securities Exchange Act of 1934).

⁶² Zhang, M. & Yu, T. (1999). An international analysis of business strategies: The case of the auto industry. *Journal of Accounting and Finance Research*, 7(3), 454-525.

⁶³ *Newby v. Enron Corp.* (In re Enron Corp. §, Derivative & ERISA Litig.), 2003 U.S. Dist. LEXIS 1668 (S.D. Tex., Jan 28, 2003).

D. Financial Industry Trends

Research and interviews with industry executives conducted by the Bank of America have shown that, between now and 2025, several new trends will force banks to generate growth through continuous innovation or be left behind. First, as noted above in the section on market power, consumers will play a major role as banks vie for customer loyalty. Surveys show that customers are becoming more mistrustful of banks. As technology and competition increase, it is becoming increasingly easier for people to research, compare and change banks, driving switching costs toward zero. Customers are better informed and more discerning. Banks, therefore, need to adapt to ensure they can meet the increasingly eclectic demands of customers and their unpredictable behavior.⁶⁴ Banks must also increase their transparency and openness of communication with clients, as tolerance for "fine print" is disappearing and customers want to avoid useless fees.

Another trend involves size versus specialization: large "universal" banks will serve a variety of customers, while smaller "niche" banks will cater to specific needs. In addition, although improved technology will facilitate banking for bank employees as well as consumers, this will also give rise to increased regulations in order to ensure security and privacy. Finally, population growth over the next ten years will increase opportunities and challenges, offering the possibility of a larger customer base along with difficulties in managing human capital both at home and abroad.

Loyalty will have to become the target of some marketing efforts. By 2015, we will see two prominent forces of competition among traditional banks, non-traditional banks and international banks. Large banks such as the Bank of America and the World Bank will continue to expand through acquisitions until the gap between potential targets and acquirer narrows. Moderate-size banks such as Wells Fargo and Wachovia will continue to grow and expand along with larger banks that would have a dynamic impact on banking competitions.⁶⁵

However, in order for Wachovia, Wells Fargo, Bank of America and the World Bank to survive, they must be able to intensify competitive forces in banking. Banks

⁶⁴ Stevens, B. (2004). The ethics of the U.S. business executive: A study of perceptions, *Journal of Business Ethics* 54(2), 163-171. Doi: 10.1007/s10551-004-9464-9

⁶⁵ Nissanke, M., and H. Stein. (2002, March). Financial globalization and economic development: Toward an institutional foundation. Paper presented at the 2002 meeting of the EEA, Boston, MA.

must be prepared for anticipated competition and also be responsive to the changing and emerging conditions of the financial market. In order to maintain their competitive edge in the financial market, banks must be able to develop new, innovative strategies that will help support their employees in performing their jobs efficiently and effectively, in ways that will promote increased numbers of customers and bank growth.

In order to sustain value in banking, leaders must be able to provide new products and services to meet the needs and expectations of the customers. One important new innovation in banking is E-banking, which streamlines procedures for deposits, loans, and accounts, can allow for product integration and international expansion, and—most of all—provides convenience for customers and businesses.⁶⁶

VIII. Conclusion

Organizations in the global economy of the 21st century face challenges and threats never before experienced. At the end of the 20th century, Greenwood and Tunings (1996) observed that in our modern society, changes are revolutionary and no longer evolutionary in nature. Revolutionary changes are constant, swift, frequent, and affect virtually all parts of an organization simultaneously. While these changes may evoke a sense of fear and anxiety in organizations' administrators who are unprepared for the future, organizations with strong strategic leadership will welcome this new millennium as an immense opportunity to excel.⁶⁷

X. Recommendation

Financial corporations need to develop strategic goals and plans or else they risk loss of investments from shareholders and, ultimately, financial failure. Two goals will help corporations: the first goal is to optimize financial planning and auditing for investment corporations, which means being able to demonstrate quality financial

⁶⁶ Monteleone, J. P. & Conca, N. J. (1996). Directors and Officers Indemnification and Liability Insurance: An Overview of Legal and Practical Issues, 51 *Bus. Law* 573, 574.

⁶⁷ Greenwood, R. & Tunings, C. (1996). Understanding radical organizational change: Bringing together the old and the new institutionalism. *Academy of Management Review*, 21, 1022-1054.

planning and services to shareholders throughout the global economy and maintain quality assurance for shareholders, investors, and clients globally.⁶⁸

The second goal is to provide quality leadership among management and its shareholders. Effective leaders need to understand their employees; they need to know the goals and expectations of the corporation in meeting the demands of the economy and its competitors; and above all, they need to serve as impeccable models of integrity and ethical behavior. Christensen described an effective strategic leader as someone who will create a viable future for the organization by anticipating, envisioning, maintaining flexibility, thinking strategically, and working with others to initiate change.⁶⁹ And Huey noted that effective organizational leadership can enhance a firm's ability to cope with the turbulent and unpredictable environments that are exemplified in today's global environment.⁷⁰

Two years before the Enron scandal, Stiglitz and Bhattacharya (1999) warned that “Governments are not subject to the discipline that the market provides in the production, dissemination, and processing of information. Thus, especial attention needs to be focused on openness in governments, at every level Recent research has pointed out both that lack of transparency is related to corruption and to poor economic performance. There is thus a high return and a special responsibility for increased openness in financial corporations.”⁷¹

XI. Future Areas of Research

All financial corporations need to be held accountable for their actions and also increase quality assurance while meeting the demands of the global economy. Enron, WorldCom and other corporations that have suffered financial failure will symbolize the global economy for years to come, but it may be hoped that—by their example and the changes that resulted from it—they will also help teach other financial corporations to learn from their mistakes.

⁶⁸ Trew, A. (2006, Dec.). Finance and growth: A critical survey. *Economic Record*, 82(259): 481-490.

⁶⁹ Christensen, C. (1997). *Making strategy: Learning by doing*. Harvard Business Review, 75, (6), 141-156.

⁷⁰ Huey, J. (1994, Feb. 21). The new post-heroic leadership. *Fortune*, 42-50.

⁷¹ Stiglitz, J., and A. Bhattacharya. (1999, April 28-30). Underpinnings for a stable and equitable global financial system: From old debates to a new paradigm. Paper prepared for the Eleventh Annual Bank Conference on Development Economics, Washington, DC.

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