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## [MUSIC PLAYING]

For six years, the University of Maryland's Business School has been sending its MBA students to prison for a scared straight field trip in white collar crime.

Suppose your boss asks, "can't you fudge the financials?"

Can't you pick up a million dollars so we can do this?" And your answer should be unequivocally, absolutely, no.

Just say no, advises former developer Daniel Colton or you may wind up like him, serving a three-year sentence for conspiracy. His audience, students just days away from entering a business world where morals may be looser than ever.

The big joke is that business ethics is an oxymoron, i.e., you can't simply talk about ethics when you're talking about business. There are none.

Barbara Toffler is a Professor of Business Ethics and thus thinks it isn't a contradiction in terms, though she admits stock scams like the ones that have made Enron a household name are as old as the market itself.

Consider this poem. Some in clandestine companies combine; Erect new stocks to trade beyond the line; With air and empty names beguile the town, And raise new credits first, then cry 'em down; Divide the empty nothing into shares, and set the crowd together by the ears. That's Daniel Defoe, of Robinson Crusoe fame, writing in the early 1700's.

Here's the French artist Daumier in the mid-1800's depicting a speculator in the stock market planting false rumors to manipulate prices.

And we're all old enough to remember the insider trading and junk bond scandals of the late 1900's starring Ivan Boesky, Mike Milken and the like. But Barbara Toffler thinks ethics now are actually worse than ever. At least in the 1980's, she says,

"It was a big boy's game. And in fact, much of the history of unethical behavior, if you will, in business has been kind of a big boy's game."

So in a sense, it was them against themselves.

Exactly. And obviously, stock prices were affected. Obviously, the stock market was affected. Obviously, the institutional and the individual investor were affected. But we did not have the kind of impact on you and me and the general population that we now do.

Where more vulnerable investors are the ones getting disproportionately hurt, like the blue collar phone workers we interviewed recently at Global Crossing. The modern business ethics industry was born in the late 70's, part of the post-Watergate reform movement. Business ethics became so hot, a firm like Arthur Andersen-- yes, that Arthur Andersen-- spent millions to be identified with the topic, making and distributing videotapes to explain why morality was vital to US corporate success. Here's one of their stars, Stew Leonard, Sr., CEO of a discount dairy chain.

The most important single fundamental thing of success in business is to build your house on a solid foundation of integrity, of a solid foundation of ethics.

One hint that things were getting worse. Though Andersen hired Barbara Toffler in 1995, it was to help them make money, not clean up their act.

They hired me to sell services to clients. They didn't hire me to do work with them internally. I was hired to set up a consulting practice in ethics and responsible business practices. I was not hired to do internal work at Arthur Andersen.

Did you ever expect that Arthur Andersen's internal culture would be at odds with what you were trying to teach?

I learned that as I was trying to sell services and found people asking me if Arthur Andersen was doing internally those things that I was trying to sell to them. And they weren't.

Meanwhile, the ethics of Arthur Andersen, once the purest of pure auditors, sank to new lows. Why? Well perhaps we should use the famous words of Watergate. Follow the money. Or as white-collar criminal Daniel Colton puts it,

"Money is the hugest intoxicant there is. "

Barbara Toffler says that intoxicant became the drink of choice, even for the top accounting firms.

Everybody was making money. They were jumping on the bandwagon. They forgot what they were supposed to be doing. They forgot that they were watchdogs. They forgot they were protectors of the investor. And they became hotshot firms. We're a big name, we can play with the big boys and we can make big money. And they did start making big money. So they too were seduced. I'll honest with you. I stayed at Arthur Andersen probably longer than I would have, because I liked the money that I was making.

By the late 90's, Andersen's ethics consulting had petered out for lack of clients. And Anderson's ethics tapes, despite their lofty ambitions and earnest host, don't seem to have had much impact.

Over the years, our family, our religion, our community and schools have helped to shape our values. Thou shalt not steal.

But maybe it's a good thing that these tapes never became best sellers, seeing as how the one with Stu Leonard might be a better guide to sin than sincerity.

The people that look for the short cut, the prisons are filled with them.

But just two years after this tape was sent to schools all over the country, Stew Leonard, Sr. pleaded guilty to skimming \$17 million in profits, much of which he carried, the government reported, on tens if not hundreds of trips to St. Martin in the Caribbean, in amounts ranging from \$10,000 to upwards of \$250,000, in suitcases or even wrapped as baby gifts. It was the largest tax fraud in Connecticut history, and Leonard was sentenced to 52 months in prison. Two brothers-in-law received sentences. Son Stew, Jr., the store's president, also admitted involvement but was granted immunity as part of his dad's plea bargain, which makes the ethical rule of thumb with which this tape ends almost surreal.

Would the boy you were be proud of the man you are? And I would say that the boy I was would be proud of the man I am and I would wish that on anyone. If my dad were alive today, he would say,

"Atta boy, Stew."

Today, Leonard is out of jail and Stew Leonard's chain is expanding. If any stigma remains, it hasn't seemed to hurt business. But the biggest surprise may be that anyone did jail time at all, because according to Justice Department data US attorneys prosecuted only 187 defendants over the last decade for white collar crimes. And while 142 were found guilty, a healthy 76% conviction rate, only 87 did time, usually at a minimum security so called "Club Fed." Attorney Jake Szymanski believes lenient sentencing has helped create the current climate.

There needs to be some serious jail time for analysts who are caught committing fraud, CEOs that are looting their companies. until. We send somebody away for a long period of time in a real prison, nothing is going to change.

Now Szymanski used to represent defendants.

I was revolted by my clients. I didn't like going to work and doing what I was doing, getting brokerage firms away with murder. And it got to me.

So in 1998, Szymanski switched sides.

I am now representing public customers in claims against major Wall Street firms, like Merrill Lynch and Smith Barney. And unfortunately, I have seen at major Wall Street firms the same type of boiler room tactics that I saw in the '90s at these other firms.

This is a Business Ethics class for MBA students at Babson College in Wellesley, Massachusetts.

If they're committing fraud, that's a crime. And that's punishable by five years, ten years, fifteen years.

If you go and you punish people just because the stock ended up tanking and the market ended up not performing, then you go punishing people for taking risks.

But I think where we get into trouble and firms should pay the price are when there's ulterior motives and there's other funding going on by the company.

After several hours of heated, knowledgeable debate, I asked whether they would have touted stocks they didn't believe in.

How many would have knuckled under, essentially?

Not a single hand went up. But then one student suggested pushing the hypothetical a bit further.

So if you ask this question again, how many people would put that buy if it got them \$20 million in the bank, I think you'd see a lot of hands go up.

\$20 million for one buy recommendation. How many people? Honestly, now. Honest answer.

The class' professor had been there for the vote. The Reverend Tom Sullivan is a Presbyterian minister.

What would Jesus have thought of it?

[LAUGHTER] Jesus would have said, "oh come on, you can't do that. And you know you can't do it." He would have been a good Jew in saying that. He'd be a good Christian in saying that. He'd be a good

Hindu, he'd be a good Buddhist. Nobody who takes any kind of spiritual values seriously is going to say, oh yeah, that's fine.

Indeed, spiritual values may explain the results of one last vote.

How many of you would imagine that your parents think that your generation is less ethical than theirs? Every single one of you.

Now not everyone thinks we're going to hell in a hand basket. Ed Petrie, who runs the nation's largest group of in-house corporate ethics officers, says that in some areas ethical standards have improved.

Conflict of interest inside the organization, gifts and gratuities, time charging, sexual harassment issues, diversity issues. Vast improvement on those fronts inside the organization.

But nobody was paying much attention to things like corporate governance, reporting your financial statements.

Well, I won't say people weren't paying attention to them, but part of the problem is that the expectations are much higher than they used to be. And you also have far more employees who are willing to come forward with allegations. And you have the public, who is looking and eager to hold companies to a higher standard and want them to be accountable.

But is corporate America responding by hiring ethicists like Barbara Toffler?

Do I have a lot of work as a business ethics consultant? No.

Instead, Toffler is writing a book on her years at Arthur Andersen and teaching ethics at Columbia Business School. Easier perhaps than teaching them the real world of recent years, since in economic terms the bigger the payoffs became for playing fast and loose, the greater the cost of being ethical in terms of risks not taken, opportunities foregone. Of course that's true of any boom, not just this one, suggesting that in the end business ethics may simply be at one of its cyclical ebbs. But whether we've hit new lows or not, Daniel Colton's words ring equally true.

Please, please be vigilant, be careful, be honest, be open. Do not expose yourself to these kinds of dangers.

Words easier to say than to live by, it seems, when you get down to business.

Finally tonight, business ethics. Enron, Andersen, Global Crossing, Tyco, and now, Worldcom. Our business correspondent, Paul Solomon of WGBH Boston, has been looking into these recent scandals of cooked books and other corporate misdoings. Here's part two of his series, *A Talk with Five Veteran Business Journalists*. It was conducted before the most recent Worldcom news

Thank you all for coming. First question. Has American business hit some kind of ethical ebb?

Where are the sounds of the tumbrils rolling through the cobblestone streets to the guillotines. Of course it has. JP Morgan--

Loyal PBS viewers will recognize the first journalist as the eponymous host of Adam Smith's Money World.

Now we've seen famous firms eager to sell themselves out just to make this year's numbers.

There is an old line that the four most dangerous words on Wall Street are, "this time, it's different."

Next, Allan Sloane, financial writer for Newsweek.

We're not in any ethical ebb. What you're seeing now is what's been going on for years. Now it's only surfaced. It's not that things are worse now than they were. It's that you're seeing how bad they were.

The question is, what is the quality of our miscreants versus the miscreants of yesteryear? And I submit to you that ours are ever so much worse.

Jim Grant was with Barron's in the 1970's, and now writes and edits Grant's Interest Rate Observer.

I'm not sure that people were nobler or more honest in the past. I dare say they were not. But I think the standards of behavior were better on Wall Street and in finance.

One of my readers has suggested the Wheel of Misfortune.

Andy Tobias, personal finance writer since 1970.

White collar criminals would get the trials that they now get, and every so often someone is convicted. But then they go to the Wheel of Misfortune. And if you're unlucky and you're the tenth or the twenty second or whatever number it is, you get the death penalty. Now let's say to make it actually a little bit less silly, you get some serious prison where you don't get to play tennis and you don't have a phone in your room, and you don't have a double bed.

I want to take it more back to executive compensation and stock options and that kind of thing.

Carol Loomis started covering business for Fortune magazine in 1954.

But I believe that much of this bad behavior is tied to what I have called in the past, the madness of executive compensation. And to the arrogance that sort of comes out of that, where the guys think they can do anything. And I say, guys, advisedly, because there aren't many of my sex in this.

Well the sense I get is that everyone, or many people in the public, are outraged but everybody was doing it. Am I wrong?

What I'm wondering is, why aren't the American people angrier? Will we see some of this anger in the months to come?

How do they exhibit the anger, if they are angry? They can withdraw from the market. And I think we are indeed seeing some of that. But I don't think we have seen the kind of withdrawal from the market that yet says that we're going to burn everybody who's involved here at the guillotine.

I think the anger is going to come from people who thought they had paid for their retirement. After all, we had a big move to the 401(K)s, and we had-- in order to get the pension obligations off the company's expense sheet. So we moved the people in. And if you're in your own company stock, and the company is Enron, you've lost your pension. And even in those companies that are not Enron, many of them have very desiccated looking 401(K)s.

Well, people-- on the upside, no one was complaining when things got so unrealistic and people thought they could retire young because the market was going to go up 15% a year. Maybe one of the reasons the outrage isn't quite what it will be if things keep going is that, to a certain extent, people somehow

know that some of this wasn't real. They knew some of this wasn't real. But I think people will go to jail. I think people should go to jail. And I think a certain number of people are outraged enough that they would like to see that.

I'm not quite as convinced that sending a few of these people to jail will kill the wrongdoing out there. We saw Michael Milken go to jail, and that doesn't seem to have done much at all.

The question is-- you don't have to shoot them, you have to scare the others. It takes a long time for people to go to jail. It takes a long time to get indictments. Look at this fellow, Kozlowski from Tyco. The company goes offshore a few years ago, ducks out on probably by now a billion dollars of federal income tax, and nobody cares. New York state gets him for a million dollars of sales tax personally, and he's criminally indicted.

The likes of Kozlowski are reminders that in any capital society, there is an implicit social contract between the rich and the others. And the idea is that the rich can get as rich as they like, as long as the poor can also try to get rich. But when there is a breach of the contract, when the rich take what is not theirs, there is a sense that something is wrong and. And the result is that envy and avarice meet head on. And that is what I think we're looking at socially with the contemporary crop of bad guys. It's one wishes one had lived in the Coolidge boom.

It's a lot easier to cheat now than it used to be, I think. It used to be if you wanted to make up phony numbers, you had to sit, the numbers had to add up across and down, you needed imagination. Now with the spreadsheet, you're just pushing your conclusions, you work backwards to your assumptions, you get the accountants to sign anything. And then it all gets disseminated in about three seconds. And what we're seeing now is not what's happening now. We're seeing now what happened three and five and seven years ago. That surface economy. Right, it's a new economy of frauds.

Another factor is the multiplier in the bubble economy was so much greater. That is, everything went up so much more. You could have a company-- there are always little companies coming out that weren't worth very much, but you couldn't have them be worth \$5 billion, \$10 billion, the day they came out, when they still have no earnings and no earning power. That didn't happen--

--or revenues.

--or revenues, or anything. In other words, this was the biggest boom in fiction since Dickens and Thackeray in the mid-nineteenth century.

The legacy of a boom is excess in all forms. During the great bubble years, the late 90's, capital was virtually free to takers. You signed up an investment bank and basically you funded your enterprise. People availed themselves of it. They built stuff. They built to excess. And the excess weighs on an economy. When when there's too much investment, people produce too much. They produce too much at uneconomic margins. They drive out competitors who haven't got free capital behind them. The result is a kind of a chronic low level of virus in the economy. And people talk about stagnation. Japan has been sitting in the soup for about a decade. It too had a bubble. It refused to clear the debris. It wouldn't let markets work. It wouldn't mark things down. And lo and behold, it's still struggling.

But you explain it the way Jim does. That is that a bubble, or period of euphoria, inevitably brings with it weird, aberrant behavior.

You don't see the bones on the beach 'til the tide goes out. And what you're seeing now is the bones on the beach. There's more to come.

I've always heard that you never know who's swimming naked 'til the tide goes out. Which I like much better than the bones. Ever since the SEC came into being, we've had an expectation that the markets supposedly are working well under a strong regulatory scheme. And so you don't expect the kind of thing that is happening today. And also, I think it's very broad. To borrow a line from Warren Buffett, the people who are engaging in bad behavior today are people that you would be willing to have marry your daughter, or be a trustee of your trust. But there isn't-- these people are accepting that it's OK to do this managing the books and doing anything to produce the kind of earnings that is desired.

My question is, here are great firms like Morgan Stanley and Merrill Lynch, and they are paying people \$15 million a year for a product that they know is not really first class. And if they have any sense of history, it's going to lose a lot of people a lot of money. But it will make money this quarter. And so that's why they do it. It's a kind of myopia, that is terrifying.

I don't know what the repercussions should be for someone like that. But a lifelong of happy, repercussion-free retirement? I don't think so.

Would you feel the same if they were making \$200,000 a year, instead of \$15 million?

Well I think-- [INTERPOSING VOICES] less. But you know, for not being paid much, you figure maybe they're doing it to preserve their job or to try to somehow pay for their child's bad leg. But for \$15 million, you figure that they're doing it because they want to be rich beyond imagining.

So it was just a question of a screwed up set of incentives?

Wall Street has never been a holy place. Wall Street is always greedy. It's the nature of the beast. What happened was, there was far more money around than ever, the boom was greater than ever. And largely because of the Internet, and partly because certain members of my profession fell for this nonsense or promoted some of these people who shouldn't have been allowed out without keepers, you had this irrational boom, this idea that everybody can get rich. All of us here, all of us panelists, knew this wasn't true. But you'd raise your voice, it didn't make any difference. It was like madness and it burned out about 2000, and now the hunt is on for villains.

Thank you all very much.

Today it was Xerox and questions over its accounting. The scandals hitting corporate America continue to unravel and our business correspondent, Paul Solomon of WGBH Boston, continues to shed some light on them for us. Here's part three of his series on Money and Ethics. This one focuses on the behavior of investment stock analysts.

I'm looking at your portfolio right now. You've got to buy.

A new ad for discount broker Charles Schwab, playing off one of the year's top business scandals.

I think you should buy.

It's a buy.

Buy it.

Just buy.

It's a no brainer. I'd sell. Did I say sell? No, no, I meant buy, buy, yes.

The ad mocks Wall Street firms touting stocks not because they like the companies, but because they were getting paid to hype them, despite misgivings documented in their emails.

This is only a sample of some of the communications revealed in our investigation.

New York Attorney General Eliot Spitzer has made a name for himself by going after Wall Street, getting Merrill Lynch to pay a \$100 million fine for having misled investors.

The motive was investment banking fees and enormous personal compensation for the analysts. In the process, an untold number of people were left to rely on stock ratings the analysts themselves didn't believe, and there's no telling how much they lost as a result.

Merrill has also promised reforms to prevent such abuses in the future. But several questions remain. Why did so many analysts become stock shills? And why did so few of us seem to notice until now?

We start in good old PBS fashion with a bit of history, and a good old PBS celebrity. The host of Adam Smith's Money World started as a stock analyst in 1960 at a modest salary.

It was barely \$15,000 a year, and it was a kind of like a treasure hunt. The field wasn't a very crowded. And you'd go out and you'd see the competitors of a company, you'd see the people that the company sold to, you'd see the company that the people who supplied the company with its goods. Only at the very end would you go to see the company itself.

Now the title stock analyst describes the job, analyzing companies, their revenues, profits, their business, so that investors can decide whether or not to buy their stock.

It was basically a search for the truth.

Money manager Alan Benasuli describes what he was looking for as an analyst in 1966, fresh from Harvard Business School.

Is it true that the ratings are going to be rising, as they tell us they will? If they're not, why will they not? And what will be the impact on the price of the stock, assuming we are right and they're wrong?

And Benasuli was right enough to be named airline analyst of the year six times by Institutional Investor magazine. Its readers were the big money managers at banks, insurance companies, pension funds and the like. The more helpful they found Benasuli's analysis, the more stock trades they funneled through his firm, which charged hefty commissions fixed at a sizable percentage of the trade's total value. The firm then paid the analyst from those commissions since, after all, he'd helped bring them in.

In other words, the way you got paid was sort of indirectly, in that the people who read your reports and trusted them would buy or sell stocks through your firm.

That is correct. That was called soft dollars or commissions, general commissions. And then that disappeared.

The disappearance began on May 1, 1975, known forever on Wall Street as May Day, the day the government forced Wall Street to compete on price instead of charging fixed stock commissions. And not surprisingly, commissions promptly plummeted.

The going rate went very quickly to twenty cents, and ten cents, and six cents per share, which is what it is today. And therefore, the firms were in their research business had to find ways to get paid.



The way they found to get paid in the 80s was investment banking, the new profit center of the old brokerage houses. Investment bankers did mergers and acquisitions, took companies public by selling millions of dollars of their stock in IPOs, initial public offerings. The commissions on these deals were enormous. Analysts were now valuable to the extent they could help the investment bankers. In the early 90s, just as the system was changing, analyst Tom Brown switched brokerage firms and joined DLJ.

Their compensation system was every quarter, you got a check for any investment banking transaction that you helped with.

At the time, Brown was considered Wall Street's top bank analyst, renowned for his research. But he was paid only a fourth as much as a hot new colleague who was much more involved in investment banking deals. Brown's epiphany, he says, came on the day his colleague addressed a DLJ analysts conference in confessional mode.

And his line was, to work well with selling deals that you had to be able to say, "Father forgive me, for I have sinned." And he went on to say that the way you sold deals was basically to lie and exaggerate about the company's prospects.

He said this to the entire group?

That's what he said.

Nearly everyone played this game, as an old college classmate of mine told me in January.

When I was in industry, and I was a senior financial executive at two New York Stock Exchange companies, I used to say to the analysts, you want to be in the deal? All right, we're going to earn a \$1.35 next year. This is what each division is going to make. This is what the company is going to do. And if you write or say anything different from what I'm telling you, you won't be in our next offering.

You mean your company, your bank will not get a piece of the action?

Right. When I was in industry--

You would actually say that to them?

Absolutely. Why are you looking at me like it's strange? I wanted one story out there. I wanted every analyst to have the same story. And if they weren't willing to go along with exactly the way I wanted that story managed, I wouldn't take their phone calls.

Look like people were listening to you and buying on your list.

It had a pretty good day today.

You can see how within such a system analysts helped inflate the stock bubble.

We're forecasting 25% growth this year, 30 % next, and 25% the following year.

In the 60s, says Alan Benasuli, he spent 90% of his time on research.

And I would say that of my recommendations, maybe 30% of my universe were buys.

Benasuli says that by the 90s, analysts were spending 10% of their time on research, their buy recommendations up to 98%.

Star internet analyst Mary Meeker on the wild tech sector.

It would seem then that the new pay system turned the analyst game and the internet stock boom into something deeply cynical.

Give us your quick picks. What are the stocks to own?

Yahoo, Amazon and EBay.

But that ignores another important element. Boundless enthusiasm.

The economy was in recession.

Jack Hidary was an internet entrepreneur who took his company public in an IPO in the 90s. And though he auditioned many investment banks and their analysts, he says CEOs like him were never thinking about conflicts of interest.

You're not thinking that at all. No. What you're really thinking is, I'm excited, I want to take my company public, I want to raise capital for my company so that we can then expand our company. That's what you're thinking.

And you think, oh, he understands me.

Exactly. He knows the space, understands me, gets my company.

It was only after Hidary's company crashed that he began to realize how corrupted the system had become, how compromised analysts were.

Traditional research goes to the CEOs of companies and asks them, how is your company doing? Well it turns out, most often the answer is, pretty well.

What a surprise.

Yeah, what a surprise.

And so he decided to open Vista Research, a new firm--

That did not have any banking, any mergers and acquisitions advisory work, any trading, really just pure research. And we only get paid by one kind of company, the fund manager, the investor. We do not get paid by the companies that we talk about.

So perhaps stock analysis post-bubble will return to the golden days of yesteryear, assuming of course that investors will actually pay enough to fund extensive, unbiased research.

Upgrading the stock to a strong buy--

But if they do, it will be a very different environment from the one stock analysts have grown into in the last decade or two.

The younger analysts particularly, they didn't know anything else. So they weren't around when the

analysts really did good, hard research. All they knew was promotion. And that's what was so distressing to see, is their lack of concern about the people who were buying these deals. They didn't care about whether the company actually succeeded. They just wanted to do the transaction, because that's how they got paid.

Anybody ever take them aside and say, hey you know, you've got these other constituents, that is to say the investors you're giving advice to.

No, nobody ever talked about that. I was the odd man out.

Nobody on Wall Street ever talked about that, nor did they want Tom Brown to. Even after he was fired back in 1998 for refusing, he says, to tout questionable deals. His severance pay discussions, according to him, dragged on for months because--

--in the whole negotiation, what they wouldn't give up on is that Tom Brown couldn't speak to the media about his departure from DLJ. And for that, they were willing to pay me half a million dollars.

\$500,000 just for that one clause.

That's just for that clause.

DLJ's response, "such clauses are common on Wall Street, and Brown was fired for other reasons." But the one certainty, Tom Brown refused the money.

Let's get back to our original question, however. Why did some analysts become virtual shills? Because the end of fixed high commissions meant their brokerage firms had to find another way to pay them. A way that proved so lucrative, new ethical norms took over. And why did so few of us squawk or even notice? Perhaps because the system was so lucrative for us as well. Or as Allan Sloan of Newsweek puts it--

--this has been going on for at least 18 years. And for the first 17, nobody cared. It didn't make any difference. The only reason we're seeing any of this now is that the market has been in the dumps for 27 months, and people were screaming.

And perhaps more worrisomely, they're not investing.

Two-thirds of investors say that the conflict of interest between research and banking is holding back the investment climate. So the confidence of the investor has been lost in the system. And the big picture here is that unless we restore that credibility, we're not going to be able to get our financial markets going again.

And if we don't, that would give further impetus perhaps to the furor over who helped create the Wall Street bubble in the first place.