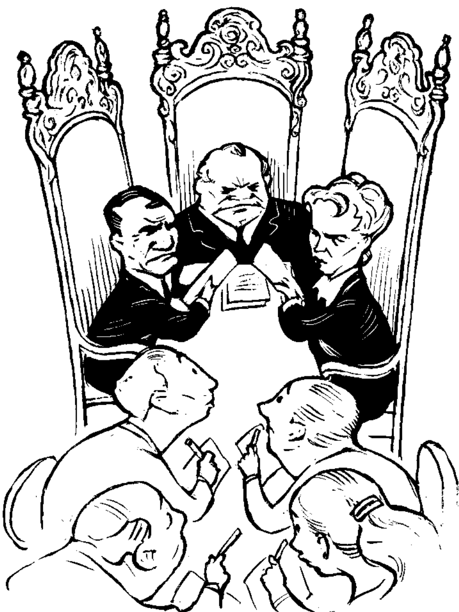
Core Group Therapy

In every company, an insider set of managers influences decision making. In some cases, that's healthy, in others (witness Enron), it's a nightmare.

by Art Kleiner

Illustration by Lars Leetaru



Midway through 2001, a passionate young vice president at an oil company showed me a chart of energy-company stock prices making the rounds in his office. Most of the companies showed nearly horizontal performance over the past few years, tottering gloomily toward stasis or decline. Only one line ascended, dizzyingly, from a market capitalization below the others to a peak high above them. "How can we *ever* get our top management," asked the VP, "to think more like Enron's?"

That same question was being asked in at least two other energy companies that I know of — and at the Harvard Business School, where researcher David Lane and Professor Pankaj Ghemawat had just published a glowing case study of the company, titled "Enron: Entrepreneurial Energy." Why, Professor Ghemawat asked from his lectern, weren't the established oil companies emulating the Enron Corporation? They were all beefing up their commodities and derivatives trading operations and trying to recruit brilliant, aggressive MBAs to run them, but they still couldn't match Enron's stock price growth or its competitive edginess. Nor — fortunately for them — its stunning collapse.

Why not? Asking around the energy industry, I've heard many people blame Enron's ruthless, take-no-prisoners, everything-for-an-advantage corporate culture. It has become fashionable in some circles to argue that *all* corporations are ruthless in their business practices these days because of the short-term pressure to boost share price and performance. According to this reasoning, all companies are likely to end up like Enron unless they are tightly regulated.

Yet plenty of companies never succumb to "short-termism." And some that do, like the Exxon Mobil Corporation and the Intel Corporation, remain at the top of their industries for decades.

March of Folly

So why do things go wrong in good companies? The more people I talk to from different workplaces, the more I've observed different and complicated cultural forces — both inside and outside companies — that undermine business perform-

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Mr. Kleiner would like to know your reactions to this column for his forthcoming book, *The Core Group*. He can be contacted by e-mail or through his Web site.

ance. It's as if each company is culturally predisposed to fall victim to its own potential forms of folly and its own way of self-destructing, whether the cause is illegal actions or just bad judgment.

Such cultural predilections are certainly true of political institutions: Historian Barbara Tuchman wrote one of her best books, *The March of Folly: From Troy to Vietnam* (Alfred A. Knopf, 1984), about the tendency of governments from the Trojans to the Americans in Vietnam to pursue, as she put it, "policies contrary to their own interests."

In business, there are many discernible flavors of folly. There is the one-big-ad-campaign-to-build-mind-share flavor of folly; the let-quality-slip-to-save-costs flavor; the protect-the-executives-from-bad-news flavor; the expand-and-merge-beyond-our-capabilities flavor; the not-invented-here flavor; the jump-on-the-industry-bandwagon flavor; the perennial hide-losses-by-borrowing-from-future-profits flavor; and the ever-popular addiction-to-downsizing flavor. Wayne Cascio, a professor of management and international business at the University of Colorado, identifies the organizationally debilitating spiral in which downsizing cuts back a company's capability, which leads to lower profits, which leads to a perceived need to downsize again.

It's not always easy to see a company's cultural predispositions, from either outside or inside. Enron's folly is visible to all now, but if you wanted to find it, say, in that two-year-old Harvard case study, you'd have to read closely between the lines. Jeffrey K. Skilling, interviewed in January 2000 just before he became CEO (and 19 months before his departure), described Enron's policy of paying traders based on performance evaluations, and not automatically giving them a percentage of the value of the trades they closed: "Almost everyone else in the industry [pays traders a percentage]. I absolutely refuse to because it puts the interests of Enron and the individual at odds.... People who are getting a percentage of the book would make risky bets to get big numbers." He concluded by saying, "I'm not going to subject the company to agency risk."

In other words, Mr. Skilling recognized that Enron's culture was so prone to risky bets, and so loyalty-deficient, that he had to police his junior people — hard. In such an atmosphere, it's not surprising that members of senior management, who are much harder to police, would look for ways to bend the rules. The infamous partnerships may have started as precisely such a maneuver.

Cultures of Consensus

Meanwhile, the older, more mainstream oil companies (which also have their own trading desks) generally have the same policy — they, too, pay traders a flat wage, not a percentage. As a result, those traders often grumble and sometimes leave. But these mainstream companies don't develop questionable schemes like the Enron partnerships — not because their people are more noble, but because they are culturally risk-averse. These companies tend to have deeply instilled cultures of consensus and caution, evolved from years of managing accidents in refineries and offshore platforms, where a simple misstep can lead (for instance) to drowning or deadly fire.

I've been at oil company meetings where the first few minutes are

reserved for safety procedures, on the million-to-one chance that we have to beat a hasty exit from the hotel room. And I've even been asked by oil company acquaintances to curb my habit of crouching on sofa arms. They don't seriously expect me to fall, but the precariousness of my posture just *bothers* them. They are also used to investments, like refineries and oil platforms, that take 20 years to pay back their costs. That kind of mind-set makes it far more difficult for people to go out on a limb with questionable deals.

Of course, such companies may find themselves prone to other forms of folly — squelching innovation in some parts of their businesses, for instance, simply because they find it too risky. And some companies may seem like Enron on the surface, and even have a similar reputation for ruthlessness, without succumbing to the same temptations. What's really needed is deeper perspective, from both inside and outside, to identify the cultural forces that determine why some companies become Enrons, others become Kodaks, others become Exxon Mobils, and still others become Ben and Jerry's.

For several years, I've been informally studying the ways in which each organization's cultural predisposition (for example, the attitudes, values, and behaviors it celebrates and tolerates) influences its strategic direction and its purposes as a business. In this context, I've come to see all organizations, including corporations large and small, as the aggregate sum of the decisions made at every level. It's as if every company were a giant computer game controlled by thousands of small joysticks, each pulling in a different direction. Some people (at the top of the hierarchy) have more sway over the cursor than others (below them), but all employees have influence; even a decision about which brand of paper clip to buy may contribute, in a tiny way, to the organization's ultimate direction.

What, then, are the common threads to all these individual decisions — the patterns that add up to large-scale organizational predispositions? I have come to think that there are basically three universal factors that influence corporate culture. I have never seen an organization operate without them, but their characteristics vary dramatically from place to place. If you understand all three in a particular organization, you truly understand how to reinforce what the organization is doing right, or change its direction.

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The Core Group

Any organization is trying, at heart, to fulfill the perceived needs and wants of a Core Group of privileged people. In every organization, there is a group of people — its exact nature and makeup varies from workplace to workplace — on whose behalf decisions are made. This Core Group (as I call it) is never mentioned in any formal policy, for it has no formal authority. Instead, it has legitimacy: the respect, recognition, and fealty of decision makers throughout the organization, who continually favor its members as they choose which deals to close (and how to close them), which suppliers to court, which products to promote, and which initiatives to quietly let die.

Core Groups can be as small as a founder/CEO and a few close associates, or they can extend to hundreds of people. They tend to be complex, ever-shifting, almost living entities, which is why insiders spend so much time and effort trying to figure them out. Ambitious junior managers who aspire to become part of the Core Group watch and emulate its actions closely. Senior people who have been around a long time are judged (and judge themselves) according to their closeness to the Core Group. Insurgents look for ways to infiltrate the Core Group. Indeed, industry upheavals are often targeted at changing the Core Group: Advertising's creative revolution in the 1960s, for instance, lifted copywriters and art directors up from the status of hired hands into the Core Groups of Madison Avenue agencies.

The larger the Core Group, the more resources are needed to fulfill its perceived wants and needs. Thus, in many companies, there is a continual tension between the established Core Group and those who keenly wish to be part of it. And no wonder. If you've ever been in a Core Group, you know the heady feeling of having an entire organization constantly trying to guess your

needs and wants and satisfy them, almost as if the company itself were infatuated with you. If you are in the Core Group and need work, the organization will find work for you. If you need money, it will boost your pay (as much as it can without endangering the wealth of other Core Group members). If your pay is already so high that you bridle at your taxes, it will manage your accounting and set you up with stock options. If you do not want people to think of you as arrogant, the Core Group will give you opportunities to act humble (and train you to express your humility authentically). The more you ask of your organization, the more it will do for you — up to its limits.

Core Groups are not inherently bad or dysfunctional. Every organization needs a Core Group; without one, there is no way to set immediate priorities. But Core Groups can also be self-indulgent and complacent, especially in times of stress. Enron appears to have had a fascinatingly deceptive Core Group. In its flush days, the company acted as if all employees were special; and the employees themselves, apparently, came to feel as if they were all part of the Core Group, with the entire organization making decisions on behalf of all its members. Reading early employee memoirs (in, for example, a series of letters published in the *Houston Chronicle* in December 2001), it's clear that it wasn't just stock options, but the feeling of being part of an extended Enron family, that kept people motivated to show up at 6:00 A.M. and leave at 7:00 P.M., day after day.

Then came the crash, and suddenly employees were stalled when they tried to sell their stock or confirm their severance packages; they were dismissed summarily, often without any explanation of their future; and while their pensions shrank to 5 percent or less of their former value, they learned that $55 million in last-minute bonuses had been divided among 500 key employees. Suddenly, it became clear exactly how small the Enron Core Group was.

"As a young child of 10 years of age, I witnessed the fall of Vietnam," wrote one Enron employee to the *Chronicle*. "Last Monday, Dec. 2, 2001, those memories came flooding back. There were plenty of rumors and unofficial information, but not one word of communication from upper management. By around noon, we were all told to go home and evacuate the building immediately. We did not know what to do with our badge, our parking card, or if we were officially severed from the company. Security guards walked around the floors and watched people while they packed, as if they were potential thieves." In other words, 10,000-odd employees had suddenly dropped from the Core Group to the ranks of the unemployed — or, worse, to a recognition of their own lowered status within Enron.

The Core Group has no formal authority. It has legitimacy: the respect and fealty of decision makers throughout the company.

The Creative Imperative

Money and the illusion of Core Group status weren't all the employees at Enron lost, for companies also have other critical factors that drive collective decision making: *People want to expand their chances to be creative at a larger-than-individual scale.*

Big organizations are not typically seen as creative. The very word "bureaucracy" connotes the opposite of an innovative enterprise. But in reality, progress in civilization depends on the ingenuity of its large organizations. If we learn how to harness an organization's creativity effectively, then almost nothing is impossible. That's why society's great innovators, from Thomas Edison to Steve Jobs, inevitably begin by building a place for brilliant and imaginative people to work together.

But different organizations are creative in different ways. The exact nature of their creativity tends to surface as a challenge to people throughout the hierarchy. Can a securities company create a compelling investment vehicle? Can a packaged-goods company corner the market on toothpaste? Can a utility reshape the energy industry? Can a marketer invent a franchise that puts its name all over the world? It's as if each individual is saying to him- or herself, "Let's take the organization out for a spin and see what this baby can do."

Money is important to people (which is why the Core Group holds tight to the purse strings), but employee commitment to an organization's creative imperative has little to do with salaries or bonuses.

Former Enron employees, while they grieve the loss of their savings, also keenly miss the excitement they felt there. Like the former investment bank Drexel Burnham Lambert, to which it has been compared, Enron brought an intensive spark of originality to its operations, although often bringing them to the edge of convention and propriety. Enron's risk-taking culture gave a heightened thrill even to the nontrading departments: "By far my best days in my career were as a consultant for Enron," wrote contractor Katie Walthall to the *Chronicle*. "The environment was an extreme rush."

That brings us to the third factor, which is primarily influenced by the Core Group. *People are trying to make a better world — not in any idealistic way, but by following their unconscious sense of what the "right thing to do" is for the organization (and themselves).*

Organizations exist to prove, again and again, what the eminent organizational development expert Chris Argyris of Harvard University calls "theories in use" — an organization's tacit views of the way it believes the world is supposed to work. For instance, some organizations maintain the prevailing belief that people are basically good and need to be nurtured to be developed; others, no matter what they espouse, believe that most people must be tightly controlled to get anything done effectively. Either of these views suggests a "right" way to treat people, and the organization will attract people who concur with its view.

No matter how craven or criminal an organization seems to outsiders, the people inside it are driven by their own conception of honor. Enron is a perfect example: Even in its high-flying days, Enron was perceived by many outsiders as a bunch of buccaneers. But inside, it was apparently driven by at least three shared ideals: a belief that deregulation was a virtuous and liberating force; a trader's belief in high-speed, high-status gamesmanship as the best road to success; and a fierce sense that the company should protect its "family" of employees. (For instance, when floods struck Houston early in 2001, Enron immediately gave $1,000 to all employees who needed emergency cash.)

Most oil companies see themselves, as investigative reporter Seymour Hersh has noted, as keeping humanity safe from the cold and dark; Enron saw itself as pushing the boundaries of conventional supply and demand, a very different ideal.

The Cultural Profile

I think of these three factors — the nature of the Core Group, the prevailing creative imperative, and the conception of honor — as components of a core profile of an organization's culture.

The core profile and the individual elements of culture are hard to articulate, but most people associated with a company will recognize them when they hear them. I've been testing this by asking people to send me core profiles of companies they know well. At Procter & Gamble Company, for instance, the Core Group is composed largely of marketing people who joined the company straight from college; the creative proficiency is dominating shelf space and overseeing markets; and P&G people genuinely see themselves as guardians of purity and cleanliness.

I'm very interested in hearing from people with whom this theory resonates, or those who disagree with it. If it's right, then it suggests that senior executives have a choice. They can try to design an organization in which everyone is part of the Core Group, although that would require an extraordinary degree of attention. They can settle for the sort of abusive, deceptive Core Group dynamics that exist in many organizations, and that seem to lead to various kinds of folly. Or they can be open and clear about the purpose of the company — the priorities of the Core Group, the creative proficiency on which its success depends, and the ideals it wants to promote.

Senior executives cannot control these three elements of culture, but they can influence them, particularly through the people they hire and the people they promote. If the core cultural qualities are authentic, and people can talk openly about them, then a company may have a far better chance of thriving than if there is a serious gap (as there seems to have been at Enron) between the perceived and believed core qualities and the underlying truth.

A predisposition to arrogant folly will find its way around any regulation. Accounting and other reforms intended to make corporate operations more visible to shareholders are all for the best. But we also need to make business organizations' core characters more transparent, so that everyone can see where they're going — and make an informed judgment as to what the consequences might be. ✚

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