

Madoff securities essay

[Business](#), [Business Ethics](#)



EXECUTIVE SUMMARY In the aftermath of the revelation that Bernard Madoff's investment fund was a tremendous Ponzi scheme, businesses have fallen under heavy scrutiny and continue to be challenged by the public as the result of a growing mistrust in the way business is conducted. Issues in management practices, like conflict of interest, can be raised from this debacle.

Madoff developed a culture of individualism and arrogance that silenced any insurgence. His communication and manipulation skills helped him generate income for himself, while keeping any suspicion of fraud away. Formal control mechanisms and transformational leadership skills may have avoided such an unethical attitude.

Madoff's scam has been impacting several charities, private investors as well as the health of the financial markets. Madoff's low moral development stage and his well oiled reputation management skills were reasons for his long lasting success. In actual fact, Madoff disregarded social impact management. Unless radical changes happen in the institutional due diligence, in risk assessment practices and in ethical leadership training, we will see more and more such cases, especially during uncertain times.

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INTRODUCTION This

report discusses and illustrates the role of the internal and external environments, ethics and social responsibility in a modern organization.

The main case study used is Madoff Securities, the US finance company that collapsed last year after a web of fraudulent and unethical activities were exposed. The discussion blends theory and facts, from which recommendations for better management emerge. 1.

THE INTERNAL AND EXTERNAL ENVIRONMENTS 1. 1 Organisational culture of Madoff Securities A corporate culture is the present values, beliefs, and norms that exist within an organisation. Culture is the foundation that will assist in the prevention of fraudulent behaviour.

It can also be looked at as a social control that can manipulate members into perceiving, thinking, and feeling in certain ways. Robins et al (2006, p. 98) identifies the internal culture of a company often reflects the vision and character of his founder. Through poor execution of all the basic management functions, i. e.

planning, leading, controlling and organising, Madoff allowed a culture to develop at Madoff Securities that would accept unethical behaviour and social irresponsibility. Madoff believed he could control all outcomes. This refers to the omnipotent view of management theory. (Robins et al. 2009, p. 80). Madoff made it a point to spread a culture of greed, arrogance and exclusivity among his branch sites (Schein, p. 13). Many people think that Madoff was selfish and heartless and put profit before people (Harburg, 2009). On his credit, humans are blinded by their self interest. We have little

time worry about the morality that affects the common good. It appears Madoff had a strong ego and an internal locus of control as he took responsibility for consequences and relied on his own standard of right and wrong to guide his behaviour.

Madoff was viewed as a charismatic man and stellar financier with favorable connections to power brokers on Wall Street. This may have given him overconfidence and high tolerance to uncertainty and risks when building his Ponzi scheme. Madoff used his reputation as a former Nasdaq chairman to build unlimited confidence and deceive notorious victims like Elie Wiesel. Madoff relied on social engineering and the predictability of human nature to generate income for himself. Madoff used the tactic that only elite could invest in his funds. Wiesel said: “ There was a myth that he created around him that everything was so special, so unique, that it had to be secret” (Fenton, 2009). Moreover, funds were scarce and some investors or employees were dumped if they asked too many questions.

Madoff’s attitude and web of deception inevitably impacted on teams and functioning of his business. Madoff imposed a closed culture of superiority and impregnability, of dominance and self importance, which affected his employees’ individual behaviour. Madoff carried ‘ get it done’ values to the extreme. He valued personal ambition over teamwork and earnings growth at any cost. Employees were not expected to exhibit precision analysis and attention to detail. Individuals who obtained results, by any means possible, were likely to succeed in the organization.

Madoff's strong culture was influencing employees with low ego strength and low moral development. This would have prevented a whistleblower from ever emerging. HIH is another case of corporate debacle where employees lacked diligence and did not question what a domineering chief executive officer was doing. There was a blind faith in leadership that resulted in the loss of thousands of jobs and thousands of shareholders' life savings. Loose accountability, low integrity, poor controls resulted in a high fraud environment.

Information was filtered, no feedback was solicited and active listening skills were nonexistent. Transactions were deliberately and dishonestly structured to misrepresent the true nature of the money. Such frauds could have been detected if audits were carried out and formal control mechanisms set up. Effective internal controls are typically supported by a highly ethical culture, proper management skills, and are made part of a continuing corporate strategic plan. In an ethical culture, ethical expectations would be communicated and rewarded, and ethical dilemmas reported without fear. 1. The external environment Organisations are open system continually interacting with and receiving feedback from the external environment.

The external environment consists of the specific environment and the general environment. 1. 2. 1 General environment Today's corporate world is characterized by globalization, turbulence and complexity. Multinational companies like Madoff Securities operated within a network of offshore contacts and satellite companies. Madoff took advantage of the boom in IT technology to transfer funds quickly and secretly.

It appears that Madoff laundered cash out of his London operation. Madoff promised the implausible combination of good returns and low risk, and people believed him. He was effectively putting money into nothing which is exactly what the American economy had been doing. The USA were spending more than they made and then borrowing more and more from China. The economic situation in the USA in the late 1990s gave an illusion of prosperity. Interest rates for most forms of borrowing were at their lowest levels for decades and inflation was at record low levels. This atmosphere of optimism probably contributed to Madoff's escalation of commitment to consciously protect his early flawed decision. The political/legal conditions set by the US government played a role in Madoff Securities' external environment.

The Securities Exchange Commission (SEC) defective control system indirectly enabled the fraud. A fairly basic examination of employed strategies and/or risk management would spot the Ponzi scheme instantly. His funds even never used an independent custodian, which itself was supposed to raise a red flag immediately. Madoff conned the regulators as well as the investors. People will only do what you inspect not what you expect. The scandal says as much about our culture as it does about the financial system. Our society is willing to assume something is ethical when it offers a decent return and social stamp of approval. The deception worked out for everyone.

People had interest in maintaining their stake in Madoff's scheme, even if their guts told them it was hollow. 1. 2. 2 Specific environment Madoff

Securities was operating in a dynamic environment where change was fast and relatively unpredictable. The financial sector can be considered as homogeneous.

Table 1 – Madoff Securities environmental uncertainty matrix Degree of complexity Degree of change Stable Dynamic Simple MADOFF SECURITIES Complex Adapted from ‘ Management’ by Robbins, Bergman, Stagg & Coulter, 5th edition, published by Pearson Education Australia 2009, page 90 A critical part of managing the specific environment is stakeholder management. This relates to suppliers, customers, competitors, government agencies and public pressure groups. Madoff’s stakeholders were misled and lied to. Madoff used favourability influence. Madoff believed the environment was malleable and that he could be successful by manipulating it.

This refers to the resource dependence model in terms of organization-environment interaction (Bartol et al. 001, p. 78).

The techniques he used included advertising and engaging in public relations, boundary spanning, recruiting, negotiating contracts, co-opting, joining trade associations and engaging in political activities. Boundary spanning was achieved through a family member who held an influential position at the SEC. This person was collecting, filtering and transmitting key information. Madoff was also an active member of the trade association of brokers. He engaged in political activity by trying to influence legislation and the behaviour of government regulatory agencies. 2. ETHICS Misleading the market, inflating revenues through fictitious sales, market manipulation and forged documents were examples of Madoff’s unethical conduct.

Ethics refer to the principles that define right or wrong conduct (Robins et al. 2009, p. 183). In Madoff's mind, right is determined by what satisfied his ends. It has a social orientation of individualism, instrumentalism and exchange. (Davidson & Griffin 2005, p. 102). His sole objective was to pursue his own long term self interests.

'The end justifies the means'. This is summarized in Schermerhorn individualism view of ethics (1993, p. 76). The reality is that the pursuit of economic gain at both the organisational and individual level has often meant that ethics have been left out of business practice. Apart from responsibilities to shareholders, pressures from global competition seem to leave little room for management concerns about ethics and responsibility to anyone else. The understanding of the different perspectives that people hold with regard to ethical decision making provides an important insight and essential foundation for discussion. In society, there are influences that dictate ethical values, and exert varying degrees of control over managers.

These include religion, philosophy, cultural experience and law (Steiner & Steiner 2000, p. 219). Corporate officers who had abused power and disregarded fiduciary responsibilities were able to hide their ethical deficits behind corporate cultures of deceit. (Kermis & Kermis 2009). The Parmalat collapse is an illustration. A great irony of the Madoff Securities fraud was that Madoff had campaigned for greater transparency in Nasdaq and was ultimately charged for his culture of deception. Madoff's individual characteristics highlight a low stage in moral development, probably at the pre-conventional thinking stage (Davidson & Griffin 2005, p. 02).

He followed the rules only when doing so was in his immediate interest. He ignored the intensity of the ethical issue too. Madoff carefully chose his employees and treated them with little respect. He assigned DiPascali the task to design, develop and oversee a wide and varying array of fictitious books and records – all prepared to conceal the scheme from investors, auditors and regulators (Masters, 2009). Inequalities in revenues distribution and secrecy were part of everyday's employee life at Madoff Securities. There was no charter for expected behaviour and potential whistleblowers were muzzled.

Madoff's behaviour contradicts Kirrane's view of ethical human resources management, which asserts that altering people's values or souls isn't the aim of an organizational ethics program, but managing values and conflict among them is (1990). The other dimension of the ethical study of Madoff case is how the organization treated other economic agents. Madoff did not recognize the various social, cultural, political, and legal influences on what is appropriate and acceptable behaviour when working on the international stage. Madoff lies on financial records affected competition, customers, shareholders and unions. Madoff committed an unethical offence by using information gained during his employment at the Nasdaq to affect personal gain through the buying and selling of shares.

Share sales made on the basis of privileged information is illegal. Madoff was also a master at cultivating and exploiting social connections. Madoff preyed on affinity groups that weren't likely to ask many questions, like the Jewish community. Madoff presented himself as a conservative investor and

involved Jewish philanthropist living a respectable family life (Business Week Online, 2009). He seems to have been an equal opportunity thief, who shamelessly made off with funds from close relatives and charities in his scheme (Vinod, 2009). Madoff knew that by recruiting feeder funds from different customer bases, he could increase the number of circles he could tap into for new victims (Wells, 2009).

Through donations to charities, Madoff was supporting his desired public image. The Madoff story illustrates the learning and manipulation problem. Madoff had a good knowledge of human nature and used it to enhance communication as a tool of manipulation. Madoff possessed all the bona fide – the record, the resume, the expertise and the social connections.

There was something about this person, pedigree and reputation that inspired people. Madoff practiced reputation management to achieve advantageous change. His mistake though was to believe it's all about saying the right thing. Tighter rules and regulatory oversight are short sighted tools to fix such an unethical attitude. This would address symptoms, not the cause. The solution probably lies in a strong focus on moral education. We need to pursue such education with diligence and perseverance (Scherer, 2008).

The chief executive should announce the program, and champion its development and implementation. Most important, the chief executive should consistently aspire to show integrity and fairness when resolving ethical dilemmas. 3.

Corporate social responsibility Many corporations are looking for better ways to conduct business in an ever changing environment across the globe. In the 1960s, social awareness movements raised expectations of businesses to use their massive financial and social influence to address social problems such as poverty, crime, environmental protection, equal rights, public health and improving education. Indeed, corporations are accountable to a variety of stakeholders: shareholders, employees, customers, the local community, the national and international community. This is inline with the socioeconomic view of social responsibility which asserts that organisations must play an activist role in improving society by involving themselves in their community and contributing to charitable associations (Robins et al. 2009, p. 167). Corporations generally have responsibilities in four fields: economic, legal, ethical and discretionary. The basic management principles to support the corporations would be accuracy, neutrality, transparency, inclusiveness and auditability.

Madoff would be an advocate of another theory, the classical view, which says that management's only social responsibility is to maximize profits (Robins et al. 2009, p. 167).

Facts prove that Madoff never considered the ethical nature of his decisions and tried to hide his transgressions - he took a social obstruction stance. He was enriching himself beyond the imagination of people, which raises the side issue of overpaid executives. Madoff disregarded social impact management. He did not operate his business in the best interest of shareholders, nor did he protect and improve society's welfare. Madoff case

is an example of breach of social obligation. As opposed to Virgin which built his success on social responsibility or Nike which takes social responsibility as a major source of learning, relevant to its core business strategy and practices (Zadek, 2004), Madoff had no social responsiveness. The external environment was not monitored and no internal response mechanism was applied.

His fraudulent activity destroyed the community he served. On the one hand, Madoff undermined public confidence in investing. The effect of the Madoff Ponzi scheme will drive rates up, coverage may narrow and limits available may compress for the next few years (Holbrook 2009). There is a contingent process now, where investors will be less trusting of legitimate, honest fund managers. There are going to be a lack of liquidity, so the market will be harmed by this (, 2009). It is instructive to examine the relationship between business and governments in regard to social responsibility. Madoff Securities was in fact a black box, with inadequate oversight, and had nothing going for it except for a track record. Madoff was a good lobbyist and his Ponzi scheme lasted because he had his family in key positions at the Financial Industry regulatory authority and SEC.

Madoff appears to have used his cronies, connections and intelligence to give proper political donations to secure positions of trust and power in the public regulatory bodies. The US government failed to regulate the market place to achieve a fairer business environment. This may be because the ethical issue of funds and investments before the scandal was at a latent stage. The maturity of this societal issue has now shifted. The SEC

recognized its failure to uncover Madoff's massive scheme. Since then, it has beefed up enforcement efforts as it moves to restore investor confidence. On the other hand, the collapse of Madoff has crippled the ability of many charities to carry out their mandates. Although Madoff had donated to a range of charities for years including education, welfare and the arts, he also created conflicts of interest between personal and institutional interest.

The case of the Yeshiva University is an example. But with the management rosters of these institutions now spotted with gaping financial holes, Madoff's massive mismanagement continues its degenerative effect. Boards of directors are reviewing their policies and procedures to ensure they are at the highest standards. Nowadays corporate social conscience involves a far more structured and integrated approach, incorporating input from employees, than giving money away to charities.

It is more about cultivating systems that provide value not only for your organisation but also for stakeholders. Along with proper business culture, management skills and outside support, businesses must be actively involved in preventing and detecting fraudulent behaviour. There is a need to maintain a competent in house investigative staff, although this can be time consuming and sensitive. Business policies and corporate social audits should be implemented. Proper procedures should be established to communicate the results of audits and activate proper follow ups.

Transformational leaders are particularly skilled to trigger change and create a highly ethical atmosphere within a company. CONCLUSION The Madoff case illustrates that transitive trust can lull people into a false sense of

security (Kramer, 2009). People were misled by Madoff's power and knowledge. Ideally, integrity should not go up or down with market condition, as the value of a stock does. While legislation and increasing disclosure requirements and penalties for malpractice by corporate officers can be seen as the solution to unethical behaviour, there is little evidence to demonstrate this approach is effective. The answer may lie with ethics education and training. This may include developing a new generation of leaders who believe in sustainable returns for their shareholders, in ethical conduct, in corporate social responsibility, and who create value adding relationships with all stakeholders in societies.

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