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The Devil's in the Emails: A Sociological Examination of Organizational Failure

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THE DEVIL'S IN THE EMAILS:

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ORGANIZATIONAL FAILURE

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Considered the largest casualty of the subprime mortgage crisis, Lehman Brothers began issuing subprime home loans in 2000 (Williams 2010). By 2006, Lehman, together with its subsidiaries, was originating nearly $50 billion in new real estate loans each month (Williams 2010). Like other Wall Street banks, Lehman sold AAA-rated collateralized debt obligations to pension funds and endowments while maintaining large positions in lower-rated, but higher yielding tranches of these same securities (McLean and Nocera 2010). In the second quarter of 2008, Lehman began reporting billion dollar losses on their real estate portfolio and reluctantly raised $6 billion of new capital by issuing additional stock (Anderson and Dash 2008a). Following the withdrawal of Korea Development Bank from negotiations to acquire the bank, Lehman shares plummeted 45% in early September (Anderson and Thomas 2008; Anderson and Sorkin 2008). On Wednesday, September 10th, Lehman announced losses of $3.9 billion prompting the Federal Reserve Bank of New York to convene an emergency meeting to discuss the firm's solvency (Anderson and Dash 2008b). Without government funds forthcoming and unable to galvanize investor support, Lehman entered the weekend amidst widespread uncertainty and speculation. On Monday morning September 15, 2008 Lehman Brothers filed for chapter 11 bankruptcy protection, reporting assets in excess of $639 billion. Some suggest that the fall of Lehman was a crisis of leadership and fault critical decisions made by individual executives (McDonald and Robinson 2009). Others argue a more structural explanation, implicating both the lack of regulation that allowed the crisis to build and the inaction of external actors such as the Federal Reserve Bank and Treasury Department (McDonald 2015). Ward (2010) was the first to suggest that Lehman's own organizational culture may have precipitated the firm's downfall. Through interviews with former executives, Ward traces the final twenty years of Lehman's history and attributes its demise to a rigid organizational culture that resulted in an "echo chamber" of hollow corporate ideology. Her analysis, however, paid little attention to the institutional context of the financial sector and ultimately relied upon retrospective accounts of the firm's collapse solicited from Lehman executives in the aftermath of the crisis. Continuing the work begun by Ward, the following analysis will demonstrate how organizational culture, situationally enacted by Lehman Brothers' employees across the organizational hierarchy through intra-organizational interaction, was among the contributing factors expediting the firm's downfall. This research is the first to consider the fall of Lehman Brothers in its own terms and as it happened. It relies on the content of emails sent by Lehman employees during the weeks and months preceding the firm's insolvency and demonstrates how distinct organizational modifications of recognized institutional myths impeded the implementation of alternate courses of action by those within Lehman Brothers even when confronted with evidence that existing operations were ineffective.

LITERATURE REVIEW

Prior research establishes that organizational failure, defined by Vaughn (1999:273) as "*an event, activity, or circumstance, occurring in and/or produced by a formal organization, that deviates from both formal design goals and normative standards or expectations, either in the fact of its occurrence or in its consequences, and produces a suboptimal outcome*," is not the result of chance, but rather the product of routine nonconformity within the systemic characteristics that allow the organization to function (see also Vaughan 1996). Previous social scientists attribute the causes of organization failure to three different analytic levels: institutional environments, organizational characteristics, and individual cognition (Mone et al.

1998; Vaughan 1999). Organizations are embedded within institutional environments, but their environment is never a solitary one (Baum and Singh 1994). As such, institutional explanations for organizational failure implicate the effects of other organizations either through resource competition or networks of collusion (McGahan and Porter 1997; Barlow 1993). Others take a more local view, arguing that the risk and uncertainty of individual actions produce micro-failures capable of causing individual misperceptions and mistakes to accumulate when exposed to organizational activities (Goffman 1974, Starbuck et al. 1978, Mone et al. 1998). Between these positions stand those who ascribe the source of organizational failure to mechanisms of the organization and divide these operations into structures, processes, and tasks (Vaughan 1999). Organizational structures include the means by which information is shared and to what extent work groups are isolated from one another, what Lazega calls "the micropolitics of knowledge," (1992). Organizational processes, such as accounting system idiosyncrasies, contribute to organizational failure when extreme adherence paralyzes adaptation and adjustment (Diamond 1992). Technological factors lead to task-related causes of failure when only a handful of employees possess the tacit knowledge required to operate the technology and are unable to articulate this to colleagues (Collins 1981).

The sites at which these layers overlap are salient, as response to failure is informed by social interactions within and across levels of analysis. Responses to organizational failure constitute the accrual of historically situated cultural knowledge culminating in the alteration of established social relationships (Tilly 1996). "Mistake, misconduct, and disaster are defined only in retrospect when outcomes are known, and these meanings are historically contingent," (Vaughan 1999:283). To this, Deeds and Pattillo (2015) add that failure is an interpretive process whereby members negotiate both the meaning of failure and responses to it. Current explanations of organizational decline and failure postulate that individuals construct accounts that justify and legitimize deviant behavior following or in the face of organizational crisis (Vaughan 1996, 1999). Barmash clarifies this with the observation, "corporations are managed by men; and men, never forget, manage organizations to suit themselves. Thus corporate calamities are calamities *created by men*," (1973:299 emphasis added). At the same time, organizational culture functions to persuade employees of the security of the enterprise (Clarke and Perrow 1996). Organizational culture is imbued with further false confidence and even arrogance when work groups and individual leaders isolate themselves from the advice, criticisms, and attitudes of others within the organization (Kroll et al. 2000). When effectiveness is trivialized and abandoned in the pursuit of perceived legitimacy, the institutional environment itself has the potential to amplify organizational vulnerability (Landau and Chisholm 1995). While all of these processes are important, none occur in isolation. Individuals enact the same organizational culture under which they are both enabled and constrained. Organizational culture is principally the product of group interaction. It is initially produced by and thereafter reproduced through individual interactions and informed by the institutional environment in which it is situated. Local interactions between individuals construct organizational culture in ways that at times reaffirm, at times challenge, and at times modify the institutional myths that define the environment. Vaughan suggests this point in claiming "individual engagement in routine nonconformity can encompass violation of normative standards and expectations that are either internal or external to the organization," (1999:281). As the case of Lehman Brothers demonstrates, conformity to organizational culture possesses the potential to contribute to organizational failure, as well. The literature on organizational failure would benefit from an institutional perspective that recognizes that institutions are inhabited with action, while respecting the ability of the institutional environment to inform these actions. An approach capable of traversing different levels of analysis and interpreting the interactions embedded within organizations is needed to move the field forward.

THEORETICAL RATIONALE

Toward the end of his incisive critique of the administrative regime under industrial capitalism, Jurgen Habermas makes a seemingly innocuous observation. "In primitive stages of social development," he says, "the problems of survival – and thus man's experiences of contingency in dealing with outer nature – were so drastic that they had to be counterbalanced by the narrative production of an illusion of order, as can be seen in the content of myth," (1973 [1975]:119). Habermas holds that within industrial society expertise and efficiency supplant myth as the functionaries of social cohesion, capable of monopolizing meaning-making (1973 [1975]). However, as ecological disaster looms, inequality worsens, "alternative facts" mount, and people increasingly retreat to the comfort and consolation of familiar institutions, the use of myth in shaping and propelling worldviews appears as prominently as ever. Reasserting the significance of myth in no way constitutes a novel outlook. Long have social scientists recognized that even "modern societies are filled with institutional rules which function as myth depicting various formal structures as rational means to the attainment of desirable ends," (Meyer and Rowan 1977:345).

Just like the myths found in Habermas' "primitive stages of social development" these "institutional myths" bear a dual character: (1) They are rational explanations of social phenomena that prescribe action and (2) they appear in idealized forms that enjoy presumed legitimacy even if false (Meyer and Rowan 1977). By encouraging conformity to prevailing institutional logic these myths can serve as powerful sources of both organizational continuity and change. Neo-institutionalists remind us, "within any system having multiple levels or orders of organization, primary levels of organization can operate as institutions relative to secondary levels of organization," (Jepperson 1991:146). This bifurcation of institutions and organizations is critical as institutions define the environment in which organizations operate. Organizations conforming to rationalized institutional myths are more likely to be seen as legitimate, thereby improving their access to resources and, as a consequence, their chances of survival (Meyer and Rowan 1977). Thus, organizations will adhere to those institutional myths most likely to induce perceptions of legitimacy (DiMaggio and Powell 1983). The processes by which institutional myths are embraced and implemented by organizations, however, often eschew efficiency (DiMaggio and Powell 1983). Previous scholarship has demonstrated that "the formal structures of many organizations in postindustrial society dramatically reflect the myths of their institutional environments instead of the demands of their work activities," (Meyer and Rowan 1977:341). As such, tension exists between the goals of operational efficiency and organizational conformity to myth.

Meyer and Rowan (1977) maintain that organizations seek to avoid this forced choice in one of two ways. By erecting ceremonial facades that celebrate the institutional myth apart from the operational activities of the organization, firms can employ a "logic of confidence" that serves as an outward manifestation of their legitimacy within the field. Alternatively, organizations might "decouple" institutional myths from organizational practice by establishing ambiguous goals and avoiding integration between organizational components. Hallett and Ventresca (2006), by reasserting the role of everyday interaction and local practices, clarify how work activities and institutional ideals are capable of becoming "loosely-coupled." Foregrounding the ways in which individuals make sense of and enact local practices and institutional myths in everyday interaction, Hallet and Ventresca recount, "Although institutions penetrate organizations, it is through social interactions that institutions are interpreted and modified as people coordinate the activities that propel institutions forward," (Hallett and Ventresca 2006:215). While the "organizational field" proposed by DiMaggio and Powell (1983) as a unit of analysis may preserve the totality of relevant organizational actors, it does so at the expense of displacing individual action and diminishing the dynamism of institutional change. The organizational fields approach is carried off in a "macro-analytic drift," losing sight of organizations as venues for social interaction and obfuscating individual agency (Hallet and Ventresca 2006; Hallet 2010). At the same time, it is inattentive to institutional overlap and temporality, instead portraying institutions as inert and isolated from one another (Vallas and Kleinman 2008). What is needed is a view of institutions as inhabited by people and a unit of analysis that foregrounds the interactions between them. Institutions are not simply vessels in which individuals and organizations are carried, nor can institutions be considered in isolation, contained within an "organizational field." Institutions are inhabited with interaction (Hallett and Ventresca 2006; Hallett 2010). They are permeable and overlapping (Vallas and Kleinman 2008). Inhabiting new institutionalism with organizational activity and interactions garners a more robust understanding of organizational culture and internal meaning-making processes (Hallett 2010).

Applying the inhabited institution frame to portrayals of the Lehman Brothers bankruptcy gives gravity to the charge that "institutionalists have given ground too readily to market-based accounts of organizational change," (Fligstein 1991:312). Certainly, "the market" is not itself an actor. Market outcomes must be enacted by participants and the relationships of these participants to the market are only given meaning through interaction. Adapting the second of Herbert Blumer's three premises, as suggested by proponents of inhabited institutions, is instructive (Hallett and Ventresca 2006). "The meaning of [*the market*] is derived from, or arises out of, the social interactions that one has with one's fellows," (Blumer 1969:2). What follows is an interpretive process, whereby the meaning of the market is modified and managed (Blumer 1969). Thus, borrowing from Berger and Luckmann (1967), the market is a human product not perceived as such. The institutional logic of the market penetrates the interactions of market participants just as market interactions reenact this very institutional logic. The meanings ascribed by market participants are local and immediate precisely because they are institutionally embedded even if they are not recognized as such (Hallett and Ventresca 2006). The result is the reification of institutional myths. However, when these myths "become endogenous to organizations" they undergo further modification unique to their organizational constituencies (Hallett 2010:70). The meanings of institutional myths within organizations are, therefore, negotiated through localized interaction, but so too are the construction and transmission of myths as well.

Through a process of "asymmetrical convergence" partitions previously separating distinct institutions are dismantled allowing the institutional myths of one to invade and transform the myths of another (Vallas and Kleinman 2008). The development of institutional myths is not bound to a linear trajectory, as "institutions are not inert containers of meaning," (Hallett and Ventresca 2006:215). Occasionally, they are not "containers" at all. As the case of Lehman Brothers illustrates, in the wake of global financial crisis, executives merged their own guiding myth of "market efficiency" with the institutional myths of government. Following increased interaction with regulators, executives began integrating notions of "American exceptionalism" with the institutional myth of market efficiency. This process is termed "asymmetrical convergence" because colliding institutions do not meet on the same terms. One institution always assumes a position of dominance over the other, yet their positions are not static. Like the institutional myths they share, their statuses relative to one another are the product of the interactions between and among those who inhabit them. They are fluid, overlapping, and inhabited. Adopting an inhabited institution perspective illuminates how the organizational modifications of the institutional myth of market efficiency contributed to the acceleration of Lehman Brothers' failure.

METHODS

In order to evaluate how distinct organizational modifications of the institutional myth of market efficiency hastened Lehman's decline, I analyzed 924 emails and internal memoranda that were sent and received by Lehman employees during the two years immediately preceding the Lehman Brothers bankruptcy. Emails often included between four and six correspondents, but exchanges between as few as two employees or as many as twenty were not uncommon. All told, these emails represent the work of 196 employees and total 487 pages of transcribed text. The Chicago law firm Jenner and Block compiled these documents in late 2008 during the discovery period of the Lehman Brothers bankruptcy proceedings and the preponderance of emails collected are dated between January and September 2008. As a result of the bankruptcy hearing, all of the emails included in this research entered the public record and are now available upon request.

The research question "How do distinct organizational modifications of recognized institutional myths impact organizational failure?" guided the initial coding as I categorized the data according to the conceptual components of interest appearing in each email (Charmaz 2006). The second time through the data I applied axial coding in order to further examine the fit of those categories identified, with particular attention given to how negative cases informed the suitability of the categories that emerged (Strauss and Corbin 1990). Locating common themes among the conceptual components discovered during initial coding, I collapsed the data into three focused codes: “market expectations, “just the way it is,” and “good guys versus bad guys.” Following this second time through the data, I chose to narrow the scope of analysis to include only those emails coded “good guys versus bad guys.” This was the largest data group and included the greatest collection of individuals in leadership positions. Due to its size and the authority wielded by those represented, this was the only data group to receive additional treatment. Two rounds of non-exclusive, selective hierarchical coding followed whereby I further scrutinized those emails already coded “good guys versus bad guys.” Each email appearing within this portion of the dataset received coding related to the organizational actors identified and discussed therein. I followed a non-exclusive paradigm during this portion of coding with many emails being assigned more than one code, including, among others: “competitors,” “regulators,” and “rating agencies.” In order to establish a modicum of coder reliability, I completed this process twice and include only those emails coded the same way during both rounds in the final analysis and subsequent presentation of results.

As the institutional literature suggests that “the evolution of organizational language” is paramount to understanding organizational action, I took great care in both preserving and foregrounding respondent voice and temporal order within the data (Meyer and Rowan 1977:349). During initial coding and axial coding only the content of each email was considered. The author, recipient, and date upon which each email was sent did not factor in how data were coded during these first two rounds of analysis. Emails, however, are like bonds in that you cannot always take them at face value. The salience of temporality and the relationships between correspondents subsequently arose and both elements factored in the final stage of hierarchical coding.

The emails used as illustrations in the sections to follow are reproduced in their entirety. While only a handful of emails appear in the subsequent sections, they are representative of the themes expressed and exhibited by a great deal more. Those that do appear were selected for inclusion on the basis of how fully they embodied the theme referenced as well as their accessibility to those without previous exposure to the mechanisms of the financial crisis. Every effort was made to present the emails as they appear in court documents, preserving abbreviations, errors, and formatting when they do not impede coherence. Any corrections or clarifications made to the emails appear within brackets. I judged these bracketed changes to the original text to be necessary due to the frequent incidence of jargon as well as the use of stock ticker symbols in place of company names. In the interest of space, brackets are also occasionally used to identify those additional recipients not making contributions during the portion of the email chain presented. Ellipses signify that a portion of the email has been omitted. However, only salutations and inessential quantitative material was subject to deletion. The figures following each email correspond to unique document identification numbers used by the United States Bankruptcy Court For The Southern District Of New York to reference each exhibit in the Lehman Brothers Chapter 11 filing.

RESULTS

The belief that markets constitute the pinnacle of efficiency serves as the institutional myth around which action is oriented in the financial sector. Codified in the form of the "efficient market hypothesis," the institutional myth exists to legitimize not only the operation of markets, but also their outcomes. Market outcomes are justified as utility maximizing, which is to suggest that they secure the greatest possible good for the greatest number. First articulated by Eugene Fama, the efficient market hypothesis maintains that market actors seek to maximize utility and will consider all available information in fashioning rational expectations to guide their behavior in the market (1965, 1970). When new relevant information becomes available, actors will adjust their expectations and appropriately alter their behavior in accordance with a preference for maximizing their utility (Fama 1965, 1970). Market outcomes are, thus, the aggregate of all decisions made by actors in pursuit of their own self-interest and, in this way, deemed to be efficient. The myth of market efficiency is scientized through the theoretical models and recondite calculations of economic think tanks and university researchers, celebrated with Nobel prizes and the prestigious titles awarded to its champions, and enshrined in the curriculum of highly acclaimed business schools. Indeed, the efficient market hypothesis has even proliferated beyond the financial sector to become a principal tenet of neoliberalism (Harvey 2005).

Lehman Brothers, like all firms in the financial sector, respected the legitimacy of the efficient market hypothesis as the prevailing institutional myth through which market outcomes were understood and interpreted. During the company's fourth quarter earnings call in 2006, at a point when Lehman Brothers seemed poised for unrestrained growth, Chris O'Meara, the chief financial officer at the time, reported record revenue, adding:

> Underpinning these results was a favorable market environment, where business momentum picked up throughout the quarter. Although GDP growth continued to slow in most major economies over the period, global equity markets rose 6% in local currency terms during the quarter, due to better-than-expected corporate profitability, a decline in oil prices, and the market's anticipation of the end of the federal reserve interest rate tightening…
>
> The quickening pace of regulatory change could also serve as a catalyst for capital markets activity next year. Pension reform in the U.S. and Europe, Basel II, Regulation NMS on the New York Stock Exchange, MiFID or Market and Financial Instrument Directive in Europe, and penny pricing increments for U.S.

> options are all issues that will come into pay in 2007. We also see the forces of disintermediation continuing in 2007. For example, in the current year, Asia and Europe combined have accounted for half of completed and announced M&A volumes, 68% of equity issuance, and 48% of fixed income underwriting volumes. All of these percentages are up significantly from the past. (Lehman Brothers 4Q06 Earnings Call December 14, 2006)

Enjoying unprecedented success, O'Meara explained the company's optimistic outlook by appealing to the tenets of market efficiency. According to the efficient market hypothesis a "favorable market environment" is one that is unbridled by regulation, priced in the smallest practical increment to allow for more precise measurements, and globally diversified across open borders. O'Meara referenced each of these components in his earnings report. However, as Lehman's fortunes shifted, reliance on an undiluted market efficiency myth as an instrument of meaning-making was muted. Calls for deregulation, commitment to meticulous measurement as well as the attendant action it informs, and conviction regarding the benefits of global market diversity all disappeared internally as Lehman Brothers began modifying the institutional construct of efficiency prior to inhabiting the myth. These organizational modifications of the institutional myth of market efficiency are among the contributing factors accelerating Lehman Brother's collapse. Rather than accept the efficient market hypothesis as a kind of market dogma, Lehman Brothers crafted its own organizational modifications of the myth, which it then operationalized. This modification process is seen in the emails made publicly available during the firm's bankruptcy proceedings. Employees use distinct Lehman modifications of the efficiency myth, articulated within different cultural tropes, to make sense of market turmoil in the weeks and months prior to the company's demise.

Within the halls of Lehman Brothers the process of modification begins by qualifying the institutional myth. The cultural tropes that emerge as a result have the capacity to encourage unnecessary risk-taking when they assume a prophetic character or promise organizational invulnerability to systemic problems. Rather than reject the myth, employees qualify its application. Thus, preserving the recognized legitimacy of the myth in a way that is consistent with organizational aspirations. Wherever market efficiency is at odds with routine behaviors, the myth is reformed to reflect new and distinct organizational narratives similar to the original, but with divergent explanations for social phenomena. These organizational modifications are then conveyed through cultural tropes and accelerated by local level reenactment. They become, in effect, the localized version of the institutional myth. The processes outlined above are laid bare, when Lehman Brothers is forced to defend its real estate portfolio following a highly critical Barron's magazine article.

Subject: RE

From: Sellers, R Scot [@archstonesmith]
Sent: 19 January 2008 19:40
To: Augarten, David; Speyer, Rob; Packard, Coburn J; Walsh, Mark; Ashmun, Robert
Cc: [2 additional recipients]

…Thanks, here are some thoughts:

The principal mistake in the article is the assumption that public market share prices are in any predictive of real estate values, or represent an "efficient" market. I learned efficient market theory in business school, and it didn't take long as the CEO of a publicly traded company to realize just how wrong the public market gets valuations and even directionality from time to time. For instance, we purchased over 20% of our common stock back from 1998 through 2001 at an average price of less than $20/share, at a time when our stock traded at in excess of a 30% discount to the value of our assets. This period of time began with a similar (though not as significant) period of illiquidity in the markets (LTCM failure and Russian debt crisis) and the market overreacted by punishing real estate stocks.

Then, as now, the operating fundamentals were solid, and replacement costs were increasing, and the implicit per unit value of our portfolio (using our publicly traded share price) was at least 40% below replacement costs…

> Investors understand the incredible difficulty of amassing a significant portfolio of assets in the sub-markets we operate in, and therefore, place a very high value on the ability to acquire these types of assets, at any point in the real estate cycle. There may be points in time when transactional volume is limited (due to the unavailability of debt), but this will change, and the implicit value of the assets will become obvious to the market…
>
> The important thing to remember when faced with a situation like this is to look at longer term fundamentals. Investors who have rushed to liquidate anything in the face of an illiquid market, have always regretted these decisions. Fortunately, we have an investor group who understands long term value, and all you need to do is look at the successful NY real estate families to understand the tremendous value creation realized through long term ownership of assets in the markets we operate in.

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Despite the redolent placement of quotations around “efficient,” Sellers is not dismissive of the efficient market hypothesis. In fact, he opens his email with an appeal to its institutional legitimacy claiming to have “learned efficient market theory in business school.” He is quick, however, to resist its universal implementation arguing, “from time to time” the public market gets it wrong. Whereas the efficient market hypothesis seems to demand that Lehman Brothers reposition its real estate portfolio, a reallocation it does not have the liquidity to accomplish, the above modification of the myth permits intermittent inefficiencies when “the public market gets valuations and even directionality” wrong. This modification of the efficiency myth allows for “market overreactions” and indicates that during these occasional periods of instability “the important thing to remember… is to look at longer term fundamentals” and act in the investors best interest. Too many investors, Sellers warns, “have rushed to liquidate” positions only to regret it later.

Lehman Brothers’ organizational modifications of the market efficiency myth are communicated internally and carried forward externally using two cultural tropes, which profess, “*markets always recover*” and “*good guys always win*.” Together, these modifications foster a measure of organizational arrogance as they promote an impression of invulnerability. During periods of market instability bad firms fail, leaving the "good guys" to prosper when the market ultimately rebounds. This perspective motivates inaction under the pretense that "good guys" are insulated from short-term market volatility. Prior to its collapse, Lehman Brothers executives rejected at least five documented offers to sell the bank and avert the company's subsequent bankruptcy (Table 1).

Potential Buyer	Date of Offer	Date Declined	**Share Price at the time of Rejection**
Achieved all-time high on	*April 27, 2006*	*in advance of 2-1 split*	**$156.01**
China International Trust Investment Corporation	c. September 2, 2007	September 4, 2007	**$56.46**
Kuwait Investment Authority	January 8, 2008	c. January 10, 2008	**$57.82**
Korea Development Bank	January 31, 2008	February 1, 2008	**$66.00**
Warren Buffet	March 28, 2008	March 31, 2008	**$37.64**
Korea Development Bank	August 22, 2008**	September 9, 2008	**$7.79**
bankruptcy	*September 15, 2008*		**$0**

Table 1 – Proposed acquisition offers by date
** Korea Development Bank's August 22^{nd} offer was solicited by Lehman Brothers.

In the above email, Sellers modifies "market efficiency" toward the propitious promises of these two tropes declaring, "There may be points in time when transactional volume is limited, but this will change, and the implicit value of the assets will become obvious to the market." The reference to the assets' *implicit value* suggests that while the market may be incapable of determining the value of assets during occasional periods of inefficiency, Lehman Brothers appreciates their value because they "look at longer term fundamentals." Sellers is convinced that Lehman will survive the current downturn because Lehman does business the right way by acting on behalf of investors and operating with a long-term view.

Good Guys Always Win

Lehman's modifications are ardently defended by the firm's executive management, as evidenced in the following exchange between chief executive officer Dick Fuld and his mentor, chief legal officer and Columbia University Professor Thomas Russo. Anticipated by Meyer and Rowan (1977), amplification of compensatory ceremonies of confidence is characteristic of organizational structures increasingly reliant upon the legitimacy of institutional myths.

Subject: Tom

From: Fuld, Dick Sent: 11 April 2008 22:52 To: Russo, Thomas A Just finished the [Treasury Secretary, Hank] Paulson dinner A few takeaways// 1-we have huge brand with treasury 2-loved our capital raise 3-really appreciate u + Reiders work onm ideas 4-they want to kill the bad [hedge funds] + heavily regulate the rest 5-they want all the G7 countries to embrace Mtm stnds Cap stnds Lev + liquidity stnds 6-[Hank Paulson] has a worried view of [Merrill Lynch]- All in all worthwhile.
From: Russo, Thomas A Sent: 11 April 2008 23:14 To: Fuld, Dick We do it 4 the right reasons-and we must have faith that the "good guys" do prevail and will make things better 4 a company and a country. I feel it is really hard but we do have the drive and the ability 2 chang things 4 the better. It is that belief that will make [Lehman Brothers] special and a place where our children will be proud.

From: Fuld, Dick
Sent: 12 April 2008 4:47
To: Russo, Thomas A

You are a great teacher.
Thank you.

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Vindicated by their “huge brand with treasury,” the exchange juxtaposes the “good guys” at Lehman with the “bad hedge funds.” It is the “bad hedge funds” that have caused the market to operate inefficiently and need to be “killed” or “regulated” by Treasury. Thankfully, Lehman is “special” and knows how to weather periods of market inefficiency. While the Treasury Department seeks to induce a return to efficiency by implementing mark-to-market standards, capital standards, and liquidity standards, Lehman Brothers will continue to operate “for the right reasons” and “make things better for the company and country.” By exercising its “ability to change things for the better,” Lehman secures its standing among the “good guys,” which is crucial because “the good guys do prevail.” Thus, by doing things the right way and for the right reasons, the pair believes that Lehman can insulate itself from market instability without practicing the behaviors prescribed by the market efficiency myth. This mutually reinforcing deployment of the “good guys win” trope signals each correspondent’s confidence and commitment to maintaining the modification in the face of mounting external uncertainty. Commenting on this type of action, Meyer and Rowan note, “*The more an organization’s structure is derived from institutionalized myths, the more it maintains elaborate displays of confidence, satisfaction, and good faith, internally and externally*,” (Meyer and Rowan 1977:358 original emphasis). This is true for modifications of those myths as well. As organizational identity is increasingly defined by myth modification, ceremonies of confidence and group solidarity come to dominate organizational behavior.

The "good guys always win" narrative is embraced and repeated throughout the organization as a legitimizing trope. It is deployed and enacted in ways that both amplify and further adapt the organization's particular iteration of the institutional myth from which it derives.

Subject: RE: Lehman real estate exposure

> From: McGee III, Hugh E
> Sent: 11 June 2008 10:08
> To: Hash, Steven R; Beeson, Lisa E
> Cc: [4 additional internal recipients]
>
> We need a solution. Can we create a vehicle(trust) to dump a bunch of this into and give it to our share holders. They get upside and we get out of the "are we marked" correctly game. A bit like good bank/ bad bank.
> I think we need some creative thinking here for the home team.
> I will be convening a meeting this afternoon on this topic. Who else should we include?

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McGee's email finds the senior executive invoking Lehman's "good guy" narrative. For McGee embodying the "good guy" role is about more than modifying a decoupled institutional myth. It is about concrete action. McGee explains that by "creating a vehicle" capable of facilitating the transfer of illiquid collateralized debt obligations (CDO) "to our share holders," Lehman can "get out of the 'are we marked' correctly game," thus limiting its exposure to further losses by exiting its CDO positions. Here, myth modification motivates action. He implicitly draws upon Lehman's other dominant trope: "markets always recover," to assure his colleagues that the shareholders will "get upside" when values inevitably bounce back. McGee's proposed, and subsequently enacted, strategy is undergirded by the importance of preserving the perception that Lehman is the "good guy" for doing the right thing for its investors. He makes explicit reference to a "good bank/ bad bank" dichotomy, but remains confident that "some creative thinking" can secure a win for "the home team."

Markets Always Recover

Myth modification also motivates inaction. The firm's chief strategist, Dave Goldfarb, foregrounds Lehman's "markets always recover" trope to counsel the refusal of foreign investment by the state-owned and operated China International Trust Investment Corporation (CITIC). At a time when the efficient market hypothesis suggests Lehman should be deleveraging and plying every opportunity to shrink its balance sheet, Goldfarb mobilizes a familiar modification to motivate executive inaction and dismiss a capital infusion from CITIC.

Subject: RE: CITIC

From: Goldfarb, David Sent: 02 September 2007 8:42 To: Yang, Zhizhong Cc: Bhattal, Jasjit; Fuld, Dick I don't think we can issue convertible now, especially after Countrywide. This will signal a major stress sign (which obviously isn't true and will feed into rimors, etc) and put us in a category of those who needed infusion to help them out of this market mess. Good that they decided to kill request for return investment. Our salespoint is that we are just a better, more diversified and balanced investment then [Bear Stearns]. And we need to develop [joint venture] construct for non-Japan Asia, if we think that makes sense (probably excluding India as well). Also we need to explain why direct equity is the only way to partnership with us (assuming you all agree with me) and why convertible doesn't accomplish our objectives of modifying current shareholder base.
From: Fuld, Dick Sent: 02 September 2007 17:26 To: Goldfarb, David Dave Sounds to me like another non starter. If its just about price + not who is the right partner//then tell them [no further interest]

From: Goldfarb, David
Sent: 02 September 2007 17:32
To: Fuld, Dick

Agreed 1000 percent. How do you spell stupidity in Chinese!!!

---Redacted---

From: Fuld, Dick
Sent: 03 September 2007 20:45
To: Goldfarb, David

What happened-u didn't like my sumdum spelling??

From: Goldfarb, David
Sent: 03 September 2007 21:25
To: Fuld, Dick

I love it, better said then I could have!!! I think Mizuho is the best option for strategic partner. Any potential investor that would consider [Bear Stearns] in the same breath as [Lehman Brothers] should go fungoo themselves!!! Quarter looks like we talked about few weeks ago- in and around 4,250. Not terrible, not great-but it is what it is. Ready to rock and roll for rest of year, hopefully Fed will be accomodating and helpful.

From: Fuld, Dick
Sent: 03 September 2007 21:26
To: Goldfarb, David

I agree we need some help-but the BRos always wins!!

From: Goldfarb, David
Sent: 03 September 2007 21:36
To: Fuld, Dick

Absolutely, will and skill always win, and that be us!!!!

From: Fuld, Dick
Sent: 04 September 2007 2:04
To: Goldfarb, David

Got it + so do u

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The reassurances Goldfarb and Fuld elicit from one another amplify myth modification. Goldfarb calls upon the "markets always recover" trope to explain why a CITIC investment is unnecessary to "help them out of this market mess." At the same time, he is worried that accepting such an investment would dilute shareholders and jeopardize Lehman's position as a "good guy." Fuld vindicates Goldfarb's assessment and instructs him to "tell them [no further interest]." In return, Goldfarb validates Fuld by agreeing "1000 percent." He continues that though their quarterly earnings are "not terrible, not great," markets always recover and they are prepared "to rock and roll for rest of year." At this point, Goldfarb and Fuld return to the familiar "good guys always win" narrative.

Throughout this interaction, Goldfarb and Fuld are so engrossed in propping up and expanding organizational modifications that they are unable to recognize how their inaction imperils Lehman's very existence. Both reaffirm the other's reliance upon local myth modifications. They find in one another mutual support for employing the organizational tropes to justify inaction. Goldfarb speculates that accepting the investment may "signal a major stress sign (which obviously isn't true)" while Fuld suggests that "if it's just about price," Lehman has no further interest. Both use the combination of prevailing modifications resulting from their interaction to portray Lehman Brothers as stable and not in need of foreign investment.

Asymmetrical convergence between government and Wall Street further fuels this perception of predestined prosperity within Lehman. An August 2007 Federal Reserve bailout of Countrywide Financial, increases the level of scrutiny and attention from government regulators, who possess their own institutional myths. Increased coordination between Lehman employees and government regulators occasions a collision between the institutional myths that organize their respective fields. Following protracted exposure to and cooperation with regulators beginning in August 2007 with government intervention in the credit market and carrying through to the firm's September 2008 bankruptcy, Lehman employees began incorporating the government's institutional myth of "American exceptionalism" into modifications of their own market efficiency myth. The prior email between Fuld and Russo serves as a perfect illustration. "Good guys" prevail not only because they do the right thing for the company, but also because they "make things better for [the] country." In the previous email Fuld and Goldfarb denounce what they see as Chinese stupidity and express a tepid confidence in the conventions of American government. As Lehman employees interact with regulators with greater regularity, the incorporation of "American exceptionalism" within modifications intensifies following a temporal arch, which can be traced through email exchanges. To briefly illustrate, consider that in September 2007, employees are hopeful that the "Fed will be accommodating and helpful," but by April 2008 they are proclaiming that Lehman "will make things better for [the] country." This convergence does not, however, constitute an institutional shift. Lehman is not becoming a government agency, nor does it desire to do so. Lehman employees are forced to interact with government regulators more routinely and so must navigate new and disparate views of legitimate action. As such, Lehman employees use "American exceptionalism" normatively within their myth modifications to legitimize existing behaviors and position themselves among the good guys.

While modifications consistently culminate in the articulation of at least one of Lehman's two dominant cultural tropes, that is: "markets always recover" and "good guys always win," as above, these modifications are achieved by discrete action occurring in varied ways. Those who do not occupy leadership positions at Lehman Brothers, for example, construct modifications quite differently from firm executives.

Subject: RE: Initial results for resi and commercial exposure.

From: Thatcher, Kevin
Sent: 10 June 2008 10:53
To: Lowitt, Ian T
Cc: Tonucci, Paolo; Sayani, Faizal

Ian,
Here are the results in tabular format. Faizal is putting together some more insightful graphics which we will send to you shortly.

Right now, here are our exposures vs. [Goldman Sachs]/[Morgan Stanley]/[Merrill Lynch]

…

From: Lowitt, Ian T
Sent: 10 June 2008 11:24
To: Thatcher, Kevin; Sayani, Faizal

Actually wondered if could exclude the gross up only. Isn't that a subset of [Real Estate Available for Sale]? Ian

From: Sayani, Faizal
Sent: 10 June 2008 11:25
To: Lowitt, Ian T; Thatcher, Kevin

We are not including the gross up. RAS is the only 'at risk' position.

From: Lowitt, Ian T
Sent: 10 June 2008 11:26
To: Sayani, Faizal

Is that true for competitors?

From: Sayani, Faizal
Sent: 10 June 2008 11:28
To: Lowitt, Ian T
Cc: Thatcher, Kevin

We are taking the 'at risk positions' for all competitors (i.e. no gross ups.) Peers seem to include Real Held for Sale within their Mortgage Inventory numbers. Merrill specifically states that.

From: Lowitt, Ian T
Sent: 10 June 2008 11:30
To: Sayani, Faizal
Cc: Thatcher, Kevin

Is that what Fitch does or do they use the grossed up numbers?

From: Thatcher, Kevin
Sent: 10 June 2008 12:57
To: Lowitt, Ian T; Sayani, Faizal
Cc: Tonucci, Paolo

Here are the graphs that I promised you. They are based on the data that we sent you earlier and show that on an absolute and relative basis, Lehman has an outsized exposure to commercial real estate relative to its comparables (although the degree of this overexposure is slightly less when looking at leverage equity vs. tangible common equity). At the same time, we look very good from a residential perspective (especially when compared to [Merrill Lynch]).

I have a call in to Fitch and will ask if they look at "at risk" positions vs. gross ups.

Call if you have any comments on the graphs or further questions.

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The cadre of middle managers in the above exchange expands the process of myth modification such that the hallmark of the "good guy" is entirely relative. Unlike the company's executives, these Lehman employees do not view "good" as absolute, but rather anchored against the actions and positions of marketplace competitors as well as the expectations of rating agencies. When deciding how to report the firm's real estate exposure, this group is preoccupied with "what Fitch does" and what is "true for competitors" rather than asking which reporting method would be of greatest benefit to the shareholders, as we might expect of Lehman's executive leadership. This should not be taken to mean that lower-level employees do not invoke the same modifications as those situated higher up in the organization. This is simply a different construction of the same modification; one in which "goodness" is determined in relation to other organizations occupying the institutional environment. Middle managers still produce meaning in terms of "good guys" and "bad guys." Yet, they only recognize one through its opposition to the other. Lehman is not just a "good guy," but "very good… when compared to Merrill Lynch." Incorporating a relative perspective produces the same modification by different means.

This employee group's relational construction of what constitutes "good" organizational conduct reveals how mechanisms of mimetic isomorphism are more active and intentional than previously theorized. DiMaggio and Powell first explicated mimetic isomorphism saying, "Models may be diffused unintentionally, indirectly through employee transfer or turnover, or explicitly by organizations such as consulting firms or industry trade associations," (1983:151). The above wrangling with whether to include real estate available for sale in calculations offers a view of mimetic isomorphism as practiced at the local-level. This perspective counters the view that "…organizational change is unplanned and goes on largely behind the backs of groups that wish to influence it," (DiMaggio and Powell 1983:157). Lehman Brothers' middle management demonstrates that mimetic isomorphism can be a reflective process rather than a reflexive response. Far from coalescing out of the ether, mimetic isomorphism is consciously pursued by Lehman employees in consultation with one another. These managers actively deploy isomorphism as a method to simultaneously modify institutional myth and legitimize resulting modifications. For this group, the efficient market myth is not a normative feature of finance, but a fluid function contingent on competitors' calculations. Organizational behavior can be evaluated only in relation to other organizational actors. As Lehman occupies a favorable position relative to some competitors, Lehman is perceived as "good."

Institutional myth modification is enacted at all levels of Lehman's organizational hierarchy, but while it is always oriented toward the same end, its construction takes different forms. Both analysts and executives reproduce distinct Lehman modifications of the efficient market myth through interaction. The resulting "markets always recover" and "good guys always win" narratives serve as instruments of sense-making during periods of uncertainty.

In fact, the only irredeemable transgression seems to be the failure to modify the myth at all. Voicing his concern regarding the magnitude of Lehman's illiquid assets, Matthew Lee, a senior vice president of global finance inhabits the institutional myth of market efficiency unaltered. He is quietly laid-off less than two weeks later.

Subject: Personal and Confidential

> From: Lee, Matthew
> Sent: 18 May 2008 15:41
> To: Callan, Erin
> Cc: [3 additional internal recipients]
> …
> The Firm has tens of billions of dollar of inventory that it probably cannot buy or sell in any recognized market, at the currently recorded current market values, particularly when dealing in assets of this nature in the volume and size as the positions the Firm holds. I do not believe the manner in which the Firm values that inventory is fully realistic or reasonable, and ignores the concentration in these assets and their volume size given the current state of the market's overall liquidity.

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Lee, despite the protestations of management to the contrary, does not believe that Lehman is capable of discerning "realistic and reasonable" asset valuations absent an efficient market. More condemningly, he refuses to indulge the belief that markets always recover and presses the firm's leadership to recognize "that it probably cannot buy or sell" many of its holdings "given the current state of the market's overall liquidity." Lee implores his superiors to dispense with the delusion of inevitable market recovery and instead acknowledge "current market values." By appealing to the established and broadly accepted institutional legitimacy of market efficiency, Lee's trepidation threatens to supplant Lehman's myth modifications with the myth itself. Lee asks Lehman to abandon the pretense that "good guys always win" and accept a momentary defeat so that it can ultimately survive. Instead Lehman abandons him.

CONCLUSION

Lehman's organizational culture emerged from distinct modifications of the institutional myth of market efficiency and engendered an inhabited organizational arrogance that contributed to the acceleration of the organization's failure. Previous scholarship implicates deviance and routine nonconformity in organizational failure. The bankruptcy of Lehman Brothers demonstrates that wonted organizational culture and conformity to it can be just as pernicious. Considering, for the first time, the fall of Lehman Brothers as it happened, this piece situated an analysis of company correspondence within an inhabited institutions perspective to reveal the ways in which local-level reenactment of organizational culture can contribute to the acceleration of organizational failure. The inhabited institutions perspective deployed in this piece allows us to see how employee interaction acted as the vehicle for myth modifications. An inhabited approach emphasizes the role of group behavior, which is to say that it affirms the transformative potential of people doing things together. The construction of organizational modifications of the efficient market myth by Lehman employees in the weeks and months preceding bankruptcy diverted attention from the firm's risk of insolvency and fostered a shared sense of invulnerability to institutional trends. Adopting an inhabited approach demands acknowledgment of the importance of local interaction in shaping the organizational culture and demonstrates how particular modifications come about through interaction in ways that qualify, negotiation, and transform the meaning of the myth. For Lehman, the product of employee interaction was an organizational culture incapable of either foreseeing or forestalling the ineffective operations that hastened the firm's decline. Lehman Brothers was not the first, largest, or most highly leveraged firm to experience insolvency as a result of the Great Recession, but it was the only investment bank to declare bankruptcy during that period. It is time to count Lehman's organizational culture among the many factors contributing to its failure.

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VITA

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