The behavior of the community is largely dominated by the business mind. A great society is a society in which its men of business think greatly of their functions. Low thoughts mean low behavior, and after a brief orgy of exploitation, low behavior means a descending standard of life.

—Alfred North Whitehead

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# Preface: Short Books and Their Authors

For readers, the great advantage of short books in a harried age is that their time commitment is limited. They can spend their allotment of reading time among a number of books and articles rather than on just a few lengthy treatises.

But short books also have disadvantages. The main one is that their limited length leaves little space for documentation and elaboration. This leaves the reader more dependent on the author's judgment. To some degree, it obliges readers to take the author's assertions on faith. In a longer book, there is greater opportunity to cite sources, to elaborate, to present detailed evidence in support of controversial positions.

Authors of short books are obliged, therefore, to give readers some assurance that their assertions have a solid basis in fact and/or experience. They must present their credentials for inspection. Why should you, as readers, be willing to consider seriously the many claims I make in this book about the current state of business ethics and how they might be upgraded? What assurance can I give you, as readers, that I will serve you as a reasonably reliable guide through the thickets of

such an elusive and subtle subject, especially since I am neither a celebrated CEO nor a well-known expert on the subject?

My main qualification as a guide is that I am able to bring the perspective of *privileged witness* to the issue. By "witness" I mean the practical experience of having served on a wide variety of corporate boards of directors and trusteeships—fifteen or so—over a period of thirty years. (For a complete list of these boards and trusteeships, see the Appendix.) These boards frequently encountered the sorts of ethical dilemmas discussed in the chapters that follow. I have been steeped in the practical experience of having struggled with these kinds of ethical issues in a number of different settings, companies, industries and not-for-profit enterprises.

Often, I felt out of place on these boards. Many of my fellow board members were CEOs of other large corporations, bankers, corporate attorneys and accountants. My background and professional qualifications were quite different. I am a social scientist and researcher whose work involves analyzing public opinion and tracking social/cultural trends. In this capacity, I acted as research consultant to many corporations in addition to those on whose boards I served. On these boards I was privileged in the sense of bringing a distinctive and special perspective to bear. The perspectives of business executives and of social scientists like me differ markedly. Not surprisingly, my viewpoint often diverged from that of my fellow directors. To "diverge from" does not necessarily mean "to disagree with." Most of the time, it simply meant that we saw events from different standpoints. Diversity of perspectives is essential in resolving troublesome issues. It prevents groupthink, which I have come to believe is the main enemy of sound judgment on complex issues. To provide such diversity of point of view was one reason I was invited to serve on these boards.



There are many experienced corporate board members qualified to write this sort of book, just as there are many equally qualified social scientists. But there aren't many individuals who straddle both worlds. It is that experience of having straddled both the corporate and the social science worlds for decades that gives me the confidence to plunge into so controversial a subject and to offer what I believe are a number of sound practical recommendations.

A number of people contributed significantly to the style, the substance, and the research underpinnings of this book. First and foremost is my gifted wife, Barbara Lee, whose research skills gave the book a concreteness of examples and a depth of documentation it otherwise would not have had. And I want to acknowledge the invaluable help of my business associate Isabella Furth, who made important contributions to the preparation and drafting of the manuscript.

A number of my friends, all apparently endowed from birth with critical judgment, helped me to maintain a sense of balance and kept me from going overboard on a number of subjects about which I have grown cranky. I want to express my gratitude to Professor Emeritus Robert Weiss, of the Harvard Medical School, and University of California, San Diego, Professors Peter Gourevitch, Michael Schudson, and Sandy Lakoff for reading the full text and giving me the benefit of their understanding of the social/political/historical context in which the changes I recount in the book have taken place. I am also grateful to other friends, associates, and family members—Norton Garfinkle, Laura Nathanson, Nicole Mordecai, Steve Rosell, T. George Harris, Ruth Wooden, Hershel Sarbin, Arthur White, Leon Shapiro, and Dorothy Zinberg—who read the manuscript, gave me the benefit of their critiques, and added

deep insights into the unfolding events of the day. It made writing almost pleasurable.

I want to extend special thanks to another group of friends who bring a unique perspective to the manuscript. They are CEOs with whom I have worked over the years on corporate boards and other projects: Pete Peterson (the Blackstone Group), John Pepper (Procter and Gamble), Sandy Grieves (Ecolab), Sidney Harman (Harman International), Jack MacAllister (US West), Thomas "Mack" McLarty (Arkla), and Robert Burnett and Jack Rehm (Meredith Corporation). All have taken the time and trouble to read the manuscript and to bring their personal experiences to bear on its message, underscoring its urgency and practicality.

Richard Atkinson, former Chancellor of the University of California, and Paul Drake, Dean of Social Sciences at UCSD, gave me valued encouragement from the perspective of their academic experiences.

My editor at Yale University Press, Jonathan Brent, contributed many insightful suggestions for improving the text.

Reagan Espino and Dorothy McCarthy both provided unflaggingly cheerful help with preparing the manuscript.

# Profit with Honor

# Introduction: How to Profit from the Scandals

The purpose of this short book is to suggest that the business community can turn the scandals of recent years to good use, both for business itself and for the larger society. The scandals have shocked the business sector into realizing that something is seriously wrong with its current practice, and that to regain the trust of the American people it must institute far-reaching changes—or else suffer punitive reforms imposed by government. The most badly needed changes are ethical in character, and taken together they represent a new stage in the evolution of market capitalism.

My main argument in the book is that the time has come for market capitalism in the United States to advance to a new stage of enlightened self-interest. American business needs to develop a new ethic—a coherent set of social norms—both to counteract the forces leading to the scandals and to meet the challenges of the global economy that call upon business to take on many new responsibilities. The good news is that some

leading corporations are moving in this direction. The bad news is that most are not.

The vast changes taking place in the global economy make it essential that we evolve to a new stage of market capitalism. Coincidentally, to put the scandals behind us we also need a higher standard of ethical norms. The same set of norms, one that I am calling "stewardship ethics," can serve both purposes. Many years ago, the philosopher Alfred North Whitehead observed that "a great society is a society in which its men of business think greatly of their functions." Whitehead believed that business leaders should broaden the orbit of their concerns from those of their individual company or industry to the society at large. I would like to add that a great society is one in which its business, political, and civic leaders (men *and* women) exercise their leadership within a frame of stewardship ethics.

## Once Again, a Perfect Storm

The proliferation of recent business scandals has created a wave of public mistrust of corporate America. The mistrust, in turn, has led to onerous new regulations, to the humiliation and imprisonment of once-admired business leaders, and to an automatic presupposition that the business community is guilty of bad faith. Nowadays, few business leaders are given the benefit of the doubt when their companies run into difficulties. The assumption is, "They must have done something wrong."

The scandals cover a wide swath of corporate behavior. They range from gross criminality (Enron, WorldCom, Tyco, Adelphia), to the petty legal mistakes of Martha Stewart, to the steep fines and embarrassing revelations that have ensnared



some of the nation's premier companies, such as Fannie Mae, Citigroup, Merck, AIG, Boeing, Shell, JP Morgan/Chase, and Marsh and McLellan.

Why is our culture suddenly confronted with so much corporate wrongdoing? What are the forces giving rise to the scandals?

As time passes and we gain perspective on the first mega-scandal—the 2001 Enron/Arthur Andersen implosion—the causes for the business scandals begin to grow clearer. The scandals are not the result of a national outburst of greed, contempt for the law, the arrogance of power, or a breakdown in corporate governance, though elements of each are present. The main cause is an extraordinary convergence of three trends, the sort of rare phenomenon that generates what people like to call "a perfect storm."

One trend is deregulation. The rage for deregulation that dominated the 1980s and 1990s had many unintended effects. By removing the legal restrictions that prevent blatant conflicts of interest, deregulation tempted some of the gatekeeper guardians of the public interest to sacrifice the principles of their professions for their own economic gain. Deregulation had the perverse consequence of transforming the gatekeepers—the accounting firms, the investment bankers, the business law firms, the regulatory agencies—into enablers. Instead of saying a firm "no" to questionable business initiatives, many of these supposed watchdogs (like the once highly regarded accounting firm, Arthur Andersen) said instead, "Here's how you can do it and get away with it."

Converging with deregulation is the second trend—the practice of linking the richest part of CEO compensation to the vagaries of the stock market. Tying executive incentives to the price of the company's stock has become common prac-

tice. The intention is to align the interests of a company's managers more closely with those of its owners—the company's shareholders. This is the most popular way the economic doctrine known as "shareholder value" has been implemented. In practice, however, rewarding executives with stock options potentially worth tens of millions of dollars on top of rich salaries and bonuses has proven to be a debasement of the theory. With such huge sums of money at stake, the company's executives are sorely tempted to take questionable shortcuts, or even to cheat. The pressures on a CEO to put the short-term price of his company's shares ahead of the long-term interests of the company, its employees, and the society as a whole become almost irresistible.

The third and more intangible trend is the steady importation of social norms from the larger culture into corporate life. Ironically, American business, whose deepest tradition is rooted in the ethic of enlightened self-interest, now finds itself caught up in a frenzy of *un*enlightened self-interest. Traditional enlightened self-interest led business executives to search for strategies that benefited others as well as themselves. But the cultural norms of recent years celebrate an ethic of winning for oneself—a zero-sum social Darwinian conception of winning under which if I win, you lose. Fear of the consequences of losing is part of this outlook, as is an offhand attitude toward "gaming the system." Many of today's business executives consider it a challenge—and fun—to find ways to manipulate the system for their own personal benefit.

The convergence of these social norms from the general culture with the business norms of deregulation and the perversion of shareholder value creates conditions for the perfect storm. Combining these forces invents a machine for scandal. Their convergence made the scandals almost inevitable.



## What Is the Cure?

It would be a great relief to say that now, in the light of our experience with so many scandals, our business sector is finally taking the right medicine to cure itself. But unfortunately, this is far from the case. The medicine we *are* taking—a heavy dose of legal and regulatory actions—may be necessary, but it is far from sufficient.

Laws and regulations by themselves do not ensure compliance. One of the most prominent features of the scandals is gaming the system—finding clever ways of circumventing the rules and regulations. Accounting and financial management firms seek ways to "smooth" earnings and get around strict accounting standards. Law firms quickly come to understand that legal counsel advising against a questionable course of action wins them scant business or applause. A law practice prospers only when its attorneys are able to advise their clients how they can maneuver their way around the law. Without a normative climate that encourages compliance with laws and regulations, clever people will be tempted to skate on ever-thinner ice—and risk falling through it.

History shows that you cannot fight bad norms solely with laws. The failure of Prohibition in the 1920s—the doomed effort to use the law to prevent people from consuming alcoholic beverages—is only one case in point. The recent scandals present us with a lethal combination of bad norms and bad regulations. The key to successful reform is to combine regulations and norms in such a way that they mutually support each other in encouraging companies (and gatekeepers) to do the right things, not the wrong ones.

Sometimes we do need to resort to legal remedies. Some scandals feature serious violations of the law calling for serious

punishment. Few would argue that Bernie Ebbers, the founder of WorldCom, does not deserve his prison term. But most of the scandals—the rip-offs, the conflicts of interest, the "creative accounting"—constitute ethical rather than criminal violations. Our society is already too long on legal approaches to problems and too short on ethical ones. The legal/regulatory side of business, however important, can neither fully account for the scandals nor prevent them in the future. Only a transformation of ethical norms, supported by the right kind of regulation, can do so.

The concept of norms plays a major role in this book. Norms are social values—the unwritten rules that dictate what sorts of behavior are acceptable or unacceptable. Norms refer both to standards for acceptable behavior and to punishments meted out to those who violate the standards. Norms are often specific to particular social roles or subcultures. Every individual is subject to a wide variety of norms that overlap and sometimes conflict. In general, though, norms tend to cohere. A coherent set of norms constitutes an ethic: a generalized way of understanding one's relation to others in a tightly organized polity and society.

My focus on norms is not intended to detract from the importance of the legal/regulatory side of business. But just tightening the law, throwing some high level executives in jail, and changing the governance rules of boards of directors, however desirable or necessary, will not be sufficient to raise the level of corporate ethics. To counteract the scandals, the normative side of business must receive priority at the same time that the legal side is being strengthened.

My emphasis on norms differentiates this book from most recent writing on the corporation. Over the past forty years much scholarly work on the corporate sector has focused



on corporate governance—the legal and regulatory mechanisms for managing the problems that arise from the conflicting interests of various stakeholders, especially the separation of corporate ownership and control. Business corporations have always stirred up conflict and legal dispute because the stakes are so high. The stakes concern money and power and influence and issues of control—things people fight about. In democracies, the law often settles the fights. Scholars therefore write about contracts and regulations and legal disputes. Recently, some noted scholars have added politics to the mix, because decisions about what gets regulated and enforced are often the product of political struggle. As the political scientist Peter Gourevitch observes: "It is no wonder . . . that corporate governance provokes conflict. . . . Anything that shapes wealth, opportunities, stability, and corruption is sure to attract the concerns of the powerful and provoke the anxiety of the weak. Everyone has a stake in the corporate governance system, and everyone has an interest in how it is structured. . . . We believe that corporate governance structures are fundamentally the result of political decisions."[1]

But the law is a blunt instrument, especially when it is the product of political negotiation, and there is only so much that government can do to influence corporate behavior. Efforts to combat ethical shortcomings with legal restrictions emphasize blame, constraints, fines, jail sentences, and other negativities. If you want positive results, you need to give people a positive basis for trust and respect and an ethical vision to live by, not merely severe punishments for misdeeds. The law can't inspire the far-sighted corporate leadership that is so badly needed. It can't enhance the contribution that the business sector can and should make to the larger society. To achieve these broader goals, we need to look to the cultural and human side of cor-

porate life—to the values and motivations and belief systems of people.

There is nothing novel about this emphasis. Way back in 1932, in their classic work on the corporation, Adolf Berle and Gardiner Means spoke of their fear that "power, prestige or the gratification of professional zeal" might distract managers from their main task of making money for the company's shareholders.[2] Add to these such newer temptations as the sheer magnitude of the rewards for cheating (tens of millions of dollars) and the powerful rationalization that as long as you aren't breaking the law, you aren't doing anything wrong. These are not legal matters; they are matters of values and ethical norms.

Business scandals constitute just one symptom of normative confusion in the nation. There are countless others—the troubles of the Catholic Church, the blind spots of the Congress in budget making, the corruptions of state and city government, the muddled priorities of the American Red Cross, even baseball's steroid scandals.

I have chosen to focus on ethical confusion in the business sector for one reason above all others: I believe that the chances for success are better here than in other spheres of American life, and that a high standard of ethical clarity in the business sector will help to dispel moral confusion in the culture at large. In our country, the business sector occupies a role of centrality and prestige. As the source of our economic well-being, its health and vitality are immensely important to Americans. Just yesterday, CEOs like G.E.'s former chairman, Jack Welch, Chrysler's Lee Iacocca, and Intel's Robert Noyce were culture heroes, models to emulate. If business gets its ethical act together, it may well serve as a model and inspiration for others to do the same.

The four-hundred-year history of the limited liability corporation is replete with scandals, reforms, abuses, midcourse



corrections, and redirected energies. The present moment gives the business sector a splendid opportunity to transform scandal, embarrassment, and mounting public mistrust into revitalized ethical standards that will be good for business, good for the nation, and good for the world.

Capitalism has always been a work in progress, never a finished product. Marxists have always underestimated the flexibility of capitalism and its ability to adapt to changing circumstances. The father of modern capitalism in the eighteenth century, Adam Smith, was a moral philosopher, attributing to human nature an inborn empathy for others. It was this presupposition that gave credibility to his master concept of "the invisible hand," which made the economic pursuit of self-interest compatible with the interests of the larger society in what Smith called a "society of perfect liberty."[3] Capitalism has always aligned itself with this concept of enlightened self-interest. The key question—the one that dominates this book—is how best to apply it to our own historical era.

Potentially, our nation's prospects for upgrading corporate ethical standards are quite good, for two reasons. One is rising expectations from outside the business sector; the other is a growing urge for reform within the business sector itself.

Business leaders are growing more aware that new expectations are in the air. In the words of Samuel Palmisano, CEO of IBM: "All businesses today face a new reality. . . . Businesses now operate in an environment in which long-term societal concerns—in areas from diversity to equal opportunity, the environment and workforce policies—have been raised to the same level of public expectation as accounting practices and financial performances."[4]

In a statement published in the April 7, 2005, *New York Review of Books,* Lee Scott, the CEO of Wal-Mart Stores, defended the giant retailer against its critics. Wal-Mart is a gi-

gantic enterprise: it employs a million people; in 2004 its sales exceeded $260 billion. The final paragraph of Scott's two-page ad illustrates a business awakening that is still at a very early stage. Scott writes: "To be honest, most of us at Wal-Mart have been so busy minding the store that the way our critics have tried to turn us into a political symbol has taken us by surprise. But one thing we've learned from our critics . . . is that Wal-Mart's size and industry leadership mean that *people expect more from us. They're right to, and when it comes to playing our part . . . we intend to deliver*" (emphasis added).

Cynics may sneer at Wal-Mart's newfound religion and dismiss it as mere public relations—empty rhetoric covering hard-core hypocrisy. And so, indeed, it may turn out to be. But it may also turn out to be a far more benign phenomenon, a sign of responsiveness to changing expectations. Typically, responsiveness starts with a change in corporate attitudes at the leadership level, followed eventually by a significant change in corporate behavior.

We *do* expect more from the giant multinational corporations of our era. Under the right conditions they *can* deliver. We look to Toyota and other car manufacturers to lessen our energy dependence; BP, Shell, and other oil companies to search for alternative fuels and practical remedies to the threat of climate change; G.E., Procter and Gamble, and other giant international companies to open new markets in developing nations; General Motors and other large employers to help resolve the health care crisis; Citigroup and other financial institutions to address the capital needs of poor people in developing nations; Microsoft and other technology companies to digitize the world; the corporate sector in general to assist poor nations in securing the training, education, and resource management they need to enter the global economy.



The challenge to business is, in part, a matter of responding to these heightened expectations. Only a small number of businesses are currently responding well to the challenge. Many more are capable of responding skillfully and effectively.

## Ethical Stirrings within Business

My decades of research on American attitudes and values have led me to the conclusion that existing standards of business ethics are too weak to stop the scandals and restore trust. Our corporations need to adopt a higher standard of ethics.

The corporations I have worked with personally (either as a board director or consultant) operate at several levels of ethical standards. The lowest level is one in which the legal department is consulted to make sure that the company is not breaking any laws, or at least none whose violations might get them caught. The next level up is the ability of company policies and actions "to pass the smell test"—a term of art in business circles to refer to proposals that meet minimum legal requirements but fail to adhere to the society's conventional ethical standards. In many companies, there is at least one board director who can be counted on to say in response to a fishy-sounding proposal, "Well, maybe it's legal, but it doesn't pass the smell test." More than half of the companies I have worked with use the smell test as their everyday ethical working guide to action.

Figure 1 illustrates the hierarchy of current ethical standards in the business sector. The lower two-thirds of the pyramid reflects the dominant mores—staying within the law and passing the smell test. The top one-third symbolizes a higher standard of ethical norms.

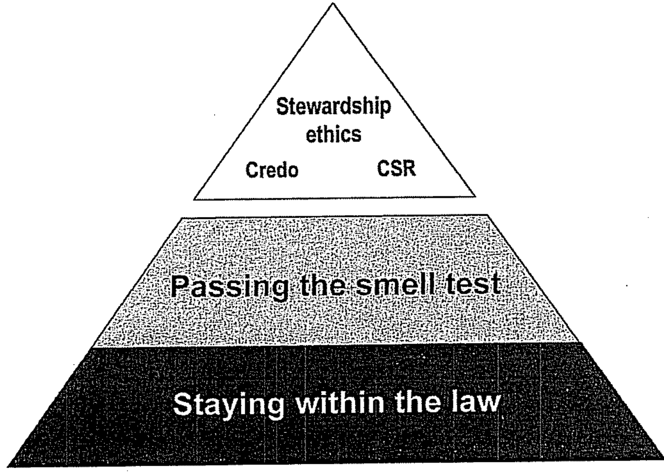


Figure 1. The hierarchy of ethical standards

In the wake of the business scandals, increasing numbers of companies are seeking to achieve the higher standard represented by the top third of the pyramid. The most traditional way of pursuing that goal is by way of a company credo—often articulated by the company's founder and maintained by his successors. Some companies faithfully live by such credos and internalize them within and throughout the company. Enron, which famously touted its high-minded credo, has cast a shadow over the practice of publicizing company credos. But companies like Johnson and Johnson with long-established credos see Enron as a symptom of flagrant hypocrisy and stick by their own tradition.

The Corporate Social Responsibility movement (CSR) represents a more recent form of striving toward higher ethical standards. For a variety of reasons spelled out in subsequent chapters, CSR has not caught on in corporate circles as



well as its advocates hoped it would. The early advocates of CSR in the 1960s, 1970s, and 1980s came mostly from the nonbusiness segments of society. They spoke in the off-putting accent of moral superiority, and they betrayed ignorance of business realities, making demands that threatened to weaken the competitive positions of companies. Moreover, their tactics were often self-defeating: they would target the most responsive companies, returning with new demands to the same company again and again, causing these companies to feel like fools for responding so readily.

CSR's biggest liability was that its early proponents had a deeply ambivalent attitude toward corporate profits. Many of them wanted to see companies that followed CSR principles make a profit, but profit making was a secondary consideration, and for some barely an afterthought. To put it mildly, this tendency limited CSR's appeal to the corporate sector.

In this earlier period of CSR's existence, the philanthropic activities of most companies consisted of writing a check (sometimes quite a fat one, as in Mobil's sponsorship of *Masterpiece Theatre*). The marketing guru Philip Kotler points out that CSR evolved into a more businesslike enterprise in the 1990s.[5] Many companies that had avoided causes related to their businesses, to avoid appearing to be self-serving, did a 180-degree turn. They focused their involvement on activities of concern to their employees and customers and related to their core businesses—for example, Shell started to cooperate with environmental groups, and Dell began a program of recycling of computers at no cost to purchasers.

The concept of stewardship ethics that I develop in this book puts more emphasis on profit than do most CSR initiatives. My conception of stewardship ethics retains profit making as a top corporate priority. But it takes the further position

that, with sufficient effort and the right sort of strategic analysis, the business sector can do a far better job than it has in reconciling profit making with taking better care of its employees, its customers, its community, and the larger society. As CSR evolves, it is likely to overlap with stewardship ethics more than it has in the past. But the emphases of the two codes of ethics are different. With its roots outside the business sector, the interests of CSR will naturally focus on the social good that corporations can do, irrespective of their profitability; stewardship ethics will focus on decisions that advance the good of the company. When General Motors had a choice years ago to invest its capital either in acquiring Hummer or in making more fuel-efficient vehicles, it chose Hummer. In retrospect, it would have been far better off today if it had made the business (and existential) choice that devotion to stewardship ethics would have dictated.

There is nothing novel about the concept of stewardship. The word is familiar to almost everyone, though it has a variety of meanings. Many businesses trot it out around Christmastime, as if it were too special to pursue every day. Churchgoers sometimes wince at the mention of stewardship because it usually means "give money now." Stewardship is also used frequently in discussions of the environment, where it has the literal and religious connotation of caring for, restoring, and improving the water, air, forests, oceans, land, animal habitats, and other parts of the physical environment so essential to nature's well-being.

In this book, I use the term *stewardship ethics* to convey the commitment to care for one's institution and those it serves in a manner that responds to a higher level of expectations. In the chapters that follow, I elaborate how the ethical commitments of corporate cultures are directly related to the social, political, and economic structures of the larger society. If our corporations can upgrade their ethical norms to the level of stewardship ethics, this achievement will also strengthen the ethical values of our society.



It is prudent to avoid ranking company credos, CSR, and stewardship ethics in hierarchical order of ethical standards. Each has its own strengths and limitations. But whether through taking company credos more seriously, or through accepting CSR principles, or through adopting stewardship ethics (as I propose in this book), it is the space in the pyramid above the smell test that is attracting the attention of more and more corporations.

## The Wider Context

If our society expects business to be more engaged in the larger problems and concerns of our times, we need to understand what those concerns are, especially ones that are unfamiliar and even startling. Though we are in only its first decade, the twenty-first century is already shaping up as strikingly different from the previous one. In the twentieth century, nation-states with highly organized military forces fought with one another over issues of balance of power, colonialism, and territory. The major ideological struggle was Marxism versus capitalism.[6]

The tensions and struggles of the current century have a far different character. Colonialism is mostly past. Balance of power and territory have grown less important, ideology more important. But unlike in the past, ideology is not mainly about capitalism and economics. Instead, it is about religion, culture, and social morality. The West is engaged in a bitter ideological struggle with Islamic fundamentalism that focuses on essential values and cuts across national boundaries.

Western leaders have made a conscious effort to avoid framing the struggle as a religious war or a clash of civilizations. But its religious fervor and intensity are hard to avoid. This ideological/religious struggle is in turn taking place in a global economy that creates ever-larger gaps between have and have-not nations—at the same time that it opens up new opportunities for the have-nots to join the haves. The several billion people in the world who live on less than two dollars a day want to join the club of prosperous market economies. Thanks to technology and advances in market capitalism, the means actually exist for them to do so—a shift that will give a giant boost to world economic growth. Technology is helping people to live longer. It is making communication easier. And it shows promise of developing technological fixes for some of the globe's most bewildering problems, such as adapting to climate change, finding substitutes for fossil fuels as sources of energy, and creating abundant supplies of fresh water and food.

In the midst of these varied global changes, the American public has become absorbed in, and distracted by, a struggle to rediscover its own ethical bearings. A muddy ethical confusion pervades the culture, and Americans increasingly turn to religion for guidance. Opinion polls show that Americans are turning to religion in their quest to find firmer ethical ground on which to stand.[7] The United States' cultural revolution, initiated in the 1960s and 1970s, made our society more tolerant, more pluralistic, and freer. But these positive developments have had unintended consequences. They have led to a disorienting moral relativism and difficulty in distinguishing between right and wrong.

On the political front, conservatives, liberals, and moderates all worry about the loss of moral rectitude in our society. Conservatives focus on family-linked issues like abortion, gay marriage, and a morally toxic environment in which to bring up children. The more liberal-minded have a different set of outrages: the ever-expanding gap between rich and poor, threats to the environment, corporate executives enriching themselves by ripping off others, and the ethics of a might-makes-right foreign policy that alienates traditional allies and engenders fear and hatred of the United States in other parts of the world.



Perhaps the clearest sign of ethical confusion in the nation is the proliferation of so-called unsustainable trends—the increasing din about the lack of "sustainability" of our present policies. Within the space of a week or so I have heard or read that . . .

- Our Social Security system is unsustainable
- The rising tide of health care costs is unsustainable
- Our swelling trade deficit with other nations is unsustainable
- The trend toward a weaker dollar is unsustainable
- Our energy policies and dependence on Middle East oil are unsustainable
- The widening gap in our society between rich and poor is unsustainable
- Our frayed relations with our traditional allies are unsustainable
- Our policy of stonewalling the efforts of other nations to do something about climate change, with its threat of global warming, is unsustainable
- The growing political polarization between the "red states" and the "blue states" is unsustainable
- Our policies toward the Muslim world, with their implicit threat of igniting a religious war, are unsustainable

- The poor performance of our students on math tests in relation to students from other nations is unsustainable

Our nation rose to greatness because we are a resourceful people blessed with a practical-minded, pragmatic, nonideological political culture—and a gift for problem solving rather than theorizing. There is nothing inherently overwhelming about these so-called unsustainable trends if we confront them with our customary pragmatism, practicality, and core American values.

What is most depressing about the current political scene is that we seem to have abandoned our habit of facing issues head-on. We are flooded with problems to which we are unresponsive. In place of wise and responsible leadership, we get denial and avoidance, pandering to wishful thinking, ideological conviction posing as thought, short term-itis, polarized politics, a loss of moral compass, infatuation with technical fixes for nontechnical problems, mythical silver bullets, simple-minded sound bites. What a strange turn of destiny it is that when we most need our traditional practicality, we decide instead to overdose on superficiality, ideological willfulness, and inadequate solutions. Situations don't start out unsustainable; they become so when they fester for too long. The more we neglect them, the worse—and less sustainable—they become. Until and unless we regain our sense of ethical direction, our moral compass, we will not be able to cope with all the forms of unsustainability that confront us.

Throughout the nation, these varied concerns hover in the back of most people's minds as a vague and anxious-making suspicion that something has gone wrong in America, without a clear and cogent diagnosis of what it is.[8]



At first glance, these broader concerns may seem unrelated to the subject of this book—the quest for a new ethic for business. But a deeper look shows that they are directly relevant. The key question for the United States is what institutions are best equipped to address the key issues confronting the present century—the cultural/ideological war with Islamic fundamentalism, the need for sustainable development, climate change, the expansion of market economies to the developing world, the harnessing of technology to achieve energy independence, and so on. The assumption that our government and our educational and religious institutions can and will address these issues is unrealistic if we assume that government can do what needs to be done without heavy reliance on the resources of the business sector.

To open the developing world to market economies we need the direct engagement of corporate America. To create customers for our products, we need to support large-scale efforts to raise education levels throughout the globe. To grope our way toward energy independence, to deal with climate change, to raise the level of global health and combat infectious diseases, to create new opportunities for women—for these and other vital tasks we need the participation and support of our powerful multinational corporations. Corporate America may also prove essential to prevailing in our struggle with Islamic fundamentalism. To win the support of Muslim moderates and isolate the extremists, we may need farsighted economic programs, not primary reliance on military force.

The late Roberto Goizueta, former CEO of the Coca-Cola Company, put the point pithily: "While we were once perceived as simply providing services, selling products and employing people, business now shares in much of the responsibility for our global quality of life."[9] This is the heart and soul

of the next stage of market capitalism. The right kind of enlightened self-interest for the new century is the one that companies like Coca-Cola, Procter and Gamble, G.E., Starbucks, Shell, and others are moving toward: a broader engagement in solving our most obdurate global challenges.

# Part I
# Framing the Problem

# I
# The Wrong Way to Stop the Scandals

The new century started with some heavyweight business scandals. Enron and its CEO, Kenneth Lay, Tyco and its CEO, Dennis Kozlowski, WorldCom and its CEO, Bernie Ebbers—in each case, colorful men, gifted with more than a touch of good old American con artistry, had apparently enlisted the aid of younger men with specialized accounting skills to cook the books. It took years of trials and mistrials and bald-faced denials and evasive legal maneuvering for their cases to move to the courts. Only the decades of sexual abuses in the Catholic Church—and the hefty fines the church paid to get out from under the resultant scandals—proved a greater shock to the public.

Among the business scandals, Enron topped all others. The Enron story unfolded in slow motion, a miasma of complex financial detail obscuring its full scope. It took a long time for the extent of Enron's apparent fraud (abetted by its accounting firm, Arthur Andersen) to reach full public consciousness. But when it did, the one fact that stood out most vividly in the

minds of observers throughout the nation was that the big boys had enriched themselves while the savings of loyal employees and small stockholders were wiped out.

In the months following the outing of these and other alleged accounting scandals, most business executives continued to plead the "few bad apples" defense. They acknowledged (how could they not?) that the gaming tactics of Enron and its accountants were out of control. But they put the blame on a handful of rogue companies and personalities, vehemently denying that the abuses were systemic.

The public, on the other hand, never bought into the "few bad apples" story. By wide margins, average citizens saw the abuses as more general. In July 2002 a *Wall Street Journal* poll found that fewer than one in five Americans thought the scandals were confined to a "few bad apples." The same month a *CBS News* survey reported that two-thirds of the public believed that most corporate executives were dishonest, *Newsweek* found that almost seven out of ten put the blame for the scandals squarely on the shoulders of corporate executives, and a *Business Week*/Harris survey discovered that 79 percent believed that "most corporate executives put their own personal interests ahead of employees and shareholders."

But even the skeptical public was unprepared for the flood of scandals that followed in the next few years. Enron, WorldCom, and Tyco had involved out-and-out chicanery. The scandals that followed described a different kind of corporate malfeasance, involving less blatant violation of the law. Instead, we saw instance after instance of conflicts of interest that may have stayed within the letter of the law but certainly flunked the smell test. Hardly a day has passed without news stories of ethically challenged corporate behavior, especially on Wall Street. Some of the nation's—and the world's—largest,



most successful, most highly respected corporations found themselves squirming in the media spotlight as they attempted to defend highly questionable actions.

## A Day's Worth of News Coverage

In later chapters, we will look more closely at some of these companies. For present purposes, let us take a quick snapshot of an average day's news as reported in the *Wall Street Journal* and the *New York Times*. We might have picked any day at random. For this exercise, I picked December 16, 2004. The date has no special significance.

Here is what these two national newspapers reported on that day in the field of finance:

- The head of the Securities and Exchange Commission ruled that the giant mortgage finance company Fannie Mae had violated accounting rules and must restate its earnings.
- Time Warner settled two separate complaints against its AOL division. In one, the Justice Department agreed to defer prosecution on securities fraud charges provided that AOL operates under strict oversight. The *Times* reported that the three executives named in this complaint "have agreed to cease violating securities laws but can remain in their current posts and will pay no penalties."
- The insurance broker Marsh and McLellan closed a $3 billion credit agreement with a variety of banks that had withdrawn their financing in the wake of charges of bid rigging and kickbacks.

- In the WorldCom class action suit, a judge rejected investment banks' efforts to have the case thrown out. The banks had claimed that they did not need to notify investors of their own reservations about WorldCom securities because they had an auditor's report indicating that the company's financial statements were accurate. The judge rejected this argument and the case went to a jury.
- The federal Pension Benefit Guaranty Corporation, which insures companies' pension plans, discovered that it faced a huge shortfall. The problem arose because the system encourages companies to make risky investment decisions and pass losses on to the pension guaranty agency.
- Morningstar, a research firm that rates mutual funds, was under investigation by the SEC and the New York attorney general on allegations that its advice to investors was compromised by payments from investment companies.
- First Command Financial Services agreed to pay $12 million to settle accusations that it used misleading information to sell mutual funds to military officers.
- Tyson and its ex-CEO offered to pay $1.7 million to settle an SEC investigation into improper company perks.
- A former sales director of a biotech company was indicted for offering doctors kickbacks in exchange for writing prescriptions for the company's AIDS drug.
- The doughnut company Krispy Kreme announced that it might need to restate its financial results



for 2003. This was the latest in a string of questions about its accounting practices, which were under investigation by the SEC.
- The New York Stock Exchange banned a floor clerk from the exchange for "front-running" customer orders (leaking word of pending orders to a client). The NYSE head of market surveillance said, "We want to make it crystal clear that at the exchange, the customer comes first."
- Regulators examined whether insiders at Wall Street firms were tipping off favored investors about deals that might cause stock prices to fall.

Nor are ethical lapses confined to business and finance. Here is what was covered in the *New York Times* and *Wall Street Journal* on that same day in some other domains:

### POLITICS

- It was announced that one of the principal authors of the new Medicare drug law would become president of the chief lobbying organization for drug companies. Critics decried this as another example of the revolving door between government and industry.
- Revelations continued in Bernard Kerik's aborted nomination to head the Department of Homeland Security. Incredibly, Kerik's problems—which ran the gamut from debt to multiple extramarital relationships to possible mob connections—had not been spotted by White House or New York City investigators. A commentary piece

concluded that political favoritism had blinded the watchdogs from doing their job. Another article examined the possibility that the undocumented nanny who provided the pretext for Kerik's withdrawal from consideration might not actually exist.

- A high-level weapons buyer in the U.S. Air Force admitted to awarding billions of dollars in contracts to Boeing at the same time that she was secretly negotiating with the company for jobs for herself and members of her family.
- Several former military lawyers decried attorney general nominee Alberto Gonzales's memos supporting the use of torture in interrogating terrorism suspects. They maintain that these memos, and Gonzales's claim that the president is not bound by international or federal laws banning torture, opened the door to widespread abuse of prisoners in Afghanistan, Iraq, and Guantánamo Bay.

SPORTS

- The New York State Police raided several racetracks and seized documents as part of an investigation into weight rigging and jockey misconduct.
- A University of Tennessee football player was dismissed from the team for cheating on a drug test, which he failed. "I just never thought I would get kicked off the team," the player said. "I always thought it would work out."



- An outfielder for the Los Angeles Dodgers began serving a jail sentence for driving away while a police officer was writing him a speeding ticket.
- The founder of the Bay Area Laboratory Co-operative (BALCO) was under investigation by the International Olympic Committee for providing steroids and other performance-enhancing drugs to elite athletes.
- In an op-ed piece, a journalist reported that the scandal, corruption and win-at-all-costs ethos that plagues professional and college sports is now trickling down to the high school level.

ENTERTAINMENT

- A British production company filed suit against the Fox television network, claiming that the Fox reality series *Trading Spouses* was in fact a blatant copycat of the British company's hit series *Wife Swap*.

This cross-section of a single day's news coverage depicts the sorry state of the nation's ethical norms as seen through the lens of journalism. When we turn to the nation's response, we see lots of action.

## Reliance on Legalism

The main effort to stop the ethical deterioration is taking place in the legal/regulatory domain. Legal authorities have levied huge fines. Well-heeled corporate executives have been forced to resign or to pay some of the fines out of their own pockets.

Some have ended up taking the "perp walk." To produce better financial reporting, Congress has passed stringent new regulations (like the Sarbanes-Oxley Act) that impose a huge accounting burden on business. State prosecutors like New York's Eliot Spitzer have relentlessly tracked down conflicts of interest in the mutual fund and insurance industries. In the overheated drive to make an example of someone, Martha Stewart got tossed into jail for five months—mainly for being a celebrity who happened to trade some shares on inside knowledge and then lied about it. Her transaction involved a few thousand dollars—a piddling sum compared to the many billions of dollars that the real pros bilked from small investors and employees.

These well-publicized legal and regulatory actions momentarily appeased the public. But experts close to the scene do not believe they have done much to remedy the problem. On the PBS program *Wall Street Week with Fortune*, the financial journalist Maggie Maher stated that conflicts of interest on Wall Street routinely persist after all the fines, regulations, and firings. She said flatly, "Mutual funds continue to pay brokers to recommend specific funds." On the same program Edward Siedle, a former SEC enforcement attorney, pointed out that the mutual fund industry is "still allowed to self-regulate, self-adjudicate, self-insure, and even control public access to the criminal and disciplinary action of its membership," with the result that the public thinks that doing business with brokers is much safer than it really is. Siedle observed that "the biggest lesson to be learned in the past few years is that anybody who purports to offer objective advice probably isn't. Most providers of advice have been corrupted, because there is far more money to be made offering tainted advice."



Under a practice euphemistically called "revenue sharing," mutual funds make secret payments to brokers to push their funds. Edward Jones, which operates the nation's largest network of retail brokerage offices (ten thousand sales offices) was fined $75 million and its top executive was forced to resign when it was revealed that its brokers earned posh vacations and cash if they pushed the mutual funds of firms making secret payments to the company. Regulators found that more than 95 percent of Jones's mutual fund sales were of this sort. Maggie Maher asked rhetorically, "Do you really want your brokers to recommend funds because they've been essentially bribed to do so?" And Siedle concluded, "Nothing [on Wall Street] has changed."[1]

## In Search of Better Norms

Traditionally, the law marks the border between criminal and noncriminal behavior. Ethical norms, on the other hand, mark the border between right and wrong, without reference to the law. The law is a floor—a foundation on which the norms of the society rest. It is not, and cannot be, a substitute for the ethical norms that sit atop it.

Every viable society depends on ethical norms to guide and restrain conduct. For most forms of conduct, norms are far more important than legal constraints. The law prescribes minimalist standards of conduct—one can act legally and still not act ethically. Ethical norms fill in the blanks necessarily left by the law, which cannot provide a complete blueprint for how individuals or institutions should behave.

In most societies, the legal foundation is relatively thin, while the layer of social ethics that sets the standards for how

people and institutions should act is heavier and thicker. Society's legal underpinnings are formal and codified. Its ethical norms are informal and left mostly *un*codified. Even though they may not be written down, however, ethical norms play an indispensable role in the healthy functioning of society.

One consequence of America's cultural revolution in the 1960s and 1970s was a weakening, a thinning out, of its ethical norms. The result is that the ethical standards of today are often put to the minimalist test of whether an action is legal or illegal. Today it is not uncommon to hear the claim: "I didn't break the law, so I didn't do anything wrong." Such a rationale for unethical behavior would have been unthinkable in the 1950s or earlier periods of American life, when society assumed that people's responsibilities encompassed far more than merely satisfying the minimal standard of legality.

The decline in ethical norms is not confined to America's corporate sector. It is also on display in incivility in public places—road rage, obscenity, violent public confrontations—and has led to the proliferation of crudeness, violence, and cheapened sex in popular culture and entertainment.

Most Americans are unhappy about the deterioration of our ethical norms. Opinion polls consistently register the public's desire for a higher level of ethical standards. But we don't seem to know how to go about the task of repairing them.

Our first impulse is to regulate or deregulate or both. Part of the fix we are in can be blamed on relying so heavily on the blunt instrument of the law to fix our ethical problems. There is an important lesson to be learned from the perfect storm. Deregulation combined with looser ethical norms created a storm of bad corporate behavior. Not only did it tempt corporate executives to cheat, it tempted the watchdogs and guardians of the public trust to cheat as well. The results were devastating.



I believe that if we rely primarily on regulatory and legal mechanisms to repair the damage, we will not get very far. We will force the gamesters of the system—clever lawyers and accountants and financial executives—to be more ingenious and more careful. But we will not transform the ethical climate. As a society, we need to develop a better understanding of how to use the law to support higher ethical standards, not as a substitute for them.

# II
# Screwed Again

Research into the causes of mistrust reveals a sure-fire formula for guaranteeing that you will never be trusted again. Here is what you must do.

- First, you work hard to win the trust of others.
- Then, when you have it, you go back on your word. You lie, you deceive, you play the others for fools.
- Then you seek their forgiveness. You admit you were wrong. You say you have learned your lesson. Slowly, gradually, painfully, you rebuild the bond of trust.
- Then, once you are sure you have regained their trust, you screw them again.

That should do the trick. It did it for Yassir Arafat. It did it for Saddam Hussein. The point here is that the present wave of mistrust of business and other institutions is not the first in living memory. If it were, it would be more likely to blow over. But mistrust of institutions, especially business, is a recurring



phenomenon in American life. The United States is now well launched into the third wave of mistrust of business and other institutions over the past three-quarters of a century.

The first wave occurred in the 1930s. This was the era of the Great Depression, a traumatic event that seared the lives of all who lived through it. Its major symptom was massive unyielding unemployment affecting an overwhelming one-third of the workforce and indirectly undermining the standard of living of all but the wealthiest Americans.

The consequences of the Great Depression transformed American political and economic life. Herbert Hoover, the Republican president who had the bad luck to usher in the Depression, was summarily dumped, along with the influence and credibility of the Republican Party. Even though the Republicans regained the White House in 1953 with Dwight David Eisenhower and again in 1969 with Richard Nixon, the dominant political ideology of the nation remained left of center for more than four decades, under the towering shadow of Franklin Delano Roosevelt. It wasn't until the election of Ronald Reagan in 1980, almost a half-century after the onset of the Great Depression, that the Republicans regained the ideological dominance they had enjoyed in the pre-Depression era, gradually succeeding in shifting the nation's political center of gravity from left to right of center, where it now resides.

In the chaotic years of the 1930s the mistrust of business was so intense and so widespread that it threatened to topple capitalism itself. Anticapitalist ideologies—Marxist, Trotskyite, socialist—gained a foothold, and in some quarters more than a foothold. Antibusiness ideologies might even have prevailed were it not for the flood of business and social legislation that the Roosevelt administration introduced, against fierce business opposition. Most business executives and political con-

servatives hated Franklin Roosevelt: they saw him as a traitor to his upper-class origins. But Roosevelt himself brushed aside this calumny, insisting that his purpose was fundamentally conservative: to save capitalism from its own excesses. The retrospect of history has vindicated Roosevelt's self-description.

The Depression—and the era of mistrust—did not end until the United States entered World War II after the Japanese attack on Pearl Harbor on December 7, 1941. From beginning to end, this wave had persisted for more than a decade.

The second wave of mistrust endured from the late 1960s to 1980—a roughly equivalent span of years. The source of the mistrust in those years differed from that of the Great Depression. This was the era of the war in Vietnam and of the Watergate scandal and its cover-up, which drove Richard Nixon from office. These political events converged with serious economic stagflation (the combined levels of unemployment and inflation exceeded 20 percent). The nation's productivity and competitiveness were so badly stalled that Americans feared that the Japanese economy would overtake our own.

Unlike the 1930s, when mistrust was sharply focused on business, virtually all institutions got caught up in the 1970s wave of mistrust. Gallup tracking polls revealed a precipitous decline of trust in government. In 1964, before the wave of mistrust hit, an impressive three-quarters of all Americans believed that "you can trust the federal government to do the right thing (almost all or most of the time)." By 1980 that hefty majority had shrunk to a mere one-fourth minority. Tracking polls conducted by Yankelovich, Skelly and White, Inc., showed decline of confidence in business to be nearly as extreme, plunging from 70 percent in 1968 to 29 percent in 1980. Harris tracking polls revealed a similar pattern for other institutions: from 1966 to 1982, confidence in the medical profession fell



from 71 percent to 32 percent, in universities from 61 percent to 30 percent, and in the media from a miserably low starting point of 29 percent to less than half of that number (14 percent). So pervasive was this climate of mistrust that it even affected the attitudes of individual Americans toward one another. *Washington Post*, Kaiser, and Harvard University polls showed that in 1968 a majority of Americans (56 percent) believed that "most other people can be trusted." By 1980 even this rudimentary precondition for civil society had suffered. A 39 percent minority had replaced that majority.

The current wave of mistrust in the business sector began to build momentum in 2002. If it follows the same pattern as the other two waves, it is still in its early stages. Most of those who lived through the first wave in the 1930s are retired or deceased. But that is decidedly not the case for those who lived through the second wave of mistrust in the late 1960s and 1970s. They are part of the baby boomer generation—a generation that exercises unprecedented influence on American life. In their formative years, boomers grew up in a pervasive climate of mistrust of business and government authority. The dominant attitude they learned at that time was that business puts its own interests first—ahead of the public's interests or those of its customers and employees.

In the 1980s and 1990s, by virtue of huge effort and success, American business restored its high standing, regaining much of the prestige and trust it had lost in the previous decades. But it is now squandering that trust once again. As it does so, the groundwork of mistrust laid down in earlier years will make it far more difficult to recover the public's trust. When inclinations of mistrust take hold in people's formative years, these are readily reawakened and reinforced, making the new layer of mistrust more difficult to penetrate. I have charted

this phenomenon in Figure 2 below, based on survey data with the public.

I believe we should take the new wave of mistrust seriously. Mistrust is a corrosive emotion that distorts everything it touches. The financier Felix Rohatyn offers the cogent observation that "only capitalists can destroy capitalism." His point is that market economies now dominate the world stage; they are too strong and too well ensconced to be destroyed by anticapitalist movements like socialism, communism, or Islamic fundamentalism. But they can be undermined by the actions of those currently in charge—the corporate CEOs, the economic theorists, and the political policy makers who rule capitalist enterprise. The smooth functioning of the market depends on trust. And the surest way to undermine our market economy is by letting mistrust run amok.

It is particularly difficult to lead corporate enterprises in periods of mistrust because the mistrust deprives business leaders of the benefit of the doubt. For example, when Merck's CEO, Raymond Gilmartin, withdrew Vioxx from the market in 2004, he believed that his action would be hailed as a sign of corporate and personal integrity. Instead, he was pilloried for not having taken action sooner. Far from being credited with an act of stewardship, the CEO saw his company's stock plunge 40 percent overnight and found himself at the vortex of a storm of ugly accusations. He resigned before his scheduled retirement. Had these same events taken place in a period of trust and confidence in corporate business, he might have been given the benefit of the doubt and the story might have unfolded in a more benign fashion.

Gilmartin's situation is not unique. CEOs of large corporations are always confronted with confusing cross-pressures and ambiguities. That is the nature of their job. Dealing sure-



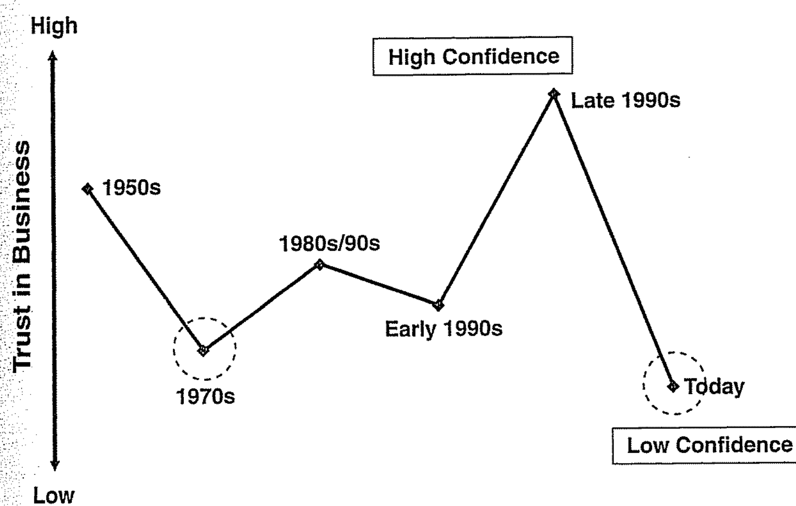


Figure 2. The "screwed again" effect

footedly with these cross-pressures is what CEOs are paid vast sums of money to do. For the most part, the day-to-day management of corporations can be left to others—to so-called COOs (chief operating officers). It is how well CEOs cope with tough ethical and business cross-pressures that separates the successful companies from the unsuccessful. And this is where the ethical norms embodied in a company's corporate culture (and those of the CEO personally) play a critically important role.

Consider, for example, the cross-pressures on CEOs in relation to how they treat employees. These days, many chief executives have strained the bonds of their relationship with employees to the breaking point by transmitting a confusing mixed message. It is not the message they intend to transmit. But it is the message that comes through.

One part of the mixed message is:

> Our corporate vision reveals an exciting path to future success in the new global economy. We know the only way it will become a reality is if you, our people, buy into it, and give it every ounce of dedication and commitment you have to give. Our success depends on you.

The other part of the mixed message is:

> Our number 1 goal in the company is to maximize shareholder value. In the pursuit of that goal, you, the employee, are expendable. We expect loyalty, dedication, and top performance from you, but you must understand that you cannot expect loyalty or dedication in return.

The reason for the mixed message is that two very different business logics drive today's management. The first goes something like this:

- We have entered a period of brutal global competition.
- In this environment, our success depends on our competitive performance.
- For profitability in today's global marketplace, we cannot count as much as in the past on rapid growth through expanding markets. We have to be strong enough to achieve profitability and growth through strengthening our share of market by being more competitive.



- Winning a bigger share of market calls for a superior level of customer focus: the name of the game is knowing customers and serving their needs better than the competition.
- The best way to achieve superior customer focus is ensuring that your own people are highly motivated. Employees who are just going through the motions and doing the minimum they have to do to protect their jobs cannot deliver superior customer focus.
- A global marketplace is full of opportunities as well as threats. Through leveraging our core competencies, we have developed a vision of a dynamic, creative, highly profitable organization—but everything depends on implementation: our people have to share our vision and give their utmost in skill, dedication, and commitment.

This business logic says to employees: "You are indispensable to the company's success." But there is a second business logic that leads to the opposite conclusion. It starts the same way: "brutal global competition . . . greater emphasis on performance . . . rich rewards that come only with outstanding profit performance." But then the logic diverges and develops along a different line of thought which goes something like this:

- Success these days is measured in terms of share price, with an ever larger chunk of our compensation coming in the form of bonuses and stock options from which we benefit only if the price of the stock goes up.

- The best way to raise the price of the stock is to accelerate the company's rate of profitability. Companies whose profits grow slowly are penalized by investor unwillingness to pay a premium on their earnings; companies whose profits grow at a fast rate often earn a substantial premium.
- Greatly improved profitability in this environment can be achieved only one way: by cutting costs to the bone.
- There are many bad features of the new global economy, but one of its good features is that a large corporation can call upon a global labor force—and not just for unskilled labor: you can get top-notch Russian scientists for $100 a month, and top-notch Indian programmers for $130 a week. There is a huge pool of highly motivated, low-cost labor available in other countries, if one is willing to think globally.
- For this and other reasons, the domestic labor market is weak and likely to remain so. The unions have lost much of their clout, and with the downsizing of middle management, there are plenty of good people available on a part-time or freelance basis to whom we don't need to give benefits or raises.
- We can reduce our labor costs to a minimum, with wondrous impact on our profit margins, share prices, and stock options.

This logic leads to the second message that employees hear: "You are dispensable."



Companies that follow this logic do not typically adopt a hostile or adversarial stance toward their employees. Rather, their attitude is a wholly impersonal one, reflecting their conviction that labor costs are a function of the market. You manage people the same way you manage money.

But of course, employees are not the same as plant and equipment and other capital expenditures. People react; machines do not. Moreover, people react differently than expected. When they feel expendable or exploited, they react by holding back as much of themselves as they can without risking their jobs. They may sell their time and raw labor for money, but not their dedication, loyalty, and commitment.

Research conducted by DYG SCAN (a trend-tracking service for corporate clients) shows five patterns of contemporary employee response:

1. Employees no longer believe that their jobs will be secure even if they perform well.
2. They no longer believe in employer loyalty and concern, and consequently lack personal commitment. (Only about one in five corporate employees shows strong commitment.)
3. Many employees have lost confidence that they will be rewarded for learning and expanding their skills. They are beginning to suspect that expertise gained through effort and experience on the job is no longer seen by employers as *valuable* but as making one a more expensive employee.
4. There is even growing skepticism about the corporate emphasis on quality. In quality enhancement programs, improved quality is equated

with fewer, not more, employees, resulting in a *devaluation* of employees by the corporation.

5. Other than the money that can be earned, work in large corporations has become a less reliable source of satisfaction.[1]

Today's corporate trumpet emits an uncertain sound. The mixed message that leaves employees confused, mistrustful, and fearful of the future is a symptom of a larger problem of ethical failure in leadership—the loss of a moral compass. These business executives are having a difficult time reconciling the norms they bring to their own personal and family relationships with corporate norms and pressures to exceed last quarter's earnings.

# III
# *Un*enlightened Self-Interest

The current climate of mistrust poisons the atmosphere. It tempts observers to grow judgmental and to blame the ethical scandals on an all-encompassing "culture of corruption." The tendency to resort to punitive legalism creates a mood in which it seems natural to hold jury trials in which highly visible CEOs (yesterday's culture heroes) face the kind of stiff prison sentences that one ordinarily associates with rape and armed robbery.

L. Dennis Kozlowski, the former CEO of Tyco, a giant conglomerate with 270,000 employees and $36 billion in annual sales, is believed to have stolen $170 million from the company. He is also accused of hiding unauthorized bonuses to himself and his chief financial officer, lending himself money from the company and then forgiving the loans so that they didn't have to be repaid, and lying to the public about the company's finances in order to pump up the price of the stock. Charged with grand larceny, falsifying business records, conspiracy, and business law violations, he has received a long prison sentence.

Bernard Ebbers, former CEO of WorldCom, has been convicted of pulling off an $11 billion fraud leading to the largest bankruptcy in American history, with employees and investors as the main victims. The charges against him include conspiracy, fraud, and filing false reports. He received a twenty-five-year prison term.

Richard Scrushy, former CEO of HealthSouth, was accused of "orchestrating a huge accounting fraud," an accusation supported by no fewer than five former CFOs at the company. He was tried in his hometown of Birmingham, Alabama, the beneficiary of much HealthSouth largesse. He was acquitted. Kenneth Lay, the former CEO of Enron is accused of the same fraud on a grander scale. He faces court trial.

Criminal indictments and long prison sentences against former culture heroes may satisfy the public's craving for justice, but they are unlikely to raise the level of business ethics. Legalistic solutions and jail terms are not enough to lead to positive initiatives. A backlash is already setting in, with business groups claiming that excessive regulation is counterproductive, producing "unintended consequences that are having significant negative effects on our economy."[1]

My argument is that instead of a primarily legalistic framework, we should adopt a primarily normative one. We should view the scandals as signs of a weakened system of ethical norms that happens to be particularly severe in the business world, but which is not confined to business. Taking strong legal action against those who wantonly break the law can reinforce ethical norms. But it cannot substitute for them.

One reason for the decline of corporate ethical norms is that the temptations are so huge. But other reasons are more compelling, such as the phenomenon that the psychologist Irving Janis terms *groupthink*. Groupthink is the tendency of



people who live and work in isolated subcultures to develop distorted views of the world because they talk mainly with one another, cutting themselves off from the viewpoints of others. In such isolation, misconceptions go unchallenged, blind spots go unnoticed, and wishful thinking hardens into received wisdom.

Groupthink is not confined to the business world. It thrives virtually everywhere, even (or especially) in places like universities that pride themselves on their independent thinking. But the pressures of groupthink in corporate life are particularly powerful. (This is one reason that the concept of "corporate culture" has so much resonance in the business world: its inhabitants are all too familiar with its workings.)

Groupthink forces people toward uniformity of norms, often at the expense of their own personal values. We are all familiar with the seeming paradox of executives who are warm and generous with their families and friends while behaving like cutthroats in the workplace. They live in two different universes of values—observing the cultural norms associated with loving families and close bonds at home, then adopting the norms associated with competitive success in the marketplace. Nor do they feel torn between these conflicting values, since they see each as appropriate for its particular settings and activities.

In other words, once a set of norms takes hold in the corporate world, groupthink ensures that it will become widespread and influential. If the norms are unethical (as seen through the lens of the larger society), they can nonetheless exercise a compelling influence on people who see themselves as highly ethical. This robs society of its two most powerful constraints on keeping average law-abiding people on a straight and narrow path: *shame* and *guilt*. Shame and guilt are the powerful mechanisms that enforce social norms—shame is imposed by one's fellows, while guilt is the distress that arises

from violating an internalized code of conduct. As corporate norms have shifted to condone behaviors that were once deemed unacceptable, the kinds of behavior that would inspire shame and guilt have likewise shifted. Yesterday's executive might have suffered guilt from cooking the books; today's might feel shame at showing insufficient tough-mindedness in a business deal.

Which current business norms lead an executive to commit outrageously unethical acts while continuing to maintain a self-image free of shame or guilt? If we understand what these destructive norms are and why they exert such a strong influence on our culture, we will have taken the first step toward stopping the scandals; we will have identified the norms that have to change.

## Destructive Norms

It may be useful to clarify what we mean by destructive norms. The concept sounds odd, almost oxymoronic. Norms are positive values. They are the unwritten rules that make communal living possible. As such, they form an inherent part of every society's culture. They represent the forms of behavior that are acceptable or unacceptable in each of the roles people occupy in a society: husband, wife, father, mother, child, parent, neighbor, relative, tribal chief, warrior, employee, citizen, consumer, rich man, mendicant, and so on. In some traditional societies, norms are rigidly, even brutally, enforced (for example, stoning a woman charged with adultery). In our own society, most norms have grown more flexible (for example, the widespread acceptance of unmarried couples living together).

Because norms dictate socially desirable behavior, it may at first glance be confusing to speak of *destructive* norms (undesirable behavior). But an instant's thought should clarify the confusion. From the point of view of our culture, stoning women—for any reason—is totally unacceptable; in some fundamentalist societies, it is unacceptable *not* to severely punish women accused of adultery. Clearly, norms vary from culture to culture. Within any culture, we also find wide variations in norms from subculture to subculture—a major source of tension between religious conservatives and other subcultures in our own society. Also, norms often conflict and pull individuals in different directions: the norms governing competition conflict with the norms prescribing cooperative and considerate behavior; the norms of self-expression collide with norms of civility.

A series of conflicting norms of ethical behavior has plunged our society into a state of confusion and disorientation. This is what people mean when they say we have lost our moral compass. They are not saying that the culture has grown evil and mean-spirited (some may believe this, but not the majority). What concerns the majority of Americans today is the suspicion that our traditional norms of right and wrong are being blurred, leaving people confused and easily tempted to go down the wrong path. The corporate scandals that do not involve outright criminality do involve cutting corners, bending the rules, gaming the system, ignoring conflicts of interest, putting one's own interests ahead of others, and seeking to win at any cost. Those guilty of such behaviors do not see themselves as bad people violating society's norms; they see themselves as bold, venturesome, innovative, smart people who are living by the norms of contemporary corporate life and who deserve to reap the rewards for doing so.

It is in this sense that norms may be destructive. From the perspective both of the culture and the individual corpo-

ration, some of the newer norms are dysfunctional and destructive. This phenomenon of conflicting norms was clearly on display in the experience of our troops in Iraq. The official norms of the military dictate that prisoner abuse is unacceptable; at the same time a normative climate that encouraged prisoner abuse had clearly been established, with the two sets of norms in confusing conflict with each other.

## Seven Deadly Norms

It would be wrong to imply that destructive norms have taken over the business community. This is emphatically not the case. Unfortunately, there is no reliable way to quantify just how far ethically pernicious norms have spread. The truth lies somewhere between "a few bad apples" and "a culture of corruption." The scope, magnitude, and frequency of the scandals do imply that something systemic is wrong. In 2004 the Corporate Fraud Task Force of the Justice Department charged more than nine hundred executives with fraud and obtained more than five hundred corporate fraud convictions. The SEC filed more than six hundred civil enforcement actions involving fraud.[2] This is certainly more than a few bad apples, especially when one realizes that it represents a minuscule fraction of corporate wrongdoing.

On the other hand, there is strong evidence that the taint has not spread throughout business. In many companies, the dominant norm remains the smell test—the conviction that staying within the letter of the law is not good enough and that the company must adhere to ethical standards of right and wrong that go beyond the law. Yet in recent years, a number of dysfunctional norms have crept into the culture, aided and abetted by groupthink. Seven destructive norms converge with



one another to form an *über*-norm that might well be called *un*enlightened self-interest.

I will elaborate on these in later chapters, but here briefly are the seven deadly norms that are causing most of ethical confusion in the nation, particularly in the business community:

### 1. EQUATING WRONGDOING EXCLUSIVELY WITH ILLEGALITY

To the extent that shame and guilt still operate in our society and are linked to wrongdoing, and to the extent that wrongdoing is linked solely to breaking the law, then one is off the hook simply by staying within the letter of the law. As noted earlier, there is no more corrosive deterioration in today's ethical norms than the conviction that "I didn't do anything illegal, so I didn't do anything wrong."

### 2. WIN AT ANY COST

The norm that winning is all that matters and that everything else is unimportant pervades the larger society but becomes particularly consequential in corporate settings. Since competition is a dominant theme in business, it reinforces the aggressive urge to win without fussing too much about the tactics for doing so. Corporations often deploy their resources in a zero-sum form of winning: if we win, you have to lose.

Because we have become such a highly individualistic society, the fierce need to win at all costs readily spreads from the company to the individual. We can see this norm at work in countless small instances in our society, from a driver who cuts another off in order to gain a few yards' advantage on a con-

gested freeway to a parent screaming abuse at the coach when his or her child's soccer team loses a game.

### 3. GAMING THE SYSTEM IS GOOD SPORT

There are large elements of fun and game-playing in seeing how far one can go gaming the system. Enron was full of computer-savvy young people who spent days and weeks with their complex computer models figuring out how to drive up the price of energy artificially (for example, through deliberately closing refineries for maintenance and repair in California to create the maximum bottleneck).

When the desire to beat the system converges with the imperative to win, the result is a deadly combination, ensuring that the energies of gifted young people will be devoted to activities whose ethical consequences are easily shoved into the background.

### 4. CONFLICT OF INTEREST IS FOR WIMPS

One of the deadliest norms in business today is the tendency to ignore or brush aside conflicts of interest as lily-livered concerns that should not interfere with making as much money as the traffic will bear. This norm is especially flagrant on Wall Street and in the insurance industry, where playing both sides of a transaction has become an art form. Practitioners protect themselves from shame and guilt by developing bland Orwellian language to describe their double-dealing transactions. The phrase "conflict of interest" is itself bloodless and legalistic. It carries none of the pungency associated with plain-talking phrases like "betraying the customer's trust" or "getting kickbacks for pushing clients into the worst performing funds."



The hypocrisy is obvious to Wall Street's own ethically concerned leaders. The celebrated Wall Street analyst Byron Wien has written extensively about "the breaking of the covenant between corporations and investors."[3] Unfortunately, Wien's concerns have done little to change Wall Street's habits.

### 5. THE CEO AS ROYALTY

In the 1990s CEOs became celebrities, partly for their outsized paychecks and partly because of the dazzling performance of the stock market in the years leading up to the bursting of the bubble. Little need be said here about the corrupting influence of money, power, and adulation. It has all been said before. Power goes to people's heads. Few can handle it well. The usual response is arrogance and the conviction that your whims should be instantly indulged, no questions asked. There is no other explanation for the excesses of people like Kozlowski, the Rigas family, Lord Black, Kenneth Lay, Bernie Ebbers, Franklin Raines, and countless others.

The destructive norm here is the assumption that the power and grandeur of the CEO is so great that he (and sometimes she) is exempt from the norms that ordinary mortals are forced to observe.

### 6. TWISTING THE CONCEPT OF SHAREHOLDER VALUE

This deadly norm is specific to business, which I discuss at length in Chapter 8. The rationale usually given for putting shareholders first is that by serving the long-term interests of committed investors, the company also serves the interests of its other stakeholders—employees, customers, suppliers, local

community, the society at large. In practice, however, shareholder value does not live up to its rationale because it suffers from two crippling distortions. The more obvious distortion is the emphasis on short-term quarterly earnings reports—the ones that clever accountants can most easily manipulate. The less obvious but arguably more serious distortion relates to the identity of the so-called "owners." The phrase conjures up images of Warren Buffet–type investors who buy and hold their stock for the long haul, or of Grandpa in Cleveland whose retirement is made comfortable by the dividends the stock pays. In practice, shareholder value has little to do with committed investors and owners of the company's shares, and everything to do with thirty-year-old mutual fund managers with zero loyalty to the company who can and do dump the stock without a second's hesitation. They are short-term renters of the stock, not committed owners. In both cases, there is a destructive shift from a long-term to a short-term focus.

In combination, these distortions make a mockery of shareholder value's stated intention of aligning the interests of management more closely with those of the company's "owners."

### 7. FREE-MARKET ECONOMIES REQUIRE DEREGULATION

This is perhaps the subtlest of the seven deadly norms—and some scholars believe it is the deadliest.[4] It ties into the laissez-faire strain of the capitalist tradition. Executives hold highly abstract and theoretical assumptions about the nature of corporations and market economies. One such assumption is the image of the corporation as an impersonal machine. Driven by



inexorable laws of profit maximization, these corporate machines cannot afford constraints like regulation or sentimentality about people's feelings and lives. This notion that the corporation runs according to inescapable, impersonal, and rigid economic laws has fostered a great deal of ill-advised deregulation, as well as rigidity, inflexibility, and undue suffering.

The experience of many nations, especially our own, has demonstrated that a market economy is not a machine with a fixed inherent nature but a system that can be remarkably flexible. The position of CEO in a large multinational corporation is the pressure point in the system. It is where all the conflicting and contradictory pressures of the modern global economy converge. This makes the job of the CEO immensely complicated. But it also makes it compelling and important. CEOs are the change agents of the emerging global economy.

A free-market economy is not well served by the automaton CEO who identifies totally with the notion of a market-driven enterprise as a machine that cannot, and should not, be constrained by regulation. It is well served by the very human CEO who brings his or her own well-developed ethical values into the job and calls upon these for guidance in juggling corporate cross-pressures.

In subsequent chapters we will return in one way or another to each of these seven deadly norms. For present purposes, however, I would underscore a single point. The combined effect of these seven norms is undermining traditional American adherence to the principle of enlightened self-interest—the notion that one can do well by doing good. Compositely, they lead instead to *un*enlightened self-interest—that one should do well at all costs and forget about doing good. Admittedly,

enlightened self-interest is a tough guide to follow: it requires a conscious effort to integrate personal advantage and larger social benefits. But unenlightened self-interest is a disaster for institutions that are meant to serve the needs of the larger community.

# IV
# Yesterday's versus Today's Ethical Norms

These seven deadly norms can be grouped into two broad categories—norms that come from within the business community and norms rooted in the general culture. The business norms are the "shareholders-come-first" norm that focuses on who the main beneficiaries of corporate success should be, and the "let-business-be-business" norm that leads to deregulation.

The shareholders-come-first norm derives from a shift in corporate culture that is only a few decades old. The norm that the laws of the free market brook no interference, intervention, or regulation is much older. It derives from economic theories that go all the way back to Adam Smith. The premise here is that if you monkey with the iron laws of market capitalism, be it through government regulation or capricious management practices (such as selling below cost, or being overly generous to employees), you will ruin the enterprise. There is certainly some validity to this observation, but it is subject to distortion and overstatement.