

Ethical Capitalism – Who Should Care?

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Introduction

Why do you want to go into business? Why do you want to be a capitalist?

You can read on the internet dozens of articles and pronouncements on ‘unethical capitalism’. Further, there are surveys done year after year on the views of the public towards the business executive. Last I checked, we were at or near the bottom on the trust scale – less than 10%; lower than used car salesmen, and politicians.

So why do you want to go into business?

There are some clear positives... in fact, capitalism is the most remarkable system mankind has come up with for creating wealth, increasing productivity, and raising both the standards of living and the quality of life for millions, if not billions of people around the world.

If individual freedom is your thing, capitalism is for you, as it is a system that encourages and rewards the development of new ideas, capabilities, technologies and offerings, as well as innovative new business models. You can look at entrepreneurship as the art of turning problems into opportunities, and ultimately solutions.

Yet, the challenges we face today – not just in Georgia, or the United States – but the world -- are raising serious questions about capitalism. While the quality of life for many is raised, the pressures and impact felt at the bottom of the pyramid is dehumanizing. The extremes of economic and societal inequality are widening, and hope for the ‘have less’ as well as the ‘have nots’ – is being squeezed out. There are real questions whether our society – or any society – can continue to prosper with such inequities and perceived unfairness. If these attributes are ‘hard-wired’ to capitalism, then what does it say about capitalism?

These and related factors force us to confront the question of the ethics of capitalism. Is capitalism unethical? And, in the end... who should care?

This is the topic that I would like to probe with you this afternoon.

Ethics

Let’s start by just touching the age-old question of what do we mean by ‘ethics’?

There are hundreds if not thousands of books on the topic of ethics. It has been discussed and debated for at least 2,500 years. One way to look at it is to consider the idea of ethics from two perspectives: *what we accomplish*, and *what we do*.

First, what we accomplish... Many brilliant thinkers define ethics around what is accomplished – David Hume and John Stuart Mill are two; they represent more of a utilitarian school of thought on ethics where the ethical judgment is derived by considering the consequences of actions. Personally, I struggle with this approach, as it seems to me to be the first step on an extremely slippery slope where you can argue that the ends justify the means. Just because a desired outcome is achieved, why is it ethical? Yet, we live with this philosophy every day. Think of the coach of the volleyball team, who challenges her players to ‘do whatever it takes to win’. In business, the goal is often as simple as just making money. The assumption is that anything goes – as long as it is not illegal, or for some, as long as they are not caught! And yet, the pursuit of self-interest has led to huge systemic failures that have hurt millions of people.

If you adhere to this approach to ethics, it begs the question of who sets the goals – the desired ‘ends’? It is one thing to make money for yourself, or for your shareholders, but then who is responsible for preserving a system that is fair, and avoiding the assumption of irresponsible systemic risk? We saw this problem in the financial meltdown of the last decade; we saw it 250 years ago in the overgrazing of public lands in England that became known as the Tragedy of the Commons. In both cases, disaster resulted from the pursuit of individual self-interest because no one took responsibility for the system.

This approach to ethics totally depends on the morality of the desired outcome. Is it fair? And for whom? If we accept that the goals are just, then we can begin to understand Gandhi’s comment that there is no difference between means and ends. This idea is embedded in the idea of teleological ethics which states that the means are the ends in the process of becoming. It can be a bit circular, but can be a helpful way of thinking in that it forces us to see the connection between means and ends – to look at ends and means as the extension, or precursor, of the other. I will come back to this point shortly as it offers a way to think about the role we need capitalism to play in our society. But for now, it opens the door to consider the second approach I outlined: that of considering our *actions*, i.e., what we *do*.

The approach of considering ethics by what we do rather than by what is accomplished is most closely associated with Aristotle and his notion of virtue. Aristotle was very clear on what constituted a virtue, and defined it as the mean between two extremes – each of which would be considered a vice. An example is courage, which taken to one extreme can be cowardice, and to the other, recklessness. Another is compassion, which to one extreme can be obsequious fawning, and to the other a cruel cold-heartedness. This approach originated not only with the Greeks, but also can be seen in China at about the same time in the thinking of Confucius. It was later embraced, in the 13th century, by Thomas Aquinas and became a key part of Middle Age Christian orthodoxy. Today, you may recognize it as the root of the Golden Rule which is so prevalent in many cultures and societies around the world. In the United States, today, this emphasis on actions rather than accomplishments tends to form the basis of our ethical framework.

Living a life of virtue – acting in accordance with a clear sense of what is right and wrong – is at the core of the idea of character. But, to be blunt: thinking – or knowing – without action is not enough. There is no ethical grounding unless one follows thought with action. I would go so far as to argue that knowing what is right, or wrong, and not acting in accordance with that knowledge is the ultimate character flaw. Confucius said it best: ‘to know what is right and to fail to do it is the worst form of cowardice’.

Yet, we see this situation in business all the time, and you – as young people launching into your business careers, will face this dilemma repeatedly – of being asked to do something that you feel is wrong, yet worried that if you don’t do it your career prospects will be jeopardized. Because of the reality of this kind of situation, I urge you to look at the work of Dr. Mary Gentile who has focused on how to ‘*Give Voice to Values*’ in the business environment. Finding your voice sounds easy, but amidst the pressures to ‘go along’, it can be immensely difficult.

Aristotle, I believe, recognized this fundamental frailty of what it means to be human by arguing that people need to habituate virtues. Through repetition, one could make virtuous living a habit, and minimize one's susceptibility to temptation. Today, we might call this the development or strengthening of conscience.

Ethics of Capitalism

With this conceptual framework of ethics as a backdrop, how do we then consider the ethics of capitalism?

Let me state up front where I come down on the question of whether capitalism is ethical. My bottom line is that capitalism is neither ethical nor unethical. It is neutral. It is like baseball, or eating. Both can be performed in unethical ways, but that does not make the game, or dinner, unethical. It is the people who practice it who can act either morally or immorally. To blame the system is to avoid looking at ourselves in the mirror.

To state the obvious, capitalism delivers the most value to all of us when it is practiced ethically. When was the last time you went into a restaurant and had to prepay for your meal? How often are you billed for services already rendered, or for a product already delivered? Trust is a foundation we must preserve in our capitalist system. Yet, it is easily eroded if we find that we don't trust the actors.

Trust is essential. Today, trust in capitalism is being challenged in three areas that we must address: first, the appropriateness of the benefits that accrue to the top; second, the plight of those being left behind; and third, the broader question of sustainability – whether we are so caught up in our own near-term self-interest that no one sees it as their responsibility to protect and preserve the system. What links these three concerns together is a moral one -- the question of fairness.

Just look at what we have seen in the United States and around the world these last few years: Switzerland proposed curbs on executive pay, and the European Union took up caps on bonuses. In the United States, we saw Occupy Wall Street movements and long unemployment lines across the country. And then with the last economic recovery, statistics showed that the top 1% received more than 100% of the economic gains. What do these factors reflect about our society, today? And, if you are unemployed, or not part of the top 1%, how do you feel about it?

There are some who argue that by getting out of the way and letting business pursue the profit motive with minimal interference, and most certainly minimal government regulation, is the best way forward. This thinking has been the doctrine of such people as Milton Friedman, and for many has its roots in the 18th century writings of Adam Smith in his *Inquiry into the Nature and Causes of the Wealth of Nations*. It was Smith who famously noted that man '*... intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was not part of his intention*'. Smith showed how the division of labor at the pin factory would lead to stunning increases in economic productivity. This thinking took the name of 'laissez-faire' capitalism, which argues for minimal government involvement because an unintended by-product of the pursuit of individual self-interest would be a greater improvement of society than if the government had actively directed it.

Yet even Adam Smith didn't fully buy it. In the *Wealth of Nations*, Smith went on and reflected on the unintended consequences of the division of labor. He noted: '*The man whose whole life is spent in performing a few simple operations ... becomes as stupid and ignorant as it is possible for a human creature to become.... The uniformity of his stationary life naturally corrupts the courage of his mind.*' Smith goes on to say: '*But in every improved and civilized society this is the state into which the laboring poor, that is, the great body of the people, must necessarily fall, unless government takes some pains to prevent it*'.

This is Adam Smith, not Karl Marx! Even Adam Smith recognized the amorality of capitalism, and the critical need of society, through governments to set rules and minimum standards. I find it highly ironic that Smith, today, is considered the champion of those who argue for minimal or no government interference in business. People actually ought to read all of Adam Smith before they site him as their intellectual godfather!

The problem with this thinking is that the goal being sought is one measured only in terms of economic productivity. But is this the kind of society in which we want to live? Where is the morality of this approach?

My point is this: If we are to live in a democracy, where individual citizens, collectively, will determine the kind of society in which we are to live, then one cannot ignore the impact on individuals – all individuals of what is clearly a highly efficient and productive economic system.

If we are not committed to democracy, and find another form of totalitarian government desirable, then the impact of the economic system on the individual may not be of concern. In this case, people may simply be viewed as economic inputs.

But, we have chosen to be a democratic society. A problem we face today is that the two major engines of our society – capitalism and democracy – are not in synch. What we have not done adequately is fully consider the link of a neutral system – capitalism – on the people it touches, and the consequent impact it has on the basic values of a democracy. Further, and even more damaging in the long-term, recent court decisions have opened the floodgates to the invasion and impact of money in politics – in both the elective and legislative processes. We seem to have reached a point whereby ‘big money’ can circumvent, or preempt the democratic process altogether.

A New Construct

Let me offer a new way to think about these challenges -- one that views capitalism not as a stand-alone and separate system, but as a fully integrated part of the fabric of our democratic society. It's rather simple, and combines the ethical focus on both ends and means. In this approach, we don't start with capitalism or a look at the economic system (the ‘means’), but instead begin with a more fundamental examination of the kind of society in which we want to live (the ‘ends’). I fully expect that we all would agree on the desirability of economic growth, productivity, and a high quality of life for as many people as possible -- but what else? What non-economic values and characteristics are important to us that we are willing to take steps to nurture, protect and preserve? The way we answer this question provides us with the moral foundation of our society.

With this initial understanding, we can then ask the question as to what kind of economic system will get us there. What are the ‘means’ that, in turn, are the ‘ends’ in the process of becoming? What are its characteristics? We then can focus on the more difficult topic of what is different in our envisioned society from the present, and how do we get there from here. It is in this context that we can best consider what we should be able to expect from business.

So, what should we do? Besides getting corporate money out of politics, let me suggest five topics that, by addressing, will help move us to achieve the necessary realignment of business with the longer term needs and goals of society.

1. Move away from the notion of shareholder primacy. Today, corporate purpose has been hijacked by the notion of shareholder primacy – that the purpose of the corporation is to maximize profits for its shareholders. This view was never the intent of corporate law, which granted certain protections in recognition that a corporation would contribute for the betterment of society, not just its shareholders; and, it is not corporate law, today. We need to recognize that a corporation has an obligation to many constituents -- first and foremost, its customers. In fact, the economic investor – the shareholder – really stands last after the company has addressed the needs of customers, employees, and in many cases, its communities.
2. Confront the disease of short-termism. In recent years, the pressures on corporations to deliver as much as possible, now, has intensified. No CFO or CEO of a public company wants to explain why they missed their earnings projections, and then see their stock collapse. The problem is that we have become caught up in what Roger Martin, the recently retired Dean of the Rothman School of Business at the University of Toronto, calls the ‘expectations game’ – the need to meet investors’ expectations at just about any cost. This pressure leads to a short-term focus, and short-term decision-making where quarterly performance is more important than the long-term health of the company.

An interesting point to note is that, in my view, addressing what I call this disease of short-termism actually helps address the conflict and tension between a shareholder and multi-stakeholder view of the corporation. If companies were to take a longer view, the interests of the shareholder and other stakeholders begin to align. A key condition for this alignment is that a company define its financial objective as building sustainable long-term value rather than maximizing short-term profit.

3. Re-think cost accounting definitions and performance metrics. Our current accounting system was developed at the time of the industrial revolution, over 200 years ago. It was established for companies that manufacture products and has not kept up with the way business has evolved. It is a ‘forced fit’ for services companies, and simply cannot adapt effectively for knowledge-based businesses. It makes no sense for the acquisition of a services company to be largely recorded as goodwill simply because our system doesn’t have asset categories that apply. Furthermore, our current accounting methodologies ignore costs that society can no longer ignore, such as pollution, environmental damage and other downstream effects. As a result, the definition of ‘profit’ is flawed. If we stay with our current cost recognition system, and if you assume that you get what you measure, it should be no surprise that companies don’t address costs and issues that, by their metrics, simply don’t exist! We need to rethink what we call ‘costs’, and ensure that we are accounting for the true impact of business operations.
4. Establish long-term investment incentives. We cannot expect business to suddenly take a long-term view; the market pressures are too intense. Yes, we will see examples of enlightened leadership, but we need it to be in everyone’s interest to take a longer view. If the market forces of capitalism are a river, we are foolish to try to stop it; however, we can redirect it. One straightforward change that I support is to redesign capital gains taxes, and make it markedly more progressive, i.e., a very high tax if an investment is held and liquidated in a short period of time, declining to zero if an investment is held for five or seven years or longer. With this kind of incentive, the market will see it in its own economic interest to become more of a long-term investor.
5. Finally, Revisit the role, responsibilities and operating model of Boards of Directors. I leave this point to the end because it think it may be the most important – certainly the area of focus where immediate traction can occur. Many boards have fallen into the trap of believing their primary role

is one of ensuring compliance. This role, while necessary, is insufficient; boards need to spend more time looking forward, not backward. The role of the Board is to ensure that purpose, vision and core values of a company are in place, to engage around matters of strategy and direction, and then to give the CEO and executive team the time and space to engage in responsible, balanced decision-making. By understanding the nuances of company strategy and how it must play out over time, boards are better able to establish the appropriate performance metrics that will indicate both progress and success, and thereby hold the CEO accountable for performance. In performing this role, Boards are more able to help CEOs counter the short-term pressures of the market, and to ensure that companies do not make short-term accommodating decisions that are not in its long-term interest as responsible contributors to society. If this work cannot be done at one or two day long quarterly board meetings, then companies should consider changing the Board operating model to enable it to properly perform its job.

Moral Dimension

Q: what right do we have to deplete critical natural resources for today's consumption – and ignore what will be available to and needed by future generations? Tell me why short-term profit that drives this kind of behavior is good for society?

Q: what right do we have to process raw materials and create products in such a way as to cause irreparable harm to the environment, contribute to global climate change and potentially cause irreversible and negative impact on the health of the earth for all future generations? Tell me what kind of cost accounting methodologies that allow us to ignore these costs are good for society?

Q: what right do managers – not founders or creators – have to profit at the level of tens and hundreds of millions of dollars for simply managing – and at times failing to manage well (it doesn't matter which!) an enterprise, the responsibility for which they are entrusted. Tell me why such extreme allocations of benefits in the face of poverty and inequality are good for society?

The new construct I propose allows us to take into consideration such moral issues as we think about the kind of society we want to have, the kind of economic system that can get us there, and the kind of behavior, metrics and leadership we need from our business leaders as the key drivers of the system.

My point is this: capitalism, as practiced in the United States today, is simply unsustainable. It is destroying other important values of society; it is ignoring the realities and tradeoffs of the global community in which we live, and with which we must co-exist. It is time that we, as a society, explicitly consider the values we treasure that we will put off limits to market forces. This point was best stated by Arthur Okun, economic advisor to President Johnson, in his 1975 book, *Equality and Efficiency: The Big Tradeoff*. He noted: *'Society needs to keep the market in its place... Given the chance, it would sweep away all other values, and establish a vending machine society.'*

I believe that unless we address these issues, capitalism as practiced today runs a risk of falling under its own weight. A system that is seen to be unfair, where the people in control are seen to benefit at the expense of increasingly large numbers of people being left behind, will rapidly lose its legitimacy. The public will not accept what business so conveniently calls 'unintended consequences'; legislators will be pressured to pass laws, and businesses will find the playing field for business to be further and further constrained. Already, we are seeing it happen. Twice in the last fifteen years when we witnessed major corporate failures of responsibility, we got added regulation. We saw it with Sarbanes Oxley following the fall of Enron, Arthur Andersen and MCI WorldCom; we saw it with Dodd Frank following the financial meltdown of a few years ago. Society simply will not stand by and allow companies to continue to profit for

themselves in the short term when the costs are so damaging to society in the long term. It would seem clear to me that it is in best interests of business, and therefore business leaders, to exercise a more responsible, longer-term leadership and to be seen to be doing something about it! It is what Alexis de Tocqueville called 'self-interest, rightly understood'. The wrong thing to do is to ignore the issue, use our corporate lobbying strength to push off any kind of undesired legislation, and only fall into line when new laws on the books force us to do so. This kind of approach is not the leadership we need from the business community. As Leo Strine, at the time Vice Chancellor of the Delaware Courts, and today (as of three weeks ago), Chief Justice of the Delaware Supreme Court, commented, referencing the Tragedy of the Commons, *'we don't have time to relearn the lessons of the 18th century.'*

What is interesting to see is that other notable organizations are reaching the same conclusion: The Aspen Institute Business and Society Program, the advisory board of which I chair, has been addressing the problem of short-termism; the Committee for Economic Development, of which I am a trustee, has just launched an initiative on 'sustainable capitalism'; the World Economic Forum at Davos, just a few weeks ago, had a panel on 'ethical capitalism', The Brookings Institution has been re-examining the topic of 'corporate purpose', and the Center of Higher Ambition Leadership in Massachusetts is working with CEOs and boards in examining the role, responsibilities and focus of boards of directors.

Further, we are seeing increasing examples of far-sighted leadership at US businesses. Take a look at the values, and the more than two decade performance, of Henry Schein. Take a look at Becton Dickinson. Recent studies completed by Harvard Business School and Babson College confirm that companies that take a more socially responsible, long-view outperform their peers. My own experience in building Veridian is that having such clear values attracts top talent which, in turn, can provide a competitive advantage.

The Human Actor

If you believe – as I do – that capitalism, the system, is by definition neutral, then you must return to the human actor – to each of us – to you.

Each of us must start with our personal values. If you don't know what you stand for, you have no basis for ethical decision making. None of us have the luxury of just living our life without thinking. The need to really think, set priorities, know what to fight for, and when to walk away – kicks in at different times for each of us. But, at some point, it does kick in.

I urge you to not allow yourself to just 'go along'. Allow yourself to be outraged! Allow yourself to be passionate! Above all, believe in something, and set moral standards for not only your own behavior, but for the community in which you want to live, and the society which you want to leave to your children.

I have four children, two of whom are ice hockey players. Wayne Gretzky, arguably the greatest hockey player of all time, gave interesting advice to young hockey players, which was to play other sports, and do other things that develop different facets of coordination and skills. His point was that it takes more than just hockey skills to be a great hockey player.

The same can be said about business – don't just study and practice business. Read a novel, embrace the humanities. I have to tell you that in my experience as a CEO when I have needed an accountant, there have been many to choose from; when I have needed an engineer, there have been many to choose from. But, when I am looking to promote someone to the executive ranks, I look for something else – not technical expertise, but judgment, critical thinking, emotional intelligence, compassion, the ability to connect with employees, values I trust; essentially, skills of leadership. So... embrace the humanities, listen to music, do the kinds of non-business things that put you in the shoes of other human beings. It will

sharpen your own thinking about your values; it will make you a better person, and ultimately a better leader.

Above all, my advice to you is don't accept the status quo.... Get involved... create networks of similar thinking students and young professionals at other business schools. And, push back on your professors that teach you that discounted cash flow analysis is the 'right' or only way to perform investment analysis. We need to challenge these 'holy grail' concepts! You are the leaders that matter, as you have far more runway than I.

Conclusion

So, in closing, to the question of ethical capitalism – who should care? We all need to care. More is at stake than capitalism itself. It is too easy to 'blame the system'. I urge you to see it as a problem that you can do something about. Any morality in our society, including in our economic system, must come from the standards and behavior of us human beings. And here, knowing what is right and wrong is not enough – As Johann Wilhelm von Goethe stated: *'Knowing is not enough, we must apply; Willing is not enough, we must do'*.

Make it personal, because in the end, it is... what kind of society do you want to leave to your children? Let's answer that question, and then unleash the extraordinary power of a new capitalism that balances society's short and longer term interests, that measures and accounts for the real costs of its activities, and which is fundamentally fair and doesn't inappropriately profit the few at the expense of the many.

In the end, yes we must care. But don't blame the system. We need to look to ourselves and expect a more responsible leadership from its practitioners! If we want to live in an ethical and moral society, those values and practices must come from us, whether businessmen, politicians, athletes, students -- or simply as citizens. For me, values-based leadership is the only form of sustainable leadership, and ethics-based capitalism is the only form of sustainable capitalism.

Thank you.