

PUTTING FIRST THINGS FIRST 1.1

If you are a leader at any level in any organization, you are a steward—of careers, capabilities, resources, the environment, and organizational values. Unfortunately, not every manager is a wise steward. Some behave like mercenaries—by mortgaging the future to inflate short-term earnings, by putting career ahead of company, by exploiting vulnerable employees, by preying on customer ignorance, or by manipulating the political system in ways that reduce competition. What matters now, more than ever, is that managers embrace the responsibilities of stewardship.

To my mind, stewardship implies five things:

1. *Fealty*: A propensity to view the talents and treasure at one's command as a trust rather than as the means for personal gain.

2. *Charity*: A willingness to put the interests of others ahead of one's own.
3. *Prudence*: A commitment to safeguard the future even as one takes advantage of the present.
4. *Accountability*: A sense of responsibility for the systemic consequences of one's actions.
5. *Equity*: A desire to ensure that rewards are distributed in a way that corresponds to contribution rather than power.

These virtues seem to have been particularly scarce in recent years, as we've careened from Enron's devious accounting to the financial chicanery at Parmalat, from Shell's overstated reserves to BP's derelict safety standards, from Bernie Madoff's epic scam to Hewlett-Packard's spying scandal, from the predatory loan practices at Countrywide Financial to the disastrous excesses at Lehman Brothers, and from India's corruption-marred sale of wireless spectrum to the firestorm ignited by News Corp's phone hacking. Despite these and other dirty deeds, I doubt that today's tycoons are any less principled than their counterparts in earlier decades. The German word *raubritter*, or "robber baron," dates back to the Middle Ages, and was first applied to grasping toll collectors along the Rhine River. In the nineteenth century, the term was revived as a fitting epithet for America's buccaneering and occasionally rapacious industrialists.

If twenty-first-century leaders seem especially amoral, it's because a globally matrixed economy magnifies the effects of executive malfeasance. Consider the sovereign debt crisis that engulfed Europe in 2011. In a world of nationally constrained institutions, the credit problems of a country like Greece would be a small-scale catastrophe. Not so in an interconnected world where avaricious strategies are quickly aped and imprudent risks spread like a virus. It was these dynamics that led French and German banks to dump more than \$900 billion into the barely solvent economies of the "PIGS"—Portugal, Ireland, Greece, and Spain. Turns out American bankers aren't the only ones who are susceptible to moral hazard. But it's not just bankers we need to worry about. In a networked world, lax security standards can imperil the confidential information of a hundred million consumers or more. A failure

to exercise due diligence over a vendor can result in a worldwide food contamination scare. And a decision that puts quality at risk can provoke a global recall.

The critical point is this: because the decisions of global actors are uniquely consequential, their ethical standards must be uniquely exemplary. It's easy to feel sorry for Mark Hurd, the former Hewlett-Packard CEO who was pushed from his perch over what seemed to be a relatively minor infraction of HP's ethics rules. I don't know whether justice was done in that particular case, but I do know it's a good thing when influential leaders are held to high standards.

If the global economy amplifies the impact of ethical choices, so, too, does the Web. Word-of-mouth can quickly turn a local misdemeanor into a global cause célèbre. Nike, Apple, and Dell are just a few of the companies that have been castigated for turning a blind eye to the subpar employment practices of their Asian suppliers. There are no dark corners on the Web—miscreants will be cuted.

The Web is also producing a new sort of global consciousness, a heightened sense of our interconnectedness. Increasingly we understand that we live on the same planet, breathe the same air, and share the same oceans. In civic and commercial life, we expect the same high standards of equity and fair play to apply everywhere, and are offended when they don't. And thanks to the Web, that displeasure can quickly congeal into a global chorus of indignation. Around the world, ethical expectations, if not behaviors, are leveling up.

The intermeshing of big business and big government is another force bringing values to the fore. As citizens and consumers, we're smart enough to know that when lobbyists and legislators sit down to a lavish meal, our interests won't be on the menu. Instinctively, we know that democracy and the economy do better when power isn't concentrated, but since it often is, we must do whatever we can to ensure that those occupying positions of trust are, in fact, trustworthy.

For all these reasons, we need a values revolution in business—and it can't come soon enough. In a 2010 Gallup study, only 15% of respondents rated the ethical standards of executives as "high" or "very high." (Nurses came in first at 81%, corporate lobbyists last at 7%.)¹

This lack of trust poses an existential threat to capitalism. Companies do *not* have inalienable rights granted to them by a Creator; their rights are socially constructed, and can be *reconstructed* any time society feels so inclined. (A fact made abundantly clear with the passage of the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act of 2010—two U.S. statutes designed to dramatically curtail corporate prerogatives.)

The good news is that the values revolution has already started. No one's waiting for executives to have an epiphany. One telling statistic: Between 2005 and 2010, U.S. assets invested in "socially responsible" funds (as defined by the Social Investment Forum Foundation) grew by 34%, whereas total assets under management grew by only 3%. Today, of the more than \$25 trillion under management in the United States, one dollar in eight is invested in socially oriented funds.² And there are other harbingers. A decade ago, no car magazine would have noted a vehicle's CO₂ emissions, but now most do—at least in Europe. A decade ago, "Fair Trade" wouldn't have been a marketing pitch, now it is. A decade ago, few would have paid attention to executive pay, now millions do.

Given all that, the question for you and your organization is simple: Are you going to be a values leader or a values laggard? It's easy to excoriate fraudster CEOs and greedy bankers, but what about *you*? (And what about *me*?) We can't expect others to be good stewards if we're not. Though some executives cast a bigger moral shadow than others, we must all shoulder the responsibility for protecting capitalism from ethical vandals.

From Adam Smith to Ayn Rand, the defenders of capitalism have argued that the common good is maximized when every individual is free to pursue his or her own self-interest. I believe this to be true, with one essential caveat. Like nuclear fission, self-interest works only as long as there's a containment vessel—a set of ethical principles that ensures enlightened self-interest doesn't melt down into unbridled selfishness. Unfortunately, the groundwater of business is now heavily contaminated with the runoff from morally blinkered egomania.

As parents, we expend enormous energy in socializing our children. While a rebellious teenage son might believe his interests are best served by dropping out of school and moving in with his girlfriend, his parents

are likely to have a different view. That's what parents do—they teach their children to become stewards of their own lives.

Problem is, if you're a manager or an executive, your stewardship obligations extend far beyond yourself and your family. Yet in recent years many business leaders have blithely dodged those responsibilities. That's why executives languish near the bottom of the trust table.

So before you go any further in this book, ask yourself, am I really a *steward*?

1. What about *fealty*? Like the executor of an estate, do I see myself as a fiduciary?
2. What about *charity*? Like a self-sacrificing parent, am I willing to put the needs of others first?
3. What about *prudence*? Like a committed conservationist, do I feel responsible for protecting and improving the legacy I have inherited?
4. What about *accountability*? Like the captain of a vessel, do I understand I am responsible for my wake—for the distant ripples created by my decisions?
5. What about *equity*? Like a conscientious mediator, am I truly committed to finding the most equitable outcome for all?

If you're struggling to think through what this means in practice, here's something that might help. For years I taught a second-year MBA course at the London Business School. In the final session, I typically offered my students some parting advice.

When you take your first post-MBA job, I'd tell them, assume that the following things are true:

First, your widowed mother has invested her life's savings in your company. She's the only shareholder and that investment is her only asset. Obviously, you'll do everything you can to make sure she has a secure and happy retirement. That's why the idea of sacrificing the long-term for a quick payout will never occur to you.

Second, your boss is an older sibling. You'll always be respectful, but you won't hesitate to offer frank advice when you think it's warranted—and you'll never suck up.

Third, your employees are childhood chums. You'll always give them the benefit of the doubt and will do whatever you can to smooth their path. When needed, though, you'll remind them that friendship is a reciprocal responsibility. You'll never treat them as human "resources."

Fourth, your children are the company's primary customers. You want to please and delight them. That means you'll go to the mat with anyone who suggests you should deceive or take advantage of them. You'll never exploit a customer.

Fifth, you're independently wealthy. You work because you want to, not because you have to—so you will never sacrifice your integrity for a promotion or a glowing performance review. You'll quit before you compromise.

These assumptions, if acted upon, will help nourish the seeds of stewardship in your business life and, by example, in the lives of others.

As we struggle with the uniquely complex challenges of the twenty-first century, it is good to remind ourselves that what matters most now is what's always mattered: *our bedrock values*.

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LEARNING FROM THE CRUCIBLE OF CRISIS

1.2

As I write this, the U.S. economy is sputtering. Though the Great Recession technically ended two years ago, unemployment remains stubbornly high and economic growth is distressingly feeble. The percentage of the U.S. population working is at a 25-year low and with 125,000 new job seekers entering the workforce each month, it may take a decade for the United States to get back to prerecession employment levels. A number of European states are in similar straits: property prices have tumbled, unemployment has soared, and growth has stalled.

What we are witnessing is the mother of all hangovers—the inevitable and entirely predictable outcome of an epically irresponsible borrowing binge. Unfortunately, in this case, the boozers weren't hard-drinking college kids on a Fort Lauderdale beach. They were the

captains of capitalism. Federal Reserve policymakers were the distillers, congressional legislators the rumrunners, and big bank CEOs the bartenders. Sure, a lot of ordinary folks bellied up to the bar of cheap debt, but they were egged on by the “adults.” If you’re looking for an analogy, picture a high school dance where parents and teachers are pouring shots at an open bar.

It’s difficult to imagine grown-ups doing anything so reckless, but then, a decade ago, it would have been difficult to imagine the world’s smartest financiers and policymakers abetting financial idiocy on a global scale.

The worst economic downturn since the 1930s wasn’t a banking crisis, a credit crisis, or a mortgage crisis—it was a moral crisis, willful negligence *in extremis*. Few of us are surprised when we witness base behaviors in lofty places (like a “sexting” congressman), but the implosion of America’s investment banking industry revealed Biblical scale transgressions. One is reminded of the Exodus account in which the entire Jewish nation abandons Yahweh to bow before a golden calf.

Every institution rests on moral footings, and there is no force that can erode those foundations more rapidly than a cataract of self-interest. In *The Radicalism of the American Revolution*, Gordon Wood notes repeatedly that the country’s founders regarded “disinterest” as a noble virtue. As they set about inventing the United States of America, that first crop of patriots endeavored to detach themselves from selfish concerns over personal gain and loss. One would struggle in vain, I think, to find evidence of “disinterest” in the behavior of Lehman Brothers’ Dick Fuld, Merrill Lynch’s Stan O’Neal, or any of the other banking chieftains who pillaged the U.S. economy for personal gain.

While much has been written about the antecedents of the banking debacle (much of it opaque and tedious), it is worth taking a few moments to perform a quick moral autopsy. This will necessitate a brief rehearsal of the facts. The goal here is not to heap more blame on the bankers (well, it’s not the *only* goal), but rather to understand what happens when self-interest slips the knot of its ethical moorings. It is easy to be contemptuous of the bankers and regulators who precipitated the crisis, but I am not so sure that you and I would have behaved

much differently if we had been faced with the same temptations. By all means let's hold the bankers responsible (Someone? Please?), but let's also use their calamitous misadventure to do a little moral reflection of our own.

So, what happened? Let's focus first on the proximate causes of the disaster.

EASY MONEY

After the dotcom bust in 2000, the U.S. Federal Reserve, under the leadership of first Alan Greenspan and then Ben Bernanke, drove borrowing costs down to disastrously low levels. Dirt-cheap money encouraged U.S. consumers to gorge on debt, dramatically increasing the risk of widespread mortgage defaults.

Asian savings also played a role. By pegging the yuan to the U.S. dollar, Chinese authorities kept exports high and internal consumption low, thus building up huge reserves. These had to be recycled, and a lot of that money went into buying mortgage-backed securities.

SECURITIZATION

By bundling mortgages into "collateralized debt obligations" and selling those CDOs to third parties, bankers were able to move dodgy loans off their books. Between 2005 and 2007, more than 85% of all U.S. mortgages were securitized.

Historically, lending had been tied to deposit taking. By taking the brakes off fund-raising, securitization led to an unprecedented boom in mortgage lending. The net result: a serious decline in lending standards. As banks competed their way to the bottom, they handed out loans to just about anyone with a pulse.

As it turned out, securitization didn't inoculate banks from the risks of subprime lending, since many banks built up large CDO holdings via off-balance sheet "Special Investment Vehicles." Commercial banks also lent billions of dollars to the biggest buyers of CDOs, investment banks and hedge funds.

INSURANCE

Credit default swaps (CDS) made it possible for CDO investors to protect themselves from a housing collapse—in theory. As with all insurance products, underwriting prudence requires a rich seam of historical data, but given the unprecedented growth of the subprime market, and the concomitant decline in lending standards, past default rates had no predictive value. As a result, CDO insurers like AIG severely underpriced the risks of a default debacle. This error was multiplied when speculators dramatically upped the demand for CDS contracts. Amazingly, the world ended up with \$62 trillion of credit default swaps and no organized trading exchange.

COMPLEXITY

The new financial instruments cooked up by the banks were mind-bendingly complex. Mortgages were packaged together, partitioned into tranches, and then sold. Many CDOs were bundles of other CDOs. These convolutions made it hard for investors and ratings agencies to decipher the real risks.

It should be noted that all this complexity didn't happen by accident. Bankers love complexity, as it creates the illusion of value-added and provides a veil behind which they can hide their porcine fees. It's even better when a financial product isn't publicly traded, as that makes it harder for a buyer to discern its real value. Unfortunately, as the world came to realize, complexity can also obscure risk.

LEVERAGE

In a bull market, the greater the leverage, the better the returns. That's why the biggest buyers of mortgage-backed securities borrowed heavily to bulk up their portfolios. With leverage ratios of 30-to-1 and higher, most of the major investment banks made massive bets on a continued

rise in U.S. home prices. While this unprecedented leverage amped their returns on the upside, it obscenely compounded risks on the downside. In their rush to profit from the subprime bonanza, many bankers seemed to forget that leverage is always a double-edged sword—sooner or later it cuts both ways.

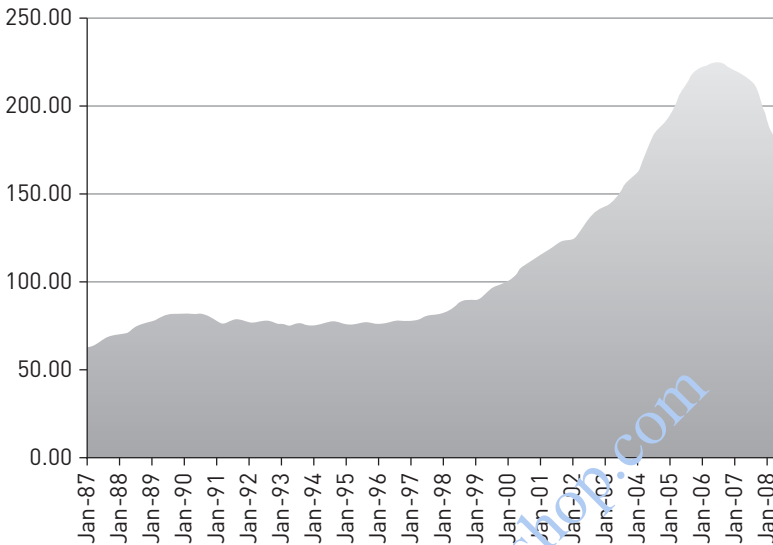
Unfortunately, much of that leverage came from loans made by commercial banks. When defaults began to accelerate, those banks started calling in their loans, forcing investment banks and hedge funds to deleverage in a down market. To do so, these institutions had to dump other assets, which sent the stock market tumbling.

ILLIQUIDITY

Because of their complexity and novelty, there was no real secondary market for many CDOs, so when things started to go south, it was hard for cash-strapped institutions to reduce their exposures.

Without a well-functioning secondary market, buyers had no way of discovering the true value of the exotic instruments they held, nor was it easy for investors and regulators to gauge the real threat to bank balance sheets. In the absence of reliable pricing data, bankers had no choice but to take punishing write-downs on their mortgage-backed securities.

Many senior bankers claimed that the subprime crisis could not have been anticipated—that it was, as the chairman of the Financial Crisis Inquiry Commission scathingly put it, an “immaculate calamity.”¹ I disagree. Anyone who was watching the unprecedented run up in U.S. house prices (see Figure 1.2.1) had to know that a crisis was looming. Indeed, in 2005 I bought a financial derivative from my broker that was, in effect, a bet against the housing market. The instrument was linked to a stock index that tracked the performance of America’s largest home builders. For every 1 percent decline in the value of the index, the value of my investment rose by 3 percent. The instrument expired in 2008 and paid off handsomely. My only regret is that I didn’t bet bigger.

Figure 1.2.1 S&P/Case-Shiller Index of U.S. House Prices*

*January 2000 prices are indexed to 100.

As I watched the crisis unfold, my initial reaction was disbelief. How could so many super-smart people be so wrong? Once the poop hit the fan, pundits of every stripe came forward with their preferred remedy (turn the Fed into a super-regulator, create living wills for the biggest banks, dramatically raise capital reserves, limit banker bonuses, and so on). At the time, I wondered if the solution might not be simpler. What about tattooing a few carefully chosen lines onto the forehead of every banker who had received bailout money:

Alchemy doesn't work. What was true for Isaac Newton all those centuries ago is still true: you can't turn dross (garbage loans) into gold (triple A-rated securities) no matter how clever you are.

Things that can't go on forever usually don't. If an extrapolated trend produces ludicrous results (like million-dollar starter homes), it will soon reverse itself—so don't bet it won't.

Risks and returns are always correlated. Maybe there's someone out there who can produce a positive "alpha" year after year, but it probably isn't you or anyone you know.

Stupidity is contagious. Reflect on the mad obsession with leverage and complexity that consumed you and your banking buddies. Smart as you may be, you're every bit as vulnerable to silly fads as Japanese schoolgirls.

The tattoos would have to be inscribed in reverse, so that every time a self-admiring banker glanced at a mirror, a teaching moment would occur.

Tats or no, bankers *do* understand these simple truths, so why did Wall Street's finest fail to heed them? Or more pointedly, why did they so completely abandon their responsibilities as the guardians of capitalism's most important citadels?

As it unfolded, the subprime banking crisis revealed a Shakespearean catalog of moral turpitude. It was a perfect storm of human delinquency. Deceit, hubris, myopia, greed, and denial were all luridly displayed.

DECEIT

We now know that a good many mortgage bankers, the folks who made those subprime loans, conspired with first-time borrowers to overstate incomes and understate debts. In addition, deceptive sales tactics and a lack of disclosure encouraged many borrowers to take on loans they'd never be able to pay off. In 2009, the FBI investigated 2,794 cases of suspected mortgage fraud, up from 721 cases in 2005.² The simple lesson: any financial instrument that is built atop lies and misrepresentations will be flimsy at its core.

HUBRIS

The Wall Street rocket scientists who were charged with packaging subprime offal into marketable securities dramatically overestimated their ability to parse and partition risk. They would learn to their sorrow that distributing risk is not the same thing as eliminating it, particularly when that risk is compounded by nose-bleed leverage. Convinced of their

own genius, they failed to distinguish between genuine sophistication and mere sophistry.

MYOPIA

In creating and pricing all those brave, new “structured products,” Wall Street’s whiz kids relied on complicated financial models to estimate potential risks. Because the models were based on recent trend data, covering a time frame when asset values had arced ever higher, they failed to anticipate the possibility of a major slump in asset values. Lenders and investment bankers could argue that the U.S. housing market had never been through a steep and prolonged nationwide slump, but then again, neither had there ever been a run-up in house values like the one that occurred between 2000 and 2007. Again, there’s a lesson here: just because you can’t remember the last hundred-year storm doesn’t mean one isn’t headed your way.

GREED

It goes without saying that everyone on the subprime ship of folly was earning big fees: the mortgage originators who approved all those “ninja” loans (no income, no job, no assets), the Wall Street bankers who bundled them into securities, the hedge funds who bought the new-fangled instruments and charged their clients big bucks for delivering above-average returns, and the rating agencies whose thirst for new business compromised their once-hallowed objectivity. The lure of multimillion dollar bonuses turned sober-suited bankers into frenzied speculators. As ever, greed proved to be a tireless cheerleader of human folly.

DENIAL

Organizations are occasionally overtaken by truly unpredictable events. This was the case for the U.S. airline industry in the aftermath of the 9/11 terrorist attacks. Usually, however, stupefaction is the product of denial. Companies get caught out by the future not because it’s

unpredictable, but because it's unpalatable. Unwilling to face facts, just about everyone who was financially vested in the housing boom chose to ignore the inevitable. To a degree, the future is always opaque, but it's a lot more so when you shut your eyes.

The subprime debacle revealed that America had a financial system of the bankers, by the bankers, and for the bankers—consumers and shareholders be damned. To a large extent this is *still* true. No high-ranking banker is in jail, the biggest banks have grown even bigger, bonuses are once again setting records, and at this moment, more than 3,000 banking lobbyists are hard at work in Washington trying to water down the reforms that were enacted in the wake of the crisis.³

This lack of accountability is baffling until one realizes that many of the watchdogs who were supposed to guard the economy from bankerly excesses—individuals like former SEC Chairman Christopher Cox and U.S. Representative Barney Frank, chair of the House Financial Services Committee from 2007 to 2011—were ardent coconspirators.

Here, too, one witnesses Faustian sell-outs and a feckless dereliction of duty.

As taxpayers and citizens, we expected the government to protect the economy from unsustainable booms and busts. Instead, it provided the monetary fuel for an unprecedented housing boom.

As taxpayers and citizens, we expected the government to avoid creating economically perverse incentives. Instead, it aggressively subsidized subprime mortgages. In the years leading up to the bust, Fannie Mae and Freddie Mac, government-sponsored entities that answered to congressional masters, bought billions of dollars of subprime mortgage loans from originators like New Century Financial Corp. and First Franklin Financial Corp. With the implicit backing of the U.S. government, Fannie and Freddie were able to borrow at preferential rates and ultimately assembled a \$1.4 trillion portfolio of mortgage-backed securities.

We expected the government to enforce prudent banking practices. Instead, it allowed investment banks to dangerously overextend themselves. In 2004, with the housing boom well under way, America's big investment banks were chafing under SEC restrictions that limited their debt levels. Eager to boost their returns by taking on more debt, Wall

Street's leading banks joined forces to lobby for regulatory relief. Up against the united front of the nation's biggest investment banks, the SEC caved. Neutered by a belief in the omniscience of billionaire bankers, and blinded by their faith in industry self-regulation, the regulators failed to exercise the due diligence that would have prevented a financial Katrina.

As taxpayers and citizen, we expected the government to ensure transparent and orderly markets. Instead, it abdicated its responsibility to create a regulatory framework for credit default swaps and other derivatives. Thanks to derelict legislators, the world ended up with a globe-spanning bazaar for mortgage-backed securities that was less well-organized than eBay's market for snowglobes.

As taxpayers and citizens, we expected the government to indemnify taxpayers against bank failures. Instead, it stood idly by while a merger boom created banks that were "too big to fail." In the 1990s, the banking industry led all others in terms of merger activity, and by 2004, 74% of U.S. bank deposits were controlled by just 1% of America's banks.

The truth is, America's regulators had all the powers they needed to curb the "irrational exuberance" that precipitated the banking crisis—but they didn't. Again, this was a moral washout. Some of the most egregious lapses included these:

Blind indifference to the human costs of ideological zeal. In the years leading up to the crisis, there was a naive belief among many regulators that banks could be trusted to police themselves. These free market zealots failed to distinguish between the freedom to trade (generally a good thing) and freedom from oversight (generally a bad thing). In October 2008, Christopher Cox ruefully remarked that "The last six months have made it abundantly clear that voluntary regulation does not work." Duh. With the exception of Nazism and communism, it's hard to think of another ideological infatuation that has cost the world so dearly.

Public responsibilities abandoned for political gain. Wall Street used its colossal profits to buy heavyweight political leverage, and few legislators had the guts stand up to their Wall Street benefactors. Consider this: between 1990 and 2008, AIG provided more than \$9.3 million in campaign contributions and spent more than

\$70 million in lobbying efforts designed to batter down regulatory obstacles, according to *Time* magazine.⁴ Virtually all of the game wardens on Capitol Hill were taking the poachers' money.

Milquetoast regulators more inclined to protect their backsides than raise an alarm. Undoubtedly there were officials in Washington (at the SEC, the Fed, the Office of the Comptroller, the Department of Justice, the Office of Thrift Supervision, and the FDIC) who were alert to the subprime contagion and who noticed the rapidly multiplying pathogens in the regulatory crevices. Yet rather than bark an alarm, the watchdogs rolled over and let the bankers scratch their tummies. Yes, there were gaps in regulatory coverage—but when you've been charged with protecting America's economy, your responsibility is to find and fill those gaps, not to take refuge in the sanctuary of a narrow regulatory remit. In the league table of execrable excuses, "it's not my job" ranks near the top.

Fact is, America's legislators and regulators were just as culpable as its bankers. The bomb that blew up the U.S. economy may have been detonated on Wall Street, but it was manufactured in Washington, DC.

As with the bankers, we are still waiting for a mea culpa from the regulators. None is likely to be forthcoming. (Among the powerful, blame deflection is a core competence.) What we have gotten instead is a barrage of proposals for increasing the powers of those who were either too cowardly or too compromised to exercise the authority they already had.

We need to be clear: in the banking crisis it wasn't capitalism that failed us, but capitalism's custodians. Those who should have been fighting to protect the moral high ground laid down their arms and auctioned off their integrity to the barbarian bankers.

We are left, then, with two critical questions: What is it that produces such a disastrous lapse in collective moral judgment? And what lessons are there for those of us who aren't bankers or policymakers? Let's take each question each in turn.

It seems to me that moral corrosion has its roots in the low-grade egomania that afflicts us all. For each of us, on any particular day, the battle between shameless self-interest and principled disinterest can be a

close-run thing. Our better angels don't always win. If it were otherwise, the notion of "sin" would have never gained currency.

Another contributing factor is the incremental nature of moral decay. Standards seldom tumble all at once; instead, they ratchet down gradually through a series of small, nearly innocuous compromises. That's why the deterioration is easy to miss, or *dismiss*. As with a slowly rusting bridge, no alarms sound until after the structure has collapsed. Faced with the carnage, people scratch their heads and wonder, how the hell did this happen? The answer: bit by bit.

Finally, there is a social dynamic which, if not challenged, levels standards down. As human beings, we often look to others for our moral benchmarks. When we're presented with a choice between self-serving expediency and self-denying duty, we are typically relieved to find that someone else has already lowered the bar for us. In other words, we are inclined to look for, and overweight, precedents that help us to normalize our own ethical concessions. We're scavengers for excuses; that's why moral equivocation is infectious.

An example: In July 2007, just weeks before the debt bomb exploded, Chuck Price, Citigroup's chief executive, defended his bank's gung-ho risk-taking in an interview with the *Financial Times*: "When the music stops, in terms of liquidity, it will get complicated. But as long as the music is playing, you have got to get up and dance. We're still dancing." The last time I heard an excuse that lame it came from a 13-year-old: "But Dad, everyone's doing it."

The freedom of every human being to pursue his or her self-interest is an essential prerequisite for an open economy, but it is not an adequate moral foundation for capitalism. In *The Wealth of Nations*, Adam Smith, the patron saint of capitalism, made a compelling, if slightly depressing, case for self-interest:

It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity, but to their self-love, and never talk to them of our own necessities, but of their advantages.

The moral superiority of capitalism rests on the fact that in a free market the only way to do well is to do well for others. Critically, though, the grocer doesn't feed us because he is concerned about our hunger—he feeds us because there is a profit in doing so. Capitalism is animated by self-interest, but when it's not tamed by moral self-discipline, it can easily become mendacious. When that happens, the powerless get abused and the ignorant get duped, legislators get bought and safeguards get trampled. The “invisible hand” of the market is a wonderful thing, but when not guided by a deep sense of moral duty, it can wreak all sorts of havoc.

Though his acolytes seldom acknowledge it, Adam Smith's philosophy was more nuanced than the previous quotation suggests. In *The Theory of Moral Sentiments*, Smith begins thusly:

How selfish soever man may be supposed, there are evidently some principles in his nature which interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it.

Thankfully, there is benevolence in each of us. Compassion, though, can shrivel. For leaders, this happens in two ways. First, compassion gets lost in the *pursuit* of success. In our strivings, we start to see colleagues, employees, shareholders, and customers as accessories to personal ambition, as instruments to be used and abused as necessary. Second, we lose our compassion in the *achievement* of success. A position of power, once attained, insulates us from the human consequences of our actions. As a twenty-first-century leader, you must be alert to these risks and consciously cultivate your compassion.

I don't have a grand plan for a moral renewal of capitalism, though I will offer a few medium-scale ideas in later chapters. Because renewal happens one soul at a time, a grand plan is, in any case, beside the point.

Nevertheless, we must face up squarely to capitalism's shortcomings. To free market zealots I would say the following: One doesn't have to disown an economic philosophy to recognize its shortcomings. So

stop being so defensive! There are things about capitalism as currently practiced that are by any standards *indefensible*. As a champion of capitalism, I'm worried when I see:

- An ever bigger share of the world's wealth going to an ever smaller global elite.⁵
- Companies spending millions of dollars to tilt the regulatory playing field in their favor.
- Three-hundred-to-one pay differentials between CEOs and first-level employees.
- Governance structures that are expressly designed to deflect shareholder concerns.
- Companies that treat employees as mere factors of production.
- Executives who reap outsized rewards for mediocre performance.
- Companies that award 90% of their share options to a handful of senior executives.
- Companies that resist calls for greater transparency and consumer protection.
- Corporations that compromise their values to do business with repressive regimes.
- Corporate PR campaigns that fudge the facts and demonize critics.
- Executives who feel that society's interests are somehow distinct from their own.

If you can't find within yourself a little righteous anger about the way your company fulfills its responsibilities, then you're not going to be very effective in helping to repair the moral fabric of capitalism.

All of us who have a stake in the future of capitalism have a non-delegable responsibility to make it better—and we must start by raising our own ethical standards and by challenging others to do the same.

The rehabilitation of capitalism won't come from top-down programs of "corporate social responsibility." While welcome, clever new strategies for producing private and social gains in tandem are not enough. It's great, for example, that in 2008, Coca-Cola's then CEO, Neville Isdell, committed his company to becoming "water neutral" by

2020—this after activists challenged the company to improve its stewardship of scarce water supplies. But a grand top-down initiative, however admirable or even profitable, will never be a substitute for a bottom-up sense of moral responsibility that informs every decision. Corporate morality needs to be proactive and pervasive—too often it is neither.

Most of us don't dump our trash out the car window, kick our pets, cheat on our taxes, lie on our CVs, or swear at telemarketers (well, four out of five isn't bad). It can be tough, though, to draw a line in the sand at work, particularly if those lines are regularly crossed by those at the top. On the other hand, if being human means anything, it means being ethically accountable—in the way that a shoe-chewing canine will never be. It was that sense of accountability that led Deitrich Bonhoeffer, the German theologian, to join the Nazi resistance, a decision that cost him his life. It was that sense of accountability that propelled civil rights marchers along the highway toward Selma, despite the tear gas and police batons. It was that sense of accountability that emboldened Aung San Suu Kyi to challenge the dictatorship in Burma.

Does the betterment of capitalism warrant the same sort of moral courage? Perhaps not, but with the exception of democracy, there's no other ideology that has done so much for so many. The ability to buy and sell freely, to raise capital, to take a risk and get a return, to start a new company, to invest where one wills, to expand or contract your business, to import or export, to innovate or cut costs, to buy another company or sell your own—these are extraordinary economic privileges—and when they're abridged, everyone loses.

But what, you ask, can one person do? Perhaps you've been told that a company's values have to emanate from the top. That's tosh. Just as turpitude compounds, so does virtue. E-mail, blogs and Twitter—these are powerful amplifiers of moral conscience, as Egypt's former president Hosni Mubarak learned to his sorrow. In a networked world, when one brave soul speaks up, it emboldens others. Yes, moral backsliding is contagious, but so is moral courage—so exercise yours!

There are risks, of course. You might piss off a few people, be labeled a malcontent, or get passed over for a promotion, but no one's going to put you under house arrest. So ask yourself, within my sphere

of leadership, what standards do I regard as inviolable? Where am I unwilling to sacrifice my own integrity? What is my “moral signature”? What values do I want others to infer from my actions? And, conversely, where have I fallen victim to greed, hubris, or power lust? When have I shut up when I should have spoken up? Moral failings on a grand scale, of the sort observed in the banking scandal, are impossible without an epidemic of moral dereliction—so if you’re incensed by what Wall Street did to Main Street, and you should be, stand tall for the moral standards *you* believe in.

And you know what? I think there’s even hope for the banking elite. Redemption is possible. I think of Mikhail Gorbachev’s embrace of *glasnost* and *perestroika* in 1984, shortly before he was appointed the general secretary of the communist party, or of F.W. de Klerk’s speech in February 1990 when, against all expectations, he announced the dismantling of apartheid. Anyone can reclaim their compassion.

My friend John Ortberg, a pastor, psychologist, and author, argues that if we’re going to have a world worth inhabiting, each one of us must have the courage to do a “fearless moral inventory.” If you’re a leader of any sort, in any organization, now would be a good time to start.