VITAL SPEECHES *of the day*

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ETHICS—THE ESSENCE OF SUCCESSFUL CAPITALISM

Don't fall for short-termism. If things are not measured in a way that gets a long-term focus, like Amazon did—so we are not going to make profits for years, we are just going to grow sales—find a way to convince others that your way, not the way the crowd is going, is the way to go.

Address by STEVE FORBES,
Chairman and Editor-in-Chief, Forbes Media // Delivered as part of the Advancing Ethical and Moral Leadership Series, Iona College, New Rochelle, New York, Oct. 15, 2016

Thank you very much, Charlie, for those very kind words. Dr. Nyre, thank you for those comments. I am glad you prefaced it with the comment that we are all, during our lifetimes, going to have some stumbles and falls. We are not perfect, which is precisely why one is a little hesitant to discuss ethics, knowing the mistakes we've made in our lives. It's precisely because we're not born with ethics that we really have to learn them and have them reinforced.

In terms of my own background, FORBES was started by my grandfather in 1917, almost 100 years ago. He was an immigrant to this country from Scotland, had only a grade-school education and arrived here with no money. But like millions of others who came to the U.S., he had dreams, ambition and the opportunity to realize his dreams. When he put out the first issue of FORBES magazine, he printed these words: "Business was originated to produce happiness, not to pile up millions."

From the very beginning FORBES has had a profound belief in what we now call "entrepreneurial capitalism," the idea that people go out into the world, take risks and, perhaps, fail along the way before they gain success. In the U.S. people are able to have the chance to, as Lincoln put it, "improve their lot in life."

We never looked at businesspeople as miscreants or potential criminals who must be sat on because, otherwise, they'd do bad things. Here's an example of my grandfather's integrity. After he started FORBES he was often asked, "What is the economy going to do?" or "What stock should we buy?" Being an honest man, my grandfather would respond, "We make more money selling the advice than following it." That was a little bit of full disclosure and integrity!

Currently, the business community is under a cloud. We are all familiar with what has happened at Wells Fargo; we are familiar with the rap against business after the 2008–09 financial crisis, which is blamed on greedy bankers. By the way, to say that it was just greed that caused that crisis is like saying airline crashes are caused by gravity. Yes, they are, but there is often more to it, which, as regards the economic crisis, we will touch on in a moment.

All institutions, whether in business or elsewhere, should take to heart what Peter Drucker, the late, great, management guru (an immigrant from Austria who wrote a lot of books still used in many business courses today) said: every organization should always ask itself, "What is our purpose, what is our mission, what is it we are trying to do?" If you do that, then you don't get overwrought if the tools to achieve the goal may change. Moreover, you will be less likely to get sidetracked by peripheral things that have nothing to do with the company's core business.

The late Ray Kroc—if there are any nutritionists here, I apologize in advance—was the mastermind behind the modern McDonald's. A lot of lessons can be learned from Ray Kroc. He was a guy who was always interested in the food business, but he had never really achieved big success. Back in the 1950s, when he was in his mid-50s, Kroc was selling milkshake machines, and one day, while he was making the rounds in California, he heard about a hamburger stand called McDonald Brothers.

The brothers had several stands and were doing well. He went to them, saw that they were doing a great business and figured, "Gee, if I can get these guys to expand, I can sell more milkshake machines." To make a long story short, the McDonald brothers didn't share Kroc's ambition, so he bought them out.

My alma mater, Princeton University, got a big endowment boost in the 1950s because of the guy running the endowment was a very unconventional man. Back then, universities didn't pay much attention to the management of their endowment funds, so this guy could pretty much do whatever he wanted to do. One of the things he did was to make an agreement with Ray Kroc, whereby the endowment fund would get a royalty for each hamburger sold for a number of years. Today, I would like to remind the people at Princeton that those Big Macs helped make the place.

Ray Kroc saw what the McDonald brothers didn't. If any of you have worked in the restaurant business, you know it's one of the toughest businesses around, with very high failure rates and inventory that's always going bad. It's very, very tough to make a go of it. What you did yesterday doesn't matter; it matters what you do today. At the time Kroc bought McDonald's, there were no national chains—only some regional ones, such as Howard Johnson, because a national chain was considered impossible.

If you ever go to a diner—and they were far more popular in the 1950s than they are today—one of the nicest things is the menus that go on for page after page after page. But the McDonald Brothers did something different: Theirs was a very small, very standardized menu. Kroc realized this standardization would make it possible to have a chain of restaurants—first, nationally then, ultimately, internationally. He saw the enormous possibilities the inventors didn't.

As McDonald's got going, people would say to Kroc, "Why don't you diversify, why don't you get into different kinds of foods?" He'd respond, "We'll do that, but only if you can guarantee that every restaurant in those 1,000 outlets is perfectly clean. If you can't guarantee that, then we're not going to go outside." In other words, focus on the mission. Drucker was right.

One of things we in leadership have to recognize is that in everything we do human nature plays a role. Every organization becomes inward looking; becomes more selfish; it loses sight of the organization's purpose. It eventually becomes a detriment and a drain, instead of performing a real mission. You see it in institutions all the time. If it happens in a business, that business eventually goes out of business. But this tendency to become inward-looking rather than focusing on your original mission happens all the time.

A good example of this was brought to light by British historian C. Northcote Parkinson. (That's a great British name—C. Northcote Parkinson. If you ever change your name, choose something like that.) In the 1950s Parkinson was working on a history of the British Navy when he discovered something that struck him. At the close of World War I, Britain had the largest navy in the world, but it soon sharply downsized the navy, thinking that it wouldn't be needed anymore. Britain mothballed a lot of ships, discharged sailors and laid off dock workers. Parkinson noted that as the British Navy got smaller, the government agency running it got bigger. He came up with a hypothesis, which he tested with other organizations: The size of an organization often has little to do with the work it is actually tasked to do. It will expand, losing sight of what its mission is.

James Madison, the father of the American Constitution, famously noted that if men were angels, no government would be necessary. "If angels were to govern men, neither external nor internal controls on government would be necessary." Manifestly, we are not angels—except, perhaps, for grandchildren and then to only a certain age. Madison recognized, along with the other Founders, that there is an underside to human nature, that we have to control passions, that things can go dreadfully wrong. The Founders were very real students of history.

The reputation of business isn't great today, but it is important, first of all, to understand what free markets are about, because people who participate in business sometimes seem to overlook what it is they are participating in. If they gain a better understanding of what they are involved with, perhaps it might make teaching them ethics—and what they should and shouldn't do—a little easier. It's very easy (and nebulous) to say, "Do right, not wrong."

Too often capitalism—or free markets, free enterprise or whatever you want to call it—doesn't have a very exalted reputation, even in the best of times. Business is seen as kind of grubby, as based on greed and as appealing to the baser instincts. It is not seen as something exalted as are, say, painting or writing poetry or literature. But, hey, it gives us a higher standard of living, so we put up with it. You've heard all the raps: The rich get richer; the strong crush the weak; it's inhuman; business puts profits before people.

The thing to keep in mind is that in a true free market, you succeed by meeting the needs and wants of other people; you succeed by providing something that somebody else wants. Even if we think we are doing it for ourselves, we end up also helping others without our really realizing it.

Research has shown that in Hollywood movies, businessmen kill more people than serial killers. That's true—and the killers are usually men, not women. The businessmen are either obese, with jowls jouncing up and down in glee as they figure out how to pollute rivers, or they are bony, thin men with spindly fingers, trying to figure out how to kill your household pets.

But even if you are a terrible person—the kind who makes dogs bark or babies cry when you walk down the street—even if you lust after the money, you won't get it unless you can find and produce something that somebody else wants. You must become attentive to the needs of other people, and what develops are these extraordinary networks of cooperation, what we call supply chains.

Consider what goes into a simple restaurant. Farmers grow the food, the food is processed, and the food is delivered by trucks. Electricity is provided; somebody makes the stoves, refrigerators, utensils, tables, chairs and uniforms, etc. that are needed to outfit and stock the restaurant.

Business—the free market—breaks down barriers between people. Contrary to the idea that markets are inhuman, the opposite is true. You may not love your neighbor, but you sure want to sell to your neighbor, which, in the end, breaks down the barriers.

When you take on a project, you want to involve the best people possible. This is a new development in human affairs. Until recent times people never trusted anyone outside of their immediate family, village, ethnic group or religious circle. In places around the world today, you still see this; there isn't a wide circle of trust. However, commerce breaks down barriers between people. If you want to succeed in selling, you have to bring in people with whom you might not otherwise associate.

Big companies in particular are discovering that if they want to continue to succeed and not fall into the Parkinson trap, they have to develop internal teams—small groups of people for a particular task at hand. Startups and entrepreneurs can have large or small projects. Research has shown the most effective teams are eight to ten people. Jeff Bezos, the founder of Amazon, uses what he calls the two-pizza rule: If you need more than two pizzas to feed the team at night, the team is too big. When a team is bigger than eight to ten, it begins to lose cohesion and unity of purpose. So even if your organization is large, break out small teams for specific tasks.

You also need diversity on teams—not in the superficial sense but in what is known as "cognitive diversity." You need young and old, left brain and right brain, experienced and new and people who don't come from similar backgrounds. If you all have different religions but went to the same university, that's not the kind of diversity you want. You want people who are truly different. Then you need effective leadership to make the team work together on the specific task, which brings about creativity. The free market, properly imposed, makes creativity possible.

A classic example is Henry Ford's moving assembly line. About 120 years ago the cost of making a typical car was more than $100,000 in today's money. Ford and his engineers created the moving assembly line, which turned a toy for the rich into something every working person could afford. When you think of an assembly line, you don't think of it as a work of art, like a painting by Michelangelo. However, the way the assembly line changed life is absolutely extraordinary. The creativity that occurs in Silicon Valley and elsewhere is absolutely extraordinary. Steve Jobs realized that a device isn't just something that performs a specific function or functions. It is a beautiful thing to hold, and though it elicits an emotion that may not be quantifiable, it is definitely real in terms of how one sees it, uses it and, through it, looks at the world.

One of the things I hope economists don't do as much of in the future as they tended to do in the past—which is why economics is called the "dismal science"—is talk about economics as being the study of "the allocation of scarce resources." The allocation of scarce resources doesn't get the heartbeat racing. What economics is really about is the creation of resources. Take, for example, what's called a natural resource today: oil. What is oil? It is not a natural resource. You can't eat it; you can't drink it; you can't feed it to camels. It is just gooey, black stuff; glop. Prior to 1859—when the oil industry started—the stuff that seeped up through the ground was considered a depressor of property values in Pennsylvania because it made animals sick. Human ingenuity turned this glop into something we now can't live without.

We see the same ingenuity in the microchip. It's made from silicon, i.e., sand— what you played with on the beach or in the sandbox as a kid. That sand could become the basis of instruments that deliver the world to your fingertips is amazing! Human ingenuity—something we all benefit from today.

This gets to what Iona is all about. The true source of wealth is the human mind, and the human mind functions best when it has a sense of purpose and knows what is right and what is wrong. That is how you move ahead. Ask yourself—as great minds like Tom Sowell has done—what the difference is between us today and people living in the Stone Age? We're the same human beings with the same appetites, living on the same planet with the same resources. The difference between us and them is knowledge; we know more. Even when there are natural catastrophes or devastating wars, if knowledge isn't destroyed, one can rebuild and move ahead. We saw that happen after World War II. Western Europe and Japan were devastated. Tens of millions of people were dead, and there was massive physical destruction. But knowledge was not destroyed. The free world had the U.S. security umbrella, and even though experts thought it would take generations to recover from the war's devastation, within a handful of years economic output was exceeding that of Western Europe and Japan before the war.

Take, for example, the water shortage in California. What there truly is is a shortage of commonsense. Yes, there has been a drought in California, but people aren't applying their knowledge to the problem. Consider Israel. The modern state of Israel was created in 1948. It is in a desert, and rainfall has been decreasing. Yet Israel doesn't have a water crisis. Since 1948 Israel's population has grown 10-fold, its agriculture 16-fold, its industrial output 50-fold, yet its net use of water is 10% less today than it was in 1948. How? Human ingenuity.

Israeli showerheads, which have about the same water pressure as ours, use one-third the amount of water. For agriculture Israel uses drip technology. It also has lots of desalination plants that recycle water, making it usable for agriculture. California has a desalination plant that's half the size of the typical Israeli plant. It took 15 years to get through all the regulatory hurdles and cost three times as much to build.

Knowledge, as you know, comes from experimentation, where the marketplace is a laboratory. None of you are old enough to remember the late 1980s and early 1990s, but back then Apple came out with a product called the Newton, which was a handheld device that turned out to be a big failure, a flop. Even though the people working on it had IQs that somebody said could boil water, it failed. However, it wasn't a total failure. From the technology invented, a key piece provided the basis for the iPod, the iPad and the iPhone. It was what a publisher called a "noble failure."

One of the things that happens when you have proper leadership, when you have free markets where people can go out and create is that they will always turn scarcity into abundance.

Take smartphones. The original cellphone was from Motorola over 30 years ago. It was as big as a shoebox, weighed as much as a brick, had a 40-minute battery life and cost $3,995. Today they give cellphones away, depending on the plan, if you want to sell your life away for two years.

Scarcity into abundance—it works all the time.

Next, we come to quality of life. The gap between the richest and the poorest—always narrows when we allow ingenuity, when we allow people to become leaders, when we allow people to take risks. Remember the "handhelds" of the past? Now, the whole world is virtually at your fingertips. You can do everything with a handheld device, but the first one just had voice. We've become so spoiled by these things that when we place a call to Outer Mongolia and it takes longer than five seconds, we complain, "What a piece of crap!"

The first computers, the old mainframes, were as big as a barn. Today, we have the same computing power with more versatility and features, yet the devices fit in your hand. The cost of that 20-year-old technology in today's money would be about $1 million, yet today's handheld devices cost a few hundred dollars. Remember that a few years ago wide-screen TVs cost $10,000 to $15,000, but now they cost a few hundred bucks. Technology and free markets turn scarcity into abundance.

A few years ago in a book called *Power, Ambition and Glory* John Prevas and I looked at leaders from the ancient world and compared them with business leaders today. Even though time and circumstances change, human nature does not. So when it is said that there are bad people in business, that isn't a news flash. People have been doing bad things from time immemorial—look at the Bible. People were doing bad things long before Adam Smith wrote the *The Wealth of Nations* in 1776 and created the intellectual foundation for the modern economy.

Human nature doesn't change. We are a flawed people. This then leads to the question, "How do you become an effective leader?" First you must have a sense of purpose. Then you must remind yourself that you are serving the needs and wants of others, even if you think you're going to get something out of it. Remind yourself that your success is other people's success. Too often, we become narrowly focused and lose sight of the larger purpose. We are going to be here tomorrow and, hopefully, the day after tomorrow and the day after that. One of the best ways to lead other people is by example, whether you are a military commander sleeping among the troops in a cold field or an executive putting in long hours like everyone else does when there's a project to get done. It's like kids and parents: If parents say one thing and do another, kids pick up on that very quickly. The same is true in a corporation.

Look at Wells Fargo. The bank won awards for the way it served its customers, but the bank has been hit with a huge scandal, which was brewing for years. Wells Fargo was "cross-selling;" it would get a person to set up a bank account and then encourage that client to get other products the bank offered, such as a credit card and other things. Wells Fargo set internal goals to get more of these products sold. There's nothing wrong with that, but the bank didn't have a monitoring system in place to catch anyone who started gaming the system.

The bank lost sight of the fact that its purpose is to serve its customers. Once the bank became aware of a problem, it should have shut down the cross-selling program until it figured out how to conduct it out without pressuring staff into compromising themselves. Wells Fargo lost sight of what Peter Drucker said a company had to keep in mind: its ultimate mission. Wells Fargo's ultimate mission wasn't cross-selling, it was serving the customer. If one way of doing that isn't working, then you have to sit down and figure out another way.

As a contrasting example, look at Walter Wriston, who died a few years ago. Wriston created modern banking in this country after World War II. At the time of the Depression banking was very simple. Bankers conducted banking business a few hours a day and then went out to the golf course. It was a very unsophisticated business—you just took in a deposit, made a few loans, played a round of golf and called it a day. Wriston came along and made enormous innovations. ATMs came into existence under his leadership in the 1970s, and he pushed credit cards and many other banking products that we now take for granted.

When Wriston retired in 1984, Citibank was on the verge of being the first bank ever to make $1 billion in a year. The bank was just shy of the goal by a few million dollars. Bank executives went to Wriston and said, "You are about to retire, and if you just make these accounting changes, which are not illegal, we will reach that billion-dollar goal, and you can retire in glory." He said, "No, I'm not going to do it. Let my successor do it the traditional way. I'm not going to do something just for the momentary glory."

Another example of someone who could see opportunity and maintain a sense of ethics, was A.P. Giannini. In the early 1900s Giannini was a young guy who had made a fortune in the fruit business in San Francisco. He retired at 31 and soon after took a seat on the board of a local savings bank. He noticed that none of the banks were serving seamen or immigrants. San Francisco was a large port with a lot of freight ships coming in, but no one would touch sailors because they were considered drunks and no-goods.

The U.S. experienced a huge wave of immigration during the 1880s, 1890s and early 1900s, but no one was serving the immigrant population. They didn't have FICO scores back then, but if they had the response would have been, "Who knows who these people are? Why would you want to risk doing business with them?" Giannini figured out a way to safely handle their business, but the bank wouldn't budge. So Giannini left the board and started his own bank, the Bank of Italy, which served underserved communities and eventually became the Bank of America.

During his entire career—and while he created the largest bank in the world—Giannini never paid himself more than $50,000 a year. At the time $50,000 was a lot of money, but it was nothing compared with the multi-tens-of-millions-of-dollar packages that are routine for today's bank leaders. Giannini came up with banking innovations, helping to finance the wine industry in California and the early movie studios in Hollywood—even saving Walt Disney from financial collapse when he went into cost overruns making *Snow White and the Seven Dwarfs.*

Giannini advanced money, even when it looked like he was going to ruin the company. He achieved huge success. When he retired in the late 1940s, Giannini's grateful Board of Directors gave him a check for $1.5 million. He said, "Thank you very much," signed it over to a scholarship fund at the University of California and walked away. That's integrity.

In addition to seeing opportunity—this is where real leadership comes in—a leader sees opportunity where others see only immediate problems. One example: In 1906 San Francisco experienced a terrible earthquake, which killed far more than the official toll. When the earthquake started, Giannini realized the tremors would rupture the gas mains and San Francisco would be engulfed by fire. He got a wagon, went to his bank vaults, brought out all of his cash and gold, loaded them onto the wagon and covered them with fruit and drove the wagon out of the city. Why? Because Giannini realized the heat of the fires would be so intense bank vaults would melt, trapping the money and gold within.

When the fires started to die down, Giannini drove back into the city and set up a table on the wharf. He put the cash out and said that any merchant could get an immediate loan to rebuild. Imagine having the presence of mind to to seize on such an opportunity during an earthquake. He was helping himself but by serving others and taking a risk. He could have taken the money and walked away, but Giannini figured it was a time to rise above narrow-mindedness.

Wells Fargo is an example of what you *don't* do. Wriston and Giannini are examples of what you *should* do. I hope they use such real life stories in business schools, that they do more than say, "Don't do bad things." Seeing how people actually react in real life situations is important.

Always keep in mind the importance of trust. It is absolutely essential. If employees don't trust the leader, don't trust their boss, it poisons an organization.

One of the things hurting our economy today is the breakdown of trust, whether it's in law enforcement or in money. I don't know what they teach about money in schools today, but money is not wealth. Money is like a claim check. You go to a restaurant, you check in your coat and you get a claim check—a piece of plastic or paper. The token is worthless, but it's a claim on a real product, your coat. You buy a ticket to a game or a concert and it's a number barcode on a computer or a piece of paper—worthless in and of itself but a claim on a real service, performance or game.

Money isn't wealth; it's a claim on products and services. It comes from what you've already created in the real world and measures value, the way scales measure weight or clocks time. Money works because of trust. The piece of paper we carry is worthless, as are a bar code and coins. When trust in our monetary system is undermined, whether through hyperinflation or over a period of years, then social trust is undermined. Research shows that when money is unreliable, crime rises and social cohesion suffers.

Good leaders have to establish trust. They must have a sense of mission. They must also keep their egos in check, even though they may be the greatest thing to ever hit the earth. Even when someone is a great success, if all the focus is on one individual it is misplaced. Effective leaders realize they need teams; they know they have to put groups of people together.

Many great companies are started by more than one person. At Ford Motor Company it was Henry Ford and James Couzens. Apple was not just Steve Jobs, but also Steve Wozniak. Each had a different strength. Same with Google's Larry Page and Sergey Brin. Enterprises are often started by pairs—not by just one genius, like a Sir Isaac Newton—who build on success even after failure. It's nice to focus on an individual, but the individual at the center of a successful venture may be someone you've never heard of but is someone who knows how to put together an effective team.

I mentioned Ford and Couzens. Henry Ford couldn't manage a grocery store; he couldn't even manage his desk. He was utterly inept as an executive. James Couzens couldn't put anything together. If you gave him a toy model, he couldn't put it together because he was all thumbs. But these two unlikely people—who didn't even like each other—ended up working together and creating what would become the greatest industrial enterprise in the world. That's innovative.

In terms of doing things, remember that, when mixed together, it's the intangibles that somehow produce amazing things.

Here's a little story about Couzens. Ford eventually bought Couzens out, who then went on to become a member of the U.S. Senate. When in the Senate, Couzens went after the IRS, because he thought it was misbehaving. In the mid-1920s, after Couzens had held a hearing criticizing the IRS, the head of the IRS served Couzens with a subpoena, saying that Couzens owed $10 million (hundreds of millions in today's dollars) because he hadn't paid enough tax on the deal he'd made with Henry Ford. Couzens fought the IRS fiercely, and in a few years they reached a settlement: The IRS paid Couzens $1 million. That's the kind of guy he was.

In closing, let me say that the Web has destroyed everything we thought we'd learned about the print business. Wiped it out. That's why newspapers are shrinking and magazines aren't what they used to be. Fortunately, we remembered what Peter Drucker had said. At FORBES we remembered our grandfather's mission. When we started our online business in the mid-1990s, we put it in a separate building, with a separate staff and separate lines of authority that reported to me and my brother instead of to the usual line of authority. Well, over time the baby became a strapping youth, and we decided it was time to put the two businesses together. It was horrible at the beginning. Print journalists thought online journalists were lazy and just churned out garbage each day; online journalists thought print journalists were overpaid snobs who didn't do much work and believed they were God's creation. Putting those two camps together wasn't easy.

One thing you have to get used to, especially in this fast-changing era, is that when faced with situations for which there is no playbook you have to rely on your gut. Things that may not have been important to you are going to become important, and you have to draw on them. Norman Borlaug won the Nobel Peace Prize for what he did for the "Green Revolution," putting together new seeds that prevented famine in India and China and saved millions of lives. He realized he'd made a great breakthrough, but, he said, he had to draw on things like economics and politics he never thought he would have to draw on. That's why a liberal arts education is important. Focus on your major, but at the same time take subjects outside of your safety zone because you might come across situations you didn't anticipate.

We need to emphasize the culture of right and wrong. Don't fall for the idea that something's OK because everyone does it. Don't fall for short-termism. If things are not measured in a way that gets a long-term focus, like Amazon did—so we are not going to make profits for years, we are just going to grow sales—find a way to convince others that your way, not the way the crowd is going, is the way to go.

In closing, even if you don't think of yourself as a leader, you should remember that leadership can come from many types of personalities. Take the example of Steve Jobs. He had a terrible personality. If you withheld his name but put a list of his personality traits before a HR department, they'd say, "Get this guy out of here; we don't even want to see him." Jobs could be nasty and selfish. He took credit for other people's ideas; he was impossible to work with; and he was fired from his own company before he was 30. He had a brilliant mind and saw opportunities, but he was a terrible leader. However, he learned from his failures. Twelve years after he left Apple, while some things hadn't worked out well, but he had learned to become an effective leader. He'd learned how not to repel people and how to bring talented people together. He became one of the most effective CEOs ever. But he was not born with that ability; he learned it painfully.

So while you are in college and then out in the workforce, if things don't seem to be going well, see that as part of a learning process. And when you are on the business side of things, remember Parkinson: Don't let the organization become insular and self-perpetuating. and never forget Drucker's admonition: "Remember what your mission is."

Thank you very much.