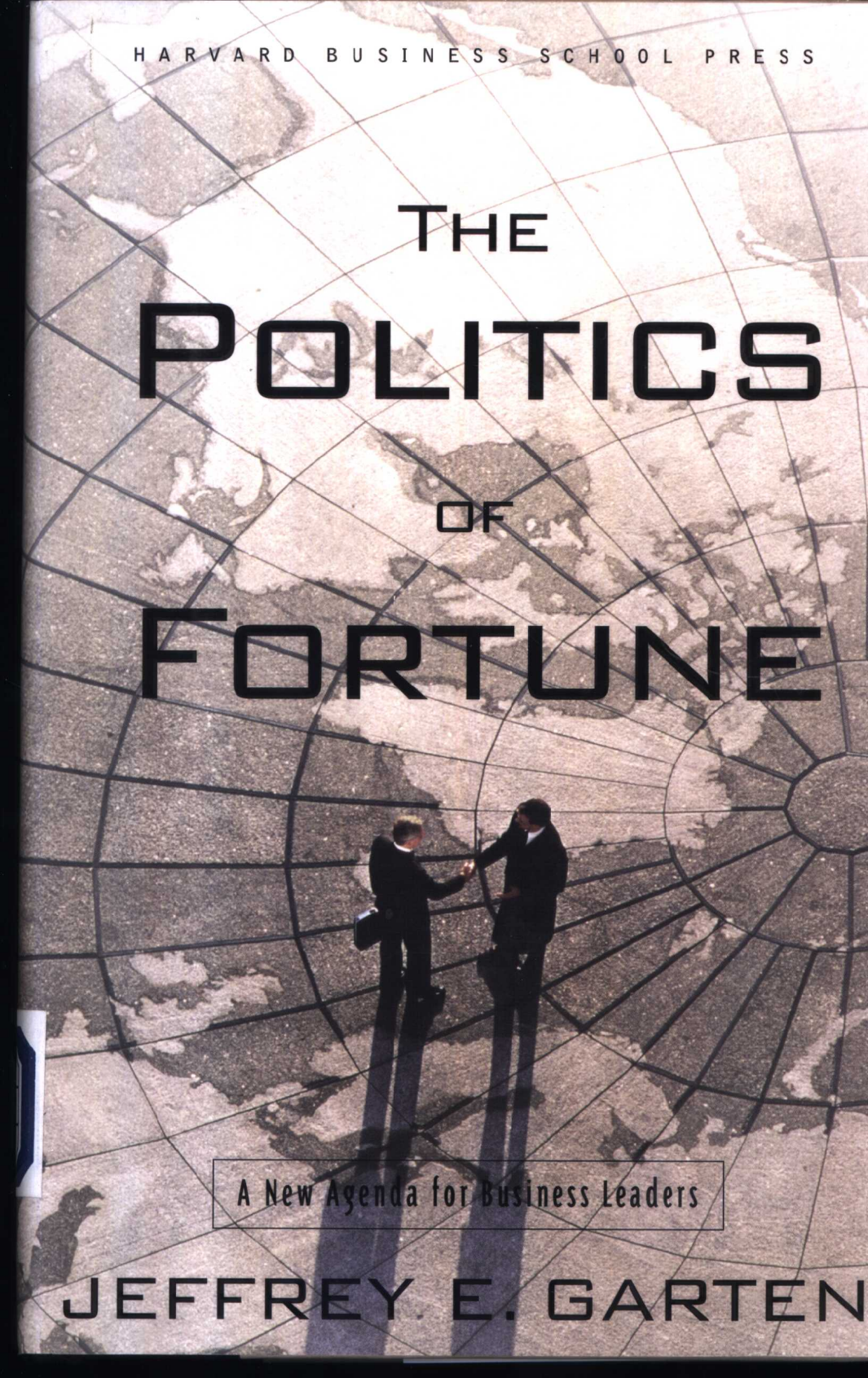


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THE POLITICS OF FORTUNE



A New Agenda for Business Leaders

JEFFREY E. GARTEN

The

POLITICS

of

FORTUNE

A NEW AGENDA FOR
BUSINESS LEADERS

JEFFREY E. GARTEN

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FOR
INA,
THE CENTER OF MY LIFE
FOR THIRTY-FIVE YEARS

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A NEW WORLD

AS THE DEAN of a business school, I spend most of my time thinking about how to educate future business leaders. I find it impossible to separate the challenge of identifying the skills and values that our students will need from our judgments about the world in which they will live and work. Their universe will differ substantially from the golden age of capitalism that the United States has enjoyed since the 1980s. Two events in particular have fundamentally altered the landscape: First, the terrorist attacks on the United States on September 11, 2001, exposed a national security problem that is spilling over into every aspect of our lives and will have a pervasive impact on the functioning of the economy as well. Two months later, the scandal involving Enron Corp. and Arthur Andersen LLP, and all the corporate transgressions that were exposed in its wake, severely undermined the integrity of American capitalism.

Each of these events creates new risks for business. Terrorism, by definition, endangers the lives of employees, the security of facilities, and the reliability of operations. What's more, the need to step up safety measures increases the uncertainty about the cost of doing business. The Enron-Andersen debacle has ushered in a period of intense scrutiny of corporate America by lawmakers, investors, and the media, putting extensive new

pressures on CEOs, their boards of directors, regulators, accountants, and credit-rating agencies. Together, terrorism and Enron-Andersen challenge the viability of an open society supported by increasingly deregulated markets because they diminish the bonds of trust on which such a free society ultimately depends.

Not surprisingly, the terrorist attacks and the allegations of misbehavior on the part of so much of corporate America have summoned significant government involvement in the economy and beyond, raising profound questions about the extent of Washington's reach. Quite possibly, an excess of regulation will prevent the business community from expanding its range of products and services or otherwise exploiting dynamic market forces. This regulatory excess could jeopardize not only company profits but also economic growth. After almost thirty years of rising political influence, moreover, business leaders could be marginalized as government reemerges as the principal guardian of the nation's welfare. As they were at the end of the nineteenth century, the country's chief executives may well be seen as little more than self-serving protectors of their own special interests.

The U.S. government could initiate policies with good intentions but with unintended consequences, raising the cost of doing business and undercutting opportunities for risk and innovation. What begins as a necessary effort to gather information on suspected terrorists and to monitor their movements ultimately threatens personal privacy and civil liberties. An attempt to adequately fund national security could eventually squeeze other programs vital to the growth of the nation and the economic security of its citizens. The need to impose controls on how people transfer funds or travel internationally—controls implemented to catch terrorists—could slow global commerce and impede immigration. America's current efforts to strengthen the international coalition against terrorism could precipitate a global preoccupation with national security, retarding the global trend toward economic expansion and individual freedom. Regarding

the Enron-Andersen scandals—and those that followed, such as WorldCom, Inc.—no one will deny the egregious breaches of law and integrity they entail. Nevertheless, if new regulation doesn't consider the complexities of today's financial markets, then it could result in a regulatory maze that hobbles new investment in the economy, slowing national growth and all that accompanies it—jobs, new technologies, and community development.

Having spent much of my career in the Nixon, Ford, Carter, and Clinton administrations, I have no ideological bias against government. On the contrary, I believe in effective public-sector action when national security is at stake or when markets break down. Indeed, I think that a shift in the balance between regulation and free markets to favor the former is overdue after the free-for-all of the last two decades when the United States unjustifiably deified free markets and vilified government. But now it is possible that Washington could go too far.

We can all appreciate the pressure on Washington to act decisively. After all, what could press a government more than threats to the lives of its citizens and deep flaws in the markets that underlie its economy? But we must recognize that the government is moving into uncharted territory. The struggle to protect ourselves against terror at home—to build ramparts against the vulnerabilities of the world's most open society—could reach every aspect of Americans' lives. We've witnessed big financial collapses before, such as those of Drexel Burnham Lambert Group Inc. in 1990 and Long-Term Capital Management in 1998. However, although some of these debacles involved issues of personal integrity, conflicts of interest, and lack of transparency, none raised such fundamental questions about the American system of accounting and auditing, or the structure of corporate governance that supports American capitalism.

The problem? Once government intervenes, the new rules are difficult to repeal, and a kind of permanent ratcheting-up ensues. For all the talk about the end of the Great Society and big

government, we've little evidence of the government's narrowing role in the economy, whether we measure the percentage of taxes relative to the gross domestic product (GDP), the volume and complexity of regulation, or the clout that Washington can exercise at will in the private sector. Indeed, the twentieth century shows that after great international upheavals—World War I, the Great Depression, and World War II—the government extended its reach and rarely retreated. In 1987, *The Economist* conducted a survey of government activity in advanced economies. It made this point:

Did somebody say the age of big government was dead? At the beginning of this century government spending in today's industrial countries accounted for less than one-tenth of national income. Last year, in the same countries, the government's share of output was roughly half. [In the United States, it went from 3 percent to 33 percent.] Decade by decade, the change in the government's share of the economy moved in one direction only: up.¹

In this context, we should be especially vigilant after September 11 and Enron. In particular, America and the rest of the world now face a potential reversal of the important momentum toward more political freedom and economic openness that accelerated after the collapse of the Berlin Wall in 1989. If we don't appropriately fine-tune the balance between private and public power, then we'll jeopardize deregulation, the privatization of state-owned companies, and the free movement of capital, goods, services, people, and ideas across borders. We will never be able to calculate the cost of those lost opportunities. How can we measure any decline in the entrepreneurial spirit in America—on products and services that we'll never enjoy, or the talent and energy that we'll never unleash? Even more unquantifiable would

be the costs incurred overseas if there is a slowdown in the opening of markets that have been positively transforming countries as diverse as China and Mexico, giving hundreds of millions of citizens a better material life and a freer existence. Most important of all, and most difficult to measure, would be the impact of more government on individual freedom of action and thought, on privacy, and on the liberties that so many of us have been fortunate enough to have taken for granted.

To use a term popularized by Andrew Grove, the chairman of Intel Corporation, the United States is at a “strategic inflection point”—a moment when the basis for strategy changes, requiring a fundamental course correction. In his 1996 book, *Only the Paranoid Survive*, Grove lists several strategic inflection points in the business world. He describes how Japanese memory-chip producers nearly destroyed Intel in the mid-1980s by bringing new technologies and new strategies to compete with U.S. firms. Had Intel not moved into the field of microprocessors just at the dawn of the age of personal computers, the firm could have collapsed. Grove emphasized the powerful forces of change that were at work.²

But strategic inflection points occur not only in the business world. They also occur as a result of disruptions in a nation’s political, economic, and social climate. The 1930s depression, the Japanese bombing of Pearl Harbor, the first explosion of the atomic bomb, the opening of China, and the collapse of the Berlin Wall are obvious examples. Regardless of the current direction of the United States, September 11, 2001, and the Enron-Andersen fallout constitute powerful strategic inflection points. Alone, either would easily qualify as being a critical discontinuity in our lives. But, for many reasons, their combined effect on the balance between government and business could constitute an earthquake in American society.

Think of America at the beginning of 2000: Before the terrorist attacks and Enron's collapse, markets—and not the government—were ascendant. The domestic and international economies were fast becoming “frictionless.” Businesses were honing their operations with ever-slimmer inventories, just-in-time deliveries, and global supply chains that exploited the most efficient manufacturers in every part of the world. At home, Americans were increasingly entrusting their fate to the stock market, and this so-called equity culture was spreading from Buenos Aires to Beijing. Jack Welch, then chairman and CEO of the General Electric Company, and John Chambers, CEO of Cisco Systems, Inc., were heroes and icons, as were their corporate counterparts overseas. Enron was among the world's most admired companies. Deregulation was a driving force in America and most other nations. The push to increase the connections between countries by lowering barriers to trade and investment—the push for more globalization—was at the center of American foreign policy and international politics. National borders were fading. Moreover, most top government officials and CEOs assumed that an era of peace and prosperity was at hand, and that American-style capitalism was the most acceptable model.

This snapshot of 2000 is enough to show how much has changed. Today, business is hunkering down, focusing less on dramatic innovation than on the accuracy of its financial statements. There are virtually no CEOs in the category of hero. “Business leaders are being knocked off their pedestals faster than the Communist heroes after the fall of the Berlin Wall,” wrote *The Economist* in late spring of 2002.³ “Across the business landscape, the imperial chief executive, hailed not long ago as the savior of entire companies and the driving force behind the turnaround of the American economy, is suddenly under seige,” wrote David Leonhardt in the *New York Times* in the summer.⁴ Equally important, an increasing amount of sand has collected in the gears of the U.S. and global economy; doing

business has become considerably more expensive. In February 2002, *Fortune* projected that, in the year following September 11, 2001, American companies could spend the following incremental amounts on security: \$65 billion on logistics, \$35 billion on insurance and liability, \$18 billion on workplace security, \$15 billion on safeguarding information technology, and \$12 billion on added costs for travel and transportation.⁵ These expenses, amounting to almost \$150 billion in the year after the attacks, constitute 1.5 percent of GDP and include property insurance, workers' compensation, higher rent for buildings in which the latest security equipment has been installed, enhanced Internet security, travel delays, and so forth. This estimate does not include the psychological impact on executives and employees operating in a more fragile environment. David Wyss, chief economist for Standard & Poor's, says corporate America will pay an incremental \$135 billion for homeland security in 2002 (including \$20 billion for workplace security, \$15 billion for back-up information systems, and \$35 billion for higher insurance premiums). David Hale, chief global economist for Zurich Financial Services Group, estimates security spending will reduce corporate profits in 2002 by 5 to 6 percent.⁶ And, of course, these projected costs pale in comparison with the effect that another terrorist attack would have on business.

There are other costs to business that have not yet come into clear focus. If security concerns result in companies holding higher inventories, the price tag could be large. If the uncertain security environment in many developing countries results in a slowdown in foreign direct investment, as may well be the case, then global trade will slow. The combined impact of terrorism and the "Enron effect" could also tarnish the American market for foreign investors. Because the United States borrows over \$1 billion a day from abroad to finance its trade deficit, a slowdown in foreign investment could cause a number of painful adjustments. The combination of terrorism and corporate malfeasance

could also cast a pall on stock markets for more than just a few quarters. This situation certainly existed in the spring and early summer of 2002, and to the extent it continues, the value of companies in many key sectors could be vastly reduced, raising the cost of financing for them, slowing their new investments, and retarding the growth of the U.S. and world economies.

But neither the increased cost of doing business nor the impact on the economy should be our greatest worry. Depending on the full ramifications of the response to terrorism and the Enron-Andersen debacle—something we won't know for a few years—these two milestones could shake our faith in the viability of an open society of the kind that Americans have known—a society in which ideas flow freely; civil liberties and privacy are protected; markets are free to generate products, services, and wealth; and government intrusion is kept to the bare minimum. Our greater fear? That these features of life will gradually erode. Indeed, the erosion may already be happening. Government is back. Borders are back. Serious military conflicts are escalating around the world, and the United States may be entering a period when national security is an all-encompassing preoccupation. Globalization has become a double-edged sword: It facilitates not only trade across borders but also heinous crime. And the many transgressions in the corporate world have tarnished the American model of capitalism, with implications for everything from our basic freedoms to the position of the United States in the world.

A continuation of the progress and prosperity of the last two decades of the twentieth century depends on defining the proper relationship between the private and the public sectors. There is some irony to this challenge. Considering the headlines of the 1980s and 1990s, the number of cover stories that depicted CEOs

as heroes, and the free-market rhetoric from both Washington and corporate America, someone might think that the United States had entered an era in which business drove the economic boom without government help. The fact is, though, that the interplay between the private and the public sector largely fostered that prosperity. After all, the government invented the Internet and allowed its commercialization. The monetary policies of the Federal Reserve, the fiscal policies of the U.S. Treasury, and the free-trade stance of the Clinton administration all contributed to low inflation and budget surpluses in the late 1990s, the heart of the long business expansion. Legislation allowed deregulation in finance, transportation, and telecommunications (imperfect as it may have been). Moreover, government-negotiated treaties led to expanded trade. That's why we must get the balance between government and business right.

The United States does not have a lot of maneuvering room in managing its sophisticated economy. True, American companies have grown larger, more powerful, more globally focused, and more technologically complex. As noted, government has also grown steadily. Yet, amid both trends, the nation has become more fragile. We saw how the destruction of just two large skyscrapers affected the U.S. and global economies, and now everyone sees how much greater the damage will be if someone attacks other parts of the nation's critical infrastructure—energy grids, telecommunications centers, food supplies, and the like. Quite separately, but almost simultaneously, we saw how quickly major companies with excellent reputations—Enron and Arthur Andersen—can collapse, and how fast other corporate icons such as General Electric and Merrill Lynch & Co., Inc. can lose their market value when facing intense public scrutiny. There are several reasons for this fragility: One is the interlocking nature of all aspects of modern society. Another is the growing demand for transparency in American institutions. There is the

instant global reach of the media, and a growing skepticism among ordinary citizens that most big institutions, public and private, can be trusted. One inevitable conclusion is that neither business nor government alone can shore up the overall system. It will take both, working together.

This partnership becomes critical when you put American society in a global context. In the international economy, in which instability is particularly great, there are few rules and institutions. Developing them will take many decades. National governments and business leaders are poorly equipped for the job. Both can abdicate, in which case there will be anarchy. Or they can cooperate to build truly international institutions, in which case the world has a better chance to enjoy a smoothly functioning global economy.

The United States has a lot to do, and neither Washington nor corporate America can do it alone. Over the next several years, the antiterrorism campaign and the response to Enron will result, one way or another, in the rewriting of the rules that govern so much of business and society. How free will Americans be to move around? How much privacy will they sacrifice? What restrictions will the United States place on finance, trade, immigration, communications? How will corporate governance change? How can a nation wage war and live in peace and prosperity at the same time? Someone will make decisions on these and a host of related issues. The question is, Who and how?

Americans need no less than a new paradigm for leadership in their society. In this book, I am looking at the agenda for business leaders, but, of course, they constitute just one important element of a more complicated picture. I don't know precisely what this paradigm should be, but I know that the roles of business, government, and nongovernmental organizations must move in