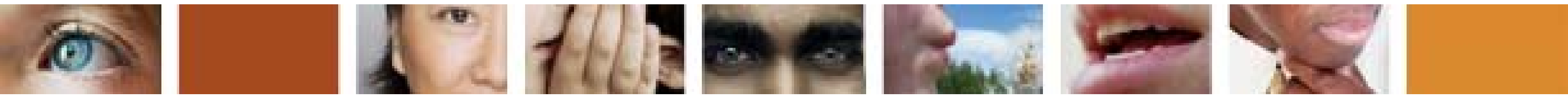
Charles H. Green, 2004



Scandals and the Backlash Against Trust

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In certain accounting industry circles the term "trusted advisor" has taken on a negative connotation. Reason? It implies a too-cozy, too-close, conflicted relationship between professional and client. In this day and age, that is not business-politically correct. The implied suggestion? Arms-length relationships.

This makes as much sense as solving male-female conflict by prohibiting marriage.

It is a misnomer to say we are living in a post-Enron world; we are in the midst of a severe backlash in reaction to the excesses of a few years ago. And as is often the case, the reaction is overdone. We are in danger of destroying real economic value—mistakenly—in the name of preventing abuses.

Business has taken the low road, to its eventual disadvantage. Faced with endemic corruption, it has chosen to fight symptoms, rather than causes. When you have a hammer, the world looks like a nail. To business and social leaders these days, the world looks like a gigantic conflict of interest; and the preferred hammer is to separate the conflicted parties. But disengagement is an inherently negative policy; in an increasingly interconnected world, it is bound

to suboptimize. We need more ethical interactions in business, not just fewer unethical ones.

What Problem Are We Trying to Solve?

We need more ethical interactions in business, not just fewer unethical ones.

Enron, Andersen, Worldcom, Frank Quattrone, Adelphia, Henry Blodgett, Parmalat, Tyco, Cendant, Putnam Funds, ImClone. Preferential treatment on IPOs, CEO compensation levels, offshore tax-avoidance incorporation, forward trading, insider trading, false research.

These are the very real sources of indigestion for the business world, only a few years old. Make no mistake: they add up to what future generations will see as a significant bubble of greed and corruption.

That was then. But this is now. Look at the solutions society has developed.

- Sarbanes-Oxley legislation, whose major impacts have been structural—distancing potentially conflicted parties from each other;
- corporate governance—trend toward more outside directors;
- a newly-energized SEC, prodded by NY Attorney General Eliot Spitzer's prosecutions;
- vast increases in the uses of RFPs, internet bidding, and 3rd party purchasers in the purchasing functions;
- within purchasing, a trend to include complex services in the traditional purchasing processes;
- within financial accounting, a move to expense options;
- separation of research and trading within the brokerage business;

All these solutions implicitly assume greed and evil-doing are in the nature of business. To most people, the benefits of separating commercial and investment banking (as US policy did for several decades), the research function from the brokerage function, consulting business from audit business seem obvious. But are they?

Entire industries exist with greater conflicts of interest at their very core. Real estate brokers and executive search firms, for example, must

juggle serving buyers and sellers, candidates and employers. Where does one draw the line?

The question is raised by the most disturbing trend of all—the dash toward arms-length purchasing of all things. Disturbing because it is self-imposed. Yes, the trend is partly due to cost pressures and a shift toward process outsourcing. But those alone don't explain companies' willingness to believe that conflict of interest lies at the very heart of business—the relationship between buyer and seller.

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To find conflict of interest between buyer and seller either requires a trivial definition of conflict of interest, or a mentality like that of the Salem Witch trial. It is simply overblown. Yet a recent Harvard Business Review article recommended viewing trust via structural solutions, e.g. recommending that clients not buy from consulting firms whose economic models encourage repeat business (which, by the way, means all consulting firms with other-than-internet-relationships).

For companies themselves to believe this is a form of self-loathing. As always, when negative systemic behavior is evident, some form of fear underlies it.

How Did We Get Here?

The culprit goes back a few decades, when we began to define business in Hobbesian terms as being about competition. Michael Porter's seminal work Competitive Strategy posited customers as one of five competitive forces defining success. In other words, the nature of business includes competing with one's customers. After decades of hearing "sustainable competitive advantage," it is not surprising that people think business is a fight and the only solution is to amend the Marquis of Queensbury rules.

But that's just one measure of how far we've gone wrong.

What We're Missing: The Economic Value of Trust

Buyer-seller relationships are like any other form of human unions between differing

parties—marriages, teacher-students, trade agreements. The whole is far greater than the sum of the parts-unless that fact gets obscured in narrowly-sectarian squabbling.

Buyers and sellers in trusted relationships create true economic value. In such a relationship, the buyer saves purchasing time, is more open to ideas, is more forthcoming about relevant information. The seller gets reduced sales costs, better pricing, access to important knowledge to improve products. At the other extreme—the one we're heading towards—every transaction is separate and depersonalized. In such relationships, the costs of isolation are high. The comparisons with segregated societies and with national economic protectionism are apt.

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The business world of the future is interconnected, not discrete. It relies on smooth interfaces, not impersonal ones. It is folly to believe that the fundamental heart of business—the exchange of goods and services—can best be done bloodlessly, without the value-adding creativity of human beings.

What Is to Be Done

The scandals are real, and demand solutions; just not the ones we have come up with as yet. On the punitive side, we need accountability; sharper laws that define individual criminal culpability, coupled with prosecutorial willingness to throw business criminals in prison.

On the preventive side, we don't need lectures on ethics. What we need is a reeducation in the basic economic principles of interdependency. We need to recognize more the real value of creating relationships in business.

We've spent enough intellectual capital on the belief that business is about competition; now we're spending moral capital. We have to remember that business is about customers, not just competitors. And about relationships with those customers.

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