

A Return to Reality

by Tricia Bisoux

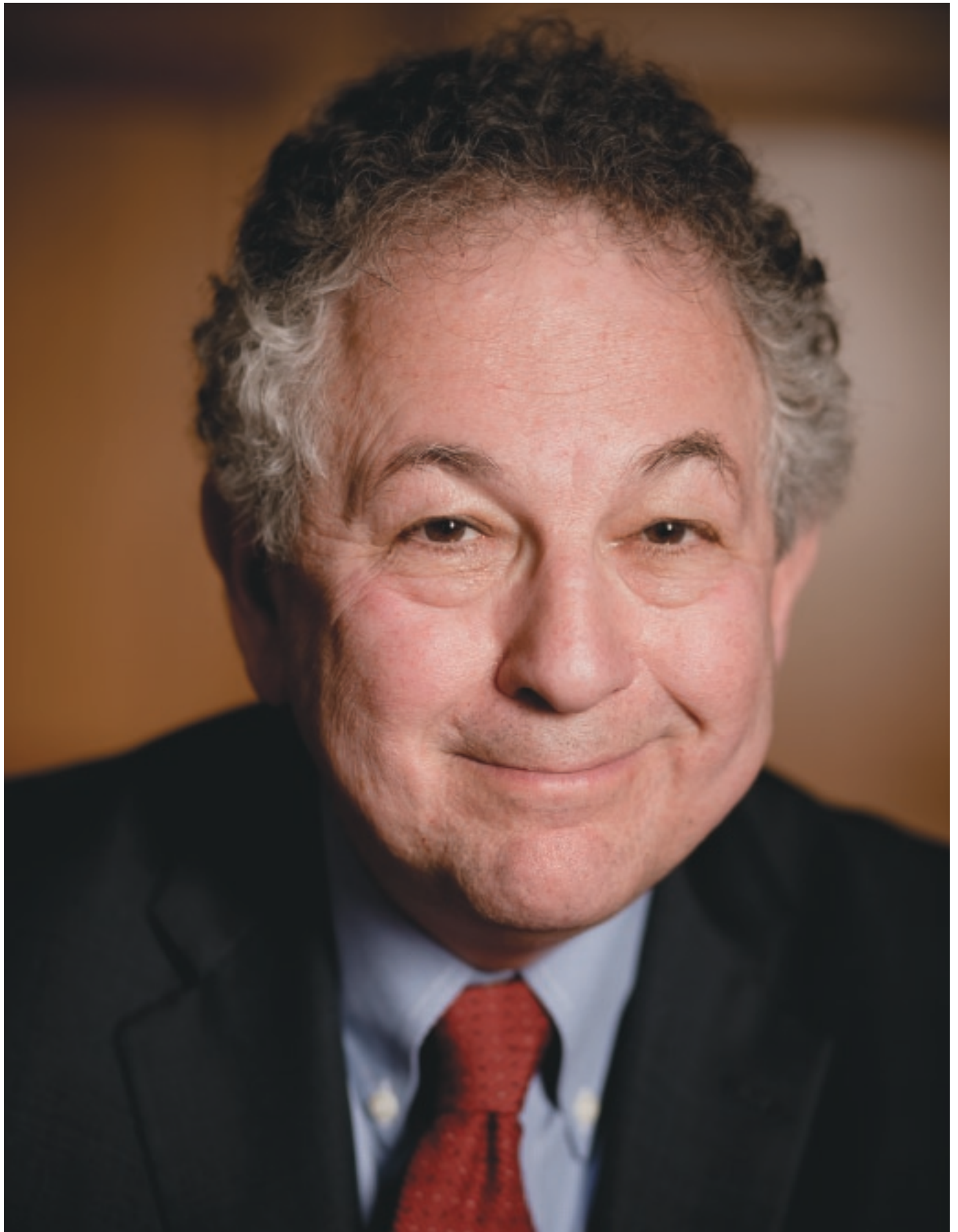
Even with his years of experience in investment, finance, and public policy, Jeffrey Garten got it wrong—and he isn't afraid to admit it. But then, so did just about everybody. In fact, the fall of Lehman Brothers and the subsequent collapse of the global markets has led Garten to change his mind about a number of issues—including the role of business in the world.

“In the past, I was guilty of having exaggerated what business can do,” he says. “As strong a case as there is for a broader business education,

there is a much bigger case for better education of public service officials, because they are the ones who must set the framework.”

Garten has had a front row seat to the global economy, where he has watched just how much business and public policy interact. He has worked with government, serving on the White House Council on International Economic Policy under President Richard Nixon and as Under Secretary of Commerce for International Trade under President Bill Clinton. In the 1980s, he worked on Wall Street as managing director of first Lehman Brothers and then the Blackstone Group. In 1995, he was named dean of the Yale School of Management in New Haven, Connecticut, a position he held until 2005.

Jeffrey Garten discusses the lessons of Lehman Brothers, the importance of public policy, and the need for a three-year MBA.



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Garten is now the school's Juan Trippe Professor of International Trade. In addition to his role on the faculty, he serves as chairman of Garten Rothkopf, an international advisory firm based in Washington, D.C., and as a trustee of The Conference Board. As he views the current global economy from these vantage points, he sees a system of business that is hampered by a number of inescapable realities.

“For all the discussion of the need for long-term thinking, we have markets that are very short-term oriented,” he says. “Our financial markets are under incredible structural pressures. They operate in a world where analysts and journalists pump up every little announcement, where accountants are still behind the curve and have no voice in their organizations.” If that's the world where business students will work, he argues, they'd better know how to handle those pressures in ways that make sense for their organizations.

That means that business schools will have to broaden the boundaries of their curricula, says Garten, to include subjects related to history, government, and public policy. He argues that tomorrow's business leaders will need a broader foundation of knowledge to draw from throughout their careers. Only then can they truly understand that the world around them is much bigger—and much smaller—than they may have imagined.

What did you think as you watched Lehman Brothers, your former employer, disappear?

I found it very sad. The company had an illustrious history of hiring investment bankers who also were great public officials. In the late 1970s, Lehman Brothers really stood out from all of Wall Street in terms of the vision of linking finance to public policy. To me, this was heaven. I was hired to help foreign governments with their finances. I was sent to Japan to help build up Lehman Brothers in Asia. Everything I did had a very major interaction with public officials. All of my aspirations were fulfilled, and I loved every minute of it for the 15 years I was there.

When it collapsed, it was like watching that part of my life crumble—first in slow motion, then in fast motion. What's most painful is that now, whenever I say I worked at Lehman Brothers, it's equated with having been part of an unsavory institution. While I know most people realize that everything that happened was very recent, it's nevertheless quite painful on a personal level. You almost don't want to identify with the company because it has become a poster child for so many things that went wrong—for greed, for short-term thinking, for all of those things. That's not what I identify with.

What are the central lessons that faculty should make sure students learn from this crisis?

Lesson No. 1 is that the CEO and top management have an obligation to take into account the soul, reputation, brand, and equity of their company in everything they do. They must view risking the institution's reputation in the same way they view risking the institution's financial investments. But they must also know the difference—a company's reputation can be almost unrecoverable if something goes wrong.

Lehman Brothers and its predecessors had been around for almost a century. It took years, if not generations, to build up its culture and its first-rate global reputation. All of that went down the drain in a matter of months. Students should know how quickly that can happen.

Lesson No. 2 is that the crowd is often wrong. The height of courage and integrity is to look at your competition and have the guts to ask whether you really want to be swimming in that same stream, at the same pace, and in the same direction. Lehman Brothers, for example, got caught up in fiercely competitive financial markets where everybody seemed to be doing well. Its natural instinct was to do the same thing, only better. That meant taking more risk. It would have been very difficult for Lehman Brothers to go against what everyone else was doing. The financial markets are relentless in penalizing those who decide to forgo some profitability in the interests of long-term viability.

Look at AT&T in the late '90s, when Michael Armstrong was CEO. All of a sudden, AT&T's returns were much lower than WorldCom's. When Armstrong and his team looked at WorldCom, they just couldn't understand how it was making so much profit. AT&T cut no corners, it engaged in no shenanigans—and it got clobbered by the market. Armstrong's reputation was badly diminished, and he was forced out. Months later, it came to light that WorldCom had cooked the books.

If the executives at Lehman Brothers hadn't engaged in “the game,” the company would have been forced to break itself up and sell itself off, just like AT&T. But, in retrospect, that would have been the right thing to do. Hats should go off to Armstrong. In all of the investigations of the tech collapse, nobody could say a word about AT&T's integrity.

How can future business leaders avoid the same fate as either company?

Business schools must stress the importance of corporate governance. Teach students about the need for a strong board that is self-aware and collectively capable of saying to the CEO, “This is the real situation.” It's important for



CEOs to surround themselves with tough-minded people who can tell them when they're doing something extraordinarily risky.

On a more profound level, business schools should educate business leaders in areas that go beyond traditional business subjects. If I could devise a curriculum, it would be heavily geared toward history. I bet very few CEOs had an education in financial history. Most business leaders know a lot about the latest strategic doctrines and fads, but I don't think they are sufficiently aware of historical cycles and how companies over the last several generations have managed to be innovative while maintaining a sense of integrity.

Rakesh Khurana of Harvard argues that business schools should view themselves as professional schools, and that their graduates should view themselves as members of a profession with a common standard of ethics. Do you agree?

I think there's a lot to that. The business world is much bigger than law, but I think there should be some common professional standards. So many people are asking, "What are the right reforms that ought to be done to prevent another financial debacle?" But it's only the government that's talking. There's no business voice right now.

What about accreditation organizations? Could they step into a role similar to the ones professional associations play for medicine or law?

As far as I know, accreditation organizations have no capability to shame the individual. Their standards relate to the schools, not to the profession. That's a big difference.

You argued in your 2003 book, *The Politics of Fortune: A New Agenda for Business Leaders*, that business needs to take a more active role in setting public policy. Would you make that same argument today?

I finished that book in 2001, right after 9/11. Now it's 2009, and the world has changed dramatically. Business has forfeited the right to have the confidence of society. Our belief in the viability of the world economy has changed.

You say business has forfeited the right to have society's confidence, but many still make the case that business can solve society's biggest problems.

The idea that business can solve the world's problems is terribly misguided, because it grows out of a sense that business is all-powerful and has all the resources. It grows from a sense that governments aren't capable anymore. That theory may have held some water in the 1990s, but we're entering a much different era. Government is returning in a big way, on national and global levels.

So, you're saying that business will have to make way for greater governmental oversight?

In the 1990s, businesses made a big move toward self-regulation. They held to the mantra that companies would get together to set and enforce standards. But it's going to be a long time before self-regulation has any credibility. Issues of food safety and toy safety were supposed to be based on some notion of self-regulation, and business fell down terribly. In the financial arena, especially, it's over; there is no trust at all.

Forget about self-regulation. In its place, I predict government regulators will be inside the organization. The level of government intrusion is going to be greater than anything that has happened in our lifetimes. That's how far this pendulum has swung.

That prediction will concern educators who are passionate about business's role in society.

I'm definitely not saying that business leaders shouldn't be very aware of the effects of what they do or that they shouldn't have social consciences. Efforts like the U.N. Global Compact are well intentioned, and I'm not saying that they shouldn't exist. But those who have arrogated to business a significant global social role, or anything close to it, need to return to reality. It is a total fantasy to say business should be in the lead.

Over the next several years, the world will be in a much slower state of growth. As their first objective, business leaders

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will have to keep their companies viable. They won't have, or won't allocate, the resources to address social issues. Society can no longer point to businesses and say, “You have to take care of education, infrastructure, and the environment,” because they won't do it. Not only will they not do it, the markets will kill them for even attempting it.

Government regulation and the education of government officials must be placed much higher on our list of priorities. If governments don't create the framework, it is an illusion to think that businesses will.

You noted at a recent conference that the events of late 2008 marked the beginning of a “massive transformation of the global financial system.” What sort of transformation?

First, we'll have to rethink the whole question of innovation. There has been the assumption that all innovation is good, but how do we control dangerous innovation? When we teach innovation, we'll have to focus on where innovation fails, where it can do damage.

We're also going to have to rethink the whole issue of compensation and incentives. There's a lot of evidence that the design of executive compensation systems has had a major impact on the way financial institutions have behaved. We need a better idea of how and why people are rewarded or penalized.

Then, we have to take a new look at conflicts of interest. We're probably headed toward a world with a number of big banking institutions and conglomerates that, no matter what they say, are rife with internal conflicts—they're putting their money in one place and their customers' money in another place. We need to look at how to manage these conflicts.

Do you think that we're transitioning into a truly global economy, where the role of the U.S. has diminished and up-and-coming nations like Brazil, China, and India will play a larger role?

You really could make the case for one of two scenarios. The first is that globalization is going to slow down, and that we're going to see a rise in nationalism and protectionism. Governments could take very protective measures in the financial arena because so many of them have been whacked by this global economy and forces outside their control. I give this scenario a 40 percent chance.

The second scenario is that globalization intensifies and financial institutions are consolidated. In this scenario, there will be more mergers among these institutions, because too many of them have too little capital. The automobile com-



panies will be reduced from, say, eight to four. There will be more international mergers and more global financial regulations when it comes to the environment. When we come out of this great storm, the world will be smaller and more integrated. I give this scenario a 60 percent chance.

In either case, the influence of the U.S. will be far less than it has been in the past. It has far less capability to tell other countries how to structure their economies. For generations, we've been telling China to do this, India to do that, Brazil to do this. But now that our model has collapsed, we have no credibility.

Certainly, the U.S. will have a very strong voice, but it will be a vastly diminished voice compared to ten years ago. The European model or the Chinese model might look a lot better to emerging economies than they did just a few years ago. Now that our brand of Darwinian capitalism has been totally discredited, there will be a big competition for ideas. The U.S. will be a part of that competition, but it won't run it.

You mentioned that business leaders will have to partner with government to a greater extent. How much should business students and public policy students know about the other side's arenas of influence?

That's a wonderful question. In theory, the more these two groups of students know about each other's arena, the better off the world will be. They need to work together. But how schools accomplish this in practice is a more difficult proposition, because to do justice to either subject, students really need to study more than two years.

Several years ago, when I was in my first term as dean at Yale, I gave a talk to GMAC on the topic, "Why an MBA should be three years." I started by saying, "There's not going to be one person who will agree with me." That turned out to be true. At the time, everybody was trying to figure out how to complete the degree in one year! Law school is three years, and medical school is four years. But for some reason business school is only two years—in Europe, it's one.

Business and public policy overlap, and there is a need for synthesis. But to teach both areas well, you have to make the program longer. I doubt anybody in this market would agree with me, but I think it's true.

You were dean of the Yale School of Management for ten years. What was your biggest challenge?

When I became dean, there was a lot of movement in areas such as globalization, entrepreneurship, and management of nongovernmental organizations. It was a huge challenge to figure out how to deal with these subjects in the classroom at a time when a lot of professors didn't study these areas. Many people also were calling for schools to increase the experiential factor for students, because a lot of business skills can be taught only on the job. I found it daunting to try to get my arms around all of that, to work

with faculty so that they were enthusiastic about these new departures, and to find and hire young faculty who would make up the core of the future.

At the same time, many foreign universities were approaching us to create joint programs. I decided that we were better off building links to other schools within Yale University than we were going abroad—a decision that, to put it mildly, wasn't universally acclaimed. I enhanced our joint programs with the schools of law, medicine, architecture, drama, art, and environmental studies. I believed that, no matter what careers students wanted to pursue, a broader education would serve them well.

Do you think that the challenges that deans face today are different?

The challenges I faced then still exist today. However, in 1996, the world economy was on an unambiguous course. The economy was more market-oriented and globalized; there were bigger roles for business. Many people, including me, would have said, "This will go on for generations."

Anybody becoming a dean now has to wrestle with questions that are much more profound than I did. What kind of world economy do we have now? How is it all going to change? What do these changes mean for how we manage a company, how we think about innovation, how we think about corporate governance?

But one of the great things about being a dean is that schools are great crucibles for debates. You may not be able to resolve questions, but you can raise them. You can get the smartest people around the world to put in their two cents' worth. If students take away the notion that even though there is a lot of ferment and things are not cast in concrete, there still are a few enduring truths—that's not nothing.

You've had a long career in business, public policy, and education. What's your next challenge?

I'm very happy being a professor, and I enjoy working with Garten Rothkopf to help organizations with issues involving energy and the environment.

I'm also working on a book due to come out in 2010. It's about the ten people in the last 1,000 years, up to the end of the 20th century, who have done the most to create the modern world. Each chapter covers the life and times of a different person, from Genghis Khan in the 12th century to Deng Xiaoping in the late 1990s. This project has been enormously engaging for me.

Doing these three things—I have no greater aspirations than that. 