



The Moral Compass Behind the Invisible Hand

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Contents

Moral Faculties and the Free Market	3
Business with a Moral Compass	7
The “Coming of Age” of Moral Capitalism	11

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Moral Faculties and the Free Market

In his October, 2008 testimony before the US Congress about the current “economic tsunami,” Alan Greenspan, Chairman of the US Federal Reserve for 18 years, declared:

“Those of us who have looked to the self-interest of lending institutions to protect shareholder's equity are in a state of shocked disbelief. I made a mistake in presuming that the self-interests of organizations... were such that they were best capable of protecting their own shareholders and their equity.”

“I found a flaw in the model that I perceived is the critical functioning structure that defines how the world works. The free market did break down. I still do not fully understand why it happened, and obviously to the extent that I figure where it happened and why, I will change my views.”¹



What is the flaw in the model?

Adam Smith – Father of capitalist economics

To discover this, let's go back to Adam Smith, the 18th century Scottish moral philosopher and author of "The Wealth of Nations." This father of capitalist economics stated that the decisions of individual owners to use their capital for their own gain, and of purchasers to buy for their own interests, would somehow be guided by an "invisible hand" to produce the greatest overall prosperity of society:

*"As every individual endeavors as much as he can to employ his capital in the support of domestic industry... [he] necessarily labors to render the annual revenue of the society as great as he can. He intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention."*²

Nobel Laureate economist Milton Friedman wholeheartedly endorsed and accentuated this basis of a "free market" economy, which maximizes the personal gain of individual owners of capital, when he wrote in 1962:

*"Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible."*³

Friedman's words echo the prevailing philosophy behind the "trickle down theory" of

economics that has dominated the last 25-30 years in America.

What could be the flaw in the concept of a free market guided by an invisible hand?

There may be many flaws. But to me, the most fundamental, tragic flaw was a selective reading of Adam Smith in the first place. He was a moral philosopher, not political economist. He believed strongly in *moral* faculties as the ultimate foundation for our thoughts, words, decisions, and actions – which include the individual economic activities that culminate in societal wealth. To him, morality was the key to individual and societal fulfillment, and the spiritual source of those moral faculties was abundantly clear in his writings:

"By acting according to the dictates of our moral faculties, we necessarily pursue the most effectual means for promoting the happiness of mankind, and may therefore be said, in some sense, to co-operate with the Deity, and to advance as far as in our power the plan of Providence. By acting other ways, we seem to obstruct the scheme which the

Author of nature has established for the happiness and perfection of the world.”⁴

“They [moral faculties] were set up within us to be the supreme arbiters of all our actions, to superintend [control] all our senses, passions, and appetites, and to judge how far each of them was either to be indulged or restrained. [These] were plainly intended to be the governing principles of human nature; the rules which they prescribe are to be regarded as the commands and laws of the Deity.”⁵

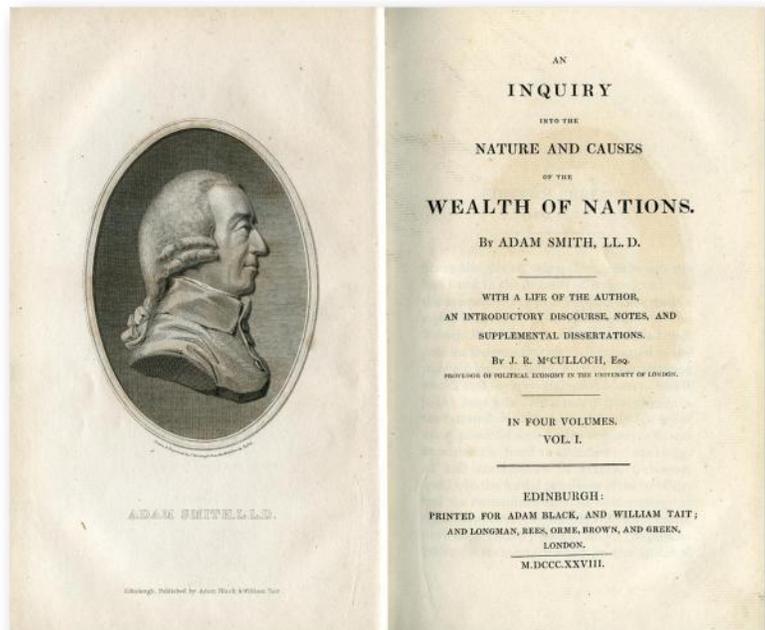
Furthermore, he did not see people as inherently self-centered or greedy in their pursuit of life. Rather, people also have an altruistic nature:

“How selfish so-ever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it.”⁶

Thus, Adam Smith depended on an *internal, moral* regulation of our individual decisions and behaviour – a set of Deity-inspired rules and laws intended to direct our free actions,

including economic ones. With these rules in practice, we might say that the invisible hand would be guided by the Divine hand. And he scoffed at our adulation of personal riches as life’s goal:

“This disposition to admire, and almost to worship, the rich and the powerful, and to despise, or, at least, to neglect persons of poor and mean condition...is...the great and most universal cause of the corruption of our moral sentiments.”⁷



So, what exactly are the moral principles required by free market capitalism in order to not produce the shock that Greenspan and the world has received? One starting point is to peruse the sacred scriptures of cultures from around the world, dating back eons, to see what the wisest of the wise have said about the healthy conduct of human society. In scriptures from Christian, Jewish, Hindu, Islamic, Buddhist, Baha'i, Confucian, and other spiritual traditions – a common theme is the “Golden Rule”:

- *Do unto others what you would have them do unto you. Love your neighbour as yourself. (Christian Bible, 1st century CE)*
- *Do nothing to your neighbor which you would not have your neighbor do to you. (Hindu Mahabharata, 6th century BCE)*

While some may find it easy to dismiss these sacred scriptures as irrelevant piety, statements like these form the basis of Smith’s moral foundation for pursuing individual and societal wealth. The “wisest of the wise” in various cultures have never

spoken of individual self-interest or greed as a basis for societal health and prosperity, and they offer no prospect that an economy based solely on the pursuit of individual gain can be healthy and beneficial to society long term. As Smith stated:



“All for ourselves’ and nothing for other people, seems, in every age of the world, to have been the vile maxim of the masters of mankind.”⁸

Greenspan and others are in shocked disbelief because of “a flaw” in their understanding of how the economic

world works. *Without a moral foundation*, turning a market economy loose for each person to pursue his or her “all for myself” interests is much like permissive parents giving the car keys and no curfew to an immature 14-year old with no drivers license: a great deal of harm is likely to occur.

Perhaps the most far-reaching lesson to learn from our current global recession is that we need to “grow up” in developing the moral faculties that Adam Smith so relied upon to guide the individual and societal decisions for economic prosperity.

Business with a Moral Compass

Adam Smith gave us a two-fold formula for individual and societal prosperity:

- The freedom for individuals to invest their capital with an eye to their own gain, while consumers bought in accord with their own benefit
- A morality based in Divine rule and law to guide both sides of the decisions made in the “free market”

Smith never claimed that the good of all was ensured by this formula. In fact, he specifically spoke of the need for government intervention to ensure the well-being of the majority of citizens. Speaking of the “far greater part” of society who “lived by labour,” he wrote:

*“The understandings of the greater part of men are necessarily formed by their ordinary employments. ... His dexterity at his own particular trade seems, in this manner, to be acquired at the expense of his intellectual, social, and martial virtues. But in every improved and civilized society this is the state into which the labouring poor, that is, the great body of the people, must necessarily fall, unless government takes some pains to prevent it.”*⁹

Besides external intervention, Smith referred us to our own “inner regulator”: our moral faculties, acting within us as our conscience:

*“It belongs to our moral faculties to determine... when and how far every other principle of our nature ought either to be indulged or restrained. What is agreeable to our moral faculties is fit and right, and proper to be done; the contrary wrong, unfit, and improper. Those vice-gerents of God within us, never fail to punish the violation of them, by the torments of inward shame and self-condemnation; and on the contrary, always reward obedience with tranquillity of mind, contentment, and self-satisfaction.”*¹⁰

What does this look like in practice?

Lars Kolind—former CEO, Oticon

Let us take the example of Lars Kolind, who in 1988 became the CEO of Oticon, a privately-owned hearing aid company in Denmark that was near bankruptcy and badly needed a turn-around. Kolind was an experienced executive who had been President or CEO of three different firms in a span of twelve years, the last being a very successful manufacturer of equipment for intensive care units in hospitals.

As he related in a 2005 interview ¹¹:

“We were under extreme pressure because the whole company was falling apart. And the pressures were coming from everywhere. I met with the management of our bank once a month and they were looking critically at everything we were doing. We were pressed to an extent that most people simply cannot imagine. We were forced to reduce staff very dramatically. On one occasion we cut away 10% of the staff overnight.”

His goal was to conduct the staff reduction in a way that ensured the well being of the company long term and all the people affected. But the huge risks of not handling the downsizing well included:

- Too few or too many people would be let go, impacting the company’s recovery
- The top talent might leave on their own
- The remaining staff might suffer low morale and give low productivity
- The remaining staff might not have the skills needed to resurrect the company
- Some of those laid off might have a very difficult time getting new jobs
- The people leaving the company might publicly speak ill of the company
- The suppliers and customers might cease doing business with Oticon, seeing the downsizing as a sign of business collapse

Lars Kolind felt that the traditional idea of seeking to lay off the poorest performing employees was not going address these risks. It was an extraordinary situation that required a different way of thinking and acting. Here is what he did, in his own words:

“I was really under pressure to determine which principles we should use to make the decisions as to who to lay off.”

“I took the decision, which no one understood, that we would not fire anyone over 50. Neither would we fire people who were so essential that we didn’t think we could survive without them. But other than that, we would let those people go who we thought would have the best chance of getting another job quickly - even though these were obvi-

ously the ones I would have preferred retaining. I just couldn't look into the eyes of all of the people that we would kick into prolonged unemployment in order for the rest of us to make money and prosper."

"Normally someone in my position would let the department heads talk to the people. But I didn't do it that way. I talked to every single person that was to be laid off and told each of them that they were going to be fired and that we would work with them to get a new job the best we could. I was experiencing all their bad feelings as I was confronting myself with the doubts and fears of all of these people. To me it would have been an act of cowardice to let others do this for me."



spected my decision. I maintained a number of the people who were fired as very good friends because they respected that it was necessary. It turned out that we managed to work with almost all of them to get new jobs."

What was the basis for Lars Kolind's decisions/actions?

"I must admit that I simply made these decisions and I didn't really think about where they came from, which was from my conscience. Later I realised that this was really an expression of my spiritual principles. I try to live and act and lead according to the principles of Christianity, the way I understand them. I believe that the theme of my spirituality would be 'Love God and love your neighbour.'"

How did it turn out?

"The interesting point was that we got through this amazingly well. There was total acceptance, even though no one really understood it. But once it was done, people said "wow" and really re-

So here is a case of a CEO making innovative decisions guided by his moral faculties – in this case, with his conscience guiding him to treat his “neighbors” as he would like to be treated. There’s another part to the story: Kolind created a new vision for the company that inspired employees, dealers, and customers alike. Rather than the old tag line of “Leaders in hearing technology,” he focused on their customers’ life experience, aiming to “Help people with impaired hearing to live

as they wish with the hearing they have.” Today, Oticon is one of the top suppliers of aids to the hearing impaired in the world.

This, I believe, is an example of the best combination of Adam Smith’s free market philosophy and the necessity of moral principles to guide it: he took care of his employees even in the midst of a necessary layoff. It’s the invisible hand guided by conscience.



The “Coming of Age” of Moral Capitalism

Over the last 100 years, four distinct contexts of business leadership have emerged around the world: *rationalist*, *humanistic*, *wholistic*, and *spiritual-based* ¹². Each context represents a fundamental change in how we view the *nature* of business, how we organize an enterprise, and how we lead its people. Each context is present in the business world today, sometimes harmoniously and sometimes not. Understanding these contexts helps to clarify where we’ve come from and where we’re going in the global economy today.



Where are we going in the global economy?

Moving to a wholistic view of business and leadership

The *Rationalist Context* first emerged in the early 1900s. In this view, the purpose of business is wealth and power for owners and shareholders. Adam Smith and Frederick Taylor were the “practical theoreticians” of this context. The leadership style is more military “command and convince” while conceiving of the organization as a “well oiled machine.” Motivation is through extrinsic carrot-and-stick methods, and employees are considered as “inter-changeable parts” and they are given assigned roles. Only specialists are given innovative work to do.

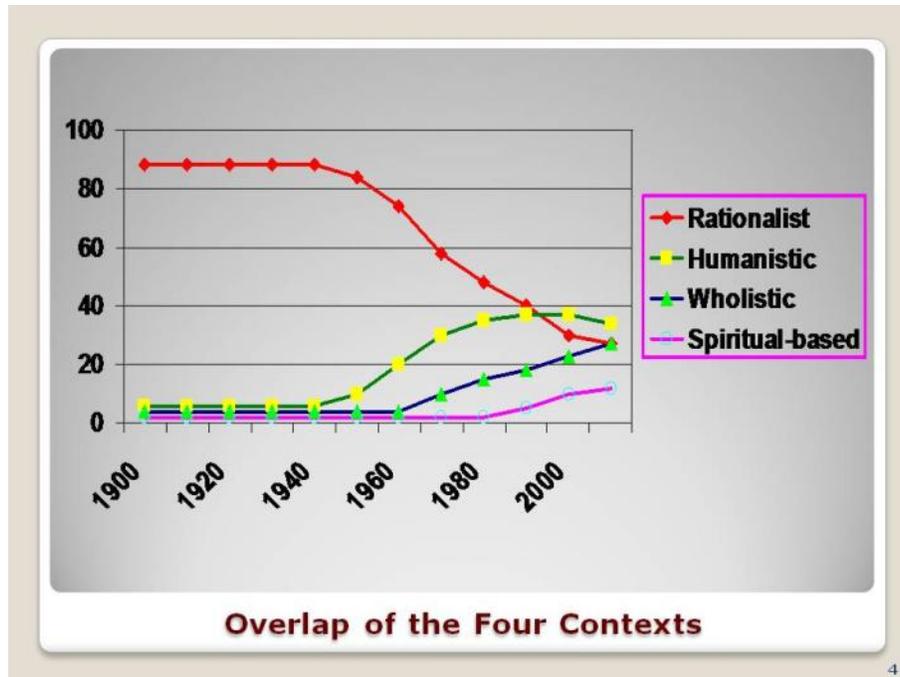
The *Humanistic Context* first emerged in the 1950s-60s through the writings of Douglas MacGregor and J. Edward Deming, among others. Here, the purpose of business is still wealth creation, but in a way that self-actualizes employees, who also share in some of the new wealth. Leadership is through situational, participative empowerment, conducted in the metaphors of sports and teamwork. People are seen as willing to do good and be good; motivation is by helping them fulfil a personal hierarchy of needs. Organizations are designed to build jobs around talent as much as fit talent to jobs. People at all levels can contribute to innovative work, such as quality process improvement.

The *Wholistic Context* first emerged in the 1970s-80s, spurred in part by the writings of Peter Senge and Stephen Covey. The pur-

pose of business is wealth and prosperity with accountability to all stakeholders. Success is measured in terms of “Triple Bottom Line” accounting (financial, social, environmental) with the notion of leaders as “stewards” of the resources at their disposal. People are seen as inter-dependent and self-organizing, motivated by wholistic principles for the good of self and society. Employees are given the opportunity to self-define their roles with great flexibility. Every person is considered able to “think globally and act locally” to foster innovation

The *Spiritual-based Context* first emerged in the 1990s, where the purpose of business is conceived as spiritual fulfilment and service to society, related to a Transcendent consciousness. Some early authors in this context include William George and S. K. Chakraborty. Leadership is through embodying one’s spiritual purpose and nature, through a purity and unity of thought, word, and action. A leader waters the spiritual roots of employees so they can fulfil their own spiritual purpose and operate from their spiritual character. There is a sincere sense that together, “we can co-create both spiritual and material prosperity.”

Until the Humanistic context emerged, the Rationalist view was the only game in town. Since then, it has declined in its total dominance, while the Humanistic has come into its own, in part through the TQM and



“Intrapreneur” movements of the 1980s. Without any empirical data, it appears that with the upswing of the Wholistic and Spiritual-based contexts in the last 30 years, the Rationalist and Humanistic represent about 70% of the business thinking today, while the Wholistic and Spiritual-based share the other 30%. Still, the trend is towards the later emerging contexts, and the Wholistic is gaining strength and maturity in business thought-leadership and practice.

What does this Wholistic leadership look like in “real life”? One case is Tata Steel Ltd. – at 100 years old, India’s premier producer of steel is known for its high quality and environmental consciousness. Dr. J. J. Irani was once its Managing Director, before becoming the director of business ethics and quality management for the whole Tata Group of companies. In an interview about his leader-

ship, he stated:

*“Business must benefit society; there is no question about it. You cannot be a spike of prosperity in a sea of poverty. Wealth creation is not the major goal; it is the means by which we can serve the community. But unless you create wealth, you cannot share it.”*¹³

Dr. Irani elaborated on what this meant day-to-day. In 1993, the Prime Minister of India told a group of industrialists, including Mr. J.R.D. Tata and Dr. Irani, that the government could not handle all the infrastructure issues around the country. The PM asked the business leaders to spend 1% of their net profits on causes that are not connected with their employees. To Mr. Tata’s and Dr. Irani’s way of thinking, the 1% figure didn’t make sense. Dr. Irani explained:

“Outside our own area, beyond our employees and our township Jamshedpur, we provide municipal services, community services, medical services, grants and donations. While the Prime Minister was asking us to spend 1%, we were already spending much more than what he was asking. How much we spend does not depend upon our net profit; it depends on the need of the community.”

This kind of corporate social responsibility, in which the moral basis of Adam Smith’s “invisible hand” is quite present, represents a new brand of “conscious capitalism.” This term was coined by Dr. Muhammad Yunus, the Nobel Peace Prize winner for his pioneering work in micro-financing in Bangladesh and elsewhere, to mean business that met social needs while turning a profit for the business owners.

Dr. Yunus is quite adamant in describing the flaw in the global economic mentality and system that has caused the current global recession:

“Today’s capitalism has degenerated into a casino. The financial markets are propelled by greed. Speculation has reached catastrophic proportions. What I rebuke is that today there is only one incentive for doing business, and that is

the maximization of profits. There need to be many more companies whose primary aim is not that of earning the highest profits possible, but that of providing the greatest benefit possible for human kind.”¹⁴

If we’re to recover from the current economic crisis, it will take more than just new economic policies and systems. It will take the *moral sentiments* that Adam Smith elucidated, and a *wholistic view of business and leadership*.

And it will take what Vaclav Havel presaged in 1978, ten years before he became the first President of Czechoslovakia:

“If a better economic and political model is to be created, then perhaps more than ever before it must derive from profound existential and moral changes in society. A better system will not automatically ensure a better life. In fact, the opposite is now true: only by creating a better life can a better system be developed.”¹⁵

That better life is, as Havel said, requires moral changes. So we come full circle to the wisdom of Adam Smith: our moral faculty must guide our lives. Only then can we fulfil the promise and potential not only of each individual, but also of the global society as a whole.

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