

# The Value of Sharing Ethical Wisdom

By James G. Jones, CFA

The conviction of Rajat Gupta in June 2012 for securities fraud and conspiracy resulting from charges of insider trading marked the end of a tragic fall from grace. The former CEO of consulting firm McKinsey and Company as well as a former board member of Goldman Sachs, American Airlines, and Procter & Gamble and a noted philanthropist, Gupta later stated during sentencing, "I regret terribly the impact of this matter on my family, my friends and the institutions that are dear to me. I have lost my reputation I built for a lifetime. The verdict was devastating."

Gupta had committed the error most common to decisions that end in great regret and pain. At the time of deciding, he did not understand the ultimate cost of his poor decision.

It goes without saying that if we could somehow foresee ultimate outcomes, we would make better decisions and have fewer regrets. As a society, we recognize this truth and have sought to communicate with clarity the costs of certain poor decisions whose consequences extend beyond the individual to other members of society. The establishment of criminal laws and sentencing guidelines serves to define and communicate both the unacceptable behavior and the personal costs of a conviction. Civil law and government regulations serve similar purposes. In our profession, the CFA Institute Code of Ethics and Standards of Professional Conduct define proper and improper behavior for CFA Institute members and impose penalties for misconduct, ranging from private censure to revocation of the CFA charter.

Most people would agree that laws, regulations, and codes of ethics are important pillars in society that inform us what ethical behavior looks like and which behaviors, by the nature of the severity of their associated penalty, are most egregious. Yet, even with these constructs, unethical behavior persists. However, I submit that these institutional systems have two major shortcomings. First, they do not shed light on the natural progression of unethical behavior, and second, they cannot effectively communicate the benefits of ethical conduct to the individual. Both of these shortcomings contribute to significant errors in estimating the expected costs and benefits of ethical behavior.

The worst ethical lapses that make the headlines are rarely the initial ethical lapse of the individual. Such ethical journeys typically begin years prior with a seemingly minor ethical misstep. By failing to address the strong tendency of ethical misconduct to progress over time in its depth and severity, the current system of laws, regulations, and codes of ethics—with their focus on the costs of individual actions—do not properly inform people of the likely long-term effects of a seemingly small ethical lapse.

Suppose a minor ethical dilemma comes before an

individual. If he estimates the costs and benefits based only on the costs of this single action, he is most likely significantly underestimating the total costs. Rather, a more enlightened individual, who is aware of the natural progression of unethical behavior, will compare the estimated benefits to a much larger cost based on a hypothetical future unethical act that would have a much more severe penalty.

A significant improvement in ethical decision making could be achieved if individuals understood the principle of progression in unethical actions and began upwardly adjusting the estimated cost of unethical behavior.

Laws, regulations, and codes of ethics by their very nature define only the direct negative consequences of unethical behaviors. The benefits of ethical conduct, often undefined and implied, are typically framed in terms of benefits to society or the avoidance of punishment.

Although most of the benefits of unethical behavior are immediate, ethical behavior bestows its benefits over a longer time horizon.

The first benefit of ethical behavior is a clear conscience. Because unethical behavior is behavior that injures another individual or society for personal gain, a rare individual would not recognize or have some empathy for those injured. The lingering guilt can slowly rot the soul. Even for those individuals who can dismiss or push feelings of guilt or empathy away, the lack of a clear conscience requires hard work. Unethical actions must be kept hidden, far from the light of day. False histories must be constructed, lies must be told, and the truth must never be discussed. One must always be on guard. Careless talk cannot be tolerated.

The ethical individual can live the carefree life, having no fear of the truth. History is an open book, freely discussed without worry. There is no fear of being "found out" for there is nothing to find. Note that having a clear conscience does not imply that regrettable mistakes were not made, but even though honest mistakes may have consequences, such mistakes are not moral failures.

A different benefit of ethical behavior is the acquisition of a reputation for integrity and honesty. Although a good reputation takes a long time to develop, the benefits are substantial. The trust of clients and the respect of peers enhance your personal brand, which creates new opportunities and increases personal satisfaction and joy. Clients are more likely to refer colleagues and friends to a professional with a sterling reputation. People are more willing to partner and engage with such a person, and the individual has a greater sense of worth and purpose.

Since the benefits of a clear conscience and a sterling reputation do not reveal themselves in the short term and are hard to quantify, it is highly likely that individuals will

substantially underestimate their benefits, resulting in more unethical behavior.

Who has witnessed the principle of progression within unethical behavior? Who has experienced the benefits of a clear conscience and a sterling reputation? Not unexpectedly, research shows that ethical decision making improves with age and experience. Therefore, seasoned and experienced investment professionals have a special role to play. It is their responsibility to inform those new to the profession of the true costs of unethical behavior and the benefits of ethical behavior.

How can we communicate these truths effectively? I believe the answer may come from our childhood. As children, our parents and caretakers wanted to teach us virtues. They knew the development of a virtuous life would benefit us as well as society, but their methods were curious. If they wanted to teach us the importance of honesty, they didn't just say, "Tell the truth, or you will get punished." Instead, they told us the story "The Boy Who Cried Wolf." They used "The Tortoise and the Hare" to teach the importance of perseverance, and "Beauty and the Beast" highlighted the virtues of compassion and loving the unlovable.

They knew something about the human condition. Stories stick with us. Propositional statements and rules are often forgotten or dismissed over time. A story resonates and settles deeper within us.

Can the power of stories be harnessed to help people become more ethical? I believe it can. Those of us who have

been in the investment profession for an extended period of time have stories to share. Some stories are born of our own experiences. Others are gathered from the observation of other people's experiences. It falls to us to bring our Code of Ethics to life by sharing these stories with others in our industry, especially those new to the profession who are most likely to misestimate future costs and benefits.

We must tell stories of those whose unethical actions may have succeeded for a season but, like the actions of Rajat Gupta, eventually led to great pain and hurt. We must help them understand the great satisfaction and joy that eventually come from a great reputation built over many years of honorable and ethical work. We must help them become better decision makers by giving them better information.

So, for those of us who have been in the investment profession for a long time, I have this admonition: Tell your story. Educate. We must not overlook this important responsibility of an investment professional. We must help the inexperienced better estimate future costs and benefits. To those who are inexperienced, I ask you to listen and consider our stories. Trust our call to pursue a higher ethical calling—for the ultimate benefit of society and you.

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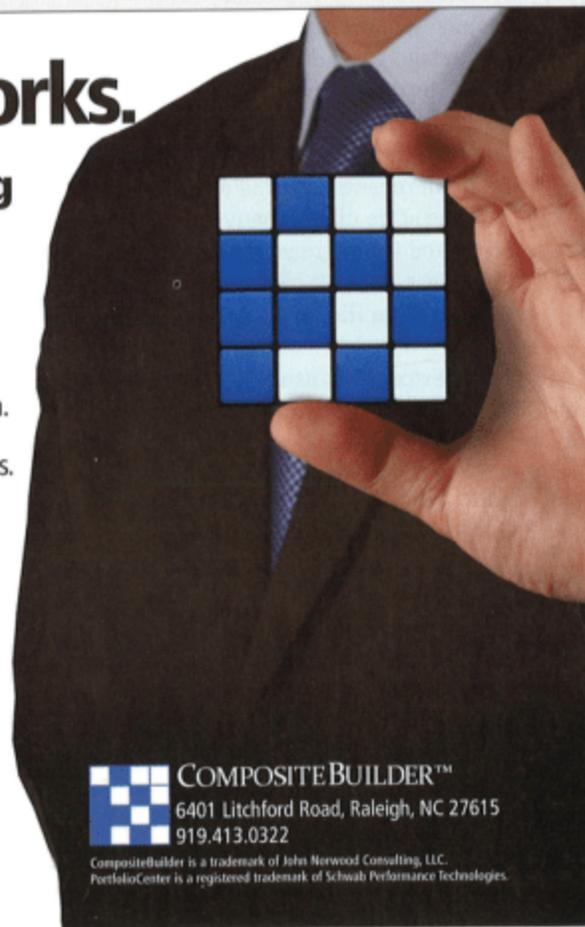
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