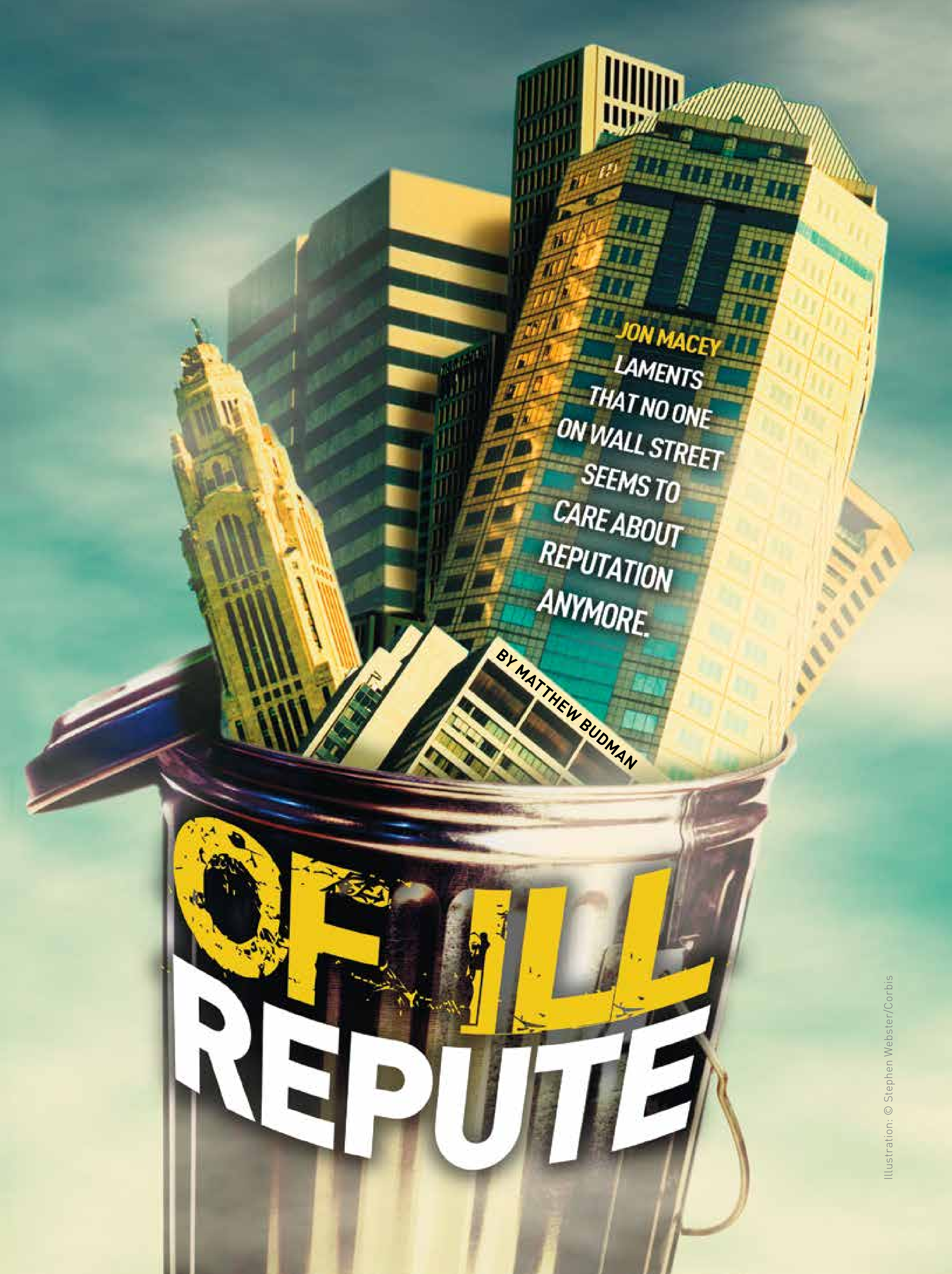

OF ILL REPUTE

JON MACEY LAMENTS THAT NO ONE ON WALL STREET SEEMS TO CARE ABOUT REPUTATION ANYMORE.

BY MATTHEW BUDMAN

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WHAT DO YOUR CUSTOMERS AND BUSINESS PARTNERS THINK OF YOU? REPUTATION IS INTEGRAL TO HOW COMPANIES DECIDE WHETHER AND HOW TO DO BUSINESS WITH EACH OTHER, AND HOW CONSUMERS CHOOSE BETWEEN FIRMS. BUT ACCORDING TO JONATHAN R. MACEY, SAM HARRIS PROFESSOR OF CORPORATE LAW, CORPORATE FINANCE, AND SECURITIES LAW AT YALE UNIVERSITY, REPUTATION MEANS A LOT LESS THESE DAYS, PARTICULARLY IN THE WORLD OF FINANCE.

As a substitute, companies increasingly depend on regulators to protect them from potential hazards—even though regulation isn't what it used to be either. And corporate implosions have ever-smaller impact, to the extent that executives are no longer permanently tainted by association with prominent failed employers. "Companies collapsing from scandals used to drag their leaders down with them," Macey writes. If you've ever wondered why the people who seem to be responsible for massive failures seem to emerge unscathed . . .

Macey, author of *The Death of Corporate Reputation: How Integrity Has Been Destroyed on Wall Street* (Pearson/FT), spoke via Skype from his home in New Haven, Conn.

IN WHAT WAYS DOES REPUTATION PLAY OUT DIFFERENTLY ON WALL STREET THAN IN THE REST OF CORPORATE AMERICA?

Think about the distinction between a company that is manufacturing automobiles or refrigerators or software versus a company that's recommending securities. If I'm selling refrigerators and I want to make a reputation for myself, I'll offer a strong warranty; I'm telling people I have a good manufacturing process, and I can stand behind the products that I build.

On the other hand, if I'm recommending a security and somebody buys that security at a price of 10, and it goes down to 5, there's no way I can issue any sort of a warranty that'll make things right for the person purchasing it, particularly if I'm selling a lot of securities or an entire IPO. And if the share does drop in price, it's not clear whether it's my fault: Did I give bad advice, or did some strange thing happen in the interim?

It's easier for companies in the real economy to put their money where their mouth is, and manufacturers take full responsibility for how their products perform; it's not a matter of the market perception affecting price or things like that. The market for reputation actually is working pretty well in the manufacturing space, what I'd call the real economy or mainstream economy, much better than it is in the financial world.

YOU WRITE THAT, IN FINANCE, "REPUTATION NO LONGER MATTERS TO SURVIVAL. . . . FIRMS THAT APPARENTLY LACK ANY REPUTATION AT ALL CONTINUE NOT ONLY TO SURVIVE BUT TO THRIVE." DO YOU FEEL THE RAMIFICATIONS OF LOSING REPUTATION SHOULD BE MORE SEVERE THAN THEY ARE?

Well, I think they're very severe for the *economy.* But I definitely think the economy would be much stronger if reputation mattered more to firms in the financial industry.

YOU DISCUSS THE ACCOUNTING FIRMS IN PARTICULAR AS BEING GOVERNED BY REGULATION, NOT REPUTATION.

The accounting firms have transitioned from a reputational model, where companies got audits because investors required that an independent third party come in and verify that the company was real—that it actually had sales, that sales were what it said they were, that reports of earnings and assets and shareholder equity were not just made up. Now we have a regulatory model, where companies get audits because the SEC *requires* them to, so it matters less what people think of the accounting firms.

And look at credit-rating agencies. It used to be that no one would ever hire a credit-rating agency unless it had a good reputation, because you have to pay the agency, and what you're paying for is a rating, and if the rating doesn't convey a credible signal—if people don't trust it or believe it—then why pay for it? Nowadays, no one really trusts credit ratings. People now buy credit ratings notwithstanding the fact that they have little or no informational advantage. Why? Because a whole bunch of obscure regulations make it difficult or impossible for investors to buy securities unless they get these ratings.

I WANTED TO TALK ABOUT REPUTATION AND INDIVIDUAL EXECUTIVES. FROM THE DREXEL SCANDAL, YOU CONCLUDE THAT "PEOPLE'S PERSONAL REPUTATIONS ARE NO LONGER FIRMLY AND INEXORABLY LINKED TO THE REPUTATIONS OF THE FIRMS THEY WORK FOR," AND THAT PEOPLE WORKING FOR FIRMS INVOLVED IN SCANDALS HAVE NO TROUBLE MOVING ON TO "SIMILAR WORK AT OTHER COMPANIES."

Certainly things are bad if you're indicted, as David Duncan was at Arthur Andersen or Andy Fastow at Enron or Dennis Kozlowski at Tyco. But if you manage to avoid indictment—or sometimes, as with Michael Milken, even if you do get indicted—you can bounce back.

WELL, SURE, YOU *CAN* BOUNCE BACK. BUT SHOULD IT BE THAT EASY? IN THE BOOK, YOU WRITE, A LITTLE INCREDULOUSLY: "PEOPLE CAN WORK FOR FIRMS THAT IMPLODE IN A TSUNAMI OF SCANDAL AND, AS LONG AS THEY ARE NOT LITERALLY IN PRISON OR OTHERWISE PHYSICALLY INCAPABLE OF OTHER EMPLOYMENT, AFTER THE IMPLOSION THEY CALMLY AND EFFORTLESSLY MOVE ON TO OTHER, SIMILAR EMPLOYMENT."

It's a good thing in the sense that the people who aren't directly to blame for financial scandals and crisis are unaffected by it. It's a very different situation than when the accounting firms and the investment banks and the law firms were all general partnerships, where each partner was personally liable for any professional misconduct by any of the partners in the firm.

BUT WHY DO HR DEPARTMENTS KEEP HIRING THESE PEOPLE? AREN'T THOSE RÉSUMÉ ENTRIES RED FLAGS?

No. What HR people care about is people's ability to generate a book of business. So as long as someone's not banned from doing his job, he can still generate revenue for the firm, and he'll get hired. It's all about the bottom line.

IT SEEMS A PRETTY LOW BAR TO CLEAR.

It's very low, absolutely.

DO YOU GET THE SENSE THAT JOB CANDIDATES IN SOME FIELDS USED TO CONCEAL PREVIOUS EMPLOYMENT WITH SCANDALOUS COMPANIES, AND NOW THEY DON'T BOTHER TO?

Well, it's harder to hide, since our technology is so much better. I think people in the middle of a scandal used to just withdraw from the job market. They don't do that anymore. One of the great things that distinguishes the United States from, say, France or Italy is that it *is* possible to bounce back. And that's usually a good thing: Think of CEOs of successful tech firms—most of these guys have been CEOs of firms that failed, and they learned from their mistakes. But it's *not* a good thing when people just completely ignore the past, including evidence of moral failings and indications that someone's not ethical. It's important to distinguish those things.

YOU WRITE THAT ON WALL STREET, "PERSONAL REPUTATION HAS REPLACED FIRM REPUTATION AS THE RELEVANT ANALYTICAL POINT OF REFERENCE." DO MOST INDIVIDUALS HAVE CLEAR ENOUGH BUSINESS IDENTITIES THAT EMPLOYERS CAN IGNORE OR OVERLOOK PREVIOUS EMPLOYERS ALTOGETHER?

To a large extent, people now have individual reputations that are not connected with the reputations of the companies they work for. And they don't really care whether those companies suffer a slip in reputation, so long as they themselves don't suffer a slip in *personal* reputation. That's why we see people who used to work at Enron or Arthur Andersen or Lehman Brothers or Dewey & LeBoeuf go on to other things—the failure of the firm has no effect on their professional careers.

SO AS LONG AS SOMEONE'S NOT BANNED FROM DOING HIS JOB, HE CAN STILL GENERATE REVENUE FOR THE FIRM, AND HE'LL GET HIRED. IT'S ALL ABOUT THE BOTTOM LINE.

YOU ARGUE THAT REPUTATION IS CRITICAL TO THE FINANCIAL SYSTEM FUNCTIONING. WHAT DOES IT MEAN THAT COMPANIES AND EXECUTIVES SEEM TO PAY SO LITTLE PRICE FOR HAVING POOR REPUTATIONS?

At some point, it's really going to matter. Think about why a company like Procter & Gamble and Gibson Greeting Cards—two companies that have been stunned by doing business with Wall Street—would enter into a complex hedging transaction, or a currency swap, with a problematic firm like Goldman Sachs or Bank of America. There are three reasons. First, the people doing these trades believe that they're going to be protected by regulation, that the SEC will come in and prevent them from being ripped off. Or they may think, "We're just as smart as anyone else in the room—we can figure out the various permutations and hidden pitfalls in this transaction; we can fend for ourselves." Or, third, they can trust the reputation of the people they're dealing with.

None of those three is going to protect the corporation. Executives can't really believe that regulation is going to protect them; we all saw what happened with Bernie Madoff. They can't really believe that they understand these incredibly complex financial transactions. And based on the reputations of Bank of America and Goldman, there's no reason to think that these firms will do anything other than milk every possible penny out of a trade. So companies should be leery about working with the likes of Goldman—and soon these guys are going to run out of people to do business with. And that's a problem. ■