Business men and women keep their word because they want to, not because honesty pays.

Why Be Honest if Honesty Doesn't Pay

by Amar Bhide and Howard H. Stevenson

We bet on the rational case for trust. Economists, ethicists, and business sages had persuaded us that honesty is the best policy, but their evidence seemed weak. Through extensive interviews we hoped to find data that would support their theories and thus, perhaps, encourage higher standards of business behavior.

To our surprise, our pet theories failed to stand up. Treachery, we found, can pay. There is no compelling economic reason to tell the truth or keep one's word—punishment for the treacherous in the real world is neither swift nor sure.

Honesty is, in fact, primarily a moral choice. Businesspeople do tell themselves that, in the long run, Amar Bhide is an assistant professor of general management at the Harvard Business School. Howard H. Stevenson is the Sarofim-Rock Professor of Business Administration at the Harvard Business School.
they will do well by doing good. But there is little factual or logical basis for this conviction. Without values, without a basic preference for right over wrong, trust based on such self-delusion would crumble in the face of temptation.

Most of us choose virtue because we want to believe in ourselves and have others respect and believe in us. When push comes to shove, hardheaded businessfolk usually ignore (or fudge) their dollars-and-cents calculations in order to keep their word.

And for this, we should be happy. We can be proud of a system in which people are honest because they want to be, not because they have to be. Materially, too, trust based on morality provides great advantages. It allows us to join in great and exciting enterprises that we could never undertake if we relied on economic incentives alone.

Economists and game theorists tell us that trust is enforced in the marketplace through retaliation and reputation. If you violate a trust, your victim is apt to seek revenge and others are likely to stop doing business with you, at least under favorable terms. A man or woman with a reputation for fair dealing will prosper. Therefore, profit maximizers are honest.

This sounds plausible enough until you look for concrete examples. Cases that apparently demonstrate the awful consequences of abusing trust turn out to be few and weak, while evidence that treachery can pay seems compelling.

The moralists’ standard tale recounts how E.F. Hutton was brought down by its check-kiting fraud.\(^1\) Hutton, once the second largest broker in the nation, never recovered from the blow to its reputation and finances and was forced to sell out to Shearson.

Exxon’s Valdez disaster is another celebrated example. Exxon and seven other oil companies persuaded the town of Valdez to accept a tanker terminal by claiming that a major spill was “highly unlikely.” Their 1,800-page contingency plan ensured that any spill would be controlled within hours. In fact, when Exxon’s supertanker spewed forth over 240,000 barrels of oil, the equipment promised in the cleanup plan was not available. The cost? According to recent (and still rising) estimates, Exxon’s costs could exceed $2 billion, and the industry faces severe restrictions on its operations in Alaska.

But what do these fables prove? Check-kiting was only one manifestation of the widespread mismanagement that plagued Hutton and ultimately caused its demise. Incompetently run companies going under is not news. Exxon’s underpreparedness was expensive, but many decisions turn out badly. Considering the low probability of a spill, was skimping on the promised cleanup equipment really a bad business decision at the time it was taken?

More damaging to the moralists’ position is the wealth of evidence against trust. Compared with the few ambiguous tales of treachery punished, we can find numerous stories in which deceit was unquestionably rewarded.

Philippe Kahn, in an interview with *Inc.* magazine, described with apparent relish how his company, Borland International, got its start by deceiving an ad salesman for *BYTE* magazine.

*Inc.*: The story goes that Borland was launched by a single ad, without which we wouldn’t be sitting here talking about the company. How much of that is apocryphal?

Kahn: It’s true: one full-page ad in the November 1983 issue of *BYTE* magazine got the company running. If it had failed, I would have had nowhere else to go.

*Inc.*: If you were so broke, how did you pay for the ad?

Kahn: Let’s put it that we convinced the salesman to give us terms. We wanted to appear only in *BYTE*—not any of the other microcomputer magazines—because *BYTE* is for programmers, and that’s who we wanted to reach. But we couldn’t afford it. We figured the only way was somehow to convince them to extend us credit terms.

*Inc.:* And they did?

Kahn: Well, they didn’t offer. What we did was, before the ad salesman came in—we existed in two small rooms, but I had hired extra people so we would look like a busy, venture-backed company—we prepared a chart with what we pretended was our media plan for the computer magazines. On the chart we

[Image: Was E.F. Hutton really brought down by its check-kiting fraud?]

had *BYTE* crossed out. When the salesman arrived, we made sure the phones were ringing and the extras were scurrying around. Here was this chart he thought he wasn’t supposed to see, so I pushed it out of the way. He said, “Hold on, can we get you in *BYTE*?” I said, “We don’t really want to be in your book, it’s not the right audience for us.” “You’ve got

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to try,” he pleaded. I said, “Frankly, our media plan is done, and we can’t afford it.” So he offered good terms, if only we’d let him run it just once. We expected we’d sell maybe $20,000 worth of software and at least pay for the ad. We sold $150,000 worth. Looking back now, it’s a funny story; then it was a big risk.3

Further evidence comes from professional sports. In our study, one respondent cited the case of Rick Pitino, who had recently announced his decision to leave as coach of the New York Knicks basketball team with over three years left on his contract. Patino left, the respondent wrote, “to coach the University of Kentucky [a school of higher learning, that like many others, is a party in breaking contracts]. Pitino was quoted in the New York Times the week before as saying that he never broke a contract. But he’s 32 years old and has had five jobs. What he neglected to say is that he’s never completed a contract. The schools always let him run out, as they don’t want an unhappy coach.

“The same thing is done by professional athletes every year. They sign a long-term contract and after one good year, they threaten to quit unless the contract’s renegotiated. The stupidity of it all is that they get their way.”

Compared with the ambiguity of the Hutton and Exxon cases, the clear causality in the Kahn and Pitino cases is striking. Deceiving the BYTE salesman was crucial to Kahn’s success. Without subterfuge, Borland International would almost certainly have folded. And there is a hard dollar number [with lots of zeros in it] that professional athletes and coaches gain when they shed a contract.

What of the long term? Does treachery eventually get punished? Nothing in the record suggests it does. Many of today’s blue chip companies were put together at the turn of the century under circumstances approaching securities fraud. The robber barons who promoted them enjoyed great material rewards at the time—and their fortunes survived several generations. The Industrial Revolution did not make entirely obsolete Machiavelli’s observation, “Men seldom rise from low condition to high rank without employing either force or fraud.”

Power—the ability to do others great harm or great good—can induce widespread amnesia, it appears. Borland International’s large ad budget commands due respect. Its early deceit is remembered, if at all, as an amusing prank. Pitino’s record for winning basketball games wipes out his record for abandoning teams in midstream.

Prestigious New York department stores, several of our respondents told us, cavalierly break promises to suppliers:

“You send the department store an invoice for $55,000 and they send you $38,000. If you question it they say, ‘Here is an $11,000 penalty for being two days late; here is the transportation tax and a dockage fee...you didn’t follow our shipping instructions, Clause 42, Section 3C. You used the wrong carrier.’ And half the time they call the order in and send the 600-page confirming document later, and they say you didn’t follow our order.”

“Department stores are horrible! Financial types have taken control, the merchants are out. The guy who keeps beating you down goes to his boss at the end of the year and says ‘Look at the kind of rebates I got on freight reduction—$482,000. I delayed payments an average of 22 days from my predecessor at this kind of amount, and this is what I saved.’”

Nevertheless, suppliers still court their tormentors’ orders.

“Don’t tell me that department stores will go out of business because they treat their suppliers like that! I don’t believe that at all. They have too much power—they screw one guy, and guys are waiting in line to take a shot at them again.”

Heroic resistance to an oppressive power is the province of the students at Tianamen Square, not the businessfolk in the capitalist societies the students risk their lives to emulate. Businesspeople do not stand on principle when it comes to dealing with abusers of power and trust. You have to adjust, we were told. If we dealt only with customers who share our ethical values, we would be out of business.

A real estate developer we interviewed was blunt: “People are really whores. They will do business with someone they know they can’t trust if it suits their convenience. They may tell their lawyers: ‘Be careful, he’s dishonest; he’s not reliable and he will try to get out of the contract if something happens’

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But those two do business with each other...I've done transactions with people knowing that they were horrible and knowing that I'd never talk to them. But the deal was so good, I just accepted it, did the best I could, and had the lawyers make triply sure that everything was covered.

Sometimes the powerful leave others no choice. The auto parts supplier has to play ball with the Big Three, no matter how badly he or she has been treated in the past or expects to be treated in the future. Suppliers of fashion goods believe they absolutely have to take a chance on abusive department stores. Power here totally replaces trust.

Usually, though, power isn't quite that absolute, and some degree of trust is a necessary ingredient in business relationships. Pitino has demonstrated remarkable abilities in turning around basketball programs, but he isn't the only coach available for hire. Borland International's business is nice to have, but it can't make or break a computer magazine. Nevertheless, even those with limited power can live down a poor record of trustworthiness. Cognitive inertia—the tendency to search for data that confirm one's beliefs and to avoid facts that might refute them—is one reason why.

To illustrate, consider the angry letters the mail fraud unit of the U.S. Post Office gets every year from the victims of the fake charities it exposes. Apparent donors are annoyed that they can't keep sending contributions to a cause they believed in. They want to avoid information that says they have trusted a fraud.

When the expected reward is substantial and avoidance becomes really strong, reference checking goes out the window. In the eyes of people blinded by greed, the most tarnished reputations shine brightly.

Many a commodity broker's yacht has been financed by cleaning out one customer after another. Each new doctor or dentist who is promised the moon is unaware of and uninterested in his or her predecessor's fate. Such investors want to believe in the fabulous returns the broker has promised. They don't want references or other reality checks that would disturb the dreams they have built on sand. Thus can the retail commodity brokerage business flourish, even though knowledgeable sources maintain that it wipes out the capital of 70% of its customers every year.

The search for data that confirm wishful thinking is not restricted to naive medical practitioners dabbling in pork bellies. The Wall Street Journal recently detailed how a 32-year-old conglomerate perpetrator perpetrated a gigantic fraud on sophisticated financial institutions such as Citibank, the Bank of New England, and a host of Wall Street firms. A Salomon Brothers team that conducted due diligence on the wunderkind pronounced him highly moral and ethical. A few months later....

Even with a fully disclosed public record of bad faith, hard-nosed businesspeople will still try to find reasons to trust. Like the proverbial "other woman," they'll reason, "It's not his fault." And so it comes to pass that Oscar Wyatt's Coastal Corporation can walk away from its gas-supply contracts; then, with the consequent lawsuits not yet settled, issue billions of dollars of junk bonds. Lured by high yields, junk bond investors choose to believe that their relationship will be different: Wyatt had to break his contracts when energy prices rose; and a junk bond is so much more, well, binding than a mere supply contract.

Similarly, we can imagine, every new Pitino employer believes the last has done Pitino wrong. Their relationship will last forever.
Ambiguity and complexity can also take the edge off reputational enforcement. When we trust others to keep their word, we simultaneously rely on their integrity, native ability, and favorable external circumstances. So when a trust appears to be breached, there can be so much ambiguity that even the aggrieved parties cannot apprehend what happened. Was the breach due to bad faith, incompetence, or circumstances that made it impossible to perform as promised? No one knows. Yet without such knowledge, we cannot determine in what respect someone has proved untrustworthy: basic integrity, susceptibility to temptation, or realism in making promises.

The following example, in which we hear the buyer of a company who was taken in by the seller’s representations, is instructive:

“The seller said: ‘We have a technology that is going to be here for a long time. We own the market.’ We liked this guy so much, it was funny. He’s in the local area, he knew my father. He’s a great guy to talk to, with all sorts of stories.”

Businesspeople learn not to get hung up about other people’s pasts.

“He managed to fool us, our banks, and a mezzanine lender, and he ended up doing quite well on the deal. Then the company went on the skids. The funny thing is, afterwards he bought the business back from us, put a substantial amount of his own capital in, and still has not turned it around. I’m just not sure what was going on.

“I guess he believed his own story and believed it so much that he bought the business back. He was independently wealthy from another sale anyway, and I think he wanted to prove that he was a great businessman and that we just screwed the business up. If he was a charlatan, why would he have cared?”

Where even victims have difficulty assessing whether and to what extent someone has broken a trust, it is not surprising that it can be practically impossible for a third party to judge.

That difficulty is compounded by the ambiguity of communication. Aggrieved parties may underplay or hide past unpleasantnesses out of embarrassment or fear of lawsuits. Or they may exaggerate others’ villainies and their own blamelessness. So unless the victims themselves can be trusted to be utterly honest and objective, judgments based on their experiences become unreliable and the accuracy of the alleged transgressor’s reputation unknowable.

A final factor protecting the treacherous from their reputations is that it usually pays to take people at face value. Businesspeople learn over time that “innocent until proven guilty” is a good working rule and that it is really not worth getting hung up about other people’s pasts.

Assuming that others are trustworthy, at least in their initial intentions, is a sensible policy. The average borrower does not plan million-dollar scams, most coaches do try to complete their contracts, and most buyers don’t “forget” about their suppliers’ bills or make up reasons for imposing penalties.

Even our cynical real estate developer told us: “By and large, most people are intrinsically honest. It’s just the tails, the ends of the bell-shaped curve, that are dishonest in any industry, in any area. So it’s just a question of tolerating them.”

Another respondent concurred:

“I tend to take people at face value until proven otherwise, and more often than not, that works. It doesn’t work with a blackguard and a scoundrel, but how many total blackguards and scoundrels are there?”

Mistrust can be a self-fulfilling prophecy. People aren’t exclusively saints or sinners; few adhere to an absolute moral code. Most respond to circumstances, and their integrity and trustworthiness can depend as much on how they are treated as on their basic character. Initiating a relationship assuming that the other party is going to try to get you may induce him or her to do exactly that.

Overlooking past lapses can make good business sense too. People and companies do change. It is more than likely that once Borland International got off the ground, Kahn never pulled a fast one on an ad salesman again. Today’s model citizen may be yesterday’s sharp trader or robber baron.

Trust breakers are not only unhindered by bad reputations, they are also usually spared retaliation by parties they injure. Many of the same factors apply. Power, for example: attacking a more powerful transgressor is considered foolhardy.

“It depends on the scale of the pecking order,” we were told. “If you are a seller and your customer breaks promises, by and large you don’t retaliate. And if you are an employee and your employer breaks promises, you usually don’t retaliate either.”

Where power doesn’t protect against retaliation, convenience and cognitive inertia often do.

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Even can be expensive; even thinking about broken
trusts can be debilitating. "Forget and move on" seems to be the motto of the business world.

Businesspeople consider retaliation a wasteful dis-
traction because they have a lot of projects in hand
and constantly expect to find new opportunities to
pursue. The loss suffered through any individual
breach of trust is therefore relatively small, and re-
venge is regarded as a distraction from other, more
promising activities.

Retaliation is a luxury you can't afford, respondents
told us.

"You can't get obsessed with getting even. It will
take away from everything else. You will take it out
on the kids at home, and you will take it out on your
wife. You will do lousy business."

"It's a realization that comes with age: retaliation
is a double loss. First you lose your money, now
you're losing time."

"Bite me once, it is your fault; bite me twice, my
fault.... But bite me twice, and I won't have anything
to do with you, and I'm not going to bite back because
I have better things to do with my life. I'm not go-
ing to litigate just for the pleasure of getting even
with you."

Only those who have their best years behind them
and see their life's work threatened actively seek
to retaliate. In general, our interviews suggested,
businesspeople would rather switch than fight. An
employee caught cheating on expenses is quietly
let go. Customers who are always cutting corners
on payments are, if practicable, dropped. No fuss,
no muss.

Our interviewees also seemed remarkably willing
to forget injuries and to repair broken relationships.
A supplier is dropped, an employee or sales rep is let
go. Then months or years later the parties try again,
invoking some real or imaginary change of circum-
stances or heart. "The employee was under great per-
sonal strain."

"The company's salesman exceeded his
brief." "The company is under new management."
Affection and cognitive inertia seem to foster
many second chances.

What about the supposed benefits of retaliation?
Game theorists argue that retaliation sends a signal
that you are not to be toyed with. This signal, we be-
lieve, has some value when harm is suffered outside a
trusting relationship: in cases of patent infringement
or software piracy, for example. But when a close
trusting relationship exists, as it does, say, with an
employee, the inevitable ambiguity about who was
at fault often distorts the signal retaliation sends.
Without convincing proof of one-sided fault, the
retaliator may get a reputation for vindictiveness
and scare even honorable men and women away
from establishing close relationships.

Even the cathartic satisfaction of getting even
seems limited. Avenging lost honor is passe, at least
in business dealings. Unlike Shakespeare's Venetian
merchant, the modern businessperson isn't inter-
ested in exacting revenge for its own sake and, in fact,
considers thirsting for retribution unprofessional
and irresponsible.

"There is such a complete identification in my
mind between my company's best interests and what
I want to do that I am not going to permit anything
official out of spite. If I can't rationalize [retaliation]
and run it through my computer brain, it will be re-
egated to my diary and won't be a company action."

We would be guilty of gross exaggeration if
we claimed that honesty has no value or
that treachery is never punished. Trust-
worthy behavior does provide protection
against the loss of power and against invisible snip-
ing. But these protections are intangible, and their
dollars-and-cents value does not make a compelling
case for trustworthiness.

A good track record can protect against the loss of
power. What if you stop being a winning coach or
your software doesn't sell anymore? Long-sup-
pressed memories of past abuses may then come to
the fore, past victims may gang up to get you.

A deal maker cited the fate of an investment bank
that was once the only source of financing for certain
kinds of transactions.

"They always had a reputation for being people
who would outline the terms of the deal and then
change them when it got down to the closing. The in-
dustry knew that this is what you had to expect; our
people had no choice. Now that the bank has run into
legal problems and there are other sources of funds,
people are flocking elsewhere. At the first opportu-
nity to desert, people did--and with a certain amount
of glee. They are getting no goodwill benefit from
their client base because when they were holding all
the cards they screwed everybody."

Another entrepreneur ascribed his longevity to his
reputation for trustworthiness:

"The most important reason for our success is the
quality of my [product] line. But we wouldn't have
survived without my integrity because our lines
weren't always very successful. There are parabola
curves in all businesses, and people still supported me, even though we had a low, because they believed in me.”

Trustworthiness may also provide immediate protection against invisible sniping. When the abuse of power banishes trust, the victims often try to get their own back in ways that are not visible to the abuser: “I’m not in business just to make a profit. If a client tries to jerk me around, I mark up my fees.” “The way to get even with a large company is to sell more to them.”

On occasion, sniping can threaten the power it rebels against. The high-handedness of department stores, for example, has created a new class of competitors, the deep discounter of designer apparel.

“Ordinarily, manufacturers don’t like to sell their goods at throwaway prices to people like us,” says one such discounter. “But our business has thrived because the department stores have been systematically screwing their suppliers, especially after all those leveraged buyouts. At the same time, the manufacturers have learned that we treat them right. We scrupulously keep our promises. We pay when we say we’ll pay. If they ask us not to advertise a certain item in a certain area, we don’t. If they make an honest mistake in a shipment, we won’t penalize them.”

“The department stores have tried to start subsidiaries to compete with us, but they don’t understand the discount business. Anyone can set up an outlet. What really matters is the trust of the suppliers.”

Neither of these benefits can be factored easily into a rational business analysis of whether to lie or keep

surely the murky future costs don’t stand a chance against the certain and immediate financial benefits from breaking an inconvenient promise. The net present values, at any reasonable discount rate, must work against honoring obligations.

Given all this, we might expect breaches of trust to be rampant. In fact, although most businesspeople are not so principled as to boycott powerful trust breakers, they do try to keep their own word most of the time. Even allowing for convenient forgetfulness, we cannot help being swayed by comments like this:

“I’ve been in this business for 40 years. I’ve sold two companies; I’ve gone public myself and have done all kinds of dealings, so I’m not a babe in the woods, OK? But I can’t think of one situation where people took advantage of me. I think that when I was young and naive about many things, I may have been underpaid for what my work was, but that was a learning experience.”

One reason treachery doesn’t swamp us is that people rationalize constancy by exaggerating its economic value.

“Costs have been going up, and it will cost me a million dollars to complete this job. But if I don’t, my name will be mud and no one will do business with me again.”

“If I sell this chemical at an extortionate price when there is a shortage, I will make a killing. But if I charge my customers the list price, they will do the right thing by me when there is a glut.”

Just as those who trust find reasons for the risks they want to run, those who are called on to keep a difficult promise cast around for justification even when the hard numbers point the other way. Trustworthiness has attained the status of “strategic focus” and “sustainable competitive advantage” in business folklore—a plausible (if undocumented) touchstone of long-term economic value.

But why has it taken root? Why do business men and women want to believe that trustworthiness pays, disregarding considerable evidence to the contrary? The answer lies firmly in the realm of social and moral behavior, not in finance.

The businesspeople we interviewed set great store on the regard of their family, friends, and the community at large. They valued their reputations, not for some nebulous financial gain but because they took pride in their good names. Even more important, since outsiders cannot easily judge trustworthiness, businesspeople seem guided by their inner voices, by their consciences. When we cited examples to our interviewees in which treachery had apparently paid, we heard responses like:

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How can you quantify the financial repercussions when suppliers you have abused ship hot items to your competitors first?

a promise. Sniping is invisible; the sniper will only take shots that you cannot measure or see. How could you possibly quantify the financial repercussions when suppliers you have abused refuse your telephone orders or ship hot items to your competitors first?

Assessing the value of protection against the loss of power is even more incalculable. It is almost as difficult to anticipate the nature of divine retribution as it is to assess the possibility that at some unknown time in the future your fortunes may turn, whereupon others may seek to cause you some unspecified harm. With all these unknowns and unknowables,
"It doesn’t matter how much money they made. Right is right and wrong is wrong."

"Is that important? They may be rich in dollars and very poor in their own sense of values and what life is about. I cannot judge anybody by the dollars; I judge them by their deeds and how they react."

"I can only really speak for myself, and to me, my word is the most important thing in my life and my credibility as an individual is paramount. All the other success we have had is secondary."

The importance of moral and social motives in business cannot be overemphasized. A selective memory, a careful screening of the facts may help sustain the fiction of profitable virtue, but the fundamental basis of trust is moral. We keep promises because we believe it is right to do so, not because it is good business. Cynics may dismiss the sentiments we heard as posturing, and it is true that performance often falls short of aspiration. But we can find no other way than conscience to explain why trust is the basis for so many relationships.

At first, these findings distressed us. A world in which treachery pays because the average businessman won’t fight abusive power and tolerates dishonesty? Surely that wasn’t right or efficient, and the system needed to be fixed! On further reflection, however, we concluded that this system was fine, both from a moral and a material point of view.

The moral advantages are simple. Concepts of trust and, more broadly, of virtue would be empty if bad faith and wickedness were not financially rewarding. If wealth naturally followed straight dealing, we would only need to speak about conflicts between the long term and the short, stupidity and wisdom, high discount rates and low. We would worry only about others’ good sense, not about their integrity. It is the very absence of predictable financial reward that makes honesty a moral quality we hold dear.

Trust based on morality rather than self-interest also provides a great economic benefit. Consider the alternative, where trust is maintained by fear.

A world in which the untrustworthy face certain retribution is a small world where every one knows (and keeps a close eye on!) everyone else. A village, really, deeply suspicious not only of commodities brokers but also of all strangers, immigrants, and innovators.

No shades or ambiguities exist here. The inhabitants trust each other only in transactions in which responsibilities are fully specified—‘deliver the diamonds to Point A, bring back cash’—and breaches of trust are clear. They do not take chances on schemes that might fail through the tangled strands of bad faith, incompetence, overoptimism, or plain bad luck.

A dark pessimism pervades this world. Opportunities look scarce and setbacks final. ‘You can’t afford to be taken in even once’ is the operating principle. ‘So when in doubt, don’t.’

In this world, there are no second chances either. A convicted felon like Thomas Watson, Sr. would never be permitted to create an IBM. A Federal Express would never again be extended credit after an early default on its loan agreements. The rules are clear: an eye for an eye and a tooth for a tooth. Kill or be killed.

Little, closed, tit-for-tat worlds do exist. Trust is self-reinforcing because punishment for broken promises is swift—in price-fixing rings, loan-sharking operations, legislative log rolling, and the mutually assured destruction of nuclear deterrence. Exceed your quota and suffer a price war. Don’t pay on time and your arm gets broken. Block my pork barrel project and I’ll kill yours. Attack our cities and we’ll obliterate yours.

At best such a world is stable and predictable. Contracts are honored and a man’s word really does become his bond. In outcome, if not intent, moral standards are high, since no one enters into relationships of convenience with the untrustworthy. On the other hand, such a world resists all change, new ideas, and innovations. It is utterly inimical to entrepreneurship.

Fortunately, the larger world in which we live is less rigid. It is populated with trusting optimists who readily do business with strangers and innovators. A 26-year-old Steve Jobs with no track record to speak of or a 52-year-old Ray Kroc with nearly ten failures behind him can get support to start an Apple or a McDonald’s. People are allowed to move from Maine to Montana or from plastics to baked goods without a lot of whys and wherefores.

Projects that require the integrity and ability of a large team and are subject to many market and technological risks can nonetheless attract enthusiastic support. Optimists focus more on the pot of gold at
the end of the rainbow than on their ability to find and punish the guilty in case a failure occurs.

Our tolerance for broken promises encourages risk taking. Absent the fear of debtors’ prison and the stigma of bankruptcy, entrepreneurs readily borrow the funds they need to grow.

Tolerance also allows resources to move out of enterprises that have outlived their functions. When the buggy whip manufacturer is forced out of business, we understand that some promises will have to be broken—promises that perhaps ought not to have been made. But adjustments to the automobile age are more easily accomplished if we don’t demand full retribution for every breach of implicit and explicit contract.

Even unreconstructed scoundrels are tolerated in our world as long as they have something else to offer. The genius inventors, the visionary organizers, and the intrepid pioneers are not cast away merely because they cannot be trusted on all dimensions. We “adjust”—and allow great talent to offset moral frailty—because we know deep down that knaves and blackguards have contributed much to our progress.

And this, perhaps unprincipled, tolerance facilitates a dynamic entrepreneurial economy.

Since ancient times, philosophers have contrasted a barbaric “state of nature” with a perfect, well-ordered society that has somehow tamed human-kind’s propensity toward force and fraud. Fortunately, we have created something that is neither Beirut nor Bucharest. We don’t require honesty, but we honor and celebrate it. Like a kaleidoscope, we have order and change. We make beautiful, well-fitting relationships that we break and reform at every turn.

We should remember, however, that this third way works only as long as most of us live by an honorable moral compass. Since our trust isn’t grounded in self-interest, it is fragile. And, indeed, we all know of organizations, industries, and even whole societies in which trust has given way either to a destructive free-for-all or to inflexible rules and bureaucracy. Only our individual wills, our determination to do what is right, whether or not it is profitable, save us from choosing between chaos and stagnation.

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