catch Sloan in the little lies—and huge misjudgments—that make him as much a tragic figure as one of history's greatest businessmen. The fact that Sloan treated World War II simply as bad for business, remaining "morally and emotionally indifferent to the spread of Nazism," betrays a moral myopia. That myopia illustrates how debates over corporate governance invariably pit public trust against private profit. GM was a vital weapon in America's arsenal of democracy, but as Farber makes all too clear, Sloan was a reluctant warrior.

Indeed, Sloan was a Roosevelt-hater who disliked the New Deal and feared the increasing government encroachment that the war would bring. To this free-marketer, this was *governance ad absurdum*. That said, Sloan was exquisitely attuned to the dimensions of institutional power, and his concerns were understandable. But what does effective governance mean when fiduciaries are more loyal to their shareholders—or their businesses—than to the rule of law? This question deeply troubles Farber, and it is essentially the question that concludes his thoughtful and comprehensive book.

The role of governance in a public institution like the University of California is equally acute. Kerr's problems began not with the student uprisings of the 1960s but with the McCarthy-era loyalty oaths. Kerr opposed them. What's more, he engineered an honorary degree for a faculty member who had successfully sued the U.C. regents over taking them. Whether he did so out of principle or pique, the regents were furious.

Writes Kerr: "This action of mine had substantial consequences. It began a long battle of survival between Regent [Edwin] Pauley and me. Pauley was very determined about his standing as senior regent and his asserted possession of certain privileges. He hated my action in taking away from him one of these claimed privileges. Later I proposed a policy of rotating chairs of the board. Pauley thought that the senior regent had a lifetime claim to chair of the board, as had been the case [previously]. My proposal was accepted. Pauley detested this outcome. He made me his number one enemy. He began charging me as being 'pro-communist.' I always thought that his opposition was really based on his view that I was anti-Pauley. He did serve twice as chair of the board but never on a lifetime basis. To him, being chair of the board was the crowning glory of his life, and I took it away from him. He was a devoted and, in many ways, a good and supportive regent. He was also an alpha male par excellence, and I had challenged his dominance, and I was never to be forgiven. In the end, he destroyed me as president."

The system, of course, survived its designer's political demise—an example of how solid an institution Kerr's U.C. system was and is. Likewise, Alfred Sloan's GM has continued to move from strength to strength, shielded from dangerously mercurial leadership. It's clear that without effective governance, you can build a business—but not a world-class institution.

Perhaps it will take our corporate crisis to refocus necessary attention on issues of governance. In the final analysis, the challenge of governance is remarkably similar to the challenge of leadership. The difference is that effective governance should be able to survive less-than-effective leadership, while recent headlines have made it painfully apparent that effective leadership may not be able to survive less-than-effective governance.

How the SEC Was Handcuffed

By Susan Webber

Take On the Street
What Wall Street and Corporate America Don't Want You to Know; What You Can Do to Fight Back
By Arthur Levitt
Pantheon, $24.95

A joke now making the rounds goes roughly like this: If a guy steals $5,000, he goes to jail for 10 years. If he steals $500 million, he appears before Congress and gets called bad names for 10 minutes.

F. Scott Fitzgerald was right. The rich are different from you and me. They get away with more. Like Fitzgerald's Roaring Twenties, the late 1990s witnessed a massive wealth transfer via the stock market (though whether wealth was created remains in doubt) and a sobering aftermath.

The regulators were not blind to the perils of that era. Arthur Levitt, Securities and Exchange Commission chairman from 1993 to 2001, recognized and tried to tackle many abuses, with limited success. He would seem to be uniquely qualified to give an inside view of what went wrong and why.

Sadly, Levitt's book, *Take On the Street*, misses the mark. Levitt's aim is to stir individual investors to take political action, believing that they can check the vested interests that influence financial regulation. He anticipates that if he can make them more savvy, they will become more engaged.

As a result, the book tries to do three things—educate investors, encourage them to participate in the political process, and chronicle Levitt's efforts to reform the industry. These themes do not dovetail well and diffuse the book's energy and focus.

For example, to highlight how high charges eat into investment returns, Levitt details the many, albeit legitimate, ways that firms can enrich themselves (loads, 12b fees, internal crosses of trades that may not provide the best execution). This discussion takes considerable space and unwittingly gives the impression that Levitt is putting high fees on the same footing as the larger-scale, systemic problems and corrupt behavior that he describes elsewhere. Even if Levitt believes in zero tolerance, describing the behavior of the squeegee men of the securities industry undercuts Levitt's larger aim of rallying individual investors.

To educate investors, the first of Levitt's three objectives, *Take On the Street* provides basic financial advice. Where Levitt is most useful, and most pointed, is on how to select brokers and fund managers and how to use various execution channels. He describes the many conflicts of interest and dubious industry practices, and provides lists of questions. However, much of this information is replicated in basic investment guides. Though helpful, this material properly belongs in an appendix.

To encourage investors to become a political force, Levitt identifies sources of information on legislative developments relevant to investors and describes how to influence the process. Levitt waxes quixotic: "[Y]ou can and should do more to make your point of view is heard in Washington. . . . You can tap into the wealth of information available over the Internet. . . . You can be just as informed as the well-paid lobbyists roaming the corridors of Capitol Hill. Once you know the important issues, and take the time to understand the pros and cons, you can speak with authority. You can weigh in at the SEC . . . or write letters or e-mails to the House and Senate members who sit on the committees considering legislation that could affect your finances." Even though Levitt's aims are estimable, it seems unrealistic to expect many readers to take up his charge.

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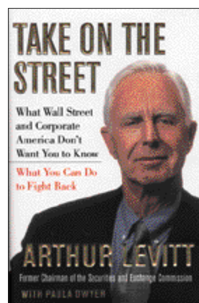

The third theme, the large-scale abuses and Levitt's often-thwarted efforts to curtail them, is gripping, often disturbing, and the real heart of the book. Levitt recounts the progress and outcome of major initiatives, such as requiring more transparent financial reporting and restoring analyst objectivity. The most appalling section describes the bitter and protracted battles over accounting standards, in which the SEC was outmanned, outgunned, and often outmaneuvered. For example, the high-tech industry was vehemently opposed to the SEC's plan to end pooling-of-interests treatment of acquisitions. This approach burnished earnings reports by eliminating the need to amortize goodwill, the price paid in excess of book value. A meeting with two Silicon Valley heavyweights, Cicso CEO John Chambers and venture capitalist John Doerr, quickly devolved into threats. Similarly, the SEC's effort to mandate separation of accounting-firm consulting and audit practices unleashed a firestorm of criticism and concerted action to cut the SEC's already meager funding.

What emerges is a portrait of a regulator in shackles—and Levitt, though tenacious and dedicated, was no Houdini. Levitt enumerates his restrictions: court decisions that narrowed the definition of securities-law violations, budgets that fell woefully short of the burgeoning need for investigation and enforcement, an anti-regulatory sentiment in the Congress and public at large, and a booming stock market that seemed to provide ample proof that the system was healthy. Levitt recounts in detail how he had to use indirect means to pursue his agenda: forming blue-ribbon committees, holding town-hall meetings to exhort small investors, using the press to expose bad practice, and calling in chips from old friends.

Take On the Street maps where Levitt fell short of his objectives and tries to advance his unfinished program. Yet the book is surprisingly unreflective: Levitt seems unable to question the framework in which he operated. For example, his remedy of rallying small investors to check powerful vested interests seems naïve, given that the securities industry is the third-biggest source of political funding. Levitt himself, first president of Shearson Hayden Stone, then head of the American Stock Exchange, proved to be a far more aggressive reformer than

anyone expected. But he is also of a more gentlemanly generation, and one wonders whether someone with more cunning might have taken more ground.

The recent securities-markets scandals are, at their core, a failure of self-regulation. However, the current system is too complex and too central to the economy to be dismantled. A stronger system of checks—such as legislation to make the courts a viable means of redress, or new, powerful, and truly independent oversight boards, as are being implemented for the accounting industry—seems the only realistic course.

But Levitt, both at the SEC and in his book, never had a rationale for regulation, save to curb specific abuses. The early to mid-1990s witnessed the ascendancy of Newt Gingrich and the Republican right, who were staunch, vocal defenders of the legitimacy—nay, the virtue—of free, unfettered markets. Government intervention in commercial activity was tarred as anti-progress and anti-prosperity. By leaving this laissez-faire philosophy unchallenged, Levitt let the Republicans take the intellectual high ground. The SEC's inability to justify its role, except as cop, meant it could act only after damage occurred, severely limiting its scope.

But there is a compelling case for regulating markets, particularly equity markets. In a prescient and oddly overlooked 1994 *Harvard Business Review* article, "Efficient Markets, Deficient Governance," Columbia Graduate School of Business professor Amar Bhidé observes that the U.S. equity markets, the most liquid and considered the safest in the world, exist solely due to regulation. Prior to the 1920s, stocks were not traded on an impersonal basis. Investors understood that equities—unlike, say, bonds—are a highly ambiguous promise. In earlier days, equity investors were more akin to venture capitalists, involved with the operations of the company and in for the long haul. The public viewed equities as highly speculative, and notorious scandals and fraud were reminders of the risk.

The 1933 and 1934 securities acts, which created the SEC, also provided for disclosure, periodic reporting, and penalties for insider trading—all necessary for liquid equity markets with distant, dispersed, and transient shareholders. As Bhidé points out, however, "arm's-length shareholders cannot provide good oversight or counsel and often evoke mistrust and hostility. . . . How wholeheartedly managers will advance the interests of anonymous shareholders is also questionable." Here we see the roots of the dysfunctional shareholder capitalism of the 1990s: executives focused on delivering the numbers, rather than pursuing sound long-term strategies, because they believed that was all that investors rewarded; these same stewards in turn using stock-market performance as the justification and mechanism for unprecedented levels of enrichment.

Conflicts between objectives, like between promoting market liquidity and good corporate governance, can be managed if they are understood. But unmanaged conflicts, like the ones surrounding securities-markets regulation, inevitably yield unexpected, sometimes disastrous, consequences. By failing to explore the root causes of the SEC's inability to regulate, Levitt misses an opportunity to make real and lasting headway on the unfinished business of his chairmanship.

Worth Noting

A sampling of recent books by contributors to Across the Board.

Nader: Crusader, Spoiler, Icon (Perseus)
By Justin Martin
Behind the mystery and secrecy of the consummate public advocate.

Carnegie (Wiley)
By Peter Krass
A biography of the 19th-century robber baron and philanthropist.

How to Break Out of Prison (Welcome Rain)
By John Wareham
Lessons from Rikers Island for the executive suite.

Intuition at Work: Why Developing Your Gut Instincts Will Make You Better at What You Do (Doubleday)
By Gary Klein
Playing your hunches may be more than it's cracked up to be.

CEO Capital: A Guide to Building CEO Reputation and Company Success (Wiley)
By Leslie Gaines-Ross
From a CEO's first 100 days to her last 100 hours.

Why Decisions Fail: Avoiding the Blunders and Traps That Lead to Debacles (Berrett-Koehler)
By Paul C. Nutt
The Challenger explosion, the Brent Spar disposal, and other disasters explicated.