

## **REAL ESTATE ETHICS**

*An experienced real estate professional discusses why it is important to teach ethics in business school.*

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In the early 1970s I was given the responsibility for Morgan Stanley's real estate unit, which was pioneering real estate investment banking. At the time I was 35 years-old, and was about to embark on what turned out to be an amazing learning experience. As my colleagues and I struggled to build a new business we looked forward to the time when we would all be successful. Many of the folks who worked with me became major players in the field of real estate finance. But in reviewing that period, almost thirty years ago, the real enjoyment and satisfaction came as much from the struggle as from the success.

Throughout that phase of my career I was concerned with the bottom line, efficiency, serving client needs, thwarting competition, dealing, negotiating, and pushing the limits. My staff had to have the same concerns. They needed the freedom to push themselves to the edge, but not be so devious that they could not command the respect of their colleagues and clients.

During this period Morgan Stanley evolved from a strictly client-relationship firm to a transactional firm, growing from 140 individuals when I joined in 1962 to 7,500 when I retired in 1990. A premium was placed on people who could perform for both relationship and transactional clients, as well as run a business unit. Upon reflection it is clear that it is much easier to do deals than to build a business, and many employees could not make this transition.

In fact, as financial institutions were deregulated in the 1970s, several hundred firms were

acquired by others or went out of business, as they could not adjust to the rapidly changing environment.

I learned quickly that my decisions about bonuses and promotions, as well as terminations, had an immense impact on the organization in terms of both communicating and generating the type of behavior that is rewarded or punished. So did choices about which clients to accept or reject. It became obvious that if I expected my people to take risks, they must be supported by the organization, that is--me. I needed to be concerned with issues such as how to set the limits of behavior, how to engender successful but “good” behavior, and how to encourage risk taking without going “over the line.” I realized that a leader creates a context, for good or ill.

Perhaps the most difficult decision a leader can take is to break and change the covenants which have woven together an organization. Such covenants are both explicit and implicit. A good leader learns what the covenants are and leads by resonating with them, not by manipulating them. There are times when the system of covenants must be changed in order for the enterprise to survive. An example is Hewlett Packard, which was once a purely scientific instrument company, with a policy of no lay-offs and no debt. The transition to a computer company brought wrenching changes to the ingrained Hewlett Packard culture. At one point it was highly questionable whether such changes could even be made. The final solution was to spin off the scientific instrument company in a public offering.

I retired from Morgan Stanley about ten years ago, and now teach business ethics at the graduate level in business schools. For the past nine years I have taught a six-hour business ethics module in the Masters in Real Estate Development program at the University of Southern

California. In my class I do not try to tell the students what to do, or give them the “right” answers. Rather I try to help them acquire the sense of moral awareness to make ethics an instinctive input when undertaking business decisions. An ethical leader must have the ability at an early stage to discern ethical issues when others may not, the self-confidence to seek out different points of view, and the tough-mindedness to make decisions in the seemingly chaotic mix of paradox and ambiguity.

## ETHICAL SYSTEMS

I divide my class into three parts. First, we discuss ethical terminology in the context of a case on insider trading. Second, we consider an actual ethical dilemma (based on my own experience). Third, we discuss students' assignments that document their own ethical stories.

In order to discuss ethics it is necessary to have a common language that is neither arcane nor doctrinaire. In the context of a case on insider trading, for example, we discuss *normative ethics*. Society has firm views on what is appropriate behavior, including such matters as expressing our sexuality, dress, gender roles, and attitudes toward race, as well as business issues such as price fixing, insider trading and anti-trust. The trouble is that society frequently changes its mind about such matters. As real estate is more often owned by public companies, real estate practitioners have become bound by different rules than thirty years ago. While competitive practices that would have been unthinkable, such as busting-up deals or violating auction proceedings, are tolerated by public companies, there is much less tolerance for insider-trading, blatant bribery, and bid-rigging. Further, overt family favoritism plays

differently in a public company than in a family-owned firm. As a result, the "easy" ethical calls of the past look seriously flawed today. This has serious ramifications. If one is exposed on the edge of the risk profile when society changes its mind about what may be appropriate behavior, one may find themselves in serious professional jeopardy and perhaps even jail.

The class discusses the difference between a rules-based approach to ethics and an approach emphasizing consequences. Enterprises based on trust require fewer rules and regulations, and fewer bureaucratic enforcers. Therefore, they are more efficient, attract a better class of co-worker and are more fun to work in. The problem is, being humans, we respond to both virtue and sanctions. Even the best trust-based environments need to make use of rewards and punishments.

We also examine ethical systems based on religious faith. Using Dante's "Divine Comedy," we discuss: 1) the surface story line, where we each spend most of our lives; 2) the allegorical level, where we use our favorite stories and heroes to make meanings out of our experience; 3) the moral level, the mores of society, the limits of behavior which society conventionally allows from time and time; and 4) the ethical level, the deep, the spiritual, the religious, where we make our intuitive meanings. A system of law, or morality, which is not rooted in the deep ethical level is rudderless and cast adrift. The issue then becomes, in a multi-cultural, pluralistic, value-free global economy, whose religion do we use?

For Christians, a good place to start is the Great Commandment to love God with all your heart and soul and mind and spirit; and the great corollary, to love your neighbor as yourself. This occurs five times in the New Testament. Interestingly, it also occurs twice in the Hebrew Bible and at least once in the Koran. So it is one of the great explicit societal organizing

principals of three of the world's great religions. I would posit that it is implicit in each of the other great religions as well. All the major religions advise us to focus on others rather than on ourselves. This is the beginning of all ethical behavior.

Peter Drucker, the sage of business management, describes the leader of the future as someone who believes in himself, has a genuine love of people, and feels a transcendent passion for the mission of the enterprise. To me, this secular description resonates perfectly with the Great Commandment and its corollary. Drucker goes on to state that a leader for the future must have the emotional strength to manage anxiety and change. Each of the world's great religions likewise focuses on creating centeredness, a sense of inner calm and peace, a sense of knowing who you are.

The chief difference between a profession and a job is that a profession has ethical underpinnings. A profession denotes an unbiased service or value creation for the other, and not only personal aggrandizement. An occupation that has as its cultural norm the practice of self-dealing, for example, is not by this definition a profession. There are many individuals and organizations attempting to work out a global ethic as the underpinning of the emerging global economy. To the extent that the global economy is triggered at present primarily by Western practices, it implicitly passes on the Judeo-Christian preconceptions, which undergird Western cultural patterns. To be truly universal, however, such a global ethical system must incorporate also core beliefs from the Muslim, Buddhist, Confucian, Hindu, Sufi and other religions of the world. One who chooses to do business in a Muslim or Hindu culture without attempting to understand the ethical belief system is unlikely to succeed.

## AN ETHICAL DILEMMA

My own ethical story involves a serious situation that took a random group of individuals completely by surprise. It occurred during a 1982 sabbatical, trekking through the Himalayas in Nepal. Our group was about thirty days out, about to traverse an 18,000-foot pass over the Annapurna Range. We were thrown together with three other climbing groups of differing skills, cultural backgrounds, and ages. My sole Western companion and I were sleep-deprived. I had also experienced a thirty-pound weight loss, and I was concerned about altitude sickness, which I had suffered on a previous Himalayan journey. Nevertheless, we had to cross the pass if we wanted to finish our trek.

Suddenly we encountered a *sadhu* or pilgrim. He was carrying no belongings, wore only a thin cotton robe, and appeared to be dying. He may even have come to this pass to enjoy a perfect death. The climbers were taken by surprise. Since we were days from any settlement, rescuing him was far beyond our capacity. We agonized over the situation, its solution, and the problems of the group. Some did not see an ethical choice--the group of Japanese had the necessary resources to help the pilgrim but refused to get involved. The situation was too complex for one person, or even two or three, to resolve. Our own lives were at risk as well--how much were we willing to sacrifice for this stranger? To take effective action, we would have to act as a cohesive group, agreeing on common goals and values. The difficulty was that without an underlying core of previously agreed upon values, it was impossible to coalesce the group around the emergency. I have always suspected that we would have reacted differently if it were our mother rather than a stranger we encountered, as we have a set of basic

precepts on how to deal with family. Finally, we left the *sadhu* with clothing, food, and drink, and moved on. We never found out what happened to him.

The story always provokes vigorous debate among my students. The point is that if a common sense of values has not been discussed and articulated before an ethical issue intrudes unexpectedly, it is too late. The situation also contains elements of multi-culture, and issues of religion, gender and race.

## ISSUES

The students have generally had prior business experience in the real estate field, with brokers, developers, construction firms, architects, and bankers. I ask them to describe an ethical problem or situation which they have actually encountered in what was typically their first job situation in real estate. The issues, which their stories have raised over the past nine years, fit into a fairly consistent pattern.

*Hard Bargaining vs. Lying.* When does one go over the line? When does self-promotion become overstating one's qualifications? At what point do we cease taking on new business if we are not adequately staffed or trained? When does "puffing" projections become an outright lie? Is it contextual? Does the level of sophistication of your counter-party make any difference? Are there circumstances where it is not OK to bluff?      *Networking vs.*

*Spying.* When is it OK to pose as a potential real estate buyer to gain competitive information, and when is it offensive, i.e. lying?      *Cheating, Lying, Falsifying Data.* It

is disturbing how often obviously improper requests are made by superiors to entry level

professional employees in the real estate business. Students report being asked to falsify data, participate in kick-back schemes, approve substandard work, and similar unethical activities.

*Whistle Blowing, Turning in a Friend.* In my experience, this is a bigger issue for younger folks than for older folks, since it is easier for a new employee to develop a personal relationship than to acquire a deep-seated loyalty to the enterprise. A significant number of students report being uncomfortable with their peers' and superiors' unethical and even illegal business behavior. However, it is always easier not to rock the boat.

*Confronting Issues.* When to go to the boss. If you go to the boss every week with a problem, you are in the wrong profession. If you never go, you are in the wrong company. Over time, we accept group norms that would have worried us when we were new to the job. Bad practices are invidious, since they can grow on us incrementally. Although many of us must compromise our value systems, from time to time, in order to get the job done, an ethical person is aware of doing this and does not become hardened. Such an individual retains a capacity for dealing with the really important issues when they arise.

*Dealing with Improper Requests.* Disobeying “bad” rules. In whose judgment are the rules “bad”? It is best to have an open atmosphere where such issues can be brought into the open and, perhaps, properly explained.

*Achieving Closure.* Where does my responsibility as an ethical person end?

Periodically I am asked to address the advisory board at USC, each of whom is an experienced and successful real estate practitioner. I summarize the ethical stories of my students for them and then inform them that they are presenting such a face to first-time employees. In many cases, bad practices are buried deep, hidden, in an organization, and the



senior leaders are simply unaware of them. In other cases, bad practices permeate the day to day operations of the organization. In my experience, their reaction is generally one of denial: these abuses may occur in other companies, but not in their firm.

## CONCLUSION

One is more likely to come up with the “correct” ethical answer if one broadly defines the group of affected parties. The deeper the list of stakeholders whose interests are a matter of concern, the better chance you will make the right decision. Back when Warren Buffet was the richest private citizen in the world, he was interviewed by *Forbes*. Buffet stated that in his 50-year business career there had been only about twenty key, strategic decisions. Now, if we apply this in ethical terms, it suggests that if you never encounter an ethical dilemma during your entire career, you are probably not calibrated properly from an ethical point of view. Conversely, if you face an ethical crisis more often than perhaps every two years, you are probably not properly calibrated ethically for that job either. We cannot quit our jobs every six months. So the issue is when do we stop trading off? Where do we take our stand?

When we consider whether or not this is the time to take our stand, it is very important to have a peer group with whom we can discuss the issue. If such a person or group exists at your place of work, you are most fortunate. An open environment which tolerates questioning and ambiguity is a treasure. If not, your peer group must come from elsewhere: friends, family, a loved one, your church, and the like. It is very difficult and probably unwise to go this road alone. In a society that exalts winners, ethics can be what you are willing to lose for. Taking an

ethical stand defines who you are. The more comfortable you are with who you are, the better chance you can match up with Drucker's requirements for the leaders of the future.

The determination of ethical behavior is a deeply centered and personal aspect of one's life. My attempt is to encourage them to become ethically fit, to obey the unenforceable, to grapple with the tough issues, to make ethics intuitive. In most cases the real impact of such considerations will not be known for many years. In my own experience, the way in which one almost unconsciously responds to a true ethical dilemma can make all the difference in a life, not just a career. Finally, just as in sports or business, practice and exposure makes one better able to deal with the spontaneous circumstances that arise, so too I believe exposing students to ethical conflict prepares them to deal with the ethical problems that they will encounter early in their careers.

[Author bio: Bowen H. "Buzz" McCoy has served as president of the Real Estate Counselors, president of the Urban Land Foundation and a trustee of the Urban Land Institute. Recently he was named by *National Real Estate Investor Magazine* as one of 100 real estate "icons" of the 20th century.]