In Defense of Business ETHICS

Mentor Capital Inc. CEO Chet Billingsley Explores How Values Give Meaning to Management Careers. pg.16

LOCKHEED MARTIN MENTORS AND DEVELOPS ITS TALENTED WORKFORCE TO MEET TOMORROW’S CHALLENGES. pg.22
Delivering Value(s)
TO THE WORLD

Businesspeople create value for their neighbors, and by acting ethically, we can even more efficiently improve all of our lives.

- By Chet Billingsley

"The men and women of business are the stewards of the assets of society." — Peter Drucker

**This defining thought from the 20th century’s greatest business writer answers that question asked, in solitude, by every manager and businessperson, be they aspiring or accomplished: “Why am I doing this?” Why work 60 hours per week, leaving early and coming home to family late? Putting up with incompetence above and inexperience below? Pushing the rock of now electronic paperwork up the hill all the day-long just to find a new boulder-like stack waiting at the base the next dawn?**

Drucker’s answer is that we have been given a trust. The work, dreams and sweat of those that came before us have been placed in our hands to better. If we do a good job as a faithful steward to those assets, our world and our children’s world will be a better place.

This has been the accelerating path throughout history. My Minnesota grandfather lived behind and dug out the basement to his coal heated general store with a mule and a dragline. My father could afford a propane heated two-bedroom house for the hunting dog and the six of us, but the basement had a dirt floor. We here in California have electric heat and air conditioning, and I’m sure that other than on some flat screen my digitally enhanced sons have never seen a mule.

**We Advance Society**
Being entrusted as the stewards for the continuing of this advancement across our society gives value and meaning to our work. No one person advances the whole, but our contribution to the movement for-
ward adds to the progress that is passed along to current and future generations.

This progress springs from the efforts of working men and women. Businesses, like players on the field, are the only ones that advance the game. The referees of government have a role and the teachers and doctors have their own coach-like positions on the sidelines. But, it is managers and their teams that advance and improve our future.

Growth and improvement across our economy is compounded, so it can be powerful. Yet being incremental, it is fragile. Some companies make money. Some lose. On average, overall profits are slim. If that societal average slips just 1 percent down, society’s growth is halved over the course of a lifetime.

The positive effect of compounding is why Singapore, a resource-less rock in the middle of the Pacific, has been transformed from the literal bamboo huts seen in Bob Hope films of my youth to today having three times as many millionaires per capita as the U.S. Conversely, the slim and fragile nature of incremental growth margins is witnessed in other areas of the world with ample resources whose economies have hardly grown during the same period.

**Ethics Reduces Friction**

One sometimes hears, perhaps because of clearer ethical lines, that it is easier to do business with a Midwestern fellow than one from other states, and it takes less special understanding to do business with an American than representatives from other countries. Sometimes these differences are subtle, but just a few percentage points in change can drastically reduce the small margin in profits that fuel societal growth.

Lawsuits, escrows, inspections, repudiations, fraud, controls, audits, paperwork, insurance and third party guarantees add nothing to the final product or service. If some of these can be avoided because the respective parties are following the same ethical structure, then, the compounded impact can be profound.

However, a key hurdle on the path to reducing transactional friction in our shrinking world is that opposite, even completely ethical parties can hold startlingly different understandings of what ethical business behavior entails. First, by way of definition, ethics are the unwritten rules that govern societal and business interactions in the game of life. Without these guidelines to cooperatively constrain us, society devolves into anarchy.

**Based in Religions**

Ethics, defined in this way, are often religiously based following the dominant beliefs in various locales that have literally become part of our culture over millennia. The religious basis results in different fundamental rules applying on different continents. In a large scale Darwinian way, each of these systems of interaction survives because they provide efficient and effective guideline that reduce social and economic friction in their respective societies. Otherwise they would have died out.

Asian cultures if under Buddhist influence ascribe to “Right thoughts, right actions, right deeds and be diligent like Buddha.” As a young man at GE I learned from our Japanese factory manager that the multi-million dollar contract I had so carefully negotiated would in reality only serve as a handy record of where we started. Of course the transfer pricing would change if circumstances changed. In the Japanese world that would unquestionably be the right and ethical thing to do.

Euro-American ethics are Judeo-Christian based and could be summed as, “Thou shalt not lie, cheat or steal, and no sexual hanky-panky.” We avoid committing to a particular price or obligation by saying, “That’s not exactly what I said.” The Asian equivalent is to say, “I don’t understand.” If one does understand, then one has a moral obligation to act in a way that is right across all areas of understanding. For smooth dealings at the Asian bargaining table one must talk through all details of the business situation, because only understanding is binding. The international parental reminders that if we don’t do the required thing we will be reincarnated as a crow or be prodded forever by a red fellow with a pitchfork seems to instill these lessons for life.

Middle Eastern cultural ethics is an extreme loyalty to concentric circles of influence. This is perhaps summed up by this old Arabic saying: “Better 100 mothers should cry than my mother, better my mother should cry...
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Between here and chaos lies only the half
step of “Anything the law doesn’t catch me
doing” is not bad enough to be immoral.

Legal as Moral
Exacerbating the confusion from the mix
of ethical doctrines is the natural tendency
of legal bureaucracies to attempt to legislate business morality. The detail of
daily interaction is so much more diverse
than can be put down in legal doctrine
that this must fail (but certainly not for
the lack of trying). Worse corruption
comes from those who lack any other
ethical moorings and ascribe to the doc-
trine that anything that is legal is moral.
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Business Ethics in Two Steps
We, of the business cadre, have the
means and the charge to make the world
a better place. This happens naturally
when we do our jobs well. Profits pro-
vide businesses with funds to expand
and improve processes and products.
Statistically, for each $5 million in new

extra value we add to the economy, over
time one life is saved because of better
nutrition, housing and healthcare. On a
macro level, our lives are better than our
parents and grandparents. The goal is
for our children’s lives to be better than
ours. Holding to and encouraging a high
ethical standard reduces friction, the
valueless checking that would otherwise
be needed in transactions. Reduction of
friction increases general margins and
accelerates prosperity, much as we see
quality of life in some areas of the world
accelerated past others.

To best deliver your part on this goal
and bring greater value to your business
life two concepts should be embraced.
First, ensure and apply the right ethics. Most
readers will be governed by the
U.S. legal system and contract law based
on Judeo-Christian tradition. If raised
within that general rubric, you know the
ethical rules that are expected. If dealing
with others with that same cultural
heritage, require commonly recognized
ethical actions of both yourself and them.
However, and this is more challenging,
be sure to determine the exact ethics of
your opposite party. They may be differ-
ent. Either you need to align with them,
they need to align with you or you need
to recognize there will be considerable
transactional inefficiencies.

Second, be a good steward of the as-
sets entrusted to your care. It is a given
that all persons are concerned with
their own self-interest. When
individuals grow beyond that
self-focus their needs continue
to be met often considerably
well, and their contribution is enhanced.
Think here of Steve Jobs spreading the
mantra for his engineers to do some-
thing “insanely great” or Wal-Mart’s
goal to “lower the cost of goods and
services to the world.” It’s not first about
the money, it is about doing the best in
your role and money will follow.

The Good Steward
The essence of stewardship is service to
a higher authority or purpose. There is a
whole range of issues that should be ad-
dressed or of concern to someone looking
after the slice of our economy put into
their care. Usually with one’s own business
this comes naturally because self-interest
and business interest so closely align.
When one is managing a portion of a busi-
ness, someone else’s business or a public
company, putting service to the enterprise
first will yield greater rewards and satis-
faction, if the company is a good one.

If the firm is less than fair in this
regard, try to find a new one because
otherwise you are not entering a fair
bargain and will be sorely tempted to
even the scales. In a smaller business, it
is helpful to assume your family’s name
is above the door. If it were your uncle’s
company, you would speak up politely or
pitch in when needed, even if it wasn’t
specifically your area of responsibility.
When you are acting in the best service
to the business you are on the path to
both doing well and good.

I’m Worth Twice That
It is hardwired within us to feel that we
are worth more than we really are. That
gives our egos permission to aspire to
higher things. We contest and struggle
upward to where we see we belong. This
oversized value is about 200 percent
it seems. When I had responsibility to
allocate substantial investment banking
fees amongst eight common Wall Street
friends each was required to indicate
how they would split 100 percent of the
fees, including to themselves. These were
all professionals and there was remark-
able matching as to what percentage
should go to the finder, legal, the CPA, etc.

However, each person, universally,
rated themselves as deserving about 200
percent of what the group consensus felt
they should have. This natural
tendency for people to value their own contribution more highly than others would is a challenge to ethical stewards when they have to judge their own worth to set compensation.

Regulation or government driven monopolies can be hugely profitable and include everything from trivially extended drug patents, taxi medallions, lawyers, CPAs, the braiding of hair and lemonade stands. The return on lobbying dollars spent to strengthen these legal monopolies is estimated at 1,000 percent. Rationales for regulated monopolies are rarely supported by study. For example, the best predictor of effective legal work is expert repetition. In a Canadian study, paralegals focused in a narrow area like wills or adoption generally do a better job than attorneys who hold a broad general monopoly on supplying legal advice. As long as barriers to competitive entry can be bought through lobbying they will continue, but perhaps some in management may lean against that wind.

Unionized labor is a monopoly on one aspect of production. In unionized industries, management is often confronted with deciding to select either a large amount of immediate pain (a strike) or accepting long-term costs (wage and benefit concessions). If a decision is made as if the business were the executive’s own private business with an eye toward the long term, then the decision will be as good as possible.

If your goal is to contribute the most to the betterment of society, recognize that coercing an excess share of economic factors into any particular area diminishes the whole by about 30 percent of the growth that would come from that area under ideal competition.

**Who Watches Your Mother’s Store?**

Imagine that your mother on the opposite coast of the U.S. fell and broke her hip and came to you to recover. You hire a new manager to step in to run her profitable antique store. You appoint a CPA, lawyer and a couple of your college friends to check on the new manager. When the manager demurs and suggests his friends, his lawyer and a couple of his employees would supervise him, I suspect you would about lose your mind.

However, this is essentially happening across the United States in almost every major company. The CEO nominates or influences the nomination of his friends, associates and employees as a slate of directors that the shareholders can then vote on. It is virtually impossible for nominated slate not to get elected, leaving the friends of the CEO, in charge of checking up on the CEO.

All manner of problems result from this because the CEO and management are essentially making large bets with the shareholder’s money without real shareholder representative oversight of the risk. Credit default swaps during the housing crisis and excessive executive compensation are just two examples.

A straightforward solution would be to have shareholders nominate directors. By having twice the number of directors nominated as board seats there would be an adequate elective choice. Nominations should be made by real or natural person shareholders deter-
minded on a lottery basis proportional to shares held. If an institution holds the shares, then their natural person owners should be traced back and those people should be given an opportunity to nominate. In this fashion, shareholders would actually supervise, through their nominated and elected directors, the CEO and senior corporate team, ensuring stewardship from the corporate leadership.

Legal Marijuana – Our Challenge
An ethical manager looking to be a solid steward of the assets put under his care will have his own mix of the challenges. At Mentor Capital, Inc. (MNTR) we decided in November 2013 to move to become a pure play in the emerging cannabis sector. For this conservative, grey-haired, CEO just the thought of being involved with marijuana was like asking a chicken to go surfing in the ocean.

However, we were a cancer company whose portfolio had been diminished by the government deciding to not reimburse treatments from our highly technical, leading edge cures. We already knew the great benefits from marijuana for our cancer patients, so we approached with an open, science-based mindset.

Medical Marijuana Advantage
We quickly found medical marijuana reduces nausea as well as it does not better than any other medicine. It famously stimulates the appetite, which for cancer patients helps them maintain the strength to fight the disease. Cannabis also reduces pain especially in the peripheries like in the case of arthritis. It does this in a way that does not slow the heart leading to overdose and death as with opiates. The medical clincher for us was the way a second component in marijuana called CBD calmed seizures without being psychoactive. Since we had as good an understanding of the medicine as any, we investigated to see if we could find a way to back the medical use of marijuana.

Legalization Saves 10,000 Lives
A long-time hard working fellow, I have little time for vacations, keggers or social use of marijuana. However, we understand some people choose to relax and for them we were pleased to find that no one ever died of a marijuana overdose – the lethal dose being 1,000 joints in one sitting. Cannabis is about as addictive as coffee and even a cold turkey stoppage after a lifetime of daily use results only in two weeks of insomnia as one’s body gets used to again relaxing naturally before falling asleep.

Benign reports of minimal negative marijuana effects is in stark contrast to the 80,000 deaths each year attributed to other illegal drug and alcohol use. There is a fixed percentage of about 3.5 percent of the population that because of personality, physiology or other circumstance are drawn to seek out regular intoxication. These are the souls that come heck or high water will shoot up or even rip apart a battery to get high.

When a “substitution effect” was first reported by law enforcement in Hawaii, and from Colorado after legalization, it became clear the current level of harm from recreational drug use could be reduced. If social users shift from crystal meth, crack, heroin, and alcohol to physically gentler marijuana use, drug deaths could be avoided. Further, in other countries, legalization has not increased overall drug usage, perhaps because drugs and alcohol are readily available. Our independent research indicated that the shift to legalized marijuana from severely damaging crystal meth and crack could be as high as 60 percent.

This means if the average substitution rate from all drugs to a legalized marijuana could reach an estimated 12.5 percent (1 in 8), then 10,000 drug and alcohol related deaths could be avoided per year in the U.S. and national health care costs could be reduced by $1.0 billion annually. These facts, coupled with the clear medical benefits, made creating an all-American public company to professionally handle the legal processing of marijuana a worthwhile goal.

Ethical Challenges in Cannabis
One can imagine that the post-prohibition transition from Al Capone and his bootlegging crews to Joe Kennedy’s exclusive U.S. distribution rights to Gordon’s Gin and Dewar’s Scotch involved some degree of adjustment. With wide-eyed alertness to this same sort of
conflict, but with pioneering naiveté, we jumped into the cannabis pool.

**Loyalty is Integrity**
The first discovery we encountered was that loyalty to members in the group was the key value across the cannabis industry. The “I’ve got your back” assurance was about all that they could count upon. As a historically welcome banker to various investment events, I was surprised at an early cannabis function when I was bluntly challenged as to what I had done to put myself on the line. How had I risked my tail in the marijuana evolution, sacrificing like they had for the group? One fellow verified his integrity to me by revealing he and his main business partner knew the location of each other’s secret stash of emergency cash. This approach is rational, accepted and necessary in an environment where if you honestly and openly report your activities, some official will come in and take all you have.

**The Law is Odd**
How exactly does one be law abiding when marijuana is legal at the state level, but illegal federally? What cannabis business actions are safe if marijuana laws are not enforced federally if you follow the state rules, unless the new federal officials decide that the previously accepted and unchanged state rules are not now clear enough. This is not a hypothetical discussion; 1,200 medical marijuana dispensaries in Los Angeles and 400 in San Diego were opened under the federal guidance. After being opened at a cost of approximately $100,000 each, subsequent local federal law enforcement teams closed and confiscated the assets of 1,600 dispensaries. The $50 billion marijuana market moves toward legalization and public companies are created to fund growth. Regulators warn that there is improper activity in some marijuana stocks and hold clearing houses responsible for future transgressions. Marijuana stock certificates are not accepted for processing or deposit, accounts are closed and many top, fully vetted Wall Street firms will not yet participate in the cannabis market. At the state and local level the storyline is repeated with regard to zoning and individual location and license approvals.

**Shakeouts Take Time**
Young cannabis companies have not yet learned and accepted the easy protocols one finds guiding interactions in other industries like biotech or Silicon Valley. Older marijuana veterans have learned well how much self-help had to be and still needs to be relied upon in marijuana related transactions to persevere. Wall Street is only beginning to look past momentum opportunities toward creating long-term value. The government and the law have just started their long trek toward consistency. And, Coors-like legitimacy is unknown to anyone who ventures to say out loud that they are involved in even just medical marijuana.

**We are Each Stewards**
At Mentor Capital, Inc. (MNTR) we have taken the not uncontroversial but rewarding step of becoming a pure play in the medical marijuana and social cannabis sector. Our ethical goal, that gives value to our work beyond the numbers, is to “Promote business professionalism and integrity to an area previously characterized by violent illegality.” Many of you will do much more. Overcoming self-interests helps make us more effective at improving the world for those that follow. Being sensitive to the different ethical rules around us reduces friction and makes our efforts efficient. Compounding will take care of the rest.

We wish you and each fellow steward fair weather and full sail as you ethically guide your own ship forward, for the ultimate benefit of us all.