HBR: How Not To Fix Capitalism

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You can fool some of the people all the time, and all of the people some of the time, but not all of the people all the time.

P.T. Barnum

In this Christmas season, when waves of warm feelings of goodwill to all are flowing, you might think that only a mean-spirited Grinch would take Harvard Business Review to task for its misguided article—headlined in vivid red letters as “the big idea” on the cover of its January 2011 issue—“How To Fix Capitalism” by Michael Porter & Mark Kramer (pp. 62-77).

Yet it is precisely because it is the Christmas season that we ought to be thinking about the grim humorless workplaces that leave four out of five people miserable for the rest of the year and considering what we should be doing to really fix capitalism.

Capitalism has a perceived problem

Obviously the inquiry should begin with: what is the problem that we are trying to fix?

Porter/Kramer’s starting point is that capitalism has a problem of perceptions. They begin:

“The capitalist system is under siege. In recent years business increasingly has been viewed as a major cause of social, environmental and economic problems. Companies are widely perceived to be prospering at the expense of the broader community. Even worse, the more business has begun to embrace corporate responsibility, the more it has been blamed for society’s failures. The legitimacy of business has fallen to levels not seen in recent history. The diminished trust in business leads political leaders to set policies that undermine competitiveness and sap economic growth. (emphasis added)

In effect, the problem of capitalism is not about the reality of how capitalism operates. Rather, capitalism has an image problem:
“The communities in which companies operate perceive little benefit even as profits rise. Instead, they perceive that profits come at their expense, an impression that has become even stronger in the current economic recovery, in which rising earnings have done little to offset high unemployment, local business distress, and severe pressures on community services.” (emphasis added)

Fixing Capitalism: Changing the Perception of Capitalism

The solution to capitalism’s problem of “perceptions”, according to Porter/Kramer, is the concept of “shared value creation” which is defined as:

“policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates.”

In simple terms, this means redefining what the firm does to include a wider set of profit opportunities. The firm no longer crassly presents itself as selfishly pursuing “what’s in it for me?” Instead the firm presents itself as pursuing “what’s in it for all of us?” The firm gets rich while showing that it is also doing some good for others.

The authors present three ways to achieve this “shared value”:

- By re-conceiving some of the firm’s products and services (e.g. making healthier food products, reducing the drain on the planet’s energy and water resources, making profits from serving disadvantaged communities)
- By re-defining productivity in the value chain (e.g. making money from doing socially worthwhile things)
- By building supportive industry clusters (e.g. helping African farmers in countries like Cote d’Ivoire, Tanzania and Mozambique improve productivity so that both the farmers and the company can earn more; also investing in locations like North Carolina’s Research Triangle).

Exemplars of the approach are said to include GE, Google, IBM, Johnson & Johnson, Nestle, Walmart and Yara.

Even in pure public relations terms, the problem for the authors is that for most of these companies, their “socially good” activities are essentially side shows to their main business.

Thus the authors are impressed that GE had as much as $18 billion of ecologically friendly products (“Ecomagination”) in 2009 and that these products are growing faster than the rest of GE’s business. To be sure, it is good to see GE making progress of this kind. However the relative size of the gains needs to be kept in mind: $18 billion is only 11.5% of GE’s total sales. Thus 88.5% of GE’s sales are still “business as usual” i.e. not ecologically friendly. In public relations term, we do not have a different view of GE as a whole simply because 11.5% of its overall business is now ecologically friendly. The question in thinking people’s minds is: when will GE get around to doing something about the rest of its business?
It’s like the Safeway supermarket in my neighborhood that not so long ago opened a small counter offering organic products while the rest of the large store continued with its usual stuff. I am happy that the organic counter now exists, but my image of the supermarket as a whole hasn’t fundamentally changed.

Moreover ecological progress is only one part of capitalism’s negative image. For instance, Walmart is making commendable, even extraordinary, efforts to put all of its activities on a sounder ecological basis. However good progress in ecological terms does not erase the extraordinary asocial nature of Walmart’s practices in other areas, including underpayment of workers resulting in a need for public support through food stamps and welfare payments, underhand tactics to prevent unionization and the negative effects on employment and small business in the locations of its stores.

Equally, we are happy to see that firms like Nestle and Yara are making the odd investment in Africa to help poor farmers become more productive. But those commendable investments do not fundamentally change our view of capitalism when the most of the business activity is driven by a very different dynamic.

Similarly, the idea of firms acting as good citizens in geographical locations where they install their operations and providing support for education, health and community activities is common sense and commendable. It has been practiced for many years by firms like Toyota which see it as sound business, not merely charity. A firm’s image however depends on how it conducts itself in its overall operations: as Toyota discovered, a lack of attention to safety can instantly wipe out decades of corporate actions as a good citizen.

The problem for firms like GE and Walmart and the authors is that, as HBR remarked on the cover of its April 2010 issue, “Customers know everything about your company. That has changed the rules of business forever.” In this age of total transparency, putting on a few positive sideshows can soften a firm’s image, but doesn’t fundamentally change it. Indeed it runs the risk of being seen as hypocrisy if the reality inside the corporation is very different.

**Inside the corporation: real performance problems**

What is the reality inside the corporation?

Curiously, as we get into the article, the authors concede that capitalism’s problems go beyond perceptions and public relations.

“Firms focused on enticing consumers to buy more and more of their products. Facing growing competition and shorter-term performance pressures from shareholders, managers resorted to waves of restructuring, personnel reductions, and relocation to lower cost regions, while leveraging balance sheets to return capital to investors. The results
were often commoditization, price competition, little true innovation, slow organic growth, and no clear competitive advantage…”

“Strategy theory holds that to be successful a company must create a distinctive value proposition that meets the needs of a chosen set of customers. The firm gains competitive advantage from how it configures the value chain or the set of activities involved in creating, producing, selling, delivering and supporting its products and services…”

“However companies have overlooked opportunities to meet fundamental societal needs and misunderstood how societal harms and weakness affect value chains…”

“In business, we have spent decades learning how to parse and manufacture demand while missing the most important demand of all. Too many companies have lost sight of the most basic of questions: Is our product good for our customers? Or for our customers’ customers?”

According to the authors, these real problems are to be addressed by managing the value chain better, through identifying a set of currently unmet demands and hidden profit opportunities.

In the authors’ “new” capitalism, the approach of viewing the business as a linear value chain doesn’t change. The firm is still using the supply chain to “push” products and services towards consumers, but doing a better job of “parsing and manufacturing demand” by looking at a wider array of profit opportunities than it did in the past.

In this respect, the author’s “new” capitalism very much resembles the capitalism that it is meant to fix. The main thing that has changed is how the firm presents what it does. In the meantime, a whole array of real issues afflicting capitalism remain unaddressed.

**Capitalism’s real issues**

The authors give no indication as to how innovation will be any different in the new scheme of things since firms continue to deploy the same approach of pushing products towards consumers in a linear value chain. They give no sign of being aware that it is precisely the mental model of that linear value chain that cripples innovation by focusing management’s attention on what the firm already does, rather than starting from the other end and using a pull cycle to figure out what could give more value to the customer sooner.

Nor does the article give any hint as to how firms will deal with the following well-documented problems of contemporary capitalism:
• The rate of return on assets on US firms is one quarter of what it was in 1965.
• The life expectancy of a Fortune 500 company has declined to 15 years and is heading towards 5 years if nothing changes.
• The “topple rate” of leading companies is accelerating.
• Only one in five workers is fully engaged in his or her work; the larger the company, the less the engagement.
• Between 1980 and 2005, firms older than five years in the US produced zero net new jobs.

The authors seem unaware that the balance of power has shifted from sellers to buyers so that static value propositions and linear value chains are no longer viable. Instead as Umair Haque has eloquently argued in The New Capitalism Manifesto, the firm needs to be managing dynamic value cycles, in which the firm is being pulled by customers and clients.

The authors don’t seem to realize that unless the whole firm is focused on delighting clients and customers and continuously innovating so as to deliver more value to customers sooner, its future is in peril.

Nor do they recognize that in the grim humorless workplaces of today’s typical large company, where only one in five workers is fully engaged in his or her work, the lack of worker commitment is a huge productivity problem.

They seem unaware that capitalism’s bad image arises not from the misunderstandings or false impressions of outsiders but rather from an accurate assessment by insiders that these workplaces are destroyers of the human spirit, not its nurturers. They don’t seem to grasp that no amount of pushing out more ecologically friendly products will change this reality.

**A prior attempt to fix capitalism**

To understand what is being attempted in this HBR article, it’s useful to look at an earlier attempt to “fix capitalism”.

In 1993, the situation of American capitalism was grim. American companies had become “bloated, clumsy, rigid, sluggish, non-competitive, uncreative, inefficient, disdainful of customer need and losing money.” Clearly, the system had to be replaced by something different.

But what?

In 1993, the fashionable solution was business process reengineering. The initial idea was sensible: to reengineer processes, essentially a new fix to the system—particularly processes that took advantage of technology to minimize handoffs and enable smaller teams to work on tasks from start to finish. Such process improvements could lead to modest gains in productivity, although the change was hardly the deep change needed to deal with the massive structural problems of the traditional workplace. Nevertheless, Michael Hammer and James Champy were able to hype this modest proposal into something they called “radically new,” “a fresh start,” “something entirely different.”³
The proposal was attractive to traditional managers for several reasons. For one thing, it was a technology fix: managers didn’t need to change their behavior. They could sit back while technology solved the problem. For another, the reengineering could be done by experts—even by reengineering “czars.” Managers could hire others to do the work.

It offered CEOs an attractive image of immaculate top-down power, while happily providing management consultants with “the next new thing”.

The downsides of the approach were mirror images of the advantages. Because the management problems were not technology problems, the introduction of technology did not address root causes. Being designed by outside “experts”, the solution often didn’t fit the specific workplace. Because the process changes were introduced without basic change in the behaviors of the managers, the problems caused by those behaviors continued.

In fact, a principal attraction of business process engineering was precisely that under the guise of being something entirely different, it was more of the same. It was another superficial fix to a system that was suffering from rot within.

“Shared value” mirrors “business process reengineering”

Porter/Kramer’s approach will no doubt be attractive to traditional managers for similar reasons. For one thing, it is a fix to the supply chain: managers don’t need to change their behavior. They can sit back while new categories of demand and profit opportunities are plugged into the supply chain. For another, the adjustment can be done by experts. Managers can hire others to do the change, while preserving the existing culture of hierarchical bureaucracy.

Once again, the downsides of the approach are mirror images of the advantages. Because most of the problems of capitalism are problems that better manipulation of the supply chain cannot resolve, a fix to the supply chain will not address root causes. Because the process changes are introduced without basic change in the behaviors of managers, the problems caused by those behaviors will continue.

It is astonishing to see how little Porter and Kramer have grasped the need for greater agility in a rapidly changing environment. It is assumed that the world is knowable and predictable. The firm can figure out what will happen and call the right plays.

In fact, a principal attraction of the new fix to capitalism is precisely that under the guise of being something entirely different, it is more of the same. It is another superficial fix to a system that is suffering from rot within. It is a bandage on a cancer.

What really fixing capitalism would look like

Manipulating value chains and more accuracy in parsing and manufacturing new categories of customer demand and profit opportunities will not fix capitalism, no matter how socially worthwhile some of those new profit opportunities turn out to be.
Instead, a growing group of leaders and writers are converging on the idea that fixing capitalism involves five fundamental and interdependent shifts:

- A shift in the firm’s **goal** from inside-out linear supply chains pushing products and services at consumers, to an outside-in approach where the whole firm is focused on delighting the client through continuous innovation.
- A shift in the **role** of managers from controllers to enablers.
- A shift in **coordination** from hierarchical bureaucracy to dynamic linking.
- A shift from a preoccupation with economic and monetary value to the values that will lay the foundation for innovation and organic growth.
- A shift in **communication** from top-down directives to interactive adult-to-adult conversation.

The authors give no inkling of what a real fix of capitalism would look like, namely:

- Creating workplaces where anyone would actually want to work.
- Involving customers in value cycles, in which customers play deciding roles: in effect, the customer becomes the boss.
- Creating simultaneously high productivity, continuous innovation, deep job satisfaction and client delight.
- Generating passion among employees so that innovation becomes as natural as drawing breath.
- Creating workplaces where deeper meaning replaces the grind of repetition with challenging and compelling work that elevates the soul.
- Turning organizations into curators of the human spirit rather than its destroyer.

To learn more about what is involved in really fixing capitalism, go to:

To join an on-line discussion group on the subject, go to.

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1 The quote is sometimes attributed to Abraham Lincoln. The *Oxford Dictionary of Quotations* lists the quote under their P. T. Barnum entry, along with the dictionary compiler’s favourite weasel words - "attributed to". There is considerable doubt that he said either of the above. Barnum’s acquaintances have claimed that the first would have been somewhat out of character for him, and Abraham Lincoln is often confidently cited as the author of the second. Actually, the 'some of the people' dictum isn’t found in print until 1887 (some years after Lincoln's death and when Barnum was in his dotage), when it appears in print in several American newspapers, again guarded by vagaries like "Lincoln once said"

2 Deloitte’s Center for the Edge: The Shift Index; The Kauffman Foundation