

The Mature Corporation

The Mature Corporation:

*A Model of Responsible
Capitalism*

By

Paul Kearns and Stuart Woollard

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PREFACE

Humankind's history is littered with conflict. If we are ever to avoid further social revolutions, political turmoil and economic trade wars, then searching for a common purpose might be a good place to start. It seems only common sense that if life appears to be unfair, especially to the disadvantaged, then we should continue to expect very strong backlashes along the way. Perhaps we are only just beginning to realise that to avoid human conflict we should all believe we are ultimately on the same side. Even today we have forced ourselves into making a false choice: are we on the left or the right; democrat or republican, conservative or labour or somewhere indistinct? What if we changed this simplistic paradigm once and for all? If the interests of all stakeholders were one and the same, then there would be no need to take sides or adopt an adversarial stance. This, in essence, is the basic premise on which we build a better business paradigm for The Mature Corporation, to take its legitimate place within a capitalist system that serves everyone's best interests.

If we are to identify the spark that ignited this search for a new paradigm it has to be the Global Financial Crisis (GFC) of 2008. Yet the roots of this crisis can be traced back to insidious changes that took place during the second half of the 20th Century. That was a quiet revolution, by stealth, where "shareholder primacy" became the mantra of those wishing to seize power and personal riches through corporate behaviour that was a perversion of legitimate capitalism. It might be called the GFC today but future historians may come to document it as the first, global, socio-economic revolution. When credit was cheap and paper profits were riding high, it may have felt like the capitalist system was working well but the day that Lehman Brothers collapsed, September 15th 2008, was a very rude wake-up call for the whole world.

When those "profits" proved to be an illusion, as they were, the system collapsed and its inherent flaws were exposed for all to see. Subsequent generations will continue to pay the price for the misdeeds of those executives who exploited the weaknesses in the system and the regulators who failed to regulate. More importantly, irrespective of any legalities, we had allowed a corporate culture to proliferate that lost its purpose and social

licence. A culture that now has to be corrected if we are ever to lay the foundations for a much more sustainable version of capitalism. This is the primary objective of this book.

We offer here a framework and a set of whole system practices, based on the work of the Maturity Institute, established in 2012 to make a new start, with a fresh agenda. It is self-evident, from the many corporate fines and legal actions since 2008, that things have to change. A key change has to be the very nature of the corporation, the fundamental building block of capitalism. Healthy corporations, using mature management practices, focused on long-term value and sustainability, are necessary for capitalism to re-assert itself as the most effective way to underpin socially cohesive nations and their economies.

Of course, the problems of capitalism can only be resolved effectively if we develop the right methodology, tools and practices for better corporate management. This mandate requires clearer definition of the core problems and a much better understanding of the complex dynamics of the whole system. For example, there is a growing consensus that “corporate culture” is now one of the main issues¹, and that requires more precise definition, diagnostics and measurement than has ever been applied before. However, culture cannot be addressed as an isolated issue. It cannot be separated out from the operating system of a sound business model and financial controls. A corrupted culture will aim to achieve a profit at any price (e.g. mis-selling sub-prime mortgages, spurious banking products, or pharmaceuticals). It will show no concern for the fair competition necessary for fair capitalism. The short-term numbers in the latest quarterly figures might look good but that same accounting convention must now incorporate counterbalancing measures of true value, including the price society is having to pay in the long-term.

This requirement for a better, conceptual framework for operational capitalism has already been well recognised for decades with the advent of balanced scorecards, notions of corporate and environmental responsibility and integrated reporting. This is why The Mature Corporation has to be measured across a range of indicators that capture the complete picture of the whole organization, working within the constraints of a legitimate, global, capitalist system, working towards a common goal.

¹ <https://www.nacdonline.org/Resources/Article.cfm?ItemNumber=48256>

How will a corporation know when it is becoming more mature? The simple answer offered here is a single measure of the extent to which any organisation is creating benefit for all those with a valid, vested interest: what we have named as the primary metric of Total Stakeholder Value (TSV). This might sound like an oxymoron; how can something be made so simple and be applied in practice, and yet truly reflect the complex dynamic of organizational systems, actions and behaviour? All of this will be explained in due course but, for now, just imagine that this TSV measure aims to match each individual's DNA with that of the organization they work for: only then might you begin to appreciate the potential of its powerful insights. The developments that led to TSV go back many years but the main part of that story is told when we explain how the Maturity Institute arrived at its Organizational Maturity Index (OMINDEX). This is a universally applicable scale of maturity, based on credit rating conventions, that can measure *any* type of organizational entity: for profit, not-for-profit, private, publicly quoted, public sector, charity or NGO. The Oxfam scandal that rocked the charity world in 2018, when it was found to be allowing its staff to abuse their position, revealed just how perverted organizational behaviour has become across all contexts. Even organizations that start out with the best of intentions can lose their way when trying to reconcile the pressures of operational delivery with the responsible management of fallible human beings. Organizations in such a situation have to be able understand how they arrived at such a low point and what they can do to be able to heal themselves.

This is why maturity analysis sees all organizations, first and foremost, as human organisms that are likely to behave in peculiar ways, unless all the right elements are in place and they are managed as a whole system. Each of these core elements of organizational leadership and management have to be identified and measured; both individually and collectively. When we cover the OM30 question set, a diagnostic instrument that produces OMINDEX ratings, you will see how each question is designed to produce new, crucial insights. In effect, we are analysing and measuring what traditional company analysis and accounting practices have always left out; often preemptorily lumped together and dismissed as the "intangibles". Questions relating to matters of organizational purpose, values, principles, learning and culture, to name but a few, are obviously critical aspects of an organization's ability to perform well. If they are not analysed and measured effectively their value creating capabilities cannot be managed. This first principle of management by measurement is irrefutable. Incorporating such factors into how we diagnose and improve organizational health creates

huge implications for the way corporations have to be led, managed and valued in the future.

Conventional management practice, company valuation, and accounting and auditing practices, have now been found to be totally inadequate. An “integrated” business strategy and accompanying company reporting will have to embed all of these “intangible” measures and indicators, to operate holistically and then tell the complete story of what drives the corporation. Investors will increasingly have to understand how to preference the allocation of funds to those organisations who have healthier corporate cultures and human value creation systems. Business schools will have to rework curricula away from the traditional, siloed approach to “business administration”. Their teachers, all with their own specialist disciplines, will have to sit down together to produce a whole system curriculum and appropriate syllabuses for teaching. This is particularly true for the those who teach human resource management. They have to convince the accounting teachers that measuring training costs, as a proxy for training impact, is no longer an acceptable convention. Organizational behaviour specialists will then have to change attitudes to leadership and management development programmes. Development expenditure must only be sanctioned if it has a direct line of sight to value creation or risk mitigation. One wonders why these simple lessons are still there to be learned.

These new rules are the defining characteristics of The Mature Corporation but their application is extremely rare. Yet, we can no longer accept the notion that such key factors can be ignored or dismissed as just too difficult to measure. These are precisely the kind of underlying issues that helped to cause the GFC and should now become the best, most crucial, predictive indicators of sustainable and legitimate organizational performance. All of this might sound like an impossibly difficult task if it were not for the fact that mature corporations already exist today. Their superior business performance and contribution to society stand out as a beacon among the mediocrity of conventional management today but the evidence is only just beginning to be recognised. Understanding and acknowledgement is bound to follow. Only then will corporations be able to replicate all of the necessary factors for sustainable success. “The Mature Corporation” is designed to provide a first text, the most important step in understanding for any board or CEO seeking to introduce a new approach to delivering long-term Total Stakeholder Value, or TSV. Or, for any emerging, purpose driven organization that needs to build the systems necessary for long-term impact and longevity.

Handelsbanken has over forty years' experience of running itself according to a mature set of disciplines built around a clear focus on the customer and society. It also has the superior financial results to show for it. Whichever theory this bank may have based their practices on, the impetus for their re-development as an organization arose from crisis but involved a great deal of practical trial and error; learning from what works best for their corporation and their primary stakeholders, their customers, as it did from conventional management². This might not sound much like a "scientific method" as it is understood by laboratory scientists. The multiple variables of running a business (the market, long-term strategy, external forces, financial constraints etc.) cannot be perfectly isolated, sequenced or controlled in real time. Conventional managers and organizational academics have only had a technology that can study performance with the benefit of hindsight, when it is too late to put it right. With the methodology and tools explained in this book, organizational leaders and managers will not have to wait for more academic research. They will be able to test what maturity means, in real time, and monitor the results based on measured, value outcomes.

The original exemplar for the establishment of the Maturity Institute, the Toyota Motor Corporation, had already changed the world of automotive and manufacturing when the institute was first formed in 2012. Copies of The Toyota Way had been seen sprouting up across other sectors, such as healthcare, for decades, but with few managing to grasp the essential, human elements necessary for success. When Ford and General Motors realised just how good Toyota were, they had already fallen even further behind its relentless pace of improvement. This is one of the main reasons why so few mature corporations currently exist today. Organizations making an acceptable profit, by conventional norms, have little motivation to constantly re-invent themselves and adapt for the future. Even if they wanted to replicate a company like Handelsbanken or Toyota, they do not seek to understand the whole, human system at play. Any manufacturer can try to copy the famous Toyota Production System (usually now referred to as "lean manufacturing") but if they fail to replicate the whole Toyota System, especially its people management and culture, they are unlikely to match its performance over a long-term time horizon, and are far more susceptible to failure.

² [https://www.handelsbanken.co.uk/shb/inet/icentsv.nsf/vlookuppics/investor_relations_en_history_pdf_2008/\\$file/history_pdf_2008.pdf](https://www.handelsbanken.co.uk/shb/inet/icentsv.nsf/vlookuppics/investor_relations_en_history_pdf_2008/$file/history_pdf_2008.pdf)

Becoming a Mature Corporation starts from a different paradigm. This paradigm is rooted in a corporate purpose based on serving societal interests first. It is then operationalised, not through one of “us and them” or a “zero sum game”, whereby every improvement in employee value is passed on to selected interests e.g. to shareholders via increased dividends. It is a simple and obvious statement that you cannot maximise true value for all stakeholders, including business and shareholder returns (or your own), if you do not maximise the value created by everyone involved in the organization’s whole system. There are no sides to be taken in The Mature Corporation because everyone works to a common purpose, which they believe to be in all of their own interests, and in the interests of future generations. This is the very nature of maturity and the most responsible platform for legitimate capitalism.

Paul Kearns
Chair
Maturity Institute

PART ONE

HOW SHOULD WE DEFINE, DIAGNOSE AND UNDERSTAND ORGANIZATIONAL HEALTH?

*“Organization – an organized group of people with a particular purpose
.... the quality of being systematic and efficient.... From the Latin
organum ‘instrument, tool’.”
Oxford English Dictionary*

CHAPTER 1

FUNDAMENTAL IMPEDIMENTS TO ORGANIZATIONAL HEALTH

“Our business model and our way of working are based on a fundamentally humanistic approach.” Anders Bouvin, CEO Handelsbanken (OMINDEX rated A+, March 2018)

A simple scale of comparative maturity

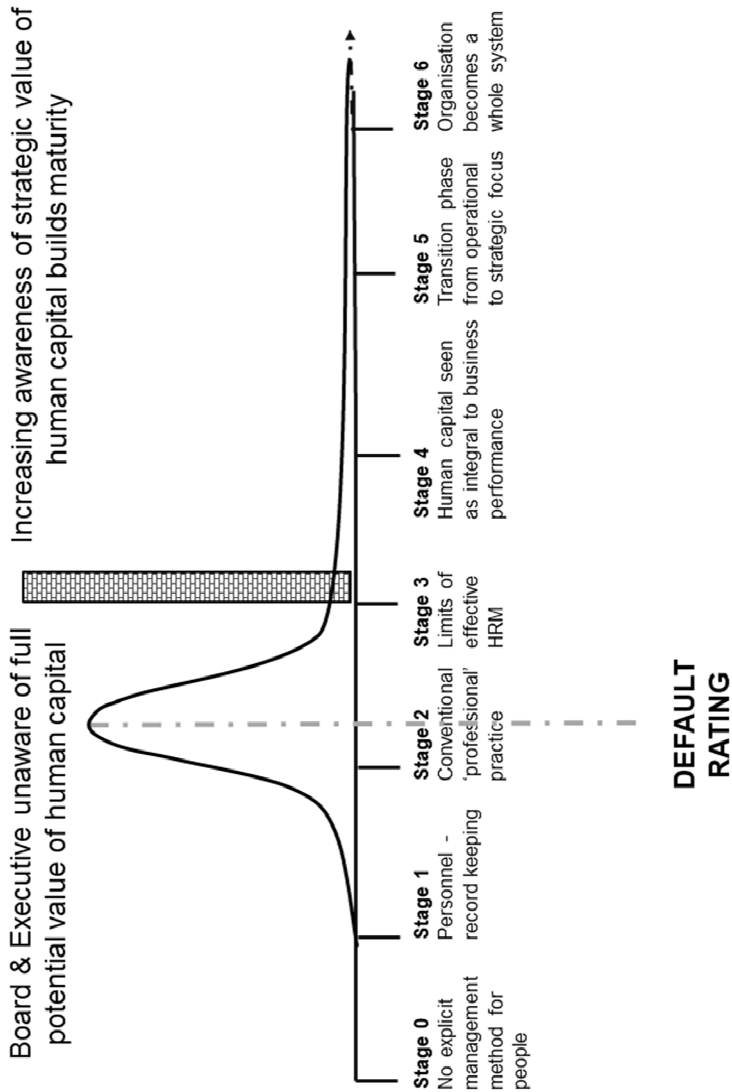
Organizations create value from all of the human beings that are connected with them and the relationships they develop through interactions with workers, suppliers, customers, and wider society. This should be a simple and obvious statement of fact yet it is something to which many organizations pay little attention. Despite much rhetoric to the contrary, corporate actions often suggest that people, human relationships and an organization’s human systems are, at best, of secondary importance. In the worst cases, some corporations even appear to operate on the basis that people are a corporate resource that is there to be exploited for the organization’s gain. Others make no apology for seeking to remove people and displacing human relationships with new technology, in the erroneous belief that this is the best way to achieve success. This is the first impediment to organizational health: the tendency of most corporations to misunderstand the crucial connections to be made between people and value.

We can represent the current spectrum of this corporate mentality graphically in Figure 1.1. This is a continuum that presents the wide range of views and attitudes in boardrooms and senior executive teams today, regarding the value of human beings to corporate strategy and performance.¹ This simple diagram was the original blueprint for the establishment of the

¹ For a fuller explanation see ‘Professional HR: Evidence-based people management and development’ Kearns, Routledge, 2013

Maturity Institute in 2012 and the basis for what has been developed into the OMINDEX (Organizational Maturity Index) scale.

Figure 1.1 A simple scale of Board and Exco attitudes towards people management



The first, very rudimentary, version of this scale was originally designed as a tool for benchmarking, measurement and improvement in 1993 and the most salient points to note are:

1. Based on our own extensive evidence, conventional management attitudes towards people management, and their manifest *human resource* practices, place the “average” organization just above Stage 2. These organizations are generally not predicated on evidence-based, causal connections to human value and risk. They also tend to focus solely on managing an organization’s workforce, rather than the value and risk arising from wider human systems. They erroneously portray loose correlations between broad concepts such as “employee engagement” and “performance” as causative of effectiveness.
2. The peak of the frequency distribution curve marks the default point in terms of organizational maturity. Based on our evidence, it is clear that people are not viewed nor managed as valuable human capital in most organizations. Rather, they are viewed and managed in narrow financial terms, primarily as a cost to the business. In Figure 1.1, boards and their executive teams only start managing people seriously, as highly valuable human capital, when they have managed to surmount a “wall” of new education, just after Stage 3.
3. Our experience has shown that education and an openness to learning is crucial for organizations to move beyond the wall. Boards, CEOs, investors, academics and professional bodies who have taken the time to understand organizational maturity, and the nature and importance of the links between human systems, value and risk, can make enormous progress very quickly. The Mature Corporation has been written as a gateway to enable this understanding.

We will explore these complex dynamics, in much greater detail as we build the full version of organizational maturity analysis and rating that the Maturity Institute and its professional members use in practice today. From our maturity analyses of over a hundred organizations, from a wide range of sectors, we will provide compelling evidence to show that those that have been able to retain, nurture and systemise a “*humanistic*” approach, such as Sweden’s Handelsbanken, are better able to serve society and deliver superior financial performance. A mature corporation will embrace the use of technological advances to create greater value and will grasp every opportunity to continuously improve organizational efficiency. However,

the essence of a mature corporation is that people absolutely matter to value, indeed they are the very source of such innovation and efficiency. Let us consider a specific example to further illustrate what this continuum brings to light.

In the automotive industry, where the Maturity Institute's origins lie, Tesla is a relatively new start-up that has developed cars and trucks to help lead the world towards a future free of fossil fuels. Tesla's technology is undoubtedly impressive and their founder, Elon Musk, is recognisable as a true visionary. The company's Achilles Heel, however, has been its struggle to actually produce its cars efficiently and at volume. It has experienced serious problems with the quality of the build.² Musk's original solution was to utilise advanced robots and, in the process, to "*reinvent*" car production through new automation. However, the company found that too much automation undermined its ability to innovate, fix issues quickly and improve further. Tesla's choice of robots, in preference to humans, even spooked Wall Street analysts, who argued that Tesla over-automated and "*baked in*" production line problems.³ In a desperate bid to hit its production line targets, Tesla put its whole reputation at risk, and proved unable to deliver on all its planned outcomes of production targets, financial budgets and bringing the best possible quality cars to market.⁴

Tesla's travails, and how Musk responded, contrast sharply with those of Toyota (Organizational Maturity rated A-). In the wake of its own high-profile recalls, primarily involving its cars in the US, Toyota's CEO, Akio Toyoda, acknowledged that the company had become too fixated on growth and had lost sight of what has always been critical to its success; the consistent and reliable quality of its cars. Toyoda boldly announced that he was reverting to making cars by hand in one production facility, thereby replacing robots with humans in an effort to regain the "art" of car making. The results of this initiative are instructive. The re-utilisation of people to hand-craft cars actually led Toyota to identify new ways of improving their manufacturing and, in doing so, develop greater efficiencies and innovation.⁵ This approach deliberately revisited what had been part of its own DNA for over 70 years. Toyota's worldview has always believed that

² <https://www.ft.com/content/bf762378-38a7-11e8-8b98-2f31af407cc8>

³ <http://www.businessinsider.com/tesla-robots-are-killing-it-2018-3>

⁴ <https://www.motortrader.com/motor-trader-news/automotive-news/tesla-model-s-least-reliable-car-car-survey-06-09-2018>

⁵ <https://www.fastcompany.com/40461624/how-toyota-is-putting-humans-first-in-an-era-of-increasing-automation>

it is people who drive value in its organization and they should only be replaced at the appropriate time, when there is no further value to be gained. Ironically, Musk's automation problems meant that he was forced to revert to using humans to make Tesla cars to meet his own production schedule, albeit very inefficiently.⁶

Human impediments to company valuation

We ignore the contribution of people to value creation at our peril. Yet conventional management teams and swathes of business analysts routinely allow financial indicators to be the predominant indicators of current and future success. A quick glance at any listed company's profile in the Financial Times will show that the health indicators supplied for its readers are nearly all financial. The only metric typically applied to the human dimension of a company is employee headcount, reflecting an underlying assumption that people are there to be managed as a commodity cost, not as a source of value.

Companies themselves pay lip service to the impact of their people. Pick up any annual report today and you are highly likely to find that, aside from any health and safety or regulatory requirement, minimal references are made to the specific value contribution from people. Company reports acknowledge a certain level of corporate responsibility, which is more risk oriented, than the added value of people. You might will see the issue of diversity feature heavily, with some kind of narrative and metric supporting the company's efforts to do better. It might include some assertion that its people are "*engaged*" with the organization and that this, in itself, is implicitly a good thing. Or it might highlight certain efforts of the company to support people, showcasing its corporate social responsibility (CSR) programmes. You are far less likely to see how the company is ensuring that its human capital is driving continuous innovation and how much value this is generating. The one area that should show a positive value from the company's expenditure, on training and development, is a missed opportunity as it expresses its main concern in terms of inputs; such as the hours, days or weeks of training each worker receives, rather than the outputs and the value it has produced.

From a business risk perspective, you will generally find that the attraction and retention of talent is a primary, or even the only, critical risk identified:

⁶ <https://www.wsj.com/articles/the-truth-is-catching-up-with-tesla-1507399374>

not because it is the *most* critical issue but simply because it is easy to say and can offer simplistic measures of hiring and turnover statistics that are unlikely to be challenged by observers who do not know any better. Generally absent are the most likely behaviours and actions of people right across the corporation's operations that may have a material bearing impact on more significant value and risk mitigation opportunities. In short, companies work hard to present a positive picture of how well they treat their people but, in most instances, fail to provide any credible evidence of how they manage their people as value generators, or how their people form a critical component of organizational risk, or market value.

The construct of The Mature Corporation is a balanced amalgam of societal purpose, aligning people to this goal, and maximising value. It posits that one essential problem, for most organizations, is a failure to realise the full, value contribution of people. Realise, in this sense, conveys two meanings. First, there is a significant and widespread failure to understand how people connect to the creation of business value and risk. Boards and senior executives have never been taught this specialised discipline and have come to rely on human resource "professionals" whose work is predicated on "*best practice*" (sic) rather than best value. The current human resource management (HRM) paradigm emerged out of a history of welfare and industrial relations: a response to immediate manpower shortages during the war years and the social changes that arrived in their wake. So its roots are firmly set in reactive, administrative, personnel tasks such as pay and conditions, so-called "*tea and toilets*", not strategic human capital management.

Even where there is some understanding of these underlying issues, organizations have limited capabilities, and often little appetite, for building the infrastructure necessary to leverage the latent value opportunities available. Consider the composition of any board or senior executive team and, for the most part, you will find little expertise has been gained and an unwillingness to make the effort to develop the systems needed to unearth this hidden source of enormous value. Companies operate as if attracting and retaining talent, finding willing suppliers, or making customer sales is all that is required to succeed. In a world of conventional mediocrity, it has been enough to compete. The essential humanity of any organization is lost though amid a preoccupation with transactional activity and myopic cost pressures. The unrealised potential that results from this state of affairs is nothing less than a monumental failure for companies, economies and the communities who depend on them for their livelihoods and welfare

provision. The overall opportunity cost to society is immense, as our evidence, born out of the Maturity Institute's research and practice, will demonstrate.

Deeper systemic problems

How do we begin to address this seemingly intractable state of affairs? We first need to comprehend the complexity of what is a much deeper and more systemic problem. We must turn our attention to the true nature of the challenges ahead by shifting our focus to the context, the wider systemic basis, within which corporations are required to operate. It is the current, distorted, capitalist paradigm that encourages firms to strip out the humanity from their operational priorities, while discouraging a strategic approach because it has been commandeered by the few executive officers who aim to benefit most. This skewed version of capitalism has to be replaced by a revised model that is actually much closer to the dominant philosophy that previously informed corporate purpose and upon which Western capitalism was built (for a full narrative of this story, see "The Puritan Gift"⁷, required reading for Maturity Institute members). Capitalism's roots, at least as a viable and valid basis for a successful socio-economic system, always had societal interests at its core.

Back in 1970 though, the Nobel prize-winning economist Milton Friedman managed to re-forge a slanted version of capitalism; positing that companies should seek to maximise profit and serve shareholders, above all other stakeholders' interests. The particular twist in the rationale came with his assertion that, by serving shareholders, companies would be fulfilling their moral obligations and responsibilities to the society they serve. In the decades since, amidst a host of corporate scandals and over ten years after the GFC, a growing chorus of voices attest to the fact that this economic philosophy is unsound. Joe Nocera captured the emerging zeitgeist and articulated the nature of this discontent in his Bloomberg article⁸:

"The shareholder-value movement did some good, especially in those early years. It became de rigueur for boards to create performance criteria that executives had to meet to get bonuses and stock options. And it was a means

⁷ <https://www.amazon.co.uk/Puritan-Gift-Reclaiming-American-Financial/dp/184511986X>

⁸ <https://www.bloomberg.com/view/articles/2017-05-04/toppling-the-idol-of-shareholder-value>

of imposing discipline...But the pendulum has swung too far, and today the ethos embodied by the phrase “maximizing shareholder value” does more harm than good. It has widened income inequality. It has rewarded short-term “make-the-quarter” thinking over long-term value creation. It is the reason companies take on too much debt and perform feats of useless — but stock-price enhancing — financial engineering. When shareholders matter more than employees or customers or communities, some people do very well, but the purpose of a corporation becomes warped and society loses.”

Nocera is absolutely right in his analysis of the causes of our current malaise. The prevailing, shareholder value paradigm encourages financial rather than humanistic returns. It is now undermining the very value it is supposed to create and comes with an in-built tendency to result in harmful externalities (e.g. social and environmental damage). These human concerns have not been properly factored into company valuations, which are still based primarily on financial calculations. This issue is not new, it has been gnawing at the heels of capitalism for a very long time and Friedman believed he had set out a definitive response in his seminal article⁹ entitled “*The social responsibility of business is to increase its profits*”. His theoretical assertion was unproven when he wrote it and we have now witnessed nearly half a century of its effects with mounting evidence of corporate misdeeds, failures and ineffective corporate governance. Even governments around the world are beginning to recognise that they need a more coherent response and a whole system solution. In the meantime, boards and their executive committees are having to convince both anxious investors and wider society that they are taking their social obligations seriously, when all the evidence clearly points in the opposite direction; society does not come first in their strategic planning.

For many corporations, having to manage the necessary transition back to responsible capitalism has taken on an air of existential crisis. Will corporations, as we have come to know them, survive as they are? Many firms would have us believe that profit maximisation can be made acceptable provided it is coupled with strong “corporate social responsibility” (CSR) or philanthropic activity. This has even given birth to the notion of “*shared value*”, a concept that allows companies to remain primarily rooted in serving shareholders as long as their business provides

⁹ From his New York Times article of 1970 entitled ‘The Social Responsibility of Business is to Increase its Profits’

social benefits. This fledgling model, which we explore in more detail in Chapter 2, is not likely to develop into a full-blown paradigm because it is relatively easy to see its inherent flaws and intrinsic incoherence. Despite any good intentions that might be motivating its progenitors and adherents, it remains an ambiguous and difficult concept to operationalise.

For example, Nestlé is a prominent advocate of this “shared value” approach¹⁰ yet struggles to reconcile and manage both societal and shareholder value while experiencing multiple controversies that affect its reputation. It has had to defend itself against allegations of slavery in supply chains¹¹ and of bottling water at the expense of local communities¹². In our own analysis and rating of Nestlé, which we issued originally in 2016, we advised asset managers and pension funds that the company was missing 5 to 10 percentage points on their operating margin. We argued that Nestlé has been suboptimal for both shareholders *and* society. This is a truism in mature thinking because shareholder and societal interests are indivisible and interdependent. Nestlé has since been under attack by an activist investor seeking better margins and shareholder returns: a clear sign that this is not an either/or question to be solved by sharing value. Society does not have to make a choice between profit and societal value: both have to work in harmony if they are to be optimised.

Interestingly, Larry Fink, founder and CEO of Blackrock, with a reputation for hard commercial instincts, has been writing an annual letter to CEOs on the state of the investment world for many years and investors listen intently to his views. His 2018 letter¹³ echoes the dangers we have articulated since the inception of the Maturity Institute: -

“Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders...It will remain exposed to activist campaigns that articulate a clearer goal, even if that goal serves only the shortest and narrowest of objectives. And ultimately, that company will provide subpar returns to the investors who depend on it to finance their retirement, home purchases, or higher education.”

¹⁰ <https://www.nestle.com/csv/what-is-csv>

¹¹ <https://www.theguardian.com/sustainable-business/2016/feb/01/nestle-slavery-thailand-fighting-child-labour-lawsuit-ivory-coast>

¹² <https://www.independent.co.uk/news/world/americas/nestle-water-selling-diverting-bottled-arrowhead-san-bernardino-forest-california-a8130686.html>

¹³ <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>

This is unusually insightful from one of the world's largest investment houses. The very best run companies have a clearly defined societal purpose that informs operational activity and aligns all human capital to this end. Our supporting evidence is clear. Those that achieve this coherence in reconciling shareholder return and societal benefit can competitively differentiate themselves. Those following this particular formula have been doing so for decades.

To be fair, Friedman's views should really be considered in the context of his time. Nearly 20 years before the Berlin wall finally fell and when communism and socialism were still economic and political realities in many parts of the world. His argument attracted weighty adherents in political leaders such as Ronald Reagan and Margaret Thatcher. Whether he intended to do so or not (we would suggest not), he was preaching to the converted in providing just the sort of justification that would be seized on by avaricious shareholders and mercenary executives to provide a "moral" basis for running their businesses accordingly. It is no coincidence that CEO pay has become increasingly aligned with profit maximisation and shareholder returns, rather than a more holistic form of value or other measure of the greater good. So where did Friedman's logic and analysis go wrong?

If Friedman were alive today he would still, most likely, be adamant that his theory is morally sound. It is based on the principles of freedom of individual choice within a free society. As such, it should sound like an idealistic, rather than cynical, view of human nature. It attempts to balance and reconcile humanity's needs with our own, evolutionary tendencies to serve our own, personal interests. In his model, the level of a company's profits is, in effect, a measure of the combined social conscience of its board and executives. What he failed to mention though, or factor into his equations, was the crucial term *value*. We rectify this omission by defining what value has to mean for the whole world system to survive and thrive.

Defining the value of capitalism

Such was the power of Friedman's argument, it clearly contributed to the unhelpful myth¹⁴ that American CEOs are under a legal obligation to

¹⁴ https://www.washingtonpost.com/opinions/harold-meyerson-the-myth-of-maximizing-shareholder-value/2014/02/11/00cdfb14-9336-11e3-84e1-27626c5ef5fb_story.html?utm_term=.35f9493f635c

maximize profits. Although a legal technicality, it appears that they *are* under an obligation to maximize value, or at least to ensure that if they sell a company they do so at the highest possible value. You may think there is no worthwhile or discernible distinction to be made between these two simple words of “profits” within Friedman’s doctrine and the true “value” of a corporation: surely one inevitably leads to the other? Certainly, a continuous stream of profits is likely to be factored into company valuations but a focus on profits, rather than value, represents an entirely different value set and business paradigm. Profit is currently measured very simplistically (revenue less costs) without full consideration given to other important factors, whereas society now demands a much wider definition of corporate value focused on its own longer-term needs.

The crucial task of defining value accurately has taxed some of the greatest minds and is not an easy debate to follow. The conventional economist’s definition of value refers to economic value; defined as what someone is prepared to pay for what value they perceive. However, for a business operation to be *socially legitimate*, value has to be defined unequivocally, with a clear purpose of serving society’s best interests. This places that onerous responsibility not only on the shoulders of boards and CEOs but every other key player in the whole capitalist system including governments, legislators and regulators who are supposed to be its custodians.

In the UK there has been a long-running debate about whether to expand London’s Heathrow airport (already number 6 in the world for passenger numbers). One UK government report recommended a third runway on primarily “economic” grounds, as though the other factors (environmental damage, demolishing homes etc.) hardly mattered. If anything has changed since Friedman’s time it is the recognition that many other considerations do matter and that profit is a poor proxy for social responsibility or whole system, societal value.

Friedman’s failure to use value as his criterion should have been his undoing. It remains the undoing of any CEO who has any pretensions to responsibility and hides behind profit, earnings per share or any other measures that might seem impressive. Yet it says nothing about their maximization of the business’s potential or its long-term value and sustainability. One lesson learned since the Enron scandal (among a growing list of catastrophic corporate failures) is that profit performance often hides underlying underperformance and, more importantly, the hidden symptoms of degeneration in corporate governance that can have

detrimental consequences for every one of us.

The thinking behind the concept of *The Mature Corporation* asserts that organizations need not be hampered or distracted by any debate hinged on an apparent conflict between the two opposing constructs of social responsibility and profitability. Our analysis of corporate “performance” and accompanying narrative around societal value, provides compelling evidence for leaders and managers to pinpoint the falseness of this apparent dichotomy, and resolve the interminable debate once and for all. The mutuality of shareholder value and societal value should really be self-evident but those who have benefited most are likely to need stronger arguments and incentives if we are to engender the necessary changes. Businesses do not and cannot exist in a vacuum; they are populated by people who all have to reconcile their company’s profitability with their own, personal values. This includes those executives who feel the sheer weight of shareholder pressure warping any natural, human inclinations to do good and help humanity. We cannot suddenly expect them to develop the inner strength of character and determination to resist pressures that have been building up in the system over many decades. Neither can we expect the other leading actors such as accountants, lawyers and investors to change the basis of their calculations. Better to show them how to work on introducing more mature thinking without having to risk their own careers. Mature thinking may be an intrinsically value-based, essentially moral pursuit but it is also a pragmatic philosophy that allows time for change to occur naturally.

Under the present regime of shareholder primacy, executives have had to adopt multiple perspectives themselves as shareholders, employees, customers, ordinary citizens and parents, all of which vie for consideration and coherence. Every single one of us has to cope with these apparent conflicts in our daily lives. The British Airways executive who may want the extra runway at Heathrow should readily accept that their own living comes at the expense of someone else’s quality of life. The democratic process is the only way we have found to resolve these in-built contradictions and plot an acceptable course for the greater good, albeit imperfectly.

It is this symbiotic relationship between freedom, democracy and capitalism that was the main thrust behind Friedman’s piece but its logic and sense was lost when his argument turned into a polemic against what he saw as the threat of creeping socialism. In this sense, it is worth re-reading his paper,

in its entirety, right down to the very last word. Only then does it reveal its full meaning and import. Friedman's exact words, in his final paragraph, were later reiterated and enshrined in his book "Capitalism and Freedom" where he does indeed say that:

"... there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits ..."

but he finishes that same sentence with the all-important proviso....

"... so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."

Friedman was obviously supremely clever. Clever enough to realize that these few words would provide adequate defence in the face of any subsequent accusation that he was promoting immoral or unethical business practices. He was not. His words are classical, economic theory that would only be uttered by a professional, academic economist.

Apart from making a profit, all boards and their executives are being confronted, all at once, by a much wider range of challenges including environment, diversity, greater global competition and the threat of tighter regulation. Yet no one has handed them a ready-made, coherent framework in which to make consistently rational decisions in society's best interests. Should Nestlé continue to make profits out of selling bottled water and, if so, should they have to clean up the bottles that end up floating in the Pacific? There is no universally agreed socio-economic framework within which such decisions can cohere. This means anyone wanting to head down the most righteous path is likely to find it a lonely walk. CEOs of banks, especially over the last two decades, were allowed to make up their own rules on lending with the tacit approval of governments, legislators and regulators seeking economic growth. With the benefit of hindsight, Friedman, much like former Federal Reserve Chair Alan Greenspan¹⁵, would have invoked his own caveats and probably declared that all bets were off for anyone hoping to see the banks behaving responsibly. We are all still having to live with the long-term consequences of our failure to measure the long-term, societal value of corporations. In the meantime, Handelsbanken is not waiting for the world's lawmakers, it continues to be more valuable than all of the other banks, having had the courage of its own

¹⁵ <https://www.nytimes.com/2008/10/24/business/economy/24panel.html>

convictions. This theory is already proven at an individual, corporate level even within an immature corporate and capitalistic context. The challenge now is distilling these lessons into a more practical and digestible form that will encourage and facilitate replication of these essentials on a global scale.

We should also constantly remind ourselves, and the main protagonists, that the capitalist system is not confined to corporate CEOs and business regulators. Every single one of us, each with our own multi-perspective viewpoint and in concert, form the democratic capitalist system that seems to have become the dominant force in the global political economy. During Greece's economic meltdown in 2009 the pensioners who had to queue up to get enough cash to live¹⁶ had all been active players in their own game. The employees of the banks, that held their money, allowed themselves to behave in a way that was dictated by their masters, irrespective of whether their social consciences dictated otherwise. We have no choice today but to co-exist in the whole global system and our daily behaviours will always shape the system for better or worse. Trying to blame others is not just hypocritical, it is unhelpful. We should design the system to allow those with integrity and courage to lead and raise the alarm if necessary. We all have to reach agreement that the main purpose of the system is the maximisation of long-term value, not profit.

The Mature Corporation is not a call for another form of socialism but everyone's contribution has to be recognised in the never-ending pursuit of maximising our combined value. We might like to believe that there is already a global economic system in place but that would be a mis-reading of the signs. Look what happened to the "banking system" that was supposedly delivering stable financing. Our economic system cannot maximise our collective, value creating capability, unless everyone in it is actively encouraged and enabled to contribute as much value as their natural talents allow. If Friedman had expressed his own question in these terms then his prescription would have allowed profits and value to become synonymous. Friedman's vision of "responsible profit" does not conflict with the concept of societal value but he expressed it in a way that almost encouraged wilful misinterpretation and certainly facilitated the warped version of corporate behaviours that we still experience today.

¹⁶ <https://www.theguardian.com/world/2015/jul/01/greek-pensioners-queue-at-dawn-as-banks-allow-them-to-withdraw-120>

When profit becomes value

Tesla, as a young business operation, faces the same challenges. Whatever social mission it might be on, it became secondary to an increasingly desperate need to serve its financial masters. The investors who poured cash into the business in the belief that Elon Musk would be able to fulfil the promises he made to them, lost some of their faith. As a consequence, any humanity it embedded within its operations fast disappeared under the intensity of pressure to hit production targets and generate a profit. Not only did Musk's strategy demand that robots replace humans but the working environment became barely recognisable from the Silicon Valley oasis epitomised by the large tech firms, and from where Musk originally emerged. Pressure to deliver the numbers exerts pressure on people and damage is always the entirely predictable, outcome; as news reports and litigation against Tesla attest.¹⁷

Musk has not learned much about mature management from his experience to date. The increasingly fractious work environment he has helped to create at Tesla brought with it the prospect of regulatory punishment for bad behaviour. Regulators who resort to the law and punitive fines offer sticking plasters for immediate symptoms and do nothing to resolve the causes of such value destruction and poor corporate culture. The only long-term, sustainable solution is for the firm to become a mature corporation. Its first lesson is to better understand the nature of value and how the entirety of its human ecosystem connects to its creation. Musk finally admitted that he may have missed something in his management strategy by stating in an April 2018 tweet:

“Yes, excessive automation at Tesla was a mistake. To be precise, my mistake. Humans are underrated.”

If Tesla's founder is serious about rectifying his own error he needs to become open to learning and more mature in terms of his own leadership and management capabilities. Musk has to drive Tesla on a new, never-ending journey of increasing the maturity levels of everyone involved within the orbit of Tesla's corporate system. This is as much an education for his fellow investors as it is for him. The Mature Corporation is a whole system analysis, and everyone involved in that system has to understand its

¹⁷ https://www.buzzfeed.com/carolineodonovan/tesla-fremont-factory-injuries?utm_term=.umLKveZ29#.ge994Ov2p