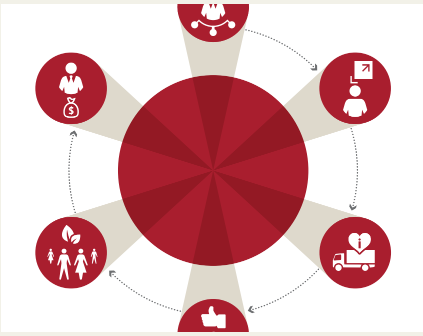
BearingPoint Institute



Repaying the stakeholder, not the shareholder

Business gurus Charles Hampden-Turner and Fons Trompenaars make the case for more sustainable business growth in this chapter summary from their new book *Capitalism with a conscience: how we can create wealth... not destroy it*

Would capitalism be better off if we all worried more about profitable relationships rather than the bottom line? Charles Hampden-Turner and Fons Trompenaars make the case for conscientious capitalism that focuses on stakeholders and benefits all.

What has capitalism become?

Over recent years, a major problem has emerged in the myopic way we think about capitalism – we prioritise shareholders whilst ignoring other stakeholders and focus on competition whilst forgetting cooperation. So, is there another way to think about how to do business?

An alternate view, 'conscious capitalism', recognises that no company can survive without a full complement of stakeholders: from employees, suppliers and partners, who create products and services; to customers, who must be satisfied; to society and the environment; and to investors, who are paid out of profits.[1]

While adopting such an approach may sound like a distraction to hard-nosed business strategists, the numbers do stack up. In the book *Firms of endearment: how world-class companies profit from passion and purpose*[2], the authors looked first for passion, not profitability. Even though profit was not the prime motivation, the shortlist of 28 'endearing' companies achieved returns on investment of 1,026% between 1996–2006 a ratio of 8:1 compared to Standard & Poor's (S&P) 500 stocks (see figure 1).

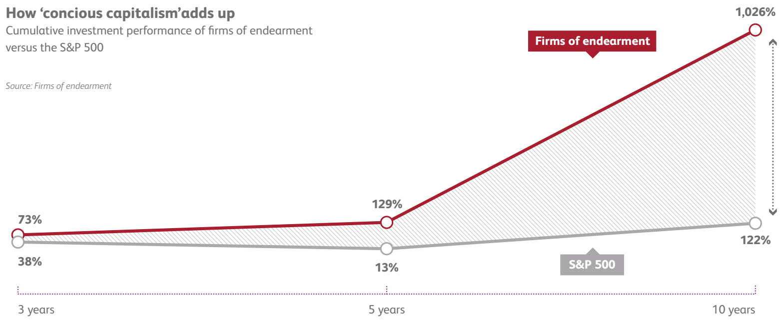
To understand how ROIs of this magnitude can be achieved, we must consider the role of each stakeholder as part of an overall business cycle, which runs from visionary leadership to satisfying the investors' needs.

IN 30 SECONDS

- The authors make a plea to consider all stakeholders, rather than just shareholders
- The future will favour companies that engage best with customers, partners and other stakeholders, say Charles Hampden-Turner and Fons Trompenaars
- Conscious capitalism is led by conscious leaders, who elicit commitment from stakeholders, catalyse innovation and engage customers
- The benefit is seen on the bottom line; firms of endearment outperformed the S&P 500 by 8:1 between 1996–2006

8x Return on investment was eight times greater for firms of endearment after ten years compared to the S&P 500

Figure 1: Firms of endearment are high-performance businesses
Firms of endearments' return on investment grew eight times faster than the S&P 500 between 1996–2006



As figure 2 shows, until other stakeholders have performed their roles, companies have no revenue for investors. We can decree that shareholders deserve the rewards of success, but other stakeholders must each excel in turn. The remainder of this article examines each of the stakeholder groups in the cycle to understand the part they have to play.

The conscious leader's higher purpose

One characteristic that defines conscious leaders is an appeal to their businesses to serve and strive for a higher purpose. This active policy elicits commitment from all stakeholders, catalyses innovation and engages customers. For example, during Bill George's time as CEO at Medtronic, the company grew from USD 1.1 billion to USD 60 billion.[3] This financial growth was never its prime purpose, however. The company's pacemaker products gave ten million people many extra years of life. Patients would give positive testimonials at every company conference, as would relatives and clinicians.

A second 'higher' objective is stakeholder integration, aimed at win–win relationships rather than a zero-sum game where if one party gains, another must lose. For example, if you pay your employees a better salary, you will recruit a higher calibre of person who stays longer and develops their skills further. Jordan's Furniture pays 15–20% above the industry norm, but sales per square foot are six times above the average of their competitors.[5]

A third characteristic is fostering a workplace culture that confirms and upholds corporate values. Culture and values guide all staff in being accountable for their promises and actions, in being loyal to the company's purposes and in treating people with respect. A culture where people trust each other is demonstrably superior to one where they do not, and incredibly less costly.

Successful leaders lead with the heart, not just the head. They possess qualities like empathy, compassion and courage. They also have the ability to establish deep, long-term and genuine relationships where others trust them.[4]

BILL GEORGE, CEO, MEDTRONICS, 1991–2001

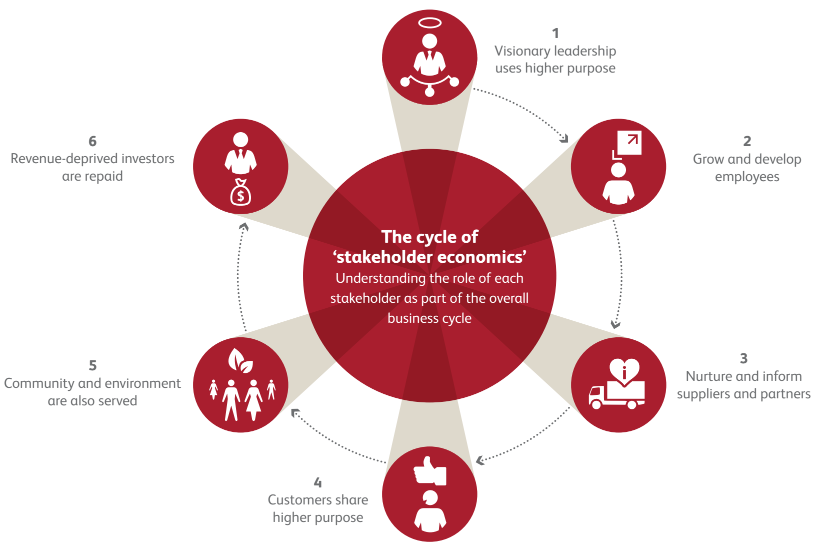
Growing and developing employees

A worldwide Gallup poll found the chief determinant of human happiness was employment in a meaningful job working alongside colleagues that were cared about.[6] This is unsurprising, as we spend one-third of our waking hours at work. However, a Conference Board survey found only 50% of Americans were satisfied with their jobs.

Work can be treated as a 'job', a 'career' or a 'calling'; companies found on the firms of endearment shortlist insist upon the latter, therefore training their people assiduously. For example, The Container Store, repeatedly voted as among the top 100 companies to work for in *FORTUNE* magazine, spends more than thirty times as much on training as the industry average.

Johnson & Johnson decided it was cheaper to keep people healthy than pay the costs of sickness. Their wellness programme actually made money by reducing medical premiums and staff absences from work. Every dollar spent earned an extra USD 1.71 in reduced costs.[7]

Figure 2: The five stages of the 'stakeholder economics' cycle
Investors can only reap rewards once each stage of the cycle has been fulfilled



EUR **182 million** The estimated amount Johnson & Johnson saved on healthcare costs through their employee wellness programme between 2002–08[7]

If you serve your community, your employees will be enthused, your customers grateful and your business will prosper

Nurturing and informing suppliers

While supplier performance is crucial to product and service delivery, organisations frequently assume that suppliers should be paid as little as possible, as late as possible. Lack of cash flow has wiped out more small businesses than any other cause.[9]

A salutary example is General Motors, which gouged USD 4 billion from suppliers in 1992–93. Wall Street applauded the strategy, but GM's suppliers began to cut quality, reduce service levels, cut back on R&D and pressurize their own suppliers. Some of GM's suppliers even reduced their exposure by switching customers, no longer supplying GM with goods and services. For GM, bankruptcy was merely a matter of time.

Conscious companies behave quite differently. Whole Foods' tens of thousands of suppliers are partners in every sense of the word. Nurturing small companies is vital to inspiring original thinking and to encouraging better land use and sustainability. The company sponsors pilot projects to be undertaken by suppliers, providing data from stores to guide strategy.[10]

The partnership concept also spreads to trade unions. Southwest Airlines, whose success despite the troubles within the industry is legendary, is among the most unionised airlines in the USA. However it agreed a ten-year contract with the Southwest Airline Pilots' Association in 1995, freezing pilots' wages for five years in exchange for stock options.[11]

Serving and delighting customers with that higher purpose

Many customers just want the product at low cost, but an increasing number choose to shop with companies whose values and wares mean something beyond price. While a trillion dollars a year is spent on advertising in the USA, a surprising aspect of conscious companies is how relatively little they spend – a higher purpose needs no jingles.

Conscious companies often support legal contracts with suppliers and buyers with often-unspoken emotional contracts that are based on trust. For example, a supplier of pizza ovens to restaurants had the idea of replacing ovens at any time during the first two years. Lawyers warned that restaurants would turn in old ovens, however well they worked, and demand new ones. The lawyers were correct, but less than 1% of customers did this, whereas the offer inspired trust and confidence for the remaining restaurants.

The most credible advertising of all is word of mouth from grateful customers, which is worth a hundred intrusive commercials. Social media amplifies word of mouth, further deepening emotional relations between companies and customers.

Growth of companies with cultures including all stakeholders, compared to 166% for others[20]

682%

Sustaining the community and society at large

The opposition to corporate social responsibility (CSR) is that the money belongs to shareholders rather than businesses. As a result many CSR programmes function as appendices to the main purpose of making money. This is myopic rather than wrong. If you serve your community, your employees will be enthused, your customers grateful and your business will prosper. Most CSR practices cost little and gain much.

The essence of conscious capitalism is that serving the community should be part of corporate strategy, for shared benefit. For example, IBM has created a Corporate Service Corps in which volunteers use their skills to help emerging economies. The initiative is designed not just to help the poor but develop IBM's future leaders.[12]

Conscious companies differ significantly in their attitude to tax. In 1943, US corporations paid 39.8% of their profits in corporate taxes.[13] In 2002, the General Accounting Office revealed that 61% of US corporations paid no corporate tax at all in the period 1996–2000.[14] In the period 1996–2004 however, average payment for firms of endearment was 33%.[15]

Repaying and enriching investors

There are serious costs in shareholders asking for profits to rise quarter by quarter. Nearly everything that pays off in the long term has costs in the short-term. The reverse is also true. Most things that pay off short-term have long-term costs. As a result, corporate lifespans are getting shorter. We work our companies to death and discard the people inside them.

This explains the extraordinary mortality among companies classed by commentators as 'good to great'.[16] Picked for their profitability, their 'good' or 'great' results were gained at the expense of other stakeholders. For example, Kroger, the retail chain was designated 'great' in 2001, but had lost over half its stock price six years later.[17]

It is easy to manage short-term rises in share price to hit a quarterly goal. Off-shoring of labour, stealthy cuts in quality, and small price rises all release equity. A study by the US National Bureau for Economic Research found 80% of executives would cut R&D and marketing expenses to hit quarterly targets, even if this would hurt the company.[18]

So how do conscious companies fare? As we saw, firms of endearment beat S&P 500 averages by a ratio of 8:1 over a ten-year period. This isn't a one-off study: a research project at Harvard Business School selected 207 large US companies, focusing upon 'strong and flexible business cultures that included all stakeholders.'[19] These hugely outperformed a sample of companies that lacked these features, for example by a revenue growth of 682% as against 166%.[20]

WHAT ARE FIRMS OF ENDEARMENT?[21]

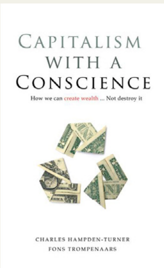
- Help people find self-actualisation
- Contribute to capitalism's radical transformation
- Create happy, productive working environments
- Unspoken, emotional contracts are honoured
- Partner relationships are mutually beneficial
- Communities enthusiastically welcome them
- All stakeholders win, including investors

Conclusion

Whilst financial analysts may assume that shareholder value must be captured from other participants, profitability targets or the attempt by shareholders to wrest money from other stakeholders, this can prove counter-productive. All stakeholders create wealth: win–win relationships can create abundance for all parties.

We have a metaphor for maximising profits for just one stakeholder. If any part of a cybernetic system insists on growing at the expense of other parts, the system will atrophy then collapse. In this sense shareholders act like aggressive cancer cells, killing the host body on which they rely. In business terms, this strategy is not only foolish, it is suicidal.

BOOK SUMMARY: *CAPITALISM WITH A CONSCIENCE: HOW TO CREATE WEALTH... NOT DESTROY IT*



Has traditional capitalism gone as far as it can go? Western businesses are driven by shareholders who will quickly back another horse if their investments do not deliver, which drives organisations towards reductionist strategies that sacrifice longer-term gain on the altar of quarterly profits.

The good news is that all is not lost. Organisations can learn from sources as wide ranging as Eastern philosophy and business practices, US stakeholder cooperation models, and European, family-run businesses. All these examples show that significant longer-term gains can be made to the benefit of all parties, not just a small group of disinterested financiers.

In this carefully researched book, authors Charles Hampden-Turner and Fons Trompenaars set out a future that is both inclusive and profitable, balancing immediate needs with more sustainable growth. As the business landscape becomes increasingly diverse and interdependent, it will favour companies that engage best with customers, partners and other stakeholders.

Capitalism with a conscience will be published in May 2014. See more details here: http://inst.be/ext-SHE

About the authors

Charles Hampden-Turner is a leading thinker and author on the paradoxical nature of value creation and the creator of Dilemma Theory. For the last few years, Charles has been the Director of Research and Development for Trompenaars Hampden-Turner. He is also a Senior Research Associate at the Judge Institute of Management Studies at Cambridge University and a Fellow of the Cybernetics Society.

Fons Trompenaars is recognised around the globe for his work as a consultant, trainer, motivational speaker and author of various books on all subjects of culture and business. As Founder and Director of Trompenaars Hampden-Turner, he has spent over 20 years helping Fortune 500 leaders manage and solve their business and cultural dilemmas to increase global effectiveness and performance and is regularly listed as one of the world's most influential management thinkers.

Notes

1. *Capitalism with a conscience,* Elliott & Thompson, London, UK, Charles Hampden-Turner and Fons Trompenaars, 15/05/14, http://inst.be/ext-SHE
2. *Firms of endearment: how world-class companies profit from passion and purpose* 2nd Ed, Pearson, London, UK, Rajendra S Sisodia, David B Wolfe and Jagdish N Sheth, 2nd edition 09/02/14, http://amzn.to/NcDphM
3. 'Incentive interview with Bill George: true leader', *Incentive magazine*, Lori Becker, 08/10/07, http://bit.ly/1eeOj0K
4. 'Incentive interview with Bill George: true leader', *Incentive*, Northstar Travel Media, Secaucus, NJ, USA, web, Lori Becker, 08/10/07, http://bit.ly/1eeOj0K
5. 'Jordan Furniture Shoppertainment', *Professor Michael Roberto's Blog*, Blogger, web, Michael Roberto, 27/10/09, http://bit.ly/1ezzXUb
6. *The coming jobs war,* Gallup Press, New York, USA, Jim Clifton, 27/10/11, http://amzn.to/1fwq2id
7. 'Creating shared value', *Harvard Business Review*, Michael Porter and M R Kramer, 01/01/11, http://bit.ly/NcETbD. The *Harvard Business Review* requires registration to access articles
8. Creating Shared Value', *Harvard Business Review*, Michael Porter and M R Kramer, Jan-Feb 2011, http://bit.ly/NcETbD
9. Read more about nurturing suppliers: 'Will your suppliers turn from strategic to catastrophic?, *BearingPoint Institute Report 004*, London, UK, Patrick Palmgren, 23/04/14, http://inst.be/004ST
10. *Conscious capitalism: liberating the heroic spirit of business,* Harvard Business Review Press, Boston, MA, USA, pp. 113–14, John Mackey and Rajendra S Sisodia, 23/01/14, http://amzn.to/1dJucUl
11. *Southwest Airlines crazy recipe for business and personal success,* Crown Business, New York, USA, pp. 101–2, Kevin Freiberg and Jackie Freiberg, reprint edition 17/02/98, http://amzn.to/1eGL4uo
12. 'IBM offers employees new "learning accounts" and global training programs', *InformationWeek*, San Francisco, CA, USA, web, Marianne K McGee, 26/07/07, http://ubm.io/1o8hx2h
13. *Firms of endearment: how world-class companies profit from passion and purpose,* Prentice Hall, London, UK, Rajendra S Sisodia, David B Wolfe and Jagdish N Sheth, 1st edition 31/01/07, http://amzn.to/NcDphM
14. *Firms of endearment: how world-class companies profit from passion and purpose,* Pearson, London, UK, Rajendra S Sisodia, David B Wolfe and Jagdish N Sheth, 2nd edition 09/02/14, http://amzn.to/NcDphM
15. *Firms of endearment: how world-class companies profit from passion and purpose,* Pearson, London, UK, Rajendra S Sisodia, David B Wolfe and Jagdish N Sheth, 2nd edition 09/02/14, http://amzn.to/NcDphM
16. *Conscious capitalism: liberating the heroic spirit of business,* Harvard Business Review Press, Boston, MA, USA, pp. 113–14, John Mackey and Rajendra S Sisodia, 23/01/14, http://amzn.to/1dJucUl
17. *Good to great: why some companies make the leap... and others don't,* Random House Business, London, UK, Jim Collins, 04/10/01, http://amzn.to/1cGQ8oe
18. *Good to great: why some companies make the leap... and others don't,* Random House Business, London, UK, Jim Collins, 04/10/01, pp 282-4, http://amzn.to/1cGQ8oe
19. 'How to escape the short-term trap', *McKinsey Quarterly*, McKinsey & Company, New York, USA, web, Ian Davis, 11/04/05 http://bit.ly/1hAqOzW. Download article from University of Verona archive: http://bit.ly/1oUW65c
20. *Corporate culture and performance,* Free Press, New York, USA, John P Kotter and James L Heskett, reprint edition 01/05/11, http://amzn.to/MBGlmZ
21. *Firms of endearment: how world-class companies profit from passion and purpose*, Pearson, London, UK, Rajendra S Sisodia, David B Wolfe and Jagdish N Sheth, 2nd edition 09/02/14, http://amzn.to/NcDphM

LEADERSHIP TEAM

Per Jacobsson, BearingPoint
Ludovic Leforestier, BearingPoint
Mike Kronfellner, BearingPoint

ADVISORY BOARD

Denis Delmas
President of TNS Sofres,
Vice-President Europe and Board member of TNS Group

Dr Jonathan Freeman
Managing Director, i2 media research ltd. & Senior Lecturer, Goldsmiths, University of London

Prof Dr Fons Trompenaars
Founder and owner, THT Consulting

Dr Victor Vroom
Professor of Management and Professor of Psychology, Yale School Management

EDITORIAL COMMITTEE

Eric Falque, BearingPoint
Kai Waechter, BearingPoint
Nick Dussuyer, BearingPoint
Anna Lindholtz, BearingPoint
Jean-Michel Huet, BearingPoint
Sergey Tkachenko, BearingPoint
Robert Bosch, BearingPoint

PRODUCTION

Michael Agar, Michael Agar Design
Thomas Clarke, BearingPoint
Jon Collins, Inter Orbis
Chris Norris, CopyGhosting
Angelique Tourneux, BearingPoint

About BearingPoint

BearingPoint consultants understand that the world of business changes constantly and that the resulting complexities demand intelligent and adaptive solutions. Our clients, whether in commercial or financial industries or in government, experience real results when they work with us. We combine industry, operational and technology skills with relevant proprietary and other assets in order to tailor solutions for each client's individual challenges. This adaptive approach is at the heart of our culture and has led to long-standing relationships with many of the world's leading companies and organizations. Our 3500 people, together with our global consulting network serve clients in more than 70 countries and engage with them for measurable results and long-lasting success.

www.bearingpoint.com

About BearingPoint Institute

At the BearingPoint Institute, our ambition goes beyond traditional 'thought leadership'. We aim to contribute original ideas to the science of business management while equipping decision makers with practical advice gained in the field and through our research projects.

www.bearingpointinstitute.com

Share your thoughts

Every change we make at the institute is with our readers in mind. Please share your opinions with us so we can work to make these reports as good as they can possibly be.
Visit inst.be/feedback or just send an email to editor@bearingpointinstitute.com

DOWNLOAD

Read the BearingPoint Institute on your tablet with the mobile app:

- iOS version from the iTunes AppStore
- Android app on Google Play
- Amazon Kindle (Fire only) store

(to guarantee a good reading experience, these apps are for tablets only)

BEI004-SHE

BearingPoint® Institute