The Six NEW RULES of BUSINESS

Creating Real Value in a Changing World

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To Lynn Stout (1957–2018)—whose scholarship and teaching about corporate governance and fiduciary duty opened our minds about corporate *purpose*—and to the many scholars and advocates she mentored who will go the next mile.

The future is already here—it is just not very evenly distributed.

—WILLIAM GIBSON

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Preface

None of the major problems confronting the globe today—
sustainability, health care, poverty, financial-system repair—
can be solved unless business plays a significant role.
—NITIN NOHRIA, DEAN, HARVARD BUSINESS SCHOOL

IT WAS DURING MY TIME at the Ford Foundation that I began to think concretely about corporations and the role and influence of the private sector.

In 1995, at a meeting of the foundation's trustees, I was asked a question for which I didn't have an answer: *Why doesn't anyone at the Ford Foundation talk about business?* The capacities and resources of the companies led by some of the foundation's trustees dwarfed our own: Cummins Engine, Levi Strauss, Reuters, Tata, Xerox. *Could we better enlist business in our work?*

It was a nose-under-the-tent moment from which I've never pulled back.

My colleagues and I began to study businesses that had followed a path or had a track record that connected with the foundation's mission of economic development. The business leaders we took note of in 1995 were influenced by myriad forces—from the personal to the political. Something had caused each of them to embrace the social impacts of their business model. They saw business opportunity in unusual places. A catalytic event or regulation or strong vision or moral code enabled a kind of business and society thinking that aligned a part of their operations or capital with the health of the commons.

At Levi Strauss, the founding family's values supported long-term investment in the communities where it manufactured jeans. Bank of America was brought to the table by the Community Reinvestment Act, a law passed in 1977 that required banks to reinvest in communities where they sourced deposits; community bankers began to understand the mechanics and strategy behind targeted lending to support the real economic potential of the inner city. An aggressive NGO-led campaign forced Nike to scrub its supply chain of sweatshop labor practices, which in turn inspired the company to go the extra mile and raise the bar on its industry and competitors. Texas Instruments found competitive advantage in a racially diverse workforce that mirrored the demographics of its state—and its future customers.

In each case, the mindset or personal engagement of the chief executive was instrumental in aligning the culture with creation of real business value. By moral code or necessity, or both, they were able to overcome, or interpret differently, the single objective function of profit maximization to consider both long-term risk and opportunity.

It was as if these leaders were playing the game by a different set of rules.

Today the pace of change in business is dizzying. It exposes reputational fault lines for companies that stick with the old rules. Dynamic forces—from Internet-powered transparency to profound changes in the role of capital to the complexity of global exchange of goods and services—conspire to clarify the new rules of value creation and put the old rules to rest.

Business is the most influential institution of our day. We need business's talent, investment, problem-solving skills, and global reach to make progress on intractable problems from climate change to inequality to equipping workers for a new age of work. This lens on business does not override the need for government regulation and public investment. Indeed, business is a powerful influencer of public policy as well. To what ends is business using its voice?

In 2018, Larry Fink, founder and chief executive of BlackRock, the world's largest asset management company, called for CEOs to consider the public purpose of their enterprises. He was echoing decades of work by scholars and advocates, posing a near-timeless question: Why do we grant corporations the license to operate? Fink's consistent message demonstrates just how much the rules of the game have changed in the last decade—and especially since economist Milton Friedman proclaimed profit seeking and returns to shareholders the organizing principle of the corporation.

Friedman has a long shadow. He and his acolytes were so successful in their quest to reorient managers that by the early 2000s, over 90 percent of earnings for the public companies in the S&P 500 were redistributed to owners of stock in the form of share buybacks and dividends rather than invested in expansion or awarded to the employees who bore real risk of business failure. Short-term noise in the markets and simplistic financial models ensured that a range of critical business issues that were threats to social stability and the biosphere stayed confined to the ethics classroom. Our vision of business is crowded with stories of greed laced with short-term thinking, from Wells Fargo to Purdue Pharma, VW to Boeing.

Yet, as we step into the ecosystem of business today, we experience profound change in attitudes and a new kind of business vision. The new rules are utilized both by employees driving change within and by sophisticated NGOs that target global brands vulnerable to extended supply chains. The rules are also making headway in boardrooms animated by self-interest—even self-preservation—from the war for talent to the quest for a reliable supply chain to the reality of a changing climate. *The new rules have staying power.*

This book is for executives, but also for those who advise business leaders or aim to influence business corporations, in order to repair damage done and ensure that business is fit for the future. In the first six chapters, we explore six trends—six new rules—and the forcing functions that are picking up the pace of change. The instruments of change are forged by the tech-and-social-media-enabled collective voice, which in turn amplifies risk, opportunity, and shifting business imperatives. Norms that influence the mindset and instincts of business leaders unquestionably have shifted, but there is still work to do. In chapters 7 and 8, we look at the road ahead—the parts of the system that reinforce the status quo and are most resistant to change.

What is needed now are a fundamental rethinking of the decision rules and a breaking down of old norms that are holding us back, from how finance classrooms teach valuation to how executives are compelled to focus on the stock price through incentives and rewards. Design for the future requires business models that value the real contributors—including workers *and* nature—and that pay dividends on the public's license to operate.

The new rules of business are the starting point for restoring trust in an institution that contributes immeasurably to much that we take for granted and depend on. The new rules are the key to real value creation and a sustainable future.

INTRODUCTION

The Cost of Ignoring the New Rules of Real Value Creation

It's all a question of story. We are in trouble just now because we do not have a good story. We are in between stories. The Old Story—the account of how the world came to be and how we fit into it—is not functioning properly, and we have not learned the New Story.

—THOMAS BERRY, "THE NEW STORY"

IN 1999, THE *NEW YORK TIMES* chronicled the egregious behavior of the Royal Caribbean cruise line. The company, founded in Norway but based in Florida, was censored for dumping toxic waste and spent fuel in the Caribbean Sea and US coastal waters, endangering the coral reefs, beaches, and sea life that their customers book passage to enjoy.

Before ships set sail, the waste containment system is inspected, so the dumping was clearly intentional. Dumping spent fuel lightens the load, saves fuel costs, and avoids waste disposal fees back in port. It also endangers the ecosystem and is a clear violation of the public trust. The actions for which Royal Caribbean was censured put both the company's long-term interests and reputation at risk.

What was the ship engineer thinking? Why risk tarnishing your own brand to save money today?

A TALE OF A SYSTEM GONE WRONG: FROM ROYAL CARIBBEAN TO BOEING

Fast-forward to 2016, when James Robert Liang became the first Volkswagen employee to admit guilt in the company's rogue program to undermine government emission standards. For Liang and others at VW, the constraints on emissions signaled the need to innovate—not by building a better diesel engine, but by designing and installing software to fake the real emission levels during testing.

The VW story was shocking when it broke, but also mystifying. How long did they expect to keep the deception secret? By the time of Liang's admission of guilt, the company had already paid out $15 billion in penalties and even greater claims, and lawsuits were piling up in both the United States and the far larger European market.

And Boeing may never fully recover from the deadly consequences of a culture driving too hard toward the bottom line. In April 2020, as the coronavirus roiled the airline industry, Boeing announced that customers had canceled orders for 150 of its best-selling plane, the 737 Max. By then, the plane had been grounded for over a year as the company worked to fix the ill-designed operating system that was linked to two airline crashes—hundreds of lives, and the trust of pilots in Boeing itself, destroyed. The sidelining of those assets resulted in hundreds of flights being canceled each day at the peak of the 2019 summer travel season. A $4.9 billion charge against earnings was just the first step in assessing the cost of the business failure—the opening pitch in the game of blame and valuation of lives lost that will proceed over years, if not decades.

Tell me which of the pressing issues of our time keep you awake at night, and I will tell you how the old rules of profit maximization and short-term thinking contribute to those problems.

Globe-hopping brands with big footprints and deep supply chains and the extensive reach of industry, technology, and commerce touch virtually every aspect of our lives. Climate change is a product of industrial processes. It is a problem with unimaginable consequences that cannot be solved without collective action; it now tops the list of global concerns. We can easily connect the dots between consumers shopping on the basis of price, low-cost labor markets, and the working conditions where human rights violations and even human trafficking persist. The economics of overconsumption and unsustainable growth create boom-and-bust cycles that favor some but push others to the side. Marketing of unhealthy products. Tax avoidance. Obesity. Our infatuation with guns. Food waste. Deforestation. Pervasive inequality and its consequences.

For good or for ill (and it's both), global business—talent-rich, capacious, and connected—is the most influential institution of our age, akin to the Church in the Middle Ages. Clues to the power of business are found in daily headlines and in politics.

We need a new script.

This book offers a different—and more useful—set of rules that can transform the game of business. And it provides stories about how the game is already changing according to the new rules.

The rules followed by corporations aren't set in one place, like the Vatican. They emerge from Congress, regulatory agencies, and trade associations. They are set by investors with different time frames and definitions of a fair return on investment (ROI), and by outside activists, internal agitators, and purchasing agents who are under pressure to redefine the narrative about business success. *But, ultimately, they emerge from business itself*—they are a function of embedded assumptions, decision rules, protocols, and incentive systems that shape intentions and behavior.

Yet, it is also true that the rules and expectations that companies choose to follow are unquestionably tied to the belief that shareholders own the firm and that clarity of managing to a single objective of shareholder value leaves us all better off. The evidence to the contrary is overwhelming, but systems change is hard, especially when the ideology is reinforced by the tenure system in classrooms and myriad forces in boardrooms.

The old rules derive from the power of the shareholder mindset. The new ones are derivative of the change that is enabled when other, more powerful contributors to value creation are revealed. The threads of this conversation about corporate purpose are woven throughout the rules that mark the chapters of this book.

The underlying narrative about the purpose of the corporation, and the practices and mindset that give shareholder primacy its power, are giving way, at last, to the reality that business and society are truly codependent. New, future-oriented sources of power and influence are already affecting the game, and a new cadre of business leaders are redefining business success. Business schools are catching up with boardrooms wrestling with a new road map—one that points the way to new measures of progress and is consistent with the values of the new generation preparing to lead.

THE COST OF IGNORING THE NEW RULES OF VALUE CREATION

The stories of Royal Caribbean, and VW and Boeing, follow a similar line. To dump waste carries some risk, but it is guaranteed to reduce the cost of doing business and keep prices low to consumers. The ship's engineer was likely rewarded for finding a way to cut costs. The engineers at VW cared about the environment, but the rules and incentives that defined the culture were principally designed to grow market share. Boeing scuttled protocols and silenced contrary voices in the campaign to beat Airbus. Wells Fargo maxed revenues by creating the conditions for account managers to push products onto unwitting customers. Goldman Sachs and JPMorgan Chase created innovative securities for the mortgage market that purported to shield investors from risk (they did not) and helped fuel the housing bubble and subsequent mortgage meltdown of 2008.

And before all of these examples became front-page news, there was Enron, a high-performing stock in the late '90s that proved to be a house of cards and spectacularly collapsed in 2001.

Enron failed several years into the design of a program I founded in 1998 with a grant from the Ford Foundation to support fresh thinking about the role of corporations in both classrooms and boardrooms. I chose the Aspen Institute, founded by a Chicago industrialist in 1949 and known for problem-solving through dialogue and leadership development, as the program's home.

A decade earlier, in 1989, I had left a job at Bankers Trust as a lender to manufacturers and importers of apparel to join Ford's Program-Related Investments division. As the head of Ford's venture in what today would be called "impact investing," I oversaw a $100 million portfolio of loans and investments structured to encourage banks and insurance companies, from Allstate to Bank of America, to coinvest in community-based economic development.

My territory at Ford was a big leap from New York's garment center. I visited US-operated factories in El Paso's neighboring city Juarez, Mexico, and villages in Bangladesh experimenting with microcredit, as well as US locations from Arkansas to rural Maine to inner-city Cleveland. The globally astute members of the foundation's board included corporate titans like David Kearns of Xerox, Ratan Tata of Tata Industries, Henry Schacht of Cummins Engine, and Bob Haas of Levi Strauss.

These trustees were at home with the intentions of the program and didn't question the risks we took. Instead, they posed questions that caused us to consider a peculiar divide between the foundation's work and its origins. We were investing and spending Henry Ford's vast wealth without pausing to think about how it had been created.

With seven years of banking under my belt, I understood that at Ford we were working in the shadows of business but without directly considering the private sector's role and impact on the foundation's mission of expanding economic opportunity in the United States and globally.

When I began the Business and Society Program at the Aspen Institute, we started by probing the connections between how leaders think about their responsibilities and the attitudes imparted by teaching in business classrooms. It was the heyday of the MBA; rising executives all seemed to come through business schools.

The demise of Enron seemed to happen overnight. It occurred while my colleagues and I were testing a format for dialogue among business leaders that over several years included Ken Lay, the CEO of Enron; and executives from Shell, McKinsey, PwC, BlackRock, General Dynamics, Cummins Engine, and Pepsi. As we headed home to New York from our conference center in Aspen, Colorado, the attacks on the Twin Towers reverberated through the markets and permanently reset our worldview.

The events that followed from the World Trade Center on September 11, 2001, and the failure of Enron that fall will always be conflated in my mind. Enron died by a host of decisions that enabled it to dominate key markets and to prop up earnings per share. The old rules of profit maximization that governed Enron enriched some but ultimately failed all of us.

It's time for a new set of rules.

The old rules paid off, at least for a while. This book is about the changes—the forces that are conspiring both inside businesses and in the business ecosystem—that enable executives to think and manage differently. It is about the consequences for businesses that fail to embrace the new rules, and a new definition of business success.

Sociologists talk about the scripts that guide human behavior—the interplay of intentions and decisions that look obscene when exposed but are, in fact, cultural norms. The engineers and professionals and managers at Enron, VW, and Boeing were not malcontents laying the seeds of the company's own destruction; they were operating within the protocols of their companies and within highly competitive industries.

Public capital markets are complicit. With all of the attention paid to so-called socially responsible investors, the stock price still falls when a business invests in public goods—for example, when a tech company announces that it is adding jobs; or a drug company spends on R&D without an immediate payback; or a consumer product company, like Pepsi, or a retailer, like CVS or Walmart, reduces its exposure to a product with a profound social cost that contributes a lot to the bottom line. When Pepsi cut marketing budgets for regular soda to make room for "good for you" drinks and snacks, it paid the price on Wall Street. In chapter 3, we see that Pepsi ultimately gave in to these pressures but continued to build a portfolio of healthier products for which it is also known.

The playing field is complex. But *the corporation itself is not moral or immoral*—it is not good or bad like a person—rather, the decisions made by the company are what have good or bad results. And the decisions are a function of the rules and incentives and metrics that influence behavior in the executive suite and on the shop floor. The rules are set by leaders—they reflect what the leaders believe to be true and what they value. To move the needle on the problems that keep us awake at night, to break this vicious circle, we need to change how business leaders—and their counterparts in finance—think and act.

In the early 2000s, in the wake of Enron's demise, the highly respected dean of the Kellogg School of Management, Don Jacobs, announced a new screening process to weed out the "bad apples" before they enrolled. But we don't fix the system by closing the gates at Kellogg or Harvard, or by sending midlevel engineers from VW or top executives of Enron to prison, as necessary or satisfying as that may be. We need to unravel the rules of the road under which the decisions of the executives of Enron—and a host of players revealed since—make sense.

The first step is to look deeply into the business system and how the core assumptions and dominant beliefs—the mindset of the executive—are shaped and reinforced and in turn shape the incentives for the middle managers, the engineers, and the CFOs.

NEW RULES: REAL VALUE

Chapter 1 examines the first of six new rules that are already influencing these assumptions and the conduct of business. Behind Rule