Three chapters from

Steve Denning's forthcoming book:

Provisional title:

Capitalism's Future Is Already Here

Introduction

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"The future is already here. It's just very unevenly distributed."

William Gibson

"A civilizing process is one in which some existing need or impulse develops well so that it serves our higher, nobler longings. Conversation is the civilization of speech; love is the civilization of sex; friendship is the civilization of loyalty. One extremely powerful existing impulse, or need, is towards material prosperity. But if we see this as the equivalent of speech or sex, what would the drive to material prosperity look like if it were civilized? The civilization of that drive would not diminish it, but would make it stronger, more important, more valuable to us; but what sort of development, what sort of process of transformation, would bring this about, and where would it lead us?"

John Armstrong, *In Search Of Civilization*

"If at first the idea is not absurd, then there is no hope for it."

Albert Einstein

Introduction

In the early 16th Century, the movement objecting to the flagrant greed and corruption in the Roman Catholic Church, now known as the Protestant Reformation, got under way in earnest. In 1517 in Germany, Martin Luther posted his “Ninety-Five Theses.” At about the same time in Switzerland, Huldrych Zwingli launched a reform movement with a remarkably similar set of “Sixty-Seven Conclusions.” The recently-introduced printing press helped spread these ideas rapidly from place to place, but unresolved differences kept the reform movements separate. At the time, the prospects of reform looked remote, as the Church, most governments, the ruling classes and civil society supported the continuance of the status quo, despite the widespread abuses.

In 1529, the German Prince Philip of Hesse saw potential in creating an alliance between Luther and Zwingli, realizing the strength of a united Protestant front to fight the entrenched elite. He convened a meeting, now known as the infamous Colloquy of Marburg. At the gathering, Luther and Zwingli agreed on everything except one thing: was Jesus Christ spiritually present at a mass? Zwingli asserted no, while Luther insisted yes. In the debate, Luther became so angry that he carved his rejection into a table in the meeting room.

The Colloquy of Marburg broke down and the Reformation proceeded in a halting and fragmented fashion for more than a hundred years. Doctrinal differences that in retrospect seem minuscule in comparison to the extensive common ground prevented a united Protestant front. With the wisdom of hindsight, we can see that if these leaders had been able to set aside their differences and explicitly recognize the issues on which they did agree, the Reformation could have moved much faster. As so often happens, the best had become the enemy of the good.

These events are worth remembering at a time when many voices from all parts of the political spectrum are calling for change in the financially destructive behavior of capitalism today. Many thought leaders are calling for fundamental change not only of management but also of the entire economy in which managers operate. Thus in June 2014, Clayton Christensen and Derek van Bever wrote in Harvard Business Review: “The orthodoxies governing finance are so entrenched that we almost need a modern-day Martin Luther to articulate the need for change.”[1]

Christensen and van Bever are not alone. Leading pro-business journals such as Harvard Business Review, The Economist, Financial Times, The New York Times, the Wall Street Journal, the Washington Post and Forbes.com, have all published articles denouncing key management practices and calling for major change.[2] These voices articulate the need for reform, much more clearly and specifically than the heartfelt cries that came from the Occupy Wall Street movement just a few years ago.

As the prospect emerges a turning point in management, and indeed in capitalism as a whole, somewhat analogous to the religious Reformation five centuries ago, the question arises: will the many voices for change be able to reach agreement on the way forward and generate an united front for change, or will they, as at the Colloquy of Marburg in 1529, splinter into different factions, as those urging change emphasize their own particular slant on the issues, with the obvious common ground among them being lost in the din of heated debate on tiny doctrinal issues?

A tale of two economies

The good news is that while some parts of the economy are systematically destroying economic value, the reformation of capitalism is already well under way. We already know what it looks like. Two very different economies have been operating side-by-side for some time.

One economy—the Traditional Economy--is the economy that we inherited from the 20th Century. It's still large and rich and often efficient. But it's less and less able to capture the gains of its efficiencies. It's not generating widespread prosperity. Its superficial profitability, built on cheap government money and financial engineering, is unsustainable. In the effort to continue its current modus operandi, further abuses and malfunctions have been occurring. Value is being systematically destroyed. In real terms, this economy is in decline. It has a limited future.

The other economy—the Creative Economy—is the economy that keeps generating new products and services that people in every country of the world feel they must have. Because it delights its customers and continuously adds value, this economy is thriving. Because it enables the full capacities and talents of the workforce, it is highly productive and innovative. Because it generates so much profit, it is less inclined to slide into abuses and malfunctions. This economy doesn't have to be imagined or invented. It's already here.

The distinction between the two economies is not a distinction between old firms and new firms or between different sectors of the economy. The Creative Economy includes young firms and old firms, big firms and small firms, firms in software and firms outside software, US firms and non-US firms. It also includes hybrids, in which part of the firm is run in one mode and the other part in the other mode. In effect, the Creative Economy isn't about a type of firm, but rather a set of leadership and managerial practices that are steadily taking over the economy.

The confusing reality of the moment is that these two different economies are operating simultaneously, albeit at different speeds and on different trajectories.

Over the past several decades, the Creative Economy has been displacing the Traditional Economy. What's now apparent is that disruption has gone beyond the invention of some new electronic gadget or a new computer chip. The Creative Economy involves the disruption of management itself. The entire "operating system of the corporation" is being disrupted.

The Creative Economy is a different kind of economy. It generates sustainable wealth and prosperity by inspiring the talents and creativity of people and communities, not by exploiting them. It makes things better for customers, rather than taking advantage of them. It generates real goods and services for real people, rather than simply making money in zero-sum games.

The Creative Economy is more than a class of creative workers or a set of creative industries. It constitutes an ongoing transformation of the entire modern economy and society, eventually affecting every person and every organization. Alternative labels for the same phenomenon include "The Innovation Economy"[3]; and "The Resilient Economy[4] and "Scalable learning,"[5]

A tale of tragedy and triumph

This book is a tale of both tragedy and triumph—a sweeping epic across many countries of power and money, fear and greed, hubris and humility, honest work and gambling, chicanery and morality, disillusion and hope. It depicts a vivid historical moment.

One part of the tale is dark. It's the story of desperate but misguided efforts by the Traditional Economy to cling to wealth and power, while the Creative Economy steadily makes inroads.

Most of the book however is devoted to the brighter side of the story, where the highest and noblest aspirations are finding a path forward, drawing on the deepest wellsprings of human creativity, and exponentially expanding the amount of human happiness and delight in the world.

Although we know that a transition from the Traditional Economy to the Creative Economy is under way, we don't know exactly how long the transition will take. Will the transition be slow and ugly and fully of unnecessary pain, like the Protestant Reformation? Or will it be, as we hope, quick and elegant and intelligent? This book is an effort to enhance understanding of what is going on, so as to generate the latter outcome.

The transformation of management

The transition from the Traditional Economy to the Creative Economy concerns in part the transformation of management—the practices by which organizations operate and get things done. The practices that drove the structure, systems and performance of organizations throughout the 20th Century helped organizations meet the demand for mass market products and services and generate widespread prosperity. They were a good fit with the marketplace that existed at the time. But the marketplace changed, as a result of deregulation, globalization and technology, particularly the Internet. The practices became less and less effective and firms began having difficulty making money.

Some leaders responded by applying the management techniques of the 20th Century even more energetically. They implemented management fixes. They downsized. They reorganized. They sought to empower their staff. They launched innovation initiatives. They set up internal venture capital funds. They reengineered processes. They launched sales and marketing campaigns. They embraced social media. They acquired new companies. They shed businesses that weren't doing well. They took on more debt and increased their financial leverage. They gave the top executives stock-based compensation in an effort to make them more entrepreneurial. They resorted to increasingly imaginative forms of financial engineering. They bought their own stock in large quantities to bolster their share price. These fixes sometimes led to short-term gains, but they didn't solve the underlying problem. Deeper change was needed. The basic methodology of management itself had become obsolete.

Another set of leaders did something different. They developed and implemented a different set of goals, methods and metrics, that was better suited to the marketplace of the 21st Century—and so the Creative Economy was born. The resulting organizations don't look much like their predecessors. They have different goals, methods and metrics. The ways in which they created, marketed, made, sold and delivered products and services were different. These organizations are highly interactive and can mobilize vast ecosystems of partners and customers, enabling them to achieve massive scale without sclerosis. Rather than tinkering with the practices that were once successful but are now increasingly irrelevant and ineffective, these organizations are reinventing the infrastructure of capitalism.[6]

The transformation of leadership

In the Traditional Economy, leaders are often what the Financial Times has called "default managers." These are managers who "fit easily into a recognizable and established corporate hierarchy, run on a basis of old-fashioned command and control and governed by title and status. They are usually passive, carrying out instructions that are either explicit in orders from the top or implicit in budgets, accounting timetables, and short-term targets and incentive plans."[7]

By contrast, leaders in this Creative Economy have bold goals. They are moving into the future. They are prudently taking risks. They are inspiring their employees. They are nurturing their cultures. They are grasping the possibilities. They are in touch with their customers. They are diligently pursuing Peter Drucker's dictum that the only valid purpose of a firm is to create a customer. These managers have both courage and ambition.

Whereas leaders in the Traditional Economy prosper within the system or on occasion despite of the system, leadership in the Creative Economy is about transforming the system. They are not successful *despite* the constraints of their worlds. Leaders in the Creative Economy are *transforming* those constraints.

The transformation of metrics and economics

A key set of issues in the transition from the Traditional Economy to the Creative Economy concerns the metrics of capitalism: the way in which progress and success is measured at both the level of the economy and the level of the individual firm.

At the level of the firm, the success of the firm must be measured in ways that capture its underlying capacity to add value to the people for whom the work is being done and the economy, rather than its capacity to extract money in zero-sum games with other players or by fleecing customers and obtaining "bad profits."

At the level of the economy, macro-economists are wringing their hands as the economy stagnates, income inequality increases and job creation sputters. There is talk of secular economic stagnation, to which the traditional remedies of macroeconomics are helpless. Models based on the "invisible hand of the marketplace," and "perfect competition" are shown to obsolete mantras, rather than useful guides to action.[8]

The underlying psychological assumption of an economic man who pursues only money is not only a sickening caricature of human existence: in business but a corrosive self-fulfilling prophecy of behavior in the C-suite, with disastrous economic consequences. The failure of macroeconomics to distinguish more clearly those parts of the economy that contribute real goods and services to citizens and those that are zero-sum in nature or worse is becoming steadily more apparent.

In one sense, none this is new. As in management, the challenge for both macro and micro economics isn't about re-inventing the discipline from scratch. It's about retiring from the mainstream concepts and methodologies that have long since ceased to be useful and moving enlightened thinking that is currently on the periphery into the mainstream.

The shift from the Traditional Economy to the Creative Economy isn't just a technical wrangle about obscure aspects of economic theory. It's about correctly measuring what actions are necessary to generate widespread prosperity in the 21st Century.

The transformation of society

The problems we are dealing with—and the solutions—involve society as a whole. Since the practices and ideology of 20th Century management and economics have come to be seen as inevitable, the problems they engender cannot be solved with actions by any one set of actors.

This isn't principally about wrongdoing by individuals, although there is some of that. It's more about whole groups of key actors—politicians, government agencies, regulators, central banks, managers, their boards, investors, financial institutions, rating agencies, business schools, economists, analysts and the media—all operating in concert, using false assumptions and obsolete guides to action.

Today, leaders of every kind find themselves operating in a society that has, as a whole, lost its way. If there is evil here, it's mostly the banal evil of people unthinkingly following goals and practices that were not of their own devising. Rather than picking on individual delinquency, we need as a society to think through how we can organize ourselves better, through different goals and practices, different structures, different processes and different values.

The champions of capitalism press for change

Fortunately, many influential voices now see the need for change. These calls come now from the most distinguished pro-business voices in the world—the heavy artillery of capitalism itself.

And it isn't just one or two voices. The critiques and the calls for change are many and simultaneous. Big-gun broadsides are coming all at once.

These thought leaders are not speaking in euphemisms or hedging their bets. These are flat-out denunciations of, not just one firm, but the whole management culture that prevails in big business. Phrases like "stock price manipulation" (Harvard Business Review), "corporate cocaine" (The Economist) and "zombie managers in the grip of management ideas that refuse to die" (Financial Times) are typical.

We are also seeing incumbents of the C-suite speaking out, such as Tim Cook at Apple, Eric Scmidt at Google, Paul Polman at Unilever, Xavier Huillard at the Vinci Group and John Mackey at Whole Foods.[9] These corporate leaders are making the case for change while they are still in office, as compared to Jack Welch, who called shareholder primacy "the dumbest idea in the world," years after he had retired. An even larger number of privately owned organizations, and small and medium organizations, are actually practicing a more creative brand of management, even if they don't always go around making speeches about capitalism.

Nevertheless, just as for the Protestant Reformation five centuries ago, the obstacles that stand in the way of the transition from one economy to another are formidable. Long-established habits are hard to break. Powerful interests are entrenched and wealthy. As members of the C-suite become not just rich but legacy-rich, they enjoy impressive incentives to maintain and defends the status quo.

Joining the dots and seeing the connections

These are obviously large-scale issues and many books have already discussed individual aspects of them. To take effective action, we need to see how all the pieces of the puzzle fit together as a whole. What's unique about this book is that it offers a comprehensive explanation of how a set of actions that are already under way—albeit in fits and starts—towards resolving the problems.

Thus there are many critiques of capitalism, particularly secular economic stagnation, sputtering job growth, growing inequality and the destruction of the middle class. This book goes further: It explains the connections between these macro-economic phenomena and their roots at the level of the corporation and the individual workplace.[10]

There are many books discussing the emerging new management principles and practices—such as self-organizing teams, massive ecosystems of producers and customers, continuous innovation. This book goes further and explains what has to happen at the level of the C-suite and the economy as a whole if those principles and practices are to be enduringly successful.[11]

There are many books discussing the demands on leadership to meet the challenges of today's economy, such as more finely honed communications skills, stronger emotional intelligence and better capacity to interact. This book goes further and explains why we need leaders need to address two even bigger challenges: both the transformation of management itself, and the transformation of the economy as a whole.[12]

There are many books discussing the ongoing disruption of the economy. But they generally deal with only small pieces of the overall transition that is occurring. Macroeconomists seek solutions in macro policy, without seeing the role that obsolete management practices play in causing the problems or how emerging practices can enable enabling the solution. They usually miss the fact that the principles and practices of management itself are being disrupted.[13]

There are many books discussing the roots of the financial meltdown in 2008 and the excessive financialization of the economy. They generally accept the continuation of existing management goals and practices. As the underlying disease hasn't been properly identified and treated, more booms and crashes are inevitable. This book goes further and explains how management itself must be adapted to support, and flourish within, a properly sized financial sector.[14]

There are many books discussing the problems of government, health and education. They tend to discuss the problems of each of these sectors in isolation from deeper economic and management issues. This book will explain that, at the very moment that it is becoming clear that hierarchical bureaucracy is failing in the private sector, it is being reinforced in these sectors as "the solution." By treating teachers and their students, and health workers and their patients, simply as resources to be processed, a degradation of performance ensues and those organizations are pushed even further from the frontier of what is possible and needed. This book will explain how the emerging principles and practices of the Creative Economy can resolve many of the issues facing these sectors.

In effect, what this book offers is a comprehensive guide to how all the pieces fit together from the big-picture macro-economic level, through the overall management of the organization, down to the fine-grained understanding of what happens at the individual workplace.

This book isn't a prediction of what will happen. It's a description of what has already happened and the dynamics that are causing that to happen. The book recognizes that what happens next will depend on what people choose to do next. If people continue to rely on obsolete knowledge as to what is going on, the consequences could be dire. If on the other hand, people take the trouble to understand what's happened and master the dynamics, the future could be very bright indeed.

This book doesn't claim to have the answer to everything. Our world is complex and evolving rapidly. Every day, new problems are being discovered and new solutions are being found. What the book offers is a comprehensive snapshot of what is going on so that players wherever they are can understand how their own activities fit into this bigger picture of massive societal change.

How the book is laid out

Here's how the chapters of this book are laid out. At the conclusion of each chapter, there is a brief section of "takeaways" that summarize the main action conclusions of that chapter.

Part A consists of an introduction to the main themes of the book.

> Chapter 1 explains how management took a wrong turning in 1970 with a total focus on maximizing shareholder value and the disastrous financial, social and economic consequences of doing so.
>
> Chapter 2 shows how the Creative Economy has emerged, where its ideas come from, how they have evolved and where they are leading.

Part B deals with the goals, methods and metrics of the Creative Economy.

> Chapter 3 deals with the goals of the Creative Economy.
>
> Chapter 4 reviews the collaborative methods of the Creative Economy. It looks at the discoveries made first in manufacturing under the heading of Lean, and then developed further software development, under the headings of Agile, Scrum and XP. It discusses why these management discoveries are so little known in general management, along

with the perennial management objections to adopting these approaches more widely. It show how these approaches are spreading to other areas such as manufacturing.

Chapter 5 discusses the metrics of the Creative Economy.

Part C explores the further implications.

Chapter 6 discusses the implications of rethinking leadership, particularly the key missing ingredient in leadership today—transforming management. It explores how you change an organizational culture. It reviews transitional strategies that companies are deploying to move from the Traditional Economy to the Creative Economy.

Chapter 7 discusses the rethinking of strategy and innovation. It shows that organizations are now transforming business models and management itself, not just improved products and services.

Chapter 8 discusses the particular problems of the financial sector, including the reasons why we had a financial crisis and why another crisis will occur unless action is taken. It explores the longer term historical roots of the financial crisis and reviews what steps need to be taken

Chapter 9 discusses rethinking government in the light of the shift from the Traditional Economy to the Creative Economy, including both the changes at the macro-economic level and the shifts in involved in the management revolution. It explains what's involved in making government innovative again, as well as how government's role in regulation needs to change.

Chapter 10 shows how the rethinking of management applies to education and health. It explains how many of the ongoing educational "reforms" are infected with the obsolete practices of hierarchical bureaucracy. It explores the single best idea for reforming K-12 education and the transformation of college education. It examines the implications of rethinking the health sector, including how the financialization of the health sector has resulted in excessive costs and poor performance, and what needs to be done to change it.

Chapter 11 looks at what's involved in rethinking the entire economy in the light of the management revolution, with two different economies going at different speeds and with very different trajectories.

Chapter 12 explores the meaning these transformational shifts for the lives of human beings in the workplace. It looks at whether the pursuit of happiness is an inalienable right and offers guideposts for the future of leadership and management. It explains why a vision of workplaces that systematically make most people unhappy is an intolerable human prospect, for which there are now happy alternatives.

An invitation

This book is an invitation. Whether you are a CEO or a worker at the bottom of the pyramid, a regulator, an institutional investor, a rating agency, an analyst or a politicians, a shift is coming to your world, if it isn't already there. So it's a good idea to find out what this is all about.

Like all obvious but radical ideas, in the first instance the possibility of something new will be ridiculed, then rejected, and finally it will be so self-evident that no one will be able to remember why anyone ever thought otherwise.[15]

So this is my invitation to you. Find out about it. Join it. Be part of it. Lead this paradigm shift. Help make it happen, sooner rather than later. Ultimately the choice isn't *whether* to be part of it. The only question is *when*. So that's my question to you: why not ….now?

Chapter One

"The dumbest idea in the world"

"Imagine an NFL coach," writes Roger Martin former Dean of the Rotman School of Management at the University of Toronto, in *Fixing The Game*, "holding a press conference on Wednesday to announce that he predicts a win by 9 points on Sunday, and that bettors should recognize that the current spread of 6 points is too low. Or picture the team's quarterback standing up in the postgame press conference and apologizing for having only won by 3 points when the final betting spread was 9 points in his team's favor. While it's laughable to imagine coaches or quarterbacks doing so, CEOs are expected to do both of these things."

Imagine also, to extrapolate Martin's analogy, that the coach and his top assistants were hugely compensated, not on whether they won games, but rather by whether they covered the point spread. If they beat the point spread, they would receive massive bonuses. But if they missed covering the point spread a couple of times, the salary cap of the team could be cut and key players would have to be released, regardless of whether the team won or lost its games.

Suppose also that in order to manage the expectations implicit in the point spread, the coach had to spend most of his time talking with analysts and sports writers about the prospects of the coming games and "managing" the point spread, instead of actually coaching the team. It would hardly be a surprise that the most esteemed coach in this world would be a coach who met or beat the point spread in forty-six of forty-eight games—a 96 percent hit rate. Looking at these forty-eight games, one would be tempted to conclude: "Surely those scores are being 'fixed?"

Suppose moreover that the whole league was rife with scandals of coaches "fixing the score", for instance, by deliberately losing games ("tanking"), players deliberately sacrificing points in order not to exceed the point spread ("point shaving"), or paying the referees to improve the score ("fixing the game").

If this were the situation in the NFL, then everyone would realize that the "real game" of football had become utterly corrupted into some kind of "expectations game" of gambling and manipulation. Everyone would be calling on the NFL Commissioner to intervene and ban the coaches and players from ever being involved directly or indirectly in any form of gambling or fixing the outcome of games, and get back to playing the game.

Which is precisely what the NFL Commissioner did in 1962 when some players were found to be betting small sums of money on the outcome of games. In that season, Paul Hornung, the Green Bay Packers halfback and the league's most valuable player (MVP), and Alex Karras, a star defensive tackle for the Detroit Lions, were accused of betting on NFL games, including games in which they played. Pete Rozelle, just a few years into his thirty-year tenure as league commissioner, responded swiftly. Hornung and Karras were suspended for a season. As a result, the "real game" of football in the NFL has remained separate from the "expectations game" of gambling or the corrupt practice of "fixing the score." The coaches and players spend all of their time and effort trying to win games, not gaming the games.

The different situation in business

In today's paradoxical world of maximizing shareholder value, the situation is the reverse. CEOs and their top managers have immense incentives to focus most of their attentions on the expectations market and fix the share price, rather than the real job of running the company producing real products and services.

The ***real market*** is the world in which factories are built, products are designed and produced, real products and services are bought and sold that make a real difference in customers' lives, and real dollars of profit show up on the bottom line. That is the world that executives control—at least to some extent.

The real market differs the ***expectations market***, where shares in companies are traded between investors—in other words, the stock market. In this market, investors assess the activities of a company today and, on the basis of that assessment, form expectations as to how the company is likely to perform in the future. The consensus view of all investors and potential investors combining the current worth of the company and the expectations of future performance shapes the stock price of the company.

"What would lead [a CEO]," asks Martin, "to do the hard, long-term work of substantially improving real-market performance when she can choose to work on simply raising expectations instead? Even if she has a performance bonus tied to real-market metrics, the size of that bonus now typically pales in comparison with the size of her stock-based incentives. Expectations are where the money is. And of course, improving real-market performance is the hardest and slowest way to increase expectations from the existing level."

In fact, a CEO has little choice but to pay careful attention to the expectations market, because if the stock price falls markedly, the application of accounting rules (regulation FASB 142) classify it as a "goodwill impairment". Auditors may then force the write-down of real assets based on the company's share price in the expectations market. As a result, executives must concern themselves with managing expectations if they want to avoid write-downs of their capital.

In this world, the best managers are those who meet expectations. "During the heart of the Jack Welch era," writes Martin, "GE met or beat analysts' forecasts in forty-six of forty-eight quarters between December 31, 1989, and September 30, 2001—a 96 percent hit rate. Even more impressively, in forty-one of those forty-six quarters, GE hit the analyst forecast to the exact penny—89 percent perfection. And in the remaining seven imperfect quarters, the tolerance was startlingly narrow: four times GE beat the projection by 2 cents, once it beat it by 1 cent, once it missed by 1 cent, and once by 2 cents. Looking at these twelve years of unnatural precision, Jensen asks rhetorically: 'What is the chance that could happen if earnings were not being "managed'?"' Martin replies: infinitesimal.

Moreover what would lead a CEO to undertake the risky difficult work of creating new businesses with new products and services, when she could simply use the firm's resources to buy back the firm's own shares, thereby causing the share price to rise and assure her own bonus to accrue as a result of the higher share price, regardless of the firm's real performance?

As it turns out, CEOs have been doing exactly that on a massive scale. Between 2004 and 2013, publicly-listed firms in the S&P 500 used a colossal amount of their earnings—54 percent or $3.4 trillion—to buy back their own stock, as research by William Lazonick, professor of economics at the University of Massachusetts Lowell, has shown.[16]

This wasn't done for the most part when stock prices were low: astonishingly, most of the big purchases came when the stock price was high. Why? "Because stock-based instruments make up the majority of executives' pay, and buybacks drive up short-term stock prices." These firms are engaged," Lazonick says, in "what is effectively stock-price manipulation."

So unlike the NFL, the "real game" of business has not remained separate from the "expectations game" of gambling or the corrupt practice of "fixing the score." The practice of corporations buying back their own shares is not only pervasive and increasing: it has become "an obsession", "an addiction" or as The Economist calls it, "corporate cocaine."[17] Or as Jack Welch called it, "the dumbest idea in the world."

Where did this thinking come from? The origins are clear.

The origin of "the dumbest idea in the world"

On September 13, 1970, *The New York Times* published an article by Milton Friedman castigating any managers of businesses who were "spending someone else's money for a general social interest" – in other words, requiring customers to pay more, employees to be paid less, or owners to accept smaller profits so that the firm could exhibit social responsibility beyond the requirements of the law.[18]

Already, in his 1962 book *Capitalism and Freedom*, Friedman had declared that "there is one and only one social responsibility of business–to use its resources and engage in activities designed to increase its profits 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." Choices about whether and how to use money to remedy social problems should be left to individuals, Friedman argued, who would be in better position to provide it if they were not being in effect taxed by corporate managers who thought they had better ideas for how to spend it.

Friedman's 1970 article reflected concerns that executives were not responding effectively to jolting changes in the marketplace. "Consider a few of the most significant jolts, which sometimes seemed like the Four Horsemen of the Corporate Apocalypse," writes Walter Kiechel in *The Lords of Strategy*. "The first, though not necessarily chronologically, was the deregulation of industries in which competition had traditionally been held in check by government rules, as in airlines, banking, and telecommunications. The second consisted of the ever-widening effect of new technologies, including the increase in computer power, its spread to desktops everywhere, and the coming of the Internet. In the third, capital markets freed themselves up, shedding inhibitions against hostile takeovers, establishing a genuine market for the control of companies. The fourth horseman usually goes by the name globalization, the fact that companies find themselves buying from, selling to, and competing with enterprises and customers from around the world."[19]

In 1970, the prevailing theory for running organizations was managerial capitalism, as expounded in legendary book: *The Modern Corporation and Private Property* by Adolf A. Berle and Gardiner C. Means in 1932. This book established the idea that firms should have professional management—"a purely neutral technocracy balancing a variety of claims by the various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity."

From 1945 to the late 1970s, firms "retained earnings and reinvested them in increasing their capabilities, first and foremost in the employees who helped make firms more competitive. They provided workers with higher incomes and greater job security, thus contributing to equitable, stable economic growth—[or] 'sustainable prosperity.'"[20]

But there was a snag. It turned out that organizations balancing multiple goals became confused and tended to resemble "garbage cans," with inconsistent and ill-defined priorities. Sometimes even the firms' own managers couldn't understand the own processes, as Dilbert cartoons have come to illustrate. Decision-making became unpredictable and capricious. Closure was only reached when shifting combinations of problems, solutions, and decision makers happened to coincide. Poorly understood problems "wandered in and out of the system."[21]

In the absence of clear goals, the systems, rules and procedures devised to help the organization achieve financial and administrative order take on a life of their own, and become the main preoccupation and values of those working within the organization. As employees orient their lives around the bureaucracy of organization, the purpose of the organization gets lost and it slides into mediocrity.[22]

A single clear goal: maximizing shareholder value

Friedman's article cut through this confusion like a knife. Managers should be focused on one thing and one thing only. Making money for shareholders. Everything else was irrelevant. The shareholders owned the company. Executives worked for the shareholders, the corporation being just "a legal fiction."

The legal case for shareholder value

Advocates of shareholder value often argue that it is somehow required by law. Law professor, Lynn Stout, has weighed in with her book, *The Shareholder Value Myth*. She argues that shareholder value is not only dumb and counter-productive: it's legally unsound.

Shareholders don't own the corporation. "What the law actually says is that shareholders are more like contractors, similar to debt-holders, employees and suppliers. Directors are not obligated to give them any and all profits, but may allocate the money in the best way they see fit. They may want to pay employees more or invest in research. Courts allow boards of directors leeway to use their own judgments. The law gives shareholders special consideration only during takeovers and in bankruptcy. In bankruptcy, shareholders become the "residual claimants" who get what's left over."[23]

Friedman's article was ferocious. Any business executives who pursued a goal other than making money were, he said, "unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades." They were guilty of "analytical looseness and lack of rigor." They had even turned themselves into unelected government officials who were illegally "imposing taxes" on employees and customers.[24]

For executives who were struggling to find their way through the apparent apocalypse of change, Friedman's proposal offered irresistible clarity: managers need only focus on owners' interests as reflected in the current share price and the rest would take care of itself. In the corporate boardrooms, the numbers people took charge, namely, "those who see the enterprise largely through the lens of the numbers—sales figures, costs, budgets"[25]

The success of the article was not because the arguments were sound, but rather because people desperately *wanted* to believe. As firms were starting to feel the pressures of globalization, technology and deregulation, executives were looking for ways to increase their returns. The idea of focusing totally on making money, and forgetting about any concerns for employees, customers or society was irresistible, regardless of the argumentation.

The icing on the cake: generous executive compensation

Better yet, in 1976, Professors Meckling and Jensen offered an economic rationale for maximizing shareholder value along with generous stock-based compensation to executives who followed the theory. In this way, the personal interests of executives would be aligned with those of the corporation and its shareholders.[26] The thinking was that compensation in stock would protect shareholders against managers wasting cash on corporate jets, lavish new headquarters and other monuments to executive extravagance. Now managers could focus on doing "the right thing"—making money for shareholders as reflected in the share price—and get well compensated for doing it. Ronald Reagan and Margaret Thatcher gave the idea political cover. Very quickly, shareholder value became the gospel of capitalism.

The article proposed that, to ensure that the firms would focus solely on making money for the shareholders, and to save the stockholders the trouble of having of monitor performance, firms should turn the executives into major shareholders, by affording them generous compensation in the form of stock. In this way, the tendency of executives to feather their own nests would be replaced by actions in the interests of the shareholders.

Known by the label, "Maximizing Shareholder Value," the concept can be summarized thus:

> A firm should explicitly and singularly focus on and dedicate its management and all employees to making as much money as it can for its shareholders. Such a focus, which utilizes executive stock-based compensation to ensure it, will not only result in the greatest benefit to shareholders, it will through "the hidden hand of the marketplace" result in the optimal allocation of societal resources and the best outcome for society as well. The measure at any point in time of how well the firm is prosecuting this goal is the current stock price, because the current stock price is the truest reflection of the value of the firm. The measure also offers a metric by which the daily activities of a firm can evaluated.

Like most bad ideas that achieve wide acceptance, shareholder value theory contained several kernels of truth. One was that generating value for shareholders is a good thing. If firms serve customers brilliantly and organize creative employees in ways that allow them to express their creative value to the greatest possible extent, shareholders will get rich and society will be better off.

Another was that having a single clear goal on which progress could be easily measured was a distinct advantage for fighting the inconsistent and ill-defined priorities of the "garbage can" organizations that had emerged in the mid-20th Century.

Yet it also became evident that, even as the goal of maximizing shareholder value as reflected in the stock price appeared to pay off in the short term, it generated unanticipated risks.

The unanticipated risks of maximizing shareholder value

The Meckling/Jensen article focused only on single decisions and the short term impact of compensating exeuctives with stock. The long-term impacts of pursuing shareholder value were described as "important issues which are left for future analysis"[27]—an analysis that Meckling and Jensen never got around to doing.

The article did envisage a risk that an executive might make "decisions which benefit himself at the (short–run) expense of the current bondholders and stockholders." The article was satisfied that this risk wouldn't happen: "If [the executive] develops a reputation for such dealings, he can expect this to unfavorably influence the terms at which he can obtain future capital from outside sources. This will tend to increase the benefits associated with 'sainthood' and will tend to reduce the size of the agency costs."

However the article didn't foresee the risk that that the "sainthood" involved in looking after the interests of shareholders might turn into combines with the shareholders *against* the organization and society. Executives might conspire with shareholders interested in short-term gains to extract value from the corporation at the expense of customers, employees, of the organization, the community in which the organization operated and ultimately society as a whole. Nor did the article perceive that this risk might materialize on a macro-economic, even gargantuan, scale.[28]

These theorists were not worried about the risk that the executives might manipulate the stock price through the use of share buybacks. In 1976, such practices were illegal. Nor did they imagine that if that legal constraint were to be removed, executives—the very leaders of society—might engage in massive self-serving behavior, involving trillions of dollars.[29]

Nor did they foresee the risk that if firms started to act on the basis that executives could only be motivated to work on behalf of the shareholders for monetary gain, this might turn into a nightmarish self-fulfilling prophecy.[30] Executives might, far from aspiring to "sainthood" of looking after the interests of shareholders, might turn into grotesque caricatures of self-interest and greed, not only grabbing extraordinary compensation and pension benefits for themselves, but also feathering the nests of their colleagues by assuring their bonuses even where there were performance shortfalls [31]

The article didn't worry about the risk to the organization itself, because to these theorists an organization was a mere "legal fiction." In the theoretical world inhabited by these economists, if one organization failed, it could be replaced by another. They didn't perceive the risk that there might be very heavy economic and social costs in dismantling corporations and even whole sectors along with the social capital embodied in them. Nor did they perceive the risk that shifting production to other parts of the world the damage to the productive national infrastructure might be irreparable. Once lost, the productive capacity could not be easily retrieved.[32]

The article was even less worried about risks to employees. To the theorists of shareholder value, employees were regarded as fungible, even disposable, instruments to serve the interests of capital: if employees lost their jobs they could always seek employment elsewhere. As Milton Friedman had written, "The employee is protected from coercion by the employer because of other employers for whom he can work."[33]

The theorists didn't foresee the possibility that if the extraction of value from corporations might become so great that there would be few "other employers" offering employment. Nor did they envisage the risk that if this process was continued over a period of time by most large organizations, the impacts might become macro-economic in scale, and there would eventually be a shortage of customers for real goods and services and no opportunities to invest in. In the language of the macro-economists, there would be a massive problem of "lack of demand."[34] The economy would be facing a period of "secular economic stagnation."[35]

Nor did the article perceive the risk that if corporations didn't invest in training and retraining their employees, by shifting work to wherever labor costs were currently lowest, there might come a day when there was an inadequate pool of trained workers from which they would draw on for the creation of future businesses.[36]

Nor did the theorists worry too much about customers. If customers didn't like what corporations were offering they could as Milton Friedman had written, take their business elsewhere: "The consumer is protected from coercion by the seller because of the presence of other sellers with whom he can deal."[37] That's capitalism—the magic of the marketplace.

The theorists didn't perceive the risk that if most corporations favored shifting resources to shareholders and executives instead of investing in innovation for customers, customers might become dissatisfied and give their business "elsewhere" to corporations who did care about them. Nor did they perceive the risk that as customers had progressively more choices from globalization and better information about those choices, the risk of transferring their business "elsewhere" might be to businesses based in other parts of the world, so that eventually the dynamism of entire industries and the whole national economy might be compromised.[38]

Nor did they perceive the risk of damage to communities by closing plants in order to benefit from lower cost labor elsewhere in the world and so boost returns to executives and their shareholders. They assumed that "the magic of the marketplace" and the process of "creative destruction" would heal any damage that a short-term extraction of value might cause. They didn't envisage the risk that the extraction of value from corporations by an alliance of executives and shareholders might reach such a scale and cause such damage that there would be insufficient resources available to the economy as a whole to heal the cost to communities caused by the short-term extraction of value.[39]

Nor did they foresee the risk that diverting resources to shareholders and executives from investments in the future might reach such a scale that the capacity of the economy to grow and compete in the international marketplace or provide livelihood for all its citizens might be compromised.[40]

Nor did they foresee the risk that by creating strong financial incentives to do the easy thing of low value to the real economy—i.e. increase the stock price—while creating no incentives to do the difficult thing of high value to the organization and the real economy—i.e. invest in and create new business opportunities—they were virtually guaranteeing that executives would spend most of their efforts on self-interested activities of low value to the organization and the real economy.[41]

In short, they didn't perceive the risk that shareholder value theory might not only fail on its own narrow terms of making money for shareholders but would also destroy the very productive capacity and dynamism of the economy.

The ugly marriage of shareholder value and bureaucracy

One of the most serious unanticipated risks was that the goal of maximizing shareholder value as reflected in the stock price would form an alliance with hierarchical bureaucracy. Since a total focus on making money for shareholders and the top management is an inherently uninspiring goal to employees, successful pursuit of shareholder value required ever tighter command-and-control to achieve it. Even as executives pursued the goal, employees who were compelled to pursue it were unlikely to do so with any engagement, let alone passion. And without engagement or passion, employees would be unlikely to put in the effort to innovate and find new ways to delight customers. The alliance of the goal of shareholder value as reflected in the stock price and the management methods of hierarchical bureaucracy thus risked crippling the capacity of the firm to innovate—an increasingly important key to enduring success in the 21st Century marketplace.

Shareholder value and hierarchical bureaucracy fitted together in a perfect interlocking relationship that tended to prevent change. If a firm tried to change one aspect to enhance innovation, such as introducing as better team practices, the other aspects—the goals and metrics of shareholder value—would in due course kick in to undermine the change. As a result, firms tended to be stuck in a state of suboptimal equilibrium, thereby further demotivating the employees and making them even less interested in or capable of delighting the increasingly empowered customers.

"Management was originally invented," management theorist Gary Hamel has noted, "to solve two problems: the first—getting semiskilled employees to perform repetitive activities competently, diligently, and efficiently; the second—coordinating those efforts in ways that enabled complex goods and services to be produced in large quantities. In a nutshell, the problems were efficiency and scale, and the solution was bureaucracy, with its hierarchical structure, cascading goals, precise role definitions, and elaborate rules and procedures."[4]

With the continuing shift from semiskilled work to what economists call knowledge work, hierarchical bureaucracy is no longer a good solution. It results in the talents, ingenuity, and inspiration of the workforce not being fully tapped. Only one in five workers is fully engaged in his or her work, and even fewer are passionate.[42] For the organization, this means that the energies and insights of four out of five people in the workplace are being needlessly squandered. When the firm's future depends on what knowledge workers can contribute, leaving talent unused becomes a serious productivity problem.

For the customers of these organizations, the situation is similarly grim: a firm full of people who are not fully engaged in their work is not much fun to deal with. Although firms talk about customer service and responsiveness, they are more often engaged in one-way communications. The recorded message might say, "Your call is important to us," but customers know that it isn't.

What is bureaucracy? Gary Hamel describes it vividly:

> "Strategy gets set at the top. Power trickles down. Big leaders appoint little leaders. Individuals compete for promotion. Compensation correlates with rank. Tasks are assigned. Managers assess performance. Rules tightly circumscribe discretion."[43]

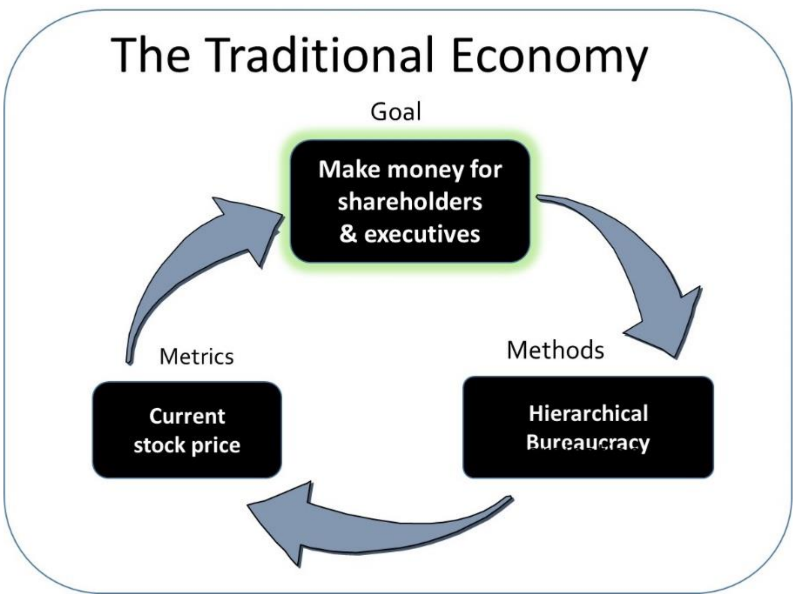
Bureaucracy, says Hamel, is **"**simple, and scalable" but "a profound liability" in today's hyperkinetic environment. It "underweights new thinking and …perpetuates the past. It misallocates power.. It discourages dissent and breeds sycophants." Bureaucracy is run top-down by "a small cadre of seasoned executives who fail to write off their depreciating intellectual capital." It is akin to Soviet-style centralization and "is the enemy of resilience… If they are unwilling to adapt and learn, the entire organization stalls. "

Bureaucracy is gripped by "the ideology of controlism" and "worships at the altar of conformance." It's hostile to "the irregular people with irregular ideas who create the irregular business models that generate the irregular returns," and so "cripples organizational vitality." It "shrinks our incentive to dream, imagine and contribute." It causes our organizations to "remain incompetent at their core."

Bureaucracy is a disease that "no amount of incremental therapy can cure." It is immune to "proactive bottom-up renewal." Its "organizational structures and processes are inherently toxic." It is "emotionally insipid" and "clueless when it comes to galvanizing …imagination, and passion."

"There's no other way to put it," says Hamel, "bureaucracy must die. We must find a way to reap the blessings of bureaucracy—precision, consistency, and predictability—while at the same time killing it."

One reason why bureaucracy is so hard to kill is that it is linked inextricably with shareholder value theory. So long as the goal of the firm is to maximize shareholder value, bureaucracy is essential. So long as executive compensation depends on the share price, shareholder value tends to remain the goal of the firm, and hierarchical bureaucracy remains the dominant way of the running the company..



The lynchpin of the system: executive compensation

What locks the marriage of shareholder value and hierarchical bureaucracy in place is stock-based executive compensation. C-suite compensation is now a large multiple of what it was when firms were doing their jobs properly and focused on "retain and reinvest." In the period

1978 to 2013, CEO compensation increased by an astonishing 937 percent, while the typical worker's compensation grew by a meager 10 percent.[44]

Moreover, this is not a situation where each CEO is on his or her own. The problem is compounded by cronyism and reciprocal rent-seeking. Thus in a recent study published in the Accounting Review, an astounding 62 percent of directors, who had a disclosed friendship with the CEO, said they would cut the budget for research and development in order to assure the bonus for their friend, the CEO. The most highly paid people, who should be actively leading in fixing the system, are busy helping their friends extract rents from it. The failure in leadership is breathtaking.[45]

In implementing market-based compensation, there is a failure to distinguish results due to sheer luck (beta) from the results due to skill (alpha). Thus when someone is running an oil company while the price of oil is skyrocketing, it doesn't need a lot of skill to generate high profits: such executives don't deserve to receive outsized compensation from a rising tide that lifts all boats.

Moreover those who should be monitoring compensation—pension funds, mutual funds and foundations—have not only been asleep at the wheel: they have been actively complicit in the debacle. They have "readily outsourced performance evaluation and compensation in order to avoid their obligation to make tough decisions and bring pay into line with performance."[46] ("Outsourced" here is a euphemism for "abandoned.")

"The combination of a foundational myth and absent monitors over the past two decades gave rise to harmful incentives, asymmetrical payoffs and windfall compensation levels," writes Professor Mihir Desai, the Mizuho Financial Group Professor of Finance at Harvard Business School. "The result has been the creation of perhaps the largest and most pernicious bubble of all: a giant financial incentive bubble." This in turn results in "the twin crises of American capitalism: repeated governance failures, which lead many to question the stewardship abilities of American managers and investors and rising income inequality."[47]

Why can't executives understand this? As Upton Sinclair noted long ago, "It is hard to get a man to understand something when he is being paid not to understand it."

The impact of the Internet

These risks didn't materialize overnight. They began brewing early. The theorists failed to anticipate how the Internet would aggravate all the other risks. Thus the Internet ...

- Shifted power in the marketplace from seller to buyer. Customers, who had access to reliable information about the available choices and a capacity to interact with other customers, were suddenly in charge.

- Raised customers' expectations. As "better, cheaper, faster, smaller, more convenient and more personalized" became the new norm, the ability to innovate with committed employees and agile processes became critical.
- Shredded vertical supply chains. Customers could buy a wider array of stuff online cheaper, and often quicker, than in a physical store. First books and music; then almost anything.
- Spawned vast new horizontal value chains, in which millions of people began creating their own virtual meeting places and marketplaces with their own lateral economies of scale. First computer code, then ideas, then music, photos and videos and finally, physical things.[48]
- Connected products with other products. The Internet of things is "leading to new analytics and new services for more effective forecasting, process optimization, and customer service experiences."[49]
- Enabled firms to create huge ecosystems of suppliers and customers that achieves massive scale without the sclerosis of big hierarchical bureaucracy.[50]

Shareholder value theory and hierarchical bureaucracy might have been appropriate in sectors where the marketplace was oligopolistic, stable and predictable. The theorist failed to see the risks of an era of increasingly unpredictable change.

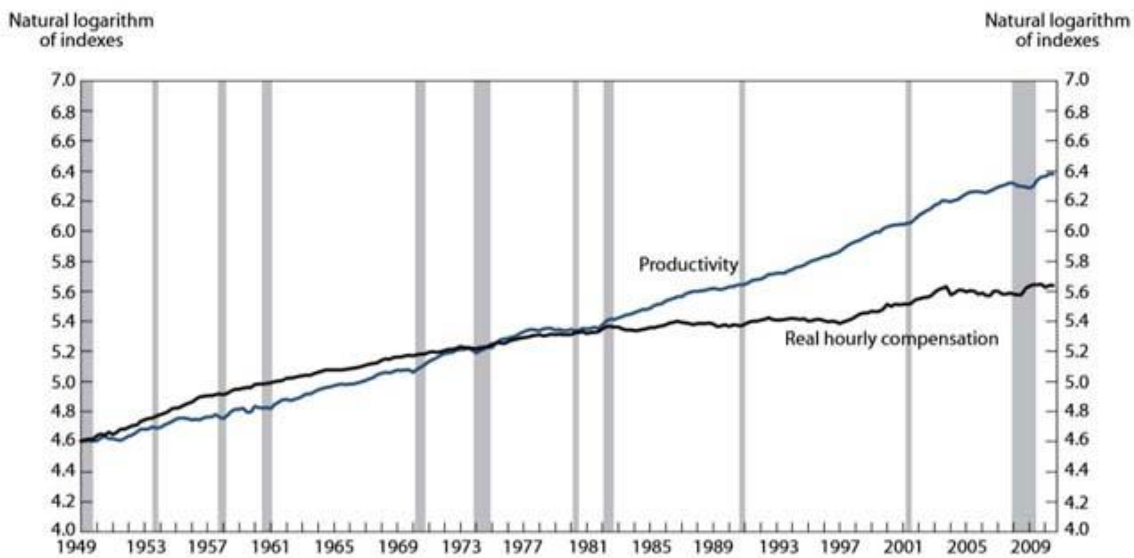
The risks materialize

Yet these were precisely the risks that materialized over the next four decades. In the period since shareholder value theory was born in the 1970s, executive compensation and the use of share buybacks exploded while corporate performance, business dynamism and economic growth have steadily declined.

- It hampered the capacity to compete on a sustained basis in international markets;[51]
- It encouraged a massive trend of offshoring that destroyed major segments of the economy;[52]
- It diverted human and financial resources from needed investments in innovation;[53]
- It led to a workforce in which only one in five worrkers were fully engaged in his or her work, and even fewer truly passionate about it.
- It crippled the capacity of firms to innovate.
- It generated "bad profits" that undermined customer loyalty;[54]
- It caused excessive "financialization" of the economy, making it vulnerable to increasingly severe financial crashes;[55]
- It undermined economic recovery from the Great Recession;[56]
- It drastically reduced rates of return on assets and on invested capital of US firms;[57]
- It appropriated gains that flowed from workers' improvements in productivity.[58]
- It led an explosion of executive compensation that became a macro-economic problem of the first order.[59]

- It led to secular economic stagnation and increasing and unsustainable economic inequality.[60]

6. Productivity and real hourly compensation, manufacturing sector, first quarter 1949–third quarter 2010



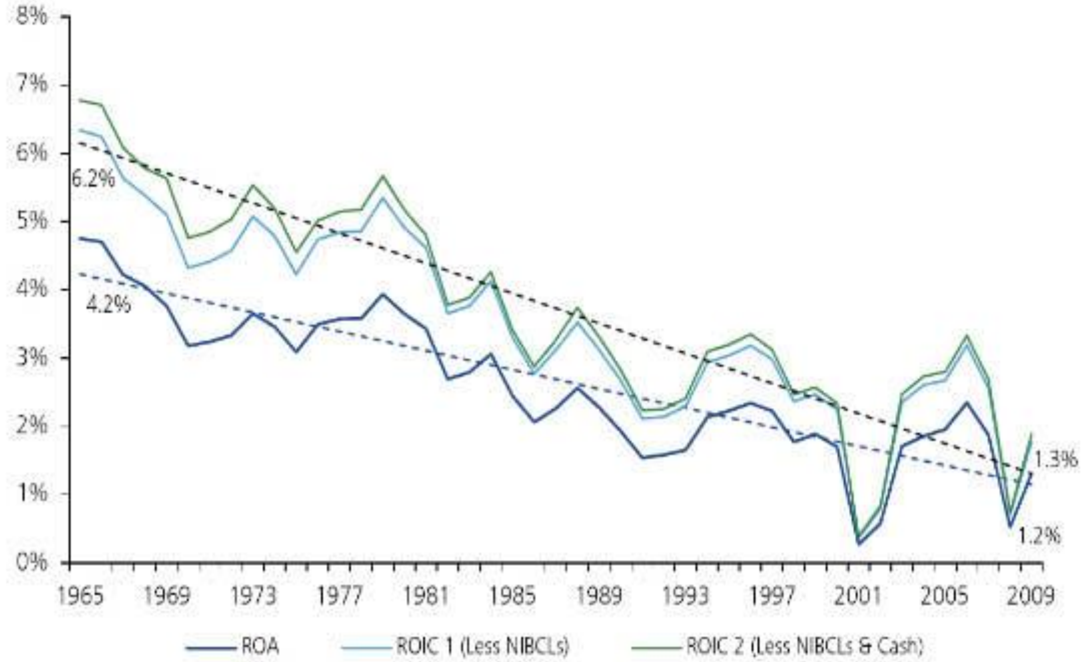
NOTE: The shaded bars denote National Bureau of Economic Research (NBER)-designated recessions.

Traditional management doubles down

It's not that executives didn't notice that their firms were running into problems. However the reaction was to continue the same approach but to try harder. They doubled down on the existing goals and practices and implemented them with even more energy and rigor. When that wasn't enough to meet short-term financial expectations, the executives began doing increasingly desperate things, like spending trillions of dollars in share buybacks.[61] They resorted to ever-more-ingenious financial engineering and tax gadgets. They ripped off pension funds, even stuffing them with cheese, Scotch whiskey or golf courses.[62] They continued to downsize and shift their workforce to lower cost countries. They lobbied legislators to obtain special tax breaks. Instead of investing in obvious new opportunities, they sought government grants and subsidies.[63] Instead of training and upgrading their own workers, they saved money by offshoring production to cheaper countries and then and then found themselves without the skills that they needed to create the future. They helped elect politicians who offered to lower taxes and free up the room for financial maneuvers by loosening regulation.

But it didn't work. The overall decline continued. Even though some firms made money in the short-run, by 2013 the rate of return on assets and on invested capital of US firms was only one-quarter of what it had been in 1965.

Exhibit 6: Economy-wide Return on Invested Capital (ROIC) (1965-2009)



" Source: Compustat, Deloitte analysis

Despite a perfect storm of technological innovation, the pace of business dynamism in the U.S. has continued to decline. “The decline in business dynamism is evident in a pronounced declining trend in the pace of both gross job creation and gross job destruction.” Moreover, “the burst of productivity growth that started in 1995 and is widely attributed to the use of new information technologies also seems to have ended in the early 2000s.”[64]

This steady decline however was kept largely invisible from public view by a set of practices that generated apparent prosperity rather than its reality. We can see how the Traditional Economy can undermine even a great old organizations, like IBM, which made a systematic long-term commitment to maximizing shareholder value and as a result, enjoys a kind of “Potemkin prosperity.” (See the Appendix)

A new operating system for the corporation

What we need is a whole new operating systems for the 21st Century corporation. Fortunately, this new operating system already exists and is flourishing in the Creative Economy.

The shift is a deep and fundamental. I have called it variously "a phase change," "a paradigm shift in the strict sense laid down by Thomas Kuhn," "a different way of thinking, speaking and acting in the workplace" and "radical management." The methods of Traditional Management fit together as a system, so that merely changing one element, like introducing innovation teams into the hierarchical bureaucracy, won't have a permanent effect unless the goals and metrics of the organization also change. At large companies, short-term priorities always favor incremental improvement at the expense of major change. The short-term priority of "making the quarterly numbers" will eventually crush the innovation team. So for the team to survive, the firms has to change its goals and the metrics. What is needed is systemic change, involving goals, methods and metrics all at once.

Fortunately we know what this new operating system looks like. It is already here. It is called the Creative Economy.

Appendix
The Potemkin prosperity of IBM

In 1787, Empress Catherine II of Russia made an unprecedented six-month trip to Crimea, the "New Russia," with her court and some foreign ambassadors. The area had recently been devastated by war. Amid fears of a new war, the purpose of the trip was to impress Russia's allies how prosperous the region had become as a result of rebuilding the region and bringing in Russian settlers.

The Empress was accompanied on the trip by the official who had been responsible for rebuilding the region and bringing in Russian settlers. The official, Grigory Potemkin, happily combined this official role with his unofficial function of bedroom companion and lover of the sex-hungry Empress.

Potemkin's problem on the visit was that the reconstruction of the area was not as far along as desired. Not wanting to disappoint his demanding imperial mistress, and being an energetic fellow, he implemented an ingenious scheme. He had a team of workers develop some "portable villages." Prior to the arrival of the Empress's barge, Potemkin's men, dressed up as peasants, would show up at the site and assemble a village. At night, in the midst of the barren territory, the fake settlements with their glowing fires would comfort the Empress and her foreign entourage. Once the Empress's barge had departed, the village would be disassembled and rebuilt downstream overnight for the imperial visit the next day.

The stratagem was a personal success for Potemkin. The Empress was sufficiently pleased with his multi-faceted services that he solidified his hold on power. Strategically for Russia, however, it was otherwise. The visiting ambassadors detected the difference between the real and the fake buildings and Potemkin's deception was in due course exposed by his political opponents. Shortly after the imperial visit, the region was once again plunged into a war between Russia and the Ottoman Empire.

The case of IBM

Fast forward a couple of hundred years to the troubles of IBM, the once-iconic technology giant, as its CEO, Ginni Rometty, struggles to convince a skeptical stock market that her tricks of financial engineering, share buybacks, tax gadgets, cost-cutting and hastily assembled acquisitions and innovation initiatives have put IBM on the path towards prosperity.

The problem is that after ten successive quarters of falling revenues, the pretense that everything is on track for the accomplishment of "Roadmap 2015," in which IBM's earnings would double to reach $20 per share, can no longer be maintained. Rometty announced in October 2014 what had been obvious for some time: IBM wouldn't hit the target after all.

She also announced that, rather than sell or shutter its chip division, it would actually pay GlobalFoundries $1.5 billion to take the division off its hands, while also taking a $4.7 billion charge.

"At the end of the day," said Rometty in an interview with CNBC, "this is about returning value to shareholders." Yet to many observers, the single-minded focus on returning value to shareholders is precisely what is killing IBM. IBM's focus on boosting the share price has been built on a foundation of declining revenues, capability-crippling offshoring, fading technical competence, sagging staff morale, massive debt-financed share buybacks, pervasive non-standard accounting practices, tax-reduction gadgets, a debt-equity ratio of nearly 174 percent, a broken business model and a flawed forward strategy. Those tactics can only work for so long, before the business reality becomes evident to all.

In June 2014, IBM's former CEO Sam Palmisano, described in an interview with Harvard Business Review how he triumphantly "managed" investors and induced IBM's share price to soar.

The key to Palmisano's success in "managing" investors at IBM was—and is–"RoadMap 2015", which promises a doubling of the earnings per share by 2015. The Roadmap is what induced Warren Buffett to invest more than $10 billion in IBM in 2011, along with many other investors, who were impressed with the methodical way in which IBM was able to make money. Buffett's investment was all the more striking because of his long-standing and publicly announced aversion to investing in technology, which he confessed he didn't understand.

After all, IBM under Palmisano had doubled earnings per share in Roadmap 2010, and was "on track" to do the same by 2015 under the leadership of his successor, Ginni Rometty, another long-time IBMer, who took over as CEO in 2012. She embraced the Roadmap with as much gusto as her predecessor.

The ticking money-bomb

Palmisano's exit package from IBM enabled him to clear a total of $225 million, including all the options, restricted stock, pensions, deferred compensation, bells and whistles.[65]

IBM's supporters see Palmisano's compensation as thoroughly justified by a job well done. "If Palmisano were sitting on a money-bomb like this after having driven IBM's share price into the ground, we would expect some outrage," writes one analyst.[66] "As it is, IBM's market capitalization rose by $85 billion while Palmisano was chief executive, and that's no small thing for shareholders. The company's share price has risen 91 percent since mid-March 2002 (with most of the gains since 2008), far outstripping the S&P 500."

But IBM was exactly that: a ticking money-bomb. It's just that the fuse was on a delayed switch. Palmisano got out while the going was good, leaving the unfortunate Rometty to deal with the impending wreckage.

What is IBM really about?

Palmisano is, according to HBR in 2006, "a true-blue IBMer, who started at the company in 1973 as a salesman in Baltimore," with "a visceral attachment to the firm." He is "a results-driven, make-it-rain, close-the-deal sort of guy." He also famously held a ValuesJam, in which thousands of IBM's employees joined in an open debate about the very nature of the computer giant and what it stood for. At the conclusion, Palmisano declared IBM's commitment to three values: "Dedication to every client's success," "Innovation that matters," and "Trust and personal responsibility in all relationships."

However critics—and many staff—suggest that what drove actual decision-making at IBM under Palmisano was not so much "clients", "innovation" or "trust', but a relentless drive to grow earnings per share, no matter what the cost.

Palmisano's 2014 interview corroborates the diagnosis. In the long interview, Palmisano never once mentions the word "client" or "trust". He mentions "innovation" only once, and then to point out how little money it involves in the overall scheme of things. "Your innovation and long-term investments are a very small portion of the SG&A [i.e. selling, general, and administrative expenses] pot—maybe 4 percent." Somehow IBM's values got lost in the shuffle.

Embracing "the dumbest idea in the world"

In the HBR interview, Palmisano reveals himself to be a true believer in maximizing shareholder value.

"We gave investors annual outlooks, and we gave them earnings," Says Palmisano. "You have to give them something—they're owners… You want people to have some clarity so that they will invest in you.,, In 2006 we told [Wall] Street that we would go from $6 to $10 in earnings per share by 2010. We then tied long-term compensation to that model… We executed it, and it worked for us."

For Palmisano, managing IBM was all about generating investment returns for the big shareholders. "If you're a small, young company and you're driving revenue without a lot of earnings, you've got a completely different model… The Berkshire Hathaways, the Neuberger Bermans, the Capital Worlds are looking at a longer-term cycle for their investment returns."

Palmisano treated the large shareholders as real owners. "We decided to treat our large shareholders with total transparency, as best we could within regulations. We would meet with them. We'd have a couple of them come in every quarter and talk with the entire senior management team… Fidelity, Capital, BlackRock, T. Rowe, Wellington, Neuberger Berman—the big guys. They would each bring four or five portfolio managers…. They could spend as much time as they wanted with the businesses. The meetings went on for hours."

Palmisano found that the big shareholders supported his primary focus on earnings per share, ahead of growing the business. "Basically, the shareholders were just asking us to be friendly with capital allocation. They wanted more margin expansion and cash generation than top-line growth, because they knew that if we generated cash, we'd give it back to them in the form of a share buyback or a dividend, not a crazy large acquisition that no one else could see value in." And so Palmisano became very friendly to his big shareholders and his own wallet.

An unholy alliance: top managers and big investors

Palmisano argues that such investors are good for business, and he is right, if you define business as making money for the top managers and the big shareholders. Palmisano's lyrical memories of the sessions that he had with the big investors in those meetings that went on for hours did indeed end wonderfully for him. How could it be otherwise?

Just think about the scene. The IBM C-Suite which is hugely compensated for jacking up the share price. And managers of the big investors are also hugely compensated if they get reliable information as to exactly how the share-price is going to be jacked up. Should it be any surprise that this self-interested cabal ends up jacking up the share price? The question remains: was this good for IBM—and society—or not?

Growing the real business

Palmisano feels that IBM not only grew shareholder returns but also the real business. "We invested $6 billion a year in R&D. Throw in another few billion for acquisitions of technologies that we weren't organically developing, and I'd say $10 billion, $11 billion a year. It was 10 percent of revenue. There aren't a lot of companies investing 10 percent of revenue. At IBM, we knew we had to invest for the long term. Not everything works out. That's why it's called research and development."

Palmisano views his role at IBM as a steward of a machine that makes money for the big investors. "You're a proprietor at a point in time; you're a steward. You're not the founder. You're there to protect the entity for long-term returns."

The contrast between the mindset of Palmisano at IBM is a stark contrast to the mindset of Steve Jobs at Apple. One was managing the money, allocating to resources to innovation but not particularly interested in what those innovations wer about. The other was passionately involved in dreaming up and creating insanely great products that would thrill the marketplace.

Palmisano believes in share buybacks. “You have jillions of dollars of cash on the balance sheet. Instead of buying an asset for $8 billion, why don’t you give some of that back?” … you’re not a start-up anymore. You begin with what I call act one—the first phase, the hit product, a great run. You’ve got companies in great runs right now, the Googles and the Facebooks. Good ideas, great returns, but then all of a sudden, you need an act two. Well, jeez, is act two going to propel you from $30 billion to $100 billion? That’s a little tougher… the investor says, “Wait a minute. I expect you to be more mature now. Your company’s not young anymore.” The investor expects returns—consistent returns.”

So Palmisano, and Rometty after him, set out to deliver consistent returns. The cost to IBM of doing so has been considerable.

The cost of consistent shareholder returns

Under Palmisano’s leadership, the steps taken to ensure IBM’s steadily increasing earnings have created significant issues, as you might expect from pursuing “the dumbest idea in the world.”

> Relentless cost-cutting: Employees bitterly refer to the Palmisano’s Roadmap 2015 “Roadkill 2015.” The cost-cutting began with “Roadmap 2010” has continued, long after obvious fat has been removed. Workers complain that the cuts now affect IBM’s muscle bone and vital organs.
>
> The shift to cheaper expertise: IBM shifted technical expertise from high-paid US staff to low-salaried staff in India, while cutting back on staff in the US. Its Indian operations grew from 3,000 to well over 100,000 employees.
>
> Automatic culling of staff: Managers are required to cull a certain percentage of their staff, regardless of absolute performance.
>
> Fading technical expertise: IBM’s failure to win the bid for the CIA’s cloud computing contract, worth some $600 million, is highlighted by BW. This bid should have been IBM’s “home field,” given its long experience with mainframes and government contracting. Its bid was 30 percent lower than Amazon’s, which had no experience with government, yet IBM’s bid was rejected on technical grounds. An appeal by IBM was even more humiliating: it only highlighted how technically inferior its proposal was and so the bid was withdrawn.
>
> Bureaucracy and lack of agility: Despite talk of delayering and collaboration across silos, IBM still has a steep hierarchy, with thirteen layers of management. When combined with the relentless cost-cutting and offshoring and the fear that these practices generate, the agility of the organization tends to be compromised.

Acquisitions instead of innovation: Despite spending some $6 billion on R&D, IBM fell behind its competitors technically. This was one of the factors behind its losing bid for the CIA project. IBM's response has been to buy firms with needed expertise, such as Aspera, which helps clients move large volumes of data quickly; Cloudant, a service for mobile and Web apps; TeaLeaf, a tool for retail marketers, and SoftLayer Technologies, a cloud computing firm. What remains to be seen is how well those acquired firms will do when faced with the demands of Roadmap 2015 and the IBM bureaucracy.

Reliance on financial incentives: "People need to understand," says Palmisano, "that if they execute the model, they will be rewarded." The problem is that when incentives are purely financial, motivation suffers. And when the financial incentives are as skewed towards the top as they are at IBM, the costs in terms of motivation are considerable.

Sagging staff morale: When layoffs are a central part of the business model, especially needless layoffs for financial positioning, it creates disaffected employees. Even IBM's fans concede that staff morale is low. Despite many talented and committed staff, the relentless cost-cutting, the steep hierarchy and lack of agility have taken their toll, particularly in key areas like innovation and generating customer delight.

An imploding business model: "IBM has three core businesses: services, software, and hardware. When times are good, they work in concert," writes Bloomberg BusinessWeek. "A decline in one of these businesses can hobble the whole company, a destructive spiral IBM is fighting to break. As more customers get their computing done cheaply in the cloud, IBM is selling less hardware, which imperils its high-margin software products. And any perception that IBM is adrift threatens its ability to advise clients on anything at all."

A cloudy future strategy: "The cold-sweat scenario for IBM," says Bloomberg BusinessWeek, "is that it does catch up to Amazon and other cloud providers—only to find that competition has driven margins toward zero. In March a price war broke out among Amazon, Google, and Microsoft, as each announced cuts of as much as 35 percent on computing; 65 percent on storage; and 85 percent on other services. Rometty has made two promises to investors: to lead corporate IT into the cloud and to deliver lustrously thick margins. Those goals may be irreconcilable, as long as IBM faces competitors willing to make the cloud a place of ever-diminishing returns."

The challenge for IBM

When Rometty took over as CEO, she had a decide what to do about the tension between the Roadmap 2015 and the internal problems that it had caused. She opted to live with the tension and continues implementing Roadmap 2015.

She also endorsed Palmisano's three values--"clients", "innovation" or "trust"'-- reinforcing them with a single purpose—"Be essential"—and nine practices: "Put the client first," "Listen for need and envision the future," "Share expertise," "Restlessly reinvent," "Dare to create original ideas," "Treasure wild ducks," Think, prepare, rehearse," "Unite to get it done now," and "Show personal interest." Communicating this 1-3-9 throughout IBM became a high priority.

"Last year," Bloomberg BusinessWeek reported, "she began distributing black plastic cards bearing the phrase "One Purpose: Be essential" to IBM's roughly 50,000 managers and has been known to demand to see them as she walks the halls." When I checked with IBM staff whether this story was really true, they told me that it was implausible since the cost of printing 50,000 cards was exactly the kind of cost that would be automatically be cut in today's IBM.

And therein lay the rub for Rometty. If her 1-3-9 package of purpose, values and practices were the whole IBM story, or even the main story, she might be on a winning trajectory. But when they are seen against the overriding pressures of Roadmap 2015, no one hears the messages. Any "wild ducks" that are still left on the staff keep their heads down and take care not to make waves.

The problem was, and still is, how to reconcile Roadmap 2015 with the steps needed to deliver it: capability-crippling outsourcing, unsustainable work pressures, fading technical competence, lagging innovation and sagging staff morale. The two tracks are incompatible—something that's been obvious to IBM staff for a very long time.

In order to keep up the growing earnings per share despite the internal problems, Rometty has resorted to ever more ingenious financial engineering, including non-standard accounting practices (125 in IBM's annual 2013 report), borrowing to fund share buybacks, and tax reduction gadgets.

Whatever's wrong with IBM isn't recent. Rometty is following exactly the Palmisano plan. We are just further down the track, and its unsustainability is becoming steadily more apparent. As time goes on, the tea-leaves become easier to read.

What's striking is Palmisano's blithe innocence as to any significant issues with what he has wrought at IBM. Palmisano is glad, BW reports "to see [his approach] continuing under Ginni." Indeed, in April 2014, he launched the Center for Global Enterprise to distribute this thinking to other companies.

The right level of discussion

This is not just a technical wrangle about whether Roadmap 2015 is the right metric to apply. It's a discussion about what we value as a society. Is the organization going to be an instrument of society or simply a short-term money-making machine for a cabal of its top managers and a bunch of major shareholders?

Is IBM, as Peter Drucker would suggest, a social institution, which can harness the capacity and potential of its people because it respects them? Or is it a money-making machine that throws talented people away like so many broken machines?

Palmisano makes no apology for being steward of a money-making machine that takes no prisoners. In fact, he celebrates it. And indeed sees no alternative. It's simply the way things are. The possibility that he got rich—legacy-wealth rich—in the process may have anything to do with it never crosses his lips. As Upton Sinclair noted, "It's hard to get a man to understand something when he is being paid not to understand it." Particularly when the amount of the payment is $225 million.

Huddled together on a sinking ship

Yet implicit in Rometty's summary is a philosophy of business as usual. It involves IBM pursuing a a set of "core accounts", namely, big firms who don't understand software and who are scared to death of everything that it is doing to their businesses. They are hoping that IBM can somehow protect them by providing a safe and stable environment and they are willing to pay a premium if IBM can do it. That will enable them to get back to their "real business" of pushing products at customers and making money.

One problem is that when IBM itself is moving so slowly, with such a disaffected workforce, and with no apparent mastery as to what is going on, let alone any clear vision as to what is coming next, the safety and security that IBM provides to its fellow mastodons constitute an illusion. IBM is just as out of touch as they are. When there are much cheaper and more flexible solutions, the option of switching looks ever more attractive, as the pressures mount on all the big firms to deliver "better, faster, cheaper, light, more mobile, more personalized and more convenient." In this environment, the extravagant premiums that IBM is hoping to extract for sticking with IBM look ever more fragile.

The reality is that IBM and its core accounts are huddled together on the sinking ship that is basically out of touch with the marketplace, with an obsolete approach to management (maximizing shareholder value and hierarchical bureaucracy) and frightened of the future. They had all hoped that by jacking up their share prices through tricks of financial engineering, share buybacks and free government money, no one would notice their real underlying problems. But change is coming, inexorably.

The problem they face is that technology isn't something that can any longer be kept locked up in some back room, overseen by IBM. Whether these firms like it or want it or will admit it, all organizations are now software organizations. All of these firms' systems run on software. The customers of these firms all want fast mobile solutions that software can provide. There is no safe space where software can be contained, no back room with the glacial progress of IBM's mainframes. "Software," as Marc Andreessen quipped in 2011, "is eating the world."[67]

For a certain period, the tricks of financial engineering could fool some of the people some of the time that the ship wasn't taking on water or losing velocity. But the moment of truth is fast approaching for IBM, just as it is for IBM's clients. The future is software. All organizations will need to learn to live with it and master it. There is no safe haven. IBM can't provide it. That era is over.

Potemkin-style financial engineering won't save these firms. Maximizing shareholder value by jacking up the share price won't help for long. Nor is the "corporate cocaine" of share buybacks the solution.

Does IBM have a future?

Yet IBM's case isn't hopeless. Despite the profound problems IBM now faces, the firm still has tremendous resources and knowledge, in particular in R&D. It enjoys a huge base of customers who are losing patience but who have not yet given up on IBM. The firms that constitute the Global Accounts have long-term relationships with IBM and want to stay with IBM. They see IBM as one of the few companies that can actually run big complex data centers. IBM has immense strengths in the field of High Performance Computing. Even critics concede that IBM still has the most secure and reliable software for mainframe systems and middleware.

IBM was once a great company that respected and rewarded its employees and served its communities and society. It's a company that still has the power to change the world if only it would choose to.

IBM needs to build on its strengths. Yet it's hard to see how it can accomplish this with the current management team or the current board. It has been evident for some time that IBM has been heading down the wrong path. Why did they just watch and not act? According to Nick Summers at Bloomberg BusinessWeek, IBM's leadership has been "like a driver obeying the commands of a GPS system even as passengers shout that the car is clearly headed toward a ditch."[68]

It's time to get back to Tom Watson Sr.'s philosophy of putting the customer first among stakeholders and earning a real living again in a very different context.

It is this kind of management that we now turn.

Chapter Two

Management in the Creative Economy

We believe customers are number one. Employees number two. Shareholders number three.

Jack Ma, CEO, Alibaba[69]

In ancient mythology, the Medusa was a face, ringed with serpents, whose very stare turned people to stone. The only hero in the ancient world to survive the Medusa's stare was the young hero, Perseus, who flew through the air on winged sandals. Perseus succeeded in cutting off the Medusa's head by refusing to look at the Medusa's face. Instead he looked at her image reflected in his bronze shield and so was able to cut off her head.[70]

The myth has tantalizing hints for the dilemmas of modern management coping with the twin challenges of petrification and transformation. If we look at our goal directly, we may succumb to petrification. In complex situations, oblique goals tend to work better;[71] a focus on adding value to customers makes more money for shareholders than directly focusing on making money.[72]

Thus even as the Traditional Economy, driven by the twin principles of maximizing shareholder value and hierarchical bureaucracy at most big publicly-owned corporations, continued its steady decline, a new economy—the Creative Economy—with a new era of leadership and management was emerging. In parts of the global economy, some organizations were pursuing a different path—a path of continuous innovation and transformation focused principally on delivering value to those for whom the work is being done, with lightweight iterative management practices that escaped the petrification of bureaucracy.

This Creative Economy has many roots and predecessors. In terms of goals, a notable source was Peter Drucker's dictum "There is only one valid definition of a business purpose: to create a customer."[73] In terms of magement methods, it owed much to lean manufacturing and agile practices in software development.

What is interesting about firms in the Creative Economy is that they are currently espousing a set of goals, practices and metrics that are enabling, rather than petrifying. These organizations get things done at speeds that traditional organizations can only dream of, as if flying through the air on winged sandals. Unlike bureaucracy that suffers sclerosis as it scales, organizations in the Creative Economy have found ways to become more productive as they scale.

The new path shares one of the genuine merits of shareholder value theory: it provides a single clear goal on which progress could be measured—a necessary step in overcoming the inconsistent and ill-defined priorities of the "garbage can" organizations that had emerged in the mid-20th Century. Shareholder value provided a single clear goal: the problem was that it chose the wrong goal. It neglected the sine qua non of a firm's existence: to generate value for those who were paying for its goods and services. Value for shareholders is the result, not the goal, of the firm's activities.

The new path also respects the rights of shareholders. By following the principle of obligquity, it makes more money for shareholders than if it focused directly on making money for shareholders. By serving customers brilliantly and organizing employees in ways that allow them to express their creative value to the greatest possible extent, these firms make shareholders, employees, customers and society as a whole all better off.

The Creative Economy is based on the premise that if firms serve customers well, benefits for shareholders and the community will follow. The reverse isn't true: maximizing shareholder value destroys value for both customers and shareholders. In the Creative Economy, customers as stakeholders are the center of the capitalist universe and its gospel.

A summary description of this path is as follows:

> If a firm works in a collaborative way with its employees and partners on continuously adding value and providing solutions to the people for whom work is being done – i.e. its customers and users – due to the resultant success of the company its shareholders will receive benefits much greater than if the firm focused single-mindedly and directly on making profits for its shareholders. At the same time, society as a whole will benefit from having more virtuous and sustainable firms. By giving every employee a clear line of sight as to how his or her work effects the ultimate customer, and by continuously measuring the interaction with customers, the firm has a clear metric that can guide day-to-day decision-making.

The combination of different goals, methods and metrics leads to organizations that feel quite different from the dispiriting hierarchical bureaucracies that we have inherited from the 20th Century. The leadership required means a different way of thinking, speaking and acting in the workplace. The goals, methods and metrics of leadership and management in the Creative Economy are thus quite different

The Creative Economy generates dramatic reductions in cost, size, and time, and improvements in convenience, of products and services with new systems of infrastructure, new ways of socializing, new meaning as to how time is spent, and new ways of living these possibilities. Organizations that exemplify it, at least in part, include prominent firms like Alibaba, Amazon

Apple, DSM, Etsy, Salesforce Haier Group, Whole Foods and Zara along with thousands of lesser-known firms.

The Creative Economy involves not merely the application of new technology or a simple set of fixes or adjustments to hierarchical bureaucracy. It means basic changes in the way organizations are led and managed. It's a paradigm shift in the strict sense as laid down by Thomas Kuhn: a different mental model of the world—a different way of thinking, speaking and acting in the world. To traditional managers, the leadership and managerial practices of the Creative Economy often appear "questionable, if not downright crazy". In the Creative Economy, these leadership and managerial practices constitute "the new normal".

The Creative Economy is a coherent constellation of principles, attitudes, values and beliefs, not just a bundle of gadgets or processes or systems or technologies. Many of the products, processes, practices or technologies of the Creative Economy have already existed for some time. But in the Traditional Economy, they have been playing a minor role or a mere complement to existing ways of doing things. These elements have moved onto center stage and become collectively part of a coherent constellation of principles that represent "the new common sense."

The leadership and management practices of the Creative Economy emerged because the internal contradictions of the Traditional Economy became so great, and the growing gap between what the marketplace needs and what the Traditional Economy could deliver became so large, that the "normal" model of leadership and management broke down and a new model emerged with a better explanation of how the world works.

The Creative Economy is a response to increasing complexity. In a world in which inspiring the creativity of employees and partners has become a central task and in which customers who have instant reliable information and who interact with each other have become dominant, the linear thinking of managers who treated employees as "resources" to be told what to do and treated customers as "demand" to be manipulated became increasingly ineffective.

Efforts to impose linear thinking on complex situations led to the opposite of what is intended. Where explicit articulation of a goal will result in the complex environment pushing back in the opposite direction, oblique goals tend to be more effective.

The Creative Economy involves not just a new process or a new system or a technique or technology, although it includes all of these. It means a fundamental shift in how leaders think, speak and act in the workplace. At its heart lie a different set of habits values, attitudes and beliefs. Whereas the Traditional Economy pursued an ethos of efficiency and control, treating both employees and customers as things to be manipulated, the Creative Economy thrives on the ethos of imagination, exploration, experiment, discovery and collaboration. It deals with employees and customers as independent, thinking, feeling human beings. It embraces complexity as an advantage, rather than a hurdle to be overcome.

Over the last several decades years, firms pursuing this path have been delivering to customers what they are coming to expect, namely, better, faster, cheaper, smaller, lighter, more convenient, more personalized and more sustainable products and services.

The Creative Economy entails a transformation in leadership and management goals, methods and metrics.

> The organization's *goal* shifts from making money for shareholders and the executives to deliver continuously more value for customers.
>
> The *methods* of running the organization shift from the rules, plans and reports of bureaucracy to an evolving set of collaborative practices that draw on the full talents of those doing the work and that spark continuous innovation.
>
> The *metrics* shift from narrow financial goals to measures that reflect the real value being generated for customers and society.[74] The new goals, methods and metrics fit together as an interlocking system, entailing a different way of thinking, speaking and acting in the workplace.
>
> The goal, methods and metrics fit together as *an integrated system* of leadership and management.

The confusing reality of the moment is that there are two different economies, operating simultaneously, albeit at different speeds and on different trajectories.

Box: The origin of the Creative Economy

Richard Florida credits Business Week with introducing the concept of the Creative Economy in August 2000.[75] Florida expanded on the theme in his book, *The Rise Of The Creative Class* (2002) "Today's economy," he wrote, "is fundamentally a Creative Economy." Although, as Peter Drucker had argued, the basic resource is knowledge, ahead of the traditional resources of capital or labor, it is, wrote Florida, creativity—"the creation of useful new forms out of that knowledge" that will be the key driver of the 21st Century economy. "None of this is totally new: humans of course have engaged in creative activities since antiquity. What we are doing now is mainstreaming those activities; building an entire infrastructure around them."

In his book, *The Creative Economy* (2001) John Howkins wrote about fifteen "creative industries" that had emerged. Don Tapscott discussed the growing scope and potential of these phenomena from an economic perspective in his books, *Wikinomics* (2006) and *MacroWikinomics* (2010).

As the Creative Economy thrived, despite the massive financial crisis of 2009, with the startling emergence of hugely profitable firms like Apple, Amazon and Salesforce, traditional organizations were increasingly unable to cope with a rapidly changing marketplace in which power has shifted from seller to buyer.

As Gary Hamel wrote in his landmark article in Harvard Business Review, *Moon Shots for Management*, "Equipping organizations to tackle the future would require a management revolution no less momentous than the one that spawned modern industry." As Don Tapscott said, we are "at a punctuation point in human history where the industrial age and institutions have finally come to their logical conclusion."

Exemplars of the Creative Economy include Alibaba, Amazon, Apple, Autodesk, DSM, Etsy, Haier Group, Salesforce and Zara.

Over time, it has become apparent that the Creative Economy is more than a class of creative workers or a set of creative industries. It constitutes an ongoing transformation of the entire modern economy and society, eventually affecting every person and every organization.

How did the Creative Economy emerge? While most firms tried to cope with the turbulence of deregulation, globalization and the Internet by doubling down on maximizing shareholder value, command-and-control and bureaucracy, some bold business revolutionaries took the opposite path and asked, "What if we ran our firm differently?"

They asked: What if we rethought the basic management heuristics of the Traditional Economy? What if we created a firm that was totally focused on the buyer, the customer, the client? What would that kind of organization look like? Could it make money? They knew it could make money on a small scale. Could it make money on a large scale if the whole of a large organization focused on delighting the customer?

These were leaders who took a hard look at what was going on in business. They saw the compromises, the diversion of resources and the resulting impact. They asked themselves: Is this the best that capitalism can do? What if we aspired higher? What could we accomplish?

Let's look at a couple of examples.

Whole Foods

One is John Mackey who co-founded a health foods store in Texas in 1978. As he developed the business over the years, he asked himself:

"What if we built a business that is born out of a dream about how the world could be and should be?

"What if we created a business built on love and care rather than stress and fear, whose team members are passionate and committed to their work?

"What if we formed a business that cares profoundly about the well-being of its customers, seeing them not as consumers but as flesh-and-blood human beings whom it is privileged to serve?

"What if we made a business that embraces outsiders as insiders, inviting its suppliers into the family circle and treating them with the same love and care it showers on its customers and team members?

"What if we developed a business that is a committed and caring citizen of every community it inhabits, elevating its civic life and contributing in multiple ways to its betterment?

"What if we made a business that exercises great care in whom it hires, where hardly anyone ever leaves once he or she joins?

"What if we created a business that chooses and promotes leaders because of their wisdom and capacity for love and care?

"What if we built a business that exists in a virtuous cycle of multifaceted value creation while also delivering superior financial results year after year, decade after decade?"[76]

Unreal?

Not so, said John Mackey, now the Co-CEO of Whole Foods Markets and co-founder of the conscious capitalism movement.[77] The chain has 360 stores and revenues of $9 billion.

By and large, Mackey has made substantial progress towards realizing his vision. Now it's true that even in Whole Foods, of which I'm personally a big fan as a customer, performance varies somewhat from store to store.[78] And there are flaws: it's almost as easy to find a disengaged checkout clerk in Whole Foods as it is in any supermarket. (By the way, why no self-checkouts?).

Let's face it: a grocery store will never thrill everyone. What delights one customer may disappoint or horrify another. Even work that provides deep meaning for employees will have its irksome moments. Mackey's vision embodies a yearning that is not—and perhaps never can be—completely fulfilled.

Yet overall, Mackey has created an organization of self-organizing teams and ecosystems of partners that is becoming steadily more "suffused with higher purpose, leavened with authentic caring, influential and inspirational, egalitarian and committed to excellence, trustworthy and transparent, admired and emulated, loved and respected."[79] Whole Foods may never fully attain that vision, but it is on a journey towards it.

Whole Foods is not a theoretical concept or an imaginary entity in some fictional utopia. It exists in real life. You go and see it in action and shop in it. And it is flourishing financially.[80]

Apple

A second example is Apple.

In 1997, Apple was practically bankrupt. It had become a big, slow-moving bureaucracy. Its products satisfied a small niche of customers. But it wasn't a serious global contender.

One reason for that is that over the preceding fifteen years, Apple had been run as a hierarchical bureaucracy, thus steadily underming its capacity to innovate.

Another reason is that between 1986 and 1993 when Apple spent about 67 percent of income on share buybacks and 12 percnet on dividends. As a result, there weren't enough resources available to innovate.[81]

In 1997, Steve Jobs came back not just to rescue the firm. He also set out to test the hypothesis: is it possible to create a firm totally focused on delighting its customers? And if it was, would it make any money? He had tried to do this twenty years earlier and had failed. Now he had another chance.

He looked around Apple and asked: who is contributing to customer delight and who isn't? He looked at roughly four thousand middle managers in Apple and he couldn't see that they were doing anything useful for customers. They were shuffling papers up and down the hierarchy.

So he said: Those positions are gone. If you want a job in Apple, then you need to be working on something that adds value to customers![82]

He found the same thing in the R&D department. He closed it down and said: If we have the best people, we'll be able to access the best knowledge in the world.[83]

And he proved it. In 2007, Apple was able to launch a state-of-the-art mobile phone from scratch in just 18 months. This was an organization that had never done anything in cell phones before that.

So Apple transformed the music business. It transformed the mobile phone business. It transformed the tablet and PC business. It did this by running the firm very differently from a hierarchical bureaucracy.

It used a network of small multidisciplinary teams, all focused on profitably delighting the customer, combined with its own complex ecosystem—a management technology platform that enabled hundreds of thousands of developers to collaborate and create Apps that could meet every conceivable human need and to offer them directly to customers. The result is that an iPhone or an iPad can be easily adapted to meet the needs, preferences and passing whims of hundreds of millions of individual users—a feat that is inconceivable with traditional management.

In achieving mass personalization, Apple answered the question: is it possible to make money by delighting the customer on a large scale? It not only makes money, it makes humongous amounts of money! Apple went from being on the brink of bankruptcy in 1997 to being the largest market cap company in the whole wide world, in just 15 years.[84]

Salesforce

The third example is Salesforce. Marc Benioff is the chief executive of this organization that provides software services on a global basis. It has headquarters in San Francisco. For several years in a row, Salesforce has been named by Forbes as the most innovative firm on the planet.[85]

How did that happen? In 2006, Salesforce was just another startup that was slowing down as it applied traditional management techniques. It had been successful, but it was turning into just another lumbering bureaucracy. With its global computer system, millions of clients and more than 30 million lines of code, where even a single tiny error could cause the entire system to crash, traditional management proceeded with ever tighter controls, trading off innovation for scale and safety.

So Salesforce did something different. It drew on an approach that had evolved in software development with names like Agile, Scrum and XP.[86] Salesforce didn't invent this approach. It had been around for more than a decade.[87] But Salesforce applied it energetically and showed what it could accomplish on a large scale. Salesforce became one of the very best exponents in the world.

And what does it involve? It's unlike a bureaucracy where you have big departments with big plans and big budgets. In this approach you start by asking: What are the most important things for customers in the whole firm?[88]

And once you've established that, you ask: What's the single most important thing in the whole firm for our customers? And once you've figured that out, you ask: Who are the very best people in the entire firm? We want the best people in the firm to work on this. After all, this is our most important thing!

If you ask those kinds of questions in a bureaucracy, the managers leap up and cry: You can't have those people because they are committed to doing other things and they are crucial to our unit meeting its targets. We need those people. You'll have to look elsewhere!

But on this approach, you ask: Is this the most important thing in the firm or not? If it's the most important thing in the firm, those people must come out from whatever they are doing and work on this task full-time!

And then you ask those people: How much do you think you can get done for customers on this task in, say, a month?

The people get together and they say what they think they can accomplish in a month.

Then you say: Right! Go away for a month and deliver at least that. More if you can. And remember: we won't interrupt you. We won't bother you. If there's anything you need, or anything that's getting in the way, just let us know, because this is the most important thing. Go for it. Make the most important thing in the whole firm happen! You have just a month!

Then you say: Now what's the next most important thing? And who are the best people to work on that? And you work down the things that the firm has to do and get the best people working full-time on the tasks that are most important for customers.

So now instead of the usual situation in a bureaucracy where only 20 percent of the people are working on tasks that are high value for customers, suddenly you've got 80 percent of the people working on high value tasks. And a lot of work that is low value for customers gets eliminated altogether.

And at the end of the month, you can see what's been accomplished from the customer's perspective and you assess what's been learned and you begin again.

What happens in this way of working is that a lot of the management roles disappear and you have a very agile organization that is learning rapidly. It doesn't take a year or two to discover that some big project is going to fail. You find it out in the first month or two. So you can make adjustments.

And when you spot opportunities, you can move very quickly to take advantage of them. You don't need months or even years of strategic planning sessions, big plans or big reorganizations to make big changes. That's because strategic adaptation is happening on a continuous basis.

The approach means changes for everyone in the organization. It's not just more productive. It's also more satisfying because finally people can get on with their jobs without being interrupted, the jobs that they wanted to do all these years. And if they are facing an impediment to getting things done, they can get it fixed.

But it's also more challenging. A smaller number of managers have to be decisive on what's strategically important for the organization and remove impediments to getting the work done. Unlike a bureaucracy, they can't defer decisions or hedge their bets and wait to see which way the corporate wind at the top is blowing. They have to decide and act in real time.

And for the workers, too, it's more interesting and more demanding. They have more responsibility. Now they have to decide how much they can get done in a month, and then deliver on what they have promised. And what they produce each month—or don't produce—is visible to everyone. They're not delivering a report, which can be fudged. They're delivering something potentially usable by a customer that can be seen and touched and tested. Unlike a bureaucracy, there's nowhere for anyone to hide. If someone is just coasting along, everyone can see that. The manager doesn't have to say a thing: it's the team itself that is responsible for performance and that deals with a team member who's coasting.

So it's a more challenging environment for both managers and workers. For workers and managers who want to do a good job, it's more satisfying, even thrilling.

And it also answers the question: does operating in this way make money? It not only makes money. It makes exponentially more money. Salesforce is growing at 40 percent a year and has increased its market cap by 800 percent since it went public eight years ago.[89]

The Creative Economy spreads

Now you might say: That's John Mackey at Whole Foods! That's Steve Jobs at Apple! That's Marc Benioff at Salesforce! Those are one-off experiences that can't be replicated!

But Whole Foods, Apple and Salesforce aren't alone. Amazon, Toyota, Haier Group, Li & Fung and Zara are other prominent exemplars going down the same path of fundamental change (at varying speeds), along with thousands of lesser-known firms. The transition is happening not just in high tech, but also in manufacturing, books, music, household appliances, automobiles, groceries and clothing.[90]

Even more important, we see these practices starting to take hold within large old hierarchical bureaucracies. As Professor Bill Fischer of IMD says, "I've been repeatedly impressed by "old economy" firms practicing "creative economy" managerial approaches, yet receiving little or no recognition for it. We need a new way to think about what is going on across all sectors of the economy, and this approach provides welcome relief to at least part of the shortcomings in the more traditional approaches."[91]

In GE Health, for instance, one can find the same Agile practices being pursued as at Salesforce, even though GE as a whole is still largely run along the lines of a hierarchical bureaucracy, pursuing shareholder value.

"Some firms are exploring "dual operating systems." One version is the dual operating system, as described by John Kotter in his HBR article and now a book, Accelerate. Kotter helps his clients build two operating systems, side by side. The challenge is to do it in such a way that the hierarchy doesn't snuff out the contributions of the network. The network must be leading the hierarchy, rather than the hierarchy leading the network.

The other option is to build a network *within* a large hierarchy. That's what we did at Federal Blue Cross Blue Shield, which was a business alliance of all of the Blue Cross Blue Shield plans. Rather than having a dual operating system as Kotter suggests, we built a self-contained network inside the larger hierarchy.

We didn't have side-by-side operating systems. We had a smaller network that was relatively autonomous from the larger hierarchical organization. This required highly developed skills of our network-based organization. We had to manage the larger organization so that we could maintain the autonomy we needed to get things done in the smaller network organization. There are different ways in which you can approach a hybrid.

None of these organizations has arrived at any final equilibrium: in each case, management practices continue to evolve. Nor is any of these organizations perfect, as they have to cope with a context that is filled with contradictions. Their virtue lies in the creative energy with which they are pioneering new ways of adding value.

Nevertheless the common elements of what all these organizations are doing has emerged. A set of leadership and management principles and practices can be discerned. It's not merely the application of new technology or a set of fixes or adjustments to hierarchical bureaucracy. It involves basic change in the way people think, talk and act in the workplace. It involves deep changes in attitudes, values, habits and beliefs.

The shift in management paradigm is as transformational as the shift from the medieval view that the sun revolves around the earth to the view that earth and the other planets revolve around the sun. It is a fundamental transition in world-view. Once you make this mental shift, everything looks very different.

The public sector

The rest of society is still catching up with the Creative Economy. Its role must shift in various ways.

The public sector, including politicians, Politicians commit themselves to prosperity for all, not just riches for the few. Government regulation needs to give priority on ensuring that the economy adds value to citizens, rather than games that extract value through activities that are zero-sum or negative for society. The primary focus of regulators needs to be on systemic soundness, not just catching individual wrongdoers.

Government must complete its efforts to rein in the financial sector. Government must ban practices that hurt society, e.g. stock price manipulation through share buybacks. Regulators pursue individual wrong-doing but remain largely indifferent to systemic failure. Rating agencies must be encouraged to focus on longer-term value.

National accounts need to be upgraded to reflect the new economic and management realities. Generally accepted accounting standards evolve to reflect the principles and practices of the Creative Economy. The "single objective financial function" by which the value extraction is enforced in decisions taken throughout the whole organization is replaced by metrics that reflect the goals of the Creative Economy.

Business schools must teach their students how to operate in the Creative Economy as part of the core curriculum, which must be cleansed of obsolete 20th Century thinking.

Institutional shareholders must shift their attention from short-term gains to longer value investments.

None of these organizations is perfect, but they feel very different from firms in the economy of yesterday. We can read more than a score of books about them. We can go and visit them and see how they are being run. We can talk to the people doing the work and see that they are passionate about what they do. We don't have to imagine what an organization implementing thirty innovations per day would look like, because we know real-life organizations which are doing just that.

Just as the methods of organizations in the traditional economy are held together by a kind of invisible glue, so too organizations in the Creative Economy are held together by the compatibility of the goals, metrics and practices, which fit together and interlock. The fact that they form an integrated whole creates a kind of invisible link that holds them in place. That's because delivering value to customers is an inherently inspiring goal: you don't need command-and-control to make employees do something they don't want to do. Unlike the Traditional Economy where firms had to tell people what to do, and watch them closely to make sure they do it, in this new economy, firms can have enabling management practices and metrics that thrive on shared goals and mutual trust. Practices like self-organizing teams, platforms, networks and ecosystems enhance and magnify the value of what employees themselves want to do. Instead of management having an adversarial relationship with employees, managers can have a collaborative trusting relationship with common goals. The goals, practices and metrics are not just a random grab bag of managerial gadgets. Together, they form a consistent, coherent and scalable whole.

The Creative Economy isn't very visible yet in the national economic accounts for several reasons. First, it's still a relatively small part of the overall economy. Second, it doesn't always create a lot of jobs in the traditional sense, although it often generates meaningful work in networks and ecosystems for vast numbers of people. Third, because the Creative Economy is occurring *inside* some of the big old firms being run overall in a traditional fashion, the change is hidden from public view. Fourth, the Creative Economy lies to a significant extent outside the purview of the national accounts which still look at the economy in terms of the Traditional Economy, which doesn't distinguish between money made in zero-sum games and money that represents real value to the economy. . In fact, economics itself is part of the problem, as economic statistics give us a distorted picture of what is going on.

The shift from the Traditional Economy to the Creative Economy isn't just a tussle over some obscure aspect of management or economic theory. It's a shift in what society demands of the managers of its most powerful institutions: from narrow definitions of their owners and decisions that serve their short-term interests, to broad acceptance of the responsibility that comes with power and leadership concerned with what is best for society. In the shift, we are learning that an argument about the proper activities of managers can be logical, can be strongly argued, can influence decades of practice in the world's largest corporations – and can still be plain, flat, dead wrong.

[1] http://www.forbes.com/sites/stevedenning/2014/05/26/clayton-christensen-do-we-need-a-revolution-in-management/

[2] http://www.forbes.com/sites/stevedenning/2014/09/26/has-capitalism-reached-a-turning-point/

[3] Doing Capitalism In The Innovation Economy, by William Janeway

[4] Brook Manville

[5] Deloitte's Center for the Edge

[6] Cf Hammer and Champy p 2

[7] Hill, S. "The Default Mode Of Managers Needs A Reset," http://www.ft.com/intl/cms/s/0/a8fe78a8-65e6-11e4-898f-00144feabdc0.html#axzz3Jseu1DgJ

[8] Baumol, W. J. (2006) Regulation Misled by Misread Theory: Perfect competition and competition-imposed price discrimination, Washington, DC: AEI-Brookings Joint Centre for Regulatory Research.

Baumol, W. J. and A. Blinder (2006) Microeconomics: Principles and policy, 10th edn, Mason, OH: Thomson South-Western.

Cited in Hill, Rod; Myatt, Tony (2010-03-11). The Economics Anti-Textbook: A Critical Thinker's Guide to Microeconomics (p. 275). Zed Books. Kindle Edition.

[9] http://www.forbes.com/sites/stevedenning/2014/03/07/why-tim-cook-doesnt-care-about-the-bloody-roi/

http://www.huffingtonpost.com/paul-polman/sustainable-business-wher_b_4064391.html

http://www.forbes.com/sites/stevedenning/2014/07/13/the-creative-economy-in-france-givenchy-vinci/

http://www.forbes.com/sites/stevedenning/2013/01/05/the-new-management-paradigm-john-mackeys-whole-foods/

How Google Works, by Eric Schmidt et al.

[10] There are many books on the politics of capitalism, such as *Saving Capitalism From Short-Termism: How to Build Long-Term Value and Take Back Our Financial Future* by Alfred Rappaport (Hardcover: 256 pages, McGraw-Hill; August 11, 2011, ISBN-10: 0071736360) and *How Much is Enough?: Money and the Good Life* by Robert Skidelsky and Edward Skidelsky (Hardcover: 256 pages, Other Press; June 19, 2012, ISBN-10: 1590515072). What they fail to do is show the connections to the management practices of the Creative Economy.

[11] There are books on the new ways of managing, such as *Succeeding with Agile: Software Development Using Scrum* by Mike Cohn (Paperback, Paperback: 504 pages, Addison-Wesley Professional; November 5, 2009, ISBN-10: 0321579364), or *Scrum: The Art of Doing Twice the Work in Half the Time* by Jeff Sutherland (Hardcover: 256 pages, Crown Business. September 30, 2014, ISBN-10: 038534645X), and *Essential Scrum: A Practical Guide to the Most Popular Agile Process* by Kenneth S. Rubin (Paperback: 504 pages, Addison-Wesley Professional; August 5, 2012, ISBN-10: 0137043295). However they are mostly limited to software development and fail to see the connections to the financial sector, the stock market and the economy, which systematically undermine the gains from these practices.

[12] http://www.forbes.com/sites/stevedenning/2012/07/27/the-key-missing-ingredient-in-leadership-today/; http://www.forbes.com/sites/stevedenning/2011/07/23/how-do-you-change-an-organizational-culture/

[13] Other discuss the ongoing disruption of the economy, such as *Big Bang Disruption: Strategy in the Age of Devastating Innovation* by Larry Downes and Paul Nunes (Hardcover: 272 pages, Portfolio Hardcover, January 7, 2014, ISBN-10: 1591846900) and *The Second Machine Age: Work, Progress, and Prosperity in a Time of Brilliant Technologies* by Erik Brynjolfsson and Andrew McAfee (Hardcover: 320 pages, W. W. Norton & Company; January 20, 2014, ISBN-10: 0393239357). But they only deal with small pieces of the overall transition that is occurring, and fail to take account of the new management practices of the Creative Economy.

[14] *Too Big to Fail: The Inside Story of How Wall Street and Washington Fought to Save the Financial System--and Themselves* by Andrew Ross Sorkin (Paperback: 640 pages, Penguin Books; September 7, 2010; ISBN-10: 0143118242) and *After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead* by Alan S (Hardcover: 496 pages; Penguin Press HC, January 24, 2013, ISBN-10: 1594205302).

[15] Schopenhauer

[16] Lazonick, W. Profits Without Prosperity, HBR, September 2014, http://hbr.org/2014/09/profits-without-prosperity/ar/1

[17] http://www.forbes.com/sites/stevedenning/2014/09/19/the-economist-blue-chips-are-addicted-to-corporate-cocaine/

[18] Friedman, M. "The Social Responsibility of Business is to Increase its Profits," The New York Times Magazine, September 13, 1970.
http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html

[19] Kiechel, W. *Lords of Strategy* (2013) page numbers not available in Kindle edition
[20] Lazonick, W. 'Profits Without Prosperity." HBR September 2014.

[21] http://www.forbes.com/sites/stevedenning/2012/08/29/is-the-hegemony-of-shareholder-value-finally-ending/ The "garbage can" theory of organizations was developed in the mid-20th Century university by trio of academics–Cohen, March and Olsen, but it had wider applicability to many large corporations.

[22] See Merton, Robert K. 1957. "Bureaucratic Structure and Personality" in *Social Theory and Social Structure* (1968 edition). Glencoe, IL: Free Press.

[23] Einhorn, J. "How Shareholders Are Hurting America," ProPublica, June 27, 2012.
http://www.propublica.org/thetrade/item/how-shareholders-are-hurting-america

[24] How did the Nobel-prize winner arrive at these conclusions? In a paper which accuses others of "analytical looseness and lack of rigor" it's curious that the paper assumes its conclusion at the outset. "In a free-enterprise, private-property system," the article states flatly at the outset as an obvious truth requiring no justification or proof, "a corporate executive is an employee of the owners of the business," namely the shareholders.

As a matter of law, the article is simply wrong. The executive is an employee of the corporation. In Friedman's mind, however the executive and the stockholders have "a voluntary contractual arrangement" which is "clearly defined", even though in the real world, no such contractual arrangement exists: the executive's legal contract is with the corporation.

In Friedman's fantasy world, an organization is an artificial thing—a mere "legal fiction"— which the article simply ignores in order to prove the pre-determined conclusion.

[25] Kiechel, W. *Lords of Strategy* (2013)

[26] Jensen, M.C. and Meckling, W.H.: "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure." Journal of Financial Economics, Vol. 3. No. 4. 1976.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=94043

[27] Jensen, M. and Meckling, W. "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure." Journal of Financial Economics, 1976 Vol 3. No 4, pp 305-360. . http://www.sfu.ca/~wainwrig/Econ400/jensen-meckling.pdf

[28] http://www.forbes.com/sites/stevedenning/2014/08/20/from-ceo-takers-to-ceo-makers-the-great-transformation/;

http://www.forbes.com/sites/stevedenning/2014/08/18/hbr-how-ceos-became-takers-not-makers/

[29] http://www.forbes.com/sites/stevedenning/2014/08/20/from-ceo-takers-to-ceo-makers-the-great-transformation/;

http://www.forbes.com/sites/stevedenning/2014/08/18/hbr-how-ceos-became-takers-not-makers/

[30] Meckling and Jensen put forward the view that the executive's motivation is solely pecuniary: "If the manager owns only 95 percent of the stock, he will expend resources to the point where the marginal utility derived from a dollar's expenditure of the firm's resources on such items equals the marginal utility of an additional 95 cents in general purchasing power (i.e., *his* share of the wealth reduction) and not one dollar. As the owner-manager's fraction of the equity falls, his fractional claim on the outcomes falls and this will tend to encourage him to appropriate larger amounts of the corporate resources in the form of perquisites. This also makes it desirable for the minority shareholders to expend more resources in monitoring his behavior. Thus, the wealth costs to the owner of obtaining additional cash in the equity markets rise as his fractional ownership falls." In due course, this became a horrifying sell-fulfilling prophesy.

[31] http://aaajournals.org/doi/abs/10.2308/accr-50734

[32] http://www.forbes.com/sites/stevedenning/2013/03/10/the-surprising-reasons-why-america-lost-its-ability-to-compete/; http://www.forbes.com/sites/stevedenning/2011/08/17/why-amazon-cant-make-a-kindle-in-the-usa/

[33] Friedman, Milton (2009-02-15). Capitalism and Freedom: Fortieth Anniversary Edition (Kindle Locations 427-429). University of Chicago Press. Kindle Edition.

[34] Friedman, Milton (2009-02-15). Capitalism and Freedom: Fortieth Anniversary Edition (Kindle Locations 427-429). University of Chicago Press. Kindle Edition.

[35] Summers, L. U".S. Economic Prospects: Secular Stagnation, Hysteresis, and the Zero Lower Bound ," Business Economics, 2014, Vol. 49, No. 2. http://larrysummers.com/wp-

content/uploads/2014/06/NABE-speech-Lawrence-H.-Summers1.pdf At first, Summers argued that the problem was one of demand. In a later article, he suggested that "supply-side chokes" were also part of the problem: http://www.businessinsider.com/larry-summers-admits-he-may-have-been-wrong-on-secular-stagnation-2014-9

[36] http://www.forbes.com/sites/stevedenning/2013/03/10/the-surprising-reasons-why-america-lost-its-ability-to-compete/

[37] Friedman, Milton (2009-02-15). Capitalism and Freedom: Fortieth Anniversary Edition (Kindle Locations 427-429). University of Chicago Press. Kindle Edition.

[38] http://www.forbes.com/sites/stevedenning/2013/03/10/the-surprising-reasons-why-america-lost-its-ability-to-compete/; http://www.forbes.com/sites/stevedenning/2011/08/17/why-amazon-cant-make-a-kindle-in-the-usa/

[39] http://www.forbes.com/sites/stevedenning/2013/03/10/the-surprising-reasons-why-america-lost-its-ability-to-compete/

[40] http://www.forbes.com/sites/stevedenning/2014/10/29/the-surprising-truth-about-where-new-jobs-come-from/

[41] http://www.forbes.com/sites/stevedenning/2011/11/28/maximizing-shareholder-value-the-dumbest-idea-in-the-world/

[42] http://www.forbes.com/sites/stevedenning/2014/10/08/debunking-myths-about-worker-passion/

[43] http://www.forbes.com/sites/stevedenning/2014/11/07/why-bureaucracy-must-die/

[44] http://www.epi.org/publication/ceo-pay-continues-to-rise/

[45] http://aaajournals.org/doi/abs/10.2308/accr-50734

[46] Lazonick, HBR

[47] HBR March 2012

[48] http://www.forbes.com/sites/stevedenning/2014/05/02/economic-game-change-from-ownership-to-access/

[49] http://blogs.hbr.org/2014/07/how-the-internet-of-things-changes-business-models/ "A variety of consumer products and services, from Nest thermostats to Philips Hue lightbulbs to If This Then That (IFTTT), highlight these new possibilities for IoT-based value creation."

[50] http://www.forbes.com/sites/stevedenning/2013/09/03/how-the-elastic-enterprise-defeats-the-sclerosis-of-scale/

[51] http://www.forbes.com/sites/stevedenning/2013/03/10/the-surprising-reasons-why-america-lost-its-ability-to-compete/

[52] http://www.forbes.com/sites/stevedenning/2013/07/22/how-modern-economics-is-built-on-the-worlds-dumbest-idea/

[53] http://www.forbes.com/sites/stevedenning/2014/08/18/hbr-how-ceos-became-takers-not-makers/

[54] http://www.forbes.com/sites/stevedenning/2014/05/26/clayton-christensen-do-we-need-a-revolution-in-management/

[55] http://www.forbes.com/sites/stevedenning/2014/06/03/why-financialization-has-run-amok/

[56] http://www.forbes.com/sites/stevedenning/2013/07/29/how-the-worlds-dumbest-idea-killed-the-us-economic-recovery/

[57] The ROA and ROIC of US firms are only a quarter of what they were in 1965 as documented in Deloitte's Shift Index: http://www.forbes.com/sites/stevedenning/2012/01/25/shift-index-2011-the-most-important-business-study-ever/

[58] http://www.forbes.com/sites/stevedenning/2014/10/29/the-surprising-truth-about-where-new-jobs-come-from/

[59] http://www.forbes.com/sites/stevedenning/2012/02/22/hbr-blows-the-lid-off-c-suite-over-compensation/

[60] http://www.forbes.com/sites/stevedenning/2014/05/16/piketty-on-inequality-can-macroeconomists-solve-this-problems/

[61] http://www.forbes.com/sites/stevedenning/2014/08/18/hbr-how-ceos-became-takers-not-makers/

http://www.forbes.com/sites/stevedenning/2014/08/20/from-ceo-takers-to-ceo-makers-the-great-transformation/

http://www.forbes.com/sites/stevedenning/2014/09/19/the-economist-blue-chips-are-addicted-to-corporate-cocaine/

[62] http://www.forbes.com/sites/stevedenning/2011/10/19/retirement-heist-how-firms-plunder-workers-nest-eggs/
http://www.forbes.com/sites/stevedenning/2011/10/21/ge-discusses-retirement-heist/
http://www.forbes.com/sites/stevedenning/2011/10/22/retirement-heist-part-3-ellen-schultz-replies-to-ge/,http://www.forbes.com/sites/stevedenning/2013/04/22/sorry-about-your-pension-scotch-cheese-or-golf/

[63] See the many examples given by William Lazonick: "Labor in the Twenty-First Century: The Top 0.1% and the Disappearing Middle-Class" AIR Working Paper #14-08/01/. (not yet published)

[64] "The Secular Decline in Business Dynamism in the U.S." Ryan Decker, John Haltiwanger, Ron S Jarmin, and Javier Miranda, 2013, http://econweb.umd.edu/~haltiwan/DHJM_JEP_5_17_2013.pdf; Justin Fox, "The Disruption Myth," The Atlantic, 2014; John G. Fernald, "Productivity and Potential Output Before, During, and After the Great Recession" Federal Reserve Bank of San Francisco, June 2014, http://www.frbsf.org/economic-research/publications/working-papers/wp2014-15.pdf

"A perfect storm of technological innovation," write Chunka Mui and Paul Carroll, "combining smartphones and other mobile devices, ubiquitous cameras and sensors, social media, the cloud, and 'big data' analytical tools—means that more than $36 trillion of stock-market value is up for what some venture capitalists are calling "re-imagination" in the near future." Mui, C. and Carroll, P. *The New Killer Apps*, 2013

[65] http://www.footnoted.com/revisiting-ibms-palmisano-equation/

[66] http://www.footnoted.com/revisiting-ibms-palmisano-equation/

[67] http://www.forbes.com/sites/stevedenning/2014/04/11/why-software-is-eating-the-world/

[68] http://www.businessweek.com/articles/2014-10-20/ibm-is-in-even-worse-shape-than-it-seemed

[69] Sixty Minutes, September 2014.

[70] Once having cut off the Medusa's head, Perseus didn't throw the severed head away. Instead, he carried it with him on his travels, concealed in a bag. When his enemies were about to overcome him, he had only to display it, holding it by its serpentine locks and it became an invincible weapon that turned his enemies to stone.

[71] http://www.forbes.com/sites/stevedenning/2013/05/30/the-management-revolution-thats-already-happening/

[72] http://www.forbes.com/sites/stevedenning/2011/04/01/is-delighting-the-customer-profitable/

[73] Drucker, P. *The Practice of Management, (*1954. HarperCollins); : Drucker, P. *Management: Tasks, Responsibilities and Priorities*, (1973). In fact, the the economy has been creative for as long as we have thought of economic activity. One of the most distinguishing features of Drucker's thinking is that history matters because it is a resource for understanding. The creative economy for instance thrived in Coalbrookdale, the "Silicon Valley" of the First Industrial Revolution. Other sources include Helmut Von Moltke's thoughts on strategy. David Hurst believes that further material on the historical roots and systemic nature of the issue are needed to correctly frame this issue.

[74] http://www.forbes.com/sites/stevedenning/2011/07/08/the-five-big-surprises-of-radical-management/

[75] http://www.businessweek.com/stories/2000-08-27/the-creative-economy

[76] Conscious Capitalism, page ???

[77] John Mackey and Raj Sisodia, Conscious Capitalism: Liberating the Heroic Spirit of Business (Harvard Business Review Press, January 2013):

[78] http://www.forbes.com/sites/stevedenning/2012/09/03/whole-foods-and-the-triumph-of-customer-capitalism/

[79] Conscious Capitalism, p.

[80] As of June 24, 2013, over the last ten years, the market capitalization of Whole Foods has incrased 330 percent, compared to a 53 percent increase for the S&P500: http://www.forbes.com/sites/stevedenning/2013/01/05/the-new-management-paradigm-john-mackeys-whole-foods/

[81] Source: William Lazonick: email of October 17, 2014

[82] Simulated conversation

[83] Simulated conversation

[84] As of June 24, 2013, Apple's market capitalization has increased 4,300 percent, compared to the S&P500 increase of 53 percent. Apple's shared price is down about 40 percent from its high in mid 2012.

[85] http://www.forbes.com/sites/frederickallen/2011/04/14/americas-best-and-worst-bosses-for-the-buck/

[86] Links to Scrum, Agile and XP

[87] "The New New Product Development Game" by Hirotaka Takeuchi, Ikujiro Nonaka, HBR Jan 1986

[88] This and the succeeding conversations are notional versions of the actual conversations, not direct quotes.

[89] As of Jun 24, 2013, over the last ten years, the market capitalization of Salesforce has incrased 750 percent, compared to a 53 percent increase for the S&P500.

[90] Give links

[91] http://www.forbes.com/sites/stevedenning/2013/05/13/the-creative-economy-can-industrial-giants-reinvent-themselves/