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REIMAGINING CAPITALISM IN PRACTICE

*Welcome to the World's
Most Important Conversation*

Neo: I know you're out there. I can feel you now. I know that you're afraid . . . afraid of us. You're afraid of change. I don't know the future. I didn't come here to tell you how this is going to end. I came here to tell how it's going to begin. I'm going to hang up this phone, and then show these people what you don't want them to see. I'm going to show them a world without you. A world without rules or controls, borders or boundaries. A world where anything is possible. Where we go from there is a choice I leave to you.

—THE MATRIX, RELEASED MARCH 1999

The First Piece of the Puzzle: Creating Shared Value

In 2012, Erik Osmundsen became the CEO of Norsk Gjenvinning (NG), the largest waste handling company in Norway.¹ The waste business was an unfashionable corner of the economy, but Erik believed it was on the edge of significant transformation. Historically the business had been largely a matter of hauling garbage to local landfills. But Erik believed the future of the industry was in recycling, which had the potential to be a high-tech business selling into a global market with significant economies of scale. He also believed that the waste business held the key to addressing two of the world's great global challenges: climate change and the increasing shortage of raw materials. In his words:

I asked myself, what other industries do we have where you can really change so much for the better? So it was the opportunity that grabbed me. I saw the potential to do something really good. The waste industry in Norway reduces Norwegian CO₂ by 7 percent, which I thought was baffling. Was that possible? We at NG collect 25 percent of all Norwegian waste and we bring 85 percent back to the industry in the form of raw materials and waste to energy. Which I thought was . . . incredible . . . I realized that our industry holds the key to achieving the circular economy—solving two global issues at the same time: the rapidly increasing global waste problem and the squeeze on the future supply of natural resources due to the projected increase in middle-class consumers around the world.

Erik was acting as interim CEO for NG and interviewing candidates for the permanent position when he made the decision to apply for the job himself. In his words:

I remember it as if it was yesterday. It was the day before Easter and I was interviewing a really good candidate and he said look, I

have one question for you, are you a candidate for this job? I went home, and I was thinking to myself, my God, I haven't been this engaged for decades. I went to my wife and I said, I don't know if this is a good idea and I haven't done this before at this scale. But every morning I wake up and I feel that I'm doing something that is really worthwhile and that we could actually make an impact. So after Easter I called up Reynir [the private equity partner who was acting as NG's chairman], and asked him if he could put my name in the ballot so to speak, and the rest is history.

Erik began by riding along with the waste trucks and hanging out at the depots. It quickly became clear that although the majority of employees were honest people, both NG and the industry were engaged in a range of corrupt practices. NG and its competitors were disposing of waste illegally, either by deliberately mislabeling hazardous waste as ordinary waste or knowingly dumping it into the municipal grid. It was ten times cheaper to export electronic waste to Asia illegally than to process it within Norway, while the regulations surrounding waste disposal were poorly enforced by a multitude of different authorities, and the fines for violations were tiny. One study suggested that more than 85 percent of all the waste transported in the country was in violation of the regulations.

Within NG, some managers were fudging their financials to meet short-term targets and misrepresenting the quality of the recycled materials they were selling. When Erik pushed for explanations, he was met with bemused variants of “but that's how it's always been around here.” In Erik's words: “The story was always that this is the way it has always been done. Everyone else is doing it. It's always just some stupid guys in Oslo who think that things can be done differently, but we know that it can't be done differently because that won't work financially or it won't work at all.”

Some people might have walked away. But Erik went back to his board, asking for the money and the time required to clean up the

business. He began by putting in place a compliance policy that had to be signed by every employee. After a short amnesty he moved to a zero-tolerance regime under which infringing the policy would result in immediate termination. This was not an entirely popular move. In the first year, thirty of the top seventy line managers left the company, together with half of the senior staff. Many took their customers with them.

Erik and his team then hammered out a new vision for the company. Instead of being merely a company that hauled away waste, NG would become a global seller of industrial recycled raw materials—a global recycling powerhouse. In Erik's words, "Everything is collected. Everything is recycled. Everything is resourced. And everything is used over again as a new resource as opposed to the stuff that is dug out of mines or cut down in the forests."

He went public with what he had found, using the publicity as one lever among many to change NG's culture. He later explained:

Hanging our dirty laundry outside the house was a very public statement not only to the industry but to our employees that we were serious. It's not lip service that we're talking here. It's not some sort of speech that you give to an industry association. We were putting our head on the block in the national media saying that we will clean things up. And we were honest about it. One of the key things we practiced from day one was this brutal truth policy.

It also gave him the opportunity to reach out to potential customers—primarily those with prominent global brands—who might be willing to pay a premium in return for peace of mind. Some customers—not as many as he had hoped, but some—responded, signing up with NG because it was the right thing to do and to avoid the possibility of scandal. Erik began to hire aggressively from firms beyond

the waste management industry, looking for raw talent, new skills, and alignment with NG's new purpose. He brought in executives from as far afield as Coca-Cola, Norsk Hydro, and NorgesGruppen, Norway's largest grocery chain.

It was a costly transformation. In the first year the compliance program alone cost as much as 40 percent of NG's earnings before interest and taxes. It took several years to bring the new employees up to speed. In the meantime the local industry association threatened to expel NG for bringing the industry into disrepute, and, since Erik's agenda threatened the interests of organized crime, he himself became the target of threats.

But the new strategy also opened up unexpected opportunities. Managers who had seen the corruption firsthand and had felt powerless to do anything about it enthusiastically took up the challenge of remaking the company, and shutting the door on sloppy and illegal practices opened up space for real innovation. Slowly but surely NG began to industrialize the waste industry's value chain by embracing increasingly high-tech recycling. NG was the first Norwegian firm to purchase a state-of-the-art machine that used optical technology to sort metals. One could put an entire car in at one end and recycle 95 to 96 percent of its contents. The machine was initially rated as having a capacity of 120,000 tons a year, but within a year Erik's team was able to nearly double this number. This led in turn to a search for more waste to process, which led to a complete rethinking of the logistics of waste collection and an expansion of NG's range to all of Scandinavia. As NG stepped up its production of high-quality metals, it was able to diversify its customer base, significantly increasing the prices it received. In combination, these moves created significant economies of scale, driving down costs, increasing margins, and allowing NG to outcompete its rivals, further increasing volumes. By 2018 NG was one of the largest and most profitable waste companies in Scandinavia.

In short, Erik was able to translate his vision for improving the sustainability of the waste business into a new, highly disruptive—and highly profitable—business. The conversation around reimagining capitalism is sometimes framed in terms of a tension between profits and purpose. NG's case illustrates why this conversation is missing the point.

Business as usual is not a viable option. We have to find a different way to operate if our planet—and with it capitalism—is to survive. We need to move from a world in which environmental and social capital are essentially free—or at least someone else's business—to a world in which the need to operate within environmental limits within a thriving society is taken for granted. The transition will be massively disruptive—but like all such transitions, it will also be a source of enormous opportunity.

Everyone must breathe to live, but the purpose of living is not breathing.² In today's world, reimagining capitalism requires embracing the idea that while firms must be profitable if they are to thrive, their purpose must be not only to make money but also to build prosperity and freedom in the context of a livable planet and a healthy society. Erik's experience illustrates the enormous power of this kind of pro-social vision. It enabled him to create “shared value,” or to build a profitable business, doing the right thing while simultaneously reducing risk, cutting costs, and increasing demand.

Contrary to what many believe, embracing pro-social goals for the firm—a pro-social purpose—is eminently legal. Nowhere in the world are firms legally required to maximize investor returns. Under US law, for example, it is probably illegal to make a business decision that will certainly destroy long-term shareholder value, but except in a few tightly defined situations such as when they have committed to sell the firm, directors have very wide latitude.³ Under Delaware law, for example, where the majority of US companies are incorporated, directors have fiduciary duties of care,

loyalty, and good faith to both the corporation *and* its shareholders. This means that directors can—and should—sometimes make decisions that do not maximize shareholder value in the short term to pursue long-term success. US directors facing hostile takeover bids do this routinely, turning down offers that value the firm at significantly more than its current stock price in the belief that the takeover will reduce the company's long-term value. They are protected by the business judgment rule, which presumes that in making a business decision, the directors of a corporation act on an informed basis, in good faith, and in the honest belief that the action taken is in the best interests of the company.

But creating shared value is not sufficient to reimagine capitalism. It's not enough to adopt a pro-social vision for the company. We also have to change the way organizations are run.

The Second Piece: Building the Purpose-Driven Organization

There are essentially two ways to run an organization. Low road firms assume that people are cogs in a machine and manage them as things, while high road firms treat people with dignity and respect, as autonomous and empowered cocreators in building a community dedicated to shared purpose. Running a high road firm might sound expensive, but it doesn't have to be. There's lots of evidence to suggest that in many circumstances high road firms are significantly more innovative and productive than their low road rivals. Making the switch from the low road to the high road is critical to reimagining capitalism for two reasons.

The first is that reimagining capitalism is not going to be easy. Deciding to create shared value is often risky. Building a just and sustainable economy will be disruptive, and the dynamics of disruption are always difficult. Purpose-inspired high road firms are much better equipped to handle the transition—as NG's example

suggests—and are likely to be catalytic in driving the kinds of change we need.

The second is that building high road organizations is in itself a crucial piece of building a just and sustainable society. Not all high road firms can afford to pay higher wages, but many can, and that in itself will be a critical contribution to reducing inequality. Moreover, good jobs—jobs with meaning, in which people are treated with respect and encouraged to grow and to contribute to the best of their ability—are themselves crucial to the development of a healthy society.

Creating shared value and building high road organizations will be hugely important steps toward reimagining capitalism, but they will not be enough. Purpose-driven firms seeking to create shared value can have enormously positive impacts on the world. NG, for example, is playing a significant role in transforming the waste business. When competitors see that there is money to be made from acting in new ways, they will often embrace the change themselves. Improving energy efficiency used to be the province of inspired individuals. Now that everyone can see it's often hugely profitable, building green is fast becoming the industry-wide standard. But many firms that would like to do more find themselves constrained by the short-termism of the capital markets. Transforming the behavior of investors is just as important as transforming the behavior of firms.

The Third Piece: Rewiring Finance

Traditional finance may be the single biggest stumbling block to reimagining capitalism. As long as investors care only about maximizing their own returns, and focus only on the short term and on what can be easily measured, firms will be reluctant to take the risks inherent in seeking to exploit shared value and to embrace high road labor practices. It may be legal—it may even be morally

required—to seek to address the big problems of our time, but if your investors will fire you if you do, you will leave the big problems for someone else to solve. It is essential to rewire the financial system if we are to reimagine capitalism.

Fortunately this process is already underway. If solving the big problems of our time is in the interest of investors—and in many cases it is—then the secret to persuading them to support companies seeking to do the right thing is to develop measures that demonstrate that the right thing is also the profitable thing. We need auditable, replicable metrics that capture the costs and benefits of addressing environmental and social problems so that investors too can understand the benefits of creating shared value (and so that they can hold firms to account). So-called ESG metrics—Environmental, Social, and Governance—is one response to this challenge. It took us over a hundred years to develop rigorous systems of financial accounting, and ESG metrics are still a work in progress, but they are already changing investor behavior. In 2018 more than \$19 trillion—20 percent of all total financial assets under management—was invested using ESG-based information.⁴

Still, even the best metrics will not be enough to get us where we need to go. There are some things that are simply too hard to measure—and there are problems that firms could profitably solve but that would reduce investor returns if they do. A second step toward rewiring finance is to look for alternative sources of capital—to so-called impact investors, who care as much about making a difference as they do about maximizing their returns—and to consumers and employees. Consumer- and employee-owned firms are much more likely to be comfortable improving consumer and employee welfare at the expense of capital returns than conventional investors. Learning to mobilize these alternative sources of capital at scale could have powerfully catalytic effects.

Another option is to reduce the power of investors—to give managers shelter from the relentless demands of the capital markets

by changing corporate governance, or the rules that specify who controls the firm. This is a tricky but exciting line of inquiry. The widespread adoption of corporate forms like the benefit corporation, could have profoundly beneficial effects—but could also have unanticipated consequences and would probably be widely resisted by today's investors.

Rewiring finance along these lines will be a critical step toward reimagining capitalism. But it will not be enough. If we can channel capital into leading-edge, purpose-driven firms, and use a focus on ESG to ensure that every firm is forced to uphold a higher standard of behavior, it would make an enormous difference. But many of the problems we face are genuinely public goods problems, and no single firm has incentives to fix them alone. We need to learn to cooperate.

The Fourth Piece: Building Cooperation

When Nike first attempted to get child labor out of its supply chain, it began by attempting to clean up its own operations, giving all its suppliers a code of conduct and auditing them regularly. This approach succeeded in improving some practices in some factories, but it proved to be impossible to fix the problem completely. Most of the large suppliers turned out to work for nearly everyone in the industry, and some of Nike's competitors had no interest in improving labor conditions—or had different ideas about how to do so. Audits proved to be a very imperfect tool for changing behavior, and many of the major suppliers routinely outsourced work to much smaller firms that proved hard to monitor. Nike was left with a serious business problem—the risk that conditions in their supply chain might cause significant brand damage—and no way to fix it.⁵

In response, Nike attempted to persuade every other major firm in the industry to join in cleaning up the entire supply chain.

Together with a number of other firms Nike pulled together the Sustainable Apparel Coalition, an organization dedicated to a cooperative response to the supply chain crisis. The core idea behind these kinds of cooperative organizations is simple—if everyone does his or her part, everyone benefits. In chocolate, for example, the major buyers of cocoa (chocolate's principle ingredient) have come to realize that the only way to ensure that cocoa is available over the long term is to band together to share the costs of building a just, sustainable supply chain.⁶ In mining, the world's largest mining companies are trying to get a handle on their human rights problems by collectively agreeing to implement the UN's guiding principles on human rights.⁷

The problem with cooperating to create public goods, of course, is that even though we all benefit from their existence, we are often tempted to “free ride” by letting others do the hard work of building or maintaining them. Fortunately humans are quite good at solving public goods problems. For example, during the years my son was growing up, I hosted a large and elaborate Easter egg hunt. In the early years I attempted to give everyone lunch, but after a while my friends started to bring dishes, and the gathering gradually became a potluck affair. Lunch was usually delicious, featuring elaborate lasagnas, tasty salads, and wonderful home-baked cookies and cakes.

But a potluck only works if everyone pitches in. Taking the trouble to cook an elaborate lasagna is like taking the trouble to make sure that your suppliers are taking care of the environment and following good labor practices. There's always a temptation to free ride—to arrive with a packet of stale cookies. If everyone thinks that no one else is going to cook, no one will take the trouble, and there will be no lunch. But—particularly when everyone knows everyone else, and when everyone expects to keep working together—this rarely happens. We heap extravagant praise on the maker of the lasagna, and we punish those who bring stale cookies by teasing them unmercifully or “forgetting” to invite them back.

Sometimes—as among many families, armies, motorcycle gangs, churches, sports fans, universities, and a thousand other clubs—we become so identified with the group that we happily contribute everything we have to ensure its success. Indeed, modern psychology suggests that we are as naturally “groupish” as we are “selfish”—that humans have evolved in groups and that emotions like shame and pride and ideas like duty and honor ensure that we like being part of a team and think badly of those who loaf or take advantage.

One way to understand the history of the human race is to look at it as the story of our increasing ability to cooperate at larger and larger scales.⁸ We built cooperation first within the family, then within the extended family group, and then within the village, the town, and the city. Successful nations cultivate disdain for the “other” and pride in the homeland to persuade people to pay their taxes and participate peacefully in the political process. At their best, large corporations are cooperative communities, persuading hundreds of thousands of people to work together toward a shared goal. Reimagining capitalism requires taking this ability to cooperate and mobilizing it to solve public goods problems at larger and larger scales.

The technical term for this kind of activity is “self-regulation,” and it can be immensely powerful. It engages firms with each other and with third-sector and government partners in the pursuit of solutions to common problems, often prototyping solutions that prove to be a model for subsequent practice. But it is also inherently fragile. Many collaborative agreements fail to reach their goal. In the case of Nike and the textile business, for example, there continue to be firms—particularly smaller ones, or those from countries where the reputational costs of behaving badly are not that great—that are tempted to “cheat” or to buy from the lowest bidder and to tolerate questionable practices. It turns out that it’s usually very hard to sustain this kind of cooperation without the help of the state—and states everywhere are failing. If we are to reimagine

capitalism, we need the private sector to be part of the effort to rebuild our institutions and to fix government.

The Fifth Piece: Rebuilding Our Institutions and Fixing Our Governments

Creating shared value, learning to cooperate, and mobilizing the power of finance will all drive progress. But there are too many problems that we cannot solve without the power of government. Even if a significant fraction of America’s firms adopts a high road labor strategy, it seems very unlikely that their commitment could significantly reduce inequality. Too many firms will have short-term incentives to take the low road and race to the bottom.⁹ Many firms believe they simply cannot afford the cost of raising wages.

Moreover, unilaterally driving up wages is unlikely to be sustainable without moves to address the full range of factors that drive inequality in the first place, from changes in the tax code to the decline in organized labor representation, to the increasing dominance of very large firms and the failure of the US educational system to keep pace with the demands of the modern workplace. These are all issues that can only be addressed through political action. And government will only enact these kinds of measures if we can move beyond populism and gridlock. The only way we will solve the problems that we face is if we can find a way to balance the power of the market with the power of inclusive institutions, and purpose-driven businesses committed to the health of the society could play an important role in making this happen.

Business has played critical roles in building inclusive institutions in the past and could do so again. In seventeenth-century England, for example, it was a coalition of merchants and other businessmen that deposed the king and first wrote the rules of parliamentary democracy.¹⁰ The Puritans of New England took a charter designed for a corporation and used it to build democratic government.¹¹

Today's firms have enormous power to influence governments if they choose to use it. In 2015, for example, the governor of Indiana signed a bill into law that legitimized discrimination against gay people. Since today's employees will not tolerate LGBTQ discrimination, the response from the business community was swift and aggressive—and a week later the Indiana legislature backed down. Business needs to take similarly focused action in support of our institutions and our society.

Rebuilding our institutions is, of course, a collective action problem—but those firms that are seeking to create shared value, that are trying to take the high road with respect to their employees, and that are learning to act cooperatively are ideally positioned to solve this problem. They have committed themselves to making a difference, and they are finding that in many cases they can only reach their goals with the support of governments firmly committed to the public good.

REBUILDING OUR INSTITUTIONS requires the development of new ways of behaving and new ways of believing, just as much as it requires the development of new laws and new regulations.

We will not reimagine capitalism unless we rediscover the values on which capitalism has always been based, and have the courage and the skill to integrate them into the day-to-day fabric of business. To pretend that this is not the case is to critically misrepresent the truth of our current situation. We are destroying the world and the social fabric in the service of a quick buck, and we need to move beyond the simple maximization of shareholder value before we bring the whole system crashing down around our heads.

I'm often tempted to downplay the role that the courage to express one's personal values will play in driving the necessary changes. Sometimes when I'm standing on a stage in full regalia (stylish black jacket, colorful scarf, the highest heels I can manage) in front of a

room full of powerful people, I'm tempted to tell them that they should try to solve the world's problems simply because it will make them all more money. It has the great virtue of being true, and I know they'll love it. I sometimes get concerned that if I start talking about "values" and "purpose," they will write me off as a simpering female who doesn't get the hard realities of life in the business world. But change is hard. I spent the first twenty years of my career trying to persuade firms like Kodak and Nokia to change their ways, and I know there are always a thousand reasons to put one's head down, ignore what's coming, and focus on next quarter's results.

I will never forget a conversation I had once at Motorola's paging division. It was a hot day in Florida, and I was in a windowless conference room, holding a rough prototype of something that looked very much like a smartphone, several years before anyone had heard of a Blackberry—let alone an iPhone. I had been preaching the benefits of making a significant investment in the new technology, but the divisional manager looked at me skeptically—to this day I remember the curve of his eyebrow—and said:

I see. You're suggesting that we invest millions of dollars in a market that may or may not exist but that is certainly smaller than our existing market, to develop a product that customers may or may not want, using a business model that will almost certainly give us lower margins than our existing product lines. You're warning us that we'll run into serious organizational problems as we make this investment, and our current business is screaming for resources. Tell me again just why we should do this?

New ways of doing things nearly always look profoundly uncertain and are nearly always less profitable than existing ways of behaving. But grasping them often yields rich rewards, while denying them—as Motorola did—often leads to disaster. Twenty years of research have taught me that the firms that were able to change were

those that had a reason to do so. Purpose is the fuel that provides the vision and the courage that is required to reimagine capitalism.

Running a company that's trying to make a difference in the world is not for the faint of heart. The successful purpose-driven leaders I know are almost schizophrenic in their ability to switch from a ruthless focus on the bottom line to passionately advocating for the greater good. Hamdi Ulukaya, the founder and CEO of Chobani, and one of the most authentically purpose-driven leaders out there, is effectively two people: a driven businessman and a compassionate humanitarian. "I'm a shepherd and I'm a warrior," he says when asked. "I come and go between those two. I'm a nomad, and nomads are the most real people. You can't pretend."

For several years I had the honor of facilitating Paul Polman's strategic retreats. Paul was the CEO of Unilever at the time, and he was in the midst of trying to persuade his senior team that committing the organization to solving the world's problems was not only the right thing to do but also the royal road to industry leadership. He would move seamlessly from passionately discussing the thousand ways in which Unilever could make the world a better place to ruthlessly cross-examining one of his divisional presidents about why she had missed her sales targets for the quarter and what exactly she was going to do about it—without missing a beat.

Running a company committed to doing the right thing is harder than running a conventional company. It's about being able to be a superb manager *and* a visionary leader. About being ruthlessly focused on the numbers and simultaneously open to the wider world. But it is eminently possible—and a lot more fun—to manage this way. Leaders like Hamdi and Paul are reimaging capitalism. They are creating value for their investors, while never losing sight of their responsibility to the world on which they depend. Building a just and sustainable world will not be easy or cheap. But in my view we have no realistic alternatives. We must find a way to make this work.

A CEO with whom I work recently described a conversation he'd had with two of his largest investors:

I gave them the usual spiel about how our operating margins were up and how the investments we'd been making for growth were paying off, and they asked me the usual questions. Then I asked them if they thought climate change was real and, if it was, if the world's governments were going to fix it. Yes, they said—and no, governments weren't going to fix it. There was a pause. I asked them if they had children. They did. So I said, "If government isn't going to fix it, who will?" There was another pause. Then we started a real conversation.

Welcome to the world's most important conversation.