Chapter 3:

A Focus on More Than Profits Leads to Long-Term Success.

> "*This American system of ours, call it Americanism, call it capitalism, call it what you will, gives each and every one of us a great opportunity if we only seize it with both hands and make the most of it.*" Al Capone, American gangster of the Prohibition era.

Our current system fosters growth and wealth creation.

When I was a young boy, I didn't understand why certain countries were poor. My reasoning was simplistic: If the country has natural resources, its people have the desire to work, and there is a need for products and services, what is missing? I later understood that government policies, capacity to trade, infrastructure, technical education, and investment have a pivotal role in kick starting and accelerating an economy. In a world of open markets, the latter ones are deemed to happen sooner or later almost automatically. Money and technical expertise will flow where there are natural resources, need, and government policies that allow them to operate. This way, the economies of countries such as Brazil, China, India, and Russia flourish once they open their markets to the flow of products, investment, and education.

Capitalism is good because it naturally fills voids and brings opportunities around. It naturally brings jobs, capital, and education to regions in need around the world. But it doesn't stop there. It rewards growth. The bigger the business, the more economies of scale from which it can benefit. Preparing 100 lb. of bread dough takes almost the same work as 50 lb. of bread dough, when we consider all the necessary activities such as buying the grain, transporting it, milling it, mixing it with water, kneading the dough, and cleaning the equipment. Whether we like it or not, the bigger business has better access to resources such as raw materials, equipment, distribution channels, and even talent.

Capitalism also rewards innovation as new and better products quickly replace the old ones and the businesses that produce them. The business that doesn't innovate stays behind, its margins get cut, and eventually faces financial trouble. Capitalism is set up to convince us that we need new products, even if we don't know about them. Businesses use advertising, marketing, and product development to create the need for their products. Capitalism also rewards efficiency and low-cost production. The business that is not competitive is soon out of the market. Producers of products and services must be constantly reviewing and improving their operations in order to remain competitive in the marketplace.

These characteristics of capitalism help us satisfy our needs for products and services, but they also foster short-term thinking. Market conditions may change in a snap, and unaware businesses may face dire consequences. Every opportunity is used to strengthen the business position. We have some of the best and brightest working exceedingly hard to develop successful business strategies, to react correctly to the frequent market shifts, and to maximize business results.

The market pressures companies into delivering ever better results.

Imagine a public company called Goodresults, Inc. Its management team has developed robust business strategies, and Goodresults is poised to grow 2% this year. The management has put strategies in place to keep the rate of growth at that level for the foreseeable future. The stock market analysts develop some calculations. Their calculations assume an enterprise value based on the expected revenue growth of 2% per year and the cost of money. They conclude, “The fair stock price of

Goodresults, Inc. is $50." It is a talented management team that weathers successfully many problems and maintains its promise; therefore, the stock price remains at $50.

John Investor Doe has bought some of the company's stock and wants to see it grow in value. The only way for the stock to grow is to increase revenue and profits beyond what is already expected.

Here comes John Goodmanager. He establishes skilled management policies, develops new products, cuts waste and unnecessary projects, refocuses the business, and is able to increase revenue 5% every year. What a fantastic manager! The analysts come back again, redo their calculations, and conclude, "Because Goodresults, Inc. is expected to grow 5% every year, considering inflation and the cost of money, the stock price should be $55."

John Investor Doe sells his stock and is satisfied he has made a profit. Here comes Jane Investor Doe, who has seen the stock price increase and decides to buy some stock, too. The only way for the stock to increase in value is by further increasing revenue and profit numbers beyond what is already expected, again! Jane Investor Doe, together with other investors, pushes the board of directors to hire an even more aggressive manager who can increase the revenue of Goodresults, Inc. beyond the 5% promised. She only wants her investment to yield a positive return. There's nothing wrong with that, right? And the cycle goes on.

I know there are additional considerations to truly determine how the price of the stock of a company varies, but this is the fundamental mechanism for a stock to change in value. My purpose in highlighting it is only to bring attention to the enormous pressure that managers receive to increase business results in the short term. It is not, therefore, unexpected that most of the company's resources are fully tied up in working out current problems or in developing new ways to grow, not in long-term concerns. These are not at the top of the management's priority list and are, in consequence, often neglected.

The pressure to achieve business results shapes company actions.

A business may have little real interest in making sure that the waste products it generates do not cause any long-term problem for the community where it operates. As long as it meets the government regulations, the business doesn't have an incentive to perform any further studies to understand other possible negative effects. From the shareholder perspective, going beyond the minimum requirement seems wasteful because it diverts resources that can be used to tackle competitive pressures and improve business results. Such expenses don't contribute to the bottom or top line of this or the next few years, and the manager that pursues them may be replaced for another, better-focused one.

The pressure to increase business results can be seen everywhere around us. Processed food companies add chemicals, use dubious suppliers and food sources, and engineer food to “fool” the brain into thinking we are ingesting nutrition-rich food, all with the purpose to sell more. Chemical producers creatively find new uses for their products and constantly fail to make sure these chemicals don't cause long-term health issues for those who use them. Farming practices produce food with a wide variety of chemicals. Multinational companies shift manufacturing, (and, increasingly, engineering work) to third world countries to lower their costs in the short-term while affecting the well-being of their home-country customers.

> According to a report by the Environmental Working Group, the average U.S. apple contains 53 different toxic chemicals.[1]

To maximize business results, companies have learned that affecting government legislation is much more cost effective than meeting it. With lobbying, businesses have found a way to steer government legislation away from policies they would find taxing or difficult to meet. Businesses spend countless hours packaging legislation to garner support from key allies such as politicians, unions, shareholders, workers, and influential associations.

> One of the top beer producers in the United States promoted a minimum wage increase for beer workers. Government officials applauded this producer for considering all beer workers. The worker's union, obviously, supported the measure, and politicians gained recognition and votes for the coming election. It was a win-win situation for everybody. Or was it? The major beer producer had studied wages across the state, and realized its wages were higher than most small

producers. These small breweries didn't have the scale and technology to produce beer as cheaply as the major producer, but because of their remote location and access to a local, cheaper labor force, they survived well by paying lower worker wages. By raising the minimum wage, the major producer eliminated a valuable competitive advantage these small producers had.[2]

Our current business practices hurt the business' long-term survival.

Is there any surprise that people have a general distrust toward businesses (think corporations) and that businesses are seen as a major cause of social, environmental, and economic problems? Is there any surprise that nongovernmental organizations (NGOs) are often focused on addressing the societal problems at the expense of businesses? What about the “Occupy Wall Street” protests across many countries in 2011? If you read the banners protesters carried, these protests were diverse, but if you paid attention, there was an underlying theme across the board: Corporations and government are failing to do what's best for society. Corporations are getting the lion's share of wealth at the expense of the many and at the expense of the environment, and government is not able or willing to help out with the situation.

Consider unemployment, the housing crash, Wall Street bonuses, credit default swaps, the Gulf oil spill, global warming, heavy metals in our food, extinction of species, increasing income gap, attempts to reduce union bargaining rights, mystery funding for political campaigns, and many others along the same lines. Corporations play a role in all of these issues, which causes people to distrust them and dislike them. Corporations must be concerned about this perception because it will sooner or later limit their capacity to exist and operate.

The ironic part is that companies cause their own long-term demise by focusing solely on their finances. This may explain why businesses have such a short life.

Fortune 500 companies have a lifespan of something between 40 and 50 years.[3] Of the 500 companies originally making up the Standard & Poor's 500 list in 1957, only 74 remained on the list in 1997.[4] For small businesses, the rate of survival is worse. Of those on the list today, less than 30% are expected to be there in 10 years.[5]

Let's create a new system that strengthens our businesses.

In the last few years, the most significant leading thinkers have begun to emphasize the importance of other stakeholders (beyond shareholders) in the long-term survival of companies. It is now understood that a short-term focus causes companies to overlook the well-being of their customers, the depletion of natural resources vital to their businesses, the viability of key suppliers, and the economic well-being of the community in which they operate. It's in the interest of a company to consider these broader social, environmental, and economic effects. If ignored, eventually they will become significant enough to cause the demise of the business.

Since the '70, American automotive producers have resisted tighter fuel economy standards. They successfully lobbied the government, and in 25 years, from 1985 to 2010, the Corporate Average Fuel Economy (CAFE) requirement, which dictates fuel economy standards for vehicles sold in the United States, didn't move from 27.5 mpg. Although they apparently succeeded in their short-term objectives, these auto companies hurt their long-term probabilities of success. While other manufacturers, such as Toyota, Honda, and BMW developed higher fuel economy vehicles fostered by the fuel economy requirements of their home markets, the American producers successfully lobbied the U.S. government and didn't need to do much in that regard. At the end of the last decade, the big-three found themselves with most of their expertise and the majority of their portfolio of architectures (the underpinnings to build new vehicles) incapable of manufacturing fuel-efficient vehicles, along with a strong negative consumer perception that has played a significant role in their financial struggles of the last few years.

Why would a business invest in education, health, and social problems in the community it operates if these expenses don't clearly translate into positive business investments? Nowadays, most every significant business thinker has reached the same conclusion: The success of businesses and the long-term welfare of communities are closely intertwined. While businesses need communities for customers, resources, and talent, communities need businesses for jobs and wealth creation. This way, we have heard concepts such as “Shared Value,”[6] “Corporate Social Responsibility,” “Conscious Capitalism,” and “Purposeful Capitalism.”

Activities that improve the business communities will improve the long-term prospects of the company, but this book suggests a slightly different point of view. Although the effects may point toward the same direction, the reasons for doing it, the fundamentals of how it works, and the overall results are all different.

This book suggests that by forming enterprises in which associates and all other stakeholders share meaningful values, purposes, and organizational ways, their work becomes much more engaging to them. Workers are happier and more fulfilled, and by consequence, their performance is much superior than that of other companies solely focused on growth and profits. By having alignment with what the company strives to achieve beyond financial results, the business stops being an exploiter of resources and people and becomes a community ally, promoting its welfare and quality of life. The business attracts the best people, doesn't have opposition by members of the community, and has access to many organizations, such as universities and NGOs that are willing to participate in the activities of the company and foster its success. In other words, everyone wins!

Note that I am not saying that the organization reduces its capacity to generate income or that generating high returns becomes less desirable. It is quite the opposite. We need to have sustainable businesses that generate income over the long run. We need the focused, driven, and passionate participation of every worker. We must improve today's current meager rate of business survival. We must reduce the excessive burnout and stress in workers and the social problems that today's businesses cause. It is the time to do it.

I believe that capitalism that fosters production and consumption will yield to capitalism with meaning, a system in which organizations not only generate income but do it in a way that improves the condition of human life. This capitalism with meaning is rooted in the company's workers and its communities. It generates income, not at the expense of its communities, workers, and customers, but with the objective to contribute to their well-being.

Who wants to eat food prepared by an upset and disgruntled cook? Who desires to give toys to children that were manufactured by people who didn't mind a manufacturing process loaded with toxic chemicals? Who wants to live in a house built by a builder whose main purpose was to squeeze out every penny from the project, never considering the dweller's long-term satisfaction?

Each of us has to decide if we want to join in or not.

This new production system cannot be a government-led system, nor can it be a dictated one. To start, government is clearly not able to police what every organization is doing, whether this is in the production of products and services, or in the creation and control of information (movies, advertising, etc.). Government cannot dictate what is good and what isn't. Doing so would be paternalistic and it may be interpreted as attempts to make citizens conform to a chosen model and to limit individual freedom. It is the individual drive to contribute to humanity that is the main driver for us to move forward to a new, more meaningful system. We will review later in this book how this is possible and why this isn't such a foreign idea.

I am certain than in the future, we will increasingly choose the products and services from the companies that go beyond worrying about their bottom line. We already do it, from grocery stores such as Whole Foods Market to air travel such as Southwest and JetBlue, from beer manufacturing such as New Belgium Brewing, to information management organizations such as Google and Wikipedia. The financial results of these companies exceed their competitors' numbers (often many times), and to top it off, these companies have satisfied, happy, and productive workers. In the future, this will be the majority of businesses. They will compose what today we call “capitalism with meaning.”

But how do we choose to buy the product or service from one organization or the other? What influences this decision? Is it affected by the level of engagement we have in our organization? To answer these questions, we must have a greater understanding of brands and how they affect the customer's buying-decision process. We will review brands in the next chapter.

“A business that makes nothing but money is a poor business.”

Henry Ford, founder of the Ford Motor Co. and sponsor of the development of the assembly line technique of mass production.

1 Environmental Working Group. *2011 Dirty Dozen.* Testing performed by Department of Agriculture and the FDA, 2011.

2 O'Dea, Raymond J. "The Determination of a Secondary Wage." *Journal of Industrial Relations*, 1968.

3 De Geus, Arie. *The Living Company: Habits for Survival in a Turbulent Business Environment.* 1st ed. Harvard Business Review Press, June 4, 2002.

4 Foster, Richard, & Kaplan, Sarah. *Creative Destruction: Why Companies That Are Built to Last Underperform the Market—And How to Successfully Transform Them.* 1st ed. Broadway Business, April 3, 2001.

5 Shane, Scott. *Illusions of Entrepreneurship: The Costly Myths that Entrepreneurs, Investors, and Policy Makers Live By*. Yale University Press, January 28, 2008.

6 Porter, Michael E., & Kramer, Mark R. "Creating Shared Value: How to Reinvent Capitalism—and Unleash a Wave of Innovation and Growth." *Harvard Business Review,* 2011.