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CHARLES H. GREEN ARTICLE SERIES VOL. 8

FEATURING

IS CAPITALISM 2.0 A MIRAGE?



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IS CAPITALISM 2.0 A MIRAGE?

BY CHARLES H. GREEN

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When Lou Gerstner took over IBM at a time of corporate crisis, he was asked if he would chart a radically new direction for the firm. His memorable response was, “[The last thing IBM needs right now is a vision.](#)”

For the past several decades, business has had a vision; one so dogmatically defined that we might even call it an ideology—the ideology of Capitalism 1.0. Now that vision has turned toxic. Many agree with Michael Porter that business is now facing a [crisis of social legitimacy](#).

The question is—what to do about it? Does capitalism need a fundamental reframing? Or is the issue more one of execution, about getting along in broader society?

In this article, I’ll examine the case for radical reframing—let’s call it the search for Capitalism 2.0.

RE-FRAMING CAPITALISM

One answer to the problem of business legitimacy is to re-frame Capitalism. Re-thinking capitalism is as tempting to capitalist ideologues as rethinking Marxism was to generations of socialist ideologues. ‘If “shareholder value maximization” isn’t working, then let’s come up with another encompassing business theory that is even broader than the old one, but that works. Let’s call it Capitalism 2.0.’

Two of our leading thinkers—[Michael Porter, with Mark Kramer](#), and new kid on the block [Umair Haque](#)—are attempting an intellectual rebooting of the capitalist operating system. Porter’s concept, contained most recently in an HBR article, is [Shared Value](#). Haque’s new book is called [The Capitalist Manifesto](#).

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“Winning was defined financially, driven by market share, in turn driven by competitive strategy.”

Can capitalism truly be re-visioned from within? Or is it a closed system whose solutions must come from without? If anyone can square the circle, these authors can. Let’s start by understanding what they’re reacting to.

CAPITALISM 1.0

The full name of Harvard Business School used to be “The Harvard Graduate School of Business Administration.” In the 1950s, that name was apt. Adam Smith was rarely mentioned—Schumpeter and Hayek, even less.

It was pragmatic, non-ideological. Peter Drucker had just begun to conceive of management as distinct from administration; ‘strategy’ was an occasional term, borrowed loosely from military theorists.

In the 70s and 80s strategy went quantitative, bringing us portfolio management theory, the growth/share matrix and log-scale experience curves.

MBA consultants flooded boardrooms with models in lieu of gray hair. Consulting firms seized thought leadership from the business schools. An ideology was being born.

CAPITALISM 1.0, CIRCA 1980

Around 1980, the core business ideology saw business as a corporate competitive struggle for dominance and survival. All players—producers, their customers, their suppliers, government and regulators—competed. Winning was defined financially, driven by market share, in turn driven by competitive strategy.

Economists and financial theorists joined the mix in the 1980s. One result was greater emphasis on debt, which led to junk bonds, LBOs, private equity and the S&L crisis. Another was the reign of Alan Greenspan and the Chicago School of Economics, whose contribution to dogma was the idea that markets are largely self-correcting.

As tech boomed, the public caught the bug as well. Wall Street created day trading, hedge funds and IPOs, and the public bought it.

Capitalism 1.5

By around 2006 capitalism’s dogma had become more sharply stated—something like:

Business is the value-creating engine of all society. It works best when left alone. Through creative destruction and the Darwinian efficiency of

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“Capitalism 1.X is under attack as a belief system. What will take its place?”

self-correcting markets, it creates value and wealth for all. All business transactions can and should be expressed in present value cash flows terms. The social purpose of a corporation is to earn a profit, and its proper goal is the maximization of shareholder value.

The dogma had held despite Michael Milken, Marc Rich, the S&L and Long-Term Capital crises, Enron and WorldCom. But then came the financial crisis of 2008.

Several items are striking. Alan Greenspan recanted his belief in Capitalism 1.X. Nearly every Chicago economist (notably excepting Eugene Fama) [shifted back in the direction of Keynesian economics](#); Paul Samuelson says Milton Friedman himself would have done so.

The [MBA Oath](#) was created at Harvard in 2008. One of the group’s faculty advisors, [Nitin Nohria](#), became the next Dean of HBS. He believes business needs to be more socially attuned—away from shareholder value maximization, toward broader social responsibilities.

In other words, Capitalism 1.X is under attack as a belief system. What will take its place?

THE SEARCH FOR CAPITALISM 2.0

Business strategists and economists love elegantly simple models. Many past successes have come via idea home runs—redefining paradigms, thinking outside boxes, changing game rules. [Porter](#) and [Haque](#) have made powerful attempts to do so, as follows:

SHARED VALUE AND THE CAPITALIST MANIFESTO

Both approaches describe Capitalism 1.X’s failures sweepingly. They indict zero-sum thinking, short-termism run amok, and a systemic inability to link corporate benefits to social costs. If anyone needs a comprehensive statement of what’s wrong, look no further than these two works.

Each work also describes a better end-state; longer time horizons, broader collaboration, comprehensive calculations. Yet the solution, both Porter and Haque seem clearly to say, lies in ideology: in re-framing the tenets of capitalism.

Here is Haque’s version:

The industrial age’s dilemma is unsolvable if we’re still confined to thinking in yesterday’s terms...

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“Profits involving a social purpose represent a higher form of capitalism—one that will enable society to advance more rapidly while allowing companies to grow even more.”

Escaping the capitalists’ dilemma *requires* a paradigm shift.

The outlines of an updated economic paradigm...include two fundamental axioms:

...first...through the act of exchange, an *organization cannot*, by action or inaction, *allow* people, communities, society, the natural world, or future generations to come to *economic harm*. [Italics are Haque’s]

Porter is equally didactic:

The purpose of the corporation must be redefined as creating shared value, not just profit per se.

The concept of shared value resets the boundaries of capitalism.

Not all profit is equal—an idea that has been lost in the narrow, short-term focus of financial markets and in much management thinking. Profits involving a social purpose represent a higher form of capitalism—one that will enable society to advance more rapidly while allowing companies to grow even more.

We need a more sophisticated form of capitalism, one imbued with a social purpose. But that purpose should arise not out of charity but out of a deeper understanding of competition

and economic value creation...It is not philanthropy but self-interested behavior to create economic value by creating social value.

This all begs some pretty big questions: what exactly do we *get* with a new definition, a new paradigm, an axiom? Do the authors mean that the single biggest, most critical issue is to fix our thinking? Is it really necessary to have a new paradigm in order to get on with matters?

And even if it is necessary to re-think capitalism—is the re-thinking a *sufficient* condition for getting the job done? For that matter—can it even be done at all? Can we really stretch “capitalism” so far as to equate social good with corporate self-interest? Or is Capitalism 2.0 really a mirage, a distraction from more mundane but critical ways of changing business?

BEWARE OF CLOSED SYSTEMS

Haque wants an axiom. Unfortunately for Haque, I don’t know of any organization for whom it is *axiomatic* that they *cannot* do any of the things he lists. Calling something “axiomatic” simply doesn’t make it so.

Porter and Kramer, in their treatment of [Shared Value](#), use the word ‘*must*’

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“Marx was wrong about communism’s inevitability.

Greenspan was wrong about large companies’ inclination to self-regulate based on reputation.

Friedman was wrong about the gyroscopic capabilities of the Invisible Hand.”

in a similar way (“The purpose of the corporation must be redefined as creating shared value, not just profit per se”). But the result is the same. Nobody ‘must’ do anything, as the human race perversely insists on proving time and again.

Karl Marx, in the Communist Manifesto, declared communism inevitable. Capitalism 1.5 had the same flavor. Haque’s ironic use of “Manifesto” and the language of ‘axioms’ suggest the same pull of logical necessity. But axioms are abstract, not empirical—they don’t drive action, unless someone chooses to act on them. And Porter’s ‘must’ has no causal force; it is exhortation dressed up in the words of logical necessity.

There is a beauty in such simple, powerful idea systems, a beauty well-loved by economists, mathematicians, physicists and strategists. The problem is—they are closed systems. That’s OK for math and physics. But for most other fields, once you get outside a closed system, things eventually degrade.

INEVITABILITY ISN’T

Marx was wrong about communism’s inevitability. Greenspan was wrong about large companies’ inclination to self-regulate based on reputation. Friedman was wrong about the gyroscopic capabilities of the Invisible Hand.

If Porter and Haque believe that they have discovered an ideology as attractive, powerful and self-sustaining as those were, then we’re probably just looking at another shiny-object, perpetual-motion, too-good-to-be-true closed system.

In fact, it was our unquestioned belief in the closed-system aspect of Capitalism 1.X that helped cause Capitalism 1.X to fail. It all sounded so good that we wanted to believe it—until long after the writing was on the wall. Not for the first time, the charm of dogma blinded us to facts on the ground until it became not just overwhelming, but undeniable. We’re left thinking, “What were we thinking?” and the answer is, we weren’t. We were just believing.

The search for another compelling but unrealistic logic is likely to be equally misguided.

Both Porter-Kramer and Haque argue that systemic adoption of Capitalism 2.0 will lead to higher systemic profitability. This is certainly true. But the heart of the matter is not a systemic issue—it is whether individual companies will make decisions that are not profitable to themselves in the short term. And this is where ideology gets in the way:

What should, and will, a company do if an initiative is profitable in Capitalism 2.0 terms—but not profitable in Capitalism

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“If ideology is ultimately empty calories, then what is to be done? How else can we get to the alternate vision of business that both Porter and Haque so clearly, and rightly, envision?”

1.X terms? Not every business problem is simply a failure of imagination, even if many—even if most—are. The [problem of the commons](#) remains unsolved.

I’m not optimistic that Porter can find a profit that is “imbued with a social purpose...that arises...out of a deeper understanding of competition and economic value creation.” I think that’s a circle that can’t be squared.

But it is also not necessary. The answer lies in sober thinking about how social change happens; not in a new Idea System.

Haque is most productive not when he’s offering ringing phrases, but when he’s offering examples of new business opportunities that are not only holistically profitable, but profitable as well in today’s simple quarterly income statement terms—examples like Threadless and Nike’s Considered Design.

Porter is today more famous for his early Five Forces model than for his value chain model, but the latter has probably had more impact. Similarly, his solid thinking today on clusters and the proper role of regulation may end up having more impact than his heroic effort to cognitively re-conceive competition.

There is richness in both works, worthy of a lot of thoughtful reading.

THE OTHER SOLUTION: DIAL BACK THE DOGMA

Ironically, it was Marx who said, “[The point is not to understand the world, but to transform it.](#)” Ideologues and dogmatists insist on the primacy of theory. Change agents are more pragmatic.

Parts of our society are addicted to dogma and ideology. Business, under Capitalism 1.X, is one; others are politics, academia and particularly economics. But it’s not the norm.

The legal profession isn’t dogmatic, apart from a general belief in advocacy. Education has many sub-currents but not one unifying theory. The practice of medicine, other than the Hippocratic Oath, is more practical than ideological.

If ideology is ultimately empty calories, then what is to be done? How else can we get to the alternate vision of business that both Porter and Haque so clearly, and rightly, envision?

First, we need to give up our addiction to ideology. What’s needed is not another intellectual home run, but a dogged effort to get better at getting along—on *all* social dimensions, not just those of business.

What can you do? Here are a few examples:

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“News media can try to stay sober, serious, thoughtful and responsible, not giving in to pure entertainment; business can play a role along with consumers in helping media resist the pull in that direction.”

1. People with visible responsibility can start talking about civic and moral virtues, instead of the virtues of an abstract system which magically does the heavy lifting for us.
 2. Porter, Kramer and Haque as writers—and all of us as readers—can use the rich and stimulating examples they have uncovered as a challenge to our imaginations, and a spur to creative thinking. The power of what they’ve written lies more in their examples and simple models than in the attempt at a Unifying Theory.
 3. Measurements are powerful in business; many managers believe that management requires it. We can all support global attempts at [Integrated Reporting accounting](#), combining traditional financial accounting with other socially-relevant measures. New vocabularies seriously drive new dialogues.
 4. Trade associations can shift emphasis from narrow sectarian lobbying to offering education and perspective on increasing the long-term viability of their industries.
 5. Business strategists and economists can look to outside functional arenas; negotiation and bargaining experts know how to integrate zero-sum oppositional positions with shared interests;
 6. Politicians can rediscover bi-partisanship and compromise, rather than scorched-earth zero-sum competitive games; citizens can hold them accountable by re-discovering the same.
 7. Elections and legislation are heavily controlled by corporate interests in the United States today. This is not long-term healthy even for business. Business organizations can collaborate with other groups to pursue campaign finance reform, thus putting stakeholder collaboration into serious practice.
 8. Business education, mainly MBAs, can start emphasizing long-term sustainable collaboration, rather than Capitalism 1.X. Ethics courses are no good if they’re contradicted by 1.X courses in competitive strategy down the hall.
 9. News media can try to stay sober, serious, thoughtful and responsible, not giving in to pure entertainment; business can play a role along with consumers in helping media resist the pull in that direction.
- There is no unifying ideology; if Santa Claus can’t pull it off, why should we

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*“Don’t argue over who gets
the slice of the pie, focus on
making the pie bigger.”*

expect strategists and economists to do so?

But there are still guidelines.

“Be the change you want in the world.”

“The best way to make someone trustworthy is to trust them.”

“Ask not what your country can do for you, ask what you can do for your country.”

“Don’t argue over who gets the slice of the pie, focus on making the pie bigger.”

Maybe even, “Do unto others as you’d have them do unto you.”

When Gerstner took over IBM he said, “The last thing IBM needs is a vision.” The last thing capitalism needs right now is a new ideology. Business needs simply to take its seat among other social and political institutions, and to play nicely in the sandbox alongside them.

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ABOUT CHARLES H. GREEN



[Charles H. Green](#) is a speaker and executive educator on trust-based relationships and Trust-based Selling in complex businesses. He is author of [Trust-based Selling](#) (McGraw-Hill, 2005), and co-author of [The Trusted Advisor](#) (with David Maister and Rob Galford, Free Press, October 2000). Charles has spoken before a variety of industry and functional groups. An engaging and content-rich speaker,

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