Competitive Theory and Business Legitimacy

The Economist once called Michael Porter the “dozen of living management gurus.” Porter is the guru of competitive strategy, the one who told companies that their route to success lay in competing not just against their direct competitors, but against their suppliers and customers as well. A great number of companies have spent the last 20 to 30 years doing just that.

So when Michael Porter says something new, it’s worth noting, as with his recent piece for Businessweek.com, “How Big Business Can Regain Legitimacy.” The idea of regaining legitimacy implies that legitimacy has been lost, which is precisely Porter’s point. And the loss of business’ legitimacy is a shame not just for business, but for society at large.

There is no “legitimacy index,” and any attempt at mapping something as ephemeral as legitimacy will be fraught with subjectivity. But let me suggest a commonsensical outline. Legitimacy broadly tracks such social phenomena as trust and confidence, heroes vs. villains, and the popularity of going into business as a career choice. By these indicia, the socially perceived legitimacy of business was low in the 1960s, high in the ‘80s, and is at a nadir now.

RELEVANT RESOURCES

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Competing With Your Customers: Where Strategy Goes Wrong

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LOWEST IN A DECADE

Somewhere in the ‘90s the tide began to turn. The dot-com meltdown, Big Oil, Long-Term Capital Management, Enron, Hurricane Katrina, Bernie Madoff, and subprime mortgages have all played a role. By January 2009, a major survey showed trust in business at a 10-year low.

In a couple of decades, we went from a President repealing Glass-Steagall to a President firing the chief executive of General Motors; from a doctrinaire laissez-faire Fed Chairman to the SEC suing Goldman Sachs (GS) and the Justice Dept. suing BP (BP). The decline in public trust of business parallels the new adversarial relationship between business and government. This is what Porter means by the decline in legitimacy of business: Businessmen are no longer social heroes, and the political class can no longer be seen to be their friends. A reminder came just last month, with the Senate’s passage of a major financial reform bill, despite intense industry lobbying.

Ironically, in the rear-view mirror we can see that Porter himself was partly responsible. Thought leaders have impact. Porter’s major impact was describing business itself as an ongoing Hobbesian state of competition—not just between competitors, but between companies and their customers, suppliers, and social institutions. Corporate success is defined as gaining sustainable competitive advantage over all one’s competitors. Adversarial relationships in Porter’s worldview are simply the Way Things Are.

THE GEKKO ERA

In the ‘80s, there was a common viewpoint about business’ relationship to society. Milton Friedman spoke the economists’ version—companies owed no social debt beyond being profitable. Reagan’s “government is the problem” was the political version. Porter was the thought leader for business; business’ relationship with government and society was one of competition, not of collaboration toward some higher, joint purpose. Hollywood
packaged it all into Gordon Gekko—the anti-hero of Wall Street. These messages all converged. Business was the source of its own legitimacy. It needed no external endorsement. It would work best when left alone, allowing Darwinian forces to work their magic.

That now seems a long time ago. Society and government are reasserting their controlling rights to business legitimacy. Regulation is back in; the American taxpayer now owns some chunk of American industry and doesn’t trust the prior management team. Today’s message from the public and government is: We don’t trust you, the free lunch is over, and as long as you continue this adversarial competitive mindset, we will continue to deny you legitimacy. It went beyond the Reaganesque complaint about government being the problem. One of Goldman Sachs’ defenses in its current litigation is caveat emptor—an argument for the bazaar, but not one for social legitimacy.

POSITIVE ENGAGEMENT

But social legitimacy comes from finding a role in society—not from complaining about society’s intrusions, albeit in the form of government.

Here’s what Porter himself says about the need for business to regain legitimacy:

“Business must find a way to engage positively in society, but this will not happen as long as it sees its social agenda as separate from its core business agenda.”

Porter is surely right about that. He goes on to argue against further CSR (corporate social responsibility) initiatives, saying that it is shared value creation, not charitable donations, that will most effectively leverage corporate capabilities to improve social conditions. Such efforts will “give purpose to capitalism and represent our best chance to legitimize business again.”

This is vintage Porter: The sustainable competitive mandate is once again front and center but now in service to social challenges such as urban blight, inequality, and unemployment. But how does he suggest business regain legitimacy when the very competitive
paradigm he helped champion seems implicated in the destruction of that legitimacy?

At this point, Porter loses me. He suggests that small business and major corporations alike must focus on job creation and entrepreneurial energy to eliminate inequality in our inner cities—all the while contributing to the competitive advantage of the individual companies. How’s that again?

In place of CSR, Porter recommends community revitalization. But what sustainable-competitive-advantage-seeking company will recruit disadvantaged local employees from local communities, instead of hiring trained workers from broader markets? Coming from the godfather of competitive advantage, the message is strange; a cognitive disconnect.

Porter is right that the key to legitimacy lies within business, not outside it. But he underestimates the power of a belief that he himself helped create—the belief that business’ best interests are in opposition to those of society, government, customers, and suppliers. But he’s got the wrong dimension. It’s not about geography or demographics. It lies in focusing on the dimension of time, not space.

The bigger challenge for legitimacy is to realign business missions to be consistent with, not in opposition to, those of other stakeholders. The easiest way to realign may be to start by focusing on time frame. Many relationships appear competitive in the short term but can be mutually beneficial in the long term: We have chosen the wrong vantage point. The old Goldman Sachs used to say, “we are long-term selfish.” That still makes sense, if we can stop focusing on business as one-off, competitive transactional deals between traders.

**PERILS OF SHORT-TERMISM**

U.S. business in the last half-century has become overwhelmingly short-term driven. The usual complaint about quarterly earnings myopia is just the surface.

We have moved resources from relationship-driven business models to market-based,
transactional business models (40 percent of recent U.S. corporate profits came from the finance sector; mortgage loans were four steps removed from the homeowner; 25 percent of daily New York Stock Exchange volume is machine-driven).

Our financial language relies heavily on capitalized value and other metrics that define value in single-number, here-now financial terms.

The majority of my clients tragically hold two contradictory beliefs:

2. No one (outside of Warren Buffett and some private equity firms) is financially motivated to follow long-term strategies.

To believe both is to believe that “the system” controls us; that we are all driven to behave badly; that we are all so untrusting of each other that we cannot live in the long term.

We have painted ourselves into such a corner of short-termism that we cannot conceive of relationships without monetizing them. In substituting markets for relationships, we traded trust for liquidity.

Thus we get an oil industry focused on offshore drilling instead of conservation and alternative energy. We get a health-care industry focused on maximizing transaction costs rather than health-care outcomes.

AN EMPHASIS ON COLLABORATION

Business legitimacy won’t be regained as long as it remains all about competing successfully with other stakeholders rather than collaborating with them. It can be regained if business can reembrace Peter Drucker’s admonition that “the purpose of business is to create and serve a customer.” A solid step toward that goal would be to force ourselves systematically to look past the short term in all our business affairs.

And business is being rudely reminded that legitimacy derives from society, which occasionally makes its will known via the political
system. The smart bet would be to collaborate, not compete.

Porter is right that legitimacy must come from within business itself, not from charity, CSR—or community development. But his own doctrine of competition will continue to work against business solutions for social problems until and unless it rids itself of the poison of short-termism.
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