1 Introduction

We have been cocksure of many things that were not so.

Oliver Wendell Holmes Jr.[1]

This is an Element in the series, *Reinventing Capitalism*, which features explorations of "the crisis of legitimacy that is facing capitalism today, including the increasing income and wealth gap, the decline of the middle class, threats to employment due to globalization and digitalization, undermined trust in institutions, discrimination against minorities, global poverty, and pollution."

The sections of this Element mainly comprise articles about the past and future of leadership, management, and capitalism that the author published over the past eleven years in Forbes.com, where he is a senior contributor. They reflect both timeless insights as well as the continuing evolution of thinking. The articles have been lightly edited to remove duplication and improve flow.

Three notes on terminology. First, in this Element, capitalism means an economic system based on the private ownership of the means of production and their operation for profit. Although its beginnings were visible much earlier, in this Element, capitalism refers to the modern industrial form of capitalism that began emerging in the late eighteenth century.

Second, the world is so varied that there are exceptions to almost every statement in this Element. To simplify reading, these exceptions are only partly reflected with qualifiers like "mostly" and "often."

Third, while the Element has many global insights, this short volume is mainly focused on capitalism in the United States. That is not meant to diminish the importance of other countries and their viewpoints. A subsequent volume in this series will deepen the analysis of historical and multicountry perspectives.

1.1 Capitalism Is at a Tipping Point

The time is right to reevaluate capitalism for multiple reasons. First, capitalism is widely perceived to be in a crisis and failing large segments of the population.

Second, a vast struggle for the future of human society is under way. Financier Ray Dalio writes:

> "While ages ago, agricultural land and agricultural production were worth the most and that evolved into machines and what they produced being worth the most: digital things that have no apparent physical existence (data and information processing) are now evolving to become worth the most. This is creating a fight over who obtains the data and how they use it to gain wealth and power."[2]

1 "Natural Law," 32 *Harvard Law Review* 40, 41 (1918).

2 R. Dalio, *Changing World Order: Why Nations Succeed and Fail* (Simon & Schuster, 2021), p. 31.

Capitalism is not just at the tipping point in its predictable life cycle. The fight comes at a time when industrial-era capitalism has put the habitability of the planet at risk.

The choices to be made by countries, companies, and individuals over the next few years could together determine humanity's material future – for better or worse – for the rest of the century, even forever.

Today, countries, companies, and individuals have unique opportunities for broad-based prosperity – and the opposite. The opportunities and risks have many dimensions. This Element is about the management choices needed both to take advantage of the opportunities and to deal with the risks. It also describes broad social and economic ramifications of seemingly narrow management matters.

The choices that decision-makers – and those advising them – now need to make are unlike those they have faced previously, even though most of those dilemmas have occurred several times during capitalism's 250-year history. Thus, in capitalism, societies evolve in slow-moving but predictable life cycles that are longer than the lifespans of individuals. If decision-makers understand what happened before they were born, they may make better decisions. Conversely, if they don't, they may make unnecessary blunders (by contrast, some decisions related to climate change have few precedents). Given the political implications of many of these issues, enhancing fact-based understanding is key to depoliticizing decision-making.

1.2 The Competing Narratives of Capitalism

This Element examines competing narratives that are widely used to explain the situation and to guide decision-making. It reviews the extent to which these narratives are grounded in fact, and which are driven by self-interest, or by misunderstandings of history or of the current situation.

Like *Narrative Economics* (2019), the path-breaking book by Nobel-Prize winning economist, Robert Shiller, this Element examines the dynamic of certain contagious narratives, which themselves can drive major economic and social change. "Ultimately," writes Shiller, "narratives are major vectors of rapid change in culture, in zeitgeist, and in economic behavior."[3]

This Element examines three main narratives: customer capitalism, shareholder capitalism, and stakeholder capitalism, and their roles in the emerging digital age.

[3] R. Shiller, *Narrative Economics: How Stories Go Viral and Drive Major Economic Events* (Princeton University Press, 2019), p. xii. See also: S. Denning, *The Leaders's Guide to Storytelling*, 2nd ed. (Jossey-Bass, 2011).

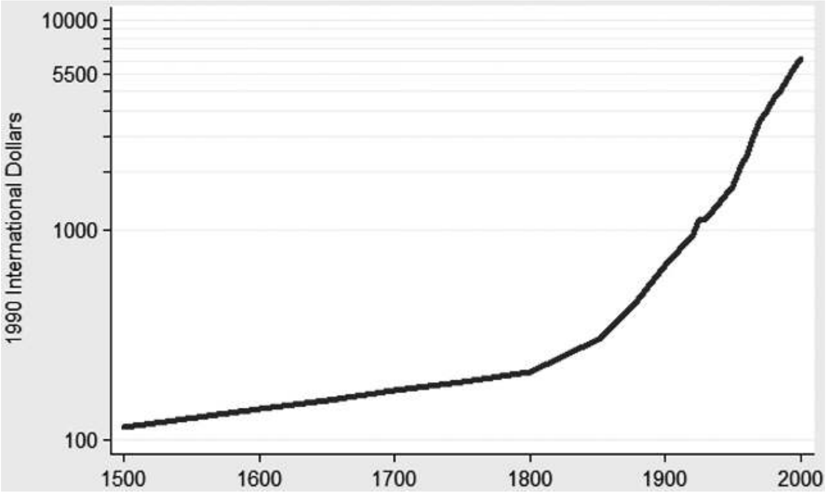

Figure 1 Global average GDP per capita 1500–2000[4]
Source: J.Bradford Delong, "Estimating World GDP, One Million B.C. - Present" (1998)

1.3 The Trajectory of Capitalism

The Element begins with a pervasive – but fallacious – narrative: the meme that everything in the world is getting worse. A comprehensive study presents evidence that questions that narrative and the unwarranted negative pall it casts over current discussions of capitalism.

The study shows that on the key dimensions of material well-being – poverty, literacy, health, freedom, and education – humanity is much better off than it was several centuries ago. This finding implies that we should not rush to judgment from capitalism's current troubles to a conclusion that capitalism itself must be scrapped.

The study suggests that humanity's material condition has significantly improved over the last two centuries, despite wars, plagues, tyrannies, communist policies, corrupt governments, and other disasters. Looking at the 500-year picture in Figure 1, we can see that the turning point in the upward thrust in humanity's material well-being coincided with the spread of capitalism and the industrial revolution in the late eighteenth century.

The fact that most people are materially better off does not alleviate the economic suffering of those individuals, companies and countries that are worse off, or diminish the importance of taking appropriate action to address those issues.

4 This file is licensed under the Creative Commons Attribution-Share Alike 3.0Unported license, https://commons.wikimedia.org/wiki/File:World_GDP_Per_Capita_1500_to_2000,_Log_Scale.png.

It is no consolation to a displaced citizen in a rich country that incomes have improved in less developed countries, or even in another part of their own country.

Aggregate numbers can hide relative changes within countries and regions, particularly relative changes between different income groups. Even where there are no losses, there may be troubling inequalities concerning which group gains. Acute social friction can arise here. Thus, the smooth upward trend shown in Figure 1 gives no hint of the growing inequality in the United States as shown in Figure 2, in which one social class has captured most of the gains for itself at the expense of those who helped create the gains.

1.4 The Last Half Century Was an Aberration of Capitalism

In one simple picture, we can see in Figure 2 the "smoking gun" of modern American capitalism and its impact on income inequality. It illustrates a central hypothesis of this Element: the American economy of the last half century is an aberration of capitalism. Before the 1970s, typical workers' compensation advanced in alignment with the gains in productivity they helped create. After the 1970s, typical workers' compensation stagnated, as the income of other sections of society, particularly executives and shareholders, grew exponentially.[5] We know where the gains went. In the period from 1978 to 2019, CEO compensation has grown 940% while typical worker compensation has risen only 12% during that time.[6]

Fraught capital–labor relations have been characteristic of capitalism's history. Since Adam Smith, businessmen are known to be pursuing their self-interest, and throughout history, individual tycoons have been notoriously avaricious.[7] But never before had efforts to elevate the current stock price of companies been conducted in such a single-minded, explicit, systematic, and public fashion across an entire economy.

Profit-making for firms and rent-seeking by executives went from being one aspect of capitalism to being the only thing that mattered. The fictional character, Gordon Gekko, in the 1987 movie, *Wall Street*, spoke for many real businessmen when he said: "Greed, for lack of a better word, is good." In

5 J. Bivens and L. Mishel, "Understanding the Historic Divergence between Productivity and a Typical Worker," *Economic Policy Institute*, Report, September 2, 2015, www.epi.org/publication/understanding-the-historic-divergence-between-productivity-and-a-typical-workers-pay-why-it-matters-and-why-its-real/; R. Wartzman in *The End of Loyalty: The Rise and Fall of Good Jobs in America* (Public Affairs, 2017) gives a blow-by-blow account of the emergence of the aberration in GE, GM, Kodak, and Coke.

6 L. Mishel and J. Wolfe, "CEO Compensation Has Grown 940% since 1978," *Economic Policy Institute*, August 14, 2019, www.epi.org/publication/ceo-compensation-2018/.

7 C. R. Morris, *The Tycoons: How Andrew Carnegie, John D. Rockefeller, Jay Gould, and J. P. Morgan Invented the American Supereconomy* (Times Books, 2006).

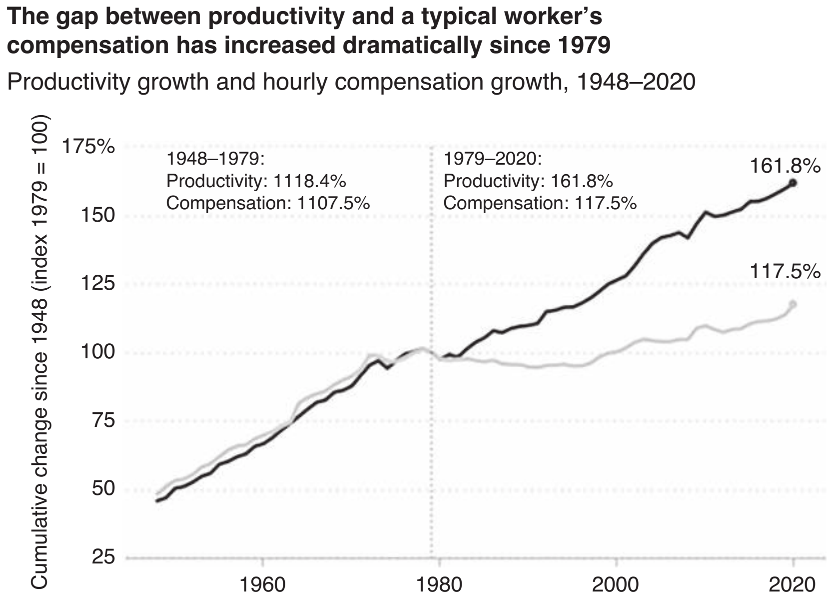

Figure 2 Distribution of productivity gains: Economic Policy Institute

Note: Data are for average hourly compensation of production/nonsupervisory workers in the private sector and net productivity of the total economy. "Net productivity" is the growth of output of goods and services minus depreciation per hour worked.

Source: EPI analysis of data from the BEA and BLS (see technical appendix for more detailed information)

1997, the Business Roundtable (BRT) gave its stamp of approval and boosting the current stock price became the official gospel of American business, until August 2019, when the BRT recognized its error and withdrew its support.[8]

Maximizing shareholder value (MSV) as reflected in the current stock price was not just an esoteric financial practice: it reflected a vast political movement, initially personified by President Ronald Reagan in the United States and Prime Minister Margaret Thatcher in the United Kingdom, and more recently with the corporate tax cuts introduced under President Trump. The political movement lives on in fictions like "corporate tax cuts pay for themselves."[9]

8 "Statement on Corporate Governance," *Business Roundtable*, September 1997, www.ralphgomory.com/wp-content/uploads/2018/05/Business-Roundtable-1997.pdf: "The Business Roundtable wishes to emphasize that the principal objective of a business enterprise is to generate economic returns to its owners"; K. Amadeo, "Greed Is Good or Is it? Quote and Meaning," *Thought & Co*, August 21, 2020, www.thoughtco.com/greed-is-good-or-is-it-quote-and-meaning-3306247.

9 S. Horsley, "After 2 Years, Trump Tax Cuts Have Failed to Deliver on GOP's Promises," *NPR*, December 20, 2019, www.npr.org/2019/12/20/789540931/2-years-later-trump-tax-cuts-have-failed-to-deliver-on-gops-promises.

MSV not only generated inequality. Ironically, it also had the opposite effect of what was intended. MSV systematically destroyed long-term shareholder value, rather than increasing it. The principal corporate exponents of MSV are mostly performing below the average S&P 500 company. Thus, growing inequality is only one of the negative consequences of shareholder capitalism.

1.5 Capitalism's Aberration: An American Phenomenon with Global Impact

The aberration in capitalism that took place over the last half century was authored by Americans – Milton Friedman, Michael Jensen, and William Meckling and the Business Roundtable. It took place in America and formally affected public companies registered in American stock exchanges. However, as business became increasingly global, and most of the largest firms in the world were registered in the American stock exchanges, they became subject to the pressures of American capital markets and hedge funds, as well as the thinking coming from American business schools. Thus, MSV had American origins, but had global impact.

Further research is needed before we accept the premise that capitalism itself must be totally reinvented. The more modest goal of remedying the current aberration of capitalism based on MSV is more promising and, as explained in later sections, has already begun.

1.6 Capitalism and Creative Destruction

In the 1940s, the political economist, Joseph Schumpeter, described the cyclical nature of capitalism as creative destruction, in which "the process of industrial mutation continuously revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one."[10]

If Schumpeter is right that capitalism embodies creative destruction, it means that capitalism is inevitably disruptive and economically harmful to all those whose livelihood is tied to arrangements that have become obsolete. The challenge of capitalism is less about reinventing capitalism from scratch, and rather determining how to enhance and share the benefits of capitalism's creative aspects, while rectifying or moderating capitalism's destructive tendencies.

The distinguished economic historian, Carlota Pérez, has provided a brilliant guidebook for accomplishing this in *Technological Revolutions and Financial Capital: The Dynamics of Bubbles and Golden Ages*.[11] Her work builds on

[10] J. A. Schumpeter, *Capitalism, Socialism and Democracy* (Routledge, 1994 [1942]), pp.82–83.
[11] C. Pérez, *Technological Revolutions and Financial Capital: The Dynamics of Bubbles and Golden Ages* (Edward Elgar, 2003).

Schumpeter's thinking and shows that "historically technological revolutions arrive with remarkable regularity, and that economies react to them in predictable phases." Thus, capitalism's creative destruction is not merely "one damned thing after another" but rather a predictable series of slow-moving phase changes.[12]

Pérez shows that capitalism has operated for the last 250 years in a recurring pattern of fifty- to seventy-year cycles, following predictable interactions between management, finance, technology, government, and politics.[13] In each cycle, as new technologies emerged, entrepreneurs grabbed the prospect of gain, financiers jumped in, and enormous fortunes were made. Then, after one or more economic crashes, during which income and wealth gaps increased, some groups in the population suffered as others advanced, existing employment was threatened, and trust in institutions crumpled. Such setbacks did not signify the collapse of capitalism, but rather the predictable consequences of capitalism's destructive aspects.

When governments responded wisely at such tipping points, a golden age of broad-based and balanced welfare ensued. If not, inequality and social discord worsened. Today, many countries are at this tipping point, where inequality within countries is deteriorating and politics is increasingly divisive. Autocratic leaders are emerging. Unless worsening inequality is addressed, entire countries may decline, and even disintegrate into chaos.

1.7 The Advent of Customer Capitalism

In the first 150 years of capitalism, there was little discussion of the purpose of a firm. Companies were owned by businessmen-entrepreneurs who preferred the practical challenge of building their business to theorizing about their firm's purpose. But in the early twentieth century, the advent of joint stock companies, the emergence of professional managers to run them, and the risk of those managers diverting the firm's money into their own pockets, led to the question: what purpose should these managers pursue?

The pivotal idea that the purpose of a firm begins with customers came from the management guru, Peter Drucker, who wrote in 1954: "There is only one valid definition of business purpose: to create a customer."[14] Only one. Drucker submitted the idea as a plausible narrative. It was not based on a quantitative study of existing firms. At the time, there were no such firms to study. It was Drucker's theorizing as to what *should* be the purpose of a firm, given his

12 W. Brian Arthur of the Santa Fe Institute: "I thought that the history of technology was – to borrow Churchill's phrase – merely 'one damned thing after another.'"

13 See also R. Dalio, *Changing World Order: Why Nations Succeed and Fail* (Simon & Schuster, 2021).

14 P. Drucker, *The Practice of Management* (Harper and Brothers, 1954), p. 98.

understanding of the dynamic of companies under capitalism. Making money was a result, not the goal of the firm.

For the next half-century, firms largely ignored Drucker's idea. As part of their public relations statements, firms often declared that "our customers are number one" and indeed, most firms did what they could for their customers within the limits of their existing structures and processes. But mostly, as explained in Section 7, firms after the 1970s increasingly pursued MSV – maximizing profits for the company, its shareholders, and its executives. Customers were not usually number one.

But in the twenty-first century, customer capitalism took off for four reasons. First, power in the marketplace shifted from seller to buyer, as customers had more choices in the emerging digital economy and better information about those choices.

Second, customers' wishes proved difficult to predict. Merely improving what the firm had delivered before or responding to what customers said they wanted didn't work. Empathy for customers was necessary to understand real needs – needs that customers might not even know they had, such as the iPhone's touchscreen keyboard.[15]

Third, customers increasingly demanded products and services that could make life easy, convenient, cheaper, more fun, or more meaningful, along with increasing disdain for products and services that didn't.

Fourth, the exponential array of digital technologies that are increasingly available in the twenty-first century helped instigate, accelerate, and enable, the management practices of customer capitalism.

1.8 Customer Capitalism: A Different Kind of Management Thinking

Many managers and analysts fail to grasp that the advent of customer capitalism involves much more than a decision to prioritize one class of stakeholder over another within the firm's existing structure and modus operandi. In fact, customer capitalism is built on a different kind of thinking, that leads to new structures, new ways of operating, and requires new kinds of leadership.

In the industrial era of the twentieth century, management thinking reflected an internal view of the firm. Management was about making the firm operate more efficiently and effectively within a relatively stable world, with given systems, processes, and practices. The firm did what it could for the customer

15 S. Denning, "How Empathy Helped Generate A $2 Trillion Company," *Forbes.com*, July 18, 2021, www.forbes.com/sites/stevedenning/2021/07/18/how-empathy-helped-generate-a-two-trillion-dollar-company/.

within the constraints of its existing systems. Top management knew best and issued directives to the rest of the organization, using steep chains of command to ensure order. Car companies competed against other car companies, banks with other banks, and so on. Managers saw themselves as solving the equivalent of familiar jigsaw puzzles. If they could fit the pieces together into the correct pattern, they could extract, and take, the value they believed to be their due.

Customer capitalism and its management practices embody different thinking. The perspective is mainly external. Success depends less on the internal workings of the firm and more on its ability to master a turbulent unpredictable world of exponential technological possibilities and to delight unpredictable customers. Innovation is pivotal and involves not merely improving what already exists, but creating what is new. The firm aspires to generate new possibilities of working, operating, interacting, playing, and living, for its customers. In the process, the firm can create new experiences for them, just as artists create works of art. Staff and partners are active in the creative process, not mere executors of management's commands. Competition can come from anywhere. The firm is not merely copying or learning known rules. Profits are emergent effects of invention and creation. They are the results of making rather than taking, often out of literally nothing but the imagination.

1.9 How the New Kind of Management Thinking Emerged

Initially, this new management thinking was of little interest to established managements. It began to take hold first in software development following the Agile Manifesto of 2001, which offered a set of priorities and principles as a better way of developing software.[16]

In time, as the digital age unfolded and developing software became steadily more important, customer-centric thinking began spreading from the IT department to running the entire firm, eventually transforming almost every facet of management, as is shown in Section 4 and Figure 16.[17]

In January 2010, management guru Roger Martin announced to the world in *Harvard Business Review* (*HBR*) that a new era – customer capitalism – had begun.[18] And in 2011, the financial sector grasped that "software is eating the world."

Today, it is increasingly becoming apparent that firms embracing the new, more agile ways of creating value for customers, can move more quickly,

[16] "Manifesto for Agile Software Development," 2001, https://agilemanifesto.org/.
[17] M. Andreessen, "Why Software Is Eating the World," *Wall Street Journal*, August 20, 2011., www.wsj.com/articles/SB10001424053111903480904576512250915629460.
[18] R. Martin, "The Age of Customer Capitalism," *Harvard Business Review*, January 2010, https://hbr.org/2010/01/the-age-of-customer-capitalism.

operate more efficiently, mobilize more resources, attract more talent, and use it more effectively, win over customers more readily, and enjoy more elevated market capitalizations. Accordingly, the most successful exponents of customer-capitalism have become the most valuable firms on the planet, while former giants, like IBM and GE, which persisted with industrial-era thinking and management, went into steep decline (Figure 3)

1.10 Customer Capitalism: A Different Kind of Leadership

Such deep-seated changes require leadership shifts at the very top of the organization. Merely telling people what to do, or delegating implementation to lower levels, or throwing money at the problem, have turned out to be ineffective.[19] Leaders must exemplify the new way of thinking and the modus operandi in their own conduct. Instead of controlling and containing, they must become inspiring and energizing.

As compared to the grind of bureaucracy in the industrial era, the new approach – with the love for customers and the use of self-organizing teams – was a nice surprise. It could potentially free the human spirit in the workplace from the dispiriting tyranny of a money-hungry hierarchy, while also making companies more productive for customers and for society. The idea of delighting customers had resonance with the other-directed thinking of age-old ethics, in sharp contrast to the self-centered avarice explicit in MSV.[20]

While no firm fully reflects all the aspirations of customer capitalism in everything it does, there is an increasingly sharp divide between the financial results of firms that embrace customer primacy and those of firms that doggedly continue as hierarchical bureaucracies.[21] This steadily growing gap ensures the continuing spread of customer capitalism, despite the disruption to established management practice.

1.11 Capitalism and the Digital Age

Customer capitalism has been fostered and accelerated by exponentially evolving digital technologies. A new economic landscape is being created. As with prior transitions from one era to another, the digital age creates and destroys.

[19] See the example of JP Morgan Chase at S. Denning, "What JPMorgan Must Do to Get the Stock Market's Respect," *Forbes.com*, May 30, 2022, www.forbes.com/sites/stevedenning/2022/05/30/what-jpmorgan-must-do-to-get-the-stock-markets-respect/.

[20] S. Denning, "How to Reconcile Management and Morality in Today's Gilded Age," *Forbes.com*, June 22, 2022, www.forbes.com/sites/stevedenning/2022/06/22/how-to-reconcile-management-and-morality-in-todays-gilded-age/.

[21] S. Denning, "Why Your Mission Statement Must Include Customer Primacy," *Forbes.com*, May 22, 2022, www.forbes.com/sites/stevedenning/2022/05/22/why-your-mission-statement-must-include-customer-primacy/.