



EVERYTHING YOU KNOW ABOUT MANAGEMENT IS WRONG

THERE'S ONE SIMPLE REASON WHY SO MANY
ORGANISATIONS HIT THE BUFFERS

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 EVERYTHING YOU KNOW...
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There is, of course, a link between all these organisations. Their misfortunes were made by the people who work in them. They were man-made, or, to be clearer, management-made.

Now, it's unlikely that managers are more stupid, ill-willed or careless than others. So why - judging by the increasing frequency and magnitude of corporate meltdown - does management, unlike the medical or technology sectors, not only not get better, but actually appear to get worse? Companies are hardly a life-form new to science; their habits are studied by more than 100 business schools in the UK alone. More university students study business than any other subject.

Recalibrating capitalism

So why are the returns so low, whether the currency is reputation, trust, customer service or social cohesion? As for economic results, consider rampaging inequality or the numbing austerity that, eight years after the financial crisis, mires the UK, with gaping shortfalls in economic fundamentals. What's gone wrong?

Try 'everything'. What if the economic problems of the world are not macroeconomic, but microeconomic? What if they are the result of pursuing the wrong kind of management within our firms? Suppose everything we know about management is wrong.

There is a dawning realisation that this may be the case. Management's major problems, organisational systems guru Russel Ackoff believed, derive from its diligent efforts "to do the wrong thing righter". This, he explained, just makes it wronger. So, if purpose and governance, management's starting points, are wrong, then managers' best efforts to make them work on the ground will just drive their organisations in the wrong direction more quickly.

This is what we have been doing for the past 40 years. It is fast becoming clear that, if the experiment of making companies an instrument of their shareholders - seeking to boost shareholder incentive and the ability to control management in pursuit of maximised shareholder returns - has failed, it is not because of poor execution, but because it is a terrible idea.

Who says so? Start with *Fortune's* manager of the century, GE's Jack Welch, who called managing for shareholder value "the dumbest idea in the world". Unilever's Paul Polman denounces "the cult of shareholder value". Richard Branson puts shareholders last. Dominic Barton, global head of McKinsey, dates the moment capitalism veered off track to a 1976 article by William Meckling and Michael Jensen that still underpins conventional wisdom about corporate governance. He believes we have 20 or 30 years to get it back on the rails.

Meanwhile, academic luminaries such as Charles Handy, the late Sumantra Ghoshal, Clayton Christensen, Henry Mintzberg, Jeffrey Pfeffer and Rakesh Khurana have drawn up a formidable charge sheet. They say that maximising

"WE'RE LIVING IN an era of fraud in America. Not just in banking, but in government, education, food, religion, journalism, prisons, baseball... Somehow, American values became, 'let's grab what we can for now and the hell with tomorrow.'"

These are the words of Mark Baum, the character based on a real-life investor, in *The Big Short*, the 2015 film adaptation of Michael Lewis's vivid unpicking of 2008's global financial crisis. Baum is a capitalist investor, not a revolutionary. He starts off looking for a way to bet against the US housing market in the early 2000s and ends up campaigning against ubiquitous business corruption.

Roll forward to 2016. Not a day passes without some fresh underlining of Baum's message (and it's not just the US): fraud at FIFA, in athletics and in tennis; Tesco exploiting suppliers; Sports Direct exploiting employees; charities (for God's sake) exploiting donors; yet more bank penalties (up to a global \$150bn since the financial crisis and counting); Libor fallout; Kids' Company; and VW.

shareholder value (MSV) has led to aggressive short-termism; privileges financial engineering over innovation, and value-extraction over creation; sets the interests of shareholders and managers against those of customers, employees, society and the planet; drives a wedge between CEOs and the rest of the organisation; holds back economic recovery; strips management of ethical content, leading to wholesale destruction of social and natural capital; and has overseen steadily falling returns on assets. Even Michael Jensen now admits that paying CEOs in stock options, instead of aligning their interests with shareholders', has had the opposite of the intended effect.

Crunching the numbers, Roger Martin, previously dean at Canada's Rotman School of Management, found that, since the late 1970s, under MSV, shareholders have done worse than in the post-war period, when managers were supposedly feathering their own nests – a finding that chimes with research showing that the most profitable companies tend to be those with a purpose beyond making profits, and with another study demonstrating that private US companies invest proportionally more and create more value than their public counterparts.

Two leading US academics go further. Pointing to a greater than 50% decline in the population of publicly listed UK and US companies, they suggest that the species is a dinosaur, now in the course of extinction. In a lecture to the British Academy last year, Colin Mayer, previously dean of Oxford's Saïd Business School, noted that "we are... on the border between creation and cataclysm, and the corporation is in large part the determinant of which way we will go". He added: "If the purpose of the corporation is just to make profits, then we are sunk."

A flawed paradigm

Purpose is key. The measures that organisations put in place to gauge performance and the methods they use to achieve it depend on purpose. Given the link between them, it's easy to see how management goes awry. As Welch rightly pointed out, shareholder value is an effect – a by-product of satisfying customers – not a cause. The consequences of adopting it as a purpose are well illustrated by the global financial crisis. Wall Street's financial metrics and incentives, untethered from the customer, not only provided no restraint, but actively encouraged bankers and traders to throw caution and ethics to the wind. Lewis's wry observation in *The Big Short* of a Morgan Stanley trader who ran up losses of \$9bn – "he was smart enough to be cynical about his market, but not smart enough to realise how cynical he needed to be" – stands perfectly for the entire financial sector. Alan Greenspan later reflected: "I made a mistake in presuming that the self-interests of organisations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their



equity in the firms... I discovered a flaw in the model that I perceived as the critical functioning structure that defines how the world works."

On a smaller scale, the same flaw derailed Tesco, VW and many others. Their antenna tuned only to financials, their de facto purpose slipped imperceptibly from the customer to shoring up financial returns and US market share respectively. Measures and methods slipped with them. Focused on hitting targets for buying margins and 'commercial income', Tesco buyers played fast and loose with supplier codes of conduct, as did VW engineers with US emissions rules. BP cut corners on safety. For newspapers, today is payback time, not just for phone-hacking, but for decades of despising their readers, just as horse meat was payback for retailers' failure to nurture supply chains. Charities' bullying treatment of their donors reflects a similarly cavalier attitude to ends and means, and illustrates the infection of the third and public sectors with the same toxic management attitudes and practices, ironically based on erroneous ideological kowtowing to the supposed superiority of private-sector governance.

The rusted cogs of management thinking are grinding into motion; the reigning paradigm is ripe for reinvention

Take performance management, another star exhibit of the unintended consequences of wrong things done righter. An organisation is a system, and it's the system (structures, measures, incentives and methods) that largely conditions how individuals perform in it. So managers' time is better spent improving the system than managing individual performance.

Shaping the future

Yet, as workers at Sports Direct, Amazon and almost any call centre would confirm, performance is ever more closely managed. The result, as Ackoff would predict, is endemic, low-level cheating to evade management attention, and shocking levels of engagement. In turn, this triggers an arms race between surveillance and the attempt to escape it, which turns workers into crafty shirkers and managers into bullying control freaks – a self-fulfilling prophecy that Orwell would have been proud to invent. Here's the reason why 'smart' devices or practices touted as 'empowering' always end up being used to tighten monitoring and control. As a research paper for the Scottish TUC put it, performance management is now synonymous "not with developmental HRM and agreed

objectives, but with a claustrophobically monitored experience of top-down, target-driven work".

The vain attempt to make perverted purpose work leads directly to a gloomy view of human nature, and in turn to management as a negative discipline that aims to prevent people doing wrong things rather than encouraging them to do right. At the extreme, the result is not just zombie people, but zombie organisations that, somewhere along the line, become their own macabre opposite. This is how we can arrive at banks that impoverish, a press that disinform, care homes and hospitals that kill rather than cure, and, more generally, organisations that sap the energy, life and humanity out of work rather than augment them. No wonder capitalism run on these lines can't seem to fulfil its basic functions for much of the world's population.

If we go on as we are doing, warns Mayer, management's self-made problems will eventually bring us "to a point of social, political and environmental catastrophe".

Yet, paradoxically, there's a message of hope here. "When the economic tide goes out, you

learn who's been swimming naked," Warren Buffett once remarked. In the face of unedifying corporate nakedness, political consensus around unthinking 'business friendliness' may be breaking down. Management is edging up the political agenda. Corporate tax is a live issue for governments everywhere. So is inequality. In a debate at Davos this year, 55% of the audience agreed

that corporate governance based on MSV is a failure. Meanwhile, in the US, where the stakes are highest, new corporate life-forms are emerging to fill the place left by the fading publicly listed corporation, as entrepreneurs stay private, opt for dual-class share structures or choose 'B-corp' status as companies with an explicit purpose beyond shareholder value. Indeed, some influential observers see in them, and 'sharing economy' firms such as Airbnb and Uber, a vigorous new economy growing up alongside the dying old one.

Reacting to these pressures, for the first time in 40 years, the rusted cogs of management thinking are grinding into motion; the reigning paradigm is ripe for reinvention. The remarkable thing about

capitalism has always been its protean nature. Even now, Mayer noted in his 2015 British Academy lecture, its chief actor, the corporation, can "be our saviour and source of wellbeing" – provided only that we don't flunk it, admit that we got its governance wrong and take responsibility for setting course in a new direction. To put it differently, this is a defining moment for management – and for the managers called on to shape it. What they choose to believe may be the most important thing they do. □

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