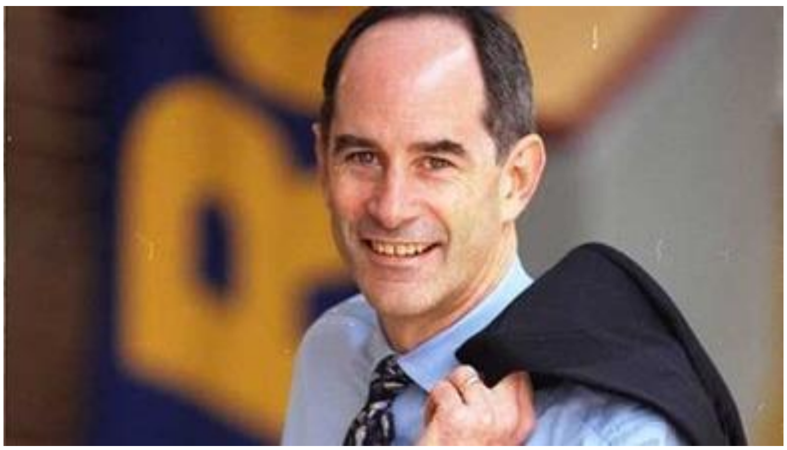
End of Modern Capitalism Debated...Over Martinis

By Dirk Smillie



The Harvard Club in Manhattan might seem a curious venue to debate "the end of capitalism as we know it." Especially when the evening is hosted by Adi Ignatius, editor of the Harvard Business Review (HBR). But that's what unfolded the evening of Feb. 9 between Ignatius and business design guru **Roger Martin**, whose new article in the Jan./Feb. HBR argues for junking the pursuit of "shareholder value" in favor of a customer-driven approach.

Both Ignatius and Martin attended Davos this year--a "seriously depressing" experience, said Ignatius. "Everyone agreed the system is broken." Martin said he found irony when European labor leaders came to Davos decrying job losses and the global economic meltdown, then went on to gorge on hors d'oeuvres at lavish parties. Apparently this is a sharper irony than debating the excesses of capitalism over crabcakes and martinis at the Harvard Club (both served in excessive quantities, and were delicious).

Martin, swathed in a charcoal suit and black t-shirt, looked more at home at a nightclub than the Harvard Club, whose walls are adorned with portraits of glowering Wall Street titans and Theodore Roosevelt's African game trophies. Martin is no radical, but a reformist with a compelling thesis. Corporate obsession with shareholder value has boosted market caps and delivered riches to folks like GE's Jack Welch and Coca-Cola's Roberto Goizueta. But the allegiance to shareholder value has helped inflate 2 of the biggest bubbles in stock market history, forced corporate leaders to pad shortterm income statements and "put chief executives in an unreal world where they lose their moral compass," said Martin.

In turn, chief executives "lie and cheat" to maximize shareholder value. Their focus is not on real performance but raising expectations about future performance. And who are these shareholders, anyway? Mutual funds and anonymous stakeholders with few ties to the company, he said. Are these really the people business leaders should coddle?

The worship of shareholder value began in 1976 when a journal article by Michael Jensen, "Theory of the Firm," critiqued the prior system of managerial capitalism and set the stage for our modern era of capitalism, writes Martin. The new approach fused the interests of management with stockholders in the form of stock-based compensation. Instead, it earned lower returns for companies, he says. A smarter approach: "Make customer value the top priority, as Johnson & Johnson and Procter & Gamble have done." These two corporate giants have posted shareholder returns as high or higher than shareholder-driven companies.

As dean of the Rotman School of Management at the University of Toronto, Martin has been a devotee of customer-driven capitalism for some time. He's a corporate director at RIM, maker of the Blackberry, whose customer-centric culture is the guiding ethos. The company penalizes any manager who dares speak of RIM's stock price at work. Anyone caught in the act must buy a donut for every employee, says Martin. RIM's chief operating officer once broke the taboo and wound up having to buy 800 donuts.

Maybe it's time to exact a similar penalty for corporate America (with crab cakes and martinis?). Peter Drucker would approve. Wasn't he the one who said that the prime directive of business should be to acquire customers and keep them?