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Thought Leader
by Des Dearlove

John Kay: The Thought Leader Interview

The controversial U.K. economist dismantles four myths about the American business model.

George Bernard Shaw observed that if all the world's economists were laid end to end, they still wouldn't reach a conclusion. Although the line sums up a popular view of the dismal science, an enormous swath of business theory and practice is rooted in economics.

John Kay personifies the bridge between theory and practice. One of the U.K.'s most prominent economists, he is a prolific writer, a business consultant, and a one-time business-school dean whose work encompasses both business strategy and public policy. Mr. Kay is no stranger to conclusions, or to controversy. Management as an academic discipline, he argues, is still in its infancy. In terms of scientific rigor, it is at the same stage of development as medicine was in the Middle Ages.

Mr. Kay's most recent book, *The Truth about Markets: Their Genius, Their Limits, Their Follies* (Penguin, 2003), argues forcefully that there is no single economic or corporate blueprint for success. Following the fall of the Berlin Wall, the industrialized West came to believe that the triumph of capital-

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ism was complete. History was over, and the American business model was victorious. That view of the workings of a market economy system is, Mr. Kay contends, a caricature of capitalism, a simplification of the American business model that was based on an ideology of market fundamentalism. Not only was it a false description of how the U.S. economy functions, but its prescriptions have actually damaged business and markets around the world.

Mr. Kay's arguments do not emerge solely from the cloistered tower; he boasts a proven commercial track record. Elected a fellow of St. John's College, Oxford, at the age of 21, he went on to hold professorships at both London Business School and Oxford University. He was also the first (and only) professor of management to receive the academic distinction of Fellowship of the British Academy. In 1986, he founded the consulting firm London Economics, and was executive chairman until 1996. During that time, the firm grew into Britain's largest independent economic consultancy, with annual revenues of $15 million and offices in London, Boston, and Melbourne.

In 1996, Mr. Kay became the first director of Oxford University's newly created Saïd Business School — an appointment he saw as an opportunity to raise the profile and academic standing of management in the U.K. But just three years later, Mr. Kay resigned in frustration, citing the university's archaic decision-making processes. "The opportunity to create a business school in Oxford is fabulous," he says of his move and the ensuing controversy. "But people need to be allowed to get on and do it. It's very hard to imagine an institution that essentially has no decision-making processes at all. What exists instead is simply a set of vehicles for evading decisions and avoiding choices."

Since then, Mr. Kay has concentrated on his writing, including a regular column for the *Financial Times*. In *The Truth about Markets*, which he began writing around the time he left Oxford, Mr. Kay argues that the strengths of markets are rooted in context — especially a nation's financial and legal institutions and business infrastructure. The U.S. economy has evolved over more than two centuries and cannot be replicated, he believes. There are no universal blueprints for success for nations or organizations. Neither the U.S. economic model nor the U.S. business model, he says, can be transplanted successfully into other countries.

The implications are profound. What works in the U.S. context, Mr. Kay asserts, will not work in India or China — just as what works at General Electric will not work at IBM.

John Kay talked with *strategy+business* in his London office.

S+B: Your most recent work attempts to separate the truths about markets and market economies from the myths. What prompted you to tackle this subject now?

KAY: The idea for this book was conceived really in 1999. At that time I said to myself, and my publisher, I need a Wall Street crash to provide the background for this, and I'm confident that we will get one. So it was planned in that sense. Quite what I'd have done if the Nasdaq was still soaring, I don't know. But I never thought that was likely.

S+B: Executives already feel chastened by their acceptance of irrational thinking during that period.

What else is left to learn about that "era"?

KAY: The key message for businesspeople is that during the 1990s they were offered a very facile and oversimplified description of how market-economy systems work. That model is not only wrong, but the attempt to act on it has actually made business and markets work worse. That's true if you're talking about the attempts to introduce a market economy into Russia, or if you look at the damage that has been done to the long-term position of companies by excessive focus on financial markets and short-term shareholder value.

S+B: Your book describes and dismantles what you call myths about markets. What are some of them?

KAY: There are four central myths behind what I call the American business model, or ABM. The first is that greed is overwhelmingly the most important motivation in economic affairs. Of course, it is a motivation, but it is not overwhelming for most people. Most people work because they want to do a good job, because they enjoy the respect of their friends, and so on. If you ignore these other motivations, you actually undermine the relationships that make corporations effective.

False premise two is market fundamentalism. It says you should impose as few restrictions and limitations as possible in the operation of markets. But this doesn't recognize that markets actually operate — and can only operate — through an elaborate social, political, and cultural context. While some of that may be government regulation, a lot of it is self-regulation — the ways people expect to behave. To suggest that unregulated markets are more efficient is wrong. Markets rely on rules and signals. Without these, you get chaos.

The third premise, which in a sense is obviously mistaken, is that a successful business needs a minimal state. This argues that the only legitimate role for the state is in the protection of property rights and the enforcement of contracts. But when you look at them closely, you find that successful market economies have the largest and most powerful governments the world has ever seen.

S+B: And the fourth myth?

KAY: The fourth is that there's an overriding need for low taxation, which is also untrue.

S+B: This is a controversial book — not least because its publication coincides with a rise in anti-American sentiment around the world. Superficially, someone might hear echoes of the anticapitalist, antiglobalization protesters.

KAY: I have no doubt at all that the market economy is the only successful form of economic organization, and that both rich and poor countries benefit from an open international trading system. But I see the market economy today described — not just by its opponents, but by its defenders — in terms of a lightly regulated society in which individual greed is the dominant motivation. This is ethically unattractive, which is why the protesters win sympathy from a much wider audience. But, more importantly, it is not a correct description of how real market economies work. The societies that are closest to that model — Nigeria, Haiti, and modern Russia — are not successful.

A polarization exists today between a market-fundamentalist view that believes there is a market solution to any problem, and the antiglobalization protesters, whose incoherence is summarized in the slogan "capitalism should be replaced by something nicer." Both positions are caricatures of markets and market economies — and they both distort the reality. And that is bad for business and economic development.

S+B: Why has this simplistic view of market economies become so pervasive?

KAY: The ABM has come to play the role in the political economy that Socialism enjoyed for most of the 20th century. All political positions, even hostile ones, are defined by their relationship to it. Prior to the fall of the Berlin Wall, the Left determined the vocabulary of politics, but with the collapse of the Soviet system, the Right has seized the language of political debate. That debate, whether for or against, is now focused around the ABM.

Markets are remarkable institutions. The creation two or three hundred years ago of what are now the great market economies of Western Europe is one of the great human achievements. But we need to understand how subtle and complicated they are. If competitive advantage weren't subtle and complex, it would be easy to reproduce and wouldn't be as remarkable in its effects.

S+B: And this subtlety and complexity means each economy is unique — there can be no blueprint?

KAY: Exactly. Market economies are necessarily embedded in social, political, and economic institutions — and cannot work unless they are. Market economies draw their strength and legitimacy from their context.

We don't have — and never can have — the capability to see the future a long way ahead and do the sort of planning that crafting these kinds of structures would demand. People find it very hard to see that Socialist plans failed for the same reasons centralized directives in market economies or large corporations will fail.

S+B: You draw parallels between the centralized planning departments at U.S. corporations in the 1960s and 1970s and the Soviet system.

KAY: The 1960s were the heyday of centralized planning, both at the level of the national economy and at the level of the corporation. Looking back on it now, there seem to be quite interesting reasons for that. People did not understand then that the Soviet Union was not doing well economically. It's hard to believe what was written at the time. Even those on the Right believed that the Soviet economy was doing pretty well; what was wrong with Socialism, they argued, was its morality. Similarly, national planning was at its height in most European states. That was also the high tide of corporate planning.

A Department of Defense study in the 1970s described GE as the best centralized-planning system in the world. When he became CEO, Jack Welch identified the problems this created, such as the absence of honest feedback — the same problem that was so damaging in the Soviet Union. Facing reality was not one of the company's strong points. Its superficial congeniality made candor extremely difficult. It is striking that Welch uses GE's approach to nuclear power to illustrate the issue.

I contrast that with experience in Britain, where superficial congeniality continued and candor was never achieved — not even today.

S+B: But by the 1980s, that kind of centralized planning was largely discredited, in the corporate world at least. There is a general acceptance now that it is not possible to create a detailed plan for five or 10 years down the road.

KAY: Both corporate and national planning faded in the 1970s because they didn't work. That was accompanied by a move to the kind of vision and leadership style of centralized corporate management in which the vision of the heroic individual becomes a key element. And again, if you think about that in terms of the experience of national economic planning, you see the corporate analogue.

Look at Khrushchev and Mao and their failures in agriculture. You can see the same mistakes reflected with business leaders. People like Henry Ford, who got some calls absolutely right early on in his career, but then for the rest of his life got them increasingly wrong. His mistake was to believe that his inspired judgment was the basis of business success.

S+B: Heroic leadership is still very much alive in both political and business thinking.

KAY: That isn't surprising. If you have an aggressively individualistic perception about how the world works, then it is hard to understand that it's the corporation as a sort of organism and entity that is the strength of market economies.

S+B: There seems to be a bit of a paradox here. You say the American

“Who paid for the most important innovations of the 20th century? Not companies or governments. It was private philanthropies.”

business model is a myth. Yet you also say the U.S. economy works very well. Can you reconcile this?

KAY: When I’m asked the question, which I frequently am, “How do you reconcile your criticism of this American business model with the success of the American economy?” the answer is that the American economy is not built on the kind of caricature model I was describing earlier, and couldn’t be.

The U.S. economy, like other successful market economies, is based on disciplined pluralism over a long period. Or to put it another way, the wealth of the richest 20 countries in the world today is a product of two centuries or more of political, social, and cultural evolution. It is naive to imagine that the lessons of that can be distilled into a few easily transferable maxims — and that is why our efforts to promote economic development in poor countries have enjoyed so little success and why the experience of post-Communist Russia has been so poor. We can only find real solutions to these problems when we understand that there are no simple solutions. As happens so often in business and economics, we are looking for prescriptions when we have very little understanding of the issues or the diagnoses.

S+B: One of the other great perceived strengths of the U.S. economy is the entrepreneurial culture. But there seem to be many instances where the originator of an idea does not reap the commercial rewards — which seems like a market failure. Do markets actually reward innovative talent?

KAY: The answer is yes, but very roughly. There are lots of reasons the inventor or originator of an idea may not get the lion’s share of the rewards. In the book, I talk about the history of the personal computer industry; few of the firms that made the innovations that were really important to the ultimate development of the industry succeeded commercially from it. The most important company in the inventive sense is probably Xerox, which is not there at all today and has never been there in terms of commercial success in that industry.

The other really important question to ask is: If you take the most important innovations of the 20th century, who paid for them? And the surprising answer to me when I looked into it was not only that it wasn’t private companies, but it wasn’t government either: It was private philanthropies of various kinds.

S+B: Can you give us an example?

KAY: My list of these innovations includes computers, antibiotics, “green revolution crops,” and television. If you take just these four for the moment — with computers, the basic idea was academic and then developed in the war by the British government. Antibiotics were discovered famously by Alexander Fleming in a hospital in the 1920s, then nothing happened for 10 years. It was only when the Rockefeller Foundation put money into research and development that things started to happen. Both the British and American governments in World War II also picked up that one.

The development of television is typical of those things that happen a lot with a certain sort of applied innovation. All the bits needed to do it were there — so television was effectively invented half a dozen times, more or less simultaneously, by different people around the world. Probably the most plausible claim to be the inventor of the commercially viable television is a

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small entrepreneur in the U.S. supported by business angels. The other example is green revolution crops. That, interestingly, was the Rockefeller Foundation again.

S+B: We’ve talked about the American business model — real or imagined. Is there a European business model?

KAY: There’s no one distinctive model. There’s a multiplicity of models. The market economy is centrally and fundamentally a West European institution. It came into being in Western Europe a couple of hundred years ago. And almost all of the countries today that are effective players in the market economy are either West European or they’re what Madison called the West European offshoots. That includes the United States because its political, social, and cultural institutions are basically West European in origin.

So what we have across most of the productive world is a set of variants on that particular theme. It’s then an open question to what extent the Asian partial success is just another variant on that theme, or to what extent that represents a somewhat independent strand of historical development.

S+B: There’s another paradox, which you rightly point out: Despite there being no single American business model, that model is the most admired in the world.

KAY: One of the oddities about the last decade has been the belief — on the basis of no evidence — that the U.S. is not just the world’s most successful economy, but that it’s so markedly more successful than any others. The truth is that the richest countries in the world are small Western European states: Switzerland, Norway, Denmark, and so on.

S+B: Do you see any decline in the competitive position of the U.S. economy relative to Europe?

KAY: If you look at growth rates during the last 20 years, there is no marked difference between American economic performance and European economic performance. The bizarre thing is that not just Americans but a lot of Europeans seem to have brainwashed themselves into believing that Europe is doing much worse than the United States. One of my favorite comments at the moment is to say American GDP is 20 percent above French; but French working hours are 20 percent shorter. The only difference is the French have more holidays and longer lunches.

There never really has been a huge gap between European and American productivity. People seem to have convinced themselves in the late 1990s that Europe has a major problem in comparative economic performance.

S+B: But many people believed that the U.S.’s rapid adoption of new technologies was giving it a major structural advantage over the rest of the world.

KAY: There is nothing to suggest that something has permanently increased the U.S. growth trend, or the growth rate of any other major economy. Nor is there any convincing evidence to support the notion that information technology has fundamentally changed the characteristics of a successful business.

S+B: Is globalization a force for economic good in the world? Does it benefit poorer countries, or is it a form of economic colonialism?

KAY: Globalization is another of those words that has so many meanings and connotations. There is an easy and positive way to define it. Market economies have really developed because of an ever-finer division of labor by which the tasks performed by both individuals and organizations become more and more specialized. Growth in international trade has been a part of that; in that sense, globalization is a great dynamic for economic development. If globalization means the international influence of large corporations, then a lot of that is good, as well. Large corporations are vehicles for transferring not just technology but institutional knowledge to poorer countries, which desperately need it.

S+B: But does it make the poorer countries richer in the long run — or does it just make the rich countries richer?

KAY: I think it makes the poorer countries richer. One of the points I emphasize at the end of the book is that the reason rich countries are rich is not because poor countries are poor.

S+B: What about globalization in terms of the opening of global markets?

KAY: I don't think the globalization of finance has been particularly helpful, but I don't think it's stoppable even if one felt that to be desirable. What I think we really have to do is recognize that active securities markets are not as important in the development of a market economy as people seem to think.

S+B: You mean stock markets aren't the engine of economic growth?

KAY: Correct.

S+B: Management is still regarded by many as a pseudoscience. It seems to occupy the position occupied by economics a century ago.

KAY: That's right. One very good test of that is if you do an introductory physics course, the basic course will be much the same wherever you do it. That's the sign of a subject that is mature — to have an agreed-upon, understood, recognized body of knowledge that anyone who is serious recognizes as being the basis of the subject. Economics has now basically got there in these terms. But I don't think management has.

S+B: But economists still get bad press.

KAY: A lot of the bad reputation of economics is because most people, especially businesspeople, think that what economists do is macroeconomic forecasting. Since they don't do that very well — not primarily because economists aren't good, but because it's impossible to answer those sorts of questions — they have a correspondingly low reputation.

S+B: Even though many business theories are adapted from economic theory?

KAY: Yes, but they have to be adapted to be accepted. The best translation of standard economics into business language is what Michael Porter did, but it involved cutting off all the laundry labels. If you look at Porter's books, there's very little indication that he was trained as an economist, or that the ideas he's using are basically drawn from economics. And that, I'm sure, is because people thought it would be less appealing if it was presented as economic theory.

S+B: Perhaps it's human nature to seek simple answers. We want to believe in a visionary leader. We want to have management gurus to hand us down the solution. Do you see that ever changing?

KAY: People have a psychological need for simple explanations. +

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