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Thought Leader
by Randall Rothenberg

Arie de Geus, The Thought Leader Interview

The guru of organizational learning says that robber baronialism helped kill the dot economy.

Conventional wisdom holds that corporations are largely economic entities whose primary purpose is rewarding shareholders. When that premise is challenged, it is usually on moral or political grounds. That's the essence of the "stakeholder" argument: A company owes fealty not just to shareholders, but also to its other constituents, such as employees and its government charter. Arie de Geus starts from a very different premise: that a company's first loyalty is not to any individual stakeholder, but *to itself.* Companies that focus single-mindedly on profits don't learn, and therefore, they don't thrive — or even survive.

His is not an outsider's perspective. Indeed, Arie de Geus had a long career in one of Europe's largest companies, the Royal Dutch/Shell Group of Companies. He first came to prominence among management thinkers in 1988, when he was the coordinator (a role akin to that of an executive vice president) in charge of the corporate planning function at Royal Dutch/Shell's central offices in London. That year, Mr. de Geus published an article in the *Harvard Business Review* called "Planning as

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Learning," which argued that the ability to continually rethink one's purpose and methods was not just a valuable add-on to corporate practice, but the single factor most responsible for competitive advantage. Companies could have their assets devalued or their ideas stolen, but as long as they possessed the ability to innovate and to develop people, they would always remain one jump ahead of their competitors.

When he first made the case, Mr. de Geus, a Dutch-born executive with an economics degree from Erasmus University in Rotterdam, drew upon Shell's experience with scenario planning — the use of several imaginative stories about the future to help managers better understand their decisions in the present. His planning department was one of the primary places scenario planning had been initiated, and he had played a key role in linking it to strategic practices throughout Shell's global group of companies. He also became a close associate of Peter Senge, then a faculty member studying business systems at the Massachusetts Institute of Technology. Mr. de Geus later helped Mr. Senge initiate the book project that became *The Fifth Discipline.*

But in Mr. de Geus's own 1997 book, *The Living Company* (Harvard Business School Press), written several years after he had retired from Royal Dutch/Shell, scenario planning and organizational learning played a secondary role. His premise about corporate purpose had become much more radical: Companies should be seen essentially as biological organisms, thriving, like any other living entity, on growth with an organic pace — evolutionary and relatively stable growth, in other words, but with lots of experimentation and offshoots at the margins.

Mr. de Geus, a very temperate and cautious writer and speaker, never argued that corporations *were* alive (his book's title notwithstanding); but he persistently claimed that if you treated your company as a living thing, it could outlive most of its competitors. This meant giving up the "economic" model of corporate success, as he termed it: the idea that a company existed as a device for extracting profit and returning it to shareholders.

Instead, he argued, companies could best serve their shareholders (and all other constituents) by cultivating the characteristics of a living being. He picked four key qualities: sensitivity to the environment, a cohesive identity, tolerance of experimentation and eccentricity, and a frugal financial approach.

The Living Company won the Edwin G. Booz prize for most innovative business book in 1997 at the Financial Times/Booz-Allen & Hamilton Global Business Book Awards, and it provoked an intense debate about the role of corporate governance, which continues to this day. A few CEOs have truly taken the book to heart, particularly in Europe: Heinrich von Pierer, the chief executive of Siemens AG, has used Mr. de Geus's characteristics of long-lived companies to defend his own company's strategies to analysts and investors. Indeed, Mr. de Geus's views may have enhanced relevance amid the collapse of the dot-com economy. In his view, the end of New Economy ebullience makes it clearer than ever that capital is becoming a commodity. The primary corporate struggle is no longer to raise money, but to recruit, keep, and deploy good people.

For this issue on Europe, and in the midst of an economic transition that seems even more unpredictable than usual, it was appropriate to seek out Mr. de Geus's views. He graciously (albeit briefly) interrupted a ski vacation in the Swiss Alps to talk with *s+b* about, in effect, the future of corporate longevity.

S+B: In *The Living Company*, you suggested that the most effective way to think of companies is as organic beings, evolving in natural ways and looking out for their own longevity. The conventional way of regarding companies, as purely economic constructions with the purpose of returning investment to shareholders, was not just inaccurate, you said, but shortsighted. It led to a lot of short-lived companies. Since then, we've

had two highly visible economic crashes, one in Asia, and the other in the market for Internet companies. How has this affected your thinking?

DE GEUS: I'm not sure about the relevance of the Asian crisis for this, but the dot-com bubble — can we refer to it as a bubble? — has confirmed that there's a lot of validity in thinking of companies as living systems. I began *The Living Company* by describing a study we had conducted at Royal Dutch/Shell during the 1980s. We found that at least 45 of the world's major commercial corporations had survived the storms of creative destruction, some for centuries. Compare this to the average life expectancy of a Fortune 500 company, which is less than 50 years. What lessons could we learn from this? We discovered one major distinction: the emphasis these companies placed on community characteristics like culture and ideology, combined with a pragmatic pursuit of profits. The long-term survivors did not see themselves as primarily economic units to produce profits and value for the entrepreneur and shareholder. They saw themselves as living systems composed of other living systems — the people who worked for them and thus belonged to them.

S+B: In what way do, or did, dot-coms differ?

DE GEUS: Many New Economy companies seemed to be based on the idea that they are primarily economic entities. When I first realized this, it surprised me, because it seemed to contradict the essence of these companies' business plans: the deployment of creative capability. These companies desperately needed high learning and innovation. Yet they organized themselves as limited liability companies, which is the legal setup of 19th-century industrial enterprises. Their executives managed the companies for the maximum profits at the shortest possible notice. Then, because the continued input of human talent was the only source of the company's success, they had no choice but to give their key employees stock and involve them in the game of quick returns.

S+B: Incentivizing employees has long been considered an excellent way of aligning them with the company's goals.

DE GEUS: Once you enter that game, your success will be measured by the price at which the shares are ultimately sold. Thus, in its early stages in particular, the dot-com bubble produced a number of wealthy individuals. They were the kind of people who can say, "I've done it all at 35, so what will I do with the rest of my life?" But at the same time, these companies were left behind to die — including the people who had hoped to build a future in them. In the end, the dot-com bubble was a fashionable sideshow of people who thought that with only an idea and some venture financing, one could set up a company as a machine to make even more money for fairly few people. And it hasn't been a very successful idea, has it?

During the last year and a half, it brought me back to the question: What about those companies which *have* thrived over the long term? What is the critical success factor for *them*? I foreshadowed this theme in *The Living Company,* when I wrote that the most critical resource that companies need to cultivate has shifted, since the 1980s, from capital to people. A company's success no longer depends primarily on its ability to raise investment capital. Success depends on the ability of its people to learn together and produce new ideas. I see even more evidence of this today than I did in 1996.

S+B: For example...?

DE GEUS: Today, in the Fortune 500, the companies which consistently rise — the Ciscos, Microsofts, and EDSs — have relatively few capital assets. The difference between their high capitalized share values and the low values of capital assets on their balance sheet represents a valuation of the intellectual capability of their human components. In the most successful companies, this valuation is comparatively high.

S+B: What are the implications of that?

DE GEUS: Until a couple of years ago, you couldn't go to a conference of personnel managers without hearing about "employability." The basic idea was [switches to mock job-interviewer's voice]: "Well, you can work for our company for a little while. Of course, we're not going to give you a contract for life. That's for the Japanese; we don't do these stupid things. Undoubtedly, after you've worked for us for a couple of years, either you

"A company's success no longer primarily depends on its ability to raise investment capital, but on the ability of its people to learn together and to produce new ideas."

will want to go or we will want you to go. But there is no drama, and no downside for you; the experience will increase your employability."

Behind that reasoning is a denial. The new people you recruit, it suggests, are not actually inherent members of the work community of your company. But then, who *is* in the company? The employability theme suggests that the company has no members at all. It is merely a device that people use to make money. The new recruit is using it, just as the boss is using it, and everyone is equally served by this.

In that sense, it's interesting that the employability theme has disappeared completely.

S+B: What happened to it?

DE GEUS: I first noticed that it was changing a few years ago, in conversations with some people in software, financial services, and consulting firms — the very places where the employability theme had first taken hold. "We're finding out," people said to me, "that if somebody works for us for four or five years and begins to achieve a certain seniority in our organization, and then if we lose that person, it costs us an awful lot of money." I remember that three years ago, someone from Oracle mentioned that it cost $50,000 or $60,000 to replace somebody who had worked for them for five years. So I began to check that figure with other rising companies. Some consultancy firms say that if they lose a senior consultant, or someone on the verge of becoming a junior partner, it costs up to £200,000 and 18 months of business to replace that person.

S+B: What do those costs consist of?

DE GEUS: They include recruitment costs, the costs of training — of getting a new recruit up to the same speed — and of replacing the business contacts and professionalism of the person who left. The real problem with people in companies is not "employability" but retention. Continuity is thus, once again, becoming recognized as an essential business principle.

S+B: Let me ask a naive question, then. If the benefits of continuity and retention are so strong, why had they fallen out of favor in the first place?

DE GEUS: Well, that was all part of the wave that considered companies as primarily money machines. And the legislation in most countries allows that game to be played very easily.

For example, the predominant corporate legislation in the United States and United Kingdom is based on the premise that the shareholders own the company. This concept derives from the past, when capital *was* the critical success factor. It attributes to the capital supplier two very strong privileges. First, the shareholder has the ultimate power of life or death in those companies — the selection of who will manage the company. Second, the shareholder has the enormous privilege of a right to the bottom line. The company has a legal responsibility to return profits to shareholders. These privileges are granted even though the shareholder typically didn't put any capital directly into the company, but rather bought a share from another outside shareholder.

But since today's companies are totally dependent on a continuing human membership that produces a superior intellectual output in comparison to the competition, then there is inevitably a fight over the right to the bottom line. Will profits go first to the so-called shareholders or to the human members of those companies?

In startup companies, this is partly harmonized. The founders convert their original small partnership into a limited liability company so that they can issue shares and give them to their employees. So far, so good. There is no conflict of interest, if you like, between the shareholder and the members of the work community. This lasts until the moment that the employees start selling their shares in an open market, or to venture finance companies.

S+B: When they retire, probably.

DE GEUS: Or when they need money, or when they want a new yacht or a villa in the Bahamas. The top people are especially likely to sell. At that moment, all the doors are open for the shareholders to ask: Is this company really being run for the maximization of shareholder value? When the new, external shareholders want to exercise their rights — to say how they want the company to be run, or to increase the revenues paid to them out of the bottom line — they find all the force of the law behind them. When the shares are concentrated in the hands of large shareholding groups — venture capitalists, pension funds, and insurance companies — then it is a matter of a few telephone calls around Wall Street or the City of London to get a sufficient percentage of the outstanding shares together and have a little discussion with the management.

And thus we find a tension emerging in those startup companies as well as in "converted" companies like Goldman Sachs — between their imperative to develop and retain their people, and the pressure they feel from their legally empowered shareowners.

S+B: You're saying, in effect, that the current prevailing form of corporate governance is unsustainable. And you're implying that companies which ignore the demands of their large shareholders will make more money in the long run than companies which don't.

DE GEUS: Well, I would not go so far as that. But I think the conflict between shareholders and community members in a living company is very real. The shareholder says, legally, "I have a right on the bottom line." The members of the work community are beginning to say, "Hey, there *is* no bottom line without our talent and our capacity for joint learning, and our production of superior intellectual output. So what about our remuneration?"

I am very intrigued by the example of one particular group of — let's call them human associations — where the conflict is nakedly visible. These are the European football clubs.

S+B: You mean what Americans call soccer.

DE GEUS: Yes. And I don't know enough about the sporting world in the States, but there are plenty of indications, from a distance, that the same tensions exist for your baseball and basketball clubs.

In Europe, during the last decade, a lot of football clubs have given in to the temptation of converting themselves into limited liability companies. But to be successful, the clubs have to pay excessive amounts of money to contract players and coaches who are the only ones who produce results in the competitions. As a result, in every country in Europe where this conversion has taken place, only a handful of soccer club companies are still financially viable. Each of them has shareholders who bought the company as a money machine: They put capital in and they want money out. But there is no money to draw out.

S+B: Because there isn't enough money to go around?

DE GEUS: Yes. The shareholders cream off the profits via the distribution of the bottom line. But the trainers say, "I need £20 million sterling to buy two or three good players." Otherwise, they won't be able to produce results. For if they can't draw fans to the seats, then the fans won't buy T-shirts, et cetera.… When the shareholders and the trainers come in conflict like this, the trainers have the more compelling case. And the same will be increasingly true in other types of businesses.

S+B: Isn't this conflict just another cycle of the conflict between management and shareholders that came up, for instance, in the 1980s?

DE GEUS: That was the beginning of this transitional period. Even then, it was possible to see human learning and capability as a critical factor on the horizon, although not sufficiently strong to influence corporate governance.

Today, we have moved further through the transition. The capital market is now a buyer's market. Capital seems to be becoming a commodity in the same way that wheat or iron ore are commodities. If that is so, then the old capitalist organizational concept of the limited liability company is no longer valid.

S+B: And this is not a temporary state?

DE GEUS: This is not a temporary state, no. I admit that one should never underestimate the capacity of banks to destroy enormous amounts of accumulated capital and reduce, temporarily, the supply. After all, capital is the accumulated savings of mankind. And banks are great masters in destroying enormous amounts of capital with great regularity.

The East Asia crisis, in that sense, was a relevant case. The figures I read suggested that more than a trillion dollars was destroyed in something like six months' time in the Thai, Malaysian, Filipino, and Japanese banking systems. Then there were hundreds of billions of dollars destroyed in the American currency speculators. Nevertheless, six months after that, the Dow Jones reached a record quote of 10,000. There is so much capital looking for an investment somewhere that if things go wrong in one place, the money just washes around the system and comes up somewhere else. In the last 20 years, the financial world has easily absorbed shocks — like the 1982 Mexico crisis, the 1986 oil price collapse, the 1987 New York Stock Exchange crash, and the 1990s currency crises — that would have produced a global economic depression in an earlier time.

S+B: Who ends up being favored in a transition like this? Is it simple enough to say that those who manage people well will gain? Or is there some other principle at work?

DE GEUS: To begin with, people with very high talents in a particular industry are favored. It is no coincidence that we now have a little clique of $20-million-salary film stars in Hollywood. In the sports world, the bottom-line remuneration is also going in the direction of people with exceptional talents. And I think this partially explains the extravagant managerial remuneration in the United States, which is beginning in Europe as well.

S+B: Well, that's a very countercultural ethic for a company like, well, like your alma mater, Royal Dutch/Shell, isn't it?

DE GEUS: Oh, yes.

S+B: How does a company like that cope?

DE GEUS: Inside every company that feels compelled to pay excessive amounts to star performers, there is a very serious question raised: What actually produces good results? Is it the star performer or team performance? Royal Dutch/Shell has always struggled with that question. Shell has therefore always been very careful with practices like bonuses and extravagant remuneration of individual people.

S+B: Does that mean that life doesn't change for Shell very much in this transition? What do they have to do differently than they might have done in the past?

DE GEUS: Well, Royal Dutch/Shell has begun to recruit top people from the outside, which they rarely did before. In the old world, really successful companies always grew their own timber. Jim Collins and Jerry Porras were very clear about this in their book *Built to Last*.

Now, I think we will see a more open-ended debate. We will hear about people who think that business success can be created by just hiring one or two stars and giving them an exaggerated remuneration. But many companies will not give in to that tendency. They will go for the team performance. My money is on the latter companies.

S+B: Even though the future is tending toward a prevailing focus on star performers?

DE GEUS: Well, that's putting it a little bit too starkly. Again, I'm inclined to look at the sports world. It is a fact that sports clubs which try to create a

> **"Every company that pays excessive amounts to star performers must ask a serious question: What produces the results — the star, or team performance?"**

success by building their teams, tactics, and reputations around a few star performers are not necessarily the long-term, high-success clubs. At least in the soccer world, the clubs with more equality among the players produce consistently better results. In business that is almost certainly also the case. But, once again, there is that almost irresistible temptation for a company in trouble to bet on one or two star performers. Get them in and see whether they can help get you out of the rut.

But the long-term thriving companies will almost certainly be those almost faceless companies where nobody really knows the name of the chief executive, like Merck in the U.S., or Roche, the Swiss pharmaceutical company, or Royal Dutch/Shell or Exxon Mobil. How many people, outside Exxon Mobil, really know who its CEO is?

Yet these companies will also have to shift their managerial methods. They will have to learn to optimize people, rather than capital. That means that they have to learn to make the maximum use of the talent they already have available. And they have to ensure access to the supply of talent, and retention of the talent they already have. This requires a completely different set of skills, in many ways far more difficult skills, than maintaining access to the supply of capital. I see a lot of companies try to do it by hiring senior people from the outside, making acquisitions, or offering deferred stock options. But the only approach that seems to work well, developing human resources internally, takes a lot of thought and attention, from senior managers on down. It takes a recognition that attending to people's growth and aspiration is the primary task that an executive has.

S+B: How does this shift in human capital development affect society outside the corporate wall?

DE GEUS: The world we are moving into will not necessarily be a nice world. In the next few years, inequality in wealth levels and incomes will continue to increase. This continues the statistical trend of the last 15 to 20 years in the United States, the United Kingdom, and to a lesser extent in continental Europe. And it will increase between countries as well. All of the countries that do not invest in the potential of their human population will lose in this new world. They can get all the capital they want to set up a car assembly plant. But they will never have the talent to compete with Japan, the United States, or Europe on the design of the cars, on the design of the manufacturing methods, or on the ability to market them.

S+B: And you believe there is no way for these countries to catch up with the head start that some countries already have.

DE GEUS: Well, I am very pessimistic. It's difficult to see how countries in, say, the Middle East could catch up with Europe or the United States or Canada. Especially not if they leave, as so many Middle Eastern countries do, all their women out of the system. Half the intelligence of the country is not available to them.

Both inside our countries and in the world at large, there will be growing income discrepancies. That will create social tensions of a type that we are not used to. If you were poor in the old capitalistic society, you could still feel that you belonged to society. But if you live in a society where glamour is attached to education, success, brilliance, and talent, and you have not been given the opportunity for any of that, then you are poor in a very different way and your feelings toward that society are very different.

S+B: In a funny way, the living companies that you're looking at could become islands of stability and nurturing in such a world.

DE GEUS: Yes, inside those companies a lot could be done. And to the extent that they are large, then they could have an influence. But around them, there will be an awful lot of, you know, very primitive gang behavior.

S+B: Do you see any viable models of companies that are effectively building human capital? Is anybody seeing this future and preparing for it?

DE GEUS: There are some examples among software firms. In the States, a group of architects came up to me; they had read *The Living Company* and organized their own company around the principles discussed there. And, of course, there are all the long-lived companies that we investigated for a Shell study back in the 1980s, the study that I quoted in *The Living Company* and that Collins and Porras investigated for *Built to Last*. These companies, I think, stand a much, much better chance of being successful in this new world. They carry along from the past a value system that is harmonious with the new economic reality. They believe that success is dependent on community human talent. The old winners stand a very good chance of being the new winners as well.

S+B: In your book, and in your other activities while at Shell and after you left Shell, you cast your lot in with organizational learning — the continuous improvement of people's capabilities for working together. Where do you see this practice going in the next few years?

DE GEUS: I think it will be very central. But that is because I am basically a team player. I have played team sports; I've worked in a company with a very strong team ethic. At Shell, for instance, we had great difficulty to agree to implement individual bonuses. And I think that the power of a well-led team is superior to any organizational structure that arranges itself around one or two stars with a support staff. Organizational learning is clearly going to be the critical area of concern in companies that try to produce a superior intellectual output through teamwork.

S+B: What has been the reception to this line of thinking in Europe, as opposed to the reception in the United States?

DE GEUS: The reception in Europe is warmer. The reception in the States is more thoughtful and reserved. I've only had one occasion — at a famous merchant bank and financial services firm — where there was an inimical reaction.

The language of this new business reality is new, however, and many people don't hear the words clearly. They don't know how to translate it into the decisions they have to make today.

You know, if you've been drenched in a frame of mind that thinks of companies primarily as limited-liability organizations, with powerful fiscal legislation behind them — and if you have been brainwashed at business school about efficiency and bottom-line return of investment capital — then you will struggle with this language about work communities. You will revert to your old business language, and since language creates reality, you will keep re-creating the reality, in your mind, of capital as the most valued commodity in business. You will have a hard time making the transition to a world where capital only has a secondary role to play, and where people shouldn't pay more for capital than its market value.

And yet, I see more and more people from conventional business recognizing that the new business reality is a human-centered one. They see that their critical competitive success factor is producing more talented output than their competitors; and they recognize that they can only accomplish this by getting people to learn and to work together better, rather than to simply work more efficiently as with machines. +

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