Business strategy reimagined: a paradigm shift based on “Creating Shared Value"

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A Paradigm Shift Based on "Creating Shared Value"

by

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I. Why Reimagining Business Strategy (again)?

Now is the time to reimagine *Business Strategy* (again)! What is the rationale for such a drastic request? We are driven by the insight that we have reached a tipping point caused by the acquisition of a critical mass of theoretical strategy knowledge coupled with sufficient practical business experience that has led to a point of no return (especially in the aftermath of the deep financial crisis that has changed the world since 2008). Consequently, in 2011, a movement was set in motion when Michael Porter's and Mark Kramer's article "*Creating Shared Value*" (*HBR 2011*) served as the spark to ignite an intellectual revolution which has the potential to become a universal *strategy-mind changer* among business leaders. In a relatively short period of time, *Creating Shared Value (CSV)* developed from an "academic idea" to becoming part of the core business strategy in myriad (small, median, large and giant) companies (among them Unilever, GE, and Nestle) to even developing into a continent-wide philosophical movement that under the name "Africapitalism" has achieved notable prominence.
To better understand how we have reached this tipping point let us put things into perspective and summarize where we are coming from and where we are heading.

II. The Traditional Strategy Model: Strategy 1.0

The *traditional model* of strategic management (I call it "*Strategy 1.0*") comprises a proliferating spectrum of aspirational strategy ideas, styles and frameworks which range from "Classical", "Adaptive", "Renewal", "Visionary" to "Shaping" approaches, from "Reinventing the Business Model" to a "Blue Ocean Strategy", from emphasizing the dichotomy between the "Positioning School" and the "Resource-Based View of the Firm" to dealing with finding the "Core Competencies" or the "Core Business" when "Competing on Resources", from playing "Hardball" and "Curveball" to using "Judo"- or "Sumo"-techniques, from "Thinking Out of the Box" to "Doing a Skunk Works", or from a reminder to switch from "Making Plans" to "Making Decisions" or even to "Behave like Start-up Firms" (*Ovans* gives an excellent overview in HBR 2015). The orthodox understanding of competition and strategy is still dominated by Michael Porter's seminal explanations of "The Five Competitive Forces That Shape Strategy" (*HBR 2008*) and "What is Strategy?" (*HBR 1996*) and is thoroughly complemented by both Sir Lawrence Freeman's comprehensive history of the discipline of "Strategy" (*2013*) and Roger Martin's and A. G. Lafley's book "Playing to Win: How Strategy Really Works" (*2013*). How does Strategy 1.0 really work? In a nutshell, it focuses on the establishment of *strategic positioning* and follows a set of fundamental *strategic principles* that all center around the ultimate business goal of generating *economic value* through maximizing the return on investment (ROI)**.** Profits obviously play the decisive role in any capitalist society. Without profitable businesses there would be no economic prosperity and no improvements in standards of living. Such *economic value*, however, can only be successfully created if the company is able to differentiate itself from competitors, that is, if it is able to create *unique value propositions* and *distinctive value chains* which allow them to be more productive when conducting its business (in Martin's and Lafley's words it means to find an answer to the two critical questions: "*What is our winning aspiration?*" and "*Where to play?*"). Uniqueness is the result of making hard choices and trade-offs that consequently lead to *competitive advantage* based on either cost leadership or differentiation strategy. Ultimately, all activities performed should be both enduring and mutually reinforcing so that an activity system results that makes imitation by competitors impossible.

Over time, however, we came to understand that *Business Strategy* has to be more than just a specialist function of value creation in the old traditional corporate-centric way where strategists perpetuate the status quo to gain a competitive advantage. The last two decades are characterized by deep transformative societal change (resulting in worsening ecological and economic crises and continuing social deprivation) stimulated by an increasingly global and interconnected world economy where business leaders seem to have accelerating difficulties not to lose their connection with the people and the environment (although we have to admit that starting a business and surviving in today's economy is much more difficult and demanding than it was, for example, twenty years ago - Jeff Immelt, CEO of GE, made the caustic remark that in the 1990s even *"…a dog could have run a business*"). In such a new business ecosystem where the traditional sources for competitive advantage disappear, business strategy has to undergo a massive renovation. We have to stop keep doing what we have been doing over and over again. This way is boring and ultimately self-destructive. The conventional trajectory to compete (having mostly short-term earnings mindsets, setting share price increases as the ultimate goal and maximizing short-run shareholder value) has to undergo a radical transformational change. This requires that we – in a first step - excogitate the quintessential role of business in society.

III. The Intrinsic Role of Business in Society: Identifying "Social Impact" as the Missing Link in Strategy 1.0

The paradigm of "*Strategy 1.0*" rests on the generally accepted understanding that business' "*social purpose*" is restricted to maximizing profit or shareholder value. The conviction that there is limited room for a corporation's ethical role in society was vehemently supported by the most influential intellectual force of its time, Economics-Nobel Prize recipient Milton Friedman, who (nearly half a century ago) saw the responsibility of a corporate executive as being confined to making "*as much money as possible*" for the business owners. Friedman's view became the mantra that was excessively used by countless academics and business practitioners as an exculpation to negate corporate social responsibility (CSR) per se (a view that seems to be a powerful position in the investment community still today). Judge Richard Posner drove the argument to the extreme when he asked whether corporate managers should *"…obey the law only when the expected costs of violating it would exceed the expected benefits, so that managers would have a duty to their shareholders to disobey the law, perhaps especially in countries in which law enforcement is very weak, a country, for example, that had a law against child labor but was unable to enforce the law*". It is a moral catastrophe that such self-destructive criminal behavior of detestable managerial greed is of any practical relevance at all – it is even worse that it is still common business practice (at least in the fashion supply chain) and therefore a subject matter in the news today! Fortunately, society's sensibility has sharpened over time. Transgressions of such magnitude typically cause a storm of anger and disgust, especially in the social media. Jeffrey Sachs' recent attack on *Gilead Sciences*, an American pharmaceutical company, serves as an eminently suited example. Currently *Unilever* feels the heat in India as "Social Media proves its power". We are lucky to live in a period of history that is characterized by an incredible degree of awareness and perception of societal challenges. Due to the fast process of technological transmission of information, societal transformations (and transgressions) become immediately visible and have the capacity to spill over to all parts in society (particularly among the young generation). As "*great companies must have a noble cause*" they should make use of the fact that a free flow of unregulated information is key to detecting (and reacting to) negative but *also positive behavior* conducted by all societal constituents involved. Business leaders with a noble cause (John Kay calls them "good companies") should utilize this to their advantage as it is "*the leader's job to transform that noble cause into such an inspiring vision that it will attract the most talented people in the world to want to join it."* (Steve Jobs) It also helps us to explicate the wider quintessential and conspicuous (*positive) role* that business plays in society (which goes well beyond just maximizing profits). We can do this from two angles: (1) from a broader top-down perspective, and (2) applying a narrower bottom-up view.

(1) **The role of business in society: A broader top-down view**

Radical systemic economic, social and political transformations are needed to help to save our planet in a sustainable way (humanity and all variations of life forms) – and it is unavoidable that business has to play a leadership role in solving these problems. We cannot continue with a short-sighted and self-limiting "doing business as usual" mentality (Richard Branson even suggests to "screw it"). A continued process of short-term global growth maximization will lead to catastrophe with unforeseeable consequences for humankind. Pope Francis' encyclical "*Laudato Si*" (2015) offers an amazingly clear analysis of the status quo. As a solution he suggests: "Strategies for a solution demand an integrated approach to combating poverty, restoring dignity to the excluded, and at the same time protecting nature" (*No. 139*). First steps in the right direction have already been taken more than a decade ago and serve as encouragement. In the year 2000, under the visionary leadership of Lord Mark Malloch-Brown (then Head of the UN Development Program), eight "*Millennium Development Goals*" (MDGs) have been implemented by the United Nations (UN) with a first-step-focus on the elimination of global extreme poverty and hunger by 2015, starting with concentrating the efforts on the Sub-Saharan African Hemisphere and South-Asia. The recent "*MDG Report"* (2015) explains that until today, more than one billion people will be brought out of extreme poverty. Such an unprecedented success, however, has only been possible as mankind – all constituents in society, public and private - agreed upon a set of common goals to fight poverty and inequality and concentrated their efforts in a *collaborative way* to reach these goals within the projected time span. As successful as these first steps have been (especially in China), in its core, more powerful and fundamental systemic steps of transformation must happen simultaneously. These steps will be taken now. In September 2015, a new set of seventeen *Sustainable Development Goals* (SDGs) will be adopted at the UN and will replace the MDGs. In December 2015 it is expected that the UN Framework Convention on Climate Change (UNFCCC) takes on a binding agreement on the long-term reduction of greenhouse gas emissions. This is in line with discussions led during this year's World Economic Forum where it became evident that we need a complete *reorientation* of the way how we think about to organizing the role that each constituent in society plays. And we (who are in business) should hence focus on the genuine role that business and the private sector plays in society. We are convinced that almost every company (across different industries and geographical locations) is able to ***create*** (some form of) ***shared value.*** Linking business goals to the company's interactions in society has to become part of the core business strategy of every firm on the planet. The general idea that broader societal issues must have relevance for profitable corporate decision making is not an new idea as it has already been discussed in *Rosabeth Moss Kanter's* contribution in HBR 1999 and has been further elaborated in "Supercorp" (2009).

(2) The role of business in society: A bottom-up view

Guided by government regulations and the rule of law, businesses – besides families - are the most powerful organizational and foundational social institution in any society (in both developed and emerging economies alike). Anita Roddick, famous entrepreneur and *Body Shop* founder, once said: *"In terms of power and influence you can forget about the church, forget politics. There is no more powerful institution in society than business".* Businesses, by making profits, make markets work as they are the income creators, the "wealth-creating machine" in a society. No other institution - neither governments nor nongovernmental organizations (NGOs) or cooperatives - creates wealth. Governments redistribute wealth and value already created by businesses (and they do it with very different degrees of success – as it has been marvelously proven in Dag Detter and Stefan Folster's "*The Public Wealth of Nations*" 2015). When providing public goods, for example, they depend on the amount (quantity) of value created at the microeconomic level of the economy. And - there is obviously never enough to redistribute in order to tackle our massive social problems or to help marginalized segments in society in a sufficient way. In addition, "good companies", by providing goods and services that meet consumers' needs, create employment and labor, which in turn constitutes an important part of the *"social value"-creation-context* that motivates us and gives individuals' lives a meaningful purpose. From cooperatively working in teams we derive self-confidence and autonomy, labor creates behavioral attributes that shape an individual's character and personality and it defines why we matter in society (Michael Lee Stallard's book *Connection Culture* (2015) drives home this point).

===================Insert here the following statement by John Kay ==================

What is a Good Company?

"I think the good company is one that understands the multiplicities of its social role. The reason corporations, or the justification rather, for the existence of corporations in the modern economies is first and foremost that they produce goods and services that people want; together with delivering satisfying work environments to the people they employ; together with existing in harmony with the community in which they operate; and together with earning good returns for stakeholders and delivering to other investors the returns which they have expected. Good companies have to do all of these things.

And I think of the job of the professional manager of one of these companies as it's kind of like steering a boat in a slightly turbulent sea or river. You are buffeted one way or the other and sometimes you go too far in one direction and sometimes too far in the other. And the job of the manager is to maintain some sort of course in the face of all these conflicting pressures."

John Kay, What is the Good Company?, Social Europe, August 7, 2015

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And there is an even more powerful argument that has to be considered. As we know since Adam Smith's "*Theory of Moral Sentiments"* (1759), it is definitely not the singular dominance of the selfish profit motive that defines capitalism or drives economic growth. It is rather a mix of scalable profit-driven and non-profit-driven values like fairness, *"…humanity, justice, generosity, and public spirit, [that] are the qualities most useful to others",* as Nobel Laureate Amartya Sen has put it. These ("justice and fairness"-based) qualities show up in a reimagined concept of business strategy without violating its inherent (profit centric) capitalistic core. I call this new strategy paradigm "**Strategy 2.0**".

=====================Insert quote from Adam Smith============================

Adam Smith on the "non-profit driven values" of capitalism

"Humanity, justice, generosity, and public spirit, are the qualities most useful to others. Wherein consists the propriety of humanity and justice has been explained upon a former occasion, where it was shewn how much our esteem and approbation of those qualities depended upon the concord between the affections of the agent and those of the spectators."

"The propriety of generosity and public spirit is founded upon the same principle with that of justice. Generosity is different from humanity. Those two qualities, which at first sight seem so nearly allied, do not always belong to the same person."

Adam Smith, The Theory of Moral Sentiments, Part IV, Chap. II, IV.1.20/IV.1.21

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IV. Strategy 2.0: A New Strategy Paradigm

The "*Smithian Moral Sentiments*"-grounded interpretation of ("justice and fairness"-based) capitalism constitutes the **first anchor-idea of Strategy 2.0** (for a similar concept see C. K. Prahalad who calls it "Inclusive Capitalism", or Mackay and Sisodia who call it "Conscious Capitalism"). Consequently, a company will win and ultimately gain a sustainable competitive advantage in a market by profitably solving a social problem when it is able to distinctively implement the *mix of both profit- and non-profit driven values* in a better manner than rivals can do.

Equivalently, this interpretation of capitalism offers a moral justification for requesting

(1) that businesses should rethink (and change) their strategy model and thus enable a new trajectory to compete (for example, through replacing the [short-term] shareholder agenda with a more [long-term] stakeholder focused approach. Hence, they contribute to a more socially responsive and responsible long-term capitalism (*Barton* *HBR 2011*)),

(2) that businesses should actually care – next to making a profit - about social responsibility (CSR) and ethical principles, and

(3) that we should be convinced of the case for business to play a key role in delivering social benefit when they are *Creating Shared Value*. CSV emphasizes the simultaneous creation of two distinct types of value - *business value and social value* - and represents the **second anchor-idea of Strategy 2.0.**

As "great *companies must have a noble cause*", Strategic Positioning 2.0 focuses on the ultimate business goal of making a "good scalable profit" (Porter and Kramer remind us that "not all profit is equal") when simultaneously solving a social problem. The traditional strategic principles (as being listed in our discussion of Strategy 1.0 above) still remain valid (but in a slightly modified manner). In order to be profitable (by producing goods that customers value enough to pay for), companies still have to create a unique and valuable position in the market, they still have to choose what not to do and must have an activity system that reflects strategic fit and is mutually reinforcing. The competitive race among companies (incumbents and potential newcomers planning to enter the market), however, will be won by such a competitor whose management (the professional business leaders) is best in implementing and enforcing the required mix of profit- *and* non-profit driven values. Therefore, Strategy 2.0 does not only throw a fresh light on the role that business plays in society, it also redefines the **role of business leaders** (following HBS Professor *Cynthia Montgomery* we call them "*strategists*"). Such strategists, operating in a world that is vulnerable, uncertain, complex and ambiguous (VUCA), have to possess a high degree of *social consciousness* that complements conventional leadership qualities (such as, demonstrating a high level of preparedness, the ability to inspire others, to exhibit integrity, to be a genuine problem solver, to facilitate change, to communicate clearly, and to collaborate effectively).

V. Strategy 2.0 In Practice

Based on several hundreds of case studies (Nestle alone publishes more than 150 case studies!) and examples of "Strategy 2.0 in Action" that I have analyzed and collected over the past years, I try to distil some distinctive capabilities that companies which successfully practice Strategy 2.0 (in both developed and emerging economies) typically have in common:

- They have a **business leader** with an entrepreneurial vision to *change the business model* (and to successfully reposition the company) (Peter Brabeck of Nestle is a prime example as well as Whole Foods Market co-CEO John Mackey); Unilever's CEO Paul Polman is a representative of a "strategist" who turned the company on its head by replacing the shareholder agenda with a more stakeholder focused approach, replacing short-termism (quarterly reporting) with a longer term focus on company objectives. Others tried to turn a social enterprise into a profitable business (as Muhammad Yunnus did with Grameen Bank) (*Martin & Osberg HBR 2015* and the Skoll Foundation provide numerous excellent examples).
- They possess an Innovation Strategy that ultimately creates shared value. In 2009, GE, under Jeff Immelt's leadership, introduced a new **innovation strategy**, "Healthymagination", where GE creates medical devices to meet the needs of low-income populations around the world. Each year more than 1 million babies die on their day of birth, 98% of them die in the developing world. In 2010, GE started a global partnership with an American non-profit organization called "Embrace" to address infant mortality in rural India. One of the leading causes of these deaths is prematurity and hypothermia (low birth weight which prevents babies to regulate their own temperature). They literally freeze to death. *Embrace* had invented an innovative, low-cost infant warmer that looks like a small sleeping bag which carries a sealed pouch of wax that is placed in a small compartment, and one can heat the wax either via an electrical heater or in hot water (or even over fire). A new-born child can be kept warm for hours and the final product sells for $200 (which is 1% of the cost of the regular incubator used in a hospital that costs $20.000). By providing production- and sales capacity, GE helped Embrace to prosper and helped to solve a critical societal problem.
- They possess the openness and flexibility to ***build partnerships*** with local suppliers to enable a more productive local environment (as Yara does).
- They possess the capability to **detect *new market opportunities*** (by extending the customer base) (as GE and Novo Nordisk do).
- They show the ability to quickly ***identify relevant social problems* and needs** (see Coca Cola in Brazil).
- They have the ability to ***measure impact*** (see Novo Nordisk in China; Unilever announced that its 'Sustainable Living Brands' were the key growth drivers in 2014 and grew at twice the rate of the rest of the rest of the business).
- They show **environmental consciousness** and follow up on the universal goal of long-term **reduction of greenhouse gas emissions** (see Yara's initiative Climate-Smart Agriculture (CSA) where the company helps farmers, policy makers and major food and brewery companies reduce their carbon footprints; on July 24, 2015 the

American Business Act on Climate Pledge was launched, where the largest U.S. companies – among them Apple, Google, Microsoft, Coca-Cola, PepsiCo, Walmart, Alcoa, Bank of America, Berkshire Hathaway Energy, Cargill, Goldman Sachs and UPS – signed a pledge that totals a collective $ 140 billion of low-carbon investments in the global economy).

- They possess the power to adapt and to ***re-conceive products and re-define productivity*** in the value chain (Fibria and WalMart's Sustainable Chemicals Policy Guide serve as examples).
- They understand the importance of key moments of transition and motives behind **socially responsible strategic decision-making.** HBS Professor *Goeffrey G. Jones* initiated the "*Creating Emerging Markets Project*" where he assembled an impressive collection of transcribed video-taped interviews (conducted by HBS faculty members) from prominent business leaders in companies operating in *emerging economies.* One central point concerns the perception of their *wider societal responsibilities*. Using examples from India and Africa, Professor Jones indicates that "…among the collection of Indian executives, Suresh Krishna of Sundram Fasteners talks of his "business dharma" that commercial success should be seen as a "tool to enable Indian citizenry to achieve a much higher level of self-respect, self-growth and economic comfort". Yusuf Hamied of Cipla noted, "I am a firm believer that if you are in the healthcare business, it's not a business per se. It is a business, plus you are saving lives." Perhaps the overall point is most explicitly made by Manu Chandaria, the Jainist head of Kenya-based multinational Comcraft. "Profit is a means, not the end…End is the difference you make in a society that you live in."

As CSV became a world-wide movement (with the Shared Value Initiative acting as an international information-hub), a growing number of examples of "CSV in action" impressively demonstrates the conceptual viability (whereby the continent of Australia seems to become the leading force within the CSV movement). The publication of the Social Outcomes Report "Shared Value in Australia" (July 2015) can serve as an incredibly useful exemplification (and encouragement) for myriad of companies around the globe to rethink strategy and to start the process of implementing CSV-based Strategy 2.0.