COMMON PURPOSE; COMMMON FATE

(REVISED EDITION)

BUSINESS THROUGH A DIFFERENT LENS

BY JERRY SCHUITEMA

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Empathy is a state.
Contribution is behaviour.
The latter is a natural outflow of the former.

CONTENT

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Foreword

It's been my privilege to call Jerry Schuitema a friend for more years than either of us would care to acknowledge. Through these decades he has always pushed the envelope, ever challenging convention, spurring the rest of us to apply our minds to issues so easily taken for granted. That's been both his gift and his curse. Not everyone appreciates being asked the difficult questions.

I remember chatting to Jerry after he had returned from sharing a stage with the late Chris Hani, then torch-bearer for nationalisation and State control of national resources, and listening in wonder as he explained although there were fundamental divergences, there was actually far more on which they agreed than disagreed. As always, he was ahead of popular perceptions. Mine very much included.

This book does not deviate from the difficult path my friend has chosen. It explores new options in a world looking for fresh answers. It shines a harsh spotlight onto "isms", exposing why all are far from perfect. It questions why South Africa continues with an outdated debate and it provides some rational, well considered suggestions.

This book will appeal to those who believe harmony is achieved through knowledge and understanding. A fine contribution from one of the deepest thinkers I know.

Alec Hogg. Founder and former Editor in Chief: Moneyweb Business News; founder and Editor in Chief: Biznews.com.

PREFACE

It's an age of economic soul searching.

One could safely say that the current shifts in human co-existence are so great that even the most insightful minds will be hard-pressed to paint a picture of the final outcome, and then only in the broadest of brush strokes. When you are too close to a tapestry, you cannot see much more than a few threads; giving an impression of disjointed disorder. Stand back a pace and it becomes clearer. A further pace or two and the majesty of the work is revealed.

A very large part of humanity, individual threads in a tapestry, are in excruciating pain. Many are in grief, in struggle and in deep stress about the future – from the child refugee separated from his or her protectors in an unknown and menacing world, to a stock broker wanting to end it all after being devastated by giddy bi-polar markets. The stark difference in circumstance between the two does not reduce the level of anxiety; perhaps the innocence of the former even tempering it.

Every day a few a few more decibels are added to the clamour of uncertainty and despair. Another line is written in the tome of hazy hopelessness that is the life of a very large part of humanity. And just as many in the final generation, those whose formative years were marked by much post-war deprivation but large promise of "never again", reflect sadly on what has been done to that promise. It's a global story. The content may differ, but the context is the same: a fractured, disconnected, economically malfunctioning world. Is the new normal, as Dutch economist, Servaas Storm says: "radical inequality, suffocating debt, job uncertainty, secular stagnation and a vanishing middle-class"? Theories abound. Purists argue that their elixirs were never purely administered. Solutions exceed the problems themselves, but none has proved to be a lasting absolute truth. Some hope that the current few green shoots in the desert will still the dissent.

We are not too afraid of "unchartered waters", drawing some comfort from history that we have been in unfamiliar places before, and somehow emerged with new approaches and discoveries. This time is no different. But perhaps it is in the scale and depth of questioning all assumptions about economics and about ourselves as a species. The view increasingly being seen is through an evolutionary rather than the traditional reactive quantitative lens – do we evolve or construct on statistical models? This lens is being captured in research directions and discoveries within evolutionary economics and complexity economics, and driven by a number of institutions and scholars.

Eric Beinhocker Executive Director of the Institute for New Economic Thinking at Oxford University, believes the financial crisis of 2008 and the momentous global political shifts recently, have heralded a collapse of major economic-political ideologies that have dominated the 20th century. Older economies in particular are searching for a completely new paradigm that can show a better way for all. Such as the OECD's NAEC (New approaches to Economic Challenges) which says: "We need a full re-vamp of our analytical frameworks and the assumptions that we make, to better capture the reality. Economic models that rely only on inputs such as GDP, income per capita, trade flows, resource allocation, productivity, representative agents, and so on can tell a part of the story, but they fail to capture the distributional consequences of the policies we make, and do not address the fact that the growth process has only benefited a few."

It will be a mistake to see these shifts in economic introspection in an ideological context, and brand them as "socialist" or "left". Indeed our sometimes powerfully drawing biases are the biggest barriers to discovery. According to Beinhocker, it's time for new economic thinking based on the best science available, not Ideology. "It should be highly interdisciplinary" he says, "involving not only economists, but psychologists, anthropologists, sociologists, historians, physicists, biologists, mathematicians, computer scientists, and others across the social and physical sciences". He notes that over the past several decades a number of Nobel prizes have been given to researchers working in what today might be called the new economics tradition.

Beinhocker reflects a common thread followed by economic evolutionary advocates in developing a view of the economy as an evolutionary system of cooperative problem solving. Prosperity is seen as "solutions to human problems" and cooperation is the key to solving more and more complex problems thus increasing prosperity. "Economics has painted itself as a detached amoral science, but humans are moral creatures. We must bring morality back into the centre of economics in order for people to relate to and trust it," he says.

Oxford and Cambridge Research Associate, Kate Raworth in following that thought in her latest book, suggests dumping GDP as the holy grail and setting a "far more ambitious and global economic goal: *meeting the needs of all within the means of the planet".* She then explores a seven step approach to achieving that.

In his article, David Wilson, renowned biologist and anthropologist at Binghamton University, suggests not only that Adam Smith's invisible hand is dead, and always fails, but that the metaphor itself has caused much harm. "We are different from other primate species," he argues, "because we are so cooperative. Why are we so cooperative? Because it is so easy to regulate each other's behaviour in small face-to-face groups." Wilson's brave challenge of the "invisible hand" has another context: Smith's assumption of high moral standards in humanity, which precluded seeing "the hand" as an instrument of pure self-gain and unbridled selfishness.

"Moral systems evolve in societies because they enhance group cohesion and survival. Implications of evolutionary thinking for economics and the social sciences have only partially been explored." (*Geoffrey M. Hodgson, research professor at Hertfordshire Business School, University of Hertfordshire, England.*)

One of the more telling indictments of orthodox economic models is from complexity economics of which Steve Keen, Kingston University economist and *author of Debunking Economics* is a leading advocate. He believes economists have to embrace complexity to avoid disaster and the fact that they don't, explains why most were caught flatfooted by the speed, depth and length of the great recession. "Macroeconomic models are painstakingly derived from microeconomic foundations, in the false belief that it is legitimate to scale the individual up to the level of society."

Using his own simulations, Keen shows a number of cases where generally accepted assumptions at a micro level, including important ones such as price and demand, simply don't hold true at a macro level. I would argue, however, that the converse is also true: extrapolating macro assumptions from micro-anecdotes.

It is extremely difficult to do this important subject justice in a broad sweep such as I have made here. Essays and articles on the website evonomics.com bear testimony to the weight, depth and breadth of a perspective that is perhaps not new but compelling, profound and refreshing in today's context. What remains unchallenged and perhaps gains significance is that economics itself is built on the enduring principle of adding value to each other's lives. This should put business and companies at the core of any economic construct seen through any lens.

From a relationship point of view, they are after all, and irrespective of motive, an inclusive collective of people serving people.

It is this perspective that the lens of the Contribution Accounting Methodology© captures. CAM© rests firmly on the pillars of empathy, common purpose and common fate; translating into maximum wealth creation for all, and optimum wealth distribution. Changing the lens changes how we see things. Changing how we see things changes how we do things. Changing how we do things changes our world.

INTRODUCTION
Survival and empathy.

It must be one of the most intriguing questions that have faced humanity over the ages – what is the nature of humankind? Until we really get to understand ourselves, can we hope to understand all of the social, political, and economic constructs that we have created as a species and which ultimately are all informed by the answer?

In economics and business especially, it is important to have some sense of our basic nature and what drives behaviour. This in turn helps us to understand the very character of social interaction, transaction, purpose, and motives that account for the way things are, the way they should be, and the path of our destiny.

It is much more than an exercise in philosophical semantics. It could be one of the most important insights of all, because it is inconceivable that we could construct an order for our species that is in conflict with or deviates far from those basic attributes that make us human. Ultimately you can distil any debate or argument about anything to that essence – economic systems, political constructs, laws, and many more -- all end up in an assumption about the why; an assumption that many are ready to make simply because we have ourselves as reference and think we know who, what and why we are, and therefore also understand what others are or should be.

It's a question that has occupied great minds over millennia: prophets, philosophers, psychologists, scientists, humanists and virtually every branch in the pursuit of knowledge. Ultimately, to understand ourselves most of us fall back onto basic instincts to explain all behaviour and if you ask anyone to name these instincts you will seldom find any beyond that of survival.

That makes a lot of sense. Because from that one instinct we can link or extrapolate most if not all of our activity: including other instincts such as sex and procreation; reflexes such as fright and flight; emotions such as fear, anger and insecurity; physiological responses such as adrenalin and serotonin; and behaviour such as ambition, competiveness and control.

It's only a small leap from there to make the same link for misbehaviours such as raw material self-interest, greed, envy, resentment, and acquisitiveness. At its core this encourages our understanding and facile acceptance of these behaviours as being part of "human nature" stopping short in condemnation and abhorrence only when these acts lead to outright crimes such as fraud, theft, or even robbery and murder. Then they become "anti-social" implying that they are not fitting for an evolved, civilised and enlightened being. In turn this implies that being part of a social construct is inherently in conflict with our natural individual selves.

But even a casual understanding of our basic selves will rebel at this narrow definition. It is obvious to all of us that we are social creatures, drawn to each other by nature, not evolvement or enlightenment, and that we have another equally powerful instinct called empathy.

This instinct in humans is so powerful that it often overrides that of survival. I was reminded of this again by a video clip someone emailed me showing the extent to which people virtually routinely can place themselves at risk in saving another. In one of my first articles I argued that our basic instinct of empathy accounts for our majesty on earth, the most powerful of all creatures and custodians of the planet.

What deserves repeating is that evidence of this instinct can be found in our reflexive response to come to the aid of another in trouble; the fact that evidence has been uncovered of this instinct that accounted for the survival of a humanlike creature more than 200 000 years ago, and that scientists have identified the presence of mirror neurons in humans that are far more active than those found in other living creatures. More recently, scientists have determined that there is an area of the human brain (the anterior insular cortex) that accounts for empathy. Of course, as with any physical feature, these can differ from person to person and accounts for excessive empathetic behaviour in some, psychopathy in others, and many variations in between.

Where have we placed business and our economic behaviour? It is a trite cop-out to argue that it is both. Ultimately one will override the other either routinely or in a certain circumstance. It can be argued that we have placed business virtually exclusively in the survival context. It's a natural thing to do because survival has always been seen as the basic motive behind behaviours such as storing, hoarding, acquisition and even barter and trading.

The basic instinct of survival and with it the self-interest motive is the most common assumption in explaining all business and economic behaviour, ultimately underpinning with highly sophisticated Nobel Prize winning Friedman logic, the unassailable and near fanatical defence of the profit motive. Questioning that fundamental premise invites condemnation as an economic heretic, enemy of freedom and anti-capitalist.

It's a legitimate question whether, under the mantle of the survival instinct, we have not too readily accepted dubious business behaviour such as poor customer service; that having a moral compass and ethics in business is seen as a "strategic" issue rather than its absence being seen as absolutely abhorrent behaviour; and that fraud, collusion, and corruption are seldom met with retribution reflecting deep disapproval and lasting outrage.

Yet I can think of no other institution that is more dependent on social goodwill than business. Indeed, within the rules of legitimate transaction, business is founded on the premise of being of service to another, without which it loses its right to exist. Tangible wealth creation itself is the outcome of that service, rooted in the principle that value depends on the contribution it makes to others.

It's an intriguing question how different business would be, how company norms would change, how executives would be rewarded, how strategies would be adjusted and how accounting formats would be altered if our understanding of business would be informed by the instinct of empathy rather than survival.

Of course, for humanity the instincts of survival and empathy are mutually supporting. The more evolved we become the more empathy dictates survival.

CHAPTER 1
A two faced business.

All economic debate is based on assumptions about humanity. Yet surprisingly, despite our scant knowledge of ourselves, we are prepared to assume fanatical stances on economic theory to the point of risking violent conflict.

It's self-evident that our economic construct cannot be too far removed from the essence of our humanity, our basic instincts, and that we will always strive to express ourselves in an optimally free environment. The latter implies freedom of transaction and markets and frankly I'm too old, cranky, impatient and perhaps even too arrogant to debate this point in the ideological kindergarten of red berets.

As argued earlier, the two mutually supportive predominant instincts that define human behaviour are survival and empathy. The convergence of the two creates a vast number of permutations – as many as the variables in individual DNA's and fluctuating constantly according to time and circumstance. These characterisations can also be applied to our understanding of companies, giving us broadly two definable approaches or models: a **survival model** and an **empathy model**. While their behaviours may show similar variations as those displayed by individuals, their purpose or intent is what defines them and will drive their predominant behaviour.

The **survival model** is the most commonly understood definition of business. It has a money focus, and is driven by self-gain, immediate self-interest, maximum profit and shareholder value. It mostly feigns empathy as a means of survival.

The **empathy model** has a people focus and a service motive. It is driven by customer and societal interests, and sees profits and wages as an essential means to service, rather than as an end in itself.

Common assumptions about both models need to be tested.

A survival motive accounts for success.

- Survival is based on fear and insecurity which promote greed and short term thinking. It's inconceivable that one will get the best out of people by appealing to the worst in them.
- It contradicts an axiomatic truth that the true value of anything depends on the contribution it makes to others.
- It makes an arbitrary and highly questionable, if not false, assumption about the intent or motive of great entrepreneurs, sustainably successful companies, and individuals.
- Virtually all successful entrepreneurs have professed to have been driven by their passion and desire to make a difference to other people's lives and not by profit.
- Long standing research by Collins and Porras of successful companies has shown that profit maximisation ranked fairly low if at all in their thinking.

Ensures prosperity for all in the profit driven deployment of capital.

- This is the most vehement defence of the survival model based on the quaint belief that wealth is created in its accumulation and deployment. Tangible wealth is and always has been the result of creating something of value for others. Capital accumulation and deployment is at best a result of that act.
- It is based on the accounting fallacy that profit is equal to wealth creation or value added.
- It is extremely difficult to avoid short term thinking in a survival model which has led to serious economic ailments such as unsustainable wealth disparities, and marginalisation of other constituents particularly customers and labour. The "trickle-down" effect becomes severely impeded.
- Paramountcy of capital which is synonymous with "capitalism" leads to accounting for profit maximisation and shareholder value. It inevitably develops in its structural and operational processes, a conflict environment by seeing other constituents as exploitable resources and as costly commodities.

The survival model is synonymous with market orientation and free enterprise.

- Nothing is further from the truth. Market orientation means being driven by the needs and wants of others. The profit focus in the survival model means being driven by self-gain and your own needs. They are actually opposites in intent.
- "Capitalism" more appropriately defines a self-gain behavioural trait within free markets – a trait which has become self-destructive and a threat to freedom itself. The economic ailments it has caused have led to increasing rules, regulations, interventions and calls for bigger government.
- The above assumption relies on a misinterpretation of classical masters such as Adam Smith. While he did propose that freedom would lead to the pursuance of self-interest, he also believed that this self-interest would be mostly enlightened and driven by humankind's instinctive empathy for each other – not predatory material self-gain.

Ensures competition and customer care.

- In the absence of a genuine intent to serve others, the survival model becomes hostile to competition, seeking either to destroy it or collude with it.
- This often leads to customer neglect.
- It also attracts further rules and regulations to govern its behaviour, which ultimately discourages new entrants, and favours big above small.

Ensures maximum productivity and efficient use of resources.

- This is partly true. But the standard macro measurement of productivity (output over input) is synonymous with profitability which again puts emphasis on the paramountcy of capital.
- Productivity is more easily achieved by reducing input rather than increasing output, encouraging containment rather than growth.
- This emphasis also prefers to grow output through mergers and takeovers, rather than through organic growth. In the process it also reduces relative input, reduces competition and marginalises other constituents.

The empathy model also conjures up many assumptions that have to be challenged.

The empathy model is leftist, socialist, Marxist and anti-free market.

- Without a strong underpinning of empathy our world would fall apart and humanity would self-destruct.
- As Adam Smith implied in "*Theory of Moral Sentiments*", empathy is nurtured in freedom. Freedom in turn cannot flourish without empathy.
- Empathy cannot be institutionalised in a system. Coerced empathy is an intolerable oxymoron and creates resentment and envy.

It goes against classic business principles.

- There is no institution in society that relies more on empathy with others than business – albeit some more than others such as mining.
- Empathy is not about charity, but about sustainable service.
- The model relies on and has to be guided by the rules of free legitimate transaction of supply, demand and price.
- It should embrace competition as enhancing choice in its market and in identifying more opportunities in the needs and wants of its customers.
- A sincere empathy model is better equipped than its survival peers to adopt principles of common purpose and common fate.

It is revolutionary and untested.

- The empathy model is followed by more companies than many believe.
- Empathetic behaviour has been the hallmark of great sustainable companies and entrepreneurship and is particularly prevalent in small and medium enterprises.
- It is, however, difficult to recognise with the obsession and near exclusive focus on shareholders in accounting and in turn strategic and operational processes. These processes become toxic and counter-intuitive when they start dictating purpose, and then behaviour, which in turn impede the forging of common purpose and common fate, as well as tarnishing the image of and trust in business.

We are witnessing a struggle to change the course of business behaviour, with a plethora of new demands and rules. The answer is a lot simpler and requires going back to the basics of the inherent benevolence of any business. But freedom itself will be threatened without a serious review of the company scoreboard to reflect empathy, maximum wealth creation and sensible distribution, all of which are far more supportive of and subservient to free markets than the survival model.

Sensible distribution in particular is not arbitrary but has to meet the legitimate expectations of all of the stakeholders. The key pre-requisite is not only that distribution has to be informed by factors such as supply and demand for skills and qualifications, and be comparatively attractive to capital investment, but that these rewards in turn are linked to and influenced by wealth creation and empathetic behaviour.

Shareholder expectations have to be defined and legitimised to what is defensible. Benchmarking informed by the relative cost of and competition for capital is easily achieved and some benchmarks already exist. Shareholder expectations cannot be legitimised under the banner of unbridled maximisation. This is a wanton challenge to social trust and constantly perverts the instinctive empathetic behaviour of business. Indeed, enlightened and serious long term investors should favour the empathy model. In time, it is conceivable that all companies will be assessed on the basic criteria of which model they live by.

The real difference between the two models however, is a philosophical one. The survival model is about being alive; the empathy model is about having a life.

CHAPTER 2
A monstrous model exposed.

There's a lie that has tarnished the best social system humanity has ever created.

Not all lies are based on deceit and malevolence. Sometimes they are based on seemingly valid assumptions but then become a lie when they are fanatically promoted as a universal truth despite clear evidence to the contrary.

There is no better example than the 40 year persistent defence of and slavish adherence to the shareholder-value driven business model; once described by American business leader, Jack Welch as "the dumbest idea in the world." The model proposes simply that the sole purpose of business is to maximise shareholder value. It found its intellectual and ideological roots in the teachings of American Nobel laureate in economics, Milton Friedman, and is still widely followed, especially by large quoted companies.

But it has had its critics from its earliest days. The latest has been published by the bullhorn of capitalism, Forbes Magazine, in an article by author and columnist, Steve Denning, titled: *Resisting the Lure of Short-Termism: Kill 'The World's Dumbest Idea'.* It is one of the most comprehensive indictments of the model I have come across. He is not the first. Some years ago Business Insider did a similar analysis, which I captured in a Moneyweb article "*Profits of Doom*."

Apart from Jack Welch, there have been many other critics and Denning mentions a few in his column. In addition, within a decade or so, we have seen prescriptions and processes being developed to address the side effects of putting companies on profit steroids, especially short termism. These included the Triple Bottom line, Balanced Scorecard and accounting protocols trying to force business to broaden its view and adopt ethical standards, good governance and sustainable procedures and controls. In South Africa, we have had the King reports. While they obviously have their merits and no doubt have dampened many excesses, they do not, and nor are they expected to change the primary strategic direction of the company. In the end they do little more than treat the side effects of addiction and perhaps dampen excesses.

With the exception of King IV. While the previous King reports address business models, King IV defines a different business world – one where the overall task of business is creating value for all. Again, this is not really new. It was the predominant view before the 80's. One should also add that not all companies have followed the steroid addicted model, and for most smaller to medium enterprises, it does not make business sense. To some extent this addresses a possible counter argument: that despite its blemishes, the model has promoted many advancements and prosperity. To this I would respond that this is not **because** of the model, but rather in spite of it.

Adapting to this new business world is a lot easier than one may think, and certainly does not need a huge turnaround intervention. In recently completing the Contribution Accounting Methodology© which is based on decades of exposure to economics, organisational theory and my own consulting work, I was struck by how much of such a transformation is simply doing what comes naturally; is easily understood by all stakeholders, and still makes sustainable business sense. It can be captured in 4 brush strokes, the fine details of which are fully documented in the methodology material.

REDEFINE PURPOSE.
There should be absolutely no ambivalence that the purpose of a company is to serve its customers. This is rooted in existential logic and the natural laws of transaction. Again, this is not a huge leap and has been endorsed through the ages by great entrepreneurs, companies and organisational theorists. It strikes me that detraction from this truth is because we make no distinction between shareholder interests and company purpose. They are not synonymous. Individual stakeholders may have different motives for being involved in a company, including, but not limited to, maximum profit. But the purpose of the business itself remains creating value for customers. Obviously reconciling individual motives with that purpose has many advantages, including entrenching authenticity.

REDEFINE RELATIONSHIPS.
Nothing is more counter-productive than trying to propose a hierarchy of stakeholder importance. It is divisive and creates conflicting interests. Being loyal to its purpose, a company would clearly see relationships with customers as by far the most important. Stakeholder cohesion and inclusivity are established through a **common purpose** of service that translates into wealth creation; and a **common fate** which impacts on distribution such as profits and pay.

REDEFINE STRATEGY.
For the most part this redefinition would merely imply changing direction. If it is customer driven, it focuses on contribution to its market; if it is profit driven, it focuses on reward. Switching focus from reward to contribution has a fundamental impact throughout the organisation, including improved and more sustainable rewards. Strategy should rest on the three pillars of maximum wealth creation and the two of optimum wealth distribution. (see Figure 8 below)

REDEFINE ACCOUNTS.
The "value" in "creating value for all", is captured in one very simple metric called value-added. It is the outcome of creating value for customers, and is the source of all rewards. It is the centre of an operational Contribution Account© which portrays stakeholder inclusivity and a simple presentation of wealth creation and distribution, and from which one can extrapolate all the standard accounts. It embraces the measurements needed for 3BL, BS, and the King prescriptions.

The direct and indirect harm done by obsession with the shareholder value approach has been substantial. Denning gives a superb account of this in his article. For me the biggest harm has simply been the assumption that this monstrous model is an unassailable reflection of free enterprise itself. Criticism of it leads to all kinds of leftist labels. That lie has gone a long way to tarnish the true spirit of free enterprise and its standing in popular perceptions.

It is an aberration and has proved to be the world's dumbest idea.

CHAPTER 3
Common purpose and common fate

Companies and business enterprises are the wheels that keep our entire transactional lives turning. In the following chapters I will offer a different perspective of a crucial feature of our lives as consumers, employees, business executives, shareholders, civil servants, small business owners, entrepreneurs and also those in the accounting profession.

A business enterprise is nothing more than a collective of individuals. It's one of those expressions of the human condition that make us social animals. There is an inherent need in all of us to be part of a society in a broader sense, and of smaller and different collectives or groups in a specific sense.

Such groupings satisfy a basic and fundamental need to belong. More importantly, they act as reflectors of ourselves, giving us a mirror that does much more than show the physical appearance reflected by glass with a silver backing. This is a mirror of comprehensive identity; it defines the human self or the ego. A human being living from the earliest years in total isolation will simply not possess such a definition and would no doubt be completely dysfunctional. On the other hand, many remain trapped in a particular definition only, and become totally disoriented when one of the definitive states such as "husband", "wife", "employee", "CEO" disappears.

Belonging to any collective, being a member of a pack, not only gives security but also satisfies the need to be needed. It is often the most tangible expression of our preparedness to ignore immediate self-interest for the sake of a greater cause or of another person. This is most clearly seen in healthy families. But it has an enormous downside. Too often, our own sense of right and wrong and our universal values are apt to be clouded by the pack mentality. The Mafia is an obvious illustration. History abounds with other examples, of which religious fanaticism and nationalism are the most powerful and invidious. Membership of any group or collective should be based on one key principle alone: being the means to unleash our true value, which lies in our capacity to make a contribution to the good of others.

The group or collective is not an end in itself, but a means to that end. If the collective itself does not serve the broader other, then it will amount to little more than multiples of self-interest, enslaving us to our lower and grosser qualities and destroying others around it. It often then becomes an instrument to alleviate our individual fears and insecurities. Of course, many collectives exist for the limited purpose of serving their members only. While there is not much wrong with that, the moment such a collective sees its purpose as taking or "getting" from others for the group's interest, it loses its legitimacy and becomes little more than a means of hiding behind a flag and escaping individual accountability.

This is not empowering for the individual. Indeed it is disempowering and debilitating. One of the more complex examples is the labour movement. Its legitimacy may be questionable in the light of the above argument, but then it also has to be seen as a response to other factors, notably unacceptable behaviour in the capitalist model. I will deal with this later. For now, let us accept that the existence of a union is a sign of failure on the part of the corporate or company collective: failure to meet the aspirations of employees, and failure to give them a sense of belonging to something whose purpose is laudable and whose values are sound.

The success of any collective depends on adherence to principles of common purpose and common fate. Common purpose should be tangible, definable, indivisible and clearly understood by all. The value of this purpose, both for individual members and the group, will be manifest in service to others outside the group. Common fate means both joint and individual accountability for the collective's actions, as well as equitable sharing in the fortunes and misfortunes of the group.

I have seen how effectively this principle works on both an individual and country level. If we were to hold the modern company up to this norm, we would have to concede that it fails dismally in many respects. Even as a conventional collective the modern corporation has severe shortcomings. For one thing, many people in that kind of collective have very little sense of belonging. This feature is automatic and spontaneous in most other collectives, whereas companies have to go to great lengths in holding social events, handing out T-shirts with logos, rah-rah occasions, and team-building exercises, to instil some sense of common belonging.

The sense of belonging was until recently a great strength of post-war Japanese companies. Remarkably and somewhat inexplicably, Japan and, more recently, Korea have abandoned the labour-focused, common-fate approach. They have been dragged into the "labour cost" definitions of their Western counterparts. It's perhaps more than coincidence that both economies have lost their growth momentum in recent years.

Linked to the absence of belonging, indeed probably the cause of it, is the fact that companies seldom have a common purpose anyhow. Virtually all involved in a company have defined the motive of their involvement primarily as a means of material self-enrichment. So a company is prejudicially defined as a place of getting. Of course this definition starts by declaring the purpose of any company as maximising profit – which simply and crassly translates into being a means of enriching owners. In the pursuit of this profit, employees are needed as a resource, or as a commodity called labour that has to be factored in as a cost.

At this level already, loyalty to a common purpose not only wavers but actually disappears, to be replaced by conflicting motives. It takes little accounting skill to see that the quickest and easiest way to increase profit is to reduce the payroll. Employees on the other hand get restless and more demanding when they are informed (mostly by external media) that the company has made a substantial profit.

As we will see later, very few ESOPs (employee share option programmes) actually work. At a general staff level they simply don't amount to enough in tangible terms to defuse the conflict between capital and labour. They work better at a senior management level but very often at the cost of alienating management and staff.

Establishing common purpose in a company is actually very simple. It is rooted in the natural economic law that supply exists to serve demand. The purpose of a company is to serve its customers. It is the purpose of the entire collective, including shareholders, employees, and even arguably the state through its involvement in providing infrastructure and services. The alignment of all individual behaviour to this common purpose will unleash the full potential of the company and become the ultimate empowering tool for everyone involved.

Despite its logical and existential simplicity, I am always amazed at how much resistance one runs into when proposing the application of the premise to companies. If one wanted a quick view of a company, one would ask three simple questions: What does the company do? How does it do this? Why does it do this? In our workshop groups, the answers to the first two questions seldom led to any debate or differences in opinion. To the third the response was mostly “for profit”. Occasionally the response was “to create jobs”; rarely “to provide a service”. This is sad. Most people at heart prefer to behave and be viewed as contributors. Most prefer to be seen as givers rather than takers.

The fact that the working environment is not conducive to focusing on contribution and in unleashing the best in the human potential, must clearly have an eventual effect on company success and sustainable national prosperity. It’s not the premise that’s at fault, but perceptions, behaviour, language, and of course, the most powerful of all, the accounting system.

The rallying points for common purpose in any company should be its mission statement, its vision and its values. Despite their being plastered on walls many employees don’t know them, understand them, believe in them or experience them as being the true and vital driving force of the company. Yet many companies spend large amounts of time, effort and money on some consultancy-designed mission statement which, interestingly, in most cases reflects a purpose of serving or contribution. Whether such statements reflect what people really think and do from day to day is another matter. Most companies have in fact gone a long way towards fulfilling their stated intentions towards their customers or markets. The mission statement is indeed being translated into action, no small thanks to growing customer awareness and competition! What seems to be missing, however, are perceptions, sincerity and reinforcing behaviour.

Common fate is closely linked to common purpose, for without common purpose common fate would not make sense. Broadly, it means common accountability and sharing in the fortunes or misfortunes of a company. In a specific and more tangible sense it’s reflected in rewards such as shareholder returns, employee pay, and government revenue or tax. The extreme difficulty in achieving common fate is already clear. The three reward categories are perceived to be in conflict with each other.

Very often rewards are out of alignment with the actual fate of the company, so an essential link in common fate is destroyed. It becomes even more incongruous when executives are awarded huge bonuses after employee lay-offs. Common fate is also destroyed if labour is seen as a “market” commodity and not as an integral contributor to common purpose. It spawns another collective in an organisation, in the form of labour unions whose existence depends on an assumption of inherent conflict between the parties involved.

The rift is fully endorsed and reinforced by the accounting focus on the bottom line or profit. Because it fallaciously expresses everything that isn't part of shareholder rewards as a drag and a cost and a burden, it is the least common to all the contributors. No amount of profit- or gain-sharing where profit is the effective trigger will enhance a common-fate understanding and approach in a company. For that to happen one needs a measurement that is truly and genuinely common to all. It is wealth created or value-added.

There is a deeper logic to the use of this key measurement. It is absolutely essential to common fate to have common purpose in place. Picture a group of people going to work singing "Sho-sha-lo-za!", the Zulu song praising work…it is difficult to believe that they could be so enthused by the thought of a cheque for near-minimum pay at the end of the month or week. It would be easier to believe that they are excited by the idea of doing something meaningful that day and being part of a camaraderie that is making some contribution to the good of their fellow beings.

The real power of the value-added measurement is that it reflects both the collective reward and the contribution. As I will show later, common purpose and common fate are combined in one unifying measurement. More importantly if value added or wealth creation measures contribution, then the individual slices of it in wealth distribution must measure relative contribution. This is a crucial understanding that enhances commitment to common fate and authentic stakeholder engagement.

Establishing full common purpose and particularly common fate is undoubtedly almost impossible to achieve. It would contradict our earlier assumption that there is no single generic definition of human nature. Individuals represent a myriad of different aspirations and expectations, which will inform motives. It is important then to distinguish between purpose and motive. But clearly, the more individual motives are aligned to a common purpose, the greater the chance of that purpose being achieved, and the more cohesive it will become. We can without question though move substantially beyond the current point of assuming an inherent and inevitable conflict between the different stakeholders.

CHAPTER 4
Profit as common purpose

In discussing the empathetic purpose of business in our workshops, I always start out feeling that there really is nothing new in the premise. The logic is unassailable; trying to defy it or not to recognise it is fruitless and will merely detract from its inherent power. Yet I still often find myself confused by the adherence to the profit-purpose or profit-motive mind-set and the extent to which I have to repeat my argument. In one discussion group, a fairly knowledgeable fellow remarked: "You are trying to overturn 300 years of the way business is done." I was stunned into silence, wondering if I could have misread my own observations of what has made companies great in this period.

I was once prompted to call in to a radio chat show on business ethics. I told the highly articulate and economically literate host that business existed to serve its customers and not to make a profit. He cut me short, saying that it was both, and that service was merely a means to an end of making profit.

It is surprising that this misunderstanding persists, despite not only the logic that this book is trying to convey but also the best writings of organisational and business gurus and the stated intentions of business visionaries of the past and present. Collins and Porras wrote *Built to Last* after six years of research into visionary companies, with a focus on companies that were founded before 1950 and of which many are still "great" today – household names are among the 18 they studied – and one of their first conclusions was that there is nothing new in the concept of sustainability. Many companies were following those principles long before sustainability became another buzzword in consultancy-speak. Collins and Porras shoot down 12 conventionally held myths, one of them being the profit driver: "Contrary to business school doctrine, 'maximizing shareholder wealth' or 'profit maximization' has not been the dominant driving force or primary objective through the history of visionary companies."

"Profits are the cost of staying in business." This aphorism by well-known management expert Peter Drucker very neatly for me puts profit in its place. But the statement almost never fails to crease the brows of accountants, who see it as a contradiction in terms. But profit is indeed a cost to the final buyer of the product and/or service. And I would argue that, defined as the cost of using money in a business, profit is as much a cost as labour is. In fact, the concept is not unfamiliar in accounting. Faced with a need to raise more capital, a business is quite likely to explore alternatives based on relative cost such as that of issuing more shares, which would require higher profits to make them attractive, or borrowing money from the bank.

Nobody in his right mind would ever propose that profits are unnecessary. Profits are like breathing: one breathes in order to live. But one doesn't live merely to breathe. I will examine the crucial role of profits in creating wealth later. For now, my point is merely that terms such as "maximising profit", or "maximising shareholder value" have tended to divert companies from their true existential purpose.

What do companies themselves say about their purpose? A few that I know of have a “statement of purpose”. This is a relatively new verbal concoction that seems to have been created as a way of justifying consultancy billings. Purpose simply means “why”. I am intrigued by how many concepts have arisen around the “why”. Mission, vision, credo, philosophy, values, purpose, and slogans…they all turn around the “why” of a business. The differences among these are often blurred. I was intensely exposed to organisational theory at the Oxford Centre for Management Studies (now known as Templeton College) in the 1980s and the verbiage left me bewildered. I became even more confused on examining different statements in different organisations. Only a few seemed to fit the academic definitions. I dare say one cause of the problem is that the academics themselves are not too sure.

Browsing through some dedicated “mission statement, how to” websites (not all of the 900,000 suggested by a popular search engine), I was amused to see that you can even buy software programs to tell you how to tell others why you exist! The criteria suggested by two different programmes made it possible for the user to define maybe two or more very different purposes for one company. In another of these programs it seemed to me that the amount of “essential information” the user was asked to supply was such that he might end up rewriting War and Peace – or at any rate having to publish two annual reports, one with the mission statement and the other reviewing the company’s activities and figures.

Still, while not all successful and sustainable companies have seen the need for these lofty statements, I do think they can have value as a guiding and unifying factor. They are particularly useful in promoting common purpose and common fate. But often enough I have come across exceptionally loyal employees who love what they do, know what contribution the company makes and understand how they themselves fit into the scheme of things, but who have never read the company’s mission statement and certainly couldn’t recite it.

The argument for a rah-rah mission statement remains unconvincing. Statistical research by California academics Lance Leuthesser and Chiranjeev Kohli examined nearly 400 annual reports of the late 1980s and mid-90s. Only 16% of the reports contained mission statements; of these, more than 90% focused on customer needs first. Of course, not publishing a mission statement in an annual report should not be taken to mean that it doesn’t exist as an operational tool in the company.

One thing is clear with all “good” mission statements. They mostly do reflect purpose and contribution to the good of others. This is the essence of entrepreneurial behaviour at an individual level. It therefore makes logical sense that the same should be present at a company level. Mission statements then convey a “giving” spirit or purpose. Where not defined, it’s implied all the same. This fits in with the empathy or market-driven model. We can fairly say at this stage that for a company to be both ethically right and successful it should have a “serving” purpose, and that most companies at least say they have it. The company whose actions don’t bear out its statements of purpose is telling a lie. And it does so at the expense of consistency in service and focus on the customer and there will be a negative outcome sooner or later.

I came across an astonishing bit of advice in one of the "do-it-yourself MBA" websites: "While firms exist to earn a profit, the profit should not be highlighted [in the mission statement] since it provides little direction to the firm's employees." This is outright duplicity! If this is what's being taught at business schools it is small wonder when employees snigger at battle cries about common purpose. But then the sages at Quick-MBA went on: "What is more important is how the firm will earn its profit since the "how" is what defines the firm." I would not have taken this source seriously if it did not reflect a fairly common phenomenon. Humanity seems to be defining itself more and more by what it does and how it does it, instead of why it does it. The "why" gives meaning and meaning comes from what we give, not from what we get. Without meaning we are nothing. We have no identity. We become very disturbed people if the "what" and the "how", which are reflections of behaviour, are out of line with purpose, motive and intent.

Of course not all mission statements or statements of purpose reflect service intent. Some focus on "beating the competitor"; missing the point that when we have only a competitor in mind we can only become as good as the competitor or slightly better. That is no guarantee of our best. The question that comes to my mind is simply: And then?

This is a sad case of "competitive angst": make people scared of something else or losing their jobs and you may achieve a rallying to common purpose. Is fear the way to unleash the best in a human being? Do we have to replicate a "war" in business to be successful? As we have seen in the United States, war talk and paranoia can make an otherwise very balanced people very gullible. The war mentality is a sad view of competition inspired by the profit-driven or survival model. One of the strange things in this model is that you are always encouraged to "beat the competition". When you finally do, and you end up being the best and biggest, you could be locked up under anti-trust laws.

Equally disturbing are mission statements that say "we will be the best" or "we will become the most preferred supplier". They smack of arrogance. If someone were to walk into a room and claim "I am going to be the best", one would at the outset probably not take her/him seriously, and one would certainly suspect the person of narcissism. Being the best above others has never been a guarantee that you are the best you can be. Your most reliable benchmark is yourself. Your willingness and your dedication to making a positive difference to the world around you are the only criteria worth following. The most successful companies don't focus primarily on beating the competition -- as Collins and Porras put it: "Visionary companies focus primarily on beating themselves."

The generally-held view is that mission and vision statements and a cluster of "core values" are required to achieve common purpose and maintain a public face. The trouble is they are often written and compiled as a "need to have" and not as something that emanates from genuinely-held beliefs within the organisation.

I have clarified my own confusion around these instruments by defining mission as the "why" of the company's existence; and vision as the "where I want to be". Core values are not necessarily the same as universal values although they do often coincide, particularly in regard to values such as respect, honesty and integrity. But they are based on “what I value” and, to the extent that they do include “values”, these don’t as a rule strictly fit the definition of universal values. Profit maximisation is often confused with values.

There has been a notable shift in the past decade or two in the way companies see themselves as reflected in mission statements, vision and core values. Reading annual reports was part of my daily fare for some thirty years, and up to about the mid-1980s I saw many mission and vision statements that either explicitly or implicitly focused on shareholder value or profits. Today you will find few that do. This may be a reflection of the need to soften the profit-driven image. In that case, however, it amounts to little more than a public-relations exercise requiring the services of some professional who is adept at stringing together a lot of lofty sentences without verbs.

Be that as it may, the shift itself is significant. It points to a growing need for companies to behave differently and become truly market-driven as opposed to profit-driven. The best companies have always done this of course, albeit that in the past they often found it necessary to defend their focus on the market and society as being part of business sense and profit maximisation. Even now, market focus is still mostly viewed as a means to an end and not as an end in itself. But the concept of “sustainability” has become a very popular one in organisational theory.

The strategic dictum of the 80s was Milton Friedman’s “profitability first” argument. In the 1990s this shifted to “short-term profitability for longer-term wealth creation”. Today in organisational theory at least, the focus is more firmly on “longer-term wealth creation”. Of course, many still see “wealth creation” as referring to shareholder wealth or value. I have a different view that will be detailed later. But the mere shift to “longer-term” and “sustainability” is a sign of a desire to change behaviour. Fake it until you make it!

The guru writings have also become more definite on this issue. They include those of Stephen Covey, Jim Collins and Jerry Porras, Robert Kaplan and David Norton of Balanced Scorecard fame, and John Elkington (Triple Bottom Line). Earlier masters such as Minzberg, Drucker, and Tom Peters were also firm on the broader visionary view of business. A South African contribution to this debate has come from the writings of Clem Sunter and Wayne Visser. They have defined greed-driven companies as predatory lions and the more visionary companies as elephants. Sunter and Visser make a very valuable argument against the “greed is good” philosophy, albeit at a non-philosophical level. Indeed their practical and statistical approach is very convincing.

And yet people still find it difficult to openly challenge the profit-purpose view of business; there seems always to be some concession to the overriding importance of the shareholder. At best the non-fringe outspoken are saying “cool it”; they’re not actually saying “stop it”. And for as long as this preoccupation is perceived to be valid, and for as long as companies still mostly focus in practice on short-term profit considerations, and even if companies took to calling themselves values- rather than profit-driven, it would still be the corporate what’s-in-it-for-me that rules.

What has to be challenged to ensure a fundamental shift is the way we measure company success. This implies a lot more than adding “softer” measures to the media release and analysts’ kit. We need to debate the validity of the income statement itself as a final scorecard.

I won’t try to rewrite the current methodology for constructing mission and vision statements. I would only suggest that behaviour is far more important than words. One needn’t articulate deeply-held beliefs for them to be effective. Articulation helps, but doesn’t in itself ensure right practices. What is truly in your heart is what will make the best mission statement for your company and your personal life.

The keys to success that apply to individuals and to countries also apply to companies. The overriding principle is that if people by and large are taking more than they are giving, they will create deficits and poverty. If they are giving more than they are taking they will create surpluses and prosperity. Having an external focus and developing people is as important to a company as it is to a country. Indeed it could not happen at a country level if it didn’t happen at the level of a company, which is after all a cell of national economic activity.

CHAPTER 5
The Concept of Adding Value

"*The purpose of a business is not to make a profit. What a dreary and demeaning description. The purpose of a business is to add value to people's lives. The consequence of doing that well is that you make a handsome profit.*" — *W K Kellogg*.

These few lines from the man who fathered one of the world's best-known businesses contain a number of extremely powerful messages. I may have already overstated the contributory purpose of a business and the fallacy of the "profit purpose". But it is a central theme of this entire work, and represents more than merely challenging conventional wisdom. I first saw Mr Kellogg's words in the office of a client of mine; he had it framed on his wall. I've unfortunately been unable to trace the original context but some exposure to Kellogg's biography has made me comfortable that it is authentic.

Kellogg's Cornflakes was a product of the early 20th century. The interesting question is: Did Bill Kellogg find it necessary to defend business as far back as that, or was the principle of contributory purpose by then already well entrenched? My own belief, as I pointed out earlier, is that it's implicit in Adam Smith's "invisible hand". Of course Kellogg's saying should not be taken to mean that it's OK for a business to run at a loss. That is the kind of exclusive argument that creates unnecessary mischief.

The phrase "dreary and demeaning" is the same as putting an individual in a room and expecting that individual to do nothing all day but to sit back and be paid for doing nothing. Simply owning something does not guarantee fulfilment – indeed it is often the opposite. Profit is not the only consequence of a serving business; there are many others, such as paying employees and taxes, or employing the services of outside suppliers. It's a moot point whether, if we were to list them in order of importance, profit would rank the highest. After all, one knows of many a company that has been running at a loss sometimes even for a number of years; if profit were indeed an absolutely vital condition of the enterprise it surely would have gone belly-up after the first loss or as soon as it started running at a loss. On the other hand it's impossible to run a business without paying employees. The company would be wound up with perhaps violent and tragic consequences. What one can say with some certainty is that if a company were to close its doors on its customers it would expire within days.

There is little merit in trying to have a ranking of stakeholders. Apart from the questionable and presumptuous practice of referring to customers as "stakeholders", the importance of the other parties involved – shareholders, employees, the state and suppliers – will always need specific attention and at times could demand more attention than others. Despite its revival under the new organisational pet name of "sustainability", Edward Freeman's 1984 stakeholder concept is relevant still today, especially if one were to ask: "Sustainability from whose point of view?" Each domain could claim: "Without me you are nothing." Indispensability and purpose are not the same thing.

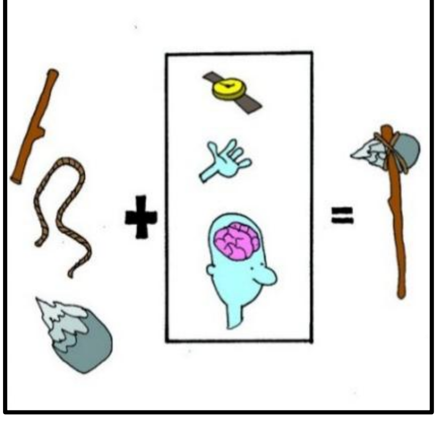
Kellogg's words confirm that companies exist in the first place because they are useful to others; that reward is the consequence of contribution, not the other way around; that reward should sustain contribution; and that employees should see companies not merely as something that uses them to enrich owners, but as something to be used to express the best in themselves and make a meaningful contribution to the good of society. The most powerful element of the quotation, however, is the concept of "adding value". To create something of value for others is the oldest business principle known to mankind.

Value-added is based on three fundamental tenets, the first of which is about behaviour. Behaviour is tied in with that purpose which was clearly defined by Mr Kellogg as being universal for all business. It's about being useful to others and making a positive difference to the world around you. If all individual aspirations are aligned to this reality, then one has forged a common purpose for the collective, and this ethos will transfer itself to national behaviour and establish the requirements for national success and prosperity. The behaviour is aimed at the customers but it undoubtedly will affect the overall behaviour of the collective towards society in general.

There are very few customer interests that will exclude the interests of society as a whole. The exceptions include tobacco and other harmful products. The strength of one's own values will determine whether and how one should be involved as a supplier: merely wait for society to determine the legal right and wrong, or take a firm stand based on one's own conscience. Ultimately demand, more than supply, has to reflect the fundamental values of society. This does not excuse supply from its own moral and ethical duty. The principle of willing seller and willing buyer is not sacrosanct; it's not a licence for just any kind of behaviour. The collective common purpose of adding value has to be cultivated by an alignment of primary motives with the deeper intent of the individual. Otherwise cracks will soon appear.

The second dimension of adding value is transformation. It means turning a given situation into another that is of more value to the user of a product or service. Most of us associate the idea of "adding value" or "value-added" nearly exclusively with this dimension; it's the most visible and physical; transformation simply has to happen wherever value is being added. It shows that adding value has been around for thousands of years and was at the core of all economic activity.

Figure 1



For example, tens of thousands of years ago, a caveman found a stone and by sharpening it and changing its form made it into a crude instrument. The difference between the stone and the instrument was the value that was added. One can apply that thought to virtually any modern activity.

Economics demands that, for value to have been added, there has to have been a transformation of one thing or situation to another, making the thing or situation more useful. Thinking in these terms is a very good way for an individual to gauge his or her own economic behaviour and those of suppliers. Many believe, for example, that shops add most of the value in their lives. In reality, retail offers convenience by bringing together a variety of products into one area. Without shops we would be forced to travel around to various manufacturers or producers and buy items individually. Of course there are other secondary "values" that could be added, including price discounting. Pick 'n Pay effectively added consumer protection. But the distribution of goods should normally not be of higher measurable value than the manufacture of these goods.

If you were to follow the value chain of a simple product like an electric kettle in a supermarket you would end with a host of functions of which the availability of the item in the store is proportionately probably the least. The manufacturer of the kettle would probably have added the most value. But he/she in turn would have used suppliers of metal, plastic, rubber, etc., who in turn would have used other suppliers and so on. Familiarity with this chain has increased in many countries because it's the basis of most spending taxes such as value-added tax and health and environmental concerns.

There are economic activities – services for the most part – that we may be less sure about but which nevertheless conform to the principle. In many, such as hairdressing or entertainment, the value they add is still clear. It becomes less so when one deals with things like financial services. On the surface, they add value by holding your money in safekeeping and creating instruments for easier exchange such as credit cards, etc. But the real value added by the financial institutions is to serve as a vehicle for moving money from those who have it (lenders) to those who need to use it (borrowers). In most banks, for example, the "interest turn" – the difference between interest received from borrowers and interest paid to depositors – comprises the biggest part of their measured value-added.

The growth of financial services and investment banking have become a key global issue. The explosion of debt and financial instruments has to many become little more than a parasitic monster adding very little tangible value. The value that is added ostensibly has to do with transferring risk, but in truth in many of these cases no real value has been added in the sense of transformation – that is, changing one situation, thing or set of things to something else of higher value. Invariably in such cases one ends up with only one party really benefiting and the other losing. Such transactions in essence are gambles where wealth is not created but is simply moved from one party to the other.

The essence of the transformation dimension of adding value is "doing something". More importantly, it means doing something in the interest of another. An understanding of value-added is critical to the debate about which is the key driver of economic prosperity: action or behaviour, as against ownership. This debate also needs an awareness of the role of measuring value, which I will deal later.

The important point about the value-adding transformation is that it always changes one situation into another of higher value. In an operational sense, it has another very important function: it's the ultimate test of efficiency and physical productivity. If all things in an operational process are tested against whether they are adding any value, one has a highly disciplined norm for testing efficiencies. To be completely objective, the efficiency test has to be about whether something is adding value to the customer's life, not one's own. I have encouraged both employees and managers to use the test regularly, if not daily, and to apply it to everything they see, use and experience in the working environment. The more direct the association between the feature being examined and the customer's expectations, needs or wants, the more valid the existence of that feature. The vaguer or less direct that association or link is, the more questionable is the need for that feature.

When this discipline is applied to physical things, it not only ensures optimal use of assets both large and small, but also reduces clutter and encourages neatness. And of course one can apply it to one's own life. If there is something that you own which cannot be validated as regularly adding value to your life, or those near to you, then you have to ask whether it should be there. This principle is an important feature of many of the structured operational efficiency processes such as the Japanese-designed 20 Keys and Total Productivity Management (TPM) and Eliyahu Goldratt's process of on-going improvement and throughput accounting. Indeed the concept is hardly new. The value chain was part of manufacturing efficiencies long before the assembly line was invented, though it does tend to be applied less rigorously in service organisations. Unfortunately, in most organisations few process improvements focus directly on customers' needs; they tend to be internal and cost-focused rather than externally focused. That has often had calamitous results.

One can apply the same principle to functions, whether they are part of job descriptions or involve the whole job and the incumbent. Nothing has the right to exist if it cannot ultimately pass the test of whether it has value for the customer. The more difficult application is in meetings, decision-making and conflict resolution. But these are also areas where the most rewarding results can be achieved. The moment one makes the customer's interest paramount in all things in the collective, and the more people align themselves to this ethos, the easier it becomes to apply this powerful litmus test.

Of course not all features of a collective have a direct link to the customer's needs. Many – and in some collectives the majority – are support functions such as financial, human-resources and administrative services. And it's perhaps no accident that these are areas where waste is most likely to occur. The key difference between the value-adding approach to operational efficiencies and other approaches is the customer focus rather than the traditional profit-and-loss test. It is a behaviour test rather than a measurement test; qualitative rather than quantitative. Which is not to say that the test is difficult: once a feature has been justified in terms of its behavioural impact on the customer, one then simply asks the question of whether the customer would be prepared to pay for it.

When one has reached a stage such as America's NASA apparently has, then one has "got it". The story goes that a visitor once asked a cleaner about her job. She replied: "I am helping to put a man into space."

CHAPTER 6
The magnificent metric

We have seen that adding value is about transforming. In essence it is about doing something. When we deal with measurements of prosperity or wealth we often confuse them with ownership or appreciation of assets. The latter has nothing to do with creating wealth; it relates purely to a change in the value of a particular thing. This can be due to a change in the supply-demand-price environment of the item itself or to a change in the value of the currency used to measure the value of that particular item.

A currency is the ruler of value. Price is a particular measurement on that ruler. As we have seen, the ruler itself is traded, and is apt to alter according to internal inflation or the exchange value with other currencies or "value rulers". To complicate matters further, value is qualitative and subjective, whereas price is quantitative and supposedly objective. Very often there is a wide disparity between the two.

Let's use property as an example. Property is generally seen as one of the best investments one can make. As populations grow, demand for property in good areas appreciates in value because demand increases. In addition, building costs tend to increase each year, thus increasing the price of new homes. This automatically raises the value of previously-built homes. Conversely, you may have built a magnificent home in an upmarket area that becomes less desirable for one or other reason such as a freeway being built nearby, squatter camps, or rezoning of nearby land for industrial purposes.

The point is, one cannot argue that wealth has been created simply because of an appreciation of an asset (if indeed the asset *has* appreciated!). It may add to your own pocket and a country's prosperity measurement of Gross Domestic Product when the property is sold, but it's not where national prosperity comes from. Capital gains resulting from liquidation of assets filter into an economy by way of additional demand resulting from increased spending. They encourage wealth creation but do not qualify as wealth creation per se. There is something of an exception in the traders of assets…someone who, say, buys property, repairs it and then sells it at a profit. One cannot deny that the profit margin the seller gets includes wealth created. The same would apply to traders in commodities and livestock. It could be argued that the value they add is in the transfer of risk or in the maintenance and repair of the asset. These are the exceptions and the activity's link to wealth creation gets broken when it develops to play a predominant role over normal transactions in products and services.

The pity is that most of us associate wealth with possessions. We think that once we own enough we believe we can stop "doing". We see possession as an end itself; the task of getting to that end is a drag and a burden. Obviously this kind of behaviour is not the right basis for sustaining national economies.

Before I examine the measurement of value-added, I should perhaps examine the relationship between behaviour and measurement itself. Human beings are obsessed with measurement, despite the aphorism which says “not all that counts can be counted”. Everything is relative and no method of measurement can truly reflect individual perceptions of value. And yet we continue to measure, and to agonise over the implications of the measurement either as a cause or as an effect. Given the importance of measurement in our lives, the least we must do is ensure that what we measure is relevant. While I have argued that behaviour determines the measurement and not the other way around, no one can discount the supporting impact of measurement. We will, ultimately, always try to measure what we value, even if it’s in fact immeasurable.

This is reflected nowhere more strongly than in sport. A good example is the team ballgame of rugby. It is sometimes referred to as the Neanderthal version of American football, but it’s an ancient sport dating back to the Middle Ages when teams from neighbouring villages would have great merriment in trying to carry a wine bag over a line protected by the opposing team. Rugby is viewed by its fans as being as tactical a game as chess is. It has features such as scrums, rucks, mauls, line-outs, first phase through to multi-phases and many others. All these are applied in the overall purpose of carrying the ball over the opponents “try” line. A successful try allows the scoring team to “convert” the try by placing the ball on the ground and kicking it between goal posts and over a cross bar. Today a try is worth 5 points and a conversion 2. A drop kick is worth 3 points; this happens when during the run of play a player kicks the ball through the goal posts. A “penalty” kick can also be aimed at the posts and if successful leads to 3 points.

Rugby statisticians, coaches and players spend a great deal of time measuring all the tactical components such as line-outs, rucks, mauls and scrums won, as well as percentage possession and territorial advantage. In addition rugby is one of the few games I know of where the scoring method has actually changed over the years. Time was when a try was worth 3 points and not the 5 it is today. The rules of play have also changed over time. The impact of the scoring on the game itself is clear even to the less knowledgeable. Increasing the value of a try has encouraged more “open” and “running” play. If, for example, they were to change the value of a try to 2, and the value of a penalty kick to 5, clearly the entire play of the game will change.

Why change the rules and scoring of any game? Is it for the benefit of the players, the coach, or the administrators? Obviously not. The ultimate customer of any sport is none of these parties: it is the spectator. What makes for good play in any game is what the spectator finds exciting and attractive. A scoring system that doesn’t pander to this need will destroy the sport itself. And surely what we choose to measure and how, should support the real purpose of that activity? If the purpose of a business is to add value to people’s lives, then that must be the real performance indicator and driver in a business. Profit has a very important role as a “sub-score”, like winning line-outs or scrums; but relying on it as the most important driving score in a business is highly questionable. Despite the growing clamour against the profit motive, few have fully challenged the profit measurement itself.

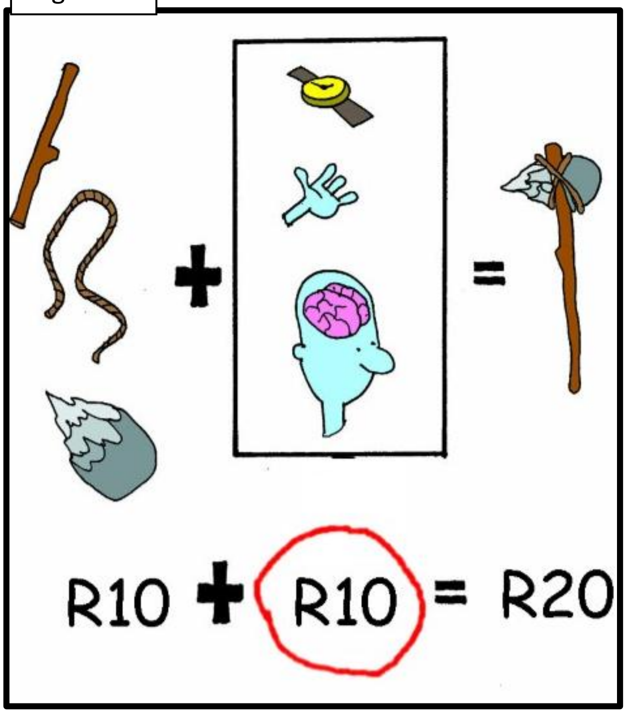
This deficiency has meant that every good reason to question the short-term profit motive merely becomes an irritant to be accommodated. We have seen laudable efforts such as Norton and Kaplan's Balanced Scorecard abused and manipulated simply to fit the ultimate profit measurement. People-development and corporate social responsibility (or corporate social investment) are components of the Triple Bottom Line. But that line is seen as a chore, a burdensome "have to have" rather than a real "want to have". TBL in any case tries to achieve the impossible of merging qualitative measurements with quantitative ones.

Trying to combine all these measurements or actions merely detracts from the effectiveness of the conventional single-purpose profit-measuring exercise, and none of the three in TBL or 3BL sits comfortably with the others. Getting this right is probably going to be costly and therefore reduce profit. In the meantime, compelling as the arguments may be in favour of people-development and corporate social investment as ways of ensuring sustainability or longer-term survival, the devil is at work in business reporting in general: we're seeing increasing emphasis on short-term profitability and ever-shortening cycles of performance reporting.

There is good news, however. It is to be found in the measurement dimension of added value what I call the magnificent metric. It addresses all of these problems and many more.

In the very beginning there was value-added. As well as being the oldest business concept known to humankind, it was the founding principle upon which all subsequent economic development was based, and it's by far the most important. No amount of manipulation, trading shenanigans, corruption, insider trading, speculation and other misdemeanours can destroy the validity of value-added as (a) the only true generator of prosperity and (b) an inducement for people to behave in a values-driven way.

Figure 2



The illustration in Figure 2 shows that it is both remarkably simple and comprehensive. Let's say a caveman found an already sharpened and shaped stone, as well as a stick and a length of vine or animal sinew, and assembled them to form a crude axe. The difference between the completed axe and the three loose items would be value-added. This would have entailed the use of time, effort and all things to do with the mind such as creativity, imagination, knowledge and experience. At this stage it's a subsistence item, intended exclusively for personal use. So it was that for centuries most economic activity was purely for subsistence and therefore immeasurable. The axe, for example, couldn't be given a single universal value because its usefulness might differ from creature to creature.

Some could have found it useful for hunting, others for cutting wood and others again for getting married. Living in social clusters from very early times meant that humankind had a propensity for exchange. Initially it might have been a spontaneous reciprocal activity among members of a family, group or tribe; in time it would have developed into a crude barter system where values were slowly becoming measurable. It was only with the development of a widely accepted and single medium of exchange that values became more accurately measurable.

If we stretch our imagination slightly and say that our caveman had to buy the stone, stick and sinew from someone for R10, then transformed the loose items into a single axe and sold it for R20, we can accurately and neutrally put the value of the time, effort, and creativity at R10. Of course an additional resource was applied in this instance because he needed money (or a form of it) in order to buy the loose items. So there is a fourth factor: capital. The illustration is a simpler interpretation than the academic one of how the factors of production are applied in economic activity.

But it is more profound than that. As an illustration of the root of exchange it proves that, for value to be established at all, there has to be a process of trading going on. Why did the caveman produce the axe in the first place? Why not leave the stone, stick and sinew as they were? Clearly it was because of the usefulness of the axe as compared with the three loose components. And if the item is to be traded, then we have to ask: To whom is it useful? Clearly, the axe is intended for use not by the maker himself but by another human being. In other words, its worth depends on the contribution it makes to the good of someone else.

The ultimate and exciting point about value-added is that it's the one measurement in accounting that measures empathy and contribution. It is also the only one that does this. In accounting terminology, the term "value-added" is synonymous with "wealth created". What this means is that wealth or prosperity is directly and exclusively linked to the contribution you make to the good of those around you. It applies at all levels: individual, company and country.

We can go yet another step further. Examining our illustration again, we see that after the sale our man has R20. He brought an initial R10, and he now has an additional R10. Where does this go? To whom does it belong? Obviously it goes to himself as the one who added the value or made the contribution. This is his reward.

So there is a clear and direct link between contribution and reward. I repeat: value-added is the only measurement in accounting that shows the clear link between contribution and reward; the only one that measures both at the same time. The order is important: contribution brings reward – not the other way around.

The linear equation for this is simple: value added = wealth created = contribution = reward = prosperity. And yet I can think of no more powerful way of saying that empathy creates both inner abundance and outer wealth and prosperity. Values do create value, even in the accounting world.

This simple arithmetic confirms the prophetic teaching that “if you give you will receive”. And it was there long, long before prophets and profits were heard of!

CHAPTER 7
The power of value-added

Behaviour is the foundation of economics and behaviour can never fully be measured. On the other hand, the measurement of value-added (or wealth created) comes close to capturing most of what we can call “abundance”. Abundance is a much broader term than wealth. Wealth is about the material and the measurable, whereas abundance implies many other things such as health, wellbeing, peace of mind and contentment. Wealth cannot exist in isolation and is arguably rendered useless if other factors of abundance are not in place. For wealth to have any meaning it must exist in healthy interaction with people around the possessor. There would be little sense in having a hoard of money in a bank if one were living totally alone, ostracised and reclusive.

While the most powerful feature of value-added is its reflection of contributing behaviour, it has other strengths. As well as being historically significant, it’s amazingly simple. Applied to a company, it expresses income less outside costs. It cannot be subjected to the same degree of account fudging as (say) profit can. I have been able to illustrate value-added to illiterate employees and get them to observe how the mechanism works in economic activity around them. To an employee, value-added is non-threatening because it reflects labour as part of the contribution. It also includes capital and state, and therefore represents the one common-purpose factor in any collective that earns an income. Because the ultimate fortune of each party is affected by the size of value-added or wealth created, it is also a measurement of common fate.

If mission statements that are constructed around the purpose of the business also reflect “giving” behaviour towards others, then value-added ought to be the measurement of this giving. It is the only one in accounting that can be, and this fact alone makes its absence from the computations puzzling to say the least. It also gives a guide on how to structure a mission statement. For example, the Mary Kay Cosmetics mission statement “To give unlimited opportunities to women” can obviously be assessed in a number of qualitative ways; but the only way to put a monetary value on the extent to which it has fulfilled this mission is to calculate value-added. The more successful Mary Kay is in meeting that mission, the higher will be the value-added. However, if Nike did crush Reebok, there wouldn’t necessarily be an improvement in value-added. A mission statement in itself means little. But a mission that reflects the company’s keenness to add value for its customers will actually raise the level of wealth created and the financial success of the company.

The obsession with competitiveness often causes business people to behave like adolescents governed by peer pressure and a need to “defeat” the other. Competition in business is not about winning but about ensuring a benchmark for service. Even a good athlete would not perform at peak without such a benchmark. A company that truly has its customers’ interest at heart welcomes competition because it offers a choice and a source of information on market needs. Indeed, one doesn’t have to be impressively innovative or unique in providing a product or service; one's mere existence in business is important as a way of helping to give the market a wider choice.

It may be as well at this point to draw a distinction between monopolies and sole suppliers: the former is normally imposed by protective regulation and dubious practices; the latter is mostly the result of organic growth based on being the best and competitively priced. As long as there are no barriers to entry into the market or undue control of resources, being a sole supplier is probably a reflection of excellence rather than misbehaviour.

Value-added or wealth created is also the most appropriate measurement of productivity. As I will show later, there are many ways of measuring productivity, the one concerned with labour being for the most part based on volume per man-hour. Value per employee also features in some annual reports that have a value-added statement (VAS), but it's less popular as an operational tool for productivity enhancement. Goldratt's throughput accounting in his Theory of Constraints does use a measurement close to value-added at operational level. The virtue of the "wealth created" measurement at company level is that it swings the productivity efforts of the collective away from cost containment towards growth.

The standard measure of productivity at a company level is output divided by input, where output is measured in income, and all input costs are as measured in a conventional profit-and-loss statement. This means that all inputs except profits are viewed as a cost to be contained or reduced so as to enhance productivity. I would submit that this is a measurement of profitability and not productivity. I would argue further that profit should be an input because it is a cost in running a business. But of course, then the result of output divided by input would always be 1.

In most productivity drives the instinct is always to cut costs first, and that does tend to happen: payroll is the first cost to be scrutinised – and cut. The doyen of productivity in South Africa was Jan Visser, founder and for many years head of the Productivity Institute. At his retirement he lamented the fact that productivity in the country had been nearly exclusively focused on cutting inputs rather than on increasing outputs. Productivity drives had become a major aggravating factor in the country's already high unemployment rate.

Productivity can be viewed from three angles. One can create the same wealth with fewer inputs. Or one can create more wealth with the same inputs. And finally, one can create much more wealth with more inputs. The typical productivity drive will involve the first – trying to get the same result with fewer inputs; this frustrates efforts to encourage growth, employment and national prosperity. As a motivator, value-added or "wealth created" forces one to favour growth over containment, and we shall see later how profitability and labour productivity take on a secondary importance, albeit still an important one, in this focus.

Another reason why it's such a pity that value-added is underrated is that it effectively reflects a company's share of a country's gross domestic product; value-added is the company's GDP. A country's GDP can be measured in a number of ways. Most of them are estimates only, but the standard method works from a spending perspective through the formula: Y=C+I+G+X-M. In plain English: gross domestic product is equal to consumption expenditure plus investment plus government expenditure plus exports, less imports. Although many features of economic activity can be missed in this equation, it has been viewed as probably the most accurate.

But another, albeit more difficult way is to add up all the "wealth created" figures for economic units such as companies, other collectives, or even self-employed individuals. The point is that the value-added figure of each economic activity is its contribution to the nation's GDP, which means that companies which focus on enhancing wealth creation rather than mere profits will make a real contribution to the country's prosperity and level of employment. Companies that focus purely on profit maximisation simply cannot guarantee that; indeed, as Dr Visser pointed out, their effect is often quite the opposite. This may not matter so much in high-employment, developed countries that have a substantial social security system, but it's a serious issue in countries with high unemployment rates such as South Africa. The fact that the wealth of nations depends on the value added by each and every cell of economic activity, and that this in turn depends on the contribution that the cell makes to its market, makes the generally light emphasis on value-added at company level both incongruous and puzzling.

The concept of sustainability may be the first nail in the coffin of the profit driver and measurement. Value-added, I submit, may be the second nail and perhaps several more. Value-added won't only protect profit in an organisation; it will enhance it. At the same time it can fully accommodate the social demands of a modern society. We shall see later that the full value-added statement, with adjustments to create a Contribution Account©, covers all the key issues facing business today.

Figure 3

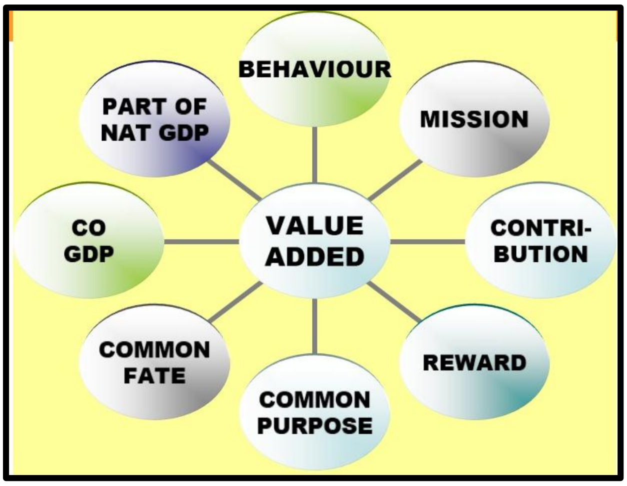


Figure 3 shows what is drawn together in a single measurement. The principle of adding value, which reflects contributing behaviour, gives a comprehensive and powerful perspective of the operations of any collective or company.

In our workshops I ask teams to take the simple example of a bead-working group and decide what this group must do to increase wealth creation (Figure 4).

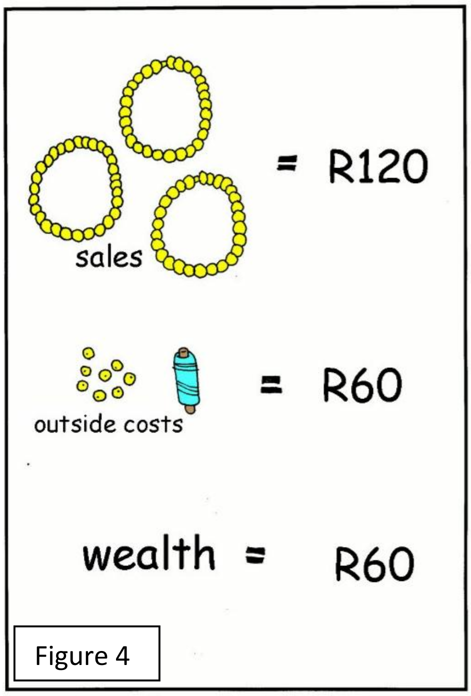


Figure 4

The beadwork group buys beads and thread for R60 and the finished product is sold for R120, giving the group value-added of R60 (the amounts are not important in the exercise because they reflect each sale and not total turnover). There are certain ground rules for the exercise. For example, the nature of the group's business may not change: this is a small company with few employees that relies on creativity of design for its sales, and is not making its own beads – vertical integration sounds like a good idea, and would certainly increase the wealth created, but the group isn't up for that just now. Also, the group won't be taking the R60 away nor either investing it or buying lottery tickets since these people are neither investors nor gamblers.

The first feature of the responses is that the teams tend to confuse value-added (or wealth created) with profit, so the distinction needs to be re-explained. Profit is part of wealth created, but wealth created is a much broader measurement: profit goes to the owners, whereas wealth created reflects both the contribution from various parties and the reward they receive. The concept may look simple, but the understanding of it isn't automatic; indeed, as observers of many Value-added statements over the years, I have come to realise that the accounting profession itself is not too clear on what constitutes value-added. I will deal with this when examining the full statement later.

Interestingly, very few of the workshop participants suggest a reduction in employment in order to increase net income. Most are quick to realise that cutting the payroll will have no effect whatsoever on wealth creation. It may affect wealth distribution insofar as the group, without creating more wealth, is sharing the available amount differently.

Overall, the exercise reveals a strong focus on customers and being market-driven. It forces the participants to be outward-looking. Where customer interests are ignored, a discussion quickly shows the dangers of that; for example, it's clear that one can quickly increase value-added by reducing the number of beads used in each piece, but the danger is that a customer may see that the work's quality is not the same as that of an item shown to her by a friend who visited the area a few months earlier.

The reduction in quality may disappoint her and along with "no sale" there may be damage to the vendor's or maker's reputation. Then again, research may have shown that there is a market for simpler and less cluttered products. One has done the same thing with a different motive! But by responding to market needs one is assured of not losing sales or tarnishing one's image. In addition, part of the benefits can be passed on to the customer in the form of lower prices.

It may be necessary at a certain point to remind the workshop teams of the objective of the exercise: find ways for the bead-workers to create more wealth. And along comes another strong temptation: to simply increase the price. Awareness of the supply-demand-price mechanism, however, quickly makes them realise that higher prices could lead to a reduction in sales and indeed reduce value-added – unless of course market research has shown that the items were under-priced to begin with.

These participant responses to the exercise are the exceptions. Most reflect a strong appreciation of the need to be demand-led and take the interest of the customer into account. As well as suggestions for expanding the bead-workers' market, there are ideas for broadening the product range, increasing quality and promoting the product. The teams look at conditions for external focus and growth. The "what must be done" is distilled into three categories: sell the most you can, get the best possible selling price, and keep outside costs to a minimum.

In all the times we have run this exercise, we've never come up with more than those three. The "why" is clearly about service and satisfying demand, and many "how's" are suggested, including advertising.

Figure 5

WHY	WHAT →	HOW →	HOW →	HOW
Demand	Sell more	Advertise	Local paper	Pretty girl wearing bracelet.
	Best sell price	Etc	Etc	
	Contain o/s costs	Etc	Etc	etc

We end up by creating a "line of sight" template that can be understood at any level of employment and operations (Figure 5).

The "why" stands on its own and ultimately is not negotiable. Anything that is done that cannot be traced back to the customer's needs is questionable. The transformation litmus test is applied to the template. The "what must be achieved" are the three I discussed earlier, each one now attached to a myriad "how's". For example "selling more" may need publicity, and this in turn can be achieved in a number of ways, such as an extensive advertising campaign. Indeed an entire industry has been established in this regard.

I have found this exercise a very useful way of enabling staff to identify line of sight from every task and function through to service to the customer. It's also good for examining systems, process and structure in terms of staff fit as well as efficiency. Given an opportunity to work with this template, a wealth of suggestions can be gathered from employees on how to increase wealth creation in their area.
The clearest effect of the template is in the definition of goals: sell the most, get the best price, and reduce outside costs.

The concept of the value chain has been around for decades. The one question that has never been fully answered is: value for whom? There clearly will be a significant impact in all areas of a company if it says "value for the customer" as opposed to "value for the shareholder". In *Business at the Speed of Thought* Bill Gates takes a giant step further: he questions the relevance of the value chain and says it has been replaced by the value network: instead of there being one solid chain from suppliers to customers, each activity in the process is a contact point for the customer. Gates uses the example of motor assembly, where a vehicle on the line can be customised at the buyer's demand while still in the process of being assembled.

In discussing the template in our workshops we are always impressed by the dynamic of a collective such as a company. It's an entire world of features, activities, events and thoughts – all potentially aimed at serving a fellow human being. I find it sad when people ascribe its existence to something as mean and mundane as making money. To me it's like the human body…just as simple, just as complex, just as magnificent and just as mysterious.

CHAPTER 8
Wealth distribution and the Contribution Account©

In a world strongly focused on what it can get rather than what it can give, it's not surprising that wealth distribution takes precedence over wealth creation. But this is totally illogical. You cannot share what has not been created. The more you create the more you have to share. The less you create the less there is to share. It has been the great failing in the self-interest and profit motive that it has diverted attention away from this essence. The "what's-in-it-for-me" mentality sees material reward as the end and everything else as a means to that end. Reward should be the supporting act of contribution instead of the other way around. Reward or wealth distribution plays a vital role in ensuring enhanced and continuing contribution or wealth creation.

We have seen that wealth creation needs the basic resources of time, effort, mind and money, and their application causes value to be added to resources that have in turn been obtained from others. They correspond to the three economic "estates" of a nation – labour, capital and state – and are the main measurable components of Gross Domestic Product. These estates are contributors to wealth creation and therefore should be recipients in wealth distribution; bearing in mind that value-added measures contribution and reward as one. The popular accounting terms for the three parties are: employees, shareholders (or owners), and government as representing the state.

The employee share is based on what people receive in the form of pay, bonuses, fringe benefits and training. Shareholders get profits and the government gets tax from both the company and employees. The simple values-driven principles of creating wealth and then sharing it with those who contributed, underpin the format in accounting called the Contribution Account©.

The value-added statement and its sister protocol, the Cash value-added statement are well known to informed accountants. Apart from some significant adjustments to both, the Contribution Account© shifts the lens from a dead set of numbers to a relationship and behaviour perspective. This may seem pure semantics but that shift creates a profoundly different way of understanding and assessing the numbers.

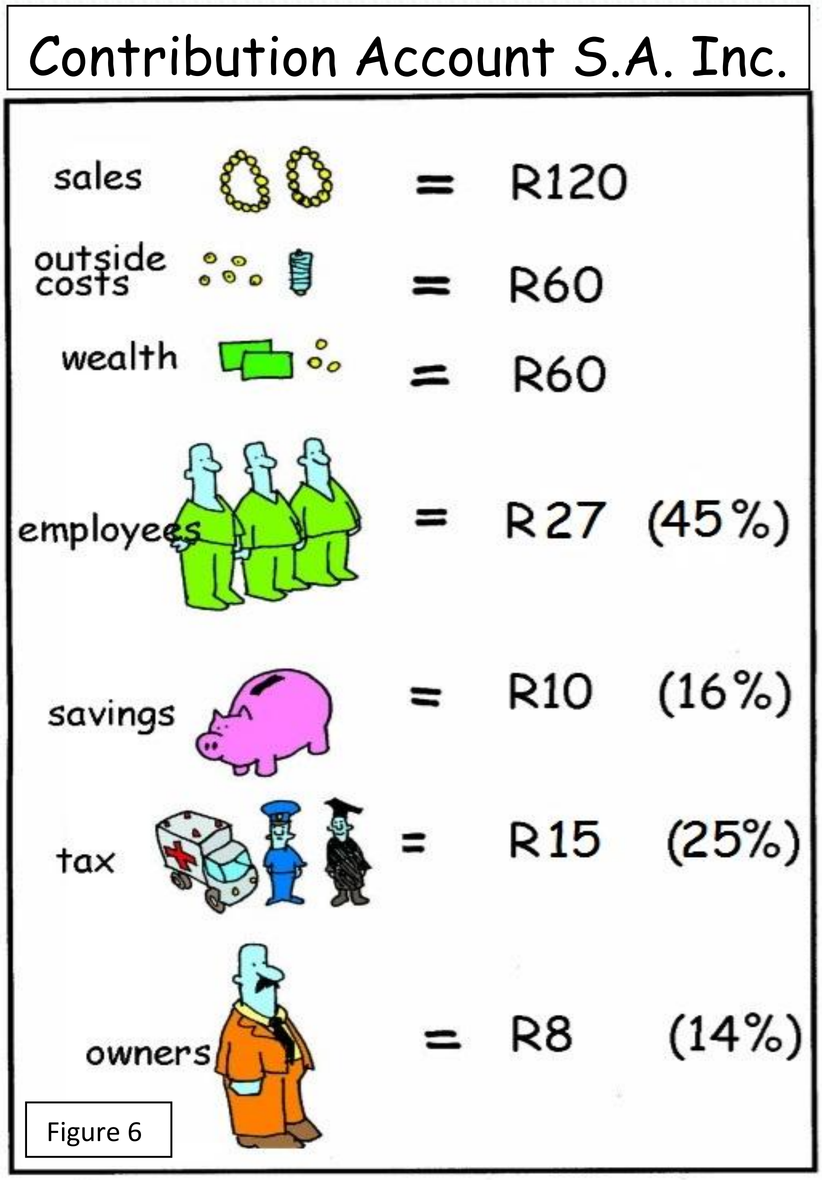


Figure 6

Figure 6 shows how simple the Contribution Account©, expressed here as the national average. My contention is that the principle – or formula if you wish – can be applied to any level of economic activity including team level if it's designed with appropriate transfer costs, which means one has to proportionately allocate costs that are centralised at group level. The VAS has become one of four final accounts that can be found in many company annual reports.

The other three accounts include the income statement, which reflects the profit performance of a company over a given period. This is aimed primarily at shareholders and the equity investment community, and is a statutory account required by the tax man and by banking institutions. In annual reports, the income statement would reflect profit performance over a year, but most countries have at least two more requirements: an interim (six-monthly) publication, and a preliminary year-end report shortly after the close of the company's year-end.

This is to be followed up by the annual report proper, with explanatory notes and now we have the sustainability report being added to the fuller reports. In the United

States, the trend is towards more frequent publication, for example quarterly. This is another sign of the obsession with performance reporting, which ignores the need to consider longer-term wealth creation or sustainability. Interestingly, South African goldmines have been reporting quarterly for many years; in part this is a reflection of the “wasting asset” nature of any mine and the volatility of its performance owing to factors largely beyond its control.

Next we have the balance sheet, which reflects the state of the company in terms of what it owes and what it owns. Next to the Contribution Account©, I believe, it can be significant in broader disclosure, particularly in employee reporting. It is crying out for simplification, shrouded in esotericism, intelligible only to the informed, and shown only in the annual report and occasionally in the sustainability report. Changes in the balance sheet are the ultimate indicators of company strength. Its significance to staff will be dealt with later in discussing employee reporting.

Finally and also statutory, there is the cash flow statement. It says what it means: cash flowing in and out of the company. Cash flow – or lack of – is a common “killer” in most company failures, especially small companies. But it has limited uses as an indicator of sustainable health: cash flow can change within months, if not weeks, and it’s quite possible for a company to report healthy cash flow in its annual report, and then “die” for lack of it within days of publication, or even before it.

The Contribution Account© is primarily a reflection of relationships and behaviour, although this was not its original purpose. The value-added statement itself, upon which the Contribution Account© is based, was originally proposed by the British accounting profession in their Corporate Report of 1975, it was conceived in the midst of labour unrest and appears to have been designed partly in response to union pressure for fuller disclosure. It became a requirement for British public companies and in turn a requirement for companies quoted on the London Stock Exchange.

The Contribution Account© succeeds where other modern attempts fail, in shifting companies away from short-term cost accounting to an emphasis on longer-term growth. Those other attempts are for the most part just a smokescreen for entrenching, rather than moving away from, the short-term cost and profit-driven goals. They ultimately lack authenticity. The power of the Contribution Account© lies in its ability to encourage a change in behaviour and what’s in the heart. It forges a common purpose and common fate. It enhances understanding and contributory and flexible behaviour.

Used as the final scoring system, a Contribution Account© makes a direct, understandable and generally acceptable link between operational measurements and the company’s fate. “It is the golden thread that binds us together,” says Factory Management at African Explosives Limited. Standard shareholder accounts can be easily figured out from the Contribution Account© and explained to the general workforce – even to illiterates!

This link not only extends to accounting formats such as the income statement, but also formulae such as EBIT, RONA, ROTA, EVA, MVA, TVA, etc. It embraces all operational tools such as 20 Keys, World Class Manufacturing, Theory of

Constraints, and accounting tools such as the Balanced Scorecard, the Triple Bottom Line, Employee Reporting, Social Reporting, Sustainability Reporting and others. Finally, the company's strategy can easily be translated into sub-scores of the Contribution Account© that become operational standards and the focal point of operational meetings. All of the above will be discussed in greater detail later.

The current value-added statement format does have its blemishes and has tended to be relegated to Cinderella status. The most important difficulty is that in most countries the VAS is not statutory and is unaudited. This obviously erodes the basis of any accounting format in respect of discipline, consistency and credibility. In spite of being recognised as one of the final accounts by the many companies that have used it since the 70s, it nevertheless still tends to be seen as a "nice to show". The Contribution Account© has so far not gained much traction apart from our own clients. From a behaviour perspective, the VAS does significantly shift the focus from numbers to behaviour, but essentially it still has a narrow shareholder bias.

Obviously, without these disciplines the VAS is easily manipulated at source. And even if it were subjected to scrutiny by auditors, it would remain open to interpretation by a wider audience than that of shareholders in a way that can affect, and has affected, its credibility. Unfortunately it has also lent itself to manipulation by certain company leaderships who see it as a way of forestalling employee unrest. Because it so often misrepresents the truth about wealth distribution – **that the share of wealth represents both contribution and reward** -- some company managements in South Africa have actually abandoned it at the insistence of unions. The same danger clearly exists for the Contribution Account©. This is a case of throwing the baby out with the bathwater. A Contribution Account© if correctly interpreted can be the most empowering tool in employee communication and development.

I believe that the Contribution Account© will become more important with the growing clamour for easily understood disclosure and pressure for other reporting formats such as Sustainability and Social Reporting. From a broader viewpoint the Contribution Account© actually reveals more than the standard income statement does, particularly when year-on-year comparisons are made.

Outside costs (the second line of the Contribution Account©) is a major consideration in assessing company health: from the size of these costs in relation to sales, and changes in this proportion, one gets an immediate feel for where the company is heading. Similarly labour's share of wealth created, and changes in this share, are of great importance in the assessment of a company. I know of some investment analysts that regularly use the VAS. In their view, despite being unaudited, it gives reliable information; most of its components would have had to be audited in arriving at an income statement. A statutory, logical and audited Contribution Account© would of course enhance improved investment analysis of companies no end.

In South Africa, following the British VAS format is a habit that formed in the 1970s out of the need for companies listed in Britain to meet that country's accounting requirements. With its emphasis on wealth creation and equitable distribution, however, the VAS and particularly the Contribution Account© have become increasingly pertinent to modern demands on a company and growing economies like South Africa.

Income is broadly defined as all the money the company receives from its customers and other sources, for example interest earned. The difference between the terms sales, turnover, income and revenue is often not clearly understood and the terms are often loosely used in-house, so I suggest simply following the top line of the income statement. Indirect taxes such as VAT should be excluded from income as it is from all of the accounts.

Outside costs or outside supplies are simply all the things you bought from others who are not part of the company "family". Some people equate the figure with variable costs or raw materials, obviously taking their cue directly from the standard accounts, but there are many fixed costs that come from outside suppliers, such as electricity, telephones, stationery, etc. Not all things bought from outsiders should automatically be included in this category. Car purchases or leases intended as employee perks, for example, should be classified under the employee share.

To repeat: value-added or wealth created is the difference between what one received in income and what one paid for supplies or services from "outsiders". It's a measurement that clearly stands on its own. There is a danger at certain levels that it may be seen as synonymous with profit or even gross profit. Because of its importance to the company as a whole, there should be no misunderstanding around this figure. Expressions such as "is this adding value?" or "what value did you add today?" should become part of everyday language and operational discussions. Employees often refer to "the pie" in discussing influences on wealth creation; they are clearly comfortable with the idea that the bigger the pie, the more there is to share. This kind of familiarity, together with awareness of the need to enhance wealth creation, creates the climate for a spontaneous movement towards flexible pay and gain-sharing.

The employee component ought to reflect everything that is spent on employees: salaries, wages, benefits, PAYE (taxation on the basis of "pay as you earn"), training, etc. Pressure has been mounting to split the measurement up into categories of employees, and in particular to distinguish between the management and the general workforce. But in most cases I have found that such a split says very little because, regardless of differentiated pay, the largest slice of the pie goes to the workforce in any case. That there may be a place for a system based on the Gini Coefficient will be argued later.

IMPORTANT NOTE: For years I argued for the retention of employee personal income taxes under the employee share. Much of my earlier work and the previous Contribution Account© are based on this assumption. I am now persuaded otherwise, especially at a time when there is a greater move to a relationship rather than an institutional understanding of a business. It also struck me that all earlier formats such as the value-added-statement and the cash VAS were still seeing the figures from a shareholder, rather than stakeholder perspective. From the latter point of view there is simply no logic in overstating the employee share and understating the government share.

In South Africa skills development qualifies for reimbursement by the state. In such cases, it would be logical to show a “net” training expenditure, which could upset the balance. The reimbursement could be offset either in higher income or lower outside costs or, better still, lower tax.

Savings are made up of retained income and depreciation. This is one area where I later argue for a change to exclude depreciation. Profits are then calculated simply by adding retained income to the dividend paid.

Taxation for the most part refers to company tax and employee tax. But it ought to include other payments to government such as local-government levies. I favour inclusion of expenditure on purely social investment programmes; reimbursements could be dealt with in the same manner as training subsidies. While VAT is clearly not an appropriate inclusion under this tax heading, the argument is less clear for other direct taxes such as customs, excise, import tariffs, etc. They should be reflected as an outside cost. Better yet, they could be shown as a reduction in income. Inevitably these taxes, like VAT, are recovered in selling prices.

The earlier argument that PAYE should be taken out of the employee share and added to the tax category needs repeating here. I have moved away from the argument that in principle, company taxes are a reflection of the company’s relationship with the government, and personal income tax reflects the relationship between the individual and the government. It may make theoretical sense, but it is certainly not logical.

Those of us who feel oppressed by the tax burden dislike the idea of classifying government as a contributor to wealth creation. It’s a point of view which in no way alters the principle that government’s primary function is to create the conditions for wealth creation. Government’s revenue from company tax is totally reliant on the size of value-added which in turn impacts on wages and profit. One could not conceivably classify government as an “expense” except in the case of a “user-pays” fee that is entailed in a particular government or parastatal service.

In the simplified example earlier I spoke of shareholders. They can also be called “owners”. This heading covers the dividend only, and is the cash component of profits; the rest being ploughed back into the business. Unfortunately the issue is often muddied by other obscure considerations. I have had great difficulty in persuading some wholly-owned subsidiaries to treat “head office” costs as an outside supply because these costs imply paying for a service or support function from another, albeit the owner.

The shareholder issue is also apt to be complicated by different categories of shareholders, but this is rare. For example, holders of “preference shares” receive a guaranteed return. They are not (in our view) fully aligned with common fate, which is a primary condition for inclusion as a beneficiary. Because preference dividends are mostly not a very significant part of the full shareholder return, they are best included in the shareholder component. In the absence of a definite convention the best policy is to follow the behavioural logic and stick with it. At the very least, explanatory notes can be used to clarify the approach where needed in specific forums.

In the original British format the term “providers of capital” was used instead of our “shareholders”. This included interest paid to banks and other institutions or bond-holders. Where I have worked, I stripped out interest paid and included it as an outside cost. I argued strongly for this change in two articles published in the professional mouthpiece Accountancy SA in May 2001. Banks and other providers of guaranteed loans are not part of the “family of contributors”. Banks cannot be viewed as risk-takers; to the extent that they take any risk at all, the level of that risk is reflected in differentiated interest rates – in premiums above or discounts below the benchmark (usually called the prime rate). As far as risk-taking is concerned, most banks are ranked higher than other creditors. No company would view interest paid as anything but a cost and a burden to a company.

Treating interest paid as an outside cost follows the same logic as the treatment of interest earned. Even in the British format, this is shown as part of income in the top line (sometimes separately). If interest earned is part of the top three lines, then surely interest paid must be as well. Otherwise one would have to show interest earned as a negative under “providers of capital”. A further argument for viewing interest paid as an outside cost is that lending institutions also add value in their own right. The largest part of the wealth created by a bank for example lies in the difference between interest earned and interest paid. If a company in debt makes interest part of its wealth distribution, then on a national level we are guilty of double accounting.

By showing interest as an outside cost and a negative factor in wealth creation one can influence behaviour that affects working capital. Operational principles like “just in time”, unnecessary stockpiling of materials and finished goods, OTIF (on time in full), debtor control and general cash flow considerations lose their significance if interest paid is viewed as part of wealth creation itself. After all, it could be argued, the more interest we as a company pay the bigger the pie! Amortisation falls in the same category as depreciation.

The other change I would agitate for is to take depreciation out of savings and add it to outside costs. This argument may not be as clear-cut as the one on interest, but it follows the same logic. Depreciation basically means “paying off” a capital item that was bought from an outsider in the first place to be reflected on the balance sheet. It entails writing off a number from the balance sheet and transferring it to the income statement. Two other arguments for classifying depreciation as an outside cost are: (a) because depreciation in essence is the cost of wear and tear of equipment from an outside supplier, and (b) removing it from savings will be a fairer reflection of the way savings have strengthened the company. Obviously, removing depreciation from savings avoids confusing changes to wealth distribution as plant is written off. It would also facilitate sensible comparisons of wealth distributions of similar companies because it eliminates the need to consider age of plant, etc.

Because depreciation does not affect cash flow, some companies take it out of the standard VAS and refer to the result as a “cash value-added statement”. One exception to the depreciation rule is where companies, influenced by inflation accounting, include “replacement of equipment at future cost” as part of the depreciation or savings component. This is not simply wear and tear and therefore is arguably very different from normal depreciation. Indeed it is still taxable and therefore classified as part of retained income. It really is nothing more than a disciplined or compulsory component of retained income.

I accept that not all of value-added reporting is as simple as I have portrayed. Financial institutions and investment companies for example have to deal with complex concepts such as imbedded value. There are a few others where the simplicity of the value-added approach may be challenged. A detailed answer to these exceptional items is beyond this work but a good general rule is to follow the same logic that is applied to the income statement. A further powerful guide is to follow the simple and unassailable logic of the Contribution Account© itself.

Our research has revealed that where legislation does not prescribe the publication of a VAS, companies follow a variety of formats that appear logical to them. Unfortunately many have just stuck blindly to a conventional format. I have insisted on excluding interest paid from wealth distribution; only very recently have I resigned myself to the logic of moving employee tax to the government share and earlier accepted the inevitability of removing depreciation from savings and including it as an outside cost. BASF in Germany (in common I suspect with much of continental Europe) use a format where they do indeed classify interest, amortisation and depreciation as outside costs. This creates a purer and more accurate definition of value-added or wealth created.

I am not an accountant but I've had close ties with the accounting profession in both my broadcasting and consulting careers and my arguments reflect years of fruitful discussion about translating the figures for less accountancy-literate groups, and employees. A set of accounts is nothing more than a presentation of figures in a certain way. The Contribution Account© is much more than a format. It's a reflection of a desired behavioural reality and creates a more suitable strategic and operational accounting process.

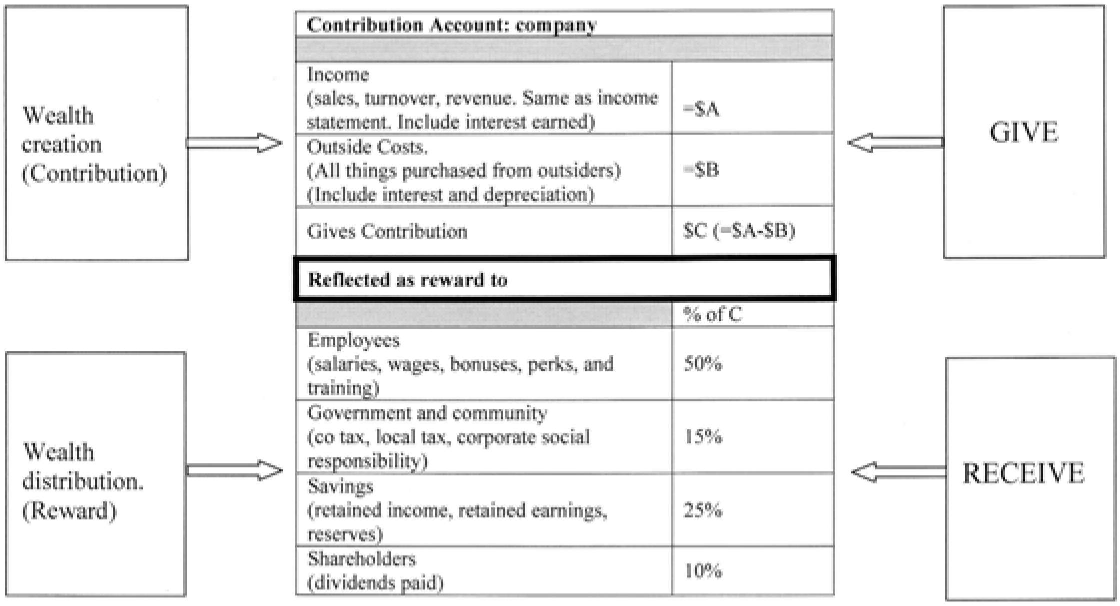
A more recent compounding factor in company accounting are executive share schemes, where executives are allocated shares and cash pay-outs under what Warren Buffet has called complex "fuzzy maths". At allocation they are assigned to the equity component of the balance sheet, diluting shareholding and eventually earnings per share. Dividend payments to executives on the VAS or Contribution account© will no doubt be reflected under this category in that statement. But when executives are paid bonuses based on vaguely defined criteria of shareholder value or share prices, and set by "Chihuahuas" on Remuneration Committees, the accounting becomes far more complex.

One simply cannot fiddle with changes on the balance sheet without these being reflected in the income statement and clearly the VAS or Contribution Account©, These allocations will have to be carefully considered and where they affect the income statement as a cost, the same logic has to be transferred to the VAS or Contribution Account©, Executive pay it will most likely have to be housed in the employee share and in time cause pressure for a distinction to be made between standard basic pay and executive remuneration.

For our part, it is clear that in many cases, shareholders are not fully aware, or even sensitive, to the cost of executive remuneration until there's some outcry in the media. Market capitalisation of most of the big corporations is so large that milking the equity account and marginally diluting share returns has little obvious impact, yet it can lead to multi-million rand pay-outs on an individual level. The "con" of the process is that in order to reduce diluted earnings, executives are under extreme pressure to maximise profits, not only exacerbating the marginalisation process I spoke of earlier, but further aggravating income disparities.

CHAPTER 9
Key issues of the Contribution account

Figure 7



If you study the diagram in Figure 7 you will see that the Contribution Account© is a lot more than simply an accounting format or a set of figures.
(Note: the diagram has NOT been adjusted for employee tax and still includes this under the employee share.)

There is a clear and direct link between behaviour and outcome; cause and effect. I dare say there is no other format in accounting that does this so well. It confirms in detail the link between contribution and reward, or giving and receiving. Even at this "headline" level, it gives all involved in the activity a clear qualitative line of sight.

A question often raised in groups is who decides on who should get what in wealth distribution. This is of course largely beyond the control of any of the parties, including shareholders. Wealth distribution will depend on the type of industry or other activity: an industry that is highly mechanised or capital-intensive will look different from one that has very little plant and equipment, or is labour-intensive. In the capital-intensive case, the cut for the shareholders needs to be much larger, whereas in a labour-intensive organisation the employee share is often as high as 70% or more; this is particularly true of retail companies, most of which own little in the way of fixed assets and lease the premises they use. In highly capital-intensive companies such as Sasol the employee share could be as low as 30% or 40%.

Trying to draw direct comparisons among companies in similar industries is not always appropriate either, since there may be substantial differences in individual structures and requirements. If the employee share of wealth is larger in retail organisation A than in organisation B, it doesn't necessarily mean that A is overstaffed; it might own some shopping malls or buildings in which it is active, and in that case the share given to capital or shareholders would naturally be higher. The shifting of depreciation from distribution to outside supplies reduces the differences between capital-intensive companies owning new plant, and those that have already written off their plants. It makes distribution comparisons more relevant, but still not fully valid.

An important argument for separating depreciation from distribution is that as plant is written off it is seldom replaced with new plant at a value equivalent to the initial investment. Well-maintained machinery can last for several decades and outlast its full straight line depreciation. This may mean that the employee share in the Contribution Account© increases, giving the false impression that employees have been paid more. It will shift attention to the value-added or the contribution measurement itself. If depreciation is treated as an outside cost, the contribution figure will increase as soon as plant is fully depreciated. This will make comparisons of value-added among companies in similar industries less than fair – not that they were altogether appropriate to begin with.

As mentioned earlier, the determination of the share of reward is not an arbitrary affair; it is governed first and foremost by the customer's needs. Arguments against mechanisation and in favour of labour-intensiveness as a way to alleviate unemployment often fail to recognise this fundamental point. One cannot simply replicate Sasol's production of fuel from coal by getting employees to chew lumps of coal and spit out refined petrol: the process requires highly sophisticated plant – many square kilometres of it. On the other hand, retailers have yet to discover a way of "processing" shoppers through their stores without there being any interaction with an assistant on the shop floor or at the checkout. While Internet home shopping is growing, epitomised by Amazon, fears that it will ultimately destroy the shopping malls are about as well founded as the historic view that the electronic media would destroy newspapers. (I can hear geeks protesting!)

The balance between the requirements of labour and capital and even the make-up of those factors themselves are ultimately determined by what makes sense in serving the customer. Of course many would argue that, because of the keenness for "profit maximisation", there is constant pressure to reduce the employee share and increase the shareholder share. This is true and again reflects the illogical obsession with distribution rather than creation. After all, it is better to have a 10% share of 1 000, than a 50% share of 100.

If we look at the way wealth created is distributed among categories we may conclude that this too is not arbitrary. What is paid to employees will depend first on how many employees one needs – the kind of skills and qualifications required – and the market price for these skills and qualifications. I will argue later that this doesn't necessarily exclude something more flexible than dogmatic adherence to market-related pay. Suffice it for now to say one is not as much in control of the employee share as one would like to be.

One is also clearly not fully in control of the government share, despite all the tax avoidance and evasion tricks tax consultants may pull. The tax is calculated on profits earned and is influenced by the amount of wealth created. Nor would it be wise for government to set company taxes more or less at will. High corporate taxes tend to discourage wealth creation and reduce the total revenue from this source. I*n addition tax evasion/avoidance becomes rife with companies seeking shelter in tax havens.

From the distribution point of view, profits (the wealth that remains after deduction of employee share and taxes) are probably the least controllable by those running or owning a company. The amount allocated to savings is normally subject to what makes sense in terms of the company's plans for the future, and the dividend must meet certain expectations over time. A company that is able to make exorbitant profits will soon face competition and pressure on its prices – unless of course it's somehow protected against competition.

I have examined the VAS's of many companies over a number of years. The distribution ratios (figure 6 above) were based on initial research covering hundreds of companies and then the calculation of an average for South Africa as a whole. The analysis was broadly confirmed by comparison with the make-up of GDP as shown in the South African Reserve Bank's quarterly bulletins, and with research done by other specialist labour consultancies and organisations. In updating the initial findings I found that, on average, distribution had not changed much. I have stuck to the original proportions because the message remains the same and I doubt if further detail can add anything significant.

So the proportions, while relatively accurate, can never be absolute. The same proviso applies in country comparisons. Although I have found wealth distribution to be remarkably similar in some countries, there seems little to be gained from a country-to-country comparison. The make-up of each economy will account for differences in distribution and overrule any other possible conclusions such as inappropriate distribution. As I mentioned earlier, the Contribution Account© may add some legitimacy to such comparisons, but still not conclusively so.

CHAPTER 10
Distribution and stakeholder engagement

Validity of comparisons aside, there are some important messages in what we do know of wealth distribution. The first is the argument I proposed earlier: there is a limit to the extent that any stakeholder can dictate the share of wealth he/she/it desires or exercise control over it. One is seldom in control of what one gets; what one gives is a different matter. In terms of the Contribution Account©, one has more control of the wealth one creates than of the way wealth is distributed. This form of accounting highlights the futility of a conventional focus on wealth distribution rather than on wealth creation – an attitude encouraged by short-term profitability motives and of course the self-interest motive itself, which assesses every action in terms of what's-in-it-for-me.

The second fact about average wealth distribution is that employees by and large are the biggest single beneficiaries of wealth creation. If one views savings differently, and considers only the cash dividend, then shareholders, or owners, would seem to be the smallest immediate beneficiaries of wealth distribution. I have found this to be the case in virtually all the Contribution Accounts that I have examined in client organisations.

When I confront managements with this detail, I am often surprised at how few of them are aware of it; such is the extent to which the Contribution Account© is ignored as an operational tool. Invariably they respond: "Yes! Go and tell them! They get the biggest share and they still always agitate for more!" This goes to show just how deeply rooted is the idea of labour commoditisation, and the assumption that labour's interests are directly at odds with those of capital. It also shows the extent to which the standard VAS has been abused: instead of being a part of on-going communication and information-sharing, it tends to be pulled out of the hat when the company management wishes to make the point that labour already gets the biggest cut. Such misuse of information destroys the messenger and ultimately the message itself.

This was one of my reasons for moving away from the value-added statement format. The Contribution Account© is admittedly not a major reformatting of the VAS. Rather, it simply changes the lens to a relationship understanding of wealth creation and wealth distribution. No doubt some people look upon wealth distribution simply as a reflection of "benefit". But my argument is based on the idea that if an undertaking is driven by the market forces of supply, demand and price, value-added reflects both reward and contribution. To see the distribution components only as benefit or reward is unhelpful and mischievous. If the total value-added or wealth created is a reflection of both contribution and reward, then surely the slices of it must represent both as well.

There is no logical reason to conclude that if wealth created is a measurement of contribution, its components can be seen as representing reward alone. The components need to be seen also as reflecting relative or proportionate contribution. Given the average breakdown of distribution as 45% to employees, 25% to the state, 16% for company savings and 14% as shareholder cash or dividend, one may argue that these elements represent not only proportionate reward but also relative contribution. And in a purely mathematical sense employees are the biggest contributors, and shareholders the smallest. Shareholders become the second biggest contributors if savings are added to the dividend to make after-tax profits. But they are still on average behind labour.

An important caveat is that while statistics may portray an objective state, interpretation is always subjective. This can be unpacked right down to its essence: the difference between value and price. The latter is objective; the former subjective. The latter is purely quantitative; the former qualitative. Any interpretation of wealth distribution relative to contribution will experience the same conundrum. One then simply has to apply the critical pillars of optimum wealth distribution:

- meeting the legitimate expectations of all of the stakeholders and
- encouraging continued contribution.

The best non accusatory way of approaching imbalances is from a **price** perspective either at individual or collective level. It does not serve the cause of sound stakeholder engagement to engage on what people are getting or taking, as opposed to what they are giving or contributing. As always, it is far easier to find common ground in contribution than in reward. The fundamental underpinning and essential ingredient of stakeholder engagement must be empathy and not self-gain.

Armed with the objective interpretation, I do indeed “go and tell labour that they get the biggest cut”. When there are howls of derision, I offer the contribution interpretation, and that leads to a chorus of: “Yes! Go and tell them (the management)!” The divide is sadly obvious. I then go on to examine the very powerful philosophical assumption about the dominance of ownership over labour. And I often stun groups into silence by asking: "Who should control companies, or any collective for that matter: the biggest contributor or the smallest? Our instinct tells us that it should be the biggest. Why then do shareholders govern companies and not the employees?”

Mostly the reaction is: “Because we’re not allowed to” or “We don’t have and aren’t given the skills to run companies”. A more honest response would be: “Because we don’t behave like contributors but like takers, and therefore have no right to govern.” Once when I suggested that, a very shrewd veteran trade unionist at a goldmine responded: “That may be true. But we behave like takers because we’re treated like takers!” Which is perhaps closest to the truth.

To revisit a point I made earlier…it’s as if there is an orchestrated conspiracy to relegate labour to the status of a wage slave. And it seems to me that labour is its own worst enemy here. Those who focus mostly on what they can get out of a situation rather than what they can give, immediately reduce their status to that of a victim.

The above arguments are based on assumptions that even the most broad-minded and compassionate of corporate executives may baulk at; in our experience there’s particular resistance to the idea that employees are bigger contributors to a company’s fortunes than shareholders are. The notion of governance by shareholders is deeply entrenched also in law; it's seen as unarguable. But in our view it ignores the figures and accounting evidence, and makes about as much sense as the fact that Eminem earns a million times more than a teacher does, yet contributes almost nothing to the enrichment of children's lives. As I see it, the monetary success of a rap artist is a reflection of how perfectly the market reflects our imperfections.

Figures and accounting evidence apart, there's a sense in which employees do have more governance of a company than shareholders do. Executives, including the CEO, are as a rule classified as employees and it's only because they are in charge of the day-to-day running of a company that governance rests with them. On the other hand employees take the view that executives govern on behalf of shareholders and therefore the interests of the owners are paramount in any company. Our own sense, however, is that more often than not, executives govern on behalf of themselves, effectively introducing another "estate" in wealth distribution.

The fact is that good companies aren't governed by shareholders, executives or employees, but by the customer. The sooner every money-hungry megalomaniac in any position in a company realises that, the sooner the debate around governance and equitable wealth distribution will be relegated to its proper place as secondary to contribution, service and consequential wealth creation.

If wealth distribution is not arbitrary, is there an equitable norm for distribution? There is, if companies can resist the temptation to behave like adolescents under peer pressure. There's little to be gained from trying to compare the Contribution Account© of one company with that of another. The true value of the Account is to be found in its comparisons with that of previous periods. Because the Contribution Account© so accurately reflects behaviour, the key to optimal distribution lies in the conditions mentioned earlier and deserves repeating:

- meeting the legitimate expectations of all of the stakeholders, and
- ensuring continued and enhanced contribution.

Clearly the two elements are mutually supportive and each is indispensable to the other. It's also clear that the conditions I apply at individual level for inner peace and contentment, apply equally to the success and health of a collective or a company. A company that has low expectations and high aspirations is arguably healthier and more flexible than one where expectations are high and aspirations low. Equally important are the perceptions of reality that each stakeholder group has.

The best example we have in South Africa was the destructive and extensive platinum mine strike, which ultimately culminated in the Marikana disaster where 34 strikers were killed in a police shootout. Some R20-billion had been lost in mine revenue, workers losing some R7-billion of that.

The gold mining industry in SA has been facing the biggest crisis since its 120 year inception. According to the Chamber of Mines, in the past decade one in three jobs has been lost with employment falling from 180 000 jobs in 2004 to around 119 000 jobs in 2014. Mining experts predict that mechanization is seemingly the only future for local gold mining, and there are likely to be fewer jobs and less restrictions on existing ones. A 120 year old industry is at stake because of the perceptions of reality that each stakeholder has!

Here’s where it matters to have effective communication both internal and external. Communication is about much more than public relations or spin; it’s about raising awareness of the reality: encouraging aspirations while containing expectations.

CHAPTER 11
Strategy, Operations and Contribution Accounting

Strategic planning must be one of the most written-about subjects in organisational theory. It's also the one best calculated to excite company leaders – an executive eagerly packs her/his bags to go off to some exotic venue and spend ten or so days designing goals, action plans and outcomes in great detail, down to the role of the smallest operating unit, based on complex what-if scenarios. I suspect many of these people see themselves as war heroes in the mould of Alexander the Great. Indeed the very word "strategic" has military connotations. It is amusing to see the number of company chiefs who see their undertakings as an army, the business environment as a battlefield and the employees as the troops. Is all of it a myth? Collins and Porras in *Built to Last* seem to think so: "*Visionary companies make some of their best moves by experimentation, trial and error, opportunism, and – quite literally – accident*."

The strength of strategic planning also contains its weakness. The urge to design the future, to remove uncertainty, is a natural one. But there is a tendency to sacrifice flexibility in the name of goals, action plans and prescribed outcomes. Conversely, what should be inflexible often becomes flexible, such as having a common purpose, a core ideology and core values. "*A visionary company almost religiously preserves its core ideology – changing it seldom, if ever*," say Collins and Porras. "*Core values in a visionary company form a rock-solid foundation and do not drift with the trends and fashions of the day*."

With this caveat, I am going to assume that strategic planning is more than a game for the top brass, although perhaps not very much more! The conventional wisdom of the 1990s, "short-term profitability for longer-term wealth creation", gives one a big enough canvas. For me the definition of wealth creation is the broader one of value-added, and not the narrow "shareholder value" which was probably implied in the original premise.

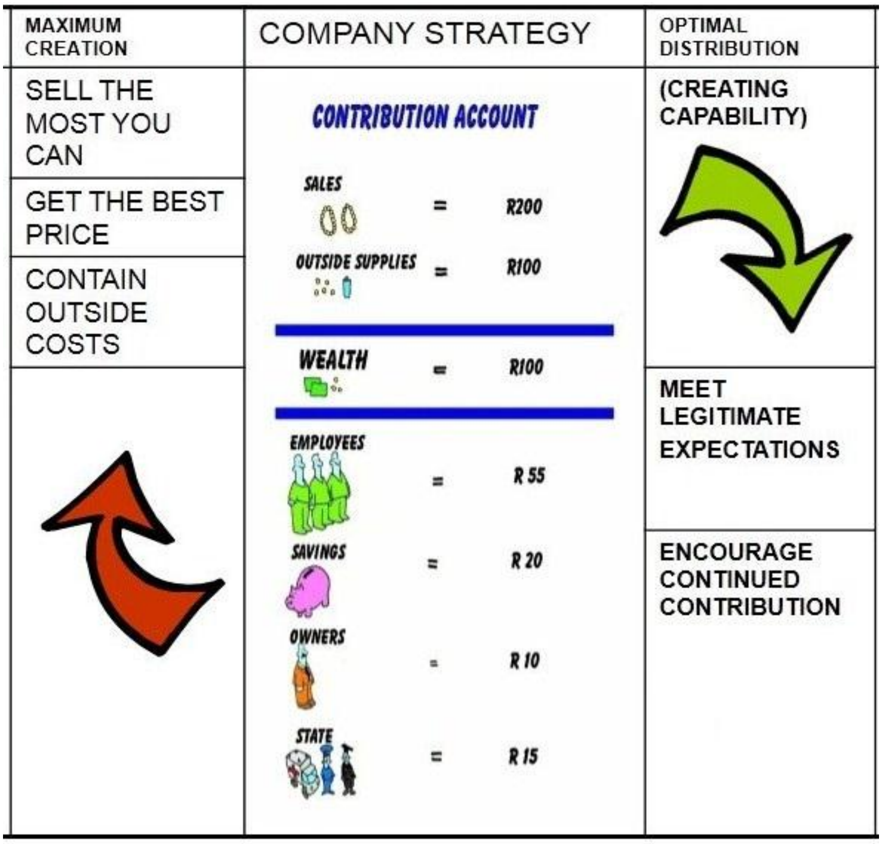
If Collins and Porras are correct, then the focus in a strategic plan should be much more on consistency of behaviour than on outcomes and measurement. Much of the process of strategic planning is questionable because of its heavy emphasis on "what" and "how" rather than on "why". Purpose and core ideology should be the foundation of any strategy, which means that a strategic plan should first of all re-examine mission and values. Many in fact do start out that way. But then the focus becomes blurred as attention is drawn to profit maximisation and away from the need to be market-driven and customer-oriented. One has seen this happen even with well-intentioned programmes such as the Balanced Scorecard and, when it does, an opportunity is lost – a chance to forge common purpose and common fate.

Here again I believe that the fault lies mostly with the final form of accounting, which is the income statement. By its very nature the income statement cannot capture behaviour and is aloof to any purpose other than profit maximisation. Reliance on the income statement as the acid test tends to push the strategic planners towards short-term goals.

It gets worse when the chosen tool is the “reverse income statement”. In this process, one begins by defining a desired level of profit or earnings. The gaps, such as resources needed and their costs, are then filled in to give an indication of sales and income needed. The strategic plan, including the design of a mission, vision and values, is then moulded around that. The fallacy of such an approach must be clear even to a novice. It ignores a simple lesson which most of us learn very early in life: We make plans but life has other plans for us. Life is what happens when we are making other plans. Or better still: the only time God laughs is when he sees our plans. To cast a strategy in the concrete of outcomes is clearly foolish and puts reliance on things totally out of our control. It makes about as much business sense as it does at a personal level.

The revival of the concept of sustainability will no doubt have a marked influence on strategic planning. If it works, the shift will be away from short-term profitability to longer-term wealth creation. My mild scepticism relates to the underlying purpose of sustainability and the means of reflecting this. So far, the disciples of sustainability have done little more than generate more paper and measurements. Without a shift in the underlying purpose and ideological core, today’s efforts at good governance and sustainability are treating symptoms and not causes. One can only hope that the focus on these symptoms will eventually point out the causes as well, in addition to raising questions about the validity of the income statement and “shareholder value” as key drivers.

Figure 8



A sustainable strategy requires appropriate behaviour. Those qualities of contribution that unleash individual potential have to be promoted in the collective. Today more than ever a sustainable company will need the attributes of values-driven common purpose and common fate. The Contribution Account© then becomes by far the superior measurement of performance and the template for a sound, sustainable strategy.

The five elements of maximum wealth creation and optimal wealth distribution create the conditions for perpetual and exponential growth (Figure 8).

Remember, maximum wealth creation means being led by the market to sell the most you can, get the best price and keep outside costs to a minimum. Optimal wealth distribution is about meeting legitimate expectations and ensuring continued contribution. Optimal wealth distribution creates the capacity for service and makes it possible to continuously create wealth in a sustainable way.

Figure 9

Sub-scores	**Max wealth creation**	**Company strategy**	**Optimum distribution (creating capability)**	**Sub-scores**
Creating wealth	• Sell the most you can • Get best price you can • Contain outside costs	Sales R X Outside Costs R Y Wealth Shared		**Distributing wealth**
• OTIF • Quality • Complaints • Throughput Value+ • Market share • Innovation • Waste • etc. • etc.		Employees 50% Savings 25% Tax 15% Investors 10%	• Meet legitimate expectations. • Encourage continued contribution	• Safety • Training • Leader diagnostic • Mentoring • Operational value add • Profitability • Productivity • Bonuses • EVA, RONA, EBIT • etc. • etc.

The depth of the approach becomes clear in unpacking each strategic area into what I call sub-scores (Figure 9). These may also be informed by the scorecards or dashboards designed for use in the Balanced Scorecard. The sub-scores are obviously company- and site-specific. Figure 9 shows a few examples such as OTIF (on time in full), quality measurements, customer complaints, production volumes, TVA (throughput value-added), etc., in creating wealth. Distributing wealth could include training, leadership diagnostics, operational value-added, etc.

There are two categories of sub-scores. There are those that reveal more of the summarised Contribution Account© and which are mostly to be found at company level, and I have called them the Extended Contribution Account©. Those at operational and team level reflect internal activities and efficiencies, and are shown in the Component Contribution Account©. Their use will become clear when I deal with the Contribution Account© as an operational framework.

Most of the strengths of the Contribution Account© that I have outlined earlier apply equally to the account as a strategic template. They were:

- Forging a common-fate focus on service excellence.
- A method of sensibly linking the smallest operational activity to the overall performance of the company in a way that everyone can understand.
- Coherence in all measurements, translating into strategic objectives and the company's mission and vision.
- A practical way of holding people to measurable outcomes that make sense.
- Enrichment of operational meetings.
- An easily-understood convention for employee reporting and information-sharing.
- Forming the base for a flexible pay system such as gain- or fortune-sharing.

As I mentioned earlier, having a common-purpose, market-driven understanding of a company fundamentally affects its strategic approach. There must be absolute clarity about the mission, and people must identify with it at all levels.

Figure 10

Figure 10 is a summary of how one develops a strategy from *Common Purpose; Common Fate*. Because of the simplicity of the concept and the Contribution Account© it is possible to involve a large number of staff at all levels. The final design of the plan will have to rest with a senior group. For the most part the process does follow standard strategic-planning conventions. You will note, however, that I have portrayed vision as the final outcome of the process, rather than putting it up front. I believe this makes more sense because vision tends to reflect a destination, which has to be based on some realistic assumptions to be valid. This reality will become clear at the end of the strategic plan, rather than at the beginning.

From the assertion in Collins and Porras that visionary companies seldom engage in detailed strategic planning, it follows that those that do find it necessary have probably reached the point of inertia, mediocrity and decay. A company with a clear vision and ideological core will seldom need a fresh and detailed strategic plan. At most it will apply such a template to new projects or ventures. The shift away from being profit-driven to being market-driven and the adoption of Contribution Accounting© as the driving measurement may require use of the template, even if it is merely to restate its components from a different perspective.

I have found it useful, before defining the mission, to condense the passionate beliefs of leadership into a superordinate goal. I begin by identifying five points at individual level and then at group level. The five points are discussed and participants arrive at a single overarching concept. If there's more than one, they are prioritised repeatedly until they can be distilled into one. Sometimes one can boil it down to a word: "innovation"; "invent", "quality", "serve", etc., but it could also be a phrase such as "quest for zero defect"; "intolerant of mediocrity"; "determined to add value to others"; "driven by others' needs", "we know the value of values", "transcending transaction".

In many cases the result may appear to be a cliché, or a statement associated with another company. As long as the result represents a concept about which all are or can be passionate, it's easily reworded. It needn't detail the product or service offered. The result of this exercise is moulded into a slogan that represents the superordinate goal of the company, which in turn will inform a succinct mission statement. I have found it useful to invite suggestions from the general staff and there are usually enough repetitions or similarities to make the conclusion obvious. General and sectorial scenarios from external experts can usefully augment the process and bring us to the next step: market identification.

Each suggestion for creating more wealth is tested against its impact on the Contribution Account© and critical components such as those of wealth distribution, capital expenditure, outside costs, etc. A final prospective Contribution Account© can then be used to inform the standard actions of a strategic plan such as the SWOT (strengths, weaknesses, opportunities and threats) analysis; the BHAG design (big, hairy and aggressive goals); action plans and deliverables. From this a realistic vision can be extracted. The important advantage of strategic planning based on Contribution Accounting© is that it can draw all in the collective into common purpose and common fate. It does so without compromising the norms of sound planning and business sense. More importantly, it does so while encouraging values-driven behaviour and transcendent transaction. And it is based on thoroughly unpacking of the appropriate relationship between parties.

Operational and process improvement is another subject in organisational theory that has consumed lakes of ink and mountains of print cartridges. A new managerial science grew out of previously spontaneous and sporadic process and operational innovations, and its development can be traced back to just after World War II and the emergence of management guru's. For decades thereafter and perhaps still largely today, the understanding of management has been based on the concept of "managing resources" within a given environment such as team, division or company. These resources include the human resource.

There are so many techniques and practices, a large number of them branded and franchised, that to delve into even a few would be beyond the scope of this book. They include Total Quality Management (TQM), Six Sigma, Seven S, Continuous Process Improvement, Theory of Constraints, Self-directed Work Teams, 20 Keys, Integrated Management Systems, Work Structure, the Balanced Scorecard and hundreds more. On top of that, some of the world's biggest company turnaround brand-names such as McKinsey; SAPS; KPMG and BAIN, have become embroiled in corporate malfeasance including corruption in big South African SOE's. The most charitable thing one can say about them is that they undoubtedly work – for a while.

The array of branded approaches encourages the consulting industry to claim a uniqueness of insight that surpasses others. This is the fallacy. No structured process will last beyond a few years if there aren't many more critical elements in place. And almost any process will work if those elements are in place: empathy, common purpose and common fate. The danger of structured processes and approaches is the same as that which has bedevilled the entire field of macro-economics. It is the view that the human spirit can be shaped by systems; that structure, systems, processes and policies determine our behaviour. Too often I have witnessed the tragic consequences in companies that subject themselves to one or other outside-driven re-engineering intervention where the structure is transformed and people are expected to fit in with it. The much wiser approach, and one with lasting effects, is to change the hearts and minds of people and then force the structure and processes to fit in with that.

Most of the operational-excellence "franchised packages" that waft across the oceans to find fertile soil in countries where their track record is less known, are based on a promise of weight loss without dieting. The package often becomes an end in itself and not a means to an end. Even if the end is implied it's seldom clearly defined as an overall common purpose, let alone a serving purpose. Also, the links between the routine requirements of the process and serving the common purpose are lost. Often there is much hoopla and hype around these processes – competitions to find "the best team to achieve Key 19", and so on. For months nothing else is talked about, until someone becomes bored with the "stuff" and starts to wonder if the emperor is actually wearing any clothes. We're suckers for fads and it's relatively easy to instil new flavours of the month into a collective. But until the meaning behind the form is fully revealed, understood and championed, the form will decay and die. Without meaning no form is sustainable.

I'm acutely aware that the Contribution Accounting Methodology© or CAM©, is itself such a package or turnaround tool-kit. Apart from the fundamental difference in approach, the tool kit itself is so designed as to be completely transferable and can be wholly self-driven. In hindsight and with the fraying of fanaticism, organisational theory has come to appreciate that "what" and "how" are always incidental to "why". Indeed, any process will work if it is there to support common purpose and common fate. Contribution Accounting© is compatible with any of these templates. If a piece doesn't fit, it can easily be made to. The real power behind Contribution Accounting© is the alignment of relationships, expectations, aspirations, understanding and commitment to a serving common purpose and common fate. This will impact in a chain from individual behaviour to country behaviour.

Clearly, behaviour change implies different activities at different levels. It's important for behaviour to change at an individual level independently of any coercion, manipulation or social engineering. The point of my non-systemic approach is that real and lasting change comes from inner individual conviction and not from external forces. This is not as difficult as it may appear. Our experience in the use of various tools at many levels has shown that such a change is indeed possible. Realignment at even one or two levels already has a marked effect. In all of our workshops I have found a natural inclination on the part of the individual to subscribe to contributory behaviour; most people spontaneously buy into the concept that service excellence is synonymous with excellence in the self. It is useful to apply four questions to the different levels in a collective:

- attitudinal changes needed?
- the process of achieving these changes?
- what would be measured in Contribution Accounting©?
- what tests would be applied to assess adherence?

At a personal level, the first and obvious task is to change one's habits. Volumes of motivational material exist to help one achieve this. Our behaviour as employees will show little genuine change if there hasn't been at least some change at a personal level. Yet our professional activities are easier to work with because the criteria are clearer cut. The behaviour shift leads to an understanding of meaning behind form, and of the link between the task and the company's overall objective in terms of service. Processes for achieving this are now more readily accepted by companies and would include service-excellence workshops and other customised company interventions. The Contribution Account© would reflect design of standards, adherence to standards and appropriate accountabilities. It also becomes possible to design tests for adherence to behaviour agreements (SLAs or Service Level Agreements), Customer Relationship Management (CRM), and Employee Relationship Management (ERM) standards.

At team level, forging the link to company purpose is part of effecting behaviour change. Servant-leadership models that include appropriate accountabilities are an important ingredient. Processes of implementation could include workshops, team-building exercises, coaching and servant-leadership training. From an organisational point of view the team is perhaps the most important link to overall *Common Purpose; Common Fate©* alignment. Of particular significance is the team meeting, where agendas can be set for reinforcing service concepts and contributory behaviour. The Contribution Account© can already come to life at this level. In some cases, with appropriate and consistent transfer pricing it may be possible to reflect a full Contribution Account© at a team level.

At some of the sites I have worked at, there was a strong desire to create a full Contribution Account© for teams. I often cautioned against it. The requirement of valid and consistent transfer pricing in which central or company costs can be allocated to teams is a major obstacle and has frustrated many an attempt at clearer "value-creation" measurements at team or sometimes even divisional level. Without it the measurements become meaningless. The difficulties in applying such measurements to support functions such as human resources departments and accounting functions are legion. Yet wherever possible such measurements should be explored. They become more appropriate when they are expressed in values rather than in volumes. For example, a team producing a record number of widgets has added little value if they had to be sold at a loss.

What is at least possible, relatively easy and desirable at team level is adherence to team goals. Team scores also form the heart of the Component Contribution Account© and acid tests include wealth created (if possible); CRM, ERM, efficiency measures, innovation measures, training and development and servant-leadership criteria. A shift of measurements from profit/loss and production volumes to value-added and contribution measurements sets the foundation for an overall shift in company behaviour. If it doesn't happen here it's unlikely to have an effect elsewhere.

Desired company behaviour is contribution based on common purpose, common fate and common values. Establishing these principles would imply an alignment of strategy and structure. Further elements are adoption of a service excellence model such as the Service Gaps model as a strategic and operational template. Executive coaching and executive mentoring are key elements as well. The Contribution Account Contribution Account© should become the focus of all activities and the Extended Contribution Account© the guiding template for strategy and operations. The Extended Contribution Account© is a breakdown of the key categories of the Contribution Account© itself. For example, turnover can have sub-categories for geographic regions or other relevant sectors.

The tests applicable at company level answer most of the concerns one may have about using the Contribution Account as the key driver. For example, typical shareholder measurements such as HEPS, EVA, RONA, the income statement and the balance sheet are all contingent on wealth creation. They become critical tests of sound wealth creation, but are no longer the exclusive purpose of the collective. Indeed they shouldn't rank higher than, or undermine the importance of, other tests such as wealth creation itself, indices of customer satisfaction and employee satisfaction and market share.

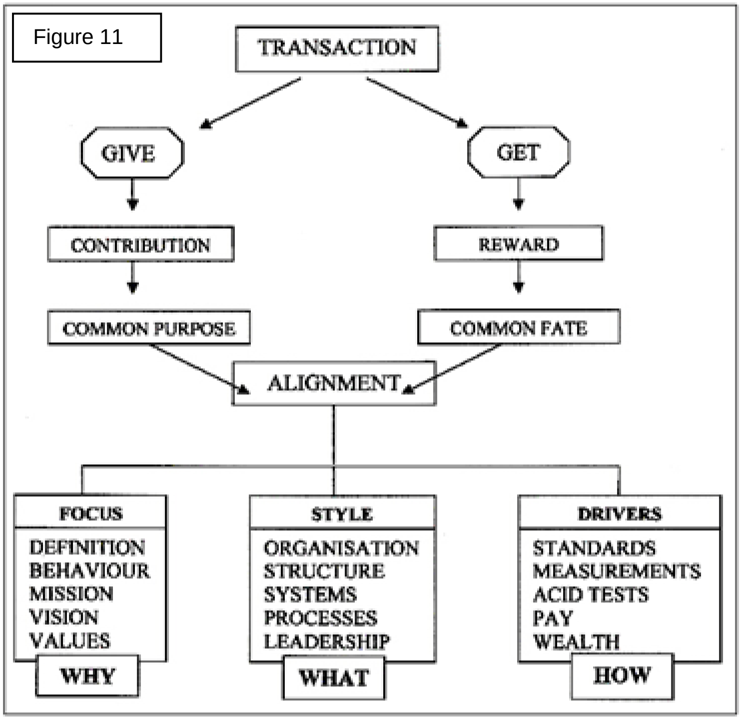


Figure 11

A graphic illustration of the above linked to legitimate transaction may look something like Figure 11.

When hearts change, minds invariably follow. When minds change, our behaviour and habits change. When this happens to a company it affects everything from mission to organisation and measurements. Consulting has always been about selling solutions, not packages. The beauty of changing behaviour is that it can be done piecemeal and in stages until a critical mass is achieved. There is no prescription in terms of where change should happen first; all that is needed is a commitment by the company itself to its overall intention.
Changing the dialogue in companies will really entrench contributory behaviour and commitment to common purpose and common fate.

"'I get more because I give more' is often heard in our warehouse."
Lynette Anderson: CEO Sanderson Special Steel.

"Changed the politics in Dulux. Focused everyone in the business on the contribution they can make. A common focus across the business on behaviours which create wealth for all stakeholders was established."
Charles Betts: Dulux.

"*Following the introduction of a common purpose; common fate approach in the organization, this Business and Operational Overview has been structured on the basis of the five strategic pillars of maximum wealth creation and optimal wealth distribution*."
Israel Noko: CEO Npi Governance consulting.

CHAPTER 12
Common Purpose and Inspired Service

“Service excellence” must be one of the most overworked clichés in business, closely associated with what I call smile courses. Our own orientation workshops have moved away from these approaches because they merely cover “what” and “how”, and these are not sustainable if the “why” is not addressed first.

To excel means simply to exceed the expectations of the other involved in the transaction. This could involve a number of techniques and it’s useful to know them. But consistency is what is really needed if one is to earn a reputation for good service, and this is going to involve much more than techniques or skills. Today’s excellence in the customer’s eyes becomes tomorrow’s norm. But nobody can be expected repeatedly to exceed expectations; no athlete can break records every time. The least that one should do, however, is to keep up the standard one has set.

There is another sense in which the cards are stacked against excellence. As a rule, expectations in a competitive environment are high, so the room for error is restricted. Advertising by nature creates Samuel Johnson’s “large promise”, a promise which in the customer’s experience is seldom fulfilled. In addition, research has shown that buyers generally don’t tolerate suppliers who fall short of expectations. But it’s rare for them to acknowledge that someone has exceeded their expectations. Perhaps this is because most people are by nature quick to complain but slow to acclaim. There is evidence suggesting that if a customer’s expectations have been met or exceeded, she/he on average will tell three others about it. But if the expectations are not met, 12 others will get to hear about it. If you add social media to that process today, the multiples must be hundreds.

The problem cannot be addressed by any one technique or skill alone. We have to get our hearts in the right place. The “why we serve” speaks to the heart. Ultimately, service excellence and excellence in the self are the same thing. The consequences of a gap between expectations and reality apply equally to a company and to an individual, and even at a national level. If expectations exceed reality you will have anxiety and discontent. If reality exceeds expectations you have peace and contentment. Insights such as these led to the development of the Service Gaps model by V A Zeithaml, A Parasuraman and L L Berry in the United States in 1990, and its further development into the Extended Service Gaps model. To this day we use it often in our work, and I have found almost no way to improve on the practicality of detail and the simplicity of its logic.

Like all templates it can be taken to extremes and become little more than four walls covered in brown paper. I am including a short summary of the model in this work, although it is so widely known and applied that academic institutions and consultants use it as a basis for their work. Many instruments and extrapolating templates have been developed from the Gaps model for a variety of industries and undertakings, including small businesses.

The model requires a keen understanding of customer expectations. Surprisingly quite a few companies do not do this basic requirement thoroughly. This neglect accounts for many a failure in small business. Being market-driven means that the customer's needs and wants are intimately known. The fact that you as a supplier have identified their needs (or think you have) is of little use unless the customer shares your view. I have found it helpful to arrange customer expectations under five broad and mostly self-explanatory headings: **tangibles, empathy, assurance, responsiveness**, and **reliability**.

While the Gaps model is aimed at improving a company's relationship with its customers, I find it handy in getting individual employees to think about areas where they can make a difference internally as well as externally. The five categories are certainly helpful although they are not part of the Gaps model design. I suggest to employees that after every interaction, whether with an internal customer or an external customer, or for that matter in their personal lives, they should test the experience against the five categories.

"*Pretend that every single person you meet has a sign on his or her neck that says, Make Me Feel Important. Not only will you succeed in sales, you will succeed in life*."
— Mary Kay Ash.

Tangibles are things that people can feel or touch, like that chocolate on the pillow in a hotel room. They become more meaningful when they are unexpected and not routine. After attending one of our programmes, an IT technician developed the habit of not only ensuring that every computer he was asked to repair in the organisation was spotlessly clean but also of leaving a mint on the keyboard. This was totally unexpected. Someone in a call centre of an insurance company was asked for a copy of a policy document and on discovering that the person lived in an area she had to pass on her way home, she delivered the copy personally. I know of a pharmacist in a local community who sends her customers a "get well" card after they have come in for prescribed medication. Clearly no-one questioned these acts on a cost/benefit basis.

Empathy is the one quality that cannot be rehearsed and depends very much on motive and deeper intent. From a supplier point of view it's the foundation of all categories of service and is based on the principles of customer understanding. Customers on the other hand often experience "empathetic behaviour" as overdone and rehearsed. There is a large computer retailing chain in South Africa that recruits IT students to man the shop floors and they obviously receive commissions based on purchases by customers they served. You can imagine how a customer must feel on entering the shop – like prey being hunted. Ironically, it leaves little space for impulse purchases from relaxed browsing, which many interested in the latest software programmes and games like doing. *Responsiveness* in this case is destroyed by lack of empathy.

The *assurance* category has to do with reputation in a broad sense, such as branding, customer perceptions and general image. *Responsiveness* speaks for itself but it's one where the potential for showing true empathy and service is often missed. Your most troublesome customers are your best customers, as long as there is good reason for their agitation. They are your real inspiration for continuous improvement. Few customers will take you to task for the occasional problem. The way you respond will determine their assessment of you. Service commitment is tested not in the routine but in the unexpected; as with Johnson & Johnson in the Tylenol case, the unexpected is the one area where all considerations other than the customer's interest go by the board. South African suppliers are often amazed at how low the country ranks in terms of service. The feedback is stifled at source because South African consumers are rather placid and apathetic.

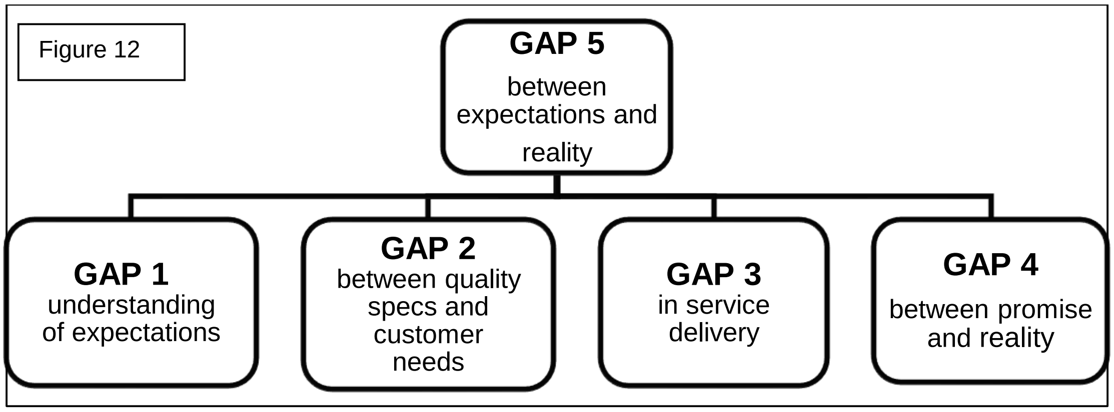
"*You should spend more time on customer complaints than you do on your financials"*.
— Bill Gates: "Business at the Speed of Thought"*.*

Reliability is closely linked to responsiveness, but perhaps with a greater emphasis on consistently getting it right first time.

You will have noticed overlaps among the broad categories of customer expectations. Their power lies in identifying your customers' specific needs, and this very quickly gives you a feeling for what your mission and operational strategy should look like. For example, research in the airline industry ranked passengers' need for reliability far higher than assurance. Reliability would cover meeting arrival and departure schedules. Assurance obviously covers safety. You would think that safety is more important to a passenger than meeting schedules. It obviously is. But it's also a given. For an airline repeatedly to emphasise its safety in its advertising may well prove counterproductive. Tangibles ranked the lowest in this research. Yet it is surprising how many airlines used to spend a lot of time and money on cutlery and crockery on their flights. Fare-cutting has tended to lessen this fixation.

A while ago, some controversy had arisen in South Africa around emergency health care. There was a broken link in the chain between the providers of ambulances and helicopters, the medical insurance companies, and the hospitals and institutions. It's a fairly complex issue to do with the costs of health care and affordability by the average patient. What makes the situation bizarre is when a medical practitioner appears on TV in front of a framed copy of the Hippocratic Oath explaining that failure to despatch a helicopter as opposed to sending an ambulance by road was "a business decision". What it says is that the "business sense" of showing empathy in what is after all the most important customer requirement in health care, probably never featured in the grand strategy sessions of companies in the industry.

Figure 12



The Gaps model (Figure 12) is a simple way of showing the difference between expectations on the one hand and delivery or reality on the other. Gap 5 is an accumulation of four other gaps.

Most of the causal gaps are self-explanatory and since this inclusion is intended as a mere introduction to the model I will refrain from a detailed explanation. What may be useful is to show the components of the gaps that have been developed in the Extended model.

Gap 1 is normally to be found in market-research orientation, upward communication and levels of management. Gap 2 emanates from management commitment (or lack of it) to service quality, goal-setting, task standards and perceptions of feasibility. Gap 3 is organisationally based and is to be found in areas such as teamwork, employee job fit, technology job fit, perceived controls, supervisory control systems, role conflict and role ambiguity. Gap 4 relates to horizontal communication and the propensity to over-promise.

The Extended Service Gaps model is clearly a very useful strategic tool for ensuring and improving service delivery. It is especially apt when people who have been converted to a service culture are looking for ways to ensure that the culture will be supported technically and systemically. For our part we exposed general staff to the model simply to guide them on what to look out for. I then asked them to respond to four or five customised points such as:

- What we should do to develop and promote a service concept.
- What we need to do to get closer to our customers.
- What we need to do to enhance our image and meet these expectations.
- Things that can impede or improve service delivery.

In most cases I found that even in companies with a good service record, these exercises produced a wealth of new ideas and critical comments. Not surprisingly perhaps, the huge bundles of data very often fell off the hierarchical escalator, showing that Gaps 1 and 2, which place the onus on senior management, were the more difficult ones to close. The model doesn't have to be the basis of a battle plan for "invading Spain". I encourage feedback in all our work, including "business awareness" programmes for barely-literate employees, and although the feedback can be easily related back to the model, even that is not essential.

In one such programme we were getting feedback from a group of fitters for a tyre-dealing chain. One participant suggested that tyre-fitters should be allowed to contact the car owner a day or so later to check whether she/he was happy with the service. A manager who had been observing the process nearly had a fit. "You know how much I already spend on useless phone calls!" he shouted.

In training at a call-centre group, participants told us that customers were being neglected because the employees were paid by number of calls rather than the content of calls. The management refused to accept this as valid feedback, pointing out that calls were recorded and randomly checked to ensure empathetic interaction. The fact that there was a gap between their perceptions and those of the people actually performing the task didn't strike the management as particularly significant.

What also escaped their notice was that only a relatively small proportion of calls were checked for content but all calls qualified for payment in volume terms, so there was an automatic loading in favour of quantity rather than quality.

I also discovered that the quality checks were done by senior people who very often had different interpretations of correctness. One cannot blame them: it's difficult to listen to someone else's conversation and make a completely objective assessment about degrees of appropriateness. Last but not least, I discovered that the quality controllers paid nearly exclusive attention to what the operator was saying and very little to the response of the caller. Apart from skewing their judgement, this also caused them to ignore an important body of customer satisfaction data. All of these things were ultimately addressed.

I firmly feel that the richest and most reliable source of customer information is in the organisation itself. Market research companies have their place but the gathering of really useful customer feedback is best done in the moment, by the people who are in the front line and dealing with the customer daily. I know there is an immense difficulty in ensuring honest feedback. It will only be possible if recognition of honesty exceeds recrimination for a mistake.

The accuracy of outsourced customer surveys can also be questioned. For the most part they rely on questions designed by the client but then not controlled in terms of how they are put to the client's customers. The other shortcoming is that any interaction that is recalled more than a few days after the event is bound to be severely flawed and short of essential detail, especially the emotions that may have been present. And we all know how we tend to react when called by some market research interviewer: "Get on with it! Supper is ready."

Much of our modern interaction with companies is becoming remote. The Internet has already eroded personal service and human contact and of course electronic responses have become the norm in a large part of transactional interaction. Calling a large company in South Africa can be quite hilarious at times. The increasing encroachment of R2D2s on our lives is probably unavoidable. Its effects on humankind in terms of a constant acceleration of life's treadmill have yet to be determined. The sadness of it is that every face-to-face human contact is an opportunity to transcend transaction to demonstrate genuine care and a desire to serve, and those opportunities are being lost. You simply can't connect with people through electronic interaction, pre-recorded messages and rehearsed behaviour. The language of the heart does not brook intermediaries.

CHAPTER 13
Leadership and service

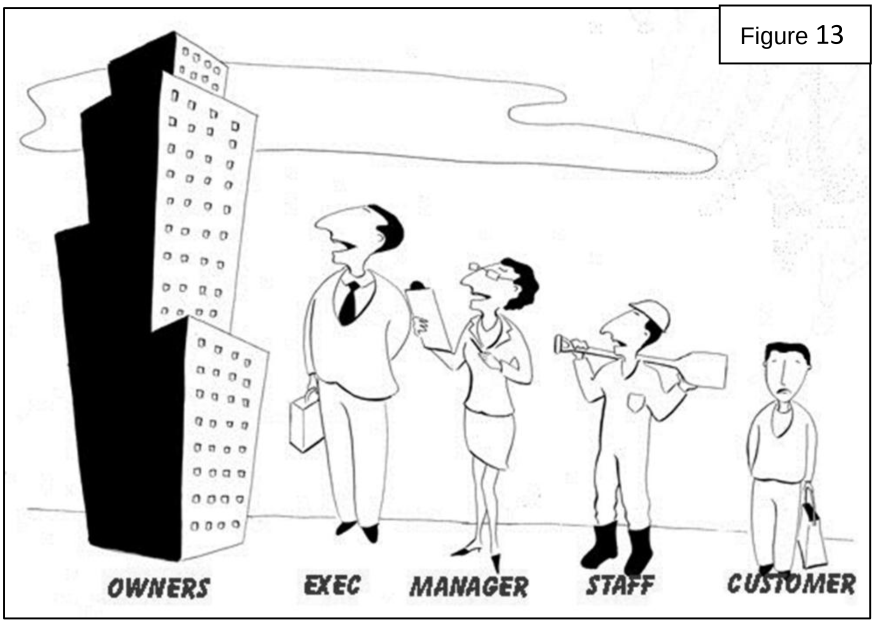
It's as if there were a huge plot to demean the role of the employee. Everybody and everything is part of it: employees themselves, the trade unions, the stockholders, the accounting conventions, and the economic philosophy and system. The conspiracy is about categorising labour as a cost, thus ensuring that employees by and large focus on what they can get and not what they can give. An employee is almost automatically defined in terms of – and confined by – what's-in-it-for-me.

The plot succeeds time and again. Invariably during our workshops someone wonders aloud: "Why should I bother? Nobody else behaves in the way you're suggesting I do." Our response is: "Aren't you lucky. You've been given a secret formula that will set you above the rest. Go and try it!"

And for a while I have released my own version of Don Quixote, set him free to charge at corporate windmills. In some cases it lasts. Nothing is more satisfying than getting a call from a participant years later, saying that his or her life has been changed. And often enough I hear from supervisors who report that they have seen a permanent change in employee attitudes. That alone makes the effort worthwhile.

The employee/resource/cost/drag phenomenon is related to the way I view the hierarchical people structure of an organisation. A former South African labour consultant, Ian Fuhr, used a role-play exercise that I adopted in our own workshops. I call on participants to come forward and stand in a line to represent the "main actors" of a simplified a modern organisation.

Figure 13



The representation (Figure 13) is based on the understanding that the ultimate purpose of a company is to serve the stockholders. We all recognise it as a "self-serving" structure, where each role player is bent on maximum reward in return for homage to the one above. The relationship between the stockholders (JSE) and the executive or “boss” is forged on that principle: the boss is in fact the servant of the owners, i.e. the shareholders. As the chief servant he/she will hold subordinates accountable for various aspects of an overall performance that will enhance maximum shareholder value. No doubt this servant-boss has a profit-driven incentive package and has been given a bundle of shares in the company, and will therefore be inclined to focus on the short term and on the easiest way of effecting a rise in the share price.

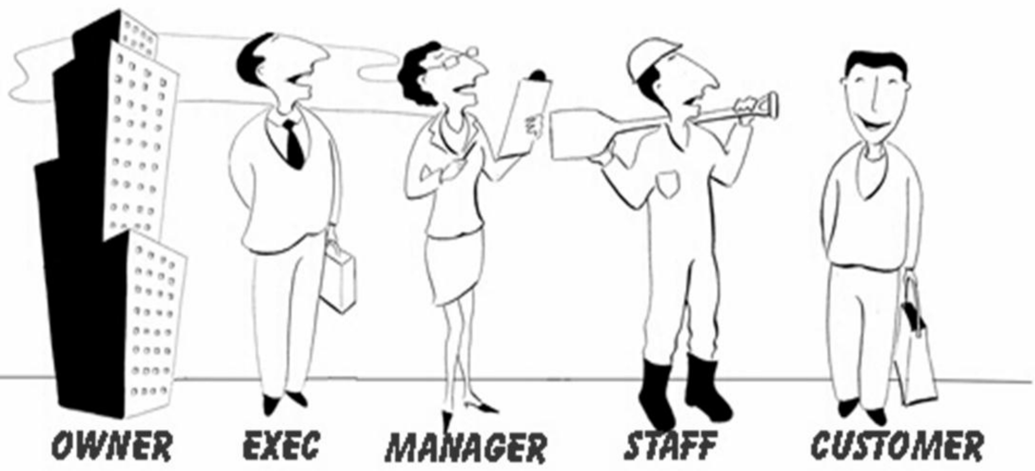
Customer service will be one of the performance areas, but not necessarily the dominant and overriding one. It’s an unfortunate fact that the easiest way to improve the bottom line is by “cost-cutting” (in which the payroll is probably the biggest factor) and account-fiddling or paper-shuffling. The longer and more risky route is to increase market share and sales.

With strong overt or covert directives coming from his superiors, the supervisor’s domain is filled with the same incentives, measurements and accountabilities. He is also likely to be drawn into one or other profit-driven bonus programme.

Depending on the type of business, there’s a shift in language at the level of general employees or workers. Here, functional accountabilities have more to do with standard customer-linked measurements such as quality, complaints, etc. In view of a more direct and visible link between functions at the operational level and customer service, smile courses are held. But they are of little use in breaking the mould. The measurements are still seen as a way of satisfying the supervisor and the employee still sees his or her role as “serving” the one above. In most of the organisations where I have run our Service Excellence programmes I have continually come up against this way of thinking. The overwhelming weight of language is about profit and costs: they are what the financial information shared with employees is about.

I consulted to a tyre-dealing chain at one time. I decided to test the attentiveness of employees. At a particular shop where I was unknown I brought in a flat tyre to be changed. The employee doing the job was called first by myself, whom he thought was the customer, and then by his immediate supervisor. The employee barely gave me a glance before going to his supervisor. As trite as the experiment may have been, it showed that most employees see themselves as serving their bosses first, and serving the customer only as a means to that end.

Figure 14



When participants see the first role play they almost immediately clamour for the line to change direction so that the whole operational line is seen to be facing towards the customer. (Figure14). This raises two main issues: the position of shareholders, and who serves whom at the operational level. The justification for the shareholders' behaviour – the kind that has been argued for incessantly in terms of the capitalist model – is that they will and should be interested in maximising profits. An operational CEO would have to be very brave to turn his back on the shareholder and face the customer, and be prepared for times when a short-term customer interest and shareholder interest are in conflict. Few CEOs have the courage to make the turn and to cease to align their own short-term interest with those of stockholders and stockholder value. When stockholder interests are made secondary to customer care, it is usually because the owners have aligned themselves with the customer.

The customer-focused organisation will be at its most powerful when stockholders see themselves primarily as part of providing service in the supply chain. This may seem strange, but it fits in with Warren Buffett's view on what makes a good investment – "our best holding is forever".

More and more nowadays customers are passing judgment on companies that defy social norms. Stockholders are customers too. And they cannot fail to question their holding in a company that has given them or the community bad service. In South Africa in particular, labour unions have begun to exercise power by way of their pension funds' investment in the stock market and are demanding greater accountability regarding labour matters. Government organisations such as the Public Investment Corporation are also becoming more particular about where they place their billions; their decisions are based on more than shareholder value. One might argue that if they concentrated on investing in customer-focused companies, the other issues would take care of themselves. There is a link between being values-driven, customer care and governance issues. I will discuss this in greater depth when examining the matter of shareholders' paramountcy.

Having dealt with the effects on the shareholder of reversing the direction of the line, we should now look at what happens at the operational level. If we allow the general employee to become fully comfortable and entrenched in his or her function of serving the customer, what becomes of the supervisor, the middle manager and those further up the line? The direction of the line makes it obvious: their role is to "serve" the subordinate. Service in this context has a very specific meaning: it's about creating the conditions in which employees can give of their best all the way down the line to the ultimate receiving end: the customer. This ties in with the idea that true value lies in a person's capacity to make a contribution to someone else's wellbeing. Ultimate empowerment is about giving a person the means to serve. This is also the recipe for *more meaning*: empowerment; coaching and mentoring; training opportunities; honesty and transparency; promotion and advancement.

The concept of "servant-leader" developed by Robert K Greenleaf in the United States in 1970 is today a powerful ingredient of sound leadership. Larry Spears, the executive director of the Greenleaf Centre for Servant-Leadership in Indianapolis describes the servant-leadership model as "one which is based on teamwork and community; one which seeks to involve others in decision making; one which is strongly based in ethical and caring behaviour; and one which is enhancing the growth of people, while at the same time improving the caring and quality of our many institutions".

Greenleaf's servant-leadership model is implicit in an empathy model, without going into the same detail of accounting as I have done. Servant-leadership on its own cannot work in an environment where the collective itself is seen to be motivated by self-interest, or what I would call profit-making purpose. One is then using "benevolent" means to a "malevolent" end. The concept of servant-leadership today is even more valid than it was in the 70s when Greenleaf first developed it. It is an important tool for alignment throughout an organisation, of common purpose; customer- and market-driven behaviour as opposed to profit-driven. It says much for the importance and validity of the servant-leadership model that it was able to survive the "greed is good" 1980s and the corporate scandals of the 90s and this decade.

Recent years have seen a clear definition of the difference between leadership and management. One leads people, the other manages things. Granted, much of the latter falls into the province of leadership, but both must have as their end aim the enhancement of service to the customer. This will ensure, more than anything else could, that employee empowerment will be advanced, and that operations run as efficiently as possible. To suggest that all tasks and functions are there merely to enhance the growth of employees or managers is as vain as saying that companies exist to exploit customers for their self-enrichment.

Leadership then has two fundamental tasks: to establish or entrench a visionary purpose and mission in a collective to serve others; and to ensure that all in the organisation are willing, committed and able to share in this mission. It must do so by personifying everything that the company stands for.

"*What I do best is share my enthusiasm*." — *Bill Gates.*

The only purpose that can be shared easily by all members of a collective is one that is clearly based on a contribution to the rest of mankind. This simply means serving the market. I will argue the point further when examining companies.

A mechanism to ensure adherence to the leadership task of enabling others to serve needs a set of accountabilities for the leader. This amounts to a checklist of whether she/he has ensured that subordinates have both the means and ability for the required tasks. If that has been done, then the subordinate, and the subordinate alone, is accountable for the performance of that task. If the subordinate fails, accountability shifts back to the supervisor or indeed to the next level up if it were found that the supervisor did not have the means or abilities.

This procedure ensures that accountabilities are correctly placed, and that people are held accountable for things within their control. Applying the principle throughout the organisation introduces an important perspective of fairness and justice. It is simply not fair to hold people accountable for things out of their control. While there may be some blurring of categories, “means” by and large are the physical tools and aids one needs to perform the task. This would include the time to do so. Ability includes skills, knowledge, awareness and those important aspects I mentioned earlier that give meaning to someone’s work. The “why” of the job is perhaps the most important of all.

If the heart is in the right place, the mind will follow. In today’s world it is very tempting to commit as much as possible to writing, like a job description, task lists with minimum-outcome requirements, or service-level agreements. Often these are prescriptions for mediocrity rather than excellence.

Given an alignment of individual behaviour that consistently explores ways of helping others to release the best in themselves…an alignment in which a company or collective remains alive to the possibilities of better service…it is unnecessary for the individual spirit to be shackled by what is on paper, or even tacitly assumed. Employee willingness to be creative and entrepreneurial should be included in a leader’s accountabilities.

A final question that the “turning of the line” raises is who should turn first? Does it matter? Everyone has the freedom and ability to turn within his or her field. Nothing prevents an employee from going to work determined to act in the interests of the customer, whether internal or external. A supervisor can change his or her approach to the job without waiting for his boss to change. Most believe it must be the CEO who turns first. In other words, we wait for someone higher up to make a move before we take our own destiny in hand. Interestingly, I have found that changing focus is easier at the employee level. That is mostly where customer service happens in any case.

A bit of legend in Pick ’n Pay came to my attention while training in the group. Like most anecdotes it has probably been embellished over the years, but the fact that staff still talk about it shows the depth of service culture within the organisation at the time. There was a “merchandiser” in a small store at a resort town on the South Coast of Kwazulu/Natal. She had been working there for a number of years and had formed close relationships with certain regular customers.

One such was an old lady who once came to the store looking for curtain rings. The store had none on the shelf and she asked if there were any in stock. On finding that they had run out of the item, the merchandiser decided to pop over the road to a hardware store that she knew had them, although at a higher price. She asked the store manager for a few cents from petty cash to buy the item from the hardware store. The manager berated her for breaking every rule in the book, including a simple business principle of not buying something to sell for less. She went across the road, bought the item with her own money and left it at security for the customer to pick up on her way out. She was rewarded with a trip to Disneyland.

So it is quite possible for leaders themselves to “jump the queue”. A good example is that of Postal Services C.E.O., Mark Barnes. After taking over the massive task of social grant pay-outs, Barnes personally visited pay-out sites to witness first-hand the experience of recipients. He immediately introduced changes to make that experience more comfortable – including seating for the elderly and ensuring that all pay-out points remain open until the last beneficiary had been paid.

Many books have been written on leadership and sub-categories such as coaching and mentoring. The key attributes of good leadership lie in an outward-looking vision and a way of dealing with one’s followers that brings out the best in them. This can only be achieved by nurturing a willingness and capacity to serve. At the same time, leadership icons of the past and present and the plethora of books and articles on leadership today, call in question the validity of any single definition or prescription of good leadership. It can be as broad as “someone who makes a difference” or as narrow as the “care and growth” of subordinates. It is very likely that history has had many leaders of great vision who had little regard for their subordinates’ welfare and probably as many who had little vision but managed to release the best in their subordinates.

CHAPTER 14
Communication and Contribution Accounting

Sound communication starts at an interpersonal level and is the keystone of effective leadership. I am going to limit our scope to communication within the collective or company and merely touch on aspects of external company communication, also sometimes called corporate communication. The two dimensions of corporate communication that I will touch on are external and internal; and we'll look at how Contribution Accounting© can be applied to both; but with emphasis on the internal activity.

Corporate external communication is itself a very wide subject covering branding, advertising, promotion, customer relations, investor relations, government relations, disclosure, transparency, sustainability and governance. Most companies make a clear distinction between "selling" such as advertising and promotions on the one hand, and social and statutory communications on the other. Communication as a whole has undergone revolutionary change with leaps in information technology and the pressing need now is for a change in terms of content. Demands for greater disclosure are increasingly focused on areas previously viewed as sensitive. This has created the danger that information is taken out of context, and huge efforts are then needed to put things into the desired perspective. At a time when most people are prepared to believe the worst about companies, the only real beneficiaries in the frenzy are sensationalist reporters, spin doctors and public relations consultants.

Of course the battle rages over a much broader front than individual companies. The real challenge for spin doctors is not to cover up or repaint the ugly face of capitalism but to reveal the real face, the kinder, generous and values-driven face implied in everything I have written so far. Making a reasonable profit is acceptable, indeed crucial. Preoccupation and obsession with profits are not. They are obscene. Not even "reasonable greed" should be excused in a values-driven business society. There is no such thing as a reasonable rascal or rogue. Any defence of bad business behaviour on the grounds that "the business of business is business" is becoming increasingly unacceptable.

The three important dimensions of communications are why, what and how: in other words, purpose, content and technique. It is clear that all three have to be seriously considered in each case. Technique has a tendency to overwhelm the others. This is certainly true in advertising. Multi-thousand-dollar productions are the norm in advertising, particularly in the electronic media. While the agencies may win awards for their thirty second epics, consumers are often left confused about what the message was, or who or what was being advertised.

In statutory and social reporting, the mass media are seldom used. At best, investors are addressed through the business pages of newspapers or business programmes in the electronic media. Company financials spill over into general news only when there is some implication of excesses. In South Africa, for example new disclosure rules are making executive pay a favourite "tabloid" topic, next to corporate scandals.

Apart from major new developments, other routine and less newsworthy events in a company are left to be covered in annual reports, employee reports, social reports and a more recent feature, the sustainability report; the latter is often simply included in the annual report. Of course, there are other social reporting activities that are used to disseminate information. They are mostly in the form of lobbying, road shows and promotional events. But routine non-investor information seldom reaches the public at large through readily accessible media. Social media has become a new and vibrant resource for companies and a new breed of consultancies has sprung up to serve that arena.

I remember that as a journalist I found very little news in annual reports. Most figures were dated, owing to the legal requirement to publish annual figures ahead and separately. Under South African company law, any information which may affect a share price and which is obtainable by someone other than a board member, has to be shared immediately with all shareholders. Insider trading would be rife if annual reports contained vital information that could affect the share price, because the reports are available to a host of people who may be less than scrupulous about confidentiality, including copy-writers, proof-readers and graphic designers. Announcements of new developments are also seldom made in annual reports. Again, if it could affect the share price, it would have to be disclosed immediately after the decision has been made. Even if the share price were not affected, most companies would disclose such news in separate media releases, in hopes of getting exposure.

Annual reports, then, are not particularly newsy. Yet they are required by law (in the case of listed companies anyway). Most of them are costly to produce, unnecessarily so considering that they aren't widely read and are often ignored even by the target market, the shareholder. Social reports are not compulsory but have been around for decades all the same. Here too the style is glossy, as companies try to capture their social activities in a publication that is distributed through company outlets and selective mail-shots; to appeal to a wider readership the report may include general-interest items, and indeed many companies with high consumer profiles publish magazines that are of largely general interest besides focusing on company products. For the most part, however, social reporting – or sustainability reporting as some now prefer to call it – is included in or accompanies the annual reports. Guided by recent developments such as the pressure for transparency and governance issues, as well as the need to convince investors of the sustainability of a company, the content requirements for social reporting have become clearer more specific and statutory.

But they are still a long way from being universal and consistent. There is no generally accepted guideline for such reporting. There have been the Global Reporting Initiative Guidelines that give some framework. There is also a certain familiarity with the Triple Bottom Line – profit performance, social responsibility criteria and human development activities. But I have already argued that the compatibility of the ingredients is questionable, not only because of the conflict between short-term and other motives but also because quantitative and qualitative data aren't easily blended.

Even a cursory glance at sustainability reports will leave the reader somewhat bewildered by the plethora of information of the "did you know" kind that is being thrown into the brew. I have examined quite a few and in all truthfulness cannot imagine that very much of the information is relevant even to specialists in that field. For example, an electricity utility's statistics on water consumption per power station are meaningless without some context and universal benchmarks. I attended an international sustainability accounting conference at which a senior accountant in a retail holding company grumbled about having had to record the average number of daily toilet flushes in the head office building. The content of sustainability reports, in other words the "what", is clearly nowhere near coherence. So far there seems little point in sustainability reporting beyond giving auditing firms a field day in establishing new divisions and giving public-relations consultants a new market. At the same time there are signs of growing rivalry about who is best suited to give advice on, process and distribute this kind of information.

It's doubtful whether, even if the content gained greater coherence, the problems of disseminating this information, in other words the "how", will be eliminated. There seems little to be gained by gathering all this information, only to have it buried in an already overloaded annual report that has a limited readership to begin with. For too long companies have accepted that being "in the public domain" is the same as being "in the public's mind". I have not seen any notable degree of media interest in the contents of sustainability reports. One could argue that sustainability reports are of greater public significance than the financial information, but the reality is that business pages and business broadcasts remain closely focused on those figures and their implications for shareholders.

Obvious reasons for this include the lack of coherence and universal benchmarking; there is no such thing as a "company sustainability index" and the subject has not developed to a point where we have sustainability specialists of the likes of investment analysts. There are no academics or qualified practitioners who can say that company X is less sustainable than company Y; or that company ABC has "improved its sustainability". It is doubtful if we will ever reach that point. Companies and their environments are so different that one could never establish benchmarks that make sense and are applicable to all.

There may be some limited value in taking a cue from the changing world of statistics. Methods such as the HDI and Gini Coefficient could be useful for a company, not necessarily for peer review purposes but at the very least as an internal progressive comparison. The Gini index for example may be useful in putting some perspective on executive remuneration and setting acceptable norms of differentiation.

Ultimately, it seems to me, all of the current misgivings have to do with a simple omission: that of the "why". We have seen time and again that "what" and "how" should be completely subordinate to "why". I dare say there are very few company boards that can clearly articulate the purpose of a sustainability report beyond the vague response to external pressure, a sense of "have to have". Faced with the difficulty of auditing qualitative factors, even those companies that are scrupulous about their financials can hardly be expected to handle these sorts of data effectively. In any case cheaters will cheat, and in the current climate of distrust it wouldn't take much for the sustainability report to be relegated to the status of a whitewash.

Clearly, however, some form of social reporting and accountability to society is here to stay. For all its faults, the sustainability report has at least served a useful purpose in making us move away from the “greed is good” ethos. Whatever method of measurement and reporting is used in future, however, it won't change behaviour – only purpose can do that. One can only hope that these measurements have the effect of raising awareness of the need for a behaviour change.

The Contribution Account© best and most suitably addresses the need for a sensible framework for sustainability or social reporting. Already some companies are including the conventional value-added statement (VAS) in their sustainability reports. The Contribution Account© is the only comprehensive format that can be of interest to all stakeholders. I have already touched on its suitability in employee reporting and will be exploring that further. The framework offers a layout from which other relevant information can be extrapolated. This can be particularly useful for creating underlying layers of information in a hyperlink web format.

But more importantly, if adopted it offers an accounting convention that will guide and encourage the information provider to consider all information that could possibly be relevant. To the reader it will present a uniform, credible, comfortable and easily understood format. The standard headings of the Contribution Account© – Turnover, Outside Supplies, Wealth Created, Employees, Savings, State, and Capital – can be expanded to reflect sustainability criteria in similar fashion to the Extended Contribution Account©.

<u>TURNOVER/INCOME/REVENUE</u>: This reflects the customer interface and the amount of possible information is limited only by one’s imagination. The concept of sustainability cannot ignore one’s standing in the marketplace. It will always be of vital interest to most stakeholders. Obvious information to include would be the usefulness of the products or service, market profile, number of customers, customer retention, volume increases, market share, competitors in the industry, innovation, new products and new markets being explored. Less obvious but very reassuring information could be about customer complaints and what has been done to address them, and other activities such as championing consumer rights. As uncomfortable as some of this disclosure may be, admitting one’s mistakes is better – especially if one is also able to show that measures have been taken to correct them – than professing perfection. A reflection of mission and values and the extent to which these have guided actions against (say) corruption fits in well under this heading.

<u>OUTSIDE SUPPLIES</u>: While strategically and financially it may make sense to view outside supplies as a cost and a drag on wealth creation, outside suppliers are an important party in wealth generation. Most pragmatic companies see them as stakeholders, although I personally prefer the definition of stakeholder to cover only those involved in wealth distribution. This heading is crucial in sustainability reporting because it covers less obvious matters such as air, water, other natural resources and all environmental issues. Simply by being the customers of others, companies play a far greater role in wealth and employment creation than they are given credit for. The nurturing role that a company plays in regard to small and medium

enterprises and adherence to Black Economic Empowerment criteria in countries like South Africa are clear topics to be included under this heading. Prescriptive moral demands on suppliers are becoming more commonplace and should be reflected.

Political and emotional issues often cloud the relationship with outside suppliers. There is the temptation to “do everything oneself” because it seems to imply organic growth, control and employment. On the other hand, the concept of outsourcing is becoming more popular as it usually relieves the employer of the need to “care” for a large number of employees. Not that the idea of “contractualisation” isn’t strongly resisted by labour unions. But there really is only one predominant criterion: what is in the customer’s interest. Even policies for promoting employment growth and empowerment of others cannot ignore this principle. With that one important proviso about the customer, a big company can nevertheless play an important role of “older brother” and protector in supporting suppliers.

<u>WEALTH CREATED</u>: This slot should consistently emphasise that the amount represents the collective’s contribution to the country’s gross domestic product or national prosperity. Larger companies could indeed play on the proportion of GDP that the amount represents. Generally a sustainability report should avoid being bombastic. Rather, it should reflect changes in wealth creation and set these against the national trend. For example, a 5% real increase in wealth created compared with a 2% national economic growth rate warrants explanation, as will an increase in wealth created that is less than the national economic growth rate.

The effect of mergers and takeovers will impact on wealth created and needs to be explained. An important opportunity that can be used under this heading is to reflect on whether the size of wealth created is sufficient for sensible wealth distribution: to meet the expectations of stakeholders (as I have narrowly defined them), and to encourage continued contribution. If it’s not, then it will beg the question of what is going to be done about restoring a balance. If it exceeds expectations, then likewise it will demand an explanation of what will be done with the discretionary surplus. In both cases, the explanation will obviously be found in the headings under wealth distribution.

Because wealth created is the sum of turnover and outside suppliers, there is a limit to what it can reflect in a sustainability report. Most of the information will be reflected under the other headings. But one can explore much more than the obvious. For example, this could offer a space for comment on broader issues such as national and international economic policies and events.

<u>EMPLOYEES</u>: This category is of course indispensable in a sustainability report. Policies in human resource (HR) management, staff development, affirmative action, pay policies, differentiated pay and employee benefits would be routine inclusions. Consecutive labour productivity statistics measured as wealth created per employee are already often included in the standard VAS.

Less obvious and perhaps more risky information could include a company Gini index; lay-off statistics, measures to soften retrenchment trauma; results of surveys on employee trust and satisfaction; disciplinary actions and union affairs. I have clearly only touched on a small part of the array of information that could be included under employees. The category has already been comprehensively covered in the fledgling sustainability-reporting styles and it need not be covered again here.

<u>STATE</u>: This is also a fairly obvious category that can generate a wealth of relevant information. Bland figures such as tax paid, and the broader impact of tax collected by the company in terms of VAT and employee income tax can be made interesting by showing how many houses it could have built for the homeless, or individual state pensions it could have paid for. These figures are particularly useful in parliamentary or government lobbying.

Corporate social investment is another obvious category. All of the current suggestions covering a company's relationships with the state, including central and local governments, NGOs and philanthropic pursuits are relevant to this heading. As mentioned, I would not include environmental issues here, but rather under outside supplies. Some sponsorship may fall under this category, but are probably better suited for inclusion under marketing and advertising to avoid provoking public scepticism. The latter could be included in outside supplies or even in turnover. There is little doubt that some sponsorship such as multi-million-dollar golf tournaments raise eyebrows among the lesser informed and disadvantaged.

<u>CAPITAL</u>: The broad category of profits can be exploded into a variety of currently relevant shareholder measurements or acid tests. The ideal is for companies to see the Contribution Account© as the consolidated primary account and all other accounts such as the income statement, cash flow and balance sheet as secondary and consequential.

The two aspects under the "capital" heading – savings (retained income) and dividends – should be reflected as separate headings because of their substantial differences.

<u>SAVINGS</u>: I have often found a lack of understanding and appreciation among general staff of the extent to which shareholders commit themselves to the future of the company through the retention of income. No greater financial proof of sustainability exists. A sentence such as "for every dollar paid to shareholders in cash, we put two more back into the company" has a strong impact. What happens to savings can reflect many balance-sheet items and certainly a sustainability report would be incomplete if it didn't reflect expansion plans to be funded or at least backed by savings. The main significance of savings is its link to the balance sheet. This statement is one of the most underrated in accounting and can be made very relevant to employees. Further shareholder information such as net asset value, dividend cover and market capitalisation can be included here.

<u>DIVIDEND</u>: This subheading provides an opportunity for shareholder profiling, clear unravelling of pyramids and final ownership and, in South Africa, for finding out the real state of Black Economic Empowerment by tracing dividends to Empowerment groups. Executive share options can also be revealed here.

Much as some company executives may baulk at my disclosure suggestions, it can't have escaped their notice that the boundaries of corporate confidentiality are being steadily pushed back. Only a few years ago, the disclosure of an executive pay package would have been unthinkable. Many of the reservations have little substance. For example, market share secrets make the ridiculous assumption that competitors have less information than the company has about who has what share of the market. There is much to be said for an attitude of candour and transparency that takes the lead.

I have touched on only some of the information that can be included in a Contribution Account©. In time standards will develop to inform the different categories. I cannot think of any current or possible requirement that won't fit snugly into the format. The adoption of it will facilitate media involvement, which is currently non-existent in sustainability reporting. The media are seldom comfortable with haphazard and non-standard forms of company reporting. Familiarity with a particular convention will help clear this hurdle.

The media are influential but are also easily influenced. If companies emphasise the Contribution Account© and consistently reflect it as an integral part of their public profile, the media will follow suit. Some companies might like to use the technique – which I find questionable – of placing Contribution Account© ads and then insisting on some editorial coverage. This works particularly well with magazines. Companies should regularly brief their public relations on the Contribution Account© and these consultants should be encouraged to apply their creative talents and media-lobbying efforts to ensure coverage. Forums such as analyst and press briefings should dedicate some time to the Contribution Account©. Ultimately the logic that the Contribution Account© contains information of greater public interest than the standard reports being churned out today should not escape notice. The conversion from "in the public domain" to "in the public's mind" is where the spin doctors have to earn their keep.

The sustainability report is arguably something of a misnomer. One is not sure whether the information is needed as a reflection of the sustainability of current world economic activity, which appears to have spawned the idea in the first place, or whether it is necessary as a way of showing the sustainability of the company itself. No analytical processes exist to draw conclusions either way from current sustainability reporting. A far better term for the kind of social reporting implied by the current approach would be either the familiar "social report", or the "empathy report". The latter would probably be more useful to reflect the true nature of the content and to get away from the current confusion.

The Contribution Account© also has the great virtue of reflecting behaviour. Behaviour is the foundation of sustainability. And if sustainability is about the long-term survival of companies, then the recipe has been around for a long time. It certainly needs no special report to inform interested parties on the sustainability of a company. If it's about the current issues of ethics, values and rampant corruption, then likewise an official report will have little or no effect without a genuine conversion of the heart. Sustainability, longer-term wealth creation, prosperity, abundance and collective and individual contentment are inextricably linked, besides being tied to the principle of adding value to one another's lives. The true measure of company sustainability is its dedication to adding value both behaviourally and measurably.

Ultimate “sustainability” is about always – always, always, but also always – acting in the interests of your customers, seeing yourself through their eyes and knowing that they are always watching you.

- Your customers want you to be around for a long time.
- Your customers want you to make a fair profit so that you won’t close your doors on them.
- They want you to treat your staff fairly so that they deal with happy, serving people.
- They want you to be driven by sound universal values.
- They want you to be a good “corporate citizen” but not to the extent that they have to pay for most of it.
- They want you to pay your taxes so that the government can provide them with services.
- They want you to be involved in their communities.
- They don’t want you to destroy the bounty of nature.
- They want you to be around for their children and their children's children.

Not for your sake…. but for theirs.

CHAPTER 15
Employee communications

This subject is another of those in organisational theory that account for great bodies of literature and discussion. It is recognised as the bedrock of sound relations in any collective. Yet in many companies it's something of a Cinderella compared with the attention paid to shareholder or external communications. Employees certainly are not protected in law as much as shareholders are in terms of information requirements. Without going into the futile argument over stakeholder rankings of importance, I have to ask: What could be more destructive to a company – poor communication with employees or with shareholders?

Internal communication in any collective is a multi-disciplined activity, but often the important central and strategic information is left to a public relations (PR) department, and often to the tender mercies of an inexperienced communications practitioner. My own experience as a journalist and as an employee communication consultant is that companies are quick to employ the services of an outside expert when it comes to external communication, but are loath to do so when it comes to internal communication.

Internal or employee communication can be subjected to the same three-pillar scrutiny that all activities should undergo: why, what and how. I have found this very useful in designing internal communication processes and systems. It's certainly helpful in getting back to the basics and placing the activity on a solid footing. Communication is one discipline where one all too often allows “why” to be superseded by “what” and “how”. A friend of mine has a PR consultancy that has as its slogan: “It's not what you say but how you say it!”

The belief in technique as the most important element of communication has become more widespread with the development of new media and information technology. Here is where the most money is spent and expertise applied. The standard approach of most PR consultancies is to simply ask a client what she/he wants to say and then employ elaborate media and techniques to get the message across. As we saw, “why” is in fact the most important of the three elements. It's the meaning. The others are form. It's the substance. The others are consequential – they follow from “why”.

What is the purpose of employee communication? The cause of many a failure of internal communication processes is revealed in the response to this question, a response that says internal communication is conducted almost exclusively in the interest of the collective. Seldom is it seen to be in the interest of the one communicated with, unless this interest is wrongly interpreted as always being the same as that of the collective.

The Machiavellian stance on internal communication is often not taken at a conscious level or even fully appreciated. Clearly trust and internal communication are mutually supportive but the one does not guarantee the other. I have observed clear suspicion of internal communications during periods of company uncertainty, even though the company had a good track record as regards employee trust.

The expedient approach to employee communication has been widely practised over decades. So much so that when I propose to companies that they adopt a developmental communication policy where everything has to be tested against the interest of the recipient, there is always much resistance. A survey on corporate credibility and employee communication by the Society for Human Resource Management in the USA found that companies in the North American continent had stepped up communication efforts in response to the public distrust of corporations at the turn of the century. “By doing so they hope to increase employee morale, productivity, performance and retention,” the report said.

Research consistently reflects the following management reasons behind employee communications:

- good public relations
- stop rumours, etc.
- improve industrial relations
- create loyalty and commitment
- improve productivity and
- moderate wage demands.

Development and empowerment of the employee seldom feature as strong motives in employee communications. In most cases then, the content is invariably experienced and judged to be manipulative and in the interests of management. Levels of trust vary a great deal according to circumstances and the kind of information being shared. But for the most part, as the global Edelman Trust survey has consistently shown, only about a third of the respondents believe their employers were always open and honest, and less than half said they were usually open and honest. But what does “usually” mean? Do employees expect that at times a company won’t be open and honest? If I’ve come to expect even just occasional dishonesty, how likely am I to accept information which is important and which it’s also important for me to believe?

Effective internal communication requires an alignment of employees’ information needs and wants with those of the collective. This is highly unlikely in the absence of common purpose and common fate.

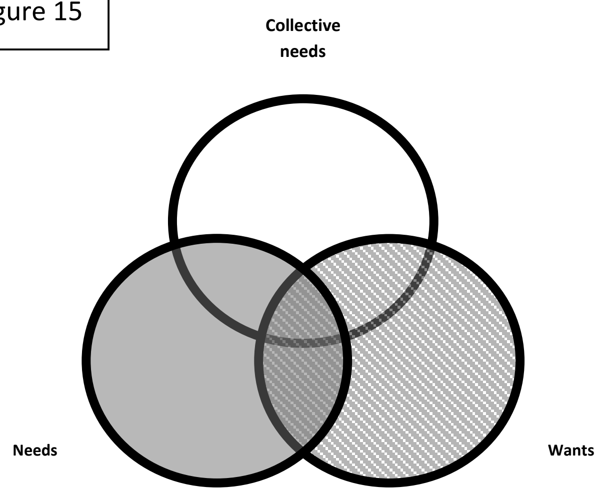
A few years before the end of my broadcasting career, I developed a personal mission to enhance economic literacy through the mass media. I soon discovered that broadcasting was the least suited for achieving this. The most appropriate environment for enhancing economic awareness was in the workplace, where people rubbed shoulders with business on a daily basis. Further research into the subject revealed the minimal use of internal communication processes as a developmental and empowering tool. This led to what even today is a unique approach: Developmental Employee Communications.

It’s not good enough to say that employee communication is by nature developmental. A conscious policy decision to adopt development, education and enlightenment as absolute goals leads to an automatic reassessment of style, approach, content and technique. Once it’s understood that the primary role of employee communication is developmental rather than manipulative – and once the employer makes a policy commitment to that – content and technique become negotiable and consultative. Students in educational institutions seldom have a problem with the syllabus. They understand that the primary purpose of being taught is the acquisition of empowering knowledge. It’s when they start to experience the instruction as propaganda that they will rebel. The student riots in Soweto in South Africa in the 1970s and 1980s, which caused the death of 170 and injuries to many more, were among the significant sparks that set fire to the citadel of apartheid and reduced it to ashes.

The acquisition of broader knowledge in the working environment is as important as, if not more important than, acquiring skills. Skills are “how to” and broader knowledge is about “why”, which represents superiority of substance over form.

Developmental employee communication is particularly important in developing countries and provides an opportunity to illustrate theory in practice. A broader approach to employee communications in most countries can lead to a meaningful shift in the way internal communication and the company itself are perceived.

Figure 15



The adoption of a developmental approach to employee reporting will guide its content. Clearly content has to be informed by the three circles of interest illustrated in Figure 15.

This means that the needs and wants of both parties have to be assessed. In turn one will find that apart from some routine and standard content, the “syllabus” will differ noticeably from one company to another. Indeed it may even differ from one department or section to another – which in turn will mean that technique has to be reassessed and cannot rely only on a mass approach.

My communication clients found it useful to have a systematic approach to content. This suggests, among other things, inclusion of employee reporting as a regular agenda item for executive meetings, the establishment of a communication steering committee with direct access to the CEO, and the latter's participation as a member of the committee. In this approach, content of communications falls into three categories: strategic, ad hoc, and routine.

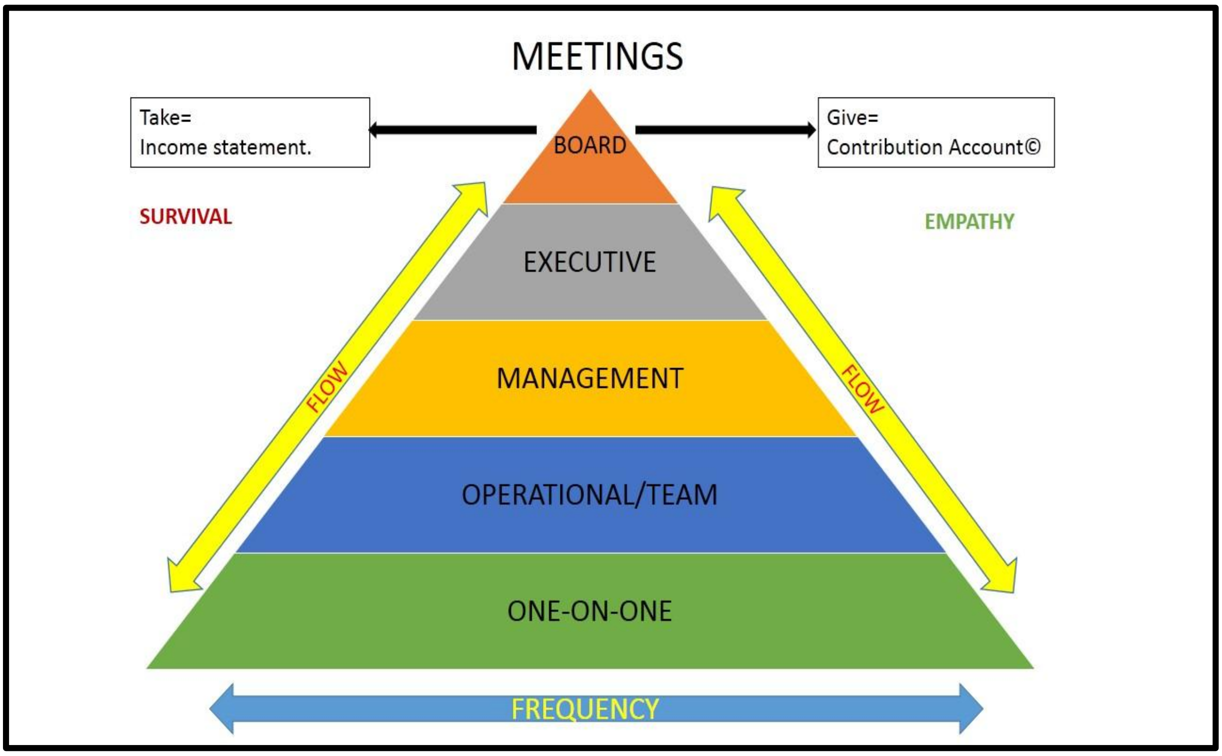
A developmental strategy opens up many areas of opportunity. For example, come personal-tax submission day, a company can open its finance department's doors for personal-tax queries. Or it can use the occasion to inform staff about how the national budget works. Another example: with the introduction of a staff housing scheme based on subsidising mortgage rates, comes a chance to explain how interest rates work. But of course one is unlikely to stage such an event for the benefit of a finance department consisting of qualified accountants! One must differentiate between company sites.

Strategic communication is not haphazard. It can be designed like an educational curriculum and be informed by the three circles of employee and employer needs. The real departure from employee reporting norms is in its broader view of content and the use of collective resources for sharing this knowledge.

Ad hoc content is literally guided by events both within and outside the company. But the net can be spread more widely. For example, news headlines about one or other corporate fraud are an opportunity for highlighting the company's own values, whistle-blowing policies and views on corruption. Routine information is self-explanatory and should be scheduled and diarised to ensure appropriate treatment; "routine" doesn't mean "less important". For example, the publication of annual figures is routine but highly significant for employees. Amazingly, however, we've noticed that many communication functionaries are caught off guard by these events. All their energies go into producing information for shareholders and internal communication goes by the board.

The above examples are not intended to dictate a norm, but rather to advocate a style that has endless possibilities for enhancing knowledge and awareness. The style is crucial to creating employee empathy with the developmental purpose, which in turn is a critical element of credibility and trust. I am not underestimating the problem of information overload; indeed part of our work with clients was to clean out overloaded systems. Invariably I found that overload was due to incorrect choice of media.

Figure 16



The real problem of credibility lies at a deeper level. I have referred repeatedly to the problem of conflicting messages that arises at different levels of discussion (Figure 16) in the absence of common purpose and common fate. This starts at the very top, with mission and strategy. The purpose of the collective may be defined in the mission statement as an empathetic one, but to determine the real motives behind the purpose all one need do is attend the regular meetings of functionaries. The topics of discussion are the ultimate reflector of motives and the more shallow layers of intent.

We've been privy to some executive meetings which I have reason to think are fairly typical of discussions at board and senior executive level. The income statement is the driver, and the driver of the income statement is maximisation of profit. So the mission may be a benevolent one, but the motive is the opposite. Already at this level the "serving" message becomes distorted. The information that flows from the board to the management contains the same language the board was preoccupied with: profit and cost.

This gets broken down into greater detail so that it permeates all discussions as the information cascades downwards along the hierarchy. Accountabilities are affected and often the most fundamental message of all, that we are here to serve our customers, becomes blurred. The responses I have had from employees, and even middle and senior management, are an overwhelming confirmation of this feature: "They say one thing but do another."

The first and most important task is to change the dialogue and information content flowing in companies. To do this one must assess and perhaps even partly dictate the agenda of all operational meetings. This is where communication really happens and it simply cannot be replaced by non-personal means.

CHAPTER 16
Communicating financial statements

Figure 17

Barlow Limited Income Statements

for the year ended 30 September 1998

	Notes	GROUP 1998 R m	1997 R m
Turnover	2	**20 538,3**	19 387,8
- continuing operations		**19 088,7**	17 233,4
- discontinued operations	12	**1 449,6**	2 154,4
Operating profit	3	**1 032,9**	1 067,7
- continuing operations		**1055,6**	1002,1
- discontinued operations		**(22,7)**	65.6
Net interest paid	4	**(109,7)**	(16,2)
Income from investments	5	**52,3**	39,9
Profit before exceptional items		**975,5**	1 091,4
Exceptional items	6	**96,0**	139,7
Profit before taxation		**1 071,5**	1 231,1
Taxation	7	**229,7**	327,1
Profit after taxation		**841,8**	904,0
Share of associate companies' retained profits		**38,7**	29,1
Attributable net profit		**880,5**	933,1
- outside shareholders in subsidiaries and 6% preference shareholders in Barlow Limited		**93,5**	123,9
- ordinary shareholders in Barlow Limited		**787,0**	809,2
Dividends on ordinary shares and capitalisation awards	8	**266,7**	268,0
Retained surplus/(deficit) for the year	15	**520,3**	541,2
		Cents	Cents
Net profit per share	10.1	**372,1**	391,8
Net profit per share (fully diluted)	10.2	**369,6**	383,5
Earnings per share excluding exceptional items	10.3	**321,5**	331,8
Earnings per share excluding exceptional items (fully diluted)	10.4	**320,0**	327,2
Dividends per share	8	**124,0**	124,0

As the culmination of all measurable performance the financial figures are a good central focal point. All operational activities can and should be linked to the final scoreboard. But the link is very difficult to make if the scoreboard is the income statement (Figure 17). Barloworld Limited has been one of the biggest industrial holding companies in South Africa for decades and its annual reports have always been comprehensive and better than most. It does however follow accepted accounting conventions, and some of these conventions make for less than helpful statements. The income statement is useless as a reflector of activities and is of limited value as a communication tool. The main and perhaps exclusive reader target is the shareholder. Even the most knowledgeable company analyst will find little of real value in the statement without reading the copious notes referred to in the second column. For example, the illustration in Figure 22 (I have deliberately chosen rather dated figures) shows a turnover increase of nearly 6%, but operating profit is down by 3%. The R19 billion difference between turnover of R20 billion and operating profit of R1 billion is simply ignored!

The focus of the income statement is indeed very narrow. In addition, the jargon and terminology of the various headings will be lost on most people, including a large number of shareholders. It certainly will be hieroglyphics to most employees. And yet many companies insist on exposing their staff to the statement and trying to get them to understand its importance. What I find amazing is the assumption (as it seems) that nobody cares about the fact that the entire activity of Barloworld, R20 billion, resulted in that tiny bit of pulp squeezed out at the end – profits of R880 million. The message coming out of the income statement is that the other R19 billion is not worth talking about compared with that final bit that goes into the hands of the shareholder.

Figure 18

Barlow Limited Value-added Statement

	1998 R m	%	1997 R m	%
Turnover	20 5383,3		19 387,8	
Paid to suppliers of materials and services	15 583,0		14 809,0	
Value-added	4 955,3		4 578,8	
Income from investments*	510,7		465,2	
Total wealth created	5 466,0		5 044,0	
Wealth distribution				
Salaries, wages and other benefits (Note 1)	3 221,5	58,9	2955,9	58,6
Providers of capital	854,1	15,6	744,4	14,8
-interest paid on borrowings	529,4		412,4	
-dividends to Barlow Limited shareholders†	266,7		268,0	
-dividends to outside shareholders in subsidiaries	58,0		64,0	
Government (see notes 2 and 3)	335,8	6,1	357,5	7,1
Reinvested in group to maintain and develop operations	1 054,6	19,4	986,2	19,5
-depreciation	536,4		370,9	
-retained profit	520,3		541,2	
-deferred taxation	(2,1)		74,1	
	5 466,0	100,0	5 044,0	100,0

The Contribution Account© or even the one I based Contribution Accounting© on, the value-added statement, gives a completely different picture (Figure 18). This statement contains more rows than are needed for the standard VAS. The extra lines become even less necessary if the statement is purified to a Contribution Account©; the only absolutely necessary lines are the seven defined earlier: turnover, outside supplies, wealth created, employees, savings, state and owners.

A notable point about the conventional VAS as used by Barloworld is that it’s shorter than the income statement and yet reveals more. The fact that operating profit fell despite higher turnover is explained by the 5% increase in outside costs, the 9% increase in employee share, the 28% increase in interest and the 44% increase in depreciation. This last for example is so conspicuous that it should at least have had a note attached. Interestingly, Worldcom's manipulation of depreciation as a way of overstating profit was part of the reason for its demise. One wonders whether it would have escaped attention had the shareholders seen a VAS.

I am not for a moment comparing Barloworld with WorldCom. One of the reasons for selecting an historic period for Barloworld was to avoid assumptions around the figures. The figures don't have to be current for purposes of comparing the two accounting methods.

Remember that in the Contribution Account©, depreciation and interest would be reflected as outside costs and employee income tax would shift to tax/government. One of the positive spin-offs of such an adjustment is the greater congruity between the income statement and the Contribution Account©. In the Contribution Account©, for example, the important figure of operating profit is easily calculated by deducting the employee share (including tax paid) from wealth created. Retained income in the income statement is the same as savings in the Contribution Account©. But by including depreciation in "reinvested in the group" in the VAS, one breaks the link with the income statement.

So even from a shareholder's point of view the Contribution Account© is potentially a more powerful analytical tool than the income statement. Where it really comes into its own is in communicating with people other than shareholders, particularly employees.

In terms of a Contribution Account© calculation, the Barloworld VAS overstates the real wealth created. If one were to exclude interest and depreciation, the 1998 wealth-created figure would be only 3% more than the adjusted 1997 figure. The fact that turnover was 6% higher meant in effect that the company was adding proportionately less value to goods and services used by others. The 7% increase in outside costs is more than the increase in turnover and this would, for example, require some explanation of the depreciation increase. The 28% increase in debt servicing would also not escape attention. While I favour limiting the Contribution Account© to seven lines, inclusion of interest and depreciation as sub-categories of outside costs could be useful. At the very least they should be reflected in notes or in the Extended Contribution Account.

The company created wealth 3% above that of the previous year but the employee share (including employee taxes) rose by 9% in money terms. This meant lower profits, resulting in less company tax being paid. These facts would be the crux of an employee-communication event. However, instead of lambasting the workers for demanding too much, the message could be about the need to create more wealth to sustain the trend and ensure that the two conditions of sensible distribution are observed: meeting legitimate expectations and ensuring continued contribution. It's critically important for the Contribution Account© not to be used as a manipulative tool. This would not only defeat the purpose of developmental employee communication, but also very quickly bring the account itself into disrepute.

The Contribution Account© can be used as an interactive information display to illustrate how virtually any development, event or action affects the content of information that shareholders and employees expect to receive, and exactly how every such factor will affect the collective.

I have already shown how the seven domains can be the source of an almost endless stream of information in general communication and in sustainability reporting. Most of what was mentioned is also very relevant to employees. In addition, all tasks and functions can somehow be qualitatively linked to one of the domains. This enables a unique line of sight which is simply not possible with any other format. For example, the functions of a Human Resource department can be linked to the employee domain, and in turn linked to turnover, which is the final reflector of customer service.

Both the Extended Contribution Account© (a horizontal breakdown of the domains) and the Component Contribution Account© (a vertical breakdown) are a rich source of knowledge and behaviour-changing information. A useful way of understanding the Extended Contribution Account© is to see it as a breakdown of the domains themselves. The Component Contribution Account© is the unpacking of things that impact on the domains. Broadly speaking, the latter could be defined as cause and the former as effect, or activities and outcomes.

From an employee-reporting point of view, other Extended Account information could be a breakdown, under turnover, of customer profiles, and geographic or divisional contributions. Useful Component Account information would be customer complaints, customer satisfaction and company quality information. It’s possible to establish a clear qualitative line-of-sight link between functions and individual actions, and turnover.

Under outside costs, the Extended Account could show a breakdown of supplies and suppliers, and how many suppliers are small and medium companies or BEE companies. The Component Account could reflect waste and excessive inventory, again offering a direct link between organisational activities and costs. The outside cost component is generally a good indicator of organisational efficiencies.
Wealth created should be a visible and known figure throughout the company. It’s the measured reflection of the total contribution that the collective has made via its mission to its market or humanity in general, and the fact that it’s ignored in most working environments is simply inexplicable. It is after all the final determinant of who gets what and indeed of the future existence of the company.

The “employees” part of the Contribution Account© represents a variety of matters and measurements such as training numbers and medical and other benefits paid. Let me repeat that it’s very important not to harp on the employee share as being the biggest without putting it in the perspective of contribution. In the above case too, the employee tax has not been moved to the tax item as we do with the revised Contribution Account©. The only time the proportionate share of any parties should be an issue is when there’s an imbalance in distribution that needs to be corrected. Then it becomes reasonable to argue that the different shares are no longer a true price reflection of relative contribution and that one stakeholder is subsidising another.

The tax domain provides the same information for employees as one may find in a sustainability report. This also applies to savings and dividend. I believe savings could be linked to the balance sheet, which can be simplified and creatively illustrated to give employees an idea of company strength and health. The principles of the balance sheet are very simple.

Without coherent, trustworthy and lucid financial information, employees cannot be expected to identify with common purpose and particularly common fate. The most important ingredients of what employees are concerned about in companies are influenced by the financials. Financial information is a critical element of developmental communications. The SHRM survey done in a continent with almost full employment (North America) showed that by far the greatest fear was losing one's job. Lower down on the list of fears were loss of retirement and other benefits, and the possibility that the company might go out of business. The results of our own research in South Africa pointed mainly to concerns about unemployment.

To recap: the ultimate aim of all communication should be empowerment; which in turn is wholly dependent on willingness to be a contributor rather than a taker and a victim. Empowerment means acceptance of accountability for oneself and one's actions. Behaviour change is critically dependent on communication. A compassionate heart will provide better answers to questions regarding technique, content and purpose, than a mercenary mind.

CHAPTER 17
Labour as a beneficiary of wealth creation

The essence of success as an employee is not to see yourself as being used by a collective or a company to achieve its ends, but rather to see the collective as an instrument for unleashing your true value. This lies in your capacity to make a contribution to the good of others. Anything in the workplace that detracts from this is reducing your value. Anything that shifts your focus from "give" to "get" ultimately does the same thing. The extent to which you fall into these traps, or allow yourself to be drawn into them, is the extent to which you hand over your true power to another. There are many of these seductive elements in a company. One of them is the way that pay has been structured. Institutionalised pay structures have firmly entrenched labour as a cost rather than as a contributor – even though, as we have seen from the Contribution Account©, labour is generally the biggest contributor to wealth creation.

The broad postulate that for most companies labour is the biggest contributor to wealth is true, but what the commodity expression of labour does is to muddy this expression. The coercive nature of determining wages and salaries in an atmosphere of conflict between labour and capital breaks a fundamental link between true value and price. It rides rough-shod over the reality that even an engineer receiving a minimum wage in a company is vastly overpriced if that company itself is adding no value or is running at a massive loss. Ultimately all rewards have to be linked to what the ultimate buyer or customer finds valuable, not to self-calculated extortion.

This questions many of the current measurements on labour productivity. There are several within two approaches based either on volume or value. For example, if say 10 workers produced 20 widgets at R10 each a month, and the following month 22, their productivity in volume terms would have increased by 10% to R220. But if, say the price obtained for each widget dropped in that month by 10%, the value of their production would be less at R198. So labour productivity has increased in volume but fallen in value. Of course, the converse would also be true – productivity in volume could fall, but in value increase. Another productivity calculation makes use of a ratio between volume output per work and capital employed.

Value-added or wealth created is probably still the best method of monitoring labour productivity. It is simply the ratio of wealth created to number of workers – thus: WC = R100m; divided 1000 employees gives R100 000 per employee. Like all other measures of productivity it does have some paradoxes, e.g. if the share of the total wage bill of wealth created increases from say 50% to 60% it most likely reflects a decline in labour productivity, especially if there's been an accompanying decline in profits or tax. On the other hand if the ratio between wealth created and number of employees increases then labour productivity has increased – thus: WC = R110m; divided by 1000 employees gives R110 000 per employee.

What this all shows is the huge pitfall in "aggregating" labour productivity on a national or country basis. It is also very questionable to make company or even country comparisons because a number of things such as mechanisation, relative technology deployment and capital deployment itself in terms of plant, age of plant and depreciation can all impact on that calculation and in relatively short time periods, questioning historic comparisons in a company. Labour productivity is subservient to the key requirements of sensible distribution: meeting the legitimate expectations of all of the stakeholders and encouraging continued contribution.

If labour productivity is to have any merit as a company indicator, it clearly has to be measured in value and not volume. In turn, this value has to be linked to value-added or wealth created as determined by the value of the product or service to the customer. This makes the case for flexible pay even stronger, because then it will also reflect true value, and not an extorted price by organised coercion.

We live in a changing and dynamic world in which little is guaranteed. The income of a company may be influenced by numerous events, many of them beyond the control of the company itself: changes in interest rates, economic booms and busts, a new competitor, and exchange-rate movements, to name just a few. Outside costs are likewise not set in concrete. They can be influenced by the very same factors that influence income.

Let's refer to the Contribution Account© shown earlier in figure 6. It is obvious that wealth created, being the sum of two potentially erratic numbers, will itself have a propensity to expand and contract beyond the control of company owners, leaders or staff. It therefore makes sense to say that if wealth created is itself variable, all components that depend on the wealth created should be as well. And so they are.

We know that profit itself is a variable number, entirely dependent on the performance of the company in a given period. The size of the profit determines how much a company pays as dividend, or whether it passes it altogether, or whether it adds anything to its savings. Indeed a loss has to be funded from savings. Tax is also highly variable: the percentage of profit might not change, but the amount obviously will. Not only will a company avoid paying tax if it runs at a loss but that loss will be carried forward to reduce its tax burden the following year.

The employee group disturbs the balance, however. Salaries and wages are for the most part set in concrete – except that in actuality they tend to increase each year. So they are a constant within an otherwise variable structure. This is illogical. It's tantamount to nailing down one's deck chair so as to secure one's position on a sinking Titanic. Unless a company grows exponentially ad infinitum, the employee share will in time crowd out the share of other parties. That crowding-out has never happened sustainably as far as I know; indeed the evidence worldwide suggests that employee shares have changed very little over the years despite constant increases in pay. The reason is obvious: companies are paying more and more to fewer and fewer people.

Payroll-cutting is perhaps not too damaging in a country with full employment, a low birth rate and a high level of social security, but the effects are truly punitive for a country such as South Africa, which has a surplus of low-skilled people, a frightening unemployment rate and inadequate unemployment benefits. For years organised labour has argued that pay increases are employment generators because they encourage consumer spending, which in turn encourages production and employment. Basic mathematical logic should tell us, however, that for a country to absorb (say) a 3% increase in job seekers, its economy would need to expand at about the same rate, and the growth would have to be at least twice that in order for the unemployment rate to be lowered, let alone brought anywhere near to zero. To accommodate increases in salaries and wages without claiming these increases from other stakeholders would be to strain resources to breaking point. Admittedly there are many other factors that could impact on growth, such as rates of interest and exchange, but I have simplified the issue as a way of emphasising that the price of labour is one of the most important prices in an economy and it cannot be deliberately engineered without distorting the economy as a whole.

At the time of writing, South Africa's unemployment rate stood at nearly 40% on a broad definition which includes people who have simply stopped looking for work. A 10% level of unemployment in developed countries is viewed as dangerous, with a potential to topple the government of the day. Yet these countries have high levels of social security to prevent poverty and starvation. Unemployment is without doubt one of South Africa's key issues, ranking with, if not higher than crime and social discord. Arguably the three are closely linked.

Scientific evidence over an extended period has confirmed a direct link between increasing wages, labour unrest and unemployment. Although poverty and malnutrition in South Africa are matters of concern, they are alleviated to some degree by "ubuntu" and the concept of the extended family; the simple reality is that the employed more than the state, feed the unemployed. The trouble with wage increases is that they are invariably accompanied by lay-offs.

The employee lucky enough to be retained barely has time to celebrate his (say) 10% pay increase before the reality hits him. In the first instance inflation swallows nearly half the increase – or more, depending on the make-up of the consumer price index. Another bite of the effective amount would be swallowed in tax. What's more, his newly-retrenched brother and his family may soon be knocking at his door and asking to be fed (it has been reliably estimated that the average worker in South Africa feeds 10 mouths). The net effect is that this employee's real disposable income has fallen, not risen. He has little option but to agitate for another increase markedly above current inflation in order for him to recover to where he was before. This self-feeding circular effect adds to income disparities in measurements such as the Gini co-efficient which measures household incomes and includes unemployed members of that household.

Labour flexibility, in which pay is probably the most important issue, is a worldwide criterion in assessing a country's growth prospects. South Africa has ranked very low in a World Competitiveness Report on labour flexibility. Variable pay, gain-sharing, profit-sharing, and incentive bonus schemes have become popular across the world. I believe most fail in the most critical aspect of all: promoting the idea of common fate in companies. They are mostly about incentive rather than involvement. In most cases they have done nothing to prevent lay-offs at the behest of those who want maximum profit.

In most developed nations, the power of organised labour has been substantially eroded. In South Africa the power of unions has been eroded further by the loss of membership through the loss of jobs, and this sector is now turning some of its attention to the struggle for the unemployed. Even so, it has largely failed to recognise the new opportunities offered by the shift to being market-driven. This may be because of its overstated political and legal clout.

Without doubt previous working conditions, especially in one of South Africa's biggest employers, the mining industry, bred strong and radical unions which could rescue workers from their plight. At the same time the government at the time hastened its own downfall by adopting the rather curious stance that, because black South Africans were politically disenfranchised, they should have an escape valve in the workplace – hence the legitimisation of unions which were previously not recognised. This politicised the workplace overnight; it was the beginning of a movement similar to the former British model of intensive labour involvement in politics.

This explains the growth of a mostly adversarial relationship between capital and labour in South Africa which is further fed by out-dated ideological paradigms, powerful competitive unions with political clout, and big, powerful capital formations. No employee can be content with working in a collective whose primary aim is to enrich the owners and which will employ any means, seductive or coercive, to ensure that he/she remains compliant. In such conditions of implicit conflict, it's natural for another collective to form within the company to protect workers' interests.

But the winds of change in business will also inevitably affect the conventional role of organised labour. Until now this role has been about protecting members and "taking" from the employment environment. As I have argued earlier, however, a collective that is fixated on its own interest becomes little more than another what's-in-it-for-me grouping and sows the seeds of its ultimate demise.

The inwardly-focused purpose can last only as long as its members are perceived to be victimised by others around them. Power is something one earns by contributing to the good of the world around one; control is something one imposes through threats and intimidation; the two should not be confused. Power can be permanent, depending on the behaviour of the ones who hold it; control eventually crumbles in the hands of those who think they have power. Organised labour has always had a measure of both, but often reverts to control through intimidating tactics. These tactics do work for a while, especially if the other parties' slates are not clean. But the situation cannot last. The trend worldwide has been a diminishing control capacity on the part of organised labour, to be replaced by a greater degree of participative management.

The participative models in Japan and others such as Taiwan and Korea were one of their greatest strengths; job security outranked pay security. With the possible exception of Taiwan, these countries have now shifted towards the capitalist model – and, ironically, have lost a lot of their growth momentum. The German model of having labour representatives serve on the boards of companies has its limitations. It may be a good device for keeping shareholders informed of grass-roots concerns, but the labour board members have less power than one unhappy employee in the workplace that is prepared to throw a spanner in the works. The worker on the board can easily be outvoted by his peers; but a disgruntled group at the coal-face can bring the entire production to a halt.

Before examining the challenges now being faced by organised labour, I need to reflect on those unclean slates. The raw logic of the market that is often applied to labour is inappropriate to say the least and some of its shortcomings have already been highlighted. And if we accept that perfect markets reflect all imperfections, it follows that these imperfections themselves can be addressed only through laws and conscience, of which the latter is more powerful. Despite all the capitalist clamour for labour flexibility, few people can condone sweatshops, child labour and slave wages. In this, organised labour, together with world bodies such as the International Labour Organisation, will always have to play a role.

The other mark on the slate has been executive pay. It's hard to believe that this is a true reflection of market forces. Differential pay linked to the supply and demand for skills and qualifications cannot on its own account for the huge disparities. Rather, the pay seems to be linked to a basket of dubious criteria underpinned by the philosophy of maximum shareholder value. The trend started a few decades ago when it became fashionable to recruit the professional executive as a trouble-shooter. This company gunslinger would be rewarded on short-term turnaround criteria. After achieving these, she/he would move on to the next ailing victim, and then the next. The mercenary rewards far outweighed the risks that one's reputation would in time collapse. Soon, the pay of "home-grown" executives ballooned to similar proportions, the thinking being that if they were any good at achieving maximum shareholder value they'd no doubt either be poached by other organisations or set themselves up as mercenaries.

Another point in their favour was that as an outcome of the "agency theory", they could in many cases write their own cheques with no deference to shareholders. A further factor in countries like South Africa is the defence of executive pay on the grounds that these people are an "international commodity" qualifying for pay similar to that of their counterparts in other countries. And the virus spreads: central-, local- and semi-government organisations start viewing "executive" as a professional category, implying that heads of departments and other organisations qualify for similar levels of pay.

If George Soros is to be believed, markets that reflect imperfections and imbalances cause bubbles. These bubbles inevitably burst. The needle to do that with executive pay is the new scrutiny that executive behaviour is being subjected to. From an employee point of view, executive pay levels do little to enhance morale. Organised labour has also found a new and legitimate bone of contention. It has always been so that large income disparities cause resentment and unrest, and a company cannot be different. At a national level, the importance of income differences is recognised by the Gini Coefficient. The differences are measured on a scale of 0 to 1, with the lower end reflecting smaller differences and the higher end reflecting larger differences. South Africa has a startlingly high coefficient of .58 and executive pay is I dare say a burning issue second only to unemployment itself.

I believe that some kind of Gini index can be applied to companies. Of course it would have to take into account the fact that a company doesn't have unemployed people in the way that a country does, and there would have to be some adjustment for this factor, as well as for sectorial differences and surpluses and shortages of skills, to arrive at a norm for national and international comparison purposes. Union agitation against executive pay levels are seldom based on the executive pay itself, as much as on the strongly emotive comparison between multi-million Rand pay-outs at one end and near-minimum wages at the other. A scientific norm will add to the unions' armoury, besides giving shareholders a benchmark for executive remuneration.

Organised labour's greatest opportunity lies in becoming outward-looking. If it's true that at a personal, private level our value lies in our capacity to contribute to the wellbeing of others, then it's equally true for an employee. As an employee one must find this contributory capacity in the collective's effort to be of service to the customer. A labour union leader that honestly has the interests of members at heart will rise to the challenge. Nothing could be of greater service to union members than ensuring that they are afforded the maximum opportunity of contributing, thereby unleashing their true value. If a labour union decides that it too has an interest in ensuring that companies never neglect the customer, that union won't only be revolutionary, but will also earn a kind of power surpassing that of any party that's inwardly-focused.

CHAPTER 18
Labour and a new World economic order

Two words, one concept, is all it takes to produce a revolutionary and exciting potential blueprint for a new economic model that breaks free from hackneyed ideological rhetoric, yet is rooted firmly in logic and accommodates best known practices. And they have come from an unlikely but authoritative and widely experienced source: that of Bobby Godsell, Chairman of Business Leadership in South Africa.

Singing the praises of labour in an article in *Times Live*, he used the term "wealth creators" in referring to the 50 million people in this country. "Work" he says, "has always been a central and valuable part of the lives of men and women. From hunter-gatherer societies, to settled agricultural communities, through the industrial age, and now in the knowledge society, the capacity to create value in a way that improves the individual's life circumstance has been central to the human story. Homo Faber - man the maker - is as central to this story as Homo Sapiens - man the knower."

He then puts labour at the very heart of wealth creation: "Work is about creating value. The best definition of entrepreneurship is the process of combining resources in new ways to make more. This more, in order to be sustainable, must create goods or services for a customer in a way that brings acceptable benefits to the provider. This, indeed, is what real wealth creation is about".

My interactions with Godsell go back to the days when he was Human Resources Chief at Anglo American and when he and N.U.M. founder Cyril Ramaphosa were regular guests on TV news and actuality shows. It does not surprise me that despite his subsequent "capitalist" public image he has always held a somewhat different view about labour from his executive colleagues and contemporary capitalist moguls. But what has surprised me is his denunciation of the current economic model and its "side-lining" of labour.

He writes: "In the past few decades, a mind-set has developed, particularly in Anglo-Saxon capitalism that has viewed employment in precisely the opposite terms to those described above. As we moved to fund-manager capitalism and a focus on short-term returns, companies that cut costs dramatically were seen as winners. Often the easiest way to cut costs was to reduce employment."

I first used the concept of labour as "wealth creators" in our earliest basic economic courses for company employees. But it was not even our idea. It came from a barely literate participant in one of our pilot programmes who made the connection after I explained the process of wealth creation or adding value in the most basic of terms. It showed me once and for all not only how simple the concept of wealth creation is but how easily the mantle is adopted by employees -- and with pride. It is not only "an entrepreneur" that creates wealth, but entrepreneurial behaviour, a willingness to make a contribution, which can be displayed and unleashed at all levels within the labour ranks or as individuals, self-employed or unemployed. In this context, the term "labour" means all "doers", from sweeper to chief executive.

Ultimately, only doing something (including rational thinking), and not simply owning or investing, creates wealth. For it means transforming one situation, circumstance or set of resources, into another. It is the oldest economic concept known to mankind – predating even trade and dating back to purely self-sufficient individuals or families. When barter and trade became part of social co-existence, then a "value" or price could be placed on the process itself. Since the beginning labour (both as human beings and human activity) has been the centre of creating value. Yet, only in rare pockets, or time frames in some countries, have I seen labour adopt this central and dominant role. Under the known systems, labour has been enslaved either to capital or governments.

Today still, the concept of "labourism" is not broadly defined as potentially another economic model, but rather as an activist movement within the understood ideologies, as a class war, as a struggle for worker's rights. Despite his criticism of capitalist behaviour in modern times and some useful suggestions on social and individual behaviour adjustments for a better employment environment, Godsell understandably does not offer an answer to the need for breaking down current ideological paradigms and putting labour onto the pedestal it deserves.

The hurdles are quite daunting. We have to at least start with recognising the huge deficiencies in the labour market which in its present commoditised form simply cannot capture the three dimensional essence of labour. One dimension is skills and qualifications; the second is willingness and passion, and the third, the most important by far, is simply that the value of labour, as in all things, is not determined by its own needs, ability to mobilise, haggle and extort, but by the usefulness to someone else of what it collectively does – for the customer, the market.

The conventional labour market places most emphasis on the first commodity dimension, and rather crudely. Some recognition is given to the second dimension, again mostly inaccurately by focussing on shareholder rather than tangible customer value, through bonus and merit schemes. But the third and most important, that the value of those efforts is ultimately determined by what the end customer, or market, is prepared to pay, is largely ignored. Some practical ways this can be done, even if only moderately and at an individual company level, are through concepts such as *Common Purpose; Common Fate* and fortune sharing.

From this perspective labourism implies the unthinkable to most labour champions at present: embracing as a collective a market orientated approach. It has to be willing to allow its *collective* value to be determined by its usefulness to others, the contribution and difference it makes, the value it adds to other people's lives. This, I know, is volatile and seldom set in stone. Real labour flexibility implies an ability of collective adjustment. This can be done while still accommodating a differentiating template for the supply of and demand for skills and qualifications.

Capitalism has (falsely in my view) claimed to be the exclusive champion of free markets. The real essence of capitalism is not market led but profit led and capital dominated, to the extent that it has created devious instruments for delinking wealth creation from tangible value based on contribution to the broader market. We have made a huge leap when business leaders such as Godsell, entrepreneurs, investors and others, can acknowledge the basic tenet that labour is at the heart of all wealth creation. All it needs to give expression to a new world economic order is for labour itself to accept the risks, responsibilities and accountabilities that go with claiming this position.

Having worked with thousands of employees, I can say with conviction that the failure to recognise their contributory potential is a demoralising factor. They feel shunned and powerless to shift the hierarchy above them. In some cases, organised labour has tried to remedy matters with additional training on its own account. But such action remains secondary to the primary role of unions as they themselves perceive it: ensuring enhanced material benefits. In my view, a number of legitimate grievances can actually be restated through the lens of service and customer interests. For example, instead of deploring the unfairness of executive pay, one could argue that it's unfair for customers to have to foot the bill for such extravagance.

Organised labour has annual negotiations on pay and working conditions. It should insist on another annual or even more regular event to discuss how company service and employee contribution may be enhanced. It seems completely wrong that the largest contributor to wealth created has a scheduled mass representative meeting only to discuss what it can get, rather than what can be given. A further role for organised labour is the development of labour cooperatives. Empowerment issues in South Africa have tended to focus on changing ownership of companies by using pension and provident funds. This has done little more than create a new black elite whose behaviour has been cloned from that of its white counterparts; by far the greater part of previously disadvantaged groups has been excluded from this empowerment. Even preferential recruiting under affirmative action is inhibited by considerations such as lack of skills.

I believe that labour cooperatives are the single best way to loosen the grip that conventional ownership has on economic enterprise. This is the most powerful way of showing that the capitalist emperor has no clothes. As we have seen with the Spanish Mondragon cooperative, there needs to be a redefinition of the relationship between capital and the enterprise. We also need a different way of accounting and a shift away from the traditional income statement. Contribution Accounting© is ideal. Indeed Mondragon applies something very close to this format with some interesting additional features. Its treatment of profit is based on the philosophy that capital is a resource, or a means to an end: 10% of annual net profits goes to charity, and 40% is allocated to a "collective internal account", which is collectively owned and managed for the common good. If the cooperative ever ceased to exist, that 40% would be added to the 10% that goes to charity. The remaining 50% would be available to owner-employees for use as collateral for a loan from the Working People's Bank.

Such an arrangement would redefine "profits" in the Contribution Account©. The other categories such as employees and tax can likewise be redefined for consistency with the spirit of a cooperative. The collective needn't ignore external pressures such as market-related pay, but it should be flexible. Variable pay is essential in a labour cooperative. Labour cooperatives should be able to qualify for special tax dispensation – although this should be kept to a minimum to avoid accusations of subsidy by government and unfair competition with other companies. The South African government's Black Empowerment criteria could be applied to labour cooperatives, irrespective of their ethnic make-up.

I have already suggested that the most important shift in modern economics is the understanding that it's all about giving and not about getting. While the two are as closely related as the sides of coin, it's the focus on contribution that makes economics the enabling and empowering environment that it is. This is true at individual and collective levels, whether the collectives are countries, companies, or any other organisation. Companies are rapidly coming around to the idea, hence the changes in statements of purpose, mission, vision and values. But unless each grouping – the primary stakeholders: labour, capital and state – understands its involvement as being about contribution and service, the words remain just verbiage.

Meanwhile, regardless of mission statements, the people most closely involved in a business, and therefore best suited to lead the revolution, are employees. Organised labour can show no greater service to its members than to arm them for rebellion against whatever hinders them from contributing and serving the customers.

CHAPTER 19
Capital as a beneficiary of wealth creation

Previous chapters have dealt with labour as a contributor to and beneficiary of wealth creation, and we should now apply the same principles to capital. If we add the dividend and retained income, we arrive at profits, and we could argue that these reflect both contribution and reward. In that case capital in most companies is second to labour as a contributor to the creation of wealth. Of course, if we were to confine the measurement to the cash pay-out – the dividend – we could argue that capital is the smallest contributor. Even the concept that capital is the second biggest contributor to wealth creation causes howls of protest among those with whom I have raised it. Protest turns to total disbelief when I further propose that as the second biggest active contributor they have less right to govern companies than labour has.

There's an automatic assumption that shareholders should govern, entrenched in law by property rights. The classic definition of shareholders' role is that they are there to appoint company leadership and to provide capital. The former implies governance and accountability; the latter ensures ownership and control. Some, including Nobel laureate economist Milton Friedman, have argued that profit maximisation is also a requirement for shareholder boards.

The principle that contributors earn power, and power in turn earns the right to govern, doesn't seem to apply to the relationship between labour and capital in a collective. The absence of this principle is explained not in the measurements, which prove that labour is a bigger contributor to wealth creation, but in the behaviour. I have already explained this in part. But we need to test the behaviour of capital and then determine whether that behaviour makes it a clear winner over the others. First we have to examine some myths upon which the power of shareholders is based.

The first is based purely on a calculation. At a recent international meeting of accountants, one of the speakers was adamant about the need, as he saw it, for the shareholder's reward to be linked not merely to profit; it should also take account of the initial capital. He was basing his view on the assumption that capital is given, or contributed unconditionally, which is not so. In effect capital is lent, and the lender receives an IOU in the form of a share certificate. The fact that this certificate is associated with greater risk than a normal debt is not the issue; nor is the fact that it usually brings more reward than a guaranteed loan.

The contribution that shareholders make is not the capital itself but the use of it. The money remains theirs and can be recouped at any time by simply selling their shares. Apart from the organic growth that most companies experience, shares tend to increase in value over time and shareholders receive additional rewards on their investment. This is similar to the change in property values, appreciation of assets mostly has nothing to do with wealth creation or adding value.

Another myth is that a few individual shareholders take all the risk. In most cases an analysis of shareholding will show that this risk is spread over a large body of individuals. Certain high-profile shareholders active in the company will have much more at risk than others. But one must be careful not to exclude the possibility that the holding companies have been structured in such a way that control is ensured with relatively little at risk. This is called a pyramid structure and is outlawed in many countries. Through two or three tiers in a holding structure, one can maintain control with relatively little at risk. For example, Joe and his mates can form holding company A, keep 51% of the shares and sell the remaining 49% to others. Holding company A buys 51% of company B, which means that Joe and his mates own half of half, which is 25%, of Company B. But they control the holding company, A, which in turn controls company B. So they have effective control over company B although in practice they own 25% of the shares only. The more tiers you add the more you reduce the shareholding while still keeping effective control.

As a rule share structures substantially dilute risk for the broadest number of shareholders. In many cases large blocks of shares are held by investment, pension and provident funds, which in turn represent thousands of smaller investors, many of them employees. This is one answer to labour’s argument that, although capital gets less than labour in the sharing of wealth, capital’s share is split among far fewer people than the employee share is. These remarks are generalisations. The situation clearly varies from company to company and is very different for smaller, privately owned companies from that of a large public corporation. However, it is the latter that is most clearly in the public view and the cause of much of the current soul-searching in business.

In addition to diluted risk there is relative risk. A minimum-wage employee arguably has far more at risk in a company than a multi-millionaire shareholder in that company. An employee who loses his job may have little prospect of getting another, have no social security and have to feed 15 mouths. Most individuals who own large blocks of shares would seldom have these investments all committed to one company; they will no doubt have hedged the risk with other investments. In addition they have probably amassed a large personal fortune and would suffer only temporary discomfort should their interest in a company prove worthless. Unless they have been totally reckless or imprudent, they are unlikely to join the queue at a soup kitchen. Again, I am generalising and oversimplifying, but I am doing so in order to show that levels of risk aren’t comparable. Wealth, like beauty, is in the eye of the beholder. To paraphrase Seneca: a person is poor not because he has little, but because he wants more.

Then there is the matter of accountability, which has become closely tied to that of governance. Shareholders as a group are notoriously unaccountable for anything. Limited companies have become legal bodies with (as their name suggests) limited accountability for what has been committed to the collective in terms of money.

Admittedly an extension of accountability is implied in the current wave of measures to improve governance and make directors more directly answerable for the behaviour of the company. The provisions are also gradually becoming applicable to advisers such as auditors and consultants, but so far governance has been an issue largely among shareholders who may as a group have become upset with the behaviour of their executives and are crying “foul” because they have been losing money. If they can put a finger on fraud or some other felony, they insist the perpetrator must be flung in jail. Ironically, they themselves were the architects of the conditions that encouraged the crime.

The problem with shareholders is that, vociferous though they may be about their own money, they are still not broadly accountable for the behaviour of their companies. They can limit their accountability to a loss of share value, pass on the blame to one or two of their kind or pin it on some official. Indeed full-time functionaries are held far more directly accountable for the behaviour of companies than shareholders are. An individual employee caught in the act of “creative accounting” could end up in prison. A stockholder in Union Carbide could easily sell his shares after the Bhopal tragedy in 1984, take a bit of a knock on his portfolio and wash his hands of the death of 3,800 people and injuries to thousands more. I am not suggesting that all the thousands of stockholders in Union Carbide should be in jail, but one certainly has sympathy for an Indian orphan who feels that justice was not served by monetary compensation alone.

All of the above is intended to point out the shakiness of the argument that shareholders should govern because they take all the risk and this risk includes being held accountable for the company’s actions. It’s very difficult in the best of circumstances to hold a collective accountable for anything. In fact it becomes remotely possible only if it can be proved that everyone in the collective had the same information, the same veto power and the same part in a collective decision. But that’s not how corporate hierarchies work.

The final and perhaps most important argument for shareholder governorship is philosophical and backed by a legal interpretation. The Western capitalist model has deeply entrenched the belief that if one owns something one has full control of it. This is an automatic assumption which we seldom examine closely. Ownership doesn't give anybody the right to allow misbehaviour in or concerning his/her property, least of all where the property can affect others or the community as a whole. Ownership implies responsibility and I have seen that society is increasingly calling to account the owners of assets on the use of those assets.

Company ownership is certainly something that has been in the firing line. The fact that in companies the link between ownership and accountability has been weakened should mean that the right to control and govern has been weakened as well. But in fact it’s less straightforward than that. For one thing not everybody thinks property rights are fundamental rights – many societies exist and have existed with far milder forms of property use than holding permanent title. I have already argued that ownership doesn’t create wealth; doing something does. And the desire to own things is increasingly being recognised as less of a motivator than the desire to do something meaningful with one’s life.

It’s a pity that empowerment is so narrowly focused on ownership. We are seeing in South Africa a substantial transfer of assets to black-owned companies under Black Economic Empowerment, but many people say that all BEE is doing is changing the “colour” of the elite. It’s a simplistic view that is perhaps relevant only to medium and big companies. But it’s also damaging, insofar as it ignores an important aim of the BEE programme: to encourage smaller businesses and the preferential treatment of suppliers made up of previously disadvantaged groups. The E of Empowerment surely shouldn't stand for ownership per se, but for enhancing the ability of an individual to make a contribution to her/his fellow humans' wellbeing. That, rather than the wealth, comfort and status of the owner, should be the point of having assets in the first place.

The emphasis on ownership also lies behind many of the silly SIPs and ESOPs or employee share schemes I have argued against. But further flaws are revealed in one of the first big employee share transfers in South Africa which occurred in the gold mining industry. Hundreds of thousands of employees were given shares valued in total at about R250 million. This represented less than 5% of the mining company's share capital. Whatever the motives were, the scheme had many shortcomings. It gave employees little power on the board because of the minimal holding: voting power relates to the number of shares held, not the number of shareholders.

As an incentive it was very dubious because each employee got a certificate of only a few shares and the six-monthly dividends represented much less than a monthly wage. As a gesture of generosity or a gift it was questionable because in a relatively short time the share price had fallen. It would have been better to give each employee some mutual fund units. Ultimately it also failed as a device for ensuring commitment and loyalty, for shortly after the share issue the mining industry slumped and the company had to retrench thousands of workers.

I remember the irony of a picture that formed in my mind at the time, of an employee packing up his meagre possessions to go home to an extended and starving family, and coming across this piece of paper that he probably couldn't read and about which everyone had made so much fuss, saying how good it was going to be for employees.

I dare say that most of the shortcomings of the earlier gold mining issue apply to employee share schemes generally. A series of corporate collapses, spectacular failures and executive misbehaviour at the beginning of this decade has led to generalisations which have hardly been helpful in addressing the issues of behaviour and accountability. The one about governance will no doubt give rise to a whole new set of laws and requirements on companies. Whether that will ensure greater and more appropriate accountability – the two obviously go hand in hand – is another matter. For as long as owners as a collective of shareholders led by mercenary executives fail to accept accountability for the behaviour of their companies, their strength as "governors" will be compromised. We all love to be in control. We are less keen to accept the responsibility that goes with that. An important reason for the entrenchment of the idea of shareholder governance and control is the amount of attention this body of stakeholders receives relative to the others. Company reports, stock markets, company laws and the business media are regular features in our daily lives. They all focus nearly exclusively on shareholders, their rights and things that affect them.

We can conclude from the above arguments that it really is a moot point whether shareholders have earned the right to govern and should be governing companies. Yet for the most part they do govern. There are a number of reasons for their governance but I still believe the most significant one is relative behaviour. Given the behaviour of the three direct stakeholders – labour, capital and state – we have already seen that labour's position in relation to a company has been defined as that of taker and not contributor. This may or may not be a traditional aberration, covertly enforced or otherwise, but it's one that only labour can correct. Where the state has been in control of companies, the track record is not good; also it's the smallest contributor of the three. We can therefore rule out the state for governance. That leaves shareholders as the obvious candidates.

Governance and control are deeply affected by the principle that the less we are driven by our higher values as human beings, the greater the need for rules and regulations. The governance issue has focused mainly on the felons and people have perhaps too readily disregarded the well-meaning majority who go about their daily business of service to customers. This group will be equally affected by whatever new legislation is passed and it's by no means a safe bet that these businesses or their customers will benefit from it. Self-governance and control are mostly unwritten and automatic in benevolent companies. They should be left alone to do their job of serving and being creative and innovative.

CHAPTER 20
The state as beneficiary of wealth creation.

For decades I subscribed to the view that the smaller the state's claim of economic resources the more prosperous that nation would be. To argue this point, capitalist champions often use a Disraeli-type statistic called Government Participation Rate (GPR). My own position is that a low GPR is no guarantee of prosperity. What is unarguable, I think, is that a vacuum in values-driven behaviour will be filled by controls, rules and regulations. In that case GPR is likely to be high. But the country wouldn't necessarily be poor.

Political scientists draw a distinction between the government and the state. From an economic perspective one could say the former normally covers the central or federal government or civil service, and other public authorities such as provincial, state, city or municipal authorities. The latter is a broader definition covering the judiciary, social structures generally, and institutions such as semi-state bodies, non-governmental organisations (NGOs), etc. Our current generation comes armed with considerable experience in these matters. The collapse of the command economies was an important lesson about government involvement in national economies, yet much of the detail is unclear and still causes debate.

This chapter is intended merely to explore the role of the state in wealth creation and its relationship with companies as one of the beneficiaries of their wealth creation. As an institution, government is by far the biggest single actor in the economies of most countries. What it does in terms of spending and income collection has a profound impact on inflation, interest rates, exchange rates, economic growth, jobs and many others.

In addition, I have noted that government's dependence on companies has to do with more than company tax. It also relies on them to collect indirect or spending taxes such as value-added tax, general sales tax, and customs and excise duties. Personal income tax is deducted from an employee's wage and then passed on to the government, although ultimately the individual is still accountable for personal income tax. Without companies governments would be hard put to have an income base in the first place and to have a means of collection in the second. The full benefit to the government is not immediately clear from the Contribution Account©. But it is quickly and easily revealed. Let's use the fortune-sharing case study figures in figure 20 of chapter 23 below. (**Note that in these illustrations, I have NOT applied the revised format of including employee tax under government**.)

In South Africa there is a 14% value-added tax; exports are exempt. R428m went to the company in the form wealth created, and roughly a further R60 million collected from invoices was paid to the government in VAT. The employee profile points to an estimated average personal income tax rate of 25%. This would amount to about R60 million. Not all of the benefits are taxable so that figure could be reduced by (say) R10 million, leaving R50 million. Adding the above to company tax of about R40 million, we can say that the government's total benefit from this company was about R150 million in that year.

Discussion on the government's relationship with a company as portrayed in the earlier Contribution Account© generates some heated debate. I had a very hard time while presenting a programme to a group of lantern-jawed steelworkers in Cape Town. They raised the point that by not showing government's further take from employees, the figures are prejudicial, suggesting that employees get more than they effectively do. At the time I defended that format on the point I made earlier: the figure reflects company tax alone as the government's share; the tax on the employee share is a reflection of the employee's personal relationship with his/her government. Understandably, what makes this idea stick in certain people's craws is the fact that government budgets aren't, and could not conceivably be, split into functions that serve individuals and ones that serve companies. Now, several years later, I join the steelworkers and have moved the employee tax from the labour share to government.

Do companies pay tax? President Ronald Reagan, in defence of supply-side economics, argued that ultimately only individuals pay tax, and company tax has to be recovered in the company's selling price of goods and services. Effectively company tax acts like an indirect tax similar to value-added tax or sales tax. This logic explains why in many countries one would find a lower tax rate on companies than on individuals. Some also differentiate between the tax payable on the portion of profit that is retained or saved, and that which is paid out as a cash dividend. A link between company tax and personal income tax has to be maintained because owners of small and medium enterprises in particular can choose between drawing income as a salary or as a dividend.

The positioning of the state as a contributor to wealth creation gives rise to vehement protest. The assessment of whether the share given to government truly reflects its contribution to wealth creation is a matter of judgement rather than mathematics, and the judgement is influenced by numerous assumptions besides the one about capital as the biggest contributor to wealth creation. The issue is highly charged and I suspect that in most countries in the world, presenting the state as a giver rather than a taker is viewed as total nonsense. History shows too that many revolutions were sparked by tax burdens. Even today it is easy to inflame emotions in a discussion on tax. Indeed the state has a much harder time defending its share than other stakeholders do; it may have the advantage of coercion but relying on that alone wouldn't be sustainable in a democratic society. I propose to put its case in principle, in an attempt to show that it does earn a reward. Whether value is reflected in price is another matter.

Government's contribution to wealth creation consists of two important and interrelated functions: to create the conditions in which others in society can create wealth, and to correct socio-economic imbalances. The first of these implies that government isn't there to create wealth in its own right. This doesn't mean it cannot be involved in wealth-creating ventures. For a government venture to qualify as wealth-creating it must first and foremost obey the rules of legitimate transaction.

This means simply that it subjects itself to the forces of supply, demand and price and four supporting conditions of freedom of choice; freely moving prices; competition and consumer awareness. There are many government services which follow the user-pays principle. They function on the income they get from people who use and then pay directly for that service. In that sense such services are legitimate wealth-creating ventures. If they fail to earn the title it's because they face no competition and customers don't have the option to go elsewhere.

This raises the matter of privatisation. I have never quite understood the hysteria around the issue. If it's based on the Milton Friedman logic that maximisation of profit is the key driver that creates efficiency and prosperity, then the transfer of ownership to the forces of greed makes sense. However, I have argued that this theory has been substantially discredited. Putting the customer first is the key driver of good companies and I believe I have shown that it's associated with all of the techniques of business sense and operational efficiency for maximum wealth creation based on maximum contribution. It comes back to the fundamental principle that ownership does not create wealth; doing something in service to others does.

I will concede that a government-owned enterprise finds it hard to follow this principle. The need for a change in purpose is probably less of an issue than the need for a change in behaviour. The very foundation of government activity is that of service, yet its employees have often acted very differently in terms of both attitude and delivery. State ownership of enterprises is normally defended on the basis of national fear, insecurity, job creation, protectionism, political lobbying, or an inability by private enterprise to provide the product or service; sometimes it is a blatant attempt at income generation. These motives put customer service at the bottom of the priorities list.

State ownership of assets presents another difficulty. Should a government own tangible capital assets when it should be focusing on other services? Is it appropriate for a family to own Rolls Royce's when its children are starving? If the purpose of selling these assets is to generate income for a state to focus on more appropriate activities, then privatisation has a different slant. But privatisation cannot simply be defended from the point of view that the motive of one collective is more appropriate to business than that of another. If that motive is customer service, the composition of ownership shouldn't matter.

Even market orientated economies recognise the need for state intervention "when markets fail". This is clearly open to wide interpretation and will forever be a subject of debate and opportunistic agitation including political power play. State involvement through direct or part ownership is generally justified when government alone has the necessary resources to provide essential services. Add BEE into the mix and you have a toxic contaminant.

State owned enterprises exist throughout the world, including highly developed Western economies, and some are just as productive and efficient as their privately owned counterparts. They are mainly to be found in infra-structural sectors such as transport, communications, energy, and health care. After the wave of privatisations worldwide from the 70's, continuing today in many previously communist regimes, these enterprises also largely adopted "commercial" practices, giving due recognition to the need to generate earnings and not rely on taxpayer funding. This is the perfect example of the vital role of profit, not as an end in itself (which would be unacceptable given their largely protected monopoly status) but to ensure maximum efficiencies and productivity.

On the surface, then, SOEs should perform as well and as efficiently as their privately owned counterparts: servicing their markets through the best use of resources. Yet they don't, particularly in South Africa. It may be a sweeping generalisation, but few would disagree that they are among the worst performing businesses in the country. So much has been written about their failures that it would be superfluous to go over them again. Of course, everyone has a view on the cause. Perhaps in part it is their "commercialisation" which has made them adopt many of the bad behaviours of their survival driven peers in the private sector, including outrageous levels of executive pay and marginalisation of labour. But paradoxically it has not prevented many of them from being on the edge of insolvency.

Without the profitability mandate being met, one would at least have expected their service mandate to be impressive. But it is the worst. Then one can only hold the owner, the government, accountable. If a state owned enterprise fails in profitability and above all in service, the motive behind and validity of government ownership becomes highly questionable. Yet, the populists want more.

While nationalisation, particularly of mining, may be a dead subject to the elite, it is very much alive in populist politics. In order to underscore its stupidity even to those who want ownership, I extrapolated a Contribution Account©, reflecting wealth creation and distribution for the industry as a whole.

Figure 19

MINING INDUSTRY CONTAC 2010		
	R bn	
revenue/income	R 441	
outside costs (1)	R 241	
gives wealth of	R 200	
shared with		
employees	R 78	39%
government	R 18	9%
savings (2)	R 88	44%
dividends (5)	R 16	8%

As figure 19 shows, nationalisation of mining will bring the state only the 8% from dividends (5). It cannot escape supply costs (1) and capital expenditure (2) which is the lifeblood of mine survival. It most likely will succumb to labour pressure which will increase the employee share, obscuring efficiencies and ultimately forcing taxpayers to sustain operations. Nationalisation may nearly double the government's revenue from mining but in return it has to manage the mine, run all the risks associated with mining, and use taxpayer's money for development. The latter demands high risk private capital and not what would be tantamount to reckless use of taxpayers' money

As they say: "Be careful what you wish for. You may just get it!"

The capitalist obsession with state ownership of assets draws attention away from many other, perhaps more harmful manipulations. Trade protectionism is rife; exports are subsidised; tax and other concessions are used to support inefficient and vulnerable ventures such as in agriculture. The logic is seldom based on more than the strength of the political lobby. Some may say: "So what? The buyer benefits and is this not in the interest of the customer?" Absolutely not, as William Boetcker would have responded: "You cannot help men permanently by doing for them what they should be doing for themselves."

If a nation decides to use taxpayers' money to subsidise a cheaper price for its customers it *may* be a different matter. That would be akin to the Swiss Red Cross. As a rule, however, the motive is very different: it's tied in with some selfish purpose, whether at a group or national level. Artificial influences on normal market forces seldom benefit customers in the long run, despite the many flaws in markets themselves. Customers may revel in the cheap prices of clothing sourced from sweatshops in the Far East. But the hangover comes in the form of a loss of local jobs and difficulty in affording even cheap shirts. In the long run, cheap dumped imports destroy domestic competition and then they are no longer cheap.

The whole issue of government involvement in domestic economies rests on Boetcker's "cannot". Just as important, however, is the recognition that even if markets are perfect, the people using them are not. Market perfection is nurtured by values-driven behaviour. Its imperfections are shown up by self-gain.

Interestingly, the two primary government functions of encouraging wealth creation and addressing social imbalances can broadly be mirrored against wealth creation and wealth distribution. They are also coincidental and mutually supportive. These functions have never been disputed. Throughout the world, tax is structured in such a way that the rich pay proportionally more than the poor. In spending too, much of the state's emphasis will be on uplifting the poor and caring for the disadvantaged. The difference in emphasis will give a particular government the stamp of either socialist or capitalist. The latter school of thought says that encouraging wealth creation is more important than equality; socialists on the other hand put equality first. I will hide behind Soros's view that no one possesses the ultimate truth.

The more fundamental question arising from the state's presence as a stakeholder in wealth creation has to do with behaviour. It does not have to deal with competition and freedom of choice; in that sense we could say it's at a disadvantage! We have seen that power is mostly earned because the follower knows that the leader has his/her interest at heart. Controls are imposed. For a government to be truly powerful, it has to move away from imposition and look for voluntary support. It may believe it does so every four or five years through elections but we all know that on a day-to-day practical basis most followers do not experience this.

The fact is that civil servants have a far greater responsibility and a much bigger task to be customer-driven. The taxpayer funds entrusted to them are not freely given. Civil servants are the custodians of public funds. They are in a position of trust where the pure and powerful checks and balances of consumer sovereignty can't be relied on to influence behaviour. In fact the individual public servant has a far greater opportunity to adopt that ethos in terms of which his/her true value lies in the capacity to make a contribution to others. Public servants' lives aren't complicated by the profit hysteria. They have been appointed to serve and that's that!

I have spent much time trying to make the Contribution Account© relevant to state institutions, but in the absence of the rules of legitimate transaction it becomes very difficult. The state is by its very nature a beneficiary of the wealth created by others, and a contributor to that process. It's not in itself a wealth-creator and so a stand-alone Contribution Account© won't fit snugly. At best – an extremely important best – we can measure the extent to which a state institution or government department succeeds in enabling others to create wealth; the more efficiently the state can deliver its contribution, the more wealth creation is encouraged and, in turn, the greater the state's income. There is at least a clear qualitative line of sight between its service to the nation and national prosperity. That line is GDP.

Notwithstanding, I have come to realise that we could indeed apply the Contribution Account© to a state institution. The watchwords for maximum wealth creation, "sell the most you can, get the best price you can and keep your outside costs to a minimum", have to be modified in two respects. Firstly, the "market" or customers have to be clearly defined and understood. The particular need for a "serving" relationship based on trust has to be deeply felt. The norm of "best price" clearly has to change to lowest price, where price is part of the tax revenue; but the other two are just as relevant to productivity.

Another obvious adjustment to the Contribution Account© would be in wealth distribution. Labour would be one beneficiary and government would fall away. Capital, however, should include that part of the wealth created (as shown in the national budgets) that gets allocated for spending on infra-structure. This would be the same as "savings" but needs a proper definition of capital versus current expenditure because infra-structure spend on structures such as dams and roads does not fully cover expenditure for long term benefit such as education.

To some extent this enhances the potential for fortune-sharing. The trouble is, the taxpayer could argue that discretionary surpluses from improved productivity reflect over-taxation. Over-taxation previously could be argued in any case when the government decides, as it often does, to reduce taxes in a particular budget year. I must confess that I have not yet applied the Contribution Account© to a state organisation. It would be much easier to do with NGOs such as charitable bodies. The operational measurements I have developed as the Extended Contribution Account© and the Component Contribution Account© are just as relevant to a state organisation as they are to a company.

The "state" category in wealth distribution by a company should include not only government taxes but donations and spending on social investment. This is a murky area where philanthropic gestures are often confused with marketing sponsorships.

We can all agree that paying Tiger Woods $5 million dollars for winning a sponsored golf tournament has little to do with social investment.

CHAPTER 21
The sharing of fortunes

The common purpose that binds people in a collective is the contribution which that collective makes to its outside environment. In the specific case of a company, contribution is about customers in the first place and the broader community, society and humanity in the second. All other benefits are consequences of this. The multiplicity of motives among individuals in the collective is not of major importance. What does matter is that they take second place to the common purpose. The extent to which individual purpose, motives and deeper intentions are aligned to the collective purpose will, however, determine the degree of ultimate success and strength of the collective.

The future of organised labour will depend heavily on an ability to align itself with this cause. Labour's traditionally inward-focused raison d'être was valid until a few decades ago. It is no longer so. The participative practices of the last few decades have eroded its base internationally. Bonds with political organisations have likewise been all but broken in most countries. Even in South Africa, the tripartite understanding between organised labour, the South African Communist Party and the ruling African National Congress has been under severe strain. The biggest challenge is yet to come. We have already seen that the development of technology and increasing mechanisation, as well as globalisation, open societies, strong trading blocs, international trade agreements, freer movement of capital, goods and services, and the need to attract investment, are putting pressure on rigid labour structures.

At the same time, ironically, American-style capitalism is at its most vulnerable; never before has there been such an opportunity for labour to align itself with those who challenge the unbridled-self-interest and profit-driven model and are concerned about the destruction of nature, the plight of the poor and unemployed, corruption, crime and unethical business behaviour. For this alignment to happen, however, the unions must first champion the cause of the consumer and customer, since they not only belong to that group but are also there to serve it.

Ultimate survival is going to depend even more heavily on the ability to adopt the idea of common fate. To foster common purpose in a company is easy enough and facilitates the empowerment of its members – indeed I believe employees make better custodians of customer interests than most managers do, especially the executive. Alignment with common fate is where it seems the biggest sacrifice is called for. Yet here is where true power lies. It will blow away the smokescreen around labour, the idea that it takes no risk because wages are fixed and the only real purpose of a union is to ensure, through control and coercion, a regular increase in material benefits. This has been a bizarre fallacy that has led to heavy job losses and therefore of members. It's time to recognise that the threat of retrenchments and dismissals far outweighs the threat of work stoppages and strikes. No amount of legislation can force private enterprise to run companies at a loss, and if labour becomes too bothersome, there are always "ways and means"… including figure-fudging and closing down the business to open elsewhere, complex mergers, pyramiding, takeovers and mechanisation

Employees should not wait too long before seizing this opportunity. Since the beginning of the 1990s many common-fate instruments have been developed from the massive retrenchments which followed processes of “containment” and its ugly sisters of re-engineering, rationalisation, restructuring, reconstruction, deconstruction, and similar terms in consultant-speak. The initial intention of variable-pay instruments was arguably not to protect jobs as much as profits, and to maintain a semblance of morale among punch-drunk staff. As they developed it became very clear that without some kind of employee participation they would fail. Indeed many have, for that very reason.

The instruments go by many names under the broad banner of “gain-sharing”. This is something of a misnomer because it implies sharing in the gains only, which in turn implies that if there are no gains, and indeed if there are losses, then the management reserves the right to cut heads. As long as this is implied, the employee initiative is removed. For labour to recapture this initiative it has to take the courageous step of offering a full fortune-sharing dispensation in exchange for reasonable guarantees of job security.

There is an element of risk here. But it’s probably less than the risk of job losses. Acceptance of it will earn labour the right to be fully informed and fully involved in all aspects of the business. Labour will automatically switch its role on an organised level from taker to giver. This is true power.

In fact it was labour that introduced one of the more successful and lasting gain-share programmes. It is known as the Scanlon Plan, named after its founder, Joseph Scanlon, who was the president of a local branch of the United Steelworkers Union in the USA. He developed the plan to help save the failing steel company of which he was an employee. That was in the mid-1930s when, interestingly, trade unions were at their mightiest in America. The Scanlon Plan worked, and the idea is alive to this day. The essence of its success is to be found in a statement by Scanlon himself:

“What we are trying to say is simply this: that the average worker knows his own job better than anyone else, and that there are a great many things that he could do if he has a complete understanding of the necessary. Given this opportunity of expressing his intelligence and ingenuity, he becomes a more useful and more valuable citizen in any given community or in any industrial operation”.

As we saw, the greatest measurable part of wealth in most organisations is created by labour. It deserves every opportunity to enhance this contribution, to control it and to put some of it at risk rather than lose jobs altogether. Organised labour merely has to know that it has the initiative and to seize it. No variable-pay system will work without labour’s full cooperation. Given this guarantee, unions need not fear flexibility and should come to see it as a new instrument for enhancing their power. In all our workshops, employees have universally and firmly supported the concept of pay-at-risk in return for a higher degree of job security. Why have unions and management done so little to explore this mood? I suspect that unions are afraid of losing the only real justification for their massive structures: the assumption of an inherent conflict, mostly about wages. For managements, the prospect of losing outright control on hiring and firing is equally daunting; it's far more comfortable to work with labour as a cost than to recognise it as a valued contributor.

There is also the fear that a failing company won't be able to attract highly qualified staff unless it can guarantee a competitive package. This fear has no basis in actual experience. For as long as differentiated pay is supported within a variable-pay system, there is some obedience to the market. Not even the staunchest of unionists can in all conscience propose equal pay or rates of pay that take no account of supply and demand. The supply-demand-price argument, however, is often taken to extremes when applied to an individual human being. It ultimately has less impact on commitment and loyalty than one may think. For the more highly skilled, the prospect of closer involvement in a company's fortunes may be a far greater attraction. This is particularly true of people who are predisposed to taking a risk.

Finally, there is of course a macro argument: the supply-demand-price mechanism may not always be appropriate to labour, but it's not a bad idea to try applying it. The best talents belong in the best ventures; failing companies shouldn't be attracting the best talents. If such people can make a significant difference in terms of a turnaround, their prospect of reward in the future will remain attractive. If they cannot, then the pay is wasted and will only hasten the failure. This is all the more reason to deplore exorbitant executive pay in poorly-performing companies.

The International Labour Organisation is an active participant in research and guidance on variable pay or gain-sharing. Gain-sharing has become a whole new branch of knowledge in organisational theory, covering highly complex processes as well as simple profit-sharing schemes which date back to 1835 when Edme-Jean Leclaire, a Parisian house painter, decided to share his profits with his employees. Because gain-sharing should be a labour initiative, it's up to organised labour to develop its own expertise and processes, bearing in mind that this can never be a one-size-fits-all approach.

With the growth of gain-sharing has come a whole new confusing language and terminology. Reams have been written on it; thousands of case studies already exist. I shall attempt only to make a few points that most experts agree on and to introduce some consistent terminology to fit in with Contribution Account©.

The first is that gain-sharing or variable pay has not yet developed fully to the point of fortune-sharing. This may be because it's necessary always to ensure some form of guaranteed or basic pay for employees. But the proportion at risk varies, especially in different countries, and it's this proportion that tends to be a bargaining issue. The options range from "all-at-risk" in exchange for the guarantee of no job losses and an assured lay-off package, to minimal risk for a large measure of job flexibility. Numerous checks and balances can be built into an agreement, such as one whereby the union is the final arbiter in any dismissal. The simple principle involved here is the same as what we discovered applies at an individual level: the most powerful act of giving is one that is unconditional. Full fortune-sharing by labour will elevate it to its peak of power.

A useful analogy for fortune-sharing is marriage. A fully participative fortune-sharing company will need the same circumspection as one needs before marriage and will undoubtedly need the same degree of constant work, communication and trust-building to ensure its survival. Not all of us will be suited for marriage to begin with. But labour has to be the suitor! Few marriages succeed if the partners are focused only on what they get out of the arrangement. The principle of fortune-sharing is about involvement of labour – Joe Scanlon understood this – and not about incentive. This is where many schemes go wrong. No doubt there are incentive programmes that have worked. They are mostly driven by greed and the desire for self-enrichment and are part of the wage-slave chains. A values-driven company should be beyond such puerile things. Of course, involvement is a process requiring many supportive actions such as a common purpose, understanding the business, transparency, communication and servant leadership.

Research has shown that variable-pay systems do as a rule enhance productivity and rewards both for the shareholders and employees. That is not to say that all have been successful; some have been dismal failures. The cost in terms of lay-offs, low morale, stress and employee discontent under variable pay based on incentive is simply not known. Ironically, most organisations that have variable pay also have a more highly paid workforce than their fixed-pay counterparts. This is understandable on a simple risk-versus-reward principle.

One need only examine the experience of Japan and other Asian countries where they progressed from guaranteed employment at little more than a bowl of rice a day to the highest-paid employees in the world a few decades ago. Up to that point employees were represented largely by what their more belligerent Western counterparts would call “sweetheart” unions. This “family” commitment within Eastern companies seems to have waned in the workforce with the entry of the first post-war generation. In addition, one mustn’t forget the pressures that grew in that cosy relationship as these countries became increasingly capital-intensive and involved in the capital shenanigans of the West.

As a broadcasting editor of business news I was invited to visit my counterpart in Taiwan in the late 1980s. At one point we were comparing salaries and I was a bit peeved to hear that he earned nearly 75% more than I did. Moreover he was living in a country with a relatively low personal income tax rate and a fairly low cost of living. When he explained that only one third of his pay was fixed or basic, the rest depending entirely on the fortunes of his organisation, I became sympathetic – unduly so in terms of what I now know and think. Another fact that emerged in the discussion was that most employees preferred to work for a company where the variable proportion of the pay was high. They saw this as a reflection of a successful company, one that was therefore good to work for. In addition, most Taiwanese took an intense interest in the performance of the company and its fortunes. Another way in which they differed from the West was that a struggling employee, instead of being subjected to condemnatory peer pressure, would be helped by his colleagues to improve. In a macro-context, Taiwan at that time always had high levels of personal savings; national reserves were also high. This was attributed partly to the fact that the average employee was encouraged to budget and calculate debt-servicing needs on the basis of guaranteed pay, rather than factoring all, or even a portion of, the variable pay into his/her spending needs.

We have seen that variable pay is a very old concept. Its modern complexities may be at least partly due to our fascination with measurements and measuring tools such as computers, spreadsheets, databases, apps and other software programs. In this too, I suspect, much of what is being counted does not count and much of what counts is not being counted. The survival of gain-sharing through decades, if not centuries, seems to show that its logic is based on much more than the measurable.

The doyen of gain-sharing experts in the United States, John Belcher, has put variable-pay systems into three categories, each with a different formula for arriving at the rewards.

- The first is cash profit-sharing. It is clearly determined by shareholder expectations being met, although not necessarily only according to the standard headline earnings.
- The second category is gain-sharing. While this term is often taken as applying to all forms of variable or flexible pay, Belcher defines it as a system where the pay-outs represent a share of financial gains. These are associated with improvements in group or organisational performance.
- Thirdly, there is goal-sharing. Here a predetermined amount is paid for the achievement of group or organisational goals. These goals can be anything from monetary values to production output.

  Historically, gain-sharing has been developed from four roots:
    - profit-sharing
    - the Scanlon Plan
    - the Rucker Plan and
    - Improshare.

Variable pay can apply to an individual, team or group, or at organisation level, for example in companies.

I have already defined profit-sharing. An estimated one million firms in the United States have some kind of profit-based variable-pay system. It clearly can be best applied at group or company level. The biggest drawback is that it's seldom fully understood by employees, especially at general staff and worker level. In most cases "line of sight" is difficult to achieve and "line of effect" even more so. I will explain these terms more fully later on, although they are fairly self-explanatory. The image of profit-sharing schemes is severely dented at times when company reporting, with or without complicity on the part of the auditing profession, reflects less than the truth about company performance. Puzzling executive pay-outs add to the distrust. In addition, bonus triggers such as EVA (economic value-added), EBIT (earnings before interest and tax), or RONA (return on net assets) and ROCE (return on capital employed) are often complex.

My own biggest problem with profit-sharing is that it's unrelated to common fate. As long as labour is viewed as a cost in accounting, shedding employees is the easiest way to improve profits. And if the purpose of incentives is to raise profits, then labour remains the instrument of profits and the profit-sharing scheme in effect only exacerbates the divide between labour and management. Some remuneration and gain-sharing consultants in South Africa actually suggest that profit incentives be confined to senior management and executive staff, and productivity incentives be applied at a lower level.

Most productivity incentive schemes ultimately have a bearing on the individual and tend to cause internal competition and “angst” among colleagues that very few favour over time: even those who run away with most of the accolades. One scheme that I have heard of proposes that groups be divided into teams where the top 10% receive impressive bonuses. The pay-out decreases from there down to the point where the bottom 10% can actually be dismissed. South African trade unions vehemently oppose these kinds of incentives. Rightly so, because they are imports mainly from America, where unemployment and job security are less of an issue.

Many companies have introduced share-ownership options for staff. These have been given different names such as SIPs (share incentive programmes) or ESOPs (employee share option programmes). Experience has shown that they work better at the executive level and less well at general staff level.

The Scanlon Plan is closely focused on cost-saving. Any reduction in costs is shared with employees as a gain. But one may well ask: gain in terms of what? In most cases, simple debit and credit bookkeeping will translate cost-saving into a gain in profits. The scheme could be quite unfair but what softens it is that the measurements usually apply only to those areas where employees are in direct control. This feature adds substantial benefits in terms of understanding, credibility, communication and perceived fairness. But again, as long as labour is accounted for as a cost, some employees could benefit by lay-offs among their colleagues. The reason for Scanlon’s survival to this day and indeed for being reinvented in various forms, is that it has tried to address these issues.

The Rucker Plan was designed by American economist Allen Rucker shortly after the Scanlon Plan came into being in the 1930s. Despite many references to it in organisational theory, I could not find a case study showing where Rucker’s plan has been successful. Nor did John Belcher provide any in his writing. Scanlon supporters Paul Davis and Majel Maes have concluded that Rucker’s plan simply ground to a halt after the death of its founder. It’s nevertheless worth examining because it’s triggered by value-added or wealth created and comes closest to my idea of a labour-empowering system.

Rucker toyed with the idea of a value-added statement (VAS) long before it became part of traditional reporting. That his gain-share system and the subsequent accounting format did not merge is quite surprising. Rucker’s critics argue that it’s the difficulty of the reporting format that made the plan vulnerable. I think I have already demonstrated that nothing is further from the truth. It is the most logical of all accounting conventions and the least susceptible to butcher-bookkeeping. The real potential of Rucker was in relation to common fate, which he unfortunately failed to recognise. Under his method, although the bonus pay out is calculated at an organisation level, it’s still quite feasible for employees to be given bonuses as a result of lay-offs of colleagues. This immediately detracts from common fate. The difficulty is not insurmountable, however, and it may be time for a Rucker revival.

I must emphasise that although Rucker trademarked his process, I have been working with and refining the VAS for decades primarily as a business awareness and communication tool for labour. The development of Contribution Accounting© and the concept of fortune-sharing was an outflow of this work and was totally independent of research on gain-sharing.

Improshare was developed some time after Scanlon and Rucker. Whereas Scanlon and Rucker are based on monetary measurements (although Scanlon can include other physical accountabilities), Improshare is based for the most part on physical productivity measurements calculated at team and individual levels. This meets a key requirement of “line of sight” and “line of effect”, and again makes for credibility, understanding and perception of fairness. However, when things are not measured in terms of monetary value one has no indication of how useful they really are. As we saw earlier, the concept of value-added puts a monetary value on the contribution one has made to the good of a customer. If the customer stops buying a product, the contribution ends – no matter what “inputs” of time, effort and mind are present. Physical measurements therefore have their limitations. You could be measuring and rewarding things that are adding no value.

“*There is nothing so useless as doing efficiently that which should not be done at all*.” — Peter Drucker.

A South African goldmine had an experience of this. It decided to pay its underground teams bonuses based on the number of cubic metres mined. People had the incentive to work long and hard hours, breaking mining records and being called into the office month after month to receive their production bonuses. The day came when they were called in and the entire staff was laid off. Why? Because although more rock was being produced, the grades had fallen – relatively less gold was being extracted from every ton of rock. In addition the gold price had fallen, so the value of each gram extracted from the ore was reduced. One analyst calculated that the mine could have been saved had it not paid out the production bonuses! The harsh reality is that you cannot only reward people on the basis of things within their control.

At a practical level, the overriding message of variable pay today is that there really isn’t a generic template or formula that fits all circumstances. Consultants working in the field should avoid and be prevented from imposing their pet projects on a company. The system must be home-grown and be constantly polished in every detail. Design and implementation are less important than policy and intention. As always the “why” far outweighs the “what” and the “how”.

We have seen that variable pay can act as an incentive, or encourage involvement, or both. The two are not the same thing, however. What is true is that involvement will act as an incentive. But incentive will not always promote involvement by all; indeed it very often has the opposite effect. Involvement is about being focused on contribution, whereas incentive is about reward. Variable pay can be empowering, compassionate and generous, but it can also become just another tool in the “what’s-in-it-for-me” kit.

CHAPTER 22
Fortune-sharing and Contribution Accounting©

I have clearly not covered the subject of variable pay in any useful detail; that would be another book – and meanwhile there is enough written material on the subject to enable anyone to design something useful for their circumstance. What is perhaps different in our approach is the concept of fortune-sharing, taking the risk-transfer notion further than what has hitherto been broadly considered or implemented. It also implies a far greater degree of participative management and a deliberate policy of involvement by labour. The adoption of *Common Purpose; Common Fate* as the principles underpinning the stakeholder relationship is possible only if that ethos is supported by the account used to measure the enterprise. To the best of our knowledge the only one that fills the bill is the Contribution Account©.

The plethora of writing on variable pay has created many terms that are being used interchangeably. This makes for confusion and difficulties in defining one's terms for a given argument. For this work I will stay with Belcher's definitions of profit- and gain-sharing as given earlier. Profit-sharing does what it says; so does gain-sharing: it's about sharing in a set of financial gains at any level. Gain-sharing therefore means paying out only when performance has been relatively good. Goal-sharing is very similar to gain-sharing, the only difference being the definite link to pre-set goals. But none of these three entails a sharing of misfortunes, beyond the waiving of a bonus.

Fortune-sharing means sharing in both the good and the bad. The extent to which it is shared is part of the design based on the Contribution Account©. Fortune-sharing doesn't necessarily mean letting go of basic pay. This can still be guaranteed, but the bigger the guarantee and the stronger the similarity between basic pay and market-related pay, the more fortune-sharing is diluted and compromised. Fortune-sharing would discourage the existence of a cap – that which puts a limit on the amount payable to employees under the system. As I proposed earlier, the greater the risk, the greater the trade-off should be in other employee benefits such as job security.

That part of pay which is neither guaranteed nor unconditional is flexible or variable. I will refer to it as pay-at-risk. A trigger is the point at which employees qualify for a bonus. The term is more applicable to the standard gain-sharing sharing schemes than to fortune-sharing; fortune-sharing implies constant flexibility. Fortune-sharing also doesn't mean abandoning conditional pay, a type of reward which is mostly incentive-based; it literally says, "If you achieve this, I'll pay you that."

Conditional pay has been popularly based on a family of measures. Consultants working in the field prefer a family of measures to one or two triggers. They point out that effective productivity improvements have to be measured on a broad front and the commitment to paying out bonuses is subject to the company's ability to afford it. A family of measures normally underpins merit bonuses. In general, conditional pay and merit bonuses erode the concept of common fate. But they can be retained as an instrument of reward for exceptional performance. Few would quibble with that.

To reduce merit pay erosion of common fate, one could make a distinction between recognition and reward. Recognition can be anything from the proverbial pat on the back to a trip to Disneyland, whereas reward is usually in the form of money or pay. Pick 'n Pay rewards outstanding performers with a Disneyland visit during which they are given customer-care training; they are also entitled to wear a badge recognising this achievement. A common-fate approach is not comfortable with punishment that implies a reduction in pay. Censure is preferred: in the form of warnings in private, or other ways of expressing displeasure with behaviour or performance. Common fate should promote peer support rather than peer pressure. But consistent and deliberate misbehaviour will lead to peer pressure and eventual censure. One doesn't abandon discipline – all of the standard procedures can still apply. The confident hope is that they will become less necessary with the adoption of common fate.

Common fate also does not imply the abandonment of differentiated pay based on supply and demand for skills and qualifications. One can still maintain common effect with differentiated pay. Common effect means that each member of the group is equally affected, by way of percentage of pay or a nominal amount. The flexible and variable part of remuneration can be guided by differentiated pay, in that surpluses can be apportioned as a percentage of pay or as an equal division or both. Equal division means every one receives the same amount. For example, if the surplus was R1 million, each of 1,000 employees would get R1,000.

Surplus is an amount in the collective as a whole that exceeds the expectations of all of the stakeholders. The definition of stakeholders for the purpose of this book is restricted to the three contributors to wealth –labour, capital and state. Surpluses can be defined as discretionary, meaning that they can be distributed either partly, fully or not at all. For example, if a company is running at a loss and expects another in a given year, a profit in that year would be a surplus, but not discretionary. It would have to be used to restore the balance in distribution to meet the legitimate expectations of all the stakeholders. Conversely, if the company has been recording acceptable bottom-line results and achieves better-than-expected profits in a given year, then the surplus over and above the expectation can be described as discretionary. This means it can be deployed in any manner negotiated between labour and capital.

This brings me to some other features that need to be clearly defined. Instead of using the term gain that is popular in variable-pay theory, I would rather speak of surplus and discretionary surplus as defined earlier. The extent to which a surplus is defined as discretionary should be informed by reasonable expectations identified by the Contribution Account. It should not be set in concrete, but the way it is treated must be clearly understood by all, preferably ahead of the results.

A surplus will be determined by an improvement in value-added or wealth created. The share to be allocated to the primary stakeholders (labour, capital and state) will clearly first depend on the extent to which it is discretionary or not. If there's a severe imbalance in the way wealth is being distributed, this simply has to be addressed. It need not be done fully in a given period but it has to be borne constantly in mind when negotiating a discretionary part of the surplus. While the share defines that part of the surplus than can be allocated to each stakeholder, this share can in turn be split into different components. This is understood in the term “profits” – they are already split into retained income and dividend. When there is a discretionary surplus that has improved the owners’ share above their legitimate expectations, there could be a further split. The collective may decide to pass it on to one of the other stakeholders, improve the company savings further or increase the dividend. It may seem odd that I have included the state in the beneficiaries of discretionary surpluses. It is explained by the fact that the “state” is not restricted to tax. It can include corporate social responsibility spending – or, to use a currently popular term, corporate social investment.

The share of the discretionary surplus allocated to employees will most likely be split in percentage bonuses or equal division. In most cases, for it to be aligned with differentiated pay, it will be split as a percentage of current salaries. Say the share of a discretionary surplus translates into R1 million and the payroll is R10 million. This would represent 10% of current wages (perhaps with some adjustments for allocations to pension and medical insurance funds). This in turn becomes a bonus of 10% on each salary or wage. The split need not be confined to a percentage of pay. Half of the 10%, – R500,000 –can be allocated to equal division. The other half can be allocated to a percentage of pay. That converts into a 5% bonus calculated on pay. If the population included in the scheme were 500, then each would get a further R1,000 from an equal division.

That’s not all! Despite the caution required in merit calculations, a fully understood merit bonus system can live fairly comfortably with common fate. If there is a system in place, it can be financed from the employee share. There are two critical elements involved. The first is that any system, including a merit bonus system, has to be self-financing and preferably through discretionary surpluses. No company should be threatened by the need to pay bonuses that it cannot afford (which is why it’s iniquitous to give executive bonuses when a company runs at a loss). The other is the extent to which the family of measures needed to underpin merit bonuses are understood and fair. By their very nature merit bonuses detract from common fate.

Common fate is unashamedly socialist in nature. But it’s also fully market-driven in terms of the collective’s relationship with its society. It performs at its fullest and best when the employee share is split in equal distribution. I have seen this work even in a highly capitalist environment. A former goldmine client had in place a simple system based on operating profit: a huge barometer was placed at the entrance of the mine, reflecting an accumulation of surpluses up to the point where the mine could afford to pay out a certain minimum bonus. It then reflected a “spilling over” and each employee got exactly the same. This was seldom less than R20 and not more than R100. The remarkable feature of the system was not the amount involved, but the extent to which it fostered camaraderie among all employees from the general manager to the lowest-skilled worker. I suspect it was also partly due to the fact that the mine was relatively low-grade and “marginal”. A pay-out showed that it was still viable.

I believe the power of common fate gives the lie to many arguments that supposedly support the self-interest culture. It is indeed possible to find an employee group offering part of its split for social service ventures in its community such as a school or a day nursery. It is also feasible for a committed and loyal group to offer some of its split for company savings – in return, perhaps, for shares.

Common fate, like any pay-at-risk scheme, is a process and not an event or a simple one-off conversion. A case study will illustrate this later. One has to move from a fixed, basic pay structure which may already include some form of conditional pay or merit bonus system. Throughout its life, the system will need maintenance and adjustments.

The proportions between basic and flexi-pay can range through phases from an initial 5% at risk, 85% basic and 10% merit, to 50% at risk and 50% basic with merit pay being phased out or made part of the split over four periods. Of course, the ultimate flexible pay system would have 100% at risk.

Because market-related basic pay is guaranteed, there has to be some kind of a contingency fund to ensure that this commitment can be met by a self-financing fortune-sharing system. This fund also has many names in gain-share theory, including bonus reserve, contingency reserve, deficit reserve or simply the bonus back-up. The difference between fortune-sharing and other forms of gain-sharing is that with the former, jobs are supposedly more stable. The reserve is needed to cushion the effect of misfortunes in the initial stages and to maintain market-related pay. For example, the participants may agree to put at risk 10% of their current market-related pay. To ensure a smooth transition, one would try to maintain market-related pay but finance the shortfall from the contingency fund at the initial stages.

With most other forms of variable pay, basic pay is a given, and a contingency fund is needed only to finance bonus pay-outs that were not covered because of previous losses. Gain-share experts differ on how much of the employee share should be allocated to a contingency fund. Most believe that at least a quarter should be saved.

If the fund has a shortfall at the end of the year this should simply be written off. The first of two variables under fortune-sharing that will determine the size of such a fund is the portion at risk against the guaranteed portion: the bigger the risk proportion, the less the need for a reserve. The second variable is the frequency of payment and it applies to most systems. An annual system clearly needs no reserve: if there is no surplus, there is no pay out. In fortune-sharing one may want a reserve in any event; but if there are consistent losses in the initial years the company's position may for some time be little changed from a normal basic-pay dispensation.

A fully supported fortune-sharing programme can achieve the near-impossible and accommodate monthly swings in pay levels. Most gain-sharing programmes lose their efficacy if the pay-out is less than twice yearly. Most schemes other than fortune-sharing cannot tolerate a frequency higher than quarterly.

This raises the issue of timing for a fortune-sharing programme. If there is a solid commitment by all of the stakeholders, then fortune-sharing can be launched at virtually any time. If there is some distrust and hesitancy, then it's perhaps best to introduce it in fairly good or stable times, and that would also enable the contingency reserve to build up so as to cater for possible swings later. There is some contradictory logic in timing. Arguably, if one introduces fortune-sharing in the good times, one has raised expectations that may not be met later and this could lead to disenchantment. Conversely, if one introduces it in bad times and expectations are not met or some income is sacrificed, one may have killed the system at birth. The key to both problems, and indeed to the ultimate success of any variable-pay system, is understanding, communication and commitment. That is why organised labour is the most suitable champion of such a system.

Fortune-sharing appears from the above description to be highly complex. I agree that the theory itself is full of definitions, complex arguments and counterarguments. Any variable-pay system becomes vulnerable unless fully understood and kept as simple as possible. One difficulty with variable pay is line of sight – an employee's understanding of the impact his/her functions and performance have on the group as a whole. Experts insist that line of sight must be present in any system, otherwise one is inclined to veer away from an organisational trigger in favour of a family of measures at smaller units or even at individual level, and this removes the focus on common fate and lessens the prospect of self-financing. I believe that those who take the purist view are ignoring the difference between qualitative line of sight and quantitative line of sight. Most functionaries can be made to understand how sweeping a floor helps put a man into space, but to quantify that effect is impossible. I am tempted to break up the concept into line of sight and line of effect.

Line of sight is qualitative and is based on behaviour. Line of effect is quantitative; it means being able to measure those things within the control of the functionary, and being able to hold that person accountable – provided of course that she/he has been given the means and has the ability to perform the task. Our intuition says the complexity of pay-at-risk is overstated. Much of that is the fault of experts and consultants unable to resist the temptation to create new jargon, either to make the matter seem esoteric or to parade their own expertise. I have been as guilty as the rest in the foregoing paragraphs; I too have wallowed in verbiage. My defence is that I felt the need to address current theory in the terms commonly used but not always understood. The principle of fortune-sharing is in fact very simple: the bigger the contribution, the bigger the pie; the bigger the pie, the more there is to share. If an overall concept is logical and clear, then details should not be allowed to bedevil it. And indeed it seldom does, as long as we refrain from pomposity and over-cleverness.

One of the devils in the detail is the accounting format. A final accounting format that is not understood; is suspect; reveals little of interest to functionaries; is inconsistent and can be fudged by policy changes explained in very small print as notes to the accounts, is no way to inform people on fortune-sharing or any pay-at-risk system. Profit-sharing schemes based on the income statement don't as a rule say much to the general workforce. They make sense only to those in the upper echelons of the corporate hierarchy. In developing countries in particular, this produces systems that have little basis in common fate. Not so with the Contribution Account© or even its less refined associate, the value-added statement.

CHAPTER 23
Fortune-sharing: a scenario

I was once asked to propose a fortune-sharing system for a client in the chemicals industry. The proposal went cold after the company sold most of its manufacturing activities to another company and the holding company introduced an EVA-based profit-sharing system for all of its subsidiaries. This was a pity as I had progressed beyond theory in the proposal. In this illustration take note that employee tax is still included in the labour share. Moving it to tax does not affect the principles discussed.

Figure 20

Contribution Account™			
Company ABC			1998
		R m	comment
sales		1 171	We had to accept the sales, outside costs and wealth figure as a given.
less outside costs		743	
gives wealth		428	
which is shared	%		
employees	61	261	For a fairly capital intensive company the employee share of wealth was too high at 60%
savings	30	128	The savings component was excessive. Much of the plant had been written off and a sale of the manufacturing process was on the cards. But the holding company was financing staff cutbacks from the balance sheet.
tax	9	39	
investors	0	0	A nil dividend is often found with wholly owned subsidiaries. We suggest reflecting the same split between dividend and retained income as applied to the holding company. In this case there was no dividend.

The Contribution Account© at the time of design is shown in Figure 20. I used a far more visual illustration based on Figure 6 from which the comments were explained. For the purposes of this book, however I have converted it into a table.

This account shows clearly that the first step needed for this company is to ensure equitable distribution. Employees had been put through a two-day training programme called "People and Wealth" which has a proven retention of 85% at illiterate level. This was followed up with an intensive communication process using whiteboards and magnetic pictures and numbers. The instruments were used at supervisory and team level and included team performance figures showing the line of sight to the Contribution Account©.

Figure 21

Contribution Account™			
Company ABC			1998 (forecast)
		R m	comment
sales		1 171	We again could not rely on improved sales and/or lower outside costs and had to accept the wealth figure as a given.
less outside costs		743	
gives wealth		428	
which is shared	%		
employees	55	236	The retrenchment plans in progress would have reduced the payroll as well as the employee share of value-added or wealth created.
savings	25	107	The need for savings was reduced because the restructuring that was financed from the balance sheet had been paid. This reduced the figure from R128m.
tax	10	43	Tax would clearly increase on the higher profits. The percentage of wealth increased only marginally.
investors	10	42	For the first time this company could show a dividend. It was calculated on total profits of R149m (R107m retained income + R42m dividend) and this met shareholder expectations.

The restoring of a distribution balance in this company was made relatively easy because of steps that had already been set in motion which made the forecast figures for that year look as in Figure 21.

For a number of reasons it became easy to design a fortune-sharing programme for the above company. One of them was the fact that they had already begun to address inequitable distribution through conventional rationalisation. Had this not been in place I would, in terms of *Common Purpose; Common Fate*©, have aggressively pursued the idea of increasing wealth so as to address the imbalance.

As we shall see later, this wouldn't have been an impossible task. The second facilitating factor was that the shareholder had a clearly defined expectation of continuing to hold this subsidiary. Shareholder expectations are often quite elusive, based as they are on "maximising profits" rather than "so much is enough". So while our hands were tied in one respect, the steps taken to address the imbalance would in any case have been necessary to sustain a fortune-sharing system.

Figure 22

Contribution Account						
Company ABC						
		1998 R m	1999 R m	comment		
sales		1 171	1 171	Again, we thought it prudent not to rely on a change in sales, outside costs and wealth created. The only difference which would have made some fortune sharing possible was on a further reduction of staff in wealth distribution, which would have reduced the payroll to R230m.		
less outside costs		743	743			
gives wealth		428	428			
which is shared	%					
employees	55	236	*(230)*	We argued that 55% employee distribution was fair. The saving on payroll was a discretionary surplus. All the other domains were treated fairly and shareholder expectations had been met.	R236m – R230m	= R6m
					⬇	
savings	25	107	107		investors	= R4m
tax	10	43	43		Contingency	=R1m
investors	10	42	42		Employees One-for-one	=R1m

Looking a year ahead, the company projected a further cutback in staff (Figure 22).

Because the shareholder expectation had been met, I argued that any further saving should be used to improve employee morale. The client had a merit system in place but this would have reached a limited number of employees at the plant; it would not have benefited all. Again, I couldn't rely on or pursue an increase in wealth created, because of the disruptive effects of rationalisation.

I also felt that a 55% employee share (inclusive of employee tax) of wealth – R236 million – was fair, sensible and appropriate. However, with a further reduction in staff, the projected payroll was calculated at R230 million. This gave a R6 million discretionary surplus equal to less than 3% of the total payroll. At the general workforce level this would hardly have made an impact if it was paid out as a percentage of wages. I suggested that the surplus be deployed on a one-for-one (equally divided) basis.

This would have meant that each employee got a "thank you gratuity" of R5,000. For some it would have equalled if not exceeded a monthly wage; for others it would have amounted to less than 10% of their monthly pay. But the rationale here was that the lower echelons experienced the greater discomfort in the event of lay-offs. The impact on camaraderie of equal division outweighed the monetary incentive possible with such a limited amount to work with. As a general statement, I believe the attraction of greater involvement far outweighs the attraction of monetary gain. The other option open to this company at the time was to put the R6 million into a contingency fund to support a more fully developed fortune-sharing programme.

Figure 23

Contribution Account

Company ABC

		1998	2000	comment			
		R m	R m				
sales		1 171	1 230	= +5%			
less outside costs		743	706	= -5%			
gives wealth		428	524	=+22%			
which is shared	%						
employees	55	236	*(288)*	R288m – R230m* share	= R58m	*All allocations have risen sharply. Profits are 81% up at R184m. Only the employee share was kept at R230m forecast after lay-offs. 55% should have increased this to R288m.	
savings	25	107	131	investors	= R19m	employee R20m split	
tax	10	43	52	contingency	= R19m	1-for-1	50%
investors	10	42	53	employees	= R20m	**merit on family of measures**	50%

I argued that pursuing fortune-sharing was quite feasible once the dust had settled after reorganisation. Indeed that is what I proposed in the next year (Figure 23), on the basis of the client's determination to refocus on its market and productivity measures that were bound to contain outside costs. Conservative estimates were that income would rise by 5% and outside costs would be reduced by a similar amount despite increased cost of sales. The impact surprised everyone when the simple calculation was made that this would increase wealth by more than 20%.

The true dynamic of focusing on wealth creation is that for most companies it means that a relatively small increase in income and a relatively small reduction in outside costs have a substantial impact. Often this will not be easy because in most people's minds an increase in income implies an increase in outside costs. I have been surprised at the extent to which this is sometimes viewed as an immutable, with little effort being applied to some zero-base thinking to address outside costs.

In the above proposal I used, as the base, the first year after the rationalisation was completed and shareholder confidence was restored. This meant that the 55% employee share was still valid at R236 million. But then I also assumed that the payroll would stay at R230 million, despite wage increases in the meantime. The increases would have been offset by further planned staff reductions. However, I again argued that this should be allocated to staff. Wealth had increased by R96 million to R524 million. This meant that there was a R58 million discretionary surplus sourced from the labour share alone. Now in normal circumstances there would be no question that this belonged to the shareholder to boost profits after paying a further R20 million in tax. (It is often forgotten that fortune-sharing pay-outs are subsidised to the tune of the company tax rate. Admittedly some of this burden then passes to the employee.)

In our proposed fortune-sharing approach I argued that the R58 million discretionary surplus from the employee share represented the difference between legitimate expectations and the reality or actual. I proposed that R19 million be allocated to the shareholder. This amounted to a quarter of the discretionary surplus.

A further R19 million should be allocated to a contingency fund to support a quarterly pay-out of fortune-sharing in the months following. That left R20 million for an employee split. As mentioned, this company had a merit system in place for workers in the plant but recognised the need to capture all of the staff in a fortune-sharing system. So I proposed that half of the R20 million should be used to finance merit bonuses and the other R10 million be allocated to an equal division pay-out. This again was based on the continuing need to enhance involvement and camaraderie rather than monetary incentive. The amount was too small to divide further into a part for a percentage of pay and a part for equal division.

Theoretically, from a shareholder point of view they could have allocated the full discretionary surplus of R58 million. The increase in wealth alone would have ensured that their after-tax profits would have risen by more than 23%. The additional R19 million boosted the increase to 36%. I simply felt it necessary to meet shareholder expectations.

I must emphasise again that as complicated as the above explanation may appear, once the Contribution Account© is understood, the process of fortune-sharing becomes easy to explain. In our training programmes I made effective use of role plays with some participants wearing labels depicting the stakeholders and "funny money" to illustrate the allocations under fortune-sharing.

A few parameters had been agreed upon before the process was side-lined. These were the acceptance of common fate at group level, and of wealth creation as the common-fate trigger. The calculations were to be based on improvements on the past and not on budgets. It was also accepted that the company would maintain fair wealth distribution as a priority in fortune-sharing. I did some further calculations that illustrated the impact of changes in wealth creation, both positive and negative, over time. These showed that the system could be maintained without resorting to further employee cutbacks in all but the most disastrous circumstances. It showed further that one didn't need constant allocation to the shareholder of discretionary surpluses sourced by labour, to maintain a steady improvement in the standard shareholder value acid tests such as headline earnings, EVA, RONA, ROCE and price-earnings ratios.

Those informed on gain-sharing may recognise similarities between our fortune-sharing process and the Rucker Plan. They are purely coincidental. Of all of the earlier plans, Rucker comes closest to a common-fate philosophy. Given the growth of participative management styles in recent years, it is inexplicable that Rucker did not experience a revival. I suspect Rucker didn't quite offer what most companies wanted from gain sharing: cost savings, including employee lay-offs. In that case Scanlon is more appropriate than Rucker. If the emphasis is on individual and team productivity, Improshare is more suitable. Allen Rucker found that the employee share of wealth created remained relatively stable over time and he could propose a three-year historic average to determine a norm for the employee share. While this may have been relevant in an environment of uncapped profits, shareholder expectations can be scientifically pinned at appropriate levels today through formulae such as EVA. Still, a three-year average can be useful to the mix.

To recap on the preceding chapters:

Involvement and not incentive is the key purpose of fortune-sharing. Involvement can act as an incentive. Incentives do not guarantee involvement. Involvement requires understanding, constant communication, transparency, honesty, generosity, servant-leadership, caring for staff and employee development. The important underpinning philosophy of fortune-sharing is that it places salaries and wages in transcendent transaction, and recognises that our true value is in the contribution we make to others. This is determined by our customers, not by a piece of paper certifying a certain skill or by agitation and strikes. This value is reflected in the value-added measurement.

POSTSCRIPT

Any work on management or organisational theory would aspire to redefining the business environment and business theory itself. I make no such lofty claims. Rather, I have set out to challenge conventional perceptions about business itself which have led to some serious challenges in the global economic environment. I would argue simply that the key ingredients for sustainable business success, ultimately impacting on sustainable national prosperity are an inherent part of good business.

They have always been. It is simply a matter of changing the lens; returning to that logic and re-examining all current systems, structures and practices to reinforce that logic. Many of our business heroes of the past and present have known this, either intuitively or consciously.

One of these is Raymond Ackerman, founder of Pick ‘n Pay, one of the biggest retail chains in South Africa, and an international award winner for his business acumen and contribution to society. He wrote the foreword to “*Value through Values*”, the book upon which “*Common purpose; Common fate*” is based. The following excerpt from that foreword best reflects the spirit of this work.

“More and more companies throughout the world are realising the importance of sound moral values and that having a clear-cut mission statement which is followed meticulously is the way to run a successful business. Profits flow from a values-driven business and Jerry has given us a great lead to follow in this book, and that is to be more clearly accountable for how we are trying to improve our people and our consumer society. We have in this book a blueprint for the way business should be run – in a values-driven, ethical way – and I think accountants and financial analysts should find the later sections in particular very interesting.

“Business at its best is driven by universal values and ethics and that is what Jerry Schuitema is trying to impress on us all. we only have to look at what has happened in the world in the last few years to realise how crucial it is for this message to really sink in. This is the way of the future, this is the whisper of tomorrow, this is what business colleges should be teaching, giving a clear understanding of how important values are in running a successful business in the world of the future.”

ENDORSEMENTS

“People constitute Society and interact with each other in many different ways. Some interactions are positive and add to the common good and some are negative and diminish society. But it is always within the gift of the individual as to how he will interact.

“So much of life is dominated by commercial interaction. The concepts of the smart deal, profit and value are absorbed at an early age and then acted upon for the rest of our lives especially in our dealings with others. Business is constituted by these very people - us - and it is we who choose its character and determine its predilection to add to the common good. It is this value in a Business Endeavour that will secure its legacy in Society and contribute mightily to a sustainable and coherent proposition for value creation for shareholders, employees, communities - for society as a whole. This book makes the case for this in a simple but powerful way”.

MICK DAVIS. FORMER CEO XTRATA MINING AND RESOURCE GROUP.

“Economic structures around the world are changing, and in the complex, turbulent ‘business as unusual’ environment we find ourselves in, there has never been a greater need for clear thinking and constructive dialogue between all stakeholders. This should include a willingness to challenge conventional thinking around sustainable wealth generation, together with a new roadmap to address the inequalities that exist in our business and socio-political world. Common Purpose: Common Fate is a refreshing, brave addition to this debate.”

FRANK AAB (THE LATE) FORMER CHAIRMAN. CONCOR CIVIL ENGINEERING.

“(The author) has exhibited a deep understanding of the need to strike a proper balance between man as homo economicus and the person who draws his or her inspiration and motivation in social and economic dealings from appropriate ethical values.”

DR ALI ALAWI. WORLD BANK ECONOMIST, INVESTMENT BANKER, FORMER FINANCE MINISTER IN IRAQI TRANSITIONAL GOVERNMENT

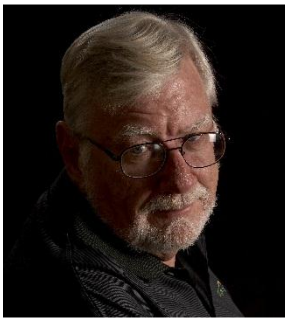
“I learnt that business was nothing more than people serving people. Everything else flowed from that.”

IAN FUHR. FOUNDER SORBET

“Changed the politics in Dulux. Focused everyone in the business on the contribution they can make. A common focus across the business on behaviours which create wealth for all stakeholders was established. The involvement of all employees in the business was increased through developing their understanding of the business.”

CHARLES BETTS ON THE TURNAROUND AT *DULUX*.

ABOUT THE AUTHOR



Jerry Schuitema has spent more than a quarter of a century in the front line of Economic communications. He pioneered many Economic broadcast products as well as the establishment of the Economics Desk at the SABC. Schuitema has won several awards and citations for work in this field, including the Rosholt Fellowship. He is the author of the bestselling "Econosense" which was recommended and prescribed reading at tertiary institutions in the 1980's; and the highly endorsed book "Value through Values". Both books are out of print.

He is also a regular columnist for South Africa's premier business news website, Moneyweb. Schuitema left full time broadcasting in 1989 to establish South Africa's first Employee Developmental communications consultancy on the clear conviction that enhancing economic awareness was best done in the workplace. The core of the developmental communications work has crystallised into a single, powerful focus on Wealth Creation and values driven market principles. Working with clients, led to the realisation that a different approach to transaction challenged virtually all of accepted practices in organisational theory, including human resource practices, remuneration, and accounting.

Schuitema studied Economics, History and Political Science at tertiary level, and management at the Oxford Centre for Management Studies.
(Full bio here)

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REFERENCES

References in the text have been given through hyperlinks in the e-book format. As this work is not intended as an academic treatise, rather as an appeal to logic and heart, the compilers felt it unnecessary to compile a full list of the sources of the many quotes and researched content. Where, in a print version, links need to be accessed, readers can obtain a PDF copy from the author.

In addition, the compilers have mostly used the same method of research as any reader would, which is simply reverting to a search engine on the internet.