

# Fast Company

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## Memo to: CEOs

Business is at a crossroads. Scandal and recession have cast a pall on the way CEOs go about leading their companies. Three distinguished professors send this memo -- Five Half-truths of Business -- as a wake-up call.

by Robert Simons, Henry Mintzberg, and Kunal Basu  
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Business is at a crossroads. Capitalism is facing a crisis. All of us who believe in business -- from CEOs to business-school professors -- must recognize that we have contributed to this crisis. The problem is simple, yet profound: We are all captives of five half-truths that shape the way we think about business and the way we do business. As a result, we may be in the process of destroying the very thing we cherish.

Enron. Andersen. Global Crossing. These business catastrophes are merely the tip of the black iceberg. Under the surface lies a culture that is increasingly defined by selfishness. To some extent, that is natural: We all want to succeed, to strive, to achieve. But carried to the extreme, the glorification of greed is causing a disconnect between the interests of the few and the well-being of the many. Consequently, the public's confidence in business and in large-scale institutions has been shaken.

Recovery is in the air. But so are feelings of deep distress on the part of anxious workers, a call for controls on the part of angry elected officials, and a palpable fear radiating from investors whose life savings may be at risk.

As business leaders and academics, we need to challenge what we do and what we teach. For some years now, we've been captured by a questionable set of beliefs -- assumptions about business that are, at best, half-truths. Here, then, are the five half-truths of business.

**1. We're only in it for ourselves.** Think of this as the first law of business: In our finance classes, we are teaching a view of the world that says that each of us is obsessively self-interested and intent on maximizing personal gain. Economic Man, we tell our students, has one goal: more. And to get more, each of us is willing to do anything.

It is, of course, a half-truth. To some extent, we are all self-interested. And today, perhaps more than ever, there are plenty of people -- business leaders, financiers, consultants, athletes, professors -- who are willing to sell their integrity for a price. There are people who just want more and who are willing to do whatever it takes -- and take whatever they can get.

But not everyone is self-interested all of the time, out for all that they can get. There are still CEOs who won't sacrifice long-term interests for short-term gains, financiers who walk away from unethical deals, consultants who level with their clients no matter what, athletes who won't endorse useless products, and professors who refuse to bend the truth as expert witnesses. These are people for whom integrity and self-respect are basic values -- absolute needs -- that are not

open to negotiation.

Beyond outer material goods lies an inner sense of good. Beyond calculation lies judgment. In fact, that is the essence of real leadership and responsible management: the ability to judge the difference between short-term calculable gains and deeply rooted core values.

But here's the problem: The half-truth of Economic Man drives a wedge of distrust into society. If we truly believe that each of us is nothing more than a calculator, then we become a society of calculations. Business simply won't work if each of us is only in it for ourselves. While we need to have individual initiative, we survive in a context of social engagement.

**2. Corporations exist to maximize shareholder value.** If there is a mantra that CEOs today have learned to repeat almost mindlessly, this is it. Analysts, the media, and institutional stock traders rate, reprimand, and reward companies and their CEOs based on this single standard of performance.

What's remarkable about the current worship at the altar of shareholder value is that it's a reversal of our prior beliefs and behaviors. We used to say that corporations exist to serve society. After all, that was why they were originally granted charters -- and why those charters could be revoked. We used to recognize corporations as both economic and social institutions -- as organizations that were designed to serve a balanced set of stakeholders, not just the narrow economic interests of the shareholders.

In fact, for years, the CEOs of the 200 largest companies in the United States promoted this view most vocally. Your predecessors of the Business Roundtable regularly asserted a balanced philosophy of corporate responsibility. Here's what they wrote in their statement on corporate responsibility from 1981: "Balancing the shareholder's expectations of maximum return against other priorities is one of the fundamental problems confronting corporate management. The shareholder must receive a good return but the legitimate concerns of other constituencies ( customers, employees, communities, suppliers, and society at large ) also must have the appropriate attention."

Then, in 1997, the Business Roundtable announced that it was making a remarkable U-turn. Its report on corporate governance assigned a new priority to CEOs: Maximize shareholder value. "The notion that the board must somehow balance the interests of stockholders against the interests of other stakeholders fundamentally misconstrues the role of directors," the report read. "It is, moreover, an unworkable notion because it would leave the board with no criterion for resolving conflicts between interests of stockholders and of other stakeholders or among different groups of stakeholders."

Here's what that statement actually means: When it comes right down to it, the customer may be king and the employees may be the corporation's greatest asset. But the CEO's only real responsibility is to serve the interests of the shareholders.

Now let's take a look at who these shareholders are, what they own, and how they own it. The way that the economy works today, with instantaneous information, global capital flows, and Internet-based stock trading, fewer and fewer shareholders are genuinely committed in any way to the companies that they "own." Giant mutual funds buy and sell millions of shares each day to mirror impersonal market indexes. Programs instruct traders on which shares to buy or sell and when -- although rarely on why. Then there are the recently arrived day traders, who become shareholders of a company and then ex-shareholders of that company within a matter of hours, as they surf the market for momentum plays or arbitrage opportunities. These are the shareholders -- who may not have any interest in the company's products, services, employees, or customers -- whose interests you are now pledged to maximize.

Of course, there is a half-truth in this mantra: Shareholders' interests are significant. The capital markets do need to work, and for that, shareholders need a fair return on their investment. But there is a larger truth to this half-truth: Maximizing shareholder value at the expense of all of the other stakeholders is bad for business and bad for capitalism. It drives a wedge between those who create the economic value -- the employees -- and those who harvest its benefits. Customers, too, recognize the cynicism of a company that only sees them as dollar signs. That may be one reason why the American Customer Satisfaction Index has declined steadily in almost every industry since the mid-1990s. "Maximize shareholder value" may be the job description that CEOs automatically recite -- but it is profoundly misguided.

**3. Companies need CEOs who are heroic leaders.** This is another half-truth. Of course, one of the CEO's roles is to provide leadership. But the real question is, What kind of leadership?

The notion of the CEO as heroic leader is one that you've heard so often that you've probably come to believe it: The CEO is the company, a heroic leader who single-handedly steers the business to success.

Two questions are worth asking: Why did this half-truth emerge? And how did it happen? In large part, the "why" is a reflection of half-truth number two. Having heroic CEOs serves the interests of the shareholders, who want disproportionate rewards. How did they bring this notion into practice? In simple terms, you CEOs were bought. All it took were huge bonuses and excessive stock options!

The fig leaf that covered those rewards was an equally large set of assumptions. The business world was led to believe that you, the CEO, are the embodiment of the company, that you alone are responsible for the company's entire performance, that your performance can be measured, and that the one important measurement is the creation of shareholder value. And all it took to validate those assumptions was the creation of heroic, larger-than-life CEOs. Taking the cue, business journalists happily provided personalities and simple explanations to fit the bill. CEOs became celebrities. One example: In its April 14, 1997 issue, *Fortune* magazine wrote of IBM CEO Louis Gerstner, "In four years Gerstner has added more than \$40 billion to IBM's market value." Admittedly, Lou Gerstner is an excellent CEO. But did he really do that all by himself?

The problem with the notion of heroic leadership, of course, is not just that it's preposterous on the face of it. It is also corrosive to the connection that needs to exist between a real leader and the people who make the company work. Real leadership is connected, involved, and engaged. It's often more quiet than heroic. Real leadership is about teamwork, about taking a long-term view, about building an organization slowly, carefully, and collectively. As CEOs, your job is to set an example of energizing others, not to take dramatic actions that let you take the lion's share of the spoils.

Nothing reveals the corruption of leadership more clearly than the record of executive compensation. According to one recent survey of executive compensation during the 1990s, your pay rose by 570%. Profits rose by 114%. Average worker pay rose 37%, barely ahead of inflation, which went up by 32%. In 1999, while median shareholders' returns fell by 3.9%, CEO direct compensation rose another 10.8%. Perhaps the real reason that we are so obsessed with leadership today is that we see so little of it from CEOs.

**4. Companies need to be lean and mean.** "Lean and mean" is back in fashion these days. It's a mantra for getting in shape after the recession, just in time for the recovery. "Lean" certainly sounds good -- better than "fat." But the fact that "mean" sounds good is a sad sign of the times.

There is nothing clever about firing large numbers of people. CEOs who have pursued slash-and-burn tactics -- the fastest way to create shareholder value! -- have produced companies that are

skinny and just plain mean. "Chainsaw" Al Dunlap, the master of slash and burn ( who eventually slashed-and-burned himself ), wasn't an aberration; he was an extreme example of a popular trend. In 2000, before the recession even hit, employers cut 1.2 million workers, ending the year with the highest number of layoffs since the Bureau of Labor Statistics resumed calculating them in 1995.

Of course, lean and mean offers the same half-promises as the other half-truths: Embrace it, and you'll get lower costs, higher productivity, flatter structures, empowered workers, and delighted customers! You'll get -- in those glib phrases of the day -- "more for less" and a "win win" situation.

Well, maybe. Or maybe you'll get burned-out managers, angry workers, quality losses under the guise of productivity gains, and bad service that alienates customers. In other words, you'll get "less for less" and a "lose lose" situation.

But the biggest loss of all may be the sense of betrayal that workers have come to feel toward their employers. One recent study reported that only 34% of employees worldwide felt a strong sense of loyalty to their employers. In the United States, only 47% of employees saw the leaders of their companies as people of high personal integrity. And that was before Enron, Andersen, or Global Crossing. In other words, that was before some of your fellow CEOs gave their workers more evidence that they were right to be distrustful.

**5. A rising tide lifts all boats.** This last half-truth helps knit together the first four. In order for the focus on personal gain, shareholder value, heroic management, and lean and increasingly mean organizations to work, we must find a way to rationalize what otherwise looks like self-serving behavior. The solution: "A rising tide lifts all boats" fits.

It's hard to argue against prosperity. And we'd all rather see the economy flowing rather than ebbing. But even as a metaphor, the idea that a rising tide lifts all boats doesn't hold water. What we've really been observing is a tidal wave. If you've ever lived along a coastline, then you know that a tidal wave lifts only those boats that aren't moored to anything. The boats that are connected to real things get swamped. For those who live on land, a tidal wave can turn into a flood. The ordinary folks who live in the lowlands get flooded out, while the wealthy few who live in high places escape. So much for the "win win" benefits.

But what about the facts of business and economics? In 1989, there were 66 billionaires and 31.5 million people in the United States living below the official poverty line. In 1999, the number of billionaires had increased to 268 -- and the number of people living below the poverty line had increased to 34.5 million. A recent UN survey of the world's wealthiest countries ranked the United States highest both in gross domestic product and in poverty rates.

And what about the stock market and all of the shareholder value that you helped create? Here again, the rising tide only lifted the yachts. Between 1989 and 1998, the wealthiest 10% of American households saw their stock-market holdings increase by more than 72%, while those in the bottom 60% saw their holdings increase by less than 4%. Yes, stock ownership has been up by about 16% during the past 10 years. But more than 50% of all Americans don't own stocks or mutual funds, and only 33% of all households with stocks have holdings worth \$5,000 or more. The bottom line: In 1999, at the height of a decadelong economic boom, one in six American children was officially poor, and 26% of the workforce was subsisting on poverty-level wages. More than 30% of U.S. households have a net worth ( including homes and investments ) of less than \$10,000.

Of course, we can all take pride in capitalism's global triumph over communism and in its spread around the world. Or can we? The recent backlash against globalization is due in no small part to

the promises that capitalism hasn't kept to poor people in poor countries -- those whose boats have not been lifted. In some countries in South America and Africa, the top 20% of the population gets more than 60% of the nation's income, while the bottom 10% of the population gets less than 1%.

Business -- and capitalism -- are at a crossroads. Newspaper headlines today suggest a gathering crisis, one of performance, values, and confidence. It's time for CEOs to rally around a new set of business truths. It's time for an agenda that restores faith in business, trust in business leaders, and hope in the future.

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