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The January-February 2019 issue, starting with Adam Smith, business thinkers doggedly viewed waste disposal as the holy grail of management. But what if the negative effects of the pursuit of the eclipse reward are effective? SAVE SHARE BUY COPIES In the lobby of the headquarters of the Ford Motor Company in Dearborn, Michigan, is a replica of the Model T. Car, the first to be produced on a moving assembly line, and available for years in only one color, the black-is a reminder that efficiency can propel the company to dominance in the industry. But upstairs on the 12th floor, President and CEO Jim Hackett leads the firm to another goal: what he calls corporate suitability. Hackett, who led the steelcase office furniture company through the IPO and defended its move from selling cabs to selling joint open workspaces, joined Ford's board of directors in 2013. He left the post in 2016 to become chairman of Ford Smart Mobility. In May 2017, he was appointed CEO by Executive Chairman Bill Ford. In a recent conversation with HBR senior editor Daniel McGinn, Hackett, who has worked for years with strategy adviser Roger L. Martin (author of High Price of Efficiency in this package), discussed the difference between efficiency and fitness as he conveys complex ideas to his employees, and the problem of Wall Street's belief that he is succeeding in moving the company forward. Edited excerpts follow. HBR: Car manufacturers are obsessed with efficiency. Isn't Roger Martin's argument that the company can be too efficient, kind of heretical? Hackett: There's always been a meme that goes: Do you want speed, quality, or low cost? You can only afford two out of three. Efficiency is the balance of all three. But today we win or lose on the basis of the best system design. The system needs to have efficiency built-in because if it uses too many resources, it can't survive. But winning is not just about efficiency. Is this about what you call corporate suitability? What do you mean? People ask: Why don't you just say, Let's get your money off? But when I say fitness, I think about what Darwin has learned about surviving the fittest, that kind of evolves to be more competitive. Being competitive now is about a lot of factors. How long does it take to deliver an order? How many products does the company offer? Do you have right or wrong people? Businesses benefit by having the right people and the right design. Do your ideas about how organizations grow come from Darwin? Yes. Years ago, a professor gave me a bunch of white papers written by physicists at the Institute and I became insatiably interested in them. I started to study the theory of complex systems, which believes that evolution is not just a biological process; it's this extend to public organizations. I asked: If Darwin's ideas exist in nature, who am I to say that they don't apply in business? What if they are applied everywhere? How do you apply them in Steelcase? I've been CEO at Steelcase for 20 years, since Darwin with biology, I have to see the company evolve over time. I ended up in a wave model where I cut the company during recessions, then growing it, then cutting it down and then growing it. It's not great. We needed to create a company for all states, by reducing our average costs. It's part of what I mean by fitness. It sounds as if you define fitness as the ability to deal with a changing landscape. So if a marathon runner is good at long races, it's effective, but the decalette can tackle different events, so he or she is a locksmith. Is that true? It's close. Let me use a different analogy. Imagine that you and I are racing to a big mountain. I beat you, but only for a nanosecond. Imagine coming into next year's race and saying, I have to do better than last year. I start the race and I win - my time is better. But the environment on the mountain has changed, so I need to work much better than last year to win again. That's what makes it hard-to-be dynamic. That's the Darwinian part. Businesses typically look at market share, profit and earnings per share. These are important things. But it's not just our earnings per share compared to other automakers. This is our time cycle compared to Amazon, for example. Amazon doesn't make cars, but it can sell them, or it can sell auto parts. That's what happens to the violation. You probably won't lose to standard competitors; it's the mutation coming on you that matters. You can't count on the mountain you climb to stay the same. Your efforts to make Ford fitter include creating models on fewer platforms and reducing the number of options and configurations consumers can choose from. Ford made a big push in that direction during the 1990s. Why didn't it work? Complexity creeps over time. In nature, forest fires really help forests thrive by burning undergrowth. At Ford, we are right in the middle of this job of eliminating complexity. We get really good results. My concern is that the pregnancy period in the automotive industry is greater than the industry I have come to. I don't want people to lose confidence: I know these theories work. People say: We haven't seen him yet. They will. The cost of complexity is hard to see until they're gone. You have an affinity for very complex ideas, and you describe them in complex ways. As a leader, does this create problems? Undoubtedly. The good news is, I've already passed. it used to be in Steelcays. My job is to help draw people can understand. I intentionally use a different language. Why talk fitness rather than cutting costs? Because the solution to lower costs is to hold your breath. And when you're holding your breath but don't change anything else, the costs are refunded. During the Great Recession, Ford brought his break-even significantly down. But all expenses are back because the company is not changing the design. I'm working on the communication part. One way is to delegate some of them. The other is to nullify our plan so people can follow it. Back in 2012 or 2013, near the end of Alan Mulally's time as CEO, what could have been done differently to put Ford in a better position today? I always start with the fact that the management team on the spot was very smart. So what did he miss? In my estimation, it was missed that all our competitors were bankrupt when our strategy appeared. Ford was a stronger, fitter player who allowed him to avoid bankruptcy, and on one level that was an advantage. The negative was that competitors came out of bankruptcy stronger and fitter. Bankruptcy forced them to restructure their business. What Ford missed was that competitors were getting fitter while we were on a trajectory we could celebrate, so we didn't change enough. Does Ford's status as a family-controlled company make it easier to make large-scale changes? Fords are what we call a long arc of shareholders. They have been owners since 1903 and they retain 40% of the total vote. It tells you that they have a deep commitment. Bill Ford wants to win. He is proud of Ford's forward attributes - the way the company treats its people, how it affects the environment. But his eyes get really big when he drives a Mustang; the viability of the product is important to it. We had long negotiations before I took this job. I told him he had a bunch of people he could pick, and that I might not be the best guy. I didn't sell myself because I was asked to review the job. Why couldn't you be the best guy? This applies to what you asked earlier: communication. Was the nature of transformation really simple and well understood in the early days? I told him it would take some time for the internal organization to gain traction. We'll get the results, and then Wall Street will follow. By becoming CEO, you announced that Ford would stop selling most car models in the United States. How did you come to the conclusion that you can't play to win in this segment? If you had drawn a contour around the T model, you would have a silhouette. I ask people: Where is this silhouette today? Is it still on the market? No. Over time, this silhouette - the shape of the car - has changed because world, markets and the size of people. The sedans mutated because the buyer's preference turned to silhouettes such as general-purpose sports vehicles. In the past, automakers were reluctant to stop selling small cars because they feared that if fuel prices were to hit, they would be killed. Low fuel prices teach us what people really prefer: they prefer large silhouettes. But now we have new forms of movement - battery electrics and hybrids. We are developing vehicles that will deliver a larger silhouette without a penalty in fuel efficiency. Roger Martin argues that efficiency increases risk by reducing redundancy and resilience. Is Ford less resilient because of its reliance on the F-150 pickup truck, which is responsible for all of the company's profits? We're actually in a very favoured place with the F-150 where we play to win. We can take more risks with him. We have other silhouettes with F-150 properties that we get to use. Super Duty - a pickup truck with more power and higher torque - grew faster than the F-150 this year. At meetings we talk about what makes a pickup truck so fit today. Why is it so popular? This is because buyers have jobs that need to be done, which is the F-150 very good. So we ask: do we really understand its performance? And how can we keep these jobs even better in the future? Evolution is not just a biological process; this also applies to organizations. Ford, like other automakers, invests a lot in autonomous vehicles. When will they get caught on the market? My optimism about this future is really high. It's probably just further than people realize. There is a quote that sounds like this: people overestimate the impact of technology in the short term and underestimate its long-term impact. This is probably true in this area. When these machines arrive, they will be a dramatic intruder. Is corporate suitability particularly important for a global producer in an era of political uncertainty and changes in trade policy? Trading systems are better for us when they are in balance. You can set up your business around balance. We don't want to be in a trade war; it's a bad idea. We do not need confidence - we can cope with the ups and downs of the weather or lack of raw materials. But it's hard to prepare for a sudden decision to put a 25% tax on something. You use the word to teach more than most other leaders do. Is that an important part of how you drive? In this kind of work, you have powerful people working for you. They don't need you to wind them up every day. So the role I should play, instead of telling them what to do, help them see how wisdom and curiosity can help us better design. I asked the staff to let me this role and have patience with it. We're in rhythm together. Your industry has a lot of focus on Tesla, which built the product people love but is struggling to scale production. What do you do their problems? People sometimes say that something is not rocket science. Actually, I have a competitor, Elon Musk, a rocket scientist. I have great respect for him because of the way he questions the design of the system. Ford builds a car every four seconds. So there is something about the suitability of our system that those who start can't yet be equal to. How it all gets choreographed is a really difficult physics problem- as hard as putting a rocket into space. But there is no doubt the suitability of the system has improved due to the arrival of Tesla. Customers are now waiting for over-the-air updates to automotive software because Tesla provides them. This will be a table betting thing in the automotive business that can be attributed to Musk. Does Tesla's presence help convince employees that they need to move beyond GM and Toyota and imagine new competitors? When a car company receives 400,000 or 500,000 pre-orders for a car, you should pay attention. Humility here is what Darwin taught us: There is no guarantee for your future. That doesn't mean we can't be optimistic. This simply means that the design probably won't stay the same. Management has come to be seen as a science whose aim is to make businesses more efficient. But a determined commitment to efficiency makes business less sustainable. Why this happens is businesses that consistently are more efficient to earn an increasing share of available profits and can start playing the market, and over time, the industry will become consolidated around one dominant business model. This result carries a high risk of catastrophic failure and a high probability of exploitation. Business solutions, government and management education should increase their focus on organizational sustainability. This will include limiting the size of enterprises, introducing additional friction in world trade and capital markets, giving long-term investors a greater voice in strategic decision-making, creating jobs that are richer in learning opportunities, and offering educational programs that balance efficiency and sustainability. In his landmark 1776 paper The Wealth of Nations, Adam Smith showed that a smart division of labour could make a commercial enterprise much more productive than if every worker took personal responsibility for building a finished product. Four decades later, in On the Principles of Political Economy and Taxation, David Ricardo took the argument further with his theory of comparative advantage, arguing that since it is more effective for Portuguese workers to make wine and English workers to make fabric, each group will better focus on their field and trade with the other. These ideas both reflected and led to an industrial revolution that was so much about technological innovation that reduced waste and improved productivity as it is new technologies. The notion that the way work is organized can affect performance more than individual effort can and that specialization creates the commercial advantages that underpin management research to this day. In this sense, Smith and Ricardo were the predecessors of Frederick Winslow Taylor, who presented the idea that governance could be considered a science, thus starting a movement that reached its climax with W. Edwards Deming, whose total quality management system was designed to eliminate all waste in the manufacturing process. Smith, Ricardo, Taylor and Deming together turned management into a science whose goal was to eliminate waste, whether it was time, materials or capital. Faith in the unalloyed power of efficiency has never dimmed. It is embodied in multilateral organizations, such as the World Trade Organization, aimed at improving trade efficiency. It is concluded in the Washington Consensus through trade and foreign direct investment liberalization, effective forms of taxation, deregulation, privatization, transparent capital markets, balanced budgets and waste-fighting governments. And it's moving in the classrooms of every business school on the planet. Recycling sounds like a reasonable goal. Why don't we want managers to make more efficient use of resources? However, as I will argue, excessive attention to efficiency can lead to strikingly negative consequences, to the extent that super-efficient enterprises create the potential for social disorders. This is because efficiency benefits are becoming more and more unequal as efficiency increases, creating a high degree of specialization and giving ever-increasing market power to the most efficient competitors. As a result, the business environment is extremely risky, with high returns being increasingly limited by a number of companies and people, an outcome that is clearly unsustainable. I believe that the remedy is to make business, government and education focus more on a less direct source of competitive advantage: sustainability. This may reduce the short-term benefits of efficiency gains, but create a more stable and fair business environment in the long run. In conclusion, I describe what may include a sustainability agenda. To understand why the relentless emphasis on efficiency is so dangerous, we must first examine our most basic assumptions about how the benefits of economic activity are distributed. The results are not really random When predicting economic results - income, profits, etc. - we often assume that any on an individual level are random: dictated by chance. Of course, this is not the case; winnings are determined by a variety of factors, including the choices we make. But these factors are so complex that, as far as we can tell, the economic results and also be identified by accident. Accident is a simplification of an assumption that corresponds to what we observe. If the economic results are random, the statistics tell us that they will follow the Gaussian distribution: When you build on the chart, the vast majority of winnings will be close to average, less and less going on we move in either direction. This is sometimes called normal distribution because many things in our world follow a pattern, including human traits such as height, weight and intelligence. It is also called the curve of the bell, for its shape. As data points are added, things become more and more common. Super-efficient enterprises create the potential for social disorder. Since the Gauss distribution is so common in human life and in nature, we tend to expect it in different areas. We believe that results are distributed and should be distributed not only in the physical world, but also in the world. For example, we expect that the distribution of personal income and solid performance in industries will be roughly public, and we build our systems and guide our actions accordingly. The classic way to think about the industry, however identified, is that it will have a small number of winners, a small number of losers (which are probably going out of business), and a lot of competitors grouped in the middle. In such circumstances, most efficiency gains are quickly erased as others take them, and as firms fail, new ones are replaced. This idealized form of competition is exactly what antitrust policy seeks. We don't want any one firm to grow so big and powerful that it shifts distribution out of impact. And if the results follow random distribution, and the competitive advantage does not last long, the competition for efficiency is sustainable. But the evidence does not justify the assumption that economic results are random. In fact, efficiency gains create an enduring advantage for some players, and the results are followed by a completely different type of distribution - one named after Italian economist Wilfredo Pareto, who noted more than a century ago that 20% of Italians owned 80% of the country's land. In Pareto's distribution, the vast majority of cases are grouped at the low end, and the tail at the high end expands and expands. There is no meaningful medium or median; distribution is not stable. Unlike what happens in the Gaussian distribution, additional data points make Pareto's distribution even more extreme. This is because Pareto's results, unlike Gaussian results, are not independent of each other. Consider the height - a trait that, as mentioned, tracks Distribution. The brevity of one person does not contribute to the height of the other person, so height (within

each sex) is usually distributed. Now think about what happens when someone decides to decide Follow Instagram. Typically, he or she looks at how many followers are different users. People with a few don't even get into the review set. Conversely, famous people with a lot of followers, such as Kim Kardashian, who finally had 115 million, immediately became attractive candidates because they already have many followers. The effect - a many followers - causes a greater effect: additional followers. Thus, Instagram subscribers track the spread of Pareto: the lion's share of subscribers in very few people, and a significant part of people have only a few. The average number of followers is between 150 and 200, a tiny fraction of what Kim Kardashian has. The same applies to wealth. The amount of money in the world at any moment is finite. Every dollar you have is a dollar that is not available to anyone else, and your earnings dollar is not dependent on the other person earning a dollar. In addition, the more dollars you have, the easier it is to earn more; As they say, you need money to make money. As we are often told, the richest 1% of Americans own nearly 40% of the country's wealth, while the bottom 90% own only 23%. The richest American is 100 billion times richer than the poorest American; by contrast, the highest adult American is less than three times higher than the shortest, demonstrating once again how much more widespread the results are in Pareto's distribution. We find a similar polarization in the geographical distribution of wealth. The rich are increasingly concentrated in several places. In 1975, 21% of the wealthiest 5% of Americans lived in the 10 wealthiest cities. By 2012, the share had increased to 29%. The same applies to income. In 1966, the average per capita income in Cedar Rapids, Iowa, was equal to the income in New York; it is now 37% behind. In 1978, Detroit was on a par with New York; it is now 38% behind. In 1980, San Francisco was 50% above the national average; it is now 88% higher. Comparable figures for New York are 80% and 172%. Business results also appear to be shifting towards Pareto's distribution. Industry consolidation is becoming more common in developed countries, with profits concentrated in a handful of companies in the growing and larger industrial sector. For example, over the past 20 years, 75% of U.S. industry has become more concentrated. In 1978, the 100 most profitable firms earned 48% of the profits of all public companies combined, but by 2015 this figure was an incredible 84%. The success stories of the so-called new economy are to some extent responsible - the dynamics of the business platform, where competitive advantages often stem from network effects, quickly transform Gaussian distributions in Pareto, as with Kardashian and Instagram. Since 1997, the vast majority of industries in the United States have become more Many are now what economists consider highly concentrated. This tends to correlate with low competition, high consumer prices and high profits. Key: How the concentration of the industry, which is controlled by the top four firms, is calculated, indicates the concentration of the industry - a measure that changes over time. In general, the concentration increases... Planning for changes in the concentration of more than 850 U.S. industries from 1997 to 2012 shows a rise in two-thirds of cases and a drop of one-third. The large gap at the top of the chart downwards indicates that almost all industries that were highly concentrated in 1997 have maintained or increased their concentration and that many industries are now indeed very concentrated. ... Especially when there are big shifts in strength of leading firms During this time 285 industries (about a third of the studied) were big drivers - the market share of the four largest firms has changed by at least 10 percentage points. Of these, 216 became more concentrated and 69 became less concentrated. This trend is even more pronounced among the 92 very large movers (for whom the market share of the four largest firms has changed by at least 20 percentage points) - and all but 10 of these industries have become more concentrated. The pattern holds at the level of the data aggregation sector, we see that entire sectors are becoming more concentrated. Here's what the top four look like. Let's look at how the drive for efficiency fits into this dynamic, along with the role of so-called monopolies and how power and vested interests lead some players to game the system, with corrosive results. Pressure to consolidate the complexity of scientists, including UCLA's Bill McKelvey, identified several factors that systematically push the results toward Pareto's distribution. Among them are the pressure on this system and the ease of communication between its participants. Think of sandpile-favorite illustrations of theorists of complexity. You can add thousands of grains of sand one by one without causing collapse; each grain has almost no effect. But then one additional grain starts a chain reaction in which the whole pile collapses; suddenly one grain has a huge effect. However, if the sandbox had been in a non-gravity context, it would not have collapsed. It falls only as gravity pulls that final grain down, shaking other grains out of position. In business results, the equivalent of gravity is efficiency. Consider the waste management industry in the United States. At one time, there were thousands of small waste management companies all over the country - garbage collectors. Each of them had from one to several trucks serving customers on a certain route. these thousands of companies were fairly well distributed. Most are grouped around the middle, with some highly efficient and companies that earn higher profits, and some weaker ones earning lower profits. The 100 most profitable U.S. firms make 84% of the profits of all government firms. Then came Wayne Huizenga, founder of Waste Management (WM). Looking at the cost structure of the business, he saw that two important factors were the purchase of trucks (vehicles are expensive, and because they are used intensively, they need to be regularly replaced) and maintenance and repair (intensive use has made it both critical and expensive). Every little player bought trucks one or maybe a handful at a time, and ran a repair depot to service his little fleet. Huizenga realized that if he purchased a number of routes in the region, two things would be possible. First, it will have much more procurement leverage from truck manufacturers and can purchase vehicles cheaper. Secondly, it could close separate repair facilities and build a single, much more efficient one. As it continued, the effect-large efficiency-became the cause more of the effect. Huizenga generates resources to continue to buy small garbage companies and expand into new territories that have made WM bigger and more efficient yet. This puts competitive pressure on all small operators because WM can come to their territory and undercut them. These small firms can either lose money or sell the success of WM. Huizenga represents a huge increase in pressure on the system. As sandpile crumbles, the industry is rapidly consolidating, with WM as the dominant player, earning the highest profit; Republic Services as the second largest player to make a decent profit; A few much smaller potential consolidators that make little profit; and a lot of tiny companies working mostly at the living wage. The industry today is structured as Pareto distribution, with WM as winner-take-most. In 2017, the company earned more than \$14 billion; Huisenga died (in March 2018) a multi-billionaire. If WM is so effective, why should we object? Not all consumers benefit, and does it matter whether WM or a collection of small firms issues sanitary workers' salaries? The answer is that a super-interface dominant model increases the risk of a catastrophic failure. To understand why, we will turn to the example of agriculture. The problem with monocultures almonds once grew in a number of places in America. However, some places were better than others and, as in most production contexts, economies of scale could be achieved through consolidation. As it turned out, the Central Valley of California is ideal for growing almonds, and today it is produced here 80% of almonds in the world. This is a classic business example of what biologists call monoculture: one factory produces a product, one company has influence in the industry, one piece of software all systems. Such efficiency has a price. Almond industry is developed from its layoffs, or slack, and in the process it has lost the insurance that redundancy provides. One extreme local meteorological event or one harmful virus can destroy most of the world's production. And consolidation has a knock-on effect. California almond flowers should all be pollinated in the same narrow time window because the trees grow in the same soil and experience the same weather. It requires delivery in hives from all over America. At the same time, widespread bee epidemics are causing concern about the ability of the U.S. population to pollinate all plants that need bee work. One theory about epidemics is that because hives are now trucking across the country like never before for such monoculture pollination, bee resistance has been weakened. Power and self-Interest As we have seen with WM, another result of effective systems is that the most effective player inevitably becomes the most powerful. Given that people act substantially out of vested interests, the more effective the system becomes, the more likely it is that effective players will play it, and when that happens, the goal of efficiency will cease to be a long-term maximization of common public value. Instead, efficiency begins to be interpreted as what provides the greatest immediate value to the dominant player. You can see this dynamic in capital markets, where key corporate decision makers are doing common cause with the largest shareholders. It goes like this: Institutional investors maintain stock-based compensation for senior executives. Managers then take steps to reduce wages and reduce the cost of RESEARCH and capital expenditure in the name of efficiency. Immediate savings increase cash flow and therefore lead to higher stock prices. These investors, especially those trading hedge funds and then executives, sell their shares to realize short-term gains, almost certainly returning after the resulting price decline. Their benefits will be expensive. The most obvious losers are employees who are fired because of the company's flagging fortunes. But long-term shareholders are losing because the future of the company is in jeopardy. And customers suffer in terms of product quality, which is at risk as the company reduces its investment in improvement. A super-essential dominant model increases the risk of a catastrophic failure. Proponents of shareholder value argue that competition from entrants with excellent products and services will compensate: newcomers will hire laid-off workers, customers will flock to their products, and will move on to investments that promise better returns. But this suggests that the market is highly dynamic and that power is not concentrated among a handful of these assumptions are valid in some sectors. The aviation industry is one: the main assets - planes and gates - are relatively easy to acquire and dispose of, so whenever demand grows, new players can enter. But it's not easy to start a bank, build a chip factory, or run a telecommunications company. (Ironically, entry is perhaps the most difficult in some of the hottest areas of the new economy, where competitive advantage is often associated with network effects that give actors a powerful boost.) And sometimes power becomes so concentrated that political action is needed to weaken the strangulation of dominant players, as in the antitrust movement of the 1890s. The pension fund's business is a particularly egregious case of abuse by dominant insiders. In theory, fund managers should compete for the quality of their long-term investment decisions, because that is what makes it worth it for retirees. But 19 of the 25 largest U.S. pension funds, which account for more than 50% of the assets of the country's 75 largest pension funds, are state and regulated monopolies. Their customers have no choice of supplier. If you're a teacher in Texas, the government prescribes that the texas-state pension system teacher-manage your retirement assets. Thus, the jobs of fund managers are relatively safe until they are somehow obvious and public. They have a good game system. The easiest way to do this is to take incentives (usually offered by hedge funds) to invest a certain way (one that benefits hedge funds). In the last 10 years alone, the ceos of America's two largest pension funds (state monopolies, I might add) have been successfully prosecuted for receiving multimillion-dollar bribes from hedge funds. We can assume that for every event we see much more avoid our control, and bribery is not always so egregious, of course. Pension fund managers also take luxury trips that they could not afford on their own, and many have left their positions for lucrative work in investment banks or hedge funds. Particularly insidious practice of the pension fund is lending shares of short-term hedge funds (pension funds are the largest such lenders), in exchange for which fund managers earn relatively modest fees, which help them to achieve their return goals. This practice allows hedge funds to create volatility in capital markets, creating opportunities for traders but jeopardizing the ability of COMPANY executives to manage in the long run. suffer while hedge funds and pension fund managers benefit. If the system is highly efficient, chances are that effective players will be the game. The invisible hand of competition directs self-interested people to maximize value for the entire long term only in very dynamic markets in which results are truly random. Random. The competition process itself works against this as long as it focuses solely on short-term efficiency, which, as we have seen, gives some players an advantage that often proves to be quite solid. As those players gain market share, they also gain market power, which makes it easier for them to acquire value for their own interests by removing rather than creating it. How can society prevent the seemingly inevitable process of effective entropy? We need to pay more attention to the less valued source of competitive advantage mentioned earlier: sustainability. To the resilience of the resilience ability to recover from difficulties to spring back into shape after a shock. Think about the difference between adapting to an existing environment (which is what efficiency provides) and adapting to changes in the environment. Sustainable systems tend to be characterized by precisely these features - diversity and redundancy or weakening - efficiency, which seeks to destroy. To curb the efficiency of creep and increase resilience, organizations can: Limit scale. Antitrust policies have tended to weaken enforcement since the early 1980s in order not to impede efficiency gains. In fact, in the United States and the European Union, efficiency gains are considered legitimate merger protections challenged on the grounds that it will result in excessive concentration, even if the benefits of this efficiency increase will be accrued to only a few powerful players. We must reverse this trend. Market dominance is not an acceptable outcome, even if it is achieved by legitimate means such as organic growth. It's not good for the world to let Facebook use its deep pockets from its core business to fund its Instagram subsidiary to destroy Snapchat. It's not good to let Amazon kill all the other retailers. It wasn't good for Intel to try to repeal AMD decades ago, giving computer manufacturers discounts for some time not to use AMD chips, and it wasn't good to have qualcomm engage in similar behavior in recent years. Our antitrust policy must be much tighter to ensure dynamic competition, even if it means reduced net efficiency. Introduce friction. In our quest to make our systems more efficient, we have banished all friction. It's as if we were trying to create a completely clean room, eradicating all the germs in it. To avoid such a trap, business and government need to regularly engage in immunotherapy. Instead of designing to save friction out of the system, we must introduce productive friction at the right time and in the right places to create a sustainable system. For example, the reduction of barriers to international trade should not be seen as an unalloyed good. While David Ricardo has clearly defined the effectiveness of trading, trading, do not foresee the impact on Pareto's results. Policy makers need to deploy some trade barriers to ensure that a few massive firms do not dominate national markets, even if such dominance appears to be maximizing. Small French baguette bakers are protected from serious competition by a stunning set of rules. Result: Although not cheap, French baguettes are arguably the best in the world. Japan's non-ariff barriers make it almost impossible for foreign automakers to enter the market, but that hasn't stopped Japan from starting some of the world's most successful car companies. Friction is also necessary in capital markets. The current goal of U.S. regulators is to maximize liquidity and reduce transaction costs. This meant that they first allowed the New York Stock Exchange to acquire a host of other exchanges and then allowed the NYSE itself to be acquired by the Intercontinental Exchange. A fuller implementation of this goal will increase the pace with which billionaire hedge fund owners are already at the far end of Pareto distributing wealth trading in a smaller but increasingly larger market and generate even more extreme Pareto results. U.S. regulators need to act more like the EU, which has blocked the merger of two of Europe's biggest players, the London Stock Exchange and Deutsche Bers. And they must stop creating obstacles in the way of new players seeking to create new exchanges, because these obstacles only strengthen the strength of consolidated players. In addition, short sales and the volatility it generate could be drastically reduced if the government prohibits public sector pension funds (such as the California Public Employees' Pension System and the New York State General Pension Fund) from lending shares. Promoting patient capital. The total share capital should be a long-term shareholding: as soon as it is given, the company conditionally has capital forever. In practice, however, anyone can buy this capital on the stock market without the company's permission, meaning that it can be a short-term investment. But long-term capital is much more useful for a company that is trying to create and develop a long-term strategy than short-term capital. If you give me \$100 but say you can change how it should be used with a 24 hour notice, that money is not as valuable to me as if you said I can use it the way I want for 10 years. If Warren Buffett's desired period of holding stocks, as he jokes, is forever, while the quantitative arbitration hedge fund Renaissance Technologies keeps the investment only for milliseconds, Buffett's capital is more valuable than that of Renaissance. Despite the difference in value for the company, two types of investment in capital receives the same rights. This is a mistake; we must base the right to vote on the period during which capital capital Spent. With this approach, each common share will give its owner one vote per day of ownership up to 3,650 days or 10 years. If you have held 100 shares for 10 years, you can vote 365,000 shares. If you sell these shares, the buyer will receive 100 votes on the day of purchase. If the buyer becomes a long-term holder, eventually that will increase to 365,000 votes. But if the buyer were a hedge fund activist like Pershing Square, whose duration is measured for months, the interests of long-term investors are quite appropriate in its impact on the strategy. Thus, the granting of voting rights will reward long-term shareholders for providing the most valuable type of capital. And that would make it extremely difficult for hedge fund activists to take effective control of the companies, because the moment they acquired the stake, his rights would be reduced to one vote. Some argue that this will strengthen poor governance. That wouldn't have happened. Currently, investors dissatisfied with management can sell their economic property per share along with one voting rights. Under the proposed system, disgruntled investors can still sell their economic property for a share along with one voting rights. But if many shareholders were happy with the management, and yet the activist would like to make a quick buck by forcing the company to sell assets, reduce investment in NIOTRI, or take other measures that could harm its future, that activist would have a reduced ability to gather the right to vote to push this agenda. Create good jobs. In our quest for efficiency, we have come to the view that routine labor is a cost that should be kept to a minimum. Companies underinvest in training and skills development, use temporary and part-time workers, have a busy schedule to avoid extra hours, and design jobs require little skill, so they can be extremely low-paid. This ignores the fact that work is not just a cost; it is a resource that can be productive, and the current way of managing it reduces that productivity because it reduces the value of the dollar. What if we focus on long-term performance? Instead of designing jobs for low-skilled, minimum-wage clock punchers, what if we designed them to be productive and valuable? In the Good Jobs Strategy, MIT's Seynep Ton describes how some discount retailers have doubled down on their employees, looking for more active and more knowledgeable employees, better customer service, lower turnover, and increased sales and profits, all leading to further investment. A key but illogical element of the strategy Build into slack, so employees have time to serve customers in unexpected but valuable ways. It's not just businesses that can benefit from a good jobs strategy. The cheap working model is extremely expensive for the economy as a whole. When they have reduced labor costs, companies like Walmart simply transfer costs traditionally borne by employers Taxpayers. A recent congressional study estimated the impact of one 200 Walmart store people on the federal budget. It turns out that each worker costs taxpayers \$2,759 a year (in 2018) for low-wage benefits such as food and energy subsidies, housing and health care, and federal tax credits. With 11,000 stores and 2.3 million employees, the much-touted efficiency company carries a hefty price tag indeed. Teach for sustainability. Management education focuses on a determined commitment to efficiency and teaches students analytical techniques that deploy short-term proxies to measure this quality. As a result, graduates head to the world to build (inadvertently, I believe) high-performance businesses that are largely lacking in sustainability. Deans, professors and students will no doubt ask to disagree. But the curriculum shows the opposite. Finance teaches the pursuit of effective financial structures. Effective cost management is the goal of management accounting. Human resources are trained in effective staffing. Marketing is an effective targeting and sale to segments. Operations management is about improving the efficiency of plants. The main goal is to maximize shareholder value. Of course, none of them is a bad thing in itself. The corporation should maximise shareholder value in the very long term. The problem is that today's market capitalization determines shareholder value. Similarly, the reduction in labour costs this quarter determines efficiency. And the optimal capital structure for this year's operating environment is what determines the efficient deployment of capital. These are all short-term ways of assessing long-term results. If we continue to promote these short-term trusted people, managers will strive to maximize them despite the costs of long-term sustainability. And activist hedge funds will take control of companies and force them to act in a way that appears, judging by short-term proxies, to be highly effective. These funds will be welcomed by regulators and institutional proxy advisers, who will continue to think that their actions have nothing to do with the production of more fragile companies. For the sake of the future of democratic capitalism, governance education must be a voice for, not a sustainable one. In his 1992 work The End of History and the Last Man, Francis Fukuyama argued that the central theme of modern history is the struggle between despotism and what we now know as democratic The latter certainly has an advantage. But it's a stretch to argue, as Fukuyama did, that he won the war. Every day we find evidence that economic efficiency, which traditionally underpins democratic capitalism, is not able to distribute the attendant benefits. The harsh realities of Pareto Pareto threaten the basic conviction of the electorate that a combination of democracy and capitalism can make the lives of most of us better over time. Our system is much more vulnerable and much less fair than we like to think. That has to change. Success breeds inequality Recovery after the Great Depression of the 1930s was characterized by a certain degree of social solidarity and the narrowing of the gap between rich and poor. The recovery from the Great Recession of 2007-2009 was very different. In the United States, for example, the gap between wage growth between the rich and the poor has widened significantly, while the income gap between the most successful firms and the rest has widened dramatically. Rich people are getting (much) richer since 1971 incomes for the bottom half of wealth distribution have stagnated, and they have grown by only a third for Americans in the 50-90s percentile, but they have more than doubled for the top 10%. The gap between the highest-paid and middle-income firms in the United States has grown sharply since 1990. The latest data show that firms at or above the 90th percentile of profits have returns that almost double their capital investments, compared with a yield of just 15% for medium-sized firms. Find this and other HBR charts in our visual library Find this and other HBR charts in our visual library The Tax System has raised less progressive federal income tax rates for most Americans steadily rising throughout the 1970s before the sharp fall in post-1981 and 1986 Reagan tax cuts. Taxes paid by the highest-paid Americans in their final dollars of income have fallen sharply since 1966, while taxes paid by those close to the middle of income distribution have fallen much less and in some cases increased. The weak recovery in house prices since the 2008 crash means that Americans whose wealth is based on housing assets have become poorer. On average, 50% of Americans lost 16% of their wealth between 2007 and 2016 (after adjusting for inflation). But the major stock indexes were 30 percent above 2007 levels by 2016 - a rebound that has largely interested the wealthy. Jacob Greenspon is a researcher at the Martin Prosperity Institute. Darren Karn is a senior fellow at the Martin Prosperity Institute. The cost of complexity is hard to see In the lobby of the headquarters of the Ford Motor Company, in Dearborn, Michigan, sits a copy of the Model T. Car, the first to be produced on a moving assembly line, and available for years in only one color, black-is a reminder that efficiency can propel the company to dominance in the industry. But upstairs on the 12th floor, President and CEO Jim Hackett leads the firm to Purpose: what he calls corporate suitability. Hackett, who headed the office furniture company Steelcase Steelcase The IPO, which championed its move from selling cabs to selling joint open workspaces, joined Ford's board of directors in 2013. He left the post in 2016 to become chairman of Ford Smart Mobility. In May 2017, he was appointed CEO by Executive Chairman Bill Ford. In a recent conversation with HBR senior editor Daniel McGinn, Hackett, who has worked for years with strategy adviser Roger L. Martin (author of High Price of Efficiency in this package), discussed the difference between efficiency and fitness as he conveys complex ideas to his employees, and the problem of Wall Street's belief that he is succeeding in moving the company forward. Edited excerpts follow. HBR: Car manufacturers are obsessed with efficiency. Isn't Roger Martin's argument that the company can be too efficient, kind of heretical? Hackett: There's always been a meme that goes: Do you want speed, quality, or low cost? You can only afford two out of three. Efficiency is the balance of all three. But today we win or lose on the basis of the best system design. The system needs to have efficiency built-in because if it uses too many resources, it can't survive. But winning is not just about efficiency. Is this about what you call corporate suitability? What do you mean? People ask: Why don't you just say, Let's get your money off? But when I say fitness, I think about what Darwin has learned about surviving the fittest, that kind of evolves to be more competitive. Being competitive now is about a lot of factors. How long does it take to deliver an order? How many products does the company offer? Do you have right or wrong people? Businesses benefit by having the right people and the right design. Do your ideas about how organizations grow come from Darwin? Yes. Many years ago a professor gave me a bunch of white papers written by physicists at the Santa Fe Institute, and I became insatiably interested in them. I started to study the theory of complex systems, which believes that evolution is not just a biological process; it can also be applied to social organizations. I asked: if Darwin's ideas exist in nature, who am I to say that they don't apply in business? What if they are applied everywhere? How do you apply them in Steelcase? I've been CEO at Steelcase for 20 years, since Darwin with biology, I have to see the company evolve over time. I ended up in a wave model where I cut the company during recessions, then growing it, then cutting it down and then growing it. It's not great. We needed to create a company for all states, by reducing our average costs. It's part of what I in mind by fitness. It sounds as if you define fitness as the ability to deal with a changing landscape. So if a marathon runner is good at long races, it's But the decalette can solve different events, so he or she is a locksmith. Is that true? It's close. Let me use a different analogy. Imagine that you and I are racing to a big mountain. I beat you, but only for a nanosecond. Imagine coming into next year's race and saying, I have to do better than last year. I start the race and I win - my time is better. But the environment on the mountain has changed, so I need to work much better than last year to win again. That's what makes it hard-to-be dynamic. That's the Darwinian part. Businesses typically look at market share, profit and earnings per share. These are important things. But it's not just our earnings per share compared to other automakers. This is our time cycle compared to Amazon, for example. Amazon doesn't make cars, but it can sell them, or it can sell auto parts. That's what happens to the violation. You probably won't lose to standard competitors; it's the mutation coming on you that matters. You can't control on the mountain you climb to stay the same. Your efforts to make Ford fitter include creating models on fewer platforms and reducing the number of options and configurations consumers can choose from. Ford made a big push in that direction during the 1990s. Why didn't it work? Complexity creeps over time. In nature, forest fires really help forests thrive by burning undergrowth. At Ford, we are right in the middle of this job of eliminating complexity. We get really good results. My concern is that the pregnancy period in the automotive industry is greater than the industry I have come to. I don't want people to lose confidence; I know these theories work. People say: We haven't seen him yet. They will. The cost of complexity is hard to see until they're gone. You have an affinity for very complex ideas, and you describe them in complex ways. As a leader, does this create problems? Undoubtedly. The good news is, I've been through this before, at Steelcays. My job is to help paint a picture people can understand. I intentionally use a different language. Why talk fitness rather than cutting costs? Because the solution to lower costs is to hold your breath. And when you're holding your breath but don't change anything else, the costs are refunded. During the Great Recession, Ford brought his break-even significantly down. But all expenses are back because the company is not changing the design. I'm working on the communication part. One way is to delegate some of them. The other is to nullify our plan so people can follow it. Back in 2012 or 2013, near the end of Alan Mulally's time as CEO, that could have been done differently to put in a better position today? I always start with the fact that the management team was very smart. So what did he miss? In my estimation, it was missed that all our competitors were bankrupt when our strategy appeared. Ford was a stronger, fitter player who allowed him to avoid bankruptcy, and on one level that was an advantage. The negative was that competitors came out of bankruptcy stronger and fitter. Bankruptcy forced them to restructure their business. What Ford missed was that competitors were getting fitter while we were on a trajectory we could celebrate, so we didn't change enough. Does Ford's status as a family-controlled company make it easier to make large-scale changes? Fords are what we call a long arc of shareholders. They have been owners since 1903 and they retain 40% of the total vote. It tells you that they have a deep commitment. Bill Ford wants to win. He is proud of Ford's forward attributes - the way the company treats its people, how it affects the environment. But his eyes get really big when he drives a Mustang; the viability of the product is important to it. We had long negotiations before I took this job. I told him he had a bunch of people he could pick, and that I might not be the best guy. I didn't sell myself because I was asked to review the job. Why couldn't you be the best guy? This applies to what you asked earlier: communication. Was the nature of transformation really simple and well understood in the early days? I told him it would take some time for the internal organization to gain traction. We'll get the results, and then Wall Street will follow. By becoming CEO, you announced that Ford would stop selling most car models in the United States. How did you come to the conclusion that you can't play in win in this segment? If you had drawn a contour around the T model, you would have a silhouette. I ask people: Where is this silhouette today? Is it still on the market? No. Over time, this silhouette - the shape of the car - has changed because the world, markets and the size of people have changed. The sedans mutated because the buyer's preference turned into large silhouettes, such as sporty SUVs. In the past, automakers were reluctant to stop selling small cars because they feared that if fuel prices were to hit, they would be killed. Low fuel prices teach us what people really prefer: they prefer large silhouettes. But now we have new forms of movement - battery electrics and hybrids. We are developing vehicles that will deliver a larger silhouette without a penalty in fuel efficiency. Roger Martin argues that efficiency increases risk by reducing redundancy and resilience. Is Ford less resilient because of its dependence on the F-150 pickup truck, which is responsible for the entire Company? We're actually in a very favoured place with the F-150 where we play to win. We can take it. risks with it. We have other silhouettes with F-150 properties that we get to use. Super Duty - a pickup truck with more power and higher torque - grew faster than the F-150 this year. At meetings we talk about what makes a pickup truck so fit today. Why is it so popular? This is because buyers have jobs that need to be done, which is the F-150 very good. So we ask: do we really understand its performance? And how can we keep these jobs even better in the future? Evolution is not just a biological process; this also applies to organizations. Ford, like other automakers, invests a lot in autonomous vehicles. When will they get caught on the market? My optimism about this future is really high. It's probably just further than people realize. There is a quote that sounds like this: people overestimate the impact of technology in the short term and underestimate its long-term impact. This is probably true in this area. When these machines arrive, they will be a dramatic intruder. Is corporate suitability particularly important for a global producer in an era of political uncertainty and changes in trade policy? Trading systems are better for us when they are in balance. You can set up your business around balance. We don't want to be in a trade war; it's a bad idea. We do not need confidence - we can cope with the ups and downs of the weather or lack of raw materials. But it's hard to prepare for a sudden decision to put a 25% tax on something. You use the word to teach more than most other leaders do. Is that an important part of how you drive? In this kind of work, you have powerful people working for you. They don't need you to wind them up every day. So the role I should play, instead of telling them what to do, help them see how wisdom and curiosity can help us better design. I asked the staff to let me play the role and have patience with it. We're in rhythm together. Your industry has a lot of focus on Tesla, which built the product people love but is struggling to scale production. What do you think of his problems? People sometimes say that something is not rocket science. Actually, I have a competitor, Elon Musk, a rocket scientist. I have great respect for him because of the way he questions the design of the system. Ford builds a car every four seconds. So there is something about the suitability of our system that those who start can't yet be equal to. How it all gets choreographed is a really difficult physics problem- as hard as putting a rocket into space. But there is no doubt the suitability of the system has improved due to the arrival of Tesla. Customers are now waiting for an over-the-air update of automotive software, that Tesla is providing them. This will be a table rate thing in the automotive business that can be attributed to Does Tesla's presence help convince employees that they need to move beyond GM and Toyota and imagine new competitors? When a car company receives 400,000 or 500,000 pre-orders for a car, you should pay attention. Humility here is what Darwin taught us: There is no guarantee for your future. That doesn't mean we can't be optimistic. This simply means that the design probably won't stay the same. Same.

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