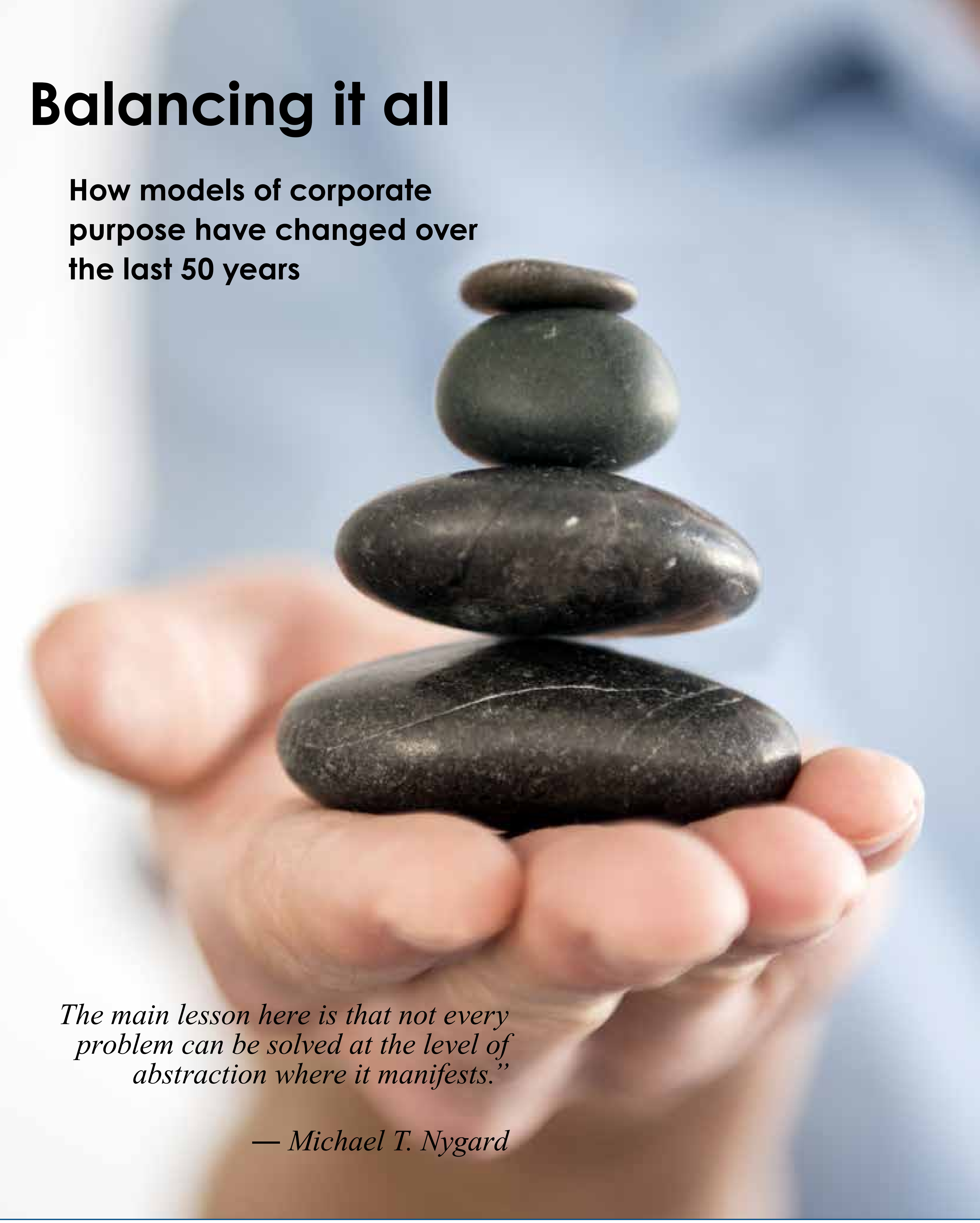
Balancing it all

How models of corporate purpose have changed over the last 50 years

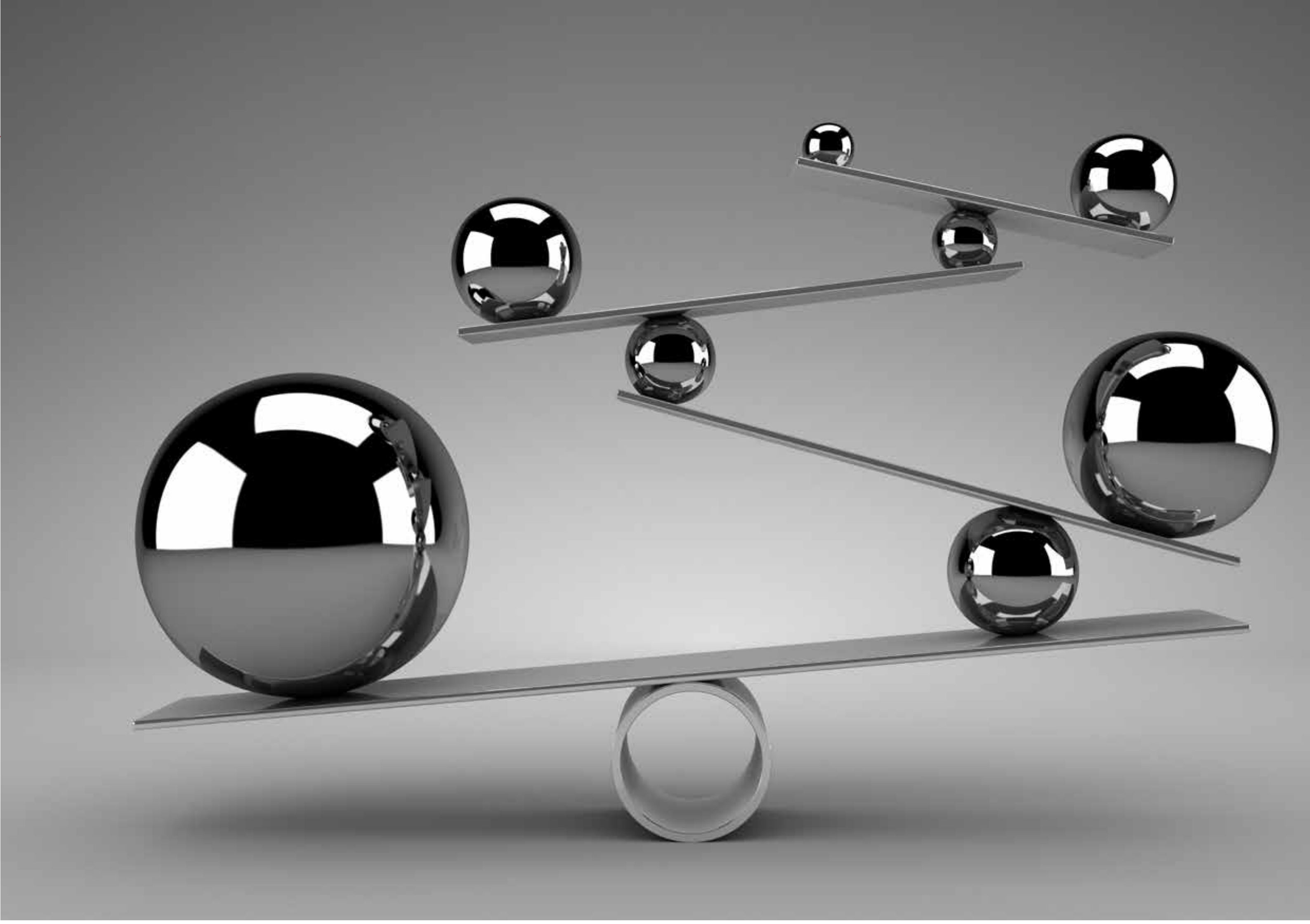


The main lesson here is that not every problem can be solved at the level of abstraction where it manifests.”

— Michael T. Nygard

A paper from Dalmau CONSULTING

Tim Dalmau



Balancing it all

How models of corporate purpose have changed over the last 50 years

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Introduction

On Sunday September 13, 1970 an article appeared in the New York Times (NYT) which came to symbolize a mindset, one that has dominated business thinking for the last 50 years. Written by the soon-to-be Nobel Prize winner Milton Friedman, it came to articulate what was called then, and since, the Friedman doctrine. It was entitled *"The Social Responsibility of Business Is to Increase Its Profits"*.

Fifty years later, his theories on the primacy of shareholders and the priority of profits are still very influential in many parts of the corporate world. For many business leaders his doctrine became translated as *"the **only** responsibility of business is to increase profits"* – it has been both a mantra and an obsession. In this Friedmanesque world, the worst thing a CEO or leader can do is loss of profitability - this is the ultimate mortal sin.

He was not the first nor was he the last Nobel Prize winning economist to espouse a set of propositions directly to the public. What made his NYT article so powerful was that he was already a celebrity when it was published and a regular on television talk shows. Indeed, one US network even gave him his own 10-part television series. In other words, he was what today we would call a social influencer. Consequently, most took his theory as a call to arms for the free market regardless of consequence.

A sea change

The last five decades have shown that the world is far more complex than was known or assumed back then and this idea has been long debunked. Friedman aside, his proposition and those who blindly followed it, are examples of a much deeper and more troubling phenomenon that is best summarized in the adage *"to every complex phenomenon there is always a simple answer and it is always wrong"*.

The world, too, has changed. As my colleague Charles Ansbach says *"we are in the middle of a transition from the industrial age to the sustainability age"* and along with this transition goes a whole different set of deep assumptions.

There are many signs of this transition. We could start December 2, 1984 in Bhopal, India with the gas leak that killed 2260 people. In the early 1990s, Erin Brockovich built a case against PG&E in California and put both herself and environmental contamination on the world stage; in the late 1990s the rising concerns about blood diamonds brought corruption and exploitation to the fore; in the 2010 BP Deepwater Horizon oil spill; the catastrophic failure on November 5, 2015 of a Brazilian tailing dam managed by a joint venture of BHP and Vale in 2015; and the extreme malpractice and ineptitude uncovered among Australian banks by the Australian Royal Commission into banking in 2018.

These are but a very few illustrations where, in hindsight, Friedman's doctrine was shown to be the simplistic view it was, and where the leaders of companies had to grapple with far more than maximizing shareholder value in order to rescue or, in the event, create shareholder value.

In every case, variables that leaders thought were within a tolerable range of variation quickly were not, and what followed were a series of physical, human and social positive feedback loops. And once these dynamics were unleashed the very purpose of the organization was called into question.

The most recent example was the event at the Juukan Caves in Western Australia where Rio Tinto dynamited caves inhabited by humans for over 46,000 years and, in so doing, destroyed much goodwill they had accumulated over recent years. More than that, they triggered very significant damage to not only their own but the entire mining sector's relationship with indigenous people in Australia.

The final nail in the Friedman doctrine coffin was probably laid with the 300-word declaration of the Business Roundtable of America on August 19, 2019 that stated among other things:

"We share a fundamental commitment to all of our stakeholders. We commit to:

- *Delivering value to our customer*
- *Investing in our employees.*
- *Dealing fairly and ethically with our suppliers.*
- *Supporting the communities in which we work.*
- *Generating long-term value for shareholders.*

Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities, and our country."

This is 180 degrees around from the simplistic Friedman view that social responsibility adversely affects a company's financial performance, and that the valuation of a company or asset should be predicated almost exclusively on the pure bottom line. It is also of note that shareholer value came last in their five core purposes.

Further, it is interesting to note that this is spoken of in terms of long term shareholder value, thereby bringing time into the equation, time, something my colleague Julius Matthys points out was totally absent from Milton Friedman's polemic.

The rise of ESG

Over this same 50 years we, as a species, have become conscious of the impact of our own behavior on the planet, to the point where it has now become clear just how many planetary boundaries we are pushing to the limits of sustainability. Climate change is only one of these and as we stretch them, we jeopardize the future of our species.

Starting in the 1950s and 60s a parallel yet quite different development in thinking about corporate leadership and governance was growing. Known as ESG, Environmental, Social, and Corporate Governance refers to the three central factors at the heart of the sustainability and societal impact of an investment in a company or business.

Symbolically, its beginning can be found in the world wide rejection of South Africa and its businesses due to apartheid in the 1970s. In the late 90s James Coleman introduced us to the notion of social capital as a core element in the measurement of value. Now it is commonplace and considered normal to judge a company's performance not only on its profitability but on how it impacts such things as climate change, sustainability, consumer protections, and human rights.

We could probably list in this domain another set of similar illustrative examples to indicate a world-wide trend. Eighteen months ago, the world's largest resource company announced it was exiting coal mining. In the last month one of Australia's big four banks announced it will soon no longer fund investment in coal mining, part of a global trend of financial institutions and sovereign funds who are rethinking their commitment to environment-damaging enterprises.

This trend is global and growing. On June 16, 2011, the United Nations Human Rights Council unanimously endorsed its Guiding Principles for Business and Human Rights, making the framework the first corporate human rights responsibility initiative of the UN. Based on the three pillars of **protecting** against human rights abuses, **respect** for and of the rights and cultures of stakeholder groups, and **remedy** when rights are violated, it is a universal call for consideration of social impacts as part of both corporate strategy and action.

Equally, the EU is prescribing mandatory levels of human rights behavior for corporations along with imposable civil and criminal sanctions regardless of jurisdiction from 2021 onwards. For example, in April 2019 the UK Supreme Court ruled that Vendanta Resources could be prosecuted for harm caused to local people from toxic waste from a copper mine in Zambia. A comparable attempt failed this last week in the British court system in relation to the BHP/Vale dam collapse in Brazil.

On January 1, 2020 the ASX Corporate Governance updates (Fourth Edition) came into effect. Corporate Australia has had nearly a year to absorb them. Among other things they require *"A listed entity to disclose whether it has any material exposure to environmental or social risks and, if it does, how it manages or intends to manage those risks."*

In a similar vein, Sir David Attenborough's film, **A Life on Our Planet** is both a stark testament and a compelling call to action in regard to what we as a species have caused to our planet. It seems to have struck a very deep and universal chord with all who have viewed it.

A turbulent environment

To this we add the rise in populism around the world, the rise of China as a geo-political force, and the inevitable entropic disintegration of the USA.

And then there is COVID. As it surges for the second and third time in so many countries around the world, it has come to cause not only immediate and far-reaching health and social impacts, but disrupted supply chains, markets, business models, and deep patterns of commerce and trade. Perhaps deepest of all, it has disrupted both our expectations and the innate human desire for some level of predictability.

Against this tapestry the Friedman doctrine is positively naïve. Companies no longer have the luxury of operating as entities independent of the social, cultural, political, and bio-physical environments in which they exist. They are key elements in an ever changing and emergent dynamic.

Into this soup we now place the corporate

Figure 1

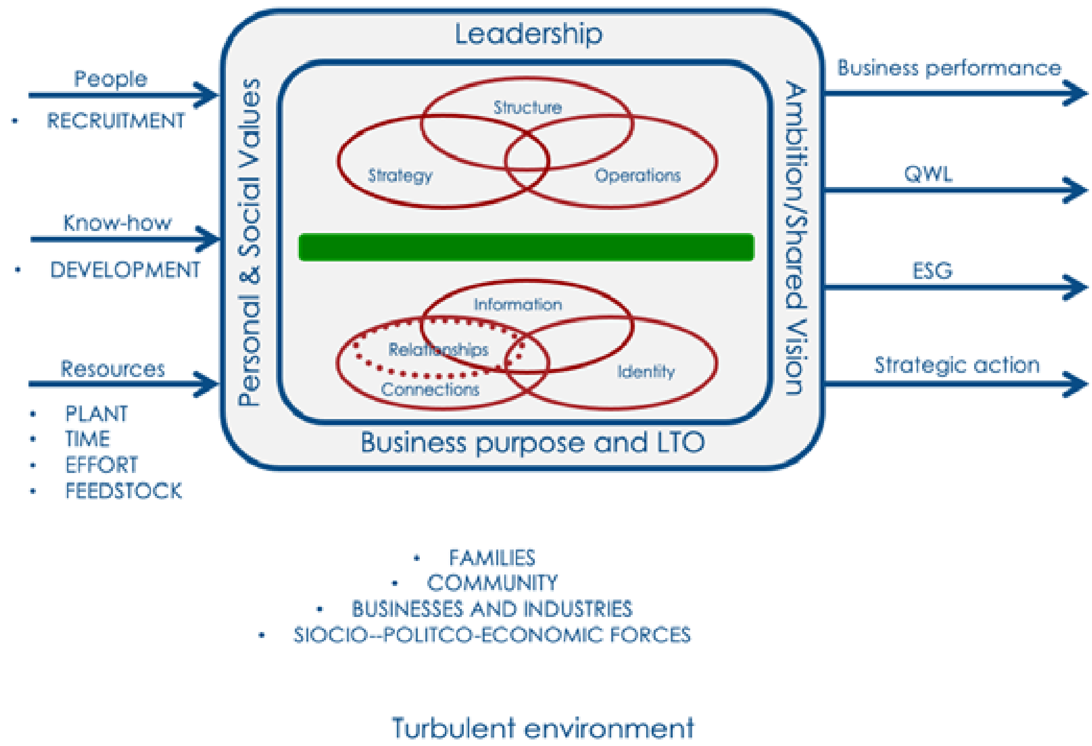


Figure 1

leader. S/he might be C-Suite member, a CEO or a Board member.

The rest of this paper is designed to chart some important characteristics of this very complex terrain in which people occupying such roles operate and to use a few examples to illustrate these.

The companies such people lead now exist in turbulent and dynamic environments. These are physical, social and cultural in nature. And regardless of what Friedman naively thought 50 years ago, they must pursue multiple goals in order to flourish.

A systems perspective

No longer is just profit the outcome they must seek. They must deliver a certain minimum quality of work-life for their employees, environmental, social governance outcomes and, of course, a capability to act strategically to all these changes.

To achieve this, they must recruit people, coalesce a mix of know-how among them and marshal resources – financial and physical resources, and shared sentiment.

They take these inputs and filter them through shared social and personal values in the direction of an ambition or vision, transforming them into the aforementioned outcomes via strategy, structures, and operational activities underpinned by information systems, relationships, and a shared sense of identity. All this rests on a business purpose and license to operate as is depicted in **Figure 1.**

The simplest understanding of complex adaptive systems theory suggests companies exist in this environment as active agents, not passive nor independent entities.

As active agents this turbulent and dynamic environment represents a minefield of possibilities where a company both acts upon, and is acted upon by elements.

To navigate this white-water world, it helps to think of four levels at which a company can come to grief.

In Figure 1, leadership sits in a place where it is designed to contain or hold the system together – a core systems-level function of a leader.

The four levels of potential grief represent four domains for active and considered engagement by senior leaders and depicted in **Figure 2.**

Rarely does the leadership of a company make tragic mistakes at only one of these levels – leaders tend to have a penchant for getting themselves and their stakeholders intro trouble at multiple levels simultaneously.

Moreover, mistakes at one level invariably trigger phenomena at other levels. Sadly, these sins of commission or (more often) omission are usually committed by intelligent, hard-working, and well-intentioned human beings.

On the other hand, when all the right elements are in place at all four levels the organization, its environment, and its stakeholder groups flourish

If we return to a few of the illustrations along the 50-year journey from Friedman's 1970 polemic to the present we can see how this plays out.

Mistakes at many levels

The banking sector of Australia has experienced much upheaval in the last 2 years with the publication of report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. An entire business sector lost the goodwill of both the community and its customer base due

Figure 2

to malpractice at the **Operations** level, with such activities as billing dead clients, failing to advise customers of hikes in charges, charging for non-existent services and other endless and curious misdeeds.

These could not have occurred without at least tacit support from other operational systems and processes within these organizations, implied support from the **Purpose** level, a corporate **Identity** that at some level thought such practice was normal, and a **Paradigm** that considered extracting money from customers regardless of means or ethics was OK.

Like banks, and IT suppliers, postal services are another sector of the community that Australians love to become aggrieved with. Despite this, Australia Post as an organization has weathered the financial white waters of business reasonably well under the recent leadership of Christine Holgate.

That is until November 2, 2020 when she resigned in the wake of a bout of manufactured righteous indignation from our Prime Minister in Parliament. Her position was untenable.

The sin she had committed was to provide a few of her senior executives with Cartier watches as a bonus for going over and above in extraordinarily demanding times. Whilst doing nothing illegal, it is worth noting there would have been not a whimper if they had been paid in cash. Her tragic mistake was to make these gifts **Symbolic**. This was compounded by an equally ill-judged comment at a Parliamentary inquiry where she stated that Australia Post's moneys are not taxpayers' moneys. This comment, again at the **Symbolic** level, sealed her fate.

Leaders, CEO's and Boards can come to grief and bring their own company, indeed a whole industry to grief, by both omissions and commissions at any one of these four levels as the two examples above illustrate. And it can happen, seemingly, in the blink of an eye.

Actually, this is rarely the case for what seems to happen suddenly and quickly has usually been years in the making. And if a company leader operates over that time with a Friedman view

of corporate purpose then the organization will inevitably reach a precipice where the consequences take both control and influence out of his or her hands and into those of society, the legislature and the stakeholders.

Juukan Caves incident

So it was when the world awoke on May 25, 2020 to read that Rio Tinto had blown up a 46,000 year old cave system in Western Australia.

Rio Tinto is, perhaps, one of the very best illustrations of a company incrementally and unwittingly moving itself to a decision-precipice that would come to deliver one of the most tragic of results for the local indigenous groups, something at the core of their cultural, group and personal identity.

The abject grief felt by some, and outrage by many, of the stakeholders may be compared with that of Iraqis when ISIS destroyed so many historical and religious buildings and artefacts between June 2014 and March 2017, items and structures that dated back 12 centuries. In this case they dated back 460 centuries.

It is also a timely example: the big four accounting firms have been telling their mining resource sector clients for the last three or four years that the #1 risk to their viability that they face is their social license to operate.

The Rio Tinto event is currently the subject of a federal Parliamentary Inquiry which has now become a treasure trove of detailed information regarding how the company got themselves into this tragic situation, including many documents I would imagine company officers never ever intended to see the light of day.

It needs to be said that on more than one occasion the company has apologized to the PKKP people whose sacred symbols and stories they trashed. It also needs to be said that there was more than one version of this, with varying levels of authenticity.

It is also true that the CEO and two senior executives have lost their jobs[1] over the incident and that the company commissioned an internal inquiry by one of its Board members – a report widely criticized by indigenous stakeholders, and one which is high on internal corporate narrative and low on factual specifics. It has little credibility among most stakeholders and interested observers.

A colleague stated recently that the Juukan Caves fiasco *"is an indigenous issue at its core and that the root cause is clearly disrespect"*. I must disagree with this assertion. In my mind it is a classic case of a company which, over a period of time, did not pay sufficient attention to all four levels of corporate life.

Then, one or two variables went outside the tolerable limits of reasonable action and a series of social, political and cultural consequences were unleashed, not only for the company but for the industry.

Both Rio Tinto and the indigenous people involved have paid a terrible price.

Indeed, as the CEO of a global resources company said to me last week *"we are all paying a huge price for their cock up"* – it has impacted the whole mining industry in Australia, severely compromising what trust had been established.

Cracks in Operations

To understand how this played out at all four levels we need to return to 1997 when Leon Davis became CEO of Rio Tinto.

He knew his biggest challenge was to restore the company's license to operate and its respect in the eyes of indigenous stakeholders after its gobsmacking escapades with

1. Some of the Chairman's peers and those familiar with the mining sector believe there will be no moving on from this event until he joins them.

Bougainville Copper[2] .

He largely achieved this and in the years since the company has enjoyed a reputation as a role model for mutually respectful and comprehensive relationships with indigenous peoples and traditional owners.

The morning of May 25, 2020 changed that forever.

But as the Parliamentary Inquiry clearly shows the change started to take hold in 2016 when Jean Sebastien-Jacques became CEO.

Facing profitability pressures, he initiated a number of changes at the **Operations** level of our four-level model.

Evidence shows this included the active retrenchment of many who held the expertise and experience in community and stakeholder relations. This is well documented in the Parliamentary Inquiry, despite the company's PR distractions to the contrary.

Put simply, activities at the **Operations** level no longer enjoyed timely and close stakeholder input into decision making when strategic operational decisions were being made.

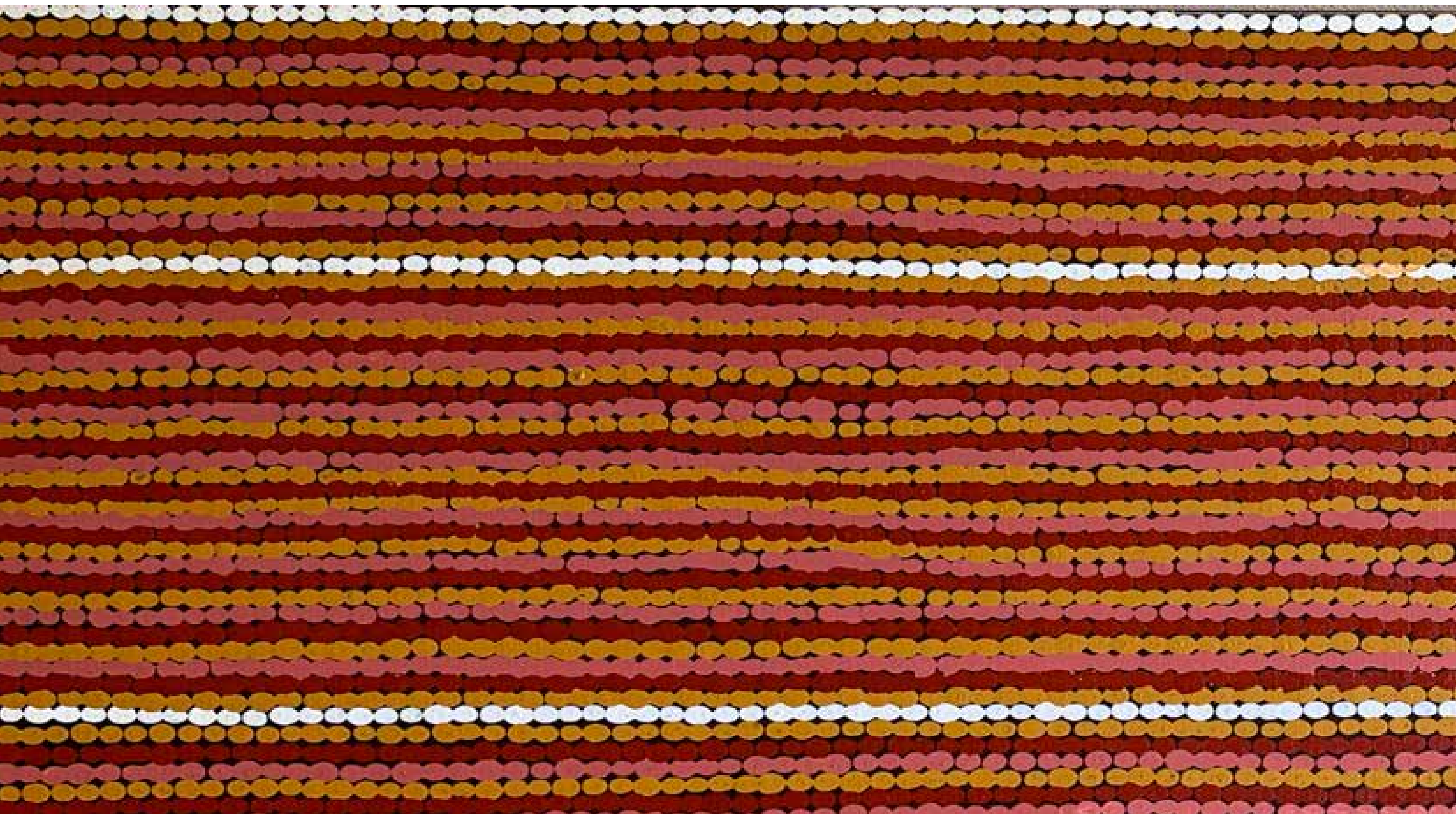
It is absolutely true in the strictly legal sense that Rio Tinto had the legal right under Section 18 of the Western Australian Aboriginal Heritage Act to destroy the caves.

Perhaps more telling is that emerging problematic ore grades in the Greater Brockman Area and Nammuldi Mine (which together supply the bulk of the company's iron ore production) prompted operational leaders and mine planners on the ground to make up grade mixes with ore from Brockman 4 (which included the caves) and to do so with a sense of shared felt pressure.

As was shown time and again in the investigations into the Challenger Disaster of January 28, 1986, when such operational decisions are made without disconfirming and challenging voices nor all relevant contextual information "in the room", they inevitably lead to disaster.

The rest is history, as they say, no matter and despite all the ins and outs that occurred in the days immediately prior to the blast

2. It is interesting to note that on September 28, 2020 more than 150 people living in Bougainville filed a complaint with the Australian legal system regarding waste from the copper and gold mine causing health problems for 12,000 people living nearby. Even though Rio divested itself of the mine in 2016, this is curious timing..



– so well documented in great detail in the Parliamentary Inquiry.

In other words the company's operating model was not fit for purpose. What perhaps is even more tragic is that the documents of the Inquiry and some of the conversations I have had a few key individuals who were in the actual meetings suggest some of those crucial decisions were led, directed, or shaped by lawyers.

Asymmetric Purpose

At the next level, **Purpose**, it seems Milton Friedman's ghost was at work.

An advisor to the company related to me how years ago he would enter a Rio workplace and *"the first word on every one's lips was excellence; then cost followed excellence"*. He went on to point out that in recent years the order has been reversed.

A senior executive of the company made a similar observation and pointed out that over the last few years people working inside the company have lost their sense of purpose and commitment compared to pre-2016.

This person said, *"they seem to just come to work for the money now, not for belonging to an excellent company"*.

Whatever noble **Purpose** Rio Tinto has espoused (and continues to) the actual **Purpose** (in the operational decisions, the strategizing how to make them happen, and the clean-up afterwards) seems quite different.

Rio Tinto was an industry role model in community relations until this event, and no amount of PR-speak and company announcements changes the fact its brand will suffer years of contamination as a result.

When a company changes its **Operating** model to save cost (primarily) without regard for how elements of that model are vital to preserving a comprehensive and appropriate view of **Purpose** then the events of May 24, 2020 are not that surprising.

Identity that leaks

It is clear that pizazz has left the hearts of more than a few Rio employees in the last few years, and for some the incident has become a matter of shame. Another who joined Rio in

reasonably senior executive position stated *"You know, they train you within an inch of your life about indigenous land rights and relations when you join this place, but they don't ever tell you why and they continually complain of how many resources they don't have"*. I personally know many long-term Rio Tinto employees who would be horrified to hear this statement.

One Rio executive close to events said to me *"Tim, we are better than this"*. When the shared **Identity** of a company has fragmented or diluted in the service of an over-arching uni-element rational purpose (profitability?). it is easy to see how individuals will lose pride in it, not feel as though they belong as much, and be less inclined to ensure all disconfirming evidence or alternative perspectives are brought to the decision-making table. More importantly such people will feel less safe to challenge the current wisdom.

Wonky World Views

Finally, at the deepest level are the **Paradigms** that create the world views or unconscious dispositions that feed our **Identity**, guide the **Purpose** we articulate (and the one we use), and form the backdrop on the stage of our **Operations**.

Using the work of Dexter Dunphy and his colleagues, Viv Oates and I once proposed a model of six different ethical levels or types of Paradigms:-

Level 1: Rejection. Exploit, use and abuse others, and especially their relative disadvantages, for your own gain, without any regard for consequence.

Level 2: Non-responsiveness. Operate from a position that measures success only in terms of one's own gain; exploit others where there is a power or monetary gain to be had and have little real concern for the law of regulation.

Level 3: Compliance. Do the minimum required by the relevant law of the land, and continue to exploit others, but minimize consequential risk. In other words, don't get caught out.

Level 4: Efficiency. Regard yourself as a good citizen (individual or corporate), and act in a manner that respects and upholds the morals, values, regulations, customs and styles of wider society, act in a holistic, integrated way across all areas of activity.

Level 5: Proactivity. Be a proactive agent for values-led leadership in the context of wider society in all areas of activity, recognizing this as a point of personal or corporate distinction. Or, be a role model by going "above and beyond."

Level 6: Sustaining. Recognize one's place in the grander scheme of things, and the interconnectedness of everyone as well as everything, and act as a coevolutionary element to foster greater effectiveness for the whole.

If we go back to pre-1989, there are few who would doubt that Rio Tinto's management of the Panguna mine in Bougainville was done within Paradigm Level 2 or, on a good day, Level 3.

However, in the many years since, Rio Tinto has built an enviable reputation in the resources sector for its thoroughness, respect, and mutuality in dealing with indigenous peoples and what they hold to be sacred.

Prior to the events of May 2020 at Juukan Caves I would have happily held up Rio Tinto as an example of a company operating at Paradigm Level 5, occasionally even Level 6.

What the thousands of pages lodged with the Parliamentary Inquiry and my own conversations with Board members and executives (and past managers) paint is a very different picture.

The **Paradigm** actually in operation since 2016 has been, at the very best Level 4, and occasionally Level 3 – especially the focus that lawyers bring to decisions, a primacy on minimizing consequential risk.

We now know this **Paradigm** took hold in 2016 and was associated with a dilution of pride and **Identity** which in turn fed a fundamental re-orientation of **Purpose** and in turn led to well-intentioned line managers in a much more poorly connected **Operating** framework making decisions that led to this corporate and social disaster.

The deep cause was not disrespect of indigenous or human rights as some have suggested, and many will continue to do.

It arose from how all humans come to organize large and complex organizations and in so doing lose sight of their encompassing purposes, dilute their own energies and identity on the altar of rational expediency and operate with inappropriate world views.

They end up employing operating models that

1. OPERATIONS

- How well does our operating model and the way we work bring all divergent information to bear in decision making?
- How do disconfirming voices get honored and heard in our decision making?

2. PURPOSES

- How well does our core purpose fit our ambition, our identity and the context in which we operate?
- How well does our behavior, decisions and processes reflect this core purpose?

3. IDENTITY

- Who are we really, what is our story, and who is part of it?
- How well does this story unite and enliven our work together?

4. PARADIGMS

- How can we make explicit the deep unconscious patterns that guide our thinking and choices?
- How appropriate are they for today's turbulent and deeply interconnected world?

Figure 3

are simply not fit for purpose, no matter how many parliamentary and PR submissions say they are.

What is not of any doubt, however, is that it has done tragic harm to the good will of the company with indigenous people.

It has caused the local PKKP people great cultural pain and has brought significant doubt back into relationships between mining houses and local communities.

Persistent critical review

In the modern world this suggests CEO's and Boards need to be regularly and continually answering the questions depicted in Figure 3.

This at times can get messy for these four layers are intimately connected and interdependent as our Rio Tinto case study illustrates. But this is not an excuse for not beginning.

Bringing into your organization discordant voices and reviewing these four levels of organizational life on a regular basis is the first step. But not with the aid of McKinsey's, BCG or similar who operate within some of the prevaling paradigms. You need discordant voices. Three of our clients employ an artist, a philosopher and sociologist respectively for their biennial corporate health checks. These visitors need to turn up with centered detachment, and the leaders involved need to turn up with huge doses of humility. For this type of regular corporate health-check you need those familiar with how large corporations work, true, but who also have wisdom, an independent philosophy and a brain to see patterns, risks and contradictions that your average high priced consulting firm cannot afford to point out to you.

This type of health-check could have

prevented the Rio Tinto disaster and many of the failings uncovered in the banking sector royal commission. On the other hand, it is unlikely to ever see the light of day in those organizations run by leaders who have a cultural bent or a tendency to believe they know best and are charged with making decisions that others should follow.

It is not easy being a CEO or Board member in this highly interconnected and turbulent environment we call the world. There is so much to balance, about which to be vigilant, and which to operate in an integrated, profitable, sustainable and respectful manner. Friedman's simplistic approach needs replacing with comprehensive, systemic and more elegant ways and means. We are moving fast into a world were failure for CEO's will not be judged in lack of profit, but in the courtrooms of the world.

There is no other viable **Paradigm** to use in such a world except **Level 6**: to see the grander scheme of things, the interconnectedness of everyone as well as everything, and act as a coevolutionary element in the whole. Milton Friedman's doctrine seems strangely anachronistic in this world.

Tim Dalmau

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