





GLOBAL CAPITALISM AT RISK

WHAT ARE YOU DOING ABOUT IT?

**Business must confront the new
challenges to the free market.**

*by Joseph L. Bower, Herman B. Leonard,
and Lynn S. Paine*

ILLUSTRATION: KENT BARTON



MARKET CAPITALISM has proven to be a remarkable engine of wealth creation, but if it continues to function in the next 25 years as it has in the past 25, we are in for a violent ride or, worse, a serious breakdown in the system itself. That sounds dire,

and it is. The threats to market capitalism are diverse. When the gap between the rich and the poor continues to widen, when millions of have-nots migrate from poor countries to rich ones and wealthy nations respond with increasingly strident protectionism, when global financial systems are fragile and less than transparent, and when society's traditional protectors—business, industry, government, and international institutions—are unable to address these and other first-order problems, we have a recipe for disaster. The failure of the financial market system in 2008 is an example of what can happen, as is the recession that ensued in the developed world.

Additionally, careful long-term projections indicate that climate change and increasing environmental degradation will have far-reaching political, social, and economic consequences.

As part of the preparation for Harvard Business School's 100th anniversary Global Business Summit, in 2008, which focused on the future of market capitalism, we asked small groups of business and government leaders around the world what issues should inform the school's agenda for the coming century. The long-term sustainability of global market capitalism was a primary concern for virtually all of them. But we heard surprising differences among them in how they thought they, as business leaders, should respond. Some said that changing their behavior would be unnecessary or even inappropriate. Others said changes were critical but were unsure how to respond to issues seldom thought to be the responsibility of individual firms.

Economic theory holds that in a market system characterized by perfect competition, the resulting

pattern of output and consumption cannot be improved. The leaders we spoke with, however, did not believe that the markets in which they participated were perfect in any way. The financial markets, they said, were too volatile, free trade was undermined by industrial policies and state capitalism, and the benefits of the market were unevenly distributed. As they saw it, outcomes like these would threaten the system.

We contemplated what we were hearing from the perspective of our decades of experience as researchers, teachers, consultants, advisers, and company directors. And we concluded that, to preserve market capitalism as we know it, both companies and their leaders must change. Instead of seeing themselves as narrowly self-interested players in a system that is tended and overseen by others, business leaders must take a more active role in protecting and improving the system. Indeed, they need to spearhead entrepreneurial activity on a massive scale. They must help devise strategies that provide employment for the billions now outside the system, which, in turn, means changing how they think about the relationship between productivity and profit. They must invent business models that make better use of scarce resources and even take advantage of looming resource shortages. And they must create institutional arrangements for coordinating and governing neglected and dysfunctional aspects of market capitalism.

Some companies are already combining technology and good management to deal with the challenges. They have found ways to provide education and access to finance, jobs, goods, and services so that large numbers of people are brought into the market system. Other companies are pioneering the search for new sources of energy and more-efficient uses of critical resources. But there is a long way to go and many serious problems to address. We believe that if enough companies develop business strategies that help tackle these problems, the entire

To preserve market capitalism, business leaders must spearhead entrepreneurial activity on a massive scale.

Idea in Brief

The past 50 years have seen unprecedented economic growth, attributable largely to the spread of market capitalism across the globe. Business leaders asked to identify the issues of deepest concern to them pointed to forces that could disrupt the global market system in the coming decades: inequality in income within countries and across regions, migration, deterioration in the environment, a fragile financial system,

and the inability of local, national, and international institutions to mitigate the problems.

For market capitalism to prosper, business must lead—as an *innovator*, developing strategies that turn systemic problems into opportunities for sustainable growth, and as an *activist*, mobilizing coalitions of companies and governments to develop institutions that can support and strengthen the system.

system can be strengthened, the forces of disruption mitigated, and market capitalism as a wealth-creating system for society preserved.

The Forces of Disruption

The leaders we talked to identified various forces that could severely disrupt the global market system in the decades ahead. Because market capitalism is part of a complex sociopolitical system, these forces arise from multiple sources. Some are fueled by negative consequences of the market system and feed back into it in disruptive ways. Others arise from sources external to the system. Still others relate to the conditions that must be in place for the market system to function effectively. Whatever their origins, the forces are interrelated and cannot be considered in isolation. (See the exhibit “The Ecosystem of Market Capitalism.”)

The fragility of the financial system. Trillions of dollars move around the world daily, at high velocities. The financial crisis of 2008 showed that if these flows are unmanaged and unregulated, transparency can be reduced and risk compounded, with devastating consequences.

Breakdowns in global trade. The financial collapse of 2008 also demonstrated that trade can break down precipitously and with far-reaching effects. The freeze in trade finance and collapse in demand for goods was reflected in a 2.8% drop in global trade in 2009, the first decrease since World War II.

Inequality and populism. Within countries and across regions, income and wealth disparities are increasing—a trend that concerned the business leaders in our forums. The growing gap makes a mockery of the idea that economic growth benefits all. And the resulting populist politics could lead to harmful government interventions, such as overregulation of market transactions, confiscation of property, and other abrogations of property rights.

Migration. Massive migration, either domestically (from rural areas to cities) or across national boundaries, is often a consequence of inequality. Cross-border movements of people tend to trigger protectionism and anti-immigrant political reactions, which frustrate would-be immigrants, undermine potential solutions to labor needs in developed nations, and generate social conflict.

Environmental degradation. The evidence is more than circumstantial that industrial growth is associated with climate change, which affects the availability of water, the health of crops, air quality, and sea levels. The consequences could be seen in migration, the disruption of manufacturing and trade, and political instability.

Failure of the rule of law. The rise of corruption, extortion, thuggery, and expropriation in some parts of the world makes it difficult to operate a capitalist system that respects property and human rights and upholds contracts. When bribes rather than competition determine winners, investment in innovation ceases to be worthwhile.

The decline of public health and education. The size of the labor force depends in part on its health, and its productivity depends on its education as well as its health. In parts of the developed world, the quality of education is in decline, and health care costs have become unmanageable everywhere.

The rise of state capitalism. For centuries, developing nations have adopted variations of mercantilist policies to accelerate economic growth. But in the 21st century, some developing nations are giants. To the extent that Russia, China, and India play by their own rules, they have the potential to disrupt market capitalism as it is practiced in the developed world.

Radical movements, terrorism, and war. The increasing challenge of maintaining sufficient peace and security for capitalism to prosper threatens the

system. Sustained conflicts could disrupt the flows of goods, services, and capital necessary for the functioning of global markets.

Evolution and pandemics. The development of resistant pathogens such as MRSA and the unwillingness of some governments to address pandemics and to engage in cooperative efforts to curb the spread of disease pose another threat. An outbreak of untreatable infectious disease could quickly disrupt trade and financial markets worldwide.

The inadequacy of institutions. Governmental and international institutions seem inadequate to deal with the scale and complexity of these varied challenges. Too often, international cooperation consists of ad hoc agreements, such as those meant to address climate change, trade, and migration. Worse,

make would be to run their companies as efficiently as possible, leaving government to address major threats.

The third group, which we labeled “business as innovator,” saw business as better able than government to address serious challenges but thought that business would do so not by influencing policy but through innovations in products, services, strategies, and business models. The fourth group, which we dubbed “business as activist,” argued that business can and must become more engaged in shaping public policy, spurring government (which they believed could not on its own solve major problems) toward policies that would strengthen the market system.

In our view, none of these responses is adequate by itself. Business as usual strikes us as untenable

Neither governments nor international institutions are set up to deal with systemic failure.

the disruptive forces interact in negative ways so that problems in one area stimulate new ones in others. It is the systemic character of the challenges that makes them especially hard to address. Neither governments nor the few international institutions currently in place are set up to deal with systemic failure.

How Can Business Respond?

How can business respond to the disruptive forces? How *should* business respond? In answering those questions, the executives typically fell into one of four camps. The first, which we called “business as usual,” didn’t dispute the challenges presented by the disruptive forces but felt that their seriousness was overstated and that the capitalist market system was fundamentally sound. Over time, those in this group argued, the issues would take care of themselves through the normal mechanisms of government, business, and other institutions. Executives in the second group, which we called “business as bystander,” felt that the best contribution they could

given the system’s dysfunctions. Business as bystander asks more of government than it can possibly deliver: Many governments today are too weak—economically and politically—to address major global disruptions. Although we see great promise in business as innovator—indeed, companies that view challenges as business opportunities can play a significant role in addressing them—current challenges also call for business as activist, in which companies could drive institutional innovations beyond what a single firm could accomplish. In short, we see a need for “business as leader.” We believe that business—as an innovator and as an activist—must lead the kind of pervasive change that could improve the functioning of market capitalism.

What would business as leader look like? First, it would produce a wide array of structural innovations. In addition to new technologies, products, processes, designs, and distribution systems—the kinds of innovation for which business is often, and rightly, celebrated—we need innovations in strategies and business models that explicitly seek to use disruptive

The Ecosystem of Market Capitalism

forces as opportunities for growth and profitability. Second, business as leader would involve activism both at the level of local policies (such as a business that supports education and training relevant to its skill needs) and at the level of the broader system (such as a company that pushes for more transparency in the global financial system). Activism at this higher level often requires institutional innovation: the creation of entities that can organize large-scale collective action.

A Call for Leadership

Opportunities for the kind of business leadership we have in mind are plentiful.

Consider the challenge of health care. The data are clear: In developed countries, the rising cost of health care threatens to bankrupt the governments that provide it. Worse, the quality of care seems largely uncorrelated with cost. The debate in the United States, focused on access to care and how to pay for care, has generally neglected two critically needed changes: improving life style and behavior (better nutrition and more exercise, decreased drug and alcohol dependence) and rationalizing health care delivery so that it is based on the analysis of patient outcomes. Instead of addressing those huge opportunities, many companies are resisting change, taking a business as usual stance. Where is the Henry Ford who will rationalize health care delivery?

Consider also income inequality. The only way to sustain the income levels that can keep people out of poverty in developed nations is to educate workers so that they can compete with those in developing nations. Education is generally considered the responsibility of government, but voters in many rich countries have expressed an unwillingness to fund it, and many companies aggressively seek to minimize their contribution to the tax base that funds public education. Where are the companies that are developing ways to train workers so that their productivity permits them to earn middle-class incomes?

In many countries, high-income jobs such as software development and jobs in modern manufacturing facilities are unfilled because the education system is not producing graduates with the necessary skills. One of our U.S. business leaders described closing a plant in southern Indiana because the local high school could not provide an adequately educated workforce. Similarly, the CEO of Siemens in the United States recently noted the mismatch between the skills his factories required and those that high-

The forces that threaten market capitalism arise within a complex and dynamic sociopolitical system characterized by both positive and negative feedback loops. The market system generates positive consequences that, in turn, reinforce and strengthen the antecedents necessary for it to function successfully. The system also generates negative consequences. If not adequately addressed, those consequences create disruptive effects that undermine the system's health and stability both directly and indirectly through interactions with forces from outside the system.



school graduates possess. Where are the companies that are using technology and good management to equip high-school graduates to work in modern factories?

What about migration? In many countries, unfavorable demographics threaten economic growth. Think of Japan, with its aging population and growing labor shortages. Well-managed immigration would go a long way toward solving such problems. But a German leader described the unwillingness in Europe to fund programs that integrate immigrants—who could provide much-needed labor—into society. In the United States, agriculture, nursing, and home health care all are dependent on immigrants, as are the high technology industries, but none have managed to resolve the political challenges that immigration poses. Where are the companies that are devising the approaches to immigration that will provide the labor force they need?

A Broader Role for Business

These are difficult questions. We do not pretend to have answers. But the disruptive forces are bound to get worse unless they are resolved. Some companies have addressed the problems in ways that are good for business. It is these examples that lead us to ask all firms to rise to this challenge. Although each illustrates only part of what is needed from business, together they point to the broader leadership role that business can and must play.

Consider China Mobile, the publicly traded subsidiary of state-owned China Mobile Communications Company, which is now the world's largest mobile phone operator in terms of subscribers and market capitalization. In 2003, the Chinese government decided to step up the pressure on its nascent telecommunications industry to bring modern telephony to 700 million rural citizens in the country's interior. Not surprisingly, companies that were coping with annual growth rates of 25% just from serving the wealthier eastern seaboard provinces resisted such pressures. But in 2004, the new chairman of China Mobile and his team had an epiphany. To maintain growth over the long term, they realized, they would need those rural customers. China Mobile developed a distribution system that reached even farther into the village structure than the Chinese postal system. And it created services for basic mobile phones so that farmers and merchants could be connected with current market information and remittances could be moved efficiently and securely

Some of the leaders we spoke with:

Nancy Barry
president, Enterprise Solutions to Poverty

Carlos F. Cáceres
president, Instituto Libertad y Desarrollo, Chile

Bertrand P. Collomb
director and honorary chairman, Lafarge

James Dimon
chairman and CEO, JPMorgan Chase & Co

Ana Maria Diniz
president, Sykue Byoenergia

John Elkann
chairman, Fiat

David N. Farr
chairman and CEO, Emerson

Paul J. Fribourg
chairman and CEO, Continental Grain Company

Victor K. Fung
group chairman, Li & Fung
honorary chairman, International Chamber of Commerce

Claudio Haddad
president, Insper Instituto de Ensino e Pesquisa
founder, Grupo Ibmeç

Jeffrey R. Immelt
chairman and CEO, General Electric

Raymond Kwok Ping Luen
vice chairman and managing director, Sun Hung Kai Properties

Maurice Lévy
chairman and CEO, Publicis Group

Sir David Scholey
senior advisor, UBS
former executive chairman, S.G. Warburg Group

Sukanto Tanoto
founder, chairman, and CEO, RGE (formerly RGM International)

James S. Tisch
president and CEO, Loews Corporation

Jaime A. Zobel de Ayala
chairman and CEO, Ayala Corporation

TITLES AND AFFILIATIONS REFLECT CURRENT ROLES.

from family members on the east coast. The number of unskilled workers in emerging markets is projected to be more than 3 billion in 2030; bringing even a third of China's 700 million into the market system would be no small accomplishment.

Another company that has found opportunity in systemic challenges is IBM with its Smarter Planet initiative, which aims to address the developing world's massive infrastructure needs. The initiative required a new allocation of resources, new capabilities, and new organizational models. To free up resources to pursue this opportunity, IBM disposed of commodity-like hardware businesses. It then acquired the entire PricewaterhouseCoopers (PWC) consulting operation in order to incorporate deep domain knowledge in its customer-facing teams in such areas as health care delivery and smart energy distribution. These new capabilities and people were then teamed up with IBM research scientists, who explored innovative solutions to critical challenges, from traffic congestion to the management of China's high-speed-rail system to the development of the IT platform for China Mobile's rural strategy.

To ensure that resource allocation would reflect strategic objectives, customer-facing activities were reorganized in a new Emerging Market group, managed from Shanghai. As a result, smaller but fast-growth countries like Poland no longer had to compete for resources with mature and profitable neighbors like Germany. IBM also developed communications programs to inform government agencies and talented young employees about its commitment to some of the very issues that our business leaders identified as threats to global market capitalism.

Both China Mobile and IBM are examples of companies that innovated by reconfiguring their resources to turn massive systemic challenges into business opportunities and by reaching out to public and private customers. Other organizations have also seen that they could not on their own resolve important problems, and so they have devised consortia and other types of collaborative groups.

Consider an example from 1942, when the private-sector Committee for Economic Development was formed to mobilize the United States for a quick conversion to full employment after World War II and to conduct nonpartisan research on how to promote high levels of employment. Afraid that the country would be plunged into another economic depression when wartime contracts were cancelled and return-

Many managers believe that grappling with large issues is beyond their capabilities.

ing troops reentered the job market, the CED mobilized more than 70,000 business leaders from nearly 3,000 U.S. communities in an effort to stimulate employment and productivity after the war. Might a similar effort be mounted to deal with high levels of unemployment in the United States today?

The international shipping industry offers another example, which may be useful for industries facing difficulty moving workers across national borders. The shipping industry has for many years worked on multiple fronts with the United Nation's International Maritime Organization (IMO) and International Labour Organization (ILO) to facilitate the movement of maritime workers and to establish standards for their employment. In 1958, for example, a joint effort by shipowners, the IMO, and the ILO resulted in an international convention for providing crews with identity documents that, in participating countries, exempted seafarers from certain immigration requirements. The arrangement made it easier for crew members, who might otherwise be deemed illegal aliens in foreign ports, to spend time ashore and then return to their jobs. After 9/11, new security restrictions impeded the flow of commerce and prevented crews from going ashore after long periods at sea. The industry again worked through the IMO and the ILO to initiate negotiations among governments, workers, and shipowners to develop an identity regime using documents that include biomarkers. The convention has not yet been widely adopted—only 19 countries have ratified it so far—but the industry's approach to immigration issues suggests intriguing possibilities. Could arrangements of this sort help the agriculture and home health care industries deal with temporary immigrant workers?

WE ARE CONVINCED that a host of problems could benefit from the attention of large enterprises that reframe them as opportunities. Perhaps governments should be doing this work, but there is no

evidence that they will. Whereas governments must respond to short-term pressures, which almost inevitably are local and parochial, companies can apply the talents of their international workforces to opportunities requiring long-term investment and complex execution.

Many managers believe that grappling with large issues is beyond their capabilities—which is why we use the word “entrepreneurial” to describe the kind of action that is required. Our colleague Howard Stevenson defines entrepreneurship as “the pursuit of opportunity without regard to resources currently controlled.” Most of the problems we have discussed will require the application of resources and capabilities that might not be available at the outset. They might require dramatic action, such as IBM's acquisition of PWC's consulting unit, or lengthy negotiation, such as that required for the development of the international shipping convention. They might also require diplomatic skills and patience not always on display in the C-suite.

Most disturbing for many leaders we heard from was the question of legitimacy. Capable or not, governments (especially elected governments) are seen by many as having a monopoly on collective action. It takes special skill to negotiate the gray areas between corporate and public interest. Many we talked to thought that active participation in this arena would be fatal. Our view is the opposite. We believe that if business does not lead the mitigation of the forces disrupting our market system, then we may well lose it. ▾

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Joseph L. Bower is a Baker Foundation Professor of Business Administration at Harvard Business School. **Herman B. “Dutch” Leonard** is the Eliot I. Snider and Family Professor of Business Administration at Harvard Business School and the George F. Baker, Jr. Professor of Public Sector Management at Harvard's Kennedy School of Government. **Lynn S. Paine** is a John G. McLean Professor of Business Administration at Harvard Business School. They are the authors of *Capitalism at Risk: Rethinking the Role of Business* (Harvard Business Review Press, 2011).

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