**IlLUminate Blog Transcript:** **Judy Samuelson – The Six New Rules of Business**

Recorded March 21, 2022. Listen to it here.

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| ANNOUNCER 00:01 | [music] This podcast is brought to you by IlLUuminate, the Lehigh Business blog. To learn more, please visit us at business.lehigh.edu/news. [music] |
| JACK CROFT 00:14 | Welcome. I'm Jack Croft, host of the IlLUuminate podcast for Lehigh University's College of Business. Today is March 21st 2022, and we're talking with Judy Samuelson, founder and executive director of the Aspen Institute Business and Society program, about her new book, The Six New Rules of Business: Creating Real Value in a Changing World. Samuelson, also a vice president of the Aspen Institute, is on campus today for a roundtable discussion with Lehigh Business student leaders. It's part of the college's Year of Learning, on the theme, The Corporation and Society. Prior to joining the Aspen Institute, she worked in legislative affairs in California and banking in New York's garment center, and ran the Ford Foundation's office of program-related investments. Thanks for being with us today, Judy. |
| JUDY SAMUELSON 01:05 | Glad to be here. |
| CROFT 01:07 | OK. I'd like to start with a quote I'm sure you're familiar with, from Milton Friedman's essay written for The New York Times in 1970, which was six years before he was awarded the Nobel Prize for Economic Sciences. And at the time Friedman wrote, "There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say engages in open and free competition without deception or fraud." Now at the Aspen Institute, you've led a 10-year campaign to disrupt Friedman's narrative about corporate purpose. What have you seen over the past half-century as that was increasingly became kind of the standard in business that led you to want to overturn that? |
| SAMUELSON 02:06 | Well, again, thanks for having me. There's a lot that Friedman got right, but I think that the extent to which—and this really took off in the 1980s and then into the early '90s—the idea that the best kind of determinant of business success was the share price, shareholder value creation. So business school students at Lehigh and everywhere else are basically taught that the purpose of the corporation is to maximize shareholder value, if they're a public company anyway, and that aligns closely with profit maximization. I think what we've seen in many respects is kind of a hollowing out of what we believe is possible through the creation of corporations. I mean, corporations are created, at their heart, in order to enable activities that you cannot accomplish through an individual's own resources and contacts. Corporations are licensed by the state, and they are granted certain powers and limited liability in order to do things that, I believe, are in the public interest. And, of course, companies need profit to both survive and flourish, if you will. But single objective functions, I think, never end well. |
| SAMUELSON 03:36 | And I think we've been living through an era in which the intense focus on the stock price has hollowed out the long-term investments that we need for companies to be able to operate successfully, to prepare for risks that are abundant and are growing, and to produce goods and services that are of high quality, but under a business |

model where the value creators are really compensated fairly for their time and their input. And I think we're seeing the impact of shareholder value—share price maximization or shareholder value—as the organizing principle. It's a driver of inequality today, and it is-- sadly, the pressure that it has put on companies means that they're not doing the kinds of investments that I think are necessary for the long-term health of the enterprise.

CROFT 04:39

Now, you mentioned the idea of value creation, and the book that you've written now talks about creating real value. So what is the difference between the real value you're talking about and the value that's been kind of-- or the definition of value that's been the standard for the past half-century?

SAMUELSON 05:05

Well, I think real value-- I think there's some characteristics of companies that create real value. I already mentioned one of them. I think they sufficiently reward those things that are absolutely instrumental to the health of the enterprise. They have to sufficiently reward workers, employees. They need to be well compensated for the work that they do to create value at the level of the enterprise. They need to get things priced right. If you don't price the real inputs to the enterprise, you find yourself in the value extraction business rather than the value creation business. And there's lots of examples of that, and some that have hit hard in the last decade or so. I think we could talk about Purdue Pharmaceuticals. We could talk about the tragic failure of Boeing, VW and Dieselgate, Wells Fargo and the creation of-- selling false accounts. These things happen because there's such an intense focus on profit maximization that companies essentially lose their way. But an important kind of calibrator of value is a principle of how long-term focused the company is. And there's this notion that the Native Americans had about seven generations—you need to assure that the decisions you make today will stand for seven generations. That was the concept, and it's a metaphor for something that actually is very difficult to accomplish.

SAMUELSON 07:02

But ultimately it is all about time frame. And so companies that are value creators, naturally, they really have kind of a sustainability mindset, that they are stewards of resources and think about how to make decisions that stand the test of time.

CROFT 07:21

Yeah. And it would seem, then, within that definition-- would explain why you include climate change, for example, as one of the things that have to be part of any value creation for a corporation, that if the actions they're taking are going to limit the number of generations we have on the planet, regardless of the immediate profits, that's not a good thing.

SAMUELSON 07:52

Corporations are critically important institutions. They're very powerful. They have a lot of influence. And we need them at the table to solve our most complex problems. And climate change clearly falls in that domain. We need industrial organizations to embed the real costs of operation, and climate is just the most exaggerated form of that. And so we both need business making the kinds of investments that are required in order to address climate change aggressively. But back to the current state of play, we're not getting that. Our tepid response to addressing climate change, a lot of that, some of it anyway, returns us to the idea of companies that are driving to the single objective of stock price, which is not an enabler of long-term investment in addressing the kinds of crises that we're facing in that domain in particular. It's expensive. Doing the changes that are needed is expensive. What has been the case for over a decade now, if we're returning-- if we're hollowing out the treasury to give

93% of the profits to the shareholders, that doesn't leave a lot of money either to withstand the kind of crises that we've been through in the last couple of years, during COVID, to make sure, again, that people get a fair wage for the work that they contribute, or certainly to do the kind of massive, expensive investment that's required to address climate change. And we're seeing that in real time. The amount of money that companies are investing in share buybacks. Share buybacks are just a-- depending on who you talk to, they're either a way to give a return to the shareholder or to manipulate the stock price.

SAMUELSON 09:49 But if you're returning that much of the free cash to the shareholders, you're simply not retaining enough to invest for the future.

CROFT 09:58 I'd like to go through the six rules, and we'll by necessity, obviously, be talking about them, and rather briefly compared to the details in the book. The first one where you start is, “Reputation, Trust, and Other Intangibles Drive Business Value.” And you contrast that with the old rule of, “Hard Assets Determine Firm Value.” So talk about that shift that you believe needs to be made, and how we think about business value.

SAMUELSON 10:33 Well, if you think about the companies that are at the top of the stock market valuation tables today, you're talking about the big tech companies, the so-called FAANG stocks, and those companies a lot-- their value is intangible. They have intellectual property. They design products. They mostly don't manufacture products. You take a company like Apple, which is always near the top of the valuation tables. They don't manufacture anything. All of that is done through third-party contracts that are not directly in the control of Apple. Obviously, they pay the contracts, but all of that value creation, if you will, resides somewhere else. The company is brilliant at designing products. It has very few employees directly on their balance sheet. And so their real value is intangible. It's about all of these companies. It's about trust, trust. Did I say trust? They're about trust. They're about talent, attracting and retaining talent. They're about reputation in all of the respects in which we know that that's part of the brand. And so it's a different conversation, and it's one that is much more fluid, prone to different kinds of risks when we're talking about what really creates value and what is the company worth and why. So it's a totally new ball game. And one of the things that I was curious about finance classrooms is what would it take for finance classrooms to kind of catch up with that reality?

CROFT 12:09 And I do want to talk about education once we go through the rules, because I think-- obviously that's part of why you're here today. But also that, when you start talking about future generations-- that's what we're talking about, is the future of business. The second new rule is, “Businesses Serve Many Objectives Beyond Shareholder Value.” Now, that would replace the old rule, that “Shareholder Value or Profit Maximization Is the Organizing Principle of the Corporation,” which was essentially the point Friedman was making in that opening quote. So what are some of the many other objectives that businesses should be serving that go beyond shareholder value?

SAMUELSON 12:55 So this is a-- in some respects, it's a complicated question, but on the other hand, I think it's just common sense. You can't run a global operation or even a domestic operation with the complexity of inputs that are critical to the company's success and only manage by a single objective function. It's just more complicated than that. And managers, they're probably best at their ability to zero in and out on the various things that need to be true in order for the company to succeed. And so, on the one hand, we're just talking about what makes-- is commonsensical for business. You can't only have one objective in the view. There's this theory that if we focus on the stock price or on shareholder value, that somehow a rising tide lifts all boats, or that that's simply a way for-- it's a good marker for how the company succeeds. But I just think that's not true. It's not turning out to be true anyway, as we see some of the costs of managing, the way that companies zero-in on the stock price today. So in 2019, the Business Roundtable, which is our largest kind of trade association of many of our largest companies in the country, they came out with this bold statement, and they essentially said, "The era of shareholder value maximization, that's over. That's not how we really manage, and we need to be attuned to all of our stakeholders." I don't like the word stakeholders, because I don't think that's a management principle. I don't think that actually guides companies about how to manage better. I prefer the examples of companies that have stepped back and said, "What business are we in, and what needs to be true in order for us to succeed?"

SAMUELSON 14:51

And that's going to be different if you're an Intel or if you're Walmart. These companies are not the same. These industries are not the same. And they have different things that need to happen in order for the company to succeed. And so I'm always drawn to the example of-- one of the things I write about, I'm always drawn to the example of Merck, back in the day, when it chose to go ahead and manufacture a drug that was a cure for a horrible disease that was common in the river valleys of Africa called river blindness, or it goes by another name, but that was a common name. And what the then-CEO, Roy Vagelos, taught me is that he knew that was the most important thing to the success of Merck was actually the science, the scientific talent, the drug, the discovery of drugs. That, if he didn't keep that at the center of the enterprise, he would be hollowing out the capacity of this extraordinary company to be able to create real value over the long haul. And so, in doing that, he understood that even if they had a drug that was not commercially viable, but it was still an important cure for a disease like that, they simply had to move forward. And I think embedded in that was a real notion of purpose and, in some respects, again, back to common sense management principles. So there's much more to say on this topic of corporate purpose.

CROFT 16:24

What also seemed to me to be a good example of your third rule, which is “Corporate Responsibility Is Defined Far Outside the Business Gates”-- obviously, if profit was not the motive there, and I think there's-- it obviously hasn't always been the case, but there's been a sense that one of the things corporations should be is a good corporate citizen where they are. But your definition seems to be much broader than that, than just kind of the-- we're not talking about just the surrounding community now.

SAMUELSON 16:59

Given the scale of these multinational corporations and the consequences of decisions and how critical-- and how many ways in which they influence the broader landscape, it's not surprising, particularly, that they've become the target of NGOs, non-governmental organizations, and nonprofits, who are perfectly capable and willing and eager to use a case example of a brand that is not delivering on a general principle that they believe is true, whether it's around water conservation, or again climate, or human rights, or fair wages, or a well-functioning supply chain, one that kind of respects rights and labor up and down the food chain. Those things mean a lot. And these NGOs have learned about how to-- they're not beyond harnessing your brand to make the larger point. And there's lots of examples of that, and they are compelling, and they are aided and abetted by social media and the ability to kind of turn a reputation of an enterprise overnight. They're not necessarily targeting the worst actors. Often, they're using the brand, again, to make a larger point. But there are study examples of that and also study examples of how these organizations can amass the following and the media support to actually transform an entire industry or kind of supply chain.

SAMUELSON 18:46 So it's almost like taking the power of the corporation and turning it on its head and saying, "How do we deploy this enterprise in pursuit of a generally kind of critically important input or resource?" And so we're seeing lots of examples of that today. But the company is not defining the rules. The rules are being set by people that are way outside the gate. And these are examples of that.

CROFT 19:10 Now, inside the gate, the employees-- and you've talked about-- mentioned paying fair wages a few times now, but beyond that, your rule number four is, “Employees Give Voice to Risk and Competitive Advantage.” So what needs to change in the roles that employees play in business?

SAMUELSON 19:34 I call it accountability from the cafeteria. And now that we're starting to go back to work again, we can see whether or not that's actually true. But if you think about who holds companies to account, neither investors nor consumers are very good at that. Consumers were bound to price and convenience. Enter Amazon. Investors come in lots of shapes and sizes. They don't all agree on what they want. They have different time frames. They have different levels of risk tolerance. But they're all bound by wanting to maximize return. I mean, there's a lot of so-called ESG [Environmental, Social, and Governance] or responsible investors that may say they have other priorities, but the noise of the stock market itself kind of perpetuates the focus on financial return. Employees, on the other hand, are a different kettle of fish. I mean, the employees benefit of the company. They're very aligned with the health of the company itself. And increasingly, employees, and I wouldn't just call out younger employees, millennials on down, but they are particularly adept at it-- and, again, social media is enabler of this. They're kind of the mediators who sit in-between the business enterprise and its values and its intentions and its reality, and a whole host of different issues that sit kind of outside the gate, but are critically important to employees, whether in their walk as community citizens in their local community or kind of global citizens. And they are willing to make those connections between these external risks and what the company is doing that is-- whether it's really creating value or extracting value. And we have lots of examples of employees being willing to step up and to drive those kinds of changes.

SAMUELSON 21:33 I could talk about Amazon. I could talk about Google, the Google walkout, which kind of put the #MeToo campaign on the radar. Amazon employees that use their own shares of stock to force Amazon to at least have a conversation about climate and what was their posture there. There's lots of examples, and I don't think this is going to change anytime soon.

CROFT 21:54 And a couple of things that you've touched on on that one, I think, apply to rule number five as well, which is, “Culture Is King and Talent Rules.” I want to contrast that with the old rule, which is, “Capital Is King, Shareholders Rule.” So that really is a profound shift in how you look at the value of a business.

SAMUELSON 22:19 It is a profound shift, and it takes us back to-- it's a different era. When General Motors was the largest company in the country and had the largest valuation as a public company, it had maybe a million employees just in the United States alone.

And of course, it was a hard-asset world. We already talked about that. But today, companies that go public that do an initial public offering, they may not actually be raising stock at all. They may just be directly listing their stock on the market to enable their early investors an exit. So they raise their money in private markets, and then they go public in name only. They're actually not raising capital. They don't need capital. Tech companies are capital light. They don't have hard assets to sustain and continue to build. So it's an interesting question: Why do we put so much importance on the stock market? It kind of becomes a self-fulfilling game over here, but it's really an aftermarket. The company gets their money at the IPO. If they raise money in the public markets, they receive their money at the IPO. And no companies return to the stock market today to raise capital. We're seeing the opposite happen. And so what does matter a tremendous amount is the culture of the enterprise, their ability to attract and retain talent. And these companies that are really human-centered design excel over time. So there's a lot of great examples to draw from, but it's a very different quality of need, if you will, the human capital. I don't even know if that's a very good word for it. We have to put capital at the end of everything. But the human quotient is critically important today. It is much more important than financial capital.

CROFT 24:15

All right. Finally, rule number six. The old rule and new only differ by one word. The new rule is, "Co-create to Win," and that replaces "Compete to Win."

SAMUELSON 24:30

Well, I don't think-- whatever it is that keeps you awake at night, we don't solve it one company at a time. Let's go back to climate change. I mean, this requires a complex set of things to happen. And I think we're starting to see more examples of companies, industries that are leaning in, kind of task forces at the level of an industry that are talking about changes in protocols and processes and the way an industry works overall, with enough power at the table to actually raise the bar on the entire industry. We've seen it in mining and metals. We've seen it in-- the airline industry recently issued some pretty dramatic changes in terms of how they look at climate change, and what needs to be true in order to kind of bring the heads of that industry behind the changes that are needed. So there's a lot of examples of that, but also across sectors. You're seeing collaborations between NGOs, as I was talking about, and for-profit corporations. And of course, government and business have always collaborated. We just don't always see it.

CROFT 25:38

OK. Getting back to that idea of the seven generations and having an eye on the long term. Obviously, business schools are key players in that. And what changes do you think need to be made to create the business leaders that we're going to need for the difficult times ahead?

SAMUELSON 26:04

Well, it is a leadership question. I write about some leaders that I really admire. The CEO's job has changed profoundly. The CEO today is the leader of a community of interests. The CEO isn't just a leader of an enterprise defined in kind of its local footprint. It needs to build the trust of a set of players, including its own employee base first and foremost. And so that's a profoundly different job. I think what we need from business schools is both to recognize that and to equip leaders to be able to think with those broad and long-term interests at play. It's tricky for business schools because as students exit business, they're often taking-- they're taking on kind of entry-level jobs that need-- that often have kind of a high kind of technical quotient of skills that somebody wants to replace them so they don't have to do that part of the job anymore. They may be directly-- it's only a person a couple of years out who's actually recruiting somebody to take their place. Where if you think longer term about what is it that individual needs to understand, what kind of attitudes and attributes do they need to actually end up being able to manage well inside the enterprise? So those are two different things, kind of getting your first job, and succeeding 10 or 15 years down the road. And that's one of the things that business schools have to balance. And it's a complicated one because of the pressure to have the right skill set to be able to get a job to begin with. But I think there's also other ideas that we need to land here.

SAMUELSON 27:58

I mean, I'm a critic of business schools that are kind of awash in shareholder primacy thinking and are not finding ways to kind of step back from that and think about what is it we need to prepare people for a world that is more complex than that. But there's all of these ideas around circular economy. We assume in business education, and in our economy generally, that it's based on growth. Growth is kind of central. And yet we live in an environmental reality that growth isn't the answer. Different kinds of products and services, and ways of limiting growth are actually going to be critical to our future. So there's first principles at play here, and I think we're seeing-- boomers are finally starting to step down from jobs, although not all of them, not all of us. And it gives an opportunity for fresh thinking to come into business schools, and I welcome it.

CROFT 28:58

For our last question then, I always like to end on one that's future looking, is you've traveled around quite a bit, meeting with students across the country. Do you feel optimistic about the future from the students that you've interacted with?

SAMUELSON 29:21

You're asking that question in a particularly hard time. For a couple of years, I haven't done much. I mean, I've taught a couple of classes, but I haven't had as much contact directly with students, although there's certainly a lot that's happened online. I think they're pragmatic. I think they see the complexity and don't always see-- they know that there are no simple solutions here. And I think that they're actually struggling with some of the same questions that plague managers, and people much more senior. It's like kind of why am I here? And what I'm hopeful about is that these students understand how much the equation has changed and how important-- how much weight they have in the system. They don't have to accept the status quo. They're entering the market at a very interesting time where they actually hold a certain amount of power in the system. I mean, one of the things that we need innovation around, real innovation, is kind of a recalibration of power within firms. We need employees to be able to step up and to be able to be heard. And we need governance systems and management systems that take that into account. It's not going to get solved the old way. It's not going to be around the resurgence of unions, although they are maybe on the rise. It's kind of too early to know.

SAMUELSON 31:02

But I think the students who are entering the market today can enter the market with some confidence that they should be able to pick and choose a company that they feel excited about working for and proud of being a part of, and that they can be raising, inside enterprises, some of this complexity and kind of whatever-- what's the expression around finding the complexity behind the simplicity, or-- what's that expression? I think they've got the right tools to do it. And I'm hopeful that they understand the importance of moving into enterprises that are real value creators. Finance is not the only game in town. There's other things that we can be doing, although that's where a lot of the jobs are. And there's new methodologies that are

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| | coming into finance in terms of measurement and value creation that I think are also an important piece that these students are equipped to kind of be thinking about. So I'm optimistic there's a lot on their shoulders. |
| CROFT 32:02 | [laughter] All right. Judy, thank you so much for joining us on the IlLUminate podcast today, and also for coming to Lehigh to share your experiences and insights with Lehigh Business faculty and students as part of the Year of Learning. |
| SAMUELSON 32:18 | I'm enjoying it very much. Thank you very much for having me. |
| CROFT 32:22 | Judy Samuelson's book The Six New Rules of Business: Creating Real Value in a Changing World, was published in 2021 by Berrett Koehler Publishers. The Year of Learning is an annual college-wide initiative that focuses Lehigh Business students and faculty on a particular area of interest through classroom activities and campus events. It is just one example of how Lehigh's College of Business prepares and challenges faculty and students to generate new ideas for education and future knowledge in the field of business. This podcast is brought to you by IlLUminate, the Lehigh Business blog. To hear more podcasts featuring Lehigh Business thought leaders, please visit us at business.lehigh.edu/news. And don't forget to follow us on Twitter @LehighBusiness. This is Jack Croft, host of the IlLUminate podcast. Thanks for listening. |