CHAPTER 1

PROFIT IS NOT A DIRTY WORD BUT VALUE IS MUCH CLEANER

Summary Profit has done a great job but it is too simplistic, limited and narrow in scope to cope with the demands of modern economic and social systems.

IS PROFIT THE BEST WAY TO ALLOCATE SCARCE RESOURCES?

The profit motive has served society very well over the years, despite the fact that it has always had its detractors. Especially those who still subscribe to the view that it is easier to push a camel through the eye of a needle than it would be for a rich man to enter into the kingdom of heaven. Yet the profit motive still has a great deal going for it. First and foremost, no one invented it. It was and always will be an entirely innate, natural, automatic, human motive to try to get the greatest rewards for one's efforts. If it is ever to be usurped, as the prime driver of wealth, any contenders will have to be based on equally natural motives; otherwise they are unlikely to be sustainable. Maybe that partly explains the failure of communism and even cooperativism to replace capitalism. They may sound like laudable, even attractive, alternative ways to run society but they have never been as powerful as that most basic of human instincts, to profit from one's own endeavours. Many of the world's greatest inventions have come about partly because of this desire. Would telephones, televisions, computers, airplanes and life-saving drugs have been invented if it were not for the rewards that profit brings to the inventor?

Well, actually, yes they probably would have.

Profit is, after all, just one part of that highly complex equation we glibly call motivation. Donald Trump and Richard Branson will always want to build the biggest golf courses or fly tourists into space because of the challenge, the personal profile, fame and many other motivational factors. Equally, Mother Teresa devoted her whole life to care for the sick because she was motivated to do so. Some writers continue to write books (poets particularly, it seems) without ever making any significant amounts of money or achieving widespread recognition. So maybe one of the key questions that we need to answer is how can we tap into those other huge reservoirs of motivation, outside of the pure profit motive, and convert them into something really valuable (poetry that the vast majority of us want to read)? But before we explore this subject in any depth let us first be clear about the key role that profit has been playing for centuries in powering economic systems.

To an economist, profit is a mechanism for the effective, some would argue optimum, allocation of scarce resources. For example, should wine drinkers be drinking the finest quality French wines or should they be getting their wine from the new world growers in countries like Chile? The only way to resolve this is to let the consumer decide in an open market. If you want to drink the best French wines then you pay the price. If you are happy enough with a standard, Chilean merlot then you will save money. The market is a very unforgiving place though for producers who do not treat the customer as king. So are these resources being allocated effectively? Both the French and Chilean producers will have to make a profit (or at least break even) if they are to stay in business. The profit motive may be driving their respective business strategies (the French choosing a quality strategy, the Chileans price?) but a motive of value might produce a much 'better' allocation of resources. In 2005 and 2006 the European Commission spent hundreds of millions of euros turning French and Italian wines into petrol because they were unable to sell all of their produce, in a market where Australian and Chilean exports to Europe are now about 20 times higher than they were a decade ago. No objective observer, economist or not, would argue that turning wine into petrol is a good use of resources. But then this is a clear case of not letting the market do its job properly. Intervention by the EU is interference in the natural mechanism of the market because it places more importance on the livelihoods of European wine producers than it does on wine consumers. It could be viewed as a symptom of an institution that has failed to reconcile all aspects of its value to society.

In the absence of a clear definition of value at this point (for which see Chapter 2) this should at least start to provide some indication of one of the essential differences between profit and value, even though, at this stage, we are just restating conventional economic theory. You may still need some convincing, of course, that there are likely to be any new insights emanating from an analysis of how the market might work better with a different goal, that of value. After all, the discipline of economics has attempted, since the time of probably the most famous founding father of economic theory, Adam Smith, to explain how the enlightened self-interest of the entrepreneur, driven by profit, satisfies the needs of society through the 'invisible hand' of market forces. He summed this up very elegantly by saying:

> Every individual endeavours to employ his capital so that its produce may be of greatest value. He generally neither intends to promote the public interest, nor knows how much he is promoting it. He intends only his own security, only his own gain. And he is in this led by an invisible hand to promote an end, which has no part of his intention. By pursuing his own interest he frequently promotes that of society more effectually than when he really intends to promote it. (Adam Smith, *Wealth of Nations*, 1776)

Adam Smith's genius has always been well recognized in many quarters but his take on life was equally seen by others as just a selfish, capitalist's charter or an apologist's view of entrepreneurship. The fact that selfish interests can produce wider societal benefits does not, of course, rule out the possibility that some entrepreneurs' motives are as much, if not more, guided by societal benefits as they are by personal gain. In fact the history of capitalism is replete with instances of successful businesspeople that have had a strong, philanthropic streak. Unfortunately though making a profit and being philanthropic, simultaneously, tends to send what might appear to be conflicting signals about motives. Perhaps a more accurate and positive view of profit could be that voiced by the late industrialist and ex-Chairman of British Rail, Sir Peter Parker, when he said 'Profit is a measure of our service to the community.'

This was a very simple yet extremely profound description of profit and the likely motives that could lie behind it. The community will support the profit maker if it believes the profit maker is doing something in the interests of the community. The relationship between the profit maker and the community is intrinsically synergistic and symbiotic. Here was someone who could see the connection between running a profitable organization and yet, simultaneously, providing a much wider range of benefits to society than just pure profit. We will look later at how even the language of profit can make a discussion of economics highly emotive, especially when it has so many historical connotations of exploitation, greed and abuse of power. For now though, even if we accept that basic, conventional economic theory is sound we also have to acknowledge all of the provisos and limitations that come with the basic profit motive. In fact, the smooth running of any economic system is fraught with potential problems when:

- the entrepreneur sees that their own selfish interests are best served by *not* providing society with what is in its best interests (most obviously encountered in monopolistic situations);
- unfair competitive practices remove or exclude producers from the market or maintain artificially high prices (e.g. cartels);
- the 'interests' of the entrepreneur (or the organization) seem at odds with the perceived interests of society (e.g. citizens see an inherent conflict in the provision of healthcare by a commercial organization);
- the market price does not fully reflect the wider societal impact of the product/service (e.g. car manufacturers do not have to include in their prices the costs of recycling the cars at the end of their natural life);
- reconciling the interests of an increasingly vociferous and disparate group of stakeholders (e.g. environmentalists versus shareholders) requires a more flexible and adaptable market mechanism;
- it does not work at all well with the non-profit sectors (e.g. introducing quasi-markets into healthcare) and requires some fundamental rethinking if it is to be adapted.

All of the problems identified above are already well recognized and have taxed the minds of the greatest economic theorists for many years. Yet the theory is only part of the challenge. In practical terms, the theories have to be adapted if they are to provide a foundation for policies that will aim to achieve the optimum allocation of resources. In the UK the state-funded NHS (National Health Service), with its ethos of providing free healthcare at the point of need, provides us with a classic example of the sort of dilemma that can result from this type of thinking. Whatever success it managed to achieve in the past it has struggled to adapt and cope with a relentlessly growing demand for its services in a society that constantly wants to widen the definition of 'health'. However, rather than let the market decide, for obvious political reasons, economic theorists have had to develop a theory of quasi-markets to try to allocate health spending on a basis that will satisfy the demands of the majority of taxpayers. In effect, such a theory is trying to reconcile a whole range of self-interests from different groups with differing perspectives, including those individuals who have conflicting self-interests due to their dual perspectives as both taxpayer and consumer, without using a pure market system. Maybe what is really required though is to forget pure economics and market forces and, instead, find another way of reconciling such disparate views?

After all, using the profit motive to allocate healthcare is bound to rankle with those who do see profit as a dirty word. Profit, like religion (and some might think a not-too-distant cousin), can often have very admirable intentions but can equally, quite easily, become a travesty in the hands of the zealot or the bigot: it is, after all, determined by some very primal, human urges. There is nothing intrinsically wrong or evil about profit, per se; it can and has provided enormous benefits. It is so easy though for critics to attack the whole principle of the profit motive when it is occasionally misused or abused. Such critics seem to choose to ignore the fact that the guilty party in such cases is the unprincipled person who applies the tenets of the theory (maximize revenue, minimize costs) in a very narrow or cynical way, rather than the motive itself. We should not throw the baby out with the bath water. Separating out, and capitalizing on, the essential, most valuable ingredients of the market mechanism and profit, whilst also ensuring any transgressors are kept in check, will be the role of the value motive. One way to move towards a more enlightened approach might necessitate the removal of as much of the emotive element from the debate as we can. In order to do this maybe it is time we briefly revisited what profit actually means.

PROFIT CAN BE A VERY EMOTIVE WORD

If you look at dictionary definitions of profit they tend to be extremely simple. Typically, it is defined in accounting terminology as:

> the positive gain from an investment or business operation after subtracting for all expenses

or even more simply, albeit negatively, as:

> the opposite of loss
> (both from www.investorwords.com).

Profit definitions tend to relate immediately to a business context (as opposed to society at large), with all of the hard-nosed and exploitative connotations that sometimes go with the term. Profit is also described as a very black-and-white, positive–negative concept. You either make a profit or you do not, there is no happy medium or halfway house. Worse still, the same word is the root of profiteering, which means to make 'excessive' profits (although who decides whether profits are excessive or not is a moot point).

Yet the *Concise Oxford Dictionary*, in addition to the normal financial definition, puts a slightly different slant on the word:

profit *n.* & *v.* – *n.* an advantage or benefit.

This suggests a much more positive concept and the Latin roots of the word come from 'advancing', 'progress' and 'doing'. What better way to describe the role of profit in bringing about improvements in society? But even in this very short glimpse at what the word means it is very easy to see how subjective views ('excessive') slip into the discussion.

Now, if you are a business manager in a commercial organization, the profit motive may seem as natural and unquestionable as breathing. You probably believe it is a worthwhile, even worthy, goal. It is tangible, you can prove it by seeing how much money you bank each month. Of course, *how* you achieve a profit leads some people to question the ethics of making a profit (e.g. do you employ 'child' labour in developing countries?) and very quickly it becomes a very emotive subject again. We will look at the question of ethics later but first we need to explore why some people think profit is a dirty word because if they genuinely believe this it will get in the way of creating value. One of the big advantages that the word 'value' has over profit is simply that there is no reason why anyone should regard it as having a negative or pernicious meaning. So how can we remove profit's unhelpful baggage?

Well, perhaps we can stop using the word profit and start talking about surplus instead. A surplus occurs when your output is bigger than your input. This definition would have applied as much to the first subsistence farmer who managed to grow more wheat than his family needed as it would today to an investment banker who invests to make a return (a surplus over their investment and costs). Interestingly, the notion of the poor subsistence farmer, struggling against the elements, probably with minimal, rudimentary tools, immediately strikes us as a noble image. Whereas for some of us the picture of the investment banker, sitting in a palatial office in Wall Street or Canary Wharf, might be more closely associated with notions of asset-stripping or keeping 'greedy' shareholders happy. Moreover, by virtue of that impression, they may appear to be much less of a boon to society. It is incredibly difficult holding back our natural, emotional responses though. So, perhaps if we consider the banker as someone who lends money to farmers in developing countries, to increase their agricultural yield, it might seem to be a mental picture that is an ideal combination of both? Both sides win but then there is still the question of motives. What is the banker's motive, to help the farmer, to feed society or just to make money?

Now, just pause for a moment. The previous sentence hinted that the banker might have an ulterior, less ethically sound, motive and we are so used to hearing derogatory comments about bankers that we do not necessarily question it anymore. But what about the farmer's motives? There is no reason why the farmer's activities should inherently, automatically, be any more noble than the banker's. The loan might be to pay for dangerous pesticides, which the farmer may well use with a total disregard for the environment, the crops in adjoining fields or even the local population. You may well already have a very open-minded, balanced view of the relative positions of the banker and the farmer but did you consider how we could decide whether this investment was truly 'valuable' rather than just profitable? Do the motives of both parties matter as long as the farmer and the banker both get what they want from the deal?

One bank that has thought long and hard about these sorts of issues is the UK's Co-operative Bank plc; a business that stems directly from the co-operative movement of the 19th century, rather than a conventional, profit making, commercial banking operation. Here is its statement about its ethical policy:

> Business does not operate in a vacuum. Activities inevitably lead to a series of ecological and social impacts. Some industries, by

> their very nature, have a huge and obvious impact on the environment and society, whilst the impact of others, such as the financial services industry, is not always so immediately apparent. At the bank, we recognise that our impact, through the provision of finance and banking services to a wide variety of business customers, can be more far-reaching and profound than the direct impact of our actual operations, so we have put measures in place to ensure that this impact is managed. (www.co-operativebank.co.uk – 15th June 2006)

All of this sounds very ethical so you may be encouraged to read further on their website but you might be disappointed to find that there appears to be no definitive statement or clear evidence, anywhere, of whether this approach provides any more value to society than some of its more profit-focused competitors. If so, the reader is entitled to ask 'what makes this policy any more ethical than any other banks'?' In fact, it could even be argued that it is rather arrogant to declare that you have an 'ethical' policy when there is no widely accepted set of criteria that determine when an organization is acting ethically. If every organization can define ethics for themselves it makes the term meaningless.

What is required is a proper, clear statement of value, not just profit figures or nice words: or even a combination of the two. This value statement has to mean something to any external observer as well as those direct stakeholders (e.g. board members, trustees, shareholders, customers, employees). It would have to say what the net result is after all inputs and outputs have been taken into account. It is this 'net' result that helps us to distinguish between high and low value organizations, and the ones whose policies genuinely add value as opposed to those who simply declare their pretensions. It is so easy for the supposedly ethical or philanthropic to be seen as contradictory. Worse still, the goals of profit and societal value can so easily become mutually exclusive.

THE MICROSOFT PARADOX

Trying to reconcile economic and wider societal goals is a huge issue but we might gain some insights if we consider what we will call the Microsoft Paradox. This could be defined as occurring where supposedly ‘philanthropic’ actions are not truly philanthropic. In other words, the philanthropist may think they are contributing something valuable to society but they are just re-allocating resources away from other, possibly equally important if not more important, philanthropic causes. Of course, those on the receiving end of the ‘philanthropist’s’ benevolence will happily accept the donations but they could well be at the expense of other sections of society. Society as a whole may not gain any net benefit.

In order to explain this more fully, and simultaneously suggest why this apparent paradox should be attributed to Microsoft, we need to look at Microsoft’s almost unique monopoly position. Bill Gates, one of the original founders of Microsoft, is the richest man in the world. Without a doubt, one of the key reasons why he has become so rich and powerful is that he is highly talented and spotted that the advent of personal computers would inevitably lead to something extremely rare – a global, natural monopoly in computer operating systems. Any businessperson worth their salt would give their eye teeth for a monopoly; they would probably also willingly give most other parts of their anatomy for a chance to gain such a natural, global monopoly. It gives the monopolist a licence to print huge amounts of money. It has to be said, though, that this did not just fall into Bill Gates’ lap. He and his highly talented team had to work very hard and take some tough decisions in order to gain such a pre-eminent position in the computer market. Even most arch profit makers have to work hard. So, there is no intention here to detract, in any way, from their huge achievements and the world would have had a slower pace of development without a common operating system platform. Monopolies can generate significant benefits for society when managed for the greater good. But society will always be at the mercy of the monopolist's motives.

It is worth briefly digressing here to acknowledge an earlier point that many inventions would also have taken place without the profit motive driving the inventor. The world of information technology provides two perfect examples of this. One is the development of the Linux operating system invented by Linus Torvalds and another is the natural monopoly that could have been the invention of the internet, often attributed to Tim Berners-Lee, except that they both, for whatever reason, either did not choose to or were unable to make them into profit-maximizing monopolies. So what are the different motives of Bill Gates and Torvalds/Berners-Lee and does it matter from a 'value to society' perspective?

To add some further complexity to this question we have to acknowledge that Bill Gates is regarded as one of the biggest philanthropists the world has ever known. The Bill and Melinda Gates Foundation has amassed billions of dollars to sponsor charitable causes and research (and has now added Warren Buffett to its list of benefactors). This makes it appear that Microsoft, therefore, fits very well into the long tradition of profit-making but highly philanthropic organizations. Moreover, from a very selfish viewpoint, the recipients of donations from the Bill Gates Foundation could be forgiven for singing the praises of Microsoft and welcoming its largesse, regardless of how it came to obtain such huge funds. It appears therefore that profits, when used in this way, really do achieve the joint goals of economic and societal value.

There is an alternative viewpoint, however. Microsoft charges handsomely for its licences to use their Windows XP operating systems and Office suite of desktop products. Many of their customers include schools and colleges (non-profit-making organizations). The bill for such licences for a college could easily amount to a five-figure sum; money that the college, on a fixed and tight budget, could usefully use for many other competing needs (e.g.

books, teaching resources). So is it right that the college loses out and the extra profits made by Microsoft end up in the Gates' Foundation to be used for other purposes? Some might even argue that Microsoft's profits are not only excessive but immoral, in the sense that they have not been won through genuine competition but from an explicit strategy of Microsoft maintaining its monopoly wherever it can. This now becomes a question for society; who should decide how resources are to be allocated? If Microsoft continues to make monopolistically high profits it will enable Bill Gates to decide for us. But Bill Gates is not a democratically elected leader. Where customers have a genuine choice about software providers their choice of company could be described as a democratic choice. However, in a monopoly situation there is no one else to 'vote' for, so this is the land of the 'totalitarian' supplier and as such is not in society's best interests. This is an abuse of the profit motive. If Microsoft really wants to provide society with maximum value it needs to give its customers the best possible products and service at the lowest possible price. Then it can donate what it wants from its well-earned profits. So how does Microsoft fare when judged against these, more value-laden criteria?

Microsoft basically has three very big and profitable businesses; Windows was contributing \$8 bn in 2004, Office \$7.15 bn and 'server' software \$1.3 bn. Windows and Office are still the main contributors to its profits but products such as the Xbox games console were not making money, despite revenues of \$2.9 bn. Consequently, Microsoft is cross-subsidizing its forays into other more competitive product areas from its monopolistic products. That means the college that has to pay Microsoft's monopolistically high prices for Windows operating licences could be deemed to be cross-subsidizing computer games for students rather than educational resources. This does not look like the sort of value proposition that society should be seeking.

If this is not already regarded as a very serious matter, any views we may harbour about Microsoft's business practices are further coloured by the many instances where it has tried to stifle the sort of competition that could be giving better value to society. There have been numerous stories of Microsoft in court over unfair practices including in 2004 the EU's Competition Commission unanimously backing a watershed, antitrust ruling that found Microsoft guilty of abusing its software monopoly; resulting in sanctions and a fine amounting to hundreds of millions of dollars. This was a case involving Microsoft bundling its Media Player software with its Windows system in an attempt to keep companies like Real Player out of the market. Another case in 2004 involved a long running dispute with Sun Microsystems which eventually cost Microsoft $1.9 bn to settle. It would be hard for Microsoft to argue that overall, taking all the pluses and minuses into account, their motive is ultimately driven by providing the most value to society, even if the Gates Foundation does have some very laudable goals such as eradicating malaria.

The motives of organizational leaders therefore are not just important, they are the very essence of societal value. The fundamental motives that drive organizations drive the cultures and individual behaviours of those who work in them. In a recent article in the *Sunday Times* (18th June 2006), announcing that Bill Gates was stepping down as head of software architecture in the company, a Windows developer who had been with the company for five years, spoke about 'Deep in the bowels of Windows (the business unit) there remains the whiff of a bygone culture of belittlement and aggression. Windows can be a scary place to tell the truth.' The same article highlights the fact that Windows is a hugely complicated piece of software with '50m lines of code and 50 layers of interdependency'. So even in terms of developing its own products Microsoft does not seem to adhere to a philosophy or the practical principles of value. It certainly does not seem to be encouraging its own people to use their talents to deliver maximum value. Yet it is quite happy to do everything it can to maximize its profits. The real irony, what lies at the very root of the Microsoft Paradox, is that even by the sort of criteria we would use to judge any software development company Microsoft could be said to be performing very poorly, despite the wealth it has created for many of its shareholders.

The reason the profit motive fails when set against the value motive is because the value motive will actually produce better profits than the profit motive while simultaneously creating more value for society. Microsoft has obviously used much of its surpluses to support a huge research and development function (including the loss-making Xbox) but in reality it often wastes research funds, because of its strategy of maintaining monopolies, by reinventing something already invented quite satisfactorily elsewhere (as in the case of Internet Explorer trying to put Netscape out of business). But this huge effort in R&D has not stopped many other competitors from stealing a march on them. One only has to look at Skype for internet telephony, Google and MySpace among the many examples on offer. Is this because these organizations have unleashed, rather than stifled, their creative talents?

The real Microsoft Paradox is in Bill Gates trying to behave as a 'philanthropist' when his company's business practices are deemed, in law, to be anti-competitive and, in that sense, decidedly unphilanthropic. There is nothing wrong with an entrepreneur giving funds to charitable causes when those profits have been earned through competitive practices, it is the existence of genuine competition that makes such profits 'moral'. It is the ability of willing customers to choose between a range of products and providers, in a market based on fair competition, that makes capitalism inherently ethical and philanthropic. Whereas, distorting the market to produce excessive profits is inherently 'immoral' regardless of what genuinely good causes eventually benefit. Of course, anyone wanting to seek a cure for malaria will welcome the funds with open arms but they may be diverting resources away from equally important causes not sponsored by a wealthy monopolist.

The simple answer to resolving this paradox of course is simply to ensure that true and effective competition reigns. The Microsoft Paradox only pertains in monopolistic circumstances. There is no inherent contradiction or conflict between competitive capitalism and philanthropy. The organization is creating a surplus while satisfying society's needs. What it chooses to do with that surplus is up to the capitalist who has made it. One may criticize the good causes he or she chooses (e.g. the local dogs' home becomes a beneficiary in the will) but this could only amount to a different set of personal values. It would be difficult to challenge the capitalist's right to dispense with their own funds as they see fit whether we, personally, think animals should always come second to humans or not. There is no absolute in value that would ever resolve this particular argument.

Having said that, following Bill Gates' own insights, the world probably really only needs one effective internet browser and media player. If Microsoft produces the best at the lowest cost that is fine, but if they replicate the work already done by somebody else's research and development that is not the best allocation of scarce resources, it is a waste. This crime is then compounded by using a dominant market position to put competitors out of business, thereby possibly depriving the world of researchers and developers who are performing better than their own. If Bill Gates really wants his legacy to be the world's biggest philanthropist, rather than its richest inhabitant, he would be better advised to stop wasting money on R&D and give the money directly to a charity that will make better use of these valuable resources.

Microsoft was chosen to give this paradox a name because it is a perfect example of a complex issue. It was also chosen because it has attracted much criticism over the years for its business practices. This makes it an easy target and probably too easy a target. Any organization making huge profits, even if they are achieved through entirely legal and ethical means, will still be in danger of attracting criticism from those who just do not like the profit motive. Such critics seem to think there is something inherently more ethical about organizations that do not have profit as their goal. But is that true? Let us now move into an even more problematic area – how ethical and philanthropic are non-profit-making organizations? Do they add any value at all, or at least more than a commercial concern would?

NOT-FOR-PROFIT? DOES THAT MEAN NOT-FOR-VALUE?

Having defined profit earlier, if we are going to discuss the non-profit sectors we had better look for a clear definition as well before we go any further. Here is one definition of 'non-profit':

> 'non profit making = not commercially driven' (www.elook.org/dictionary)

This immediately indicates a clear distinction between organizations that work on a commercial basis and those that do not. For a little more detail we can also find a definition of 'not-for-profit':

> 'Not for profit – A non-profit organization includes a club, society or association organized and operated solely for social welfare, civic improvement, pleasure or recreation, or for any other purpose except for profit, no part of the income of which is payable to, or is otherwise available for the personal benefit of any proprietor, member or shareholder.' (www.communication.gc.ca)

This tries to spell out the differences between the two, except that if we remove the key word 'solely' the definition could apply equally well to profit organizations. Food companies provide ‘welfare’ needs; alcoholic drinks companies provide ‘pleasure’; hotels and leisure centres provide recreation. So is there really any difference between profit and non-profit organizations? If you want to go for a swim you could choose to go to a municipal pool or a private leisure centre. Does the fact that one is run on a profit basis automatically mean that it will be managed differently? Are we to assume that one gives more societal benefit than the other (e.g. poorer children would not be able to swim if only the commercial pool was available)? This second definition seems to imply that there is something inherently wrong with trying to make a profit out of such services.

Maybe the clue is in the part that says ‘no part of the income of which is payable to, or is otherwise available for the personal benefit of, any proprietor, member or shareholder’? We can only guess that this is suggesting any ‘surplus’ income should not end up in the hands of a shareholder, as would be the case with dividends in a publicly quoted, commercial concern. But does that denote any substantive difference between one type of organization and another? They both aim to serve customers and if either of them fails to satisfy customers they should cease to exist. Both are, in effect, ‘operated solely’ for that purpose. When viewed from this perspective the profit/non-profit dichotomy disappears in front of your very eyes.

The more you think about it the more you have to reach the conclusion that the whole concept of a ‘not-for-profit’ organization is very strange. When we looked at definitions of profit one described profit in the negative (i.e. not making a loss). It is always odd to hear something described negatively, in terms of what it does *not* do. How ridiculous if, say, a bank were to announce all of the things it was *not* intending to do. Can you imagine it declaring to its shareholders – ‘our purpose is not-to-make-chocolate’? Following this warped logic, anyone of us could declare that we have just set up a not-for-profit organization by sitting down and watching television. Or we could put great effort into *not* producing a profit by sitting in a bar or on a beach all day. All of these non-activities would guarantee that we achieved our organizational objective – no profit.

Of course, in the process, we would not have produced any value either (sitting on a beach all day would hardly constitute value, even if it might satisfy one indolent individual's needs). The inherent contradictions exposed by this hypothetical scenario neatly directs us towards an obvious point, all organizations should be defined by what outputs they are meant to achieve (e.g. banking services, care for the elderly) and judged on what scarce resources they use up in achieving those outputs. In short, all organizations should be described as value organizations and should be able to declare, unequivocally, what value they add to society.

The cancer charity does not aim to make a profit but its value 'objective' is to care for or cure those who have cancer. However, it cannot escape the fact that it must create a surplus first. In fact all organizations have to be 'for-surplus', by definition, otherwise they would have no spare resources to work with. As soon as we describe them this, using our surplus definition of profit, there is essentially no distinction to be made between profit and non-profit organizations. This is a statement of the obvious but no less worth pointing out for that. If not, consider what a change in definition to a 'not-for-surplus' charitable organization might look like? It would, at best, just cover its operating costs with no surplus left over to grow, develop, innovate or improve its offering to its customers. The cancer charity would have no funds left to actually fulfil its raison d'être of researching future cures and caring for the terminally ill. All of this can only come from a surplus created by the charity itself or by someone else who is willing to transfer their own surpluses to the charity for distribution.

The notion of creating a surplus to produce benefits is not alien to any of us but if we now apply this concept to, say, the main non-profit sectors, the public and government sectors, some of the implications are far-reaching, to say the least. Let us consider the local government authority that runs local libraries. Should the library be run to produce a surplus? We should not forget, of course, that the source of funds for this library will always be the surpluses already produced by the commercial sector (via the mechanism of taxation). The net 'value' of the library, whether its objectives are well defined or not, is probably to provide entertainment and educational opportunities for local citizens. This value statement might not have been challenged some years ago except that there is always competition for scarce resources and if the library is not well used then a serious question has to be asked about its continuing value; regardless of the broadly beneficial aim of providing a service for those who wouldn't otherwise be able to afford it.

If we believe such public services are valuable we are drawn to that interminable debate of whether the service (in this case libraries) should be run on a commercial basis or through public provision from taxes. However, if, as we have discussed above, there is no conceptual difference between non-profit and profit organizations this question suddenly becomes irrelevant. The only relevant argument is what does society value, and let us be crystal clear about that objective, and how can that be achieved at the minimum cost? This is the output per input argument of value that has little or no automatic interest in the mode of delivery chosen.

So, when we apply this thinking to the library, if one of the objectives is to maximize use of the library and this is measured in terms of books loaned, one simple measure of value is books loaned per £ spent on the library. Then all we have to ask is which type of organization is more likely to achieve this end – a commercial or non-commercial entity? Of course, we could equally use exactly the same approach to compare the value of two competing bookshops but in reality we would tend to judge the success of commercial bookshops simply by the amount of profit they make. It is worth just mentioning in passing though that municipal libraries loan books out at no cost to the borrower yet charge for the loan of videos and DVDs. This looks very inconsistent and this happens because they do not have a coherent statement of value that has been adapted to a changing world with the advent of video stores. Yet another example of what happens when different perspectives are not fully reconciled under the unified banner of value.

Now, just in case this line of reasoning still strikes you as nothing more than a statement of the obvious, let us take one other fresh perspective. Imagine if we referred to some organizations as 'not-for-value' instead of not-for-profit? This would suggest that, whatever they were doing, they were not intending to provide value for anyone. It would be difficult not to construe this as a very strange state of affairs. Perhaps the hospice has no patients or no one is borrowing books from the library and the head of the hospice/library still tries to justify their existence by declaring they are there to provide the service when someone needs it. This would sound inconceivable, an utterly preposterous proposition: organizations with a declared raison d'être but no customers. Why would anyone want to run an organization without being absolutely clear how it was intending to create some value for society?

Yet many such organizations have tried to do so (art galleries, museums, counselling services) and some still continue to exist (e.g. counselling services offered to people after disasters even though they do not want any counselling) until such time as their lack of value becomes apparent. One good example would be the National Centre for Popular (sic) Music in Sheffield (UK), which received an £11 million grant from National Lottery coffers and had to shut within 12 months because it only managed to attract about a quarter of the visitors it expected (and needed financially). Apparently the founders and designers of this museum attached more value to it than their citizenry but common sense dictated that they could not run it at a 'loss'. The harsh realities of life should apply equally to both the profit and non-profit sectors. No one deserves a free ride and those who do not provide an acceptable service should not be allowed to continue. We have reached a point where we need to ask what rules we want our society to follow and, until there is a better alternative, profit will remain the ruler while it demonstrates that it can produce the biggest surpluses. But its crown is slipping.

PROFIT IS AN INCREASINGLY UNPOPULAR KING

They say 'profit is king' and it is easy to see why. Running an organization without such a crystal-clear goal can easily lead to conflicting objectives. Trying to satisfy aims other than profit, such as ethical purposes, might seem laudable but is fraught with uncertainties (e.g. who should choose the public library's books?), shaky criteria of success (e.g. is the actual number of museum visitors a satisfactory criterion?) and very different expectations from different stakeholders (e.g. the charitable hospice is asked to provide euthanasia by a patient). The profit motive has managed to survive this long simply because it avoided as many of these other issues as possible (e.g. when did the oil industry really start taking the environment seriously?). It was never, ever a perfect monarch and there are plenty of examples of abuse of power but it has served society very well, for thousands of years, precisely because it was not sidetracked or distracted (e.g. car drivers wanted petrol to run their cars regardless of any environmental cost). Nevertheless, globalization has brought with it a huge growth in this old monarch's population and some of its subjects have become increasingly restless.

Whether it deserves some of the bad press it gets is open to debate but one thing is for certain, the number of ideas competing for the crown of economic rule is increasing. Now we have corporate social responsibility (CSR), the social enterprise, demands for greater diversity, environmentalists and the whole human rights movement all demanding to be heard in the court of this king. This particular ruler though will not give any ground without a fierce fight and any serious contenders will have to produce clear evidence that they really do represent a better alternative. Anyone wanting to rise to this challenge could start by trying to hit this particular king where it really hurts: they could question whether the profit motive is ever likely to produce maximum profits. If it isn't then this would be a straight, knock-out blow for profit and the capitalist system as we know it.

If capitalism and profit were still the best possible basis for a high value, social and economic system this book would not need to be written. It is because profit seeking has severe limitations, in its own terms, that we are questioning here whether it is up to the challenges that lie ahead. If the profit motive resulted in society exploiting, fully, all opportunities for the creation of the biggest surpluses then it would continue to reign supreme. Of course, the choices we make in the redistribution of those surpluses would still continue to be a major political issue but the profit motive itself would be unimpeachable as the main driver. However, as we will soon clearly see, the profit motive does not necessarily provide the highest levels of profitability, never mind the highest levels of societal surpluses. The profit motive only motivates a relatively narrow group of stakeholders, who may well be totally satisfied with the returns they achieve. The value motive aims to satisfy the biggest group of stakeholders possible and will never be sated as long as opportunities for greater value still exist.

Henry Ford could have been described as the archetypal capitalist and entrepreneur and was famous for exploiting the commercial advantages to be gained from the latest developments in mass production and the scientific methods of Taylorism in the early part of the 20th century. But not everyone would automatically associate him with the sort of philanthropic sentiment implied in his statement that ‘A business that makes nothing but money is a poor kind of business’. The Ford Motor Company he founded in 1903 is struggling to survive today (with a market capitalization of $13 bn as at June 2006, a drop of over 50% in four years) and one wonders where and when this former powerhouse of the automotive market might have started to take a wrong turn. Was it just an inevitable consequence of increasing global competition? Hardly. The number one automotive company today, Toyota Motor Corporation (market capitalization $178 bn – an increase of 66% over the same period) was a late entrant into the industry back in 1937 but seems to have thrived in the same marketplace. So, is there anything fundamentally different between the ways these two behemoths do business?

Perhaps the different directions in which they have travelled are a direct consequence of the different motive forces that drive them. Henry Ford was as complex a mix of motivations as any of us. The famous Ford Model T was designed for what Ford called the ‘great multitude’ and he slashed prices between 1908 ($850) and 1915 ($360). He also fought a court battle with some of his key shareholders, the Dodge brothers, in 1916 over whether the company’s first duty was to them or their customers. Ford declared in court that the purpose of business was to ‘give employment and send out the car to where people can use it . . . and incidentally to make money. Business is a service, not a bonanza.’ Yet he was hostile to unions and harassed union leaders until he had to sign a recognition agreement in 1941. So was Ford genuinely philanthropic, a clear-headed businessman, or both? Was the real motivation behind his lowering of prices just a means to open up a mass market for his mass production techniques, thereby increasing both profits and dividends in the longer term? Perhaps he was a true visionary who saw the obvious, virtuous circle this produced. His interest in serving society and making a profit were one and the same; mutually reinforcing.

Since his death the Ford Motor Company has certainly always tried its best to make a profit but now struggles while Toyota, in its own way, is serving society's needs and becoming the most successful automotive company in the process. Are these two company's relative fortunes just the result of different types of management or does it go much deeper than that? Are the two companies driven by entirely different motives, one profit and the other value? On the surface it may appear that their motives are identical and customers might not discern any differences or even care. After all, what they look for is a quality car at the right price so why should they delve any deeper when making their choice? Even if we look at the public pronouncements of the visions of both companies it might appear, to the untrained eye, that there is nothing significant to distinguish one from the other. Take this quote from Ford's own website:

> Today, the Ford family comprises employees, dealers, suppliers, shareholders, customers, and more – all those that help fulfil the vision Bill Ford has defined for the company: to create great products that benefit customers, shareholders, and society. (www.Ford.com – 5th June 2006)

That word 'society' certainly looks like it remains consistent with the values espoused by Henry Ford back in the early 20th century but what is it providing for society today? Does it provide great cars and great value? Obviously an increasing number of customers do not think so. Certainly Ford are finding it increasingly difficult to reconcile these aims with their current level of performance and both shareholders and stock analysts would take some convincing that Ford are achieving success on any front at the moment. A more philosophical question though is, to what extent can Ford's shareholders and customers be referred to separately from society? If these are really three discrete groups then they will have their own, discrete perspectives on what they value and there will be an immediate challenge for Ford in reconciling all of these.

Compare Ford's vision with another Japanese company, Canon, who seem to have a different take altogether on what their raison d'être is, which is encapsulated in the single word 'kyosei' (see Canon's 'Corporate philosophy of Kyosei' at http://www.canon.com/about/philosophy/index.html, 3rd July 2006). They do not mention shareholders at all when they define kyosei as 'Living and working together for the common good' and add that 'True global companies must foster good relations, not only with their customers and the communities in which they operate, but also with nations and the environment . . . Canon's goal is to contribute to the prosperity of the world and the happiness of humanity, which will lead to continuing growth and bring the world closer to achieving *kyosei*.' This is a much more holistic view of what an organization exists for and Canon, while it needs to produce a profit, does not see this as its ultimate goal. It is a means to an end and everything is seen as part of a journey. The world may never achieve a state of true kyosei but that does not mean that this is not a worthwhile goal. This is not a black and white, positive/negative view of the world but one of an ever-changing continuum.

Of course, these sorts of vision statements are de rigueur for any self-respecting organization these days regardless of whether they amount to nothing more than rhetoric or public relations hype. So how do we tell the genuine from the fake and do the genuine ones, where the philosophy is really lived, actually result in greater value? Let us take our third and final example from Toyota, whose Global Vision 2010 (from the www.manufacturer.com on 8th February 2006) identifies four areas of innovation that involves Toyota becoming 'a leader and driving force in the reduction, reuse and recycling of resources', creating 'zero negative impacts on our environment and society'; 'striving to create an automobile-based society in which people can live with ease, and in safety and comfort'; promoting 'the appeal of vehicles throughout the world and strengthen(ing) Toyota's brand image'; and ensuring 'Respect for all people . . . to be a truly global company that earns the respect and support of people all over the world.'

The language used here is very important as it starts to signal a genuine and fundamentally different philosophy. This is not just PR, even though Toyota are certainly not unaware of the PR value of these statements. Toyota's development of the Prius is a clear demonstration of all of these principles. It appears that Toyota really does take its wider responsibilities to society very seriously. We could have an interesting debate about what the word 'society' really means to each of these companies but we should never forget the simple fact that whatever Toyota and Ford's respective philosophies are, when viewed purely in terms of bottom line performance, Toyota are well on their way to putting Ford out of business and a company that doesn't exist cannot fulfil any of society's needs. This, however, is not just a battle between two old rivals. We could substitute the name General Motors for Ford above and the story would be a very similar (GM's market capitalization is $13 bn in February 2006 and has a junk bond credit rating from Standard and Poor's) if not starker example of a general point.

What we are really seeing here are two competing management philosophies and methodologies. It would be too simplistic to suggest this is a West/East divide and there is certainly no intention here to hark back to the notion of 'Japanization'. For every good or bad example of an 'American' company there will probably be a good or bad 'Japanese' equivalent (in a global economy ascribing a particular company to a particular nationality is becoming increasingly inappropriate). This debate about value does not follow neat geographical lines. Nevertheless, no doubt over the years Ford and GM have hired in some of the best brains money can buy and employed the latest management theories from the 'best' American business schools, but none of this talent seems to have been converted into high market values or profits. Along the way they may have forgotten some of the principles cherished by their founders. Both companies have even tried to copy many of the practices that Toyota espouses but without similar success.

Toyota, on the other hand, applies some very simple principles to the way it does business. Principles it has trusted and adhered to virtually since its inception. Of course, the Toyota of today is vastly different to the company that existed before the Second World War but its ability to create huge amounts of value can be directly traced back to its own founding principles (for a full explanation of this point read Jeffery Liker, *The Toyota Way*, McGraw Hill, 2004). More importantly, it also seems to be winning the respect of society at large, including the 'hard-nosed' investment analysts. So, if one of the key distinguishing features between these competing management philosophies is the difference between being motivated by profit or value perhaps we should now have a much closer look at what value truly means to see if we can learn something from it.