A PLEA FOR A FUTURE
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Abridged version of the valedictory speech given by professor Fred W.I. Lachotzki at Nyenrode Business Universiteit on Wednesday 30 November 2016

Prof. Fred W.I. Lachotzki
Honored Rector Magnificus, members of the Nyenrode Governing Board, Esteemed colleagues, students and other members of the audience,

Those of you who know me know how sincerely honored I am by your presence at this, my valedictory address. After fifty years, I am taking leave from my Seat of Learning, Nyenrode Business University. First of all, I would like to share with you my feeling of gratitude for the opportunities that have been offered to me during those fifty years, both during my business and my academic careers, to learn, to create and to analyze. Thanks to combining both careers I have ultimately become a pracademic teacher.

I have been able to develop my ideas thanks to the freedom which has been given to me at the companies where I have been employed, thanks to my dearest Nyenrode, and – not to be forgotten – thanks to my mentors, of whom I would especially wish to mention two here: Jacques Postma, former rector of Nyenrode, and Hans van Meer, who was then Executive Vice President of Albert Heijn Supermarkets. Hans van Meer, and this is of quite special value to me, is present here today. Both of these leaders played a role which should not be underestimated at the beginning and during the further course of my career. I am also indebted above all to my own national and international teachers, colleagues, students and especially to the co-author of our book *Beyond Control*, Robert Noteboom, my research assistant Michael A. Olson and my former Ph.D. students Dr. Roland Kupers and Dr. Daniëlle Melis*. Both of those in the course of their research-processes also became my teachers. The business and the academic world have offered me unique opportunities and given my life extraordinary meaning and satisfaction. And I continue to enjoy these every day.
Ladies and gentlemen, for fifty years passion for “the company” stood central for me. By “the company” I mean the concept of the company. During the first half of my career, I have, as manager and executive been directly immersed in company life at Ahold, Unigro and ASKO Deutsche Kaufhaus; the second half has afforded me, as a non-executive board member and lecturer/researcher, the possibility to better fathom the concept of the company in terms of its power and its vulnerability.

In 1988 when I accepted my full professorship I delivered together with my former colleague Professor Wissema an inaugural speech entitled “Corporate Strategy: The Global Option.” Today we are confronted with several negative effects of globalization, whereas at that time it was precisely “The World as One Global System” and the ongoing initiatives for international economic cooperation which were cause for optimism. An optimism built on the assumption of growth and the prosperity that would flow from that.

**PROBLEM**

Now we discover that for years, abundant – and we might even conclude, in many cases irresponsible – use has been made of those possibilities for growth the world offered us. Such growth increased powerfully, but was in no way sufficiently sustainable. The world is indeed global, but due to the increased mutual connection and dependence it has become an ever more complex system. Neglecting to establish the right measures for guiding this system has had negative consequences for the financial markets, the economy, the environment and for society.

Governments have so far not succeeded in formulating definitive answers or policies to address the consequences of the financial crisis of 2008. A number of the measures that have been taken have mainly led to government austerity, together with often stifling regulations and more bureaucracy. Their effects are felt on companies and other organizations, including my own dear university.
The loss of jobs and lack of any coherent EU policies for immigration lead to a growing nationalism and inclination towards protectionism, which then cause further problems in the world economy. To that we can add the rapid technological developments in the areas of digitalization and artificial intelligence, and the growing uncertainty as to whether the necessary measures for climate protection will be carried out. If we add to this mix the steadily increasing income differences between rich and poor, then it is no wonder that large groups of the population are seriously worried and often feeling excluded.

The period in which we live is perceived as being out of joint. Citizens have lost their confidence in government and politicians, and also express their mistrust against the business world. The most recent “Edelman Trust Barometer” shows that a large number of people even do not trust the very company they work for.

Ladies and gentlemen, we know that only gloomy analyses lead to cynicism. Cynicism that shifts criticism to the other side and paralyzes the powers of imagination. Those powers of imagination are absolutely necessary to embrace new ways and frameworks of thinking that correspond to today’s reality and enable us to visualize a perspective for the future.

That’s why I offer you today a plea for a future in which the company, without relieving government of its own responsibilities, offers perspective by consciously taking up for itself the role of motor for prosperity and well-being. And by well-being I mean the well-being of all those involved with the company, including the societal well-being of the communities where the company operates. By consciously taking up this role for itself, a company accepts that, in a society that is ever becoming more “horizontal,” it can, may and shall become accountable for that well-being.
Today I present to you a governance concept which, thanks to transparency in decision-making, provides an opportunity to lead a company in ways that constrain both the failure of the company as a system and the failure of specific human behavior. I hope that I can convince you that, with this concept, a company is able to strengthen its power, to reduce its vulnerability and to safeguard its societal legitimacy.

GOOD VERSUS BAD GOVERNMENT

In order to stimulate a bit of imagination, I’d like to take you to a distant past, to the Middle Ages, to Siena, Italy. At the beginning of the 14th century Siena had grown from a central city-state to one of the most important medieval cities. The power was in the hands of the citizens. The city administration consisted of nine representatives from the higher layer of Siena’s society, the Nove. In 1335 this administration gave the painter Ambrogio Lorenzetti the assignment to paint a fresco on the walls of the Council Room in the mighty Palazzo Publico, the town hall, which had just been built.

(SLIDE 4)

On three walls he painted the famous fresco cycle “The Allegories of Good and Bad Government.” To begin with we direct our attention to the fresco depicting what Good Government stands for and to what this can lead. We see two prominently painted figures, placed at the same level. To the right the old Monarch, the city-authority on his throne, and to the left Lady Giustizia, or Justice, inspired by Divine Wisdom.

The Monarch is surrounded to the left and right by allegorical figures, the four cardinal virtues: Fortitude, Prudence, Temperance and Justice. To the far left on the throne we see placed Peace and to the right we see Magnanimity. From out of the Scales of Justice two cords appear, of which one leads down to the sitting female figure of Concordia, or Unity. Unfortunately, it is not clearly visible that this cord is passed on to the citizens, to strengthen the social fabric as a binding force. This is also true for the other cord, which leads by way of Virtuous Government to the scene below-right where, thanks
to Justice, people such as monks and nobles who allowed their own interests to prevail over the common good are punished for their indiscretions.

Political scientists and legal experts have taught us that Lorenzetti intended with this allegory to make clear that city of Siena derives its political legitimacy from Justice and Good Government, government supported by the cardinal virtues. I will want to convince you later on that the company, as well, can and should legitimize its Societal Authority through the same sort of good and virtuous government.

As I already said, that city was at that time the center-point of the Republic. Siena had developed into an important European financial center. In order to continue to stimulate prosperity and fight poverty, capital was necessary. There had to be an institute founded that could take up that role for itself to benefit the city, the Republic and the common good. This banking function would be regulated by the city. This led in 1472 to the founding of the world's first bank, the Monte, strictly regulated as to the maximum rates it could charge, the quality of its governance and the distribution of profits. In its Vocazione it was explicitly stipulated that, besides fighting poverty, any profits gained had to be devoted to the common good of Siena’s citizens.

(SLIDE 5)
We see the effects of Good Government in the frescos: flourishing trade, industry, education, science and art.

(SLIDE 6)
As we see, the surrounding countryside is pictured as rich and wonderful. In the course of its history the bank gained the name Monte dei Paschi di Siena. For about five centuries it has fulfilled this explicit role, in good times and bad.

(SLIDE 7)
By the end of the 20th century the Monte (as it still is called colloquially) had grown into one of the most important banks in Italy. It was partly due to its success that the city and its surrounding province, otherwise lacking in much industry, were able to develop into such a flourishing society. In 1995 a law came into effect in Italy where it was decreed that all banks, to that point
public institutions, had to privatize. The Monte, in 1999, was floated on the stock market and split into two units. Forty-nine percent of shares were offered for sale and fifty-one percent remained in the hands of the community, represented in the Fondazione. Out of that rich Fondazione’s vaults came each year 100 to 200 million euros to the benefit of Siena’s citizens. The university, the academic hospital and the cultural life were subsidized with large sums.

But then things went wrong.

With the public offering the Monte at the same time became a component of the larger international financial system. Growth and expansion became the highest priorities of the bank. With the first take-over of a small Internet bank from the South of the country it was also decided to transfer the Monte’s general leadership to the director of that same small bank. Soon afterwards, senior directors and most executives were swiftly replaced by directors and other executives from outside of Siena. In addition to its original banking activities, the bank extended ever-larger loans, plunged into new acquisitions and into activities such as investment banking and derivatives, which previously had been unknown to it. Ultimately the Monte over-played its hand with the take-over of Antonveneta, a bank that ABN AMRO Bank had acquired a number of years earlier.

After ABN AMRO’s split-up it was sold to Santander for around six billion euros. They in turn, sold it to the Monte one week later, without any proper due diligence for nine billion euros. This take-over is one of the many examples of the dramatic strategic decisions that the new Board or top executives (it was never clear which one), had made after the public offering. Next to that, the approximately twenty-seven billion euros in bad credits and loans accumulated by the bank illustrate the ultimate effects of poor governance. The executives parachuted in from the outside had seemingly little knowledge of or little affinity with the bank’s original right to exist, its raison d’être. The Board, as later became all too apparent, not only had no knowledge of the industry, but lacked all the virtues of Good Government. The Monte has been kept afloat up to today partly thanks to state support. Of the once-rich Fondazione, which had gone deeply into debt with the take-over of Antonveneta, there is little left, basically nothing. The consequence is the
visible and palpable economic, cultural and social deterioration of the city and the province.

With his Allegory of Bad Government, Lorenzetti had already warned where vices such as Pride, Idleness, Greed could lead. And just as disquieting is the position of Justice, which is not only no longer depicted on the same level as the Tyrant, but is even placed bound up under his feet.

What happened after the public offering was experienced by the Senese community as a privatization of the profits and a socialization of the losses. Through its actions the Board frittered away 500 years of societal legitimacy. This case shows the vulnerability of a company that increases as it becomes bigger and more complex. More complex not only as a consequence of the extent of its activities, but also through the unavoidable increased interconnectivity of a large complex system, within which companies today must operate as relatively small systems.

**SURVIVAL OF THE COMPANY**

Someone well aware of the vulnerability of the company was Peter Drucker. In 2001, one year before the fall of Enron and when he was 95 years old, this founder of management thinking posed the worrying question as to whether the Corporation, the large enterprise, could continue to survive. His answer was Yes, but not as we know it now. In future society, as he prophesied in an article for the *Economist*, the greatest challenge for the company would be its **Societal Legitimacy**: its values, its mission, its vision. The reason why things have gone so dramatically badly at such a number of large enterprises, according to Drucker, must be found in the failure of the system. The heavy managerial task that business leaders must master could barely or not at all be carried out with concepts known back then: he called for a new concept to come forth.

*“As each had been highly successful in his previous jobs, the recent failure rate of chief executives in big American companies points in the same*
direction. The jobs they took on had become undoable; it suggests system failure. Top management in big organizations needs a new concept”.

Peter F. Drucker

Having served as an executive I knew from my own experience that executing decisions in management practice was easier said than done. The system did indeed fail. The job had become undoable. The Company Boards expected from their Executives and Managers that they carry out a strategy then defined mainly in terms of performance goals. In other words, executives were incented to concentrate on revenue, and possibly on market-share and other bottom-line results. Big companies were overwhelmingly managed in a decentralized manner. Execution was handed over to the countries, divisions, business units and staff divisions. The responsible managers did report results periodically, but when it came to how those results had come about and the sustainability of their methods, there was hardly any structural insight offered, at least any that was truly “fact-based.” This meant that top management, without realizing it, created ever more black boxes within and from the entire system of the company. This has unmistakably become apparent not just with the Monte and before that with Lehman Brothers and other banks, but also with e.g. Enron, Vestia, IMTech and, alas, also at that time with Ahold.

In short: a new concept for “the company” was sorely needed. First of all, it was imperative to open up the black boxes in order to gain a view of the factual situation. Not just a view into the financial situation, but also into the qualities of the organization and the indicators that the company has the capability to drive the strategy.

In the Financieele Dagblad in June 2002 I wrote the following:

(SLIDE 10)

“Without better insight for managers and supervisors into the capability of the organization to carry out the formulated policy, the business world and government will continue to be surprised by dramatic examples of operational and supervisory failure.”
IN SEARCH OF THE COMPANY’S POWER AND VULNERABILITY

In order to get a grip on both the power and the vulnerability of the company, I went to take a look at its architecture. This architecture consists of structures, processes, people and culture, and is decisive for implementation of the strategy.

(SLIDE 11)

That company architecture we have broken down, together with the research bureau MeyerMonitor, into 39 capabilities and 7 dimensions.

Thanks to available technology, that firm developed at the end of the 90s a digital scan enabling the Board as well as the organization’s management to assess 39 capabilities - an assessment of the current quality of the company’s effectiveness, and at the same time an indication of the quality of structures, processes, people and culture which they consider to be essential to actually being able to carry out the strategy. With this we are able to open up, in no time, all potential black boxes in the operational arena, those in the various countries, business units and teams as well. The result provides insight into the quality of the whole company architecture as well as into the future effectiveness of the company.

(SLIDE 12)

This slide shows a file of anonymized results from one company, specifically the finance department within a business unit, operating at a great distance from the main office. The difference between the current quality and the desired quality is expressed as a gap score. The gap score of the total company was low, that is, 10. The aggregated gap score of the business unit was 17, while the finance department within the particular business unit showed this high gap score of 30. The black box has been opened, and has laid bare an alarming situation. A gap index of above 20 demands extra attention and, in most cases, serious measures. In this case it turned out to involve fraud.
Very many companies, both within and outside the Netherlands, have served as laboratories for the further development of this scan. From this laboratory research we have at the same time learned that, through involving managers in the implementation of the strategy, a number of powerful effects have been able to emerge. I will mention a few:

1. Support for the strategy is created, as long as the results of the measurements are acted upon
2. Knowledge from deep within the organization is shared throughout the rest of that organization
3. Insight is gained into the readiness for change
4. Top management places itself in the middle of the organization and can align actual performance capabilities to the strategy. All this we call the *Strategic Alignment Process*.

With the scan, the power and the vulnerability of the company are laid bare. The insights that come to the fore from the use of the scan bring us further in the direction of a governance concept with which we can better guide the company as a system.

**STRATEGIC ALIGNMENT PROCESS**

In our book *Beyond Control* Robert Noteboom and I in 2005 put forward a first serious attempt at a new management concept. Empirical research and hundreds of thousands of data points revealed to us that lack of transparency in communications and decision making forms by far the greatest system disruptor. Lack of transparency in communication and decision making. That is why we introduced in our book the *Strategic Alignment* process. This process enables the company’s Board to engage in a continued dialogue with management in charge of execution. In this way the Board and executive management can share insights into the ability to perform, and can adjust decision making about strategy and execution to each other. The individual manager plays a distinctive role in that implementation. In addition, we find that in current society the individual, enjoying ever-greater autonomy, tends to
demand more than ever, his or her individual freedom. Knowledge, as well as
the freedom to make decisions and to act is of essential importance for the
key figures within the company.
(SLIDE 15)
This demands a structure that frees knowledge, enlarges transparency and
facilitates and stimulates the freedom to act and to take decisions – without
losing a grip on managerial control.
Here we create responsibility and “ownership” as well, to lead ‘beyond control.

**COMPLEXITY THEORY**

So we arrive at a simple formulation: freedom for the individual manager to
act, without losing managerial control. How does one find the correct
reconciliation between freedom and control? Here my encounter with the
theoretical natural scientist Roland Kupers was of decisive importance. He
opened the door to what for me was the new world of complexity theory, a
world that seemed to offer interesting new perspectives. In 2014 he earned
his Ph.D. at Nyenrode with his dissertation “The Complexity Frame for Policy
and Management.” Here he asserts that policy-makers, in addition to their
existing approaches, should also look at companies and organizations
through the lens of complexity theory.

Complex systems consist of elements that are tightly connected with each
other and which mutually influence each other’s behavior. Characteristic here
is that, out of the interactions between the elements, “emergent” - that is,
spontaneously appearing – system characteristics originate. Nature as a
complex system has its own rules, such as gravity among others, but in
addition has a remedial characteristic which regulates the system. In Nature
this characteristic is referred to as “The Survival of the Fittest,” and within
Complexity Theory this is termed a “fitness criterion.” The fitness criterion
together with the rules influences the behavior of all elements acting in
Nature, and thereby determines the spontaneously appearing characteristics
through which Nature corrects itself. In an artificial system, the lack of correct
rules and fitness criteria can lead to the emergence of negative and even - as
we have evidenced - destructive emergent effects. But when the correct rules, fitness criteria and social norms are present things will go well of themselves, like magic. With a brief film I’ll give you a concrete example that you may already be familiar with.

(FILM 16)
We see here that, within apparent chaos, order automatically arises. In this example there are certain rules, among others a driver’s license and the required periodic inspection of one’s vehicle. That is, the brakes, lights, etc. have to work. The fitness criteria are flow and safety. In addition, shared social norms, such as a willingness to courteously yield to the other road user, enable flow to occur. A traditional government mostly governs through traffic rules, stoplights, signs and lines on the roads, which not infrequently lead the system to seize up completely. A government that is “Beyond Control” can, with a limited number of rules, structurally let go and still assure both flow and safety, thanks to fitness criteria supported by shared social norms. The intelligence of those using the road and their desire to proceed from point A to point B without any accident ensures that they make the right decisions in all freedom. That it all functions is due to the fact that the government’s fitness criteria correspond to those of the road users, so-called the actors in complexity theory. For success, rules are of not insubstantial importance, but just as important are fitness criteria and social norms.

(SLIDE 17)

That means that for a social system it is necessary, in addition to having clear rules, to define the correct fitness criteria and social norms with which the system can better manage itself and create order. An order with which one can reinforce the quality of the system as a whole.

THE COMPANY AS A COMPLEX ADAPTIVE SYSTEM
Using Kupers’ insights into complexity theory we can regard the company as an artificial adaptive system.

(SLIDE 18)
We thus come to the governance concept for the company, which I have come to grasp over the last year and with which, I hope, we can confidently make our way forward in these uncertain times.

A company is a juridical entity, but besides that, with all its connections and actors such as clients, employees, shareholders, partners and other relevant stakeholders, one can see it as a complex system, an organism. To be more precise: it is a value creating organism, within which the leadership changes over time. It derives its *raison d’être* primarily from creating value for customers. It is the responsibility of the Board and the task of Management to make the company more valuable in the widest sense of the word. First of all, rules are necessary to limit misuse and errors. According to the law, shareholders, via the Annual General Meeting, have a juridically compulsory voice which they can use as principals to call the Board to account on various points. They can even in certain cases demand the resignation of the Supervisory Board. But the shareholders’ interests do not always coincide with the interest of the company and its other stakeholders. There is more that is necessary than the shareholders’ voting rights as a guiding method of governance in order to be stewards of the company in a timely and effective manner. Just as with traffic regulation, next to rules there are fitness criteria and social norms needed to create order and to make the entire system more valuable. With traffic policy it is all about safety and flow. With company policy it is about **value creation**. This means that value creation forms the basis for the fitness criteria which serve as a guide for all actors involved.

(SLIDE SCHEMA 19)

In order to apply this new governance concept, with the help of a schema I would like to illuminate step-by-step and in outline form, how we can direct, control and strengthen the company’s value creation and that of its stakeholders as one system, and thereby make it more valuable. Then I will show you which fitness criteria we should define and how we have to apply these in order – in dialogue with all relevant stakeholders – to reinforce the entire system.
The Board is responsible for the continued existence of the company and formulates and/or reaffirms in short, vital terms its raison d’être. It thereby also determines for the distant future the company’s right to exist. In addition, the Board defines the derived fitness criteria:

To begin with: meeting or exceeding customer expectations. We can posit that this fitness criterion has priority over all others. After all, without customers you simply have no company.

In order to do business, the company needs capital. Those who provide capital expect a return on that capital that is in line with the company’s risk profile.

The third fitness criterion has to do with the company’s ability to perform through its organization capability, necessary in order to carry out the strategy. This Strategic Alignment process I have explained earlier in this address.

By the fourth fitness criterion, Stakeholder Alignment, we include all the other relevant stakeholders within the system, stakeholders such as: suppliers, labor unions, NGOs, governments, societal organizations and the like. This fitness criterion implies that the interests of these stakeholders be respected and brought into reconciliation or balance -- as much as possible with all other stakeholder peers.

Taking the raison d’être as a starting point, the Executive Board formulates the Definition of Success using the fitness criteria. I also call this the North Star towards which the company, in the mid term, sets its course. It is up to the CEO as Leading Actor – with her or his view firmly on the Definition of Success - to take control of meshing the company’s interests with those of the relevant stakeholders. The Corporate Dialogue serves as “enabler” for this meshing, so that, next to financial reports, the Board also has available an alignment report covering business units, the various countries in which the company operates, and the entire company as a whole.
Finally, it is the task of the company to do good things in a good manner. That requires unambiguous norms and virtues in order to have the system function responsibly and socially. These norms, described and embraced by the Board, form the moral compass on the basis of which the Board and all of the company’s responsible managers operate.

Ladies and gentlemen, in this governance concept we have applied the balance between freedom and control. Thanks to transparency in decision making, it is clear for the company and all involved parties with which rules (which are largely determined juridically) and with which fitness criteria the Board effectively provides the company as a system with direction, controls risk and manages. The Board and Management, by so doing, can address all actors involved in the company on an “evidence based” foundation. On the basis of reciprocity, the stakeholders can likewise hold the Board and Management to account. There thus need not arise any misunderstanding about the accountability. By taking upon themselves involvement and responsibility, the stakeholders receive (as does thereby the company as a system) a voice that makes it possible to intervene on occasion, whenever necessary, to make adjustments. We conclude trust based psychological contracts using the fitness criteria, on the basis of which implicit behavioral relations arise in an effective way between Management, the Board and all involved stakeholders. The starting point is the common good, which has to prevail above the self interest of any given actor, whether that actor comprehends his self interest or not. Success in functioning lies in using psychological contracts to supplement juridical contracts. In this manner the heavy job of the Leadership becomes doable and the Board can limit system failures. In addition, the social norms and the virtues offer an indispensable means to limit human failure and, in so doing, to safeguard the societal legitimacy of the company. The task description and the profile of the Board are clear. The operations of the Board can serve as an example for all involved actors. But we know that, in practice, the moral compass does not always stand open; the inner person is divided by conflicting impulses. We are frequently inclined to choose self interest. Yet if moral compass and North
Star are governed in the context of system rules and value creating fitness criteria we stand a better chance of calling on the nobility of leaders, thus discouraging zero-sum behavior.

(SLIDE 23)
That is why we should take a last look at the fresco of Good Government, which is based upon the virtues Fortitude, Prudence, Temperance and Justice. These days, these are still the same virtues upon which we can and must rely to hold the board to account, if we wish to manifest the Societal Legitimacy of the company.

I hope that I have through my argumentation, narrative and classical allusions been able to take you along in my conviction that the company in an emergent complex system must be equipped to win back trust in the business world, but also that its conscious role as motor for Prosperity and Well-being makes business sense. We must keep our ideals, and we must also tune these ideals to meet today’s reality. After all, there are many promising developments in the area of technology and science which offer world shifting and value creating possibilities. That is why, to end, I cite Eric Beinhocker from the Martin School at Oxford, who maintains that the place to be is at the very edge of chaos.

(SLIDE 24)

“Unlike creatures in nature, we are not blind, passive players in the evolution game. Through the sciences of complexity, we can come to understand how evolution works, the tricks it has up its sleeve, and the skills needed to survive in a complex world. If we do so, we may be able to harness one of the most powerful forces of all; evolution will then be the wave we ride to new levels of creativity and innovation rather than the tide that washes over us.”
It is from my heart that I wish for the new generation, our sons and daughters, students, managers and professionals of companies and organizations, including my colleagues at Nyenrode, the same freedom and the same opportunities that I have received throughout my entire career and for which, as I said earlier, I am intensely grateful.

I thank the Nyenrode Governing Board for the confidence that I have received over the last ten years to develop the New Board Program together with my colleagues. I am grateful to my faculty colleagues for their cooperation, in particular Prof. Annemieke Roobeek and Prof. Steven Schuit, Tom Cummings, Edgar Karssing, Paul Frentrop, Danielle Melis and Roland Kupers. Their wisdom has enriched my ideas to an extraordinary degree. The warm friendships that have arisen during my entire career I will continue to cherish.

I HAVE SAID.

* Dissertation: “The Institutional Investor Stewardship Myth”