The Four Vectors of the Corporate Operating Environment

A Primer for Business Leaders to Build More Sustainably Successful Enterprises Through an Integrated Approach to Managing the Demands of *State*, *Society*, *Capital Markets*, and *Organization*

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In boardrooms across the US and around the world, CEOs and boards face an *historically complex* task of figuring out what exactly they should be trying to optimize for in their businesses.

Are they meant to be agents acting principally — or exclusively — in service of their shareholders with the sole aim of profit maximization? Or are they stewards for a broader array of stakeholders including employees, communities, governments and the wider society? And, if the latter, how do they prioritize among those competing demands when trade-offs between them are required?

In the popular narrative, this debate over shareholder vs. stakeholder capitalism is about rethinking the legacy of the Reagan Revolution and the work of Milton Friedman and other economists of the Chicago School which ushered in an era of corporate focus on shareholders above all else.

While there is certainly truth in this narrative, what it fails to recognize is that corporations have *always* had to consider the views of stakeholders beyond their shareholders. This was the case in the 1780s, the 1980s and today.

Corporations always and everywhere must be responsive not only to the *Capital Markets* that finance them.

They also operate within legal and regulatory constructs created and enforced by *States* and, therefore must engage with and take into consideration the demands of those States (which we define here as the full array of government institutions including courts, regulatory and executive bodies and legislatures at all levels).

Corporations are always and everywhere embedded within *Societies* from which come their employees, customers, and business partners and so they must act in ways that protect and enhance their reputation with the members of those Societies.

And, crucially, corporations are always and everywhere *Organizations* made up of individuals who have come together to work toward a set of aspirations and objectives, to build products and services, nurture an organizational culture, and forge an identity that is distinct from the firm's shareholders. All such Organizations must weigh the impacts on its own members when making critical decisions.

Today, more than ever, business leaders must understand the *Four Vectors of the State, Society, Organization, and the Capital Markets* that together shape the overall operating environment in which companies exist. Companies in the modern era must navigate through the pushes and pulls of each of these Vectors, developing and executing strategies that seek to balance the perceived value for all four while grappling with the reality that frequently they pull the firm in opposing directions.

The Four Vectors are in a constant state of flux, reacting to each other and to their own internal divisions.

States change laws and regulations in part due to *Society's* demands, while the views of the members of *Society* are significantly shaped by the messages sent from the *State's* leadership.

Capital Markets send daily signals on the economy that can cause the *State* to change its policies and for *Society* to alter its behaviors –– along with signals on the perceived value of a particular firm.

And within the *Organization*, employees and executives evolve their goals and cultures based on the inputs of the outside world, while also using the firm's resources to try to shape the environment to their advantage.

At the center of this vastly complex swirl sits the *CEO*.

Organization

The CEO represents and leads the Organization. They must show up each day and feel whether this collective of people is aligned behind their defined goals, uplifted by the condition of the culture, proud of their common identity, and motivated to work together to create something that the Capital Markets, Society, and the State will find valuable in some mix.

State

C-suites and boards also stand as the ultimate accountable party in the firm's relationship with the State, providing both literal and symbolic commitments to comply with the laws and to act in ways that generally support (and do not harm) the security and welfare of the country in which it is operating. For multinationals, this commitment extends across jurisdictions and is made more complicated by the now increasingly frequent reality of misaligned demands from States that are at odds with one another.

Society

The CEO and board must be constantly attuned to Society as it renders its judgments through the actions of consumers, commentary in the media and on social media, and the decision of workers to join or exit.

Capital Markets

And, of course, they are bound by their own economic self-interest, as well as the law to promote the interests of their shareholders, with their success or failure in this regard communicated to the world each day through the share price (in the case of publicly traded companies) or through valuation announcements for private firms.

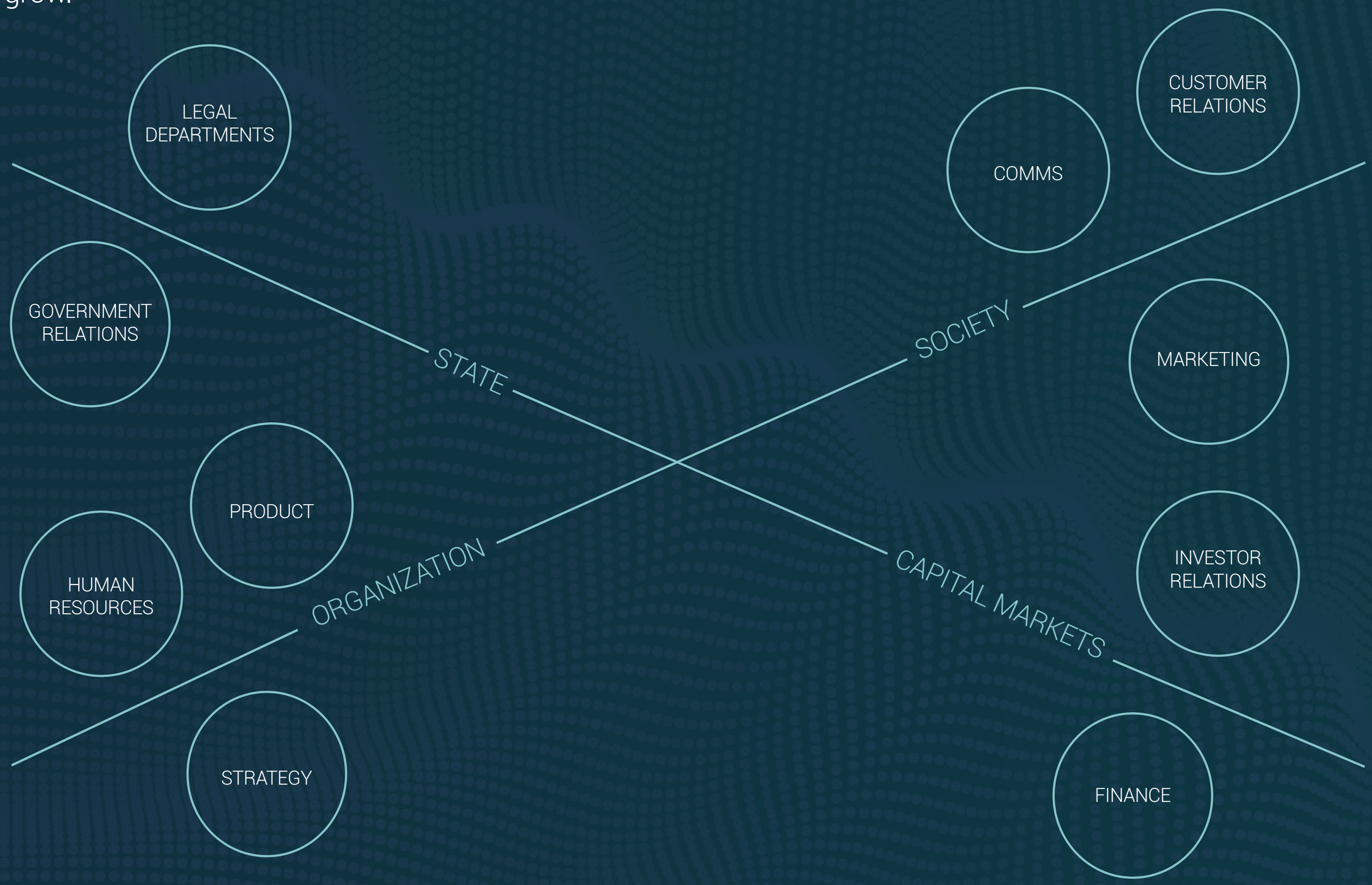
To manage the firm's relationship with each of the *Four Vectors*, CEOs typically create and oversee dedicated functions:

Legal departments and *Government Relations* that are charged with managing the relationship with the State through the courts, regulatory and executive branch agencies and legislatures.

Finance and *Investor Relations* engage with the parties that make up the Capital Markets, explaining how the firm is performing and why investors should continue to provide it with the means to operate and grow.

Marketing, *Communications* and *Customer Relations*, among others who engage with Society, telling stories through various channels about the company, its brand, products and values.

Strategy, *Product* and *HR* together define the narrative of the Organization, laying out its mission, vision, values and how it seeks to place those forward into the marketplace.



Every firm's long-term success depends on its ability to effectively navigate the operating environment shaped by the *Four Vectors*.

Sustainable success requires these functions not simply to operate effectively within siloes, but to operate cohesively and in an integrated manner, enabling executive decision making that holistically reflects the full range of costs and benefits.

The decision to close a factory may start as an economic decision driven by considerations of shareholder value. Yet no CEO can make such a decision without taking into account how it will impact the morale of the Organization, what response it might engender from the local or national State bodies, and how it might be received by Society.

The same is true about virtually every meaningful decision a CEO makes — whether to buy-back shares, invest in a new environmentally friendly technology, commit to diversity targets for the executive leadership team, bring a potentially popular product to market that may pose certain public health risks, enter a new country that is viewed as having a problematic human rights record or bringing suit against a competitor for anti-competitive practices.

Day-in and day-out decision points arise and a calculus must be made: Am I willing to trade some goodwill from the State in exchange for a boost in favorability from the Capital Markets? Do I risk a backlash from some parts of Society if it means energizing my Organization? Do I act on the basis of Organizational values even if it means shareholders may experience losses?

There is no formula and no perfectly wrong or right answers to any of these questions — and while they have moral and ethical dimensions to them, ultimately these are practical considerations that fundamentally define what the business is and what it will become.

CEOs have *few reliable tools* to directly achieve this synthesis.

Data is a critical input, but no one has yet developed a precise and agreed metric to measure performance on all these values. Machines are still far away from answering the question: if I launch *product X* and it delivers *X dollars* in revenue, it will cause a *X percentage* uptick in the stock price, but it will also offend *Social community X* and their associated NGOs and trigger an investigation by *State organ X,* while also energizing people in the *Organization* so the net utility to the *business = Y*.

CEOs generally seek to gather both qualitative and quantitative perspectives from the various functions and then use their own internal compass and judgment skills to make a decision. The best CEOs do so through highly collaborative processes in which they actively suspend judgment and in which they work to ensure fair hearings from executives responsible for each of the Four Vectors. Some CEOs are also gifted with innately accurate compasses.

More typically, the process plays out somewhat haphazardly with idiosyncratic factors like the personalities of the function leaders, their proximity to the CEO and the personal predilections of the CEO themselves shaping final decisions. As well as all the familiar cognitive and emotional biases that human decision makers grapple with, whether it be over-indexing on the most recent memorable events (recency bias), being overly risk acceptant in the domain of losses (prospect theory), or others.

Given the stakes, CEOs need clearer and more consistent approaches that are organized around a disciplined approach to the following:

1) *Recognition*

The first step to navigating the landscape is mapping it. Most organizations intuit the dynamics of the Four Vectors and how they are shaping the operating environment. Few take the time to explicitly lay out these dynamics in a comprehensive manner. That can lead to misalignments within the firm, as different functions fail to appreciate the broader implications of their actions. In the most effective companies, leaders across the firm have a strong sense of its relationship with the State, Society, Capital Markets and the Organization and are sensitive to the interplay between them.

2) Systematic *Foresight*

The relationship between the Four Vectors and their impact on the firm are never static. It is a constantly evolving and dynamic space, punctuated by occasional significant disruptions. No firm can reliably predict how these dynamics will play out over time. But through a disciplined process it is possible to focus in on the critical uncertainties that are most likely to shape the strategic space in the future. By keying in on these issues, leaders can create usable systems for sorting signals from noise and ensuring that they are paying appropriate attention to the trends that could have the greatest impact.

3) Continuous *Insight* Development

The Four Vectors are not inanimate. They are driven by people and people can be studied. Through a range of qualitative and quantitative methodologies, firms can develop rich insights into how the key actors in the State, Society, Capital Markets and the Organization are thinking and how they are likely to behave in response to actions or communications by the firm.

4) *Strategic* Synthesis

For decades, companies have refined their strategic planning processes. Yet too often this process remains siloed, with those functions responsible for managing each of the Four Vectors operating largely in isolation from one another. Comprehensive strategy development requires integration of the insights and considerations of each of these areas, combined with a deep understanding of the complex interactions between them. The strategic planning process offers a unique opportunity to ensure that leaders across the firm understand the operating environment and are thinking about all of the Four Vectors in their decision making and execution.

5) Collaborative *Execution*

It's notable that in moments of crisis, firms frequently achieve a higher state of deep integration in decision making than they do under normal circumstances. Lawyers and engineers, lobbyists and finance experts, marketers and HR find themselves around a common table contributing to solving a problem that impacts them all and which requires each of their perspectives to protect and advance the firm's interests.

That approach needs to be the rule, rather than the exception. While it is impractical to have every operational decision assessed by a cross-functional committee, a reasonable threshold can be established for that type of collaboration. More critically, executive leadership teams, guided by the CEO, can establish habits of continuous sharing of information and perspectives across functions and a norm of proactively seeking input that reflects each of the Four Vectors.

6) *Repetition*

The work of Foresight, Insight, Strategic Synthesis and Collaborative Execution has no end point. It is not a project. It is a mindset. It is a day-in-day-out approach to management that needs to be alive to the inputs of a constantly changing environment. On a continuous basis, the CEO needs to be thinking creatively about how the Four Vectors are shaping their operating space and how those Vectors could change in the future and what effects that could have.

They need to be actively and consistently studying representatives of each Vector to better understand their perspectives — what moves them, what information they have or lack, what their priorities are, what might cause them to shift their thinking and behavior. They need to be constantly pulling the leadership of the firm together to synthesize the expertise of the full range of operational functions and helping ensure that everyone, from the board and C-suite down to line managers, has a sense of the strategic imperatives that are shaping decisions. Most critically, the CEO must set the example for the entire organization of collaborative execution, bringing teams together to move the entire firm forward.

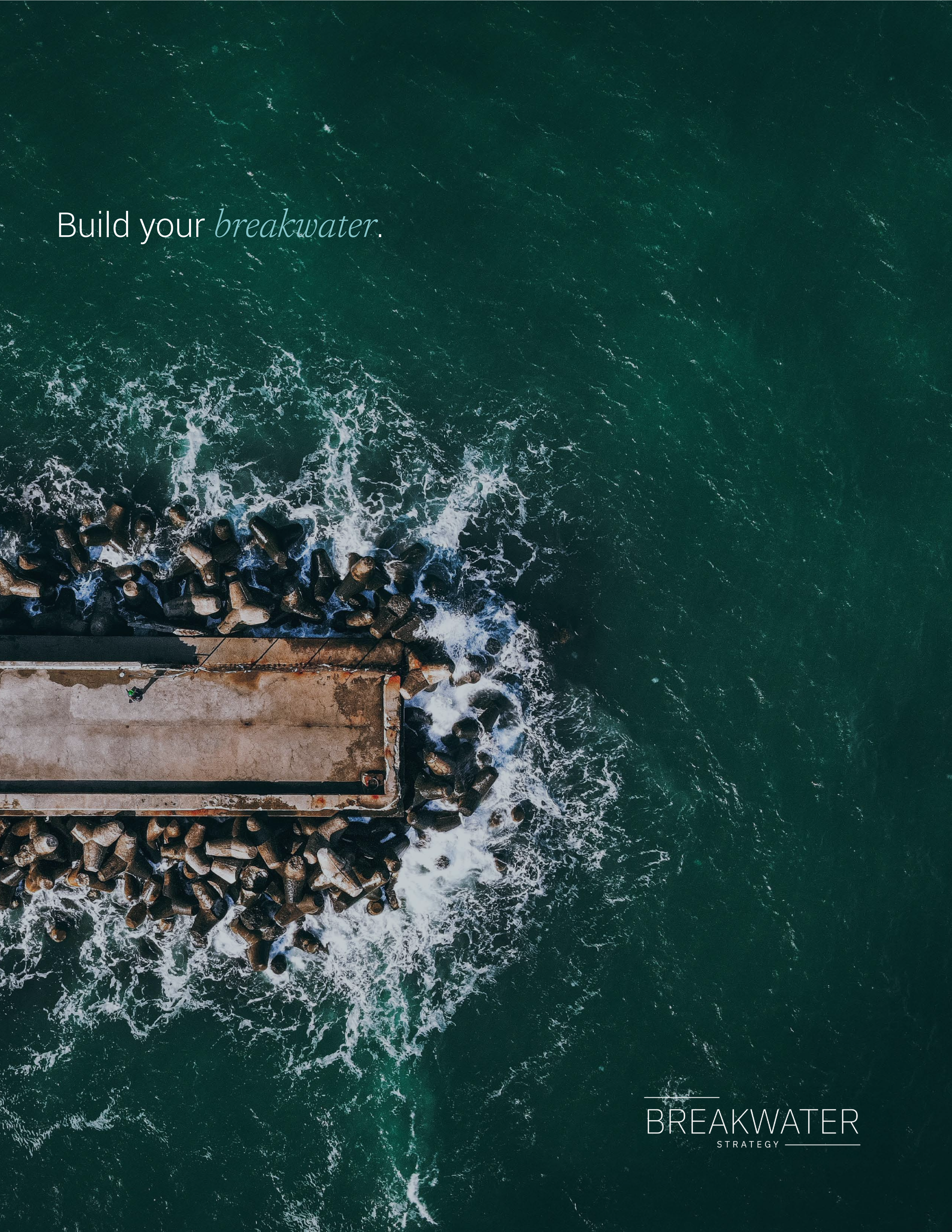

RECOGNITION
Foresight
Insight
CEO
Execution
Strategy
REPETITION

The intersecting pressures of the *Four Vectors* are becoming ever more complex and challenging. The concept of "stakeholder capitalism" is not wrong, but the stakeholder map is *more dimensional* and *dynamic* than that term and the practices that surround it typically reflect.

CEOs navigate the reality of *Societies* that are becoming more demanding, *States* that are becoming more unpredictable and often aggressive, *Organizations* that are more assertive and less controllable, and *Capital Markets* with vastly expanding sources of data, compute power, and actors willing to directly challenge management. These pressures have always existed in some form. Today, they move much faster and with greater impact.

The *successful company* does not commit to aligning with one of these Vectors and ignoring, trying to hide from or negating the others. That is the stuff of ideological purity that bears little relation to the real world.

Rather, the *successful leader* embraces their responsibility to integrate these *Four Vectors* and to develop thoughtful, sophisticated strategies and plans that seek to maximize the firm's utility across them. There never has been and likely never will be a perfect way to do so, but through the right mindset combined with systems and processes any company can improve its likelihood of success long-term. And, in doing so, position the firm to *stand the test of time*.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