

The New Capitalism of the New Entrepreneurs

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All acts of entrepreneurs are not equal. The creative act of the entrepreneur may be placed on a continuum from the mundane to the profound. To put it simply, there may be three levels of entrepreneurship.

- **Level One: The New Follower:** You decide to open a restaurant in your city or town. You think you can provide a better dining experience than other restaurants, but you will serve Italian, Chinese or some other ethnic menu like many others. For you it is an exciting and unique experience. For your marketplace, it is simply one more option in a crowded field.
- **Level Two: Product or Process Innovation:** This requires a higher level in innovation and more skilled execution. In level two you are not simply doing what others have done before. You have designed a new product or you have created a new way to produce and deliver the product. Dell Computer was not innovated in product, but was innovative in the method of production and delivery, the direct to consumer – Internet shopping experience.
- **Level Three: Relationship Innovation:** This may involve both process and product innovation, but more importantly, it redefines the relationship between the consumer, the company, and with the members of the organization. Level three creates a revolution in the culture of the company that flows all the way through from supplier to customer. Apple Computer, Starbucks, and Google are all examples of successful Level Three entrepreneurship. Level three entrepreneurs succeed in establishing a relationship with their marketplace that is as emotional as it is practical. They create a brand loyalty that goes beyond any simple understanding of the buying decision.

To succeed as a level three entrepreneur will require a new understanding of capital and capitalism. In what now seems like the ancient days of capitalism, capital was money. Capital ruled. With financial capital you could buy everything else. You could buy the land to build a steel mill, the components of the production process, the raw materials, and most

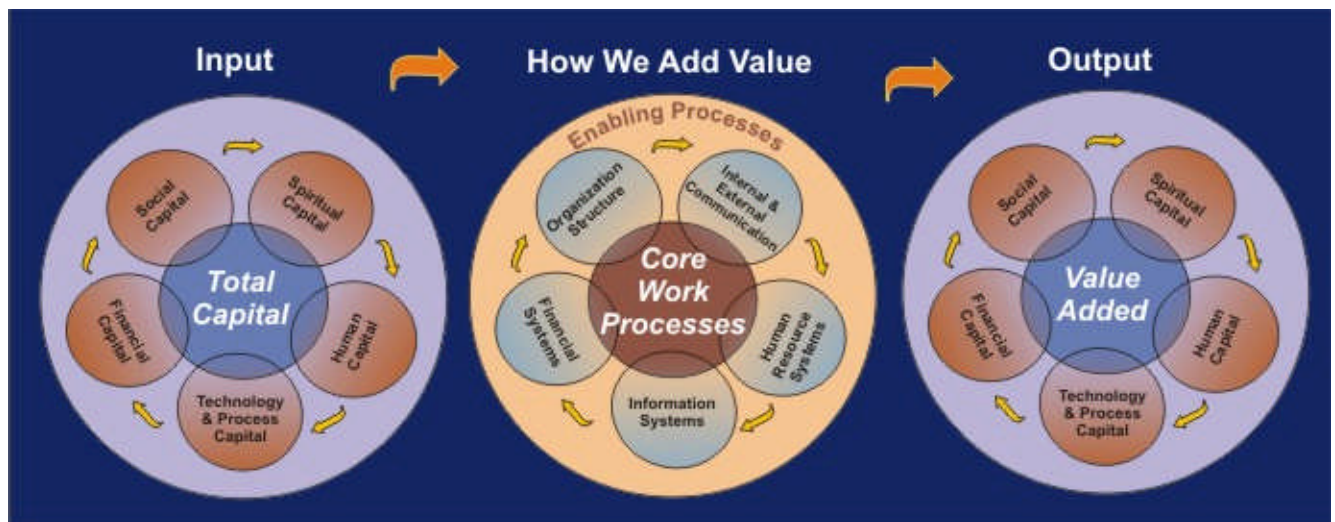
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important, the human resources to turn input into output. If you had money, you had the essential tool of building a business.

But, we live in a new age. What capital did David Filo and Jerry Yang, the founders of Yahoo, possess when they started Yahoo in their Stanford University dorm room? Ask the same question of Google founders Larry Page and Sergey Brin. Money was not the key ingredient in the founding of these and many other companies. Rather, they begin with a different kind of capital that is typical of the new age of capitalism.

All businesses can be defined as a system: Input and in-putting systems; a process that transforms the input to create value; and, the value-added output. It is clear that money is only one form of input and output.

Capitalism today can more appropriately be defined by the following:



Capitalism is not only the private control of financial capital, it is also the private control of social capital, human capital, spiritual capital, and technology or process capital. What you own when you buy the stock of a company, is not merely the value reported on the balance sheet and income statement. The job of the entrepreneur is to create wealth, the net value of all five forms of capital.

Social Capital

Social Capital is the value of trust. The degree to which other people trust you will determine the likelihood of their purchasing your products or services. Entrepreneurs often begin their business within a small circle of trust and gradually expand the radius of trust, increasing the scope of their network and their business.

In a society, there is a great deal of evidence that social capital is a critical force for development. The number of parents who participate in school activities is directly related to the quality of education and further economic success. There is even a demonstrated relationship between social capital and health. *“As a rough rule of thumb, if you belong to no groups but decide to join one, you cut your risk of dying over the next year in half. If you smoke and belong to no groups, it’s a toss-up statistically whether you should stop smoking or start joining.”*¹ Social capital, the quality of our relationships, interacts with our physical well-being.

There is increasing research, which demonstrates that the strength of social networks, particularly voluntary networks, within an organization correlate positively with higher rates of productivity. *“A social environment rich of participation opportunities, allowing people to meet frequently, is a fertile ground for nurturing shared values and social norms of trust and reciprocity. Where such values and norms develop, the likelihood of cooperative behaviors is higher, and workers may be more motivated and not inclined to shirking behaviors.”*²

To analyze the current state of social capital and plan the future, it is important to drill down to a more functional level. There are two types of social capital that may be assessed: internal sociability or trust, and external market capital or brand equity.

Internal social capital is the level of trust within the organization. Trust operates both horizontally and vertically within the organization and is critical to the ability to solve problems, innovate and satisfy customers.

Internal sociability probably has its greatest impact in the ability to solve problems. All organizations are a continual stew of problem solving. Whether it is solving the problems presented by a customer, a new technology, or a competitor, business is a game of constant adaptation to a changing environment. The apparently small act of walking down the hall to an associate’s office and sharing a problem, casually brainstorming without regard to who gets credit, or who bears what responsibility, is the most frequent, and probably the most effective way to solve problems. These encounters may escalate into a formal meeting or problem solving process. Whether the interaction remains highly informal or becomes more formal, the critical ingredient is the simple willingness to be engaged, to care about the problem, to listen deeply, think together, and brainstorm solutions.

¹ Putnam, R. D. (1995) 'Bowling Alone: America's Declining Social Capital', *Journal of Democracy* 6:1, Jan, 65-78.

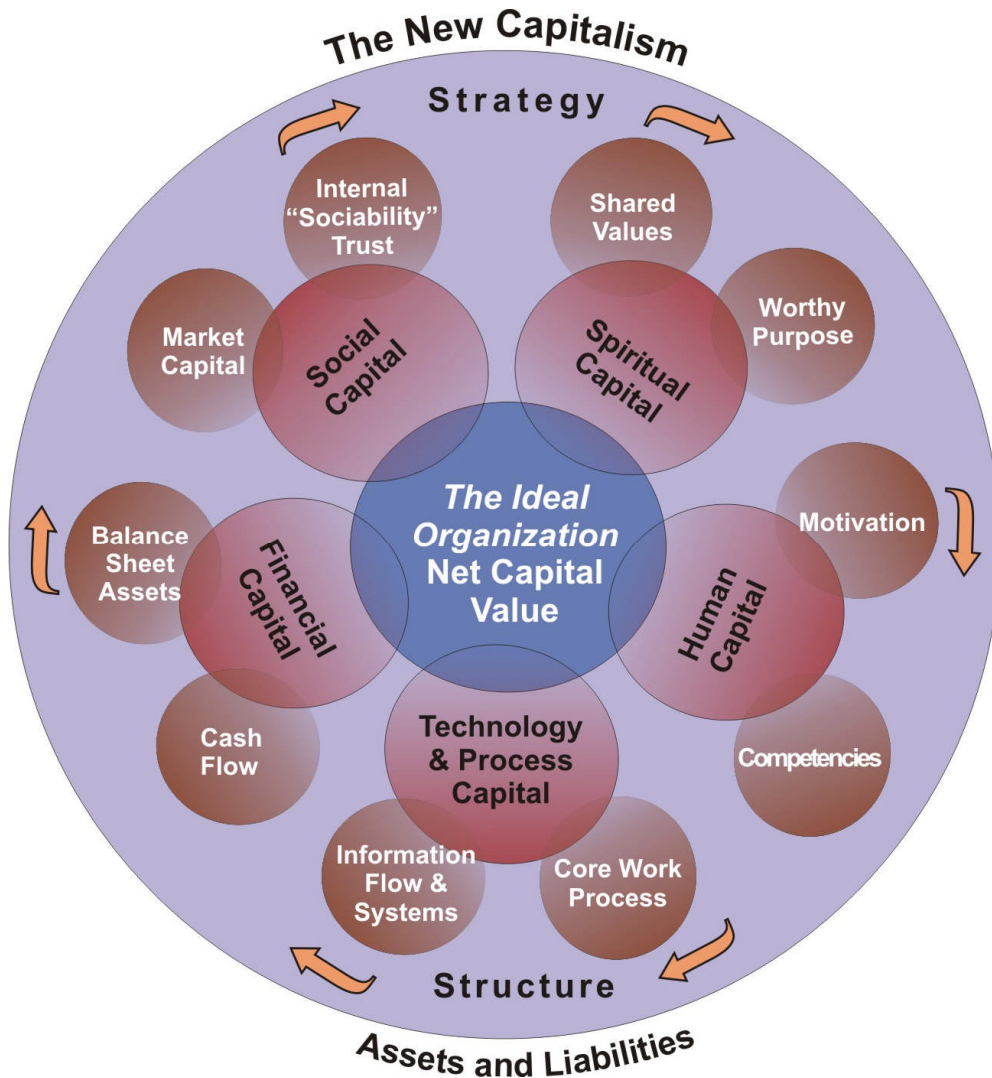
² Sabatini, Fabio (2006) *Does Social Capital Improve Labour Productivity in Small and Medium Enterprises?* Working Paper, Dipartimento Di Economia Pubblica, Rome.

Market capital is the recognition and respect given to your firm by the market place. It is brand equity, which is almost as good as money in the bank. Some have measured market capital by subtracting the financial value of all material and cash assets from the firm's market capitalization. In other words, if the stock market values the total equity of the firm at \$1 billion, and the firm has cash, accounts receivables, building, equipment, and other balance sheet items worth \$500 million, it is logical to assume that the value of the brand, the trust of the marketplace represents the other \$500 million. Of course, it can also be argued that this value may represent future cash flows.

No one has defined a single or accurate way to measure the value of reputation, trust or loyalty toward a firm's brands in the market place. But the absence of a definitive measure in no way diminishes the power of brand or market capital.

If Honda produces a new car, without any direct knowledge of that car, it will have a high degree of respect, simply because Honda, which has developed a strong image for quality and performance, produces it. This is market capital. Recent studies of brand loyalty indicated that the experience of Honda car owners led to the highest probability that they would buy another Honda product. This brand loyalty reduces the marketing cost of each sale. The dollars that would otherwise be spent on marketing to acquire a new customer can be invested in new product development. Similarly, if Pixar comes out with a new movie, even without any reviews or promotion, families will have a positive bias that this will be a good movie to see with their children. This brand equity has direct monetary value.

Arthur Andersen, the major accounting firm that sank in the Enron scandal, went out of business, not because they lost financial assets or human capital; rather, they completely lost the trust of those who read financial statements. They lost their market capital. This quickly translated into bankruptcy as customers fled to other accounting firms.



Human Capital:

Human capital is the sum of all of the skills or competencies of the people within the organization. Human capital has always been a critical component of the performance of any business, but today's entrepreneur is likely to bring with him, not money, but competency and motivation, the two key ingredients of human capital.

Motivation has been the subject of hundreds, if not thousands of books for managers. When all is said and done, the keys to motivation are relatively simple: work that is interesting and ennobling; sincere recognition by both peers and superiors; opportunities for career advancement; positive feedback that can guide performance; strong and supportive social interaction by a team; and, oh, did I forget? – fair and attractive financial rewards. There is little reason to waste time in the endless debates about money versus recognition, versus enriching work. They are all motivating, and different personalities are more or less, influenced by

different types of incentives. The job of designing an organizational system is to optimize all of the various forms of motivation. Over-reliance on any one form is a prescription for poor performance.

Human competence is the only modern parallel to production technology of the past century. Modern production most often occurs in the mind, or the collective mind of a small work group. If you have highly trained marketing professionals, skilled sales men and women, great engineers and brilliant financial managers you have an important form of capital. These competencies are a foundation of performance. Investment in these assets is likely to pay off in the creation of other classes of assets.

Those organizations that have exhibited the greatest dedication to the development of human competence have consistently outperformed those who have only given lip service to training and development. General Electric, Microsoft and other companies that have grown into the great economic powers have done so as a result of both attracting and developing the most competent people.

Competence can loosely be divided into the function skills, managerial skills and social skills. While there are many important functional skills, the most important are those that enable the core work process in the organization. If the organization is a software development company, the competence of software design and engineering are the core competencies. Managerial skills – decision-making, planning, project management, etc., are all critical to every organization, as are the social skills of communication.

Spiritual Capital:

I am fully aware that too many ears, the word *spiritual* may sound incongruous in the context of a discussion of business or capitalism. However, the perceived division between work life and spiritual life is both false and impossible. A high percentage of our social interactions occur at work. Many of our anxieties, ambitions, passions and fears center on our work life. The nature of the organization in which we work has a profound effect on our spiritual life.

Many entrepreneurs have been motivated to leave the traditional corporation and start anew, not simply to pursue their dreams of wealth, but to pursue the vision of an organization that contributes to the human spirit as well as the bank account.

I will not take the reader's time at this point for a lengthy discussion of the meaning of the word *spiritual* or *spirituality*. It simply refers to our aspirations, our guidance, our

connections that are not founded in the material world, but rather from some source, we regard as more noble. Every religion seeks to strengthen our spirituality, the inner strength and serenity, which come from knowing of a higher source of authority. Those who do not believe in God may also seek spirituality in the power and perfection of nature or through meditation.

I am also not suggesting that work organizations should in any way engage in the practice of religion or interfere in the religious life of their members. This, I believe, should remain entirely personal and voluntary. Business organizations however, can create a cultural environment that supports religious and spiritual values and that does no harm to the inner spiritual well-being of the individual.

To the degree that an organization can enable, support, or encourage a depth of personal morality and dedication to a noble purpose, it possesses spiritual capital. I sincerely believe that this form of wealth accrues both to the organization and to the individual. It will interact and support every other form of capital and ultimately, will have its effect on the actual bottom line.

In practice, many organizations have done great harm to the spiritual life of their members, even while the leaders may profess loudly their religious commitments. The reader no doubt has sufficient examples without the author providing depressing illustrations. If not, simply watch Arthur Miller's *Death of a Salesman* and know that the graveyard is well populated by kindred spirits of Willy Loman.

I believe that spiritual capital has two most significant components: first, the degree to which members of the organization are committed to an ennobling purpose; and second, the degree to which shared values serve to guide ethical behavior.

The pursuit of **worthy purpose** was the subject of an earlier chapter of this book and is the primary means of achieving *energy* in an organization. Human beings are energized by, and will sacrifice for that which they believe to be noble, and therefore ennobling of them. Any manager who believes that only technical processes, human skills or financial capital are required for competitive success is much like the racing team that spends a million dollars for the latest racecar but then hires a driver who doesn't care about winning. Purpose matters. Ennobling purpose matters most.

Shared values are the basis for trustworthy relationships and sociability. We all have beliefs about human nature and ourselves that guide our behavior. When someone holds the belief that human beings are created evil and are naturally devious than it is logical to assume that they must be watched and controlled. However, if we believe that people are essentially created noble and worthy, we treat them with an assumption of trust. Business partners, fellow managers and

employees all have a tendency to conform to our beliefs about them. These belief systems have enormous impact on the culture of organizations and it is the function of leaders to exert efforts intentionally to shape these beliefs.

Countries that are unified have a clearly articulated set of values stated in a constitution or “Bill of Rights” that form the basis for relationships. We know that (in the United States) we believe in freedom of speech, press and religion. We know that one is innocent until proven guilty. And, we know that everyone is entitled to equal treatment and opportunity regardless of race, religion or gender. These values are not innate. We were not born with them. Certainly, many people are born with contrary views. These values must be taught.

Because of our humble human condition, business and other organizations, which desire a high level of sociability or trust, internally and with external customers and partners, must clearly articulate their values, demonstrate adherence to those values, and hold all members accountable for their compliance.

Technology and Process Capital

The success of Dell is in their manufacturing and distribution processes. The success of Wal-Mart, Home Depot, L. L. Bean or McDonald’s is all about process. Processes either create or minimize cost. They assure either consistency and reliability, or the unfortunate alternative. Like other forms of capital value, the quality of the work process, and particularly any technological breakthrough that creates distinction with customers, is a significant asset.

Organization design begins, not with the design of levels or division in the organization, but with a clear definition of the future **core work process**. Many processes in an organization are not core processes. The core process is the input-to-output flow that causes a customer to write you a check. It is that simple. If customers write you a check because of the quality of your accounting then accounting is a core work process (which it is not, unless you are an accounting firm).

Information flow and technology are key enablers of performance. Information systems should not only be considered a decision-making tool, but also a key ingredient in the motivational system. How information is presented and used can create the element of a great business game that motivates everyone to play; or, it can be a cause of fear and surprise punishment.

Information systems are often changed without carefully analyzing the work system or who makes what decisions, therefore who needs what information. Information systems should be designed after the definition of the best possible work process; otherwise, the information system may actually inhibit improvement in the work.

Financial Capital

Needless to say, when the word capital is used the first thought among business managers, is the “cap ex” budget and the corporate balance sheet. It might be assumed that the discussion of social, human and spiritual capital in some way minimize the importance of financial capital. As a business owner, manager, and now private investor, the author fully appreciates the value of financial capital. I want a return on my investment, like every other investor and I have read hundreds of 10K’s and 10Q’s.

The essential components of financial capital are found on the balance sheet and the current cash flow statement. These are the indicators of financial capital, but they are not the cause. Financial capital is the outcome of the successful development and utilization of the previous four forms of capital. I have never met a highly successful entrepreneur whose first motive was to make money. Most entrepreneurs have a passion for solving a problem, creating some new social network, or technological development.

If you want to be a successful entrepreneur in the modern global society it is social, spiritual and human capital that will be your most likely sources of competitive advantage.

Capitalism has morphed into something very different. What we can be sure of is that capitalism will continue to change. However, there is a clear direction, which is away from the predominance of financial capital and toward the predominance of the more human forms of capital. It is the trend toward the unity of that which will produce material and spiritual well-being.