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From greed to decency

1. The Damoclean sword suspended

Just for once, let us deliberately put to one side the "crisis" that has been our constant companion over the past months and years. This for three reasons. Firstly, we need to avoid habituation. The issues around excessive state debt and unresolved risk exposure in the financial system are far too important to the Western nations for a weary shrug of the shoulders to become an acceptable response. Secondly, we need to take account of the fact that there is not just "the crisis": but that – as far as Switzerland is concerned – consumer confidence and, by now, industrial production are again cruising along at a high level. Those who talk only of "crisis" also overlook the fact that very many globally active companies, diversified well beyond the close confines of their domiciles, are often affected little, if at all, by the specific problems of their home countries. The peculiar conjunction of the "blood-red abyss", as a serious scenario for over-indebted states, co-existing with new prosperity on a global scale, among other things explains the hectic fluctuations on the financial markets over the past weeks. Pricing is obviously going to be difficult when there is some probability of the occurrence of both extreme risk and a happy twist of fate.

Thirdly, and this must be taken on board with a mixture of doubt and astonishment, the European Union and the International Monetary Fund have, over the past weeks, with an emergency parachute of 750 million euros and a unique supply of liquidity by the ECB, succeeded in arresting the Damoclean sword of a financial crisis in free fall. Whatever bonds are coming onto the market are being bought; the Spanish and Italian treasury auctions, awaited with foreboding, have so far gone agreeably smoothly. The evil spirits have not, however, been entirely driven out, but still flicker here and there. There is still a considerable degree of illiquidity in interbank business, and we are well aware, from the 2008 financial crisis, of how dangerous that can be. The most minor events, such as a downgrading by a rating agency, leaves market players paralysed with anxiety. For those countries that can apparently place new debt without problems, the Credit Default Swaps (CDS), yardsticks for the probability of bankruptcy, remain at far too high a level. In short, the whole situation is reminiscent of Shakespeare's *Midsummer Night's Dream* – somewhere between unreal and fairly fundamentally intoxicated.

All the measures to calm the system are aimed at gaining time. Whatever the cost, the flow of finance must be maintained. Meanwhile, all governments are undertaking "savings programmes", to make a start on what had previously been demanded by those market forces they described as a threat (in order to be able to trigger the Maastricht support process, at the price of a massive distortion of applicable law) and reviled as evil speculators and locusts: getting the state finances under control. We must hope that the efforts will prove sufficiently credible for them to appear acceptable as debtors once again. Regular readers of the Investment Commentary will be aware of our scepticism. For us, Greece corresponds to the non-bankruptcy of Bear Stearns in spring 2008; we shall be surprised if a "Lehman Brothers" for the Eurozone does not follow relatively rapidly, and put an abrupt end to the midsummer night's dream.

But we don't want to focus on the crisis, nor on the potential, or probable, repeat performance when the time bought at such high price runs out. Rather, this Investment Commentary is devoted to an extraordinarily satisfactory development that is taking place in business theory, in the areas of shareholder value, stakeholder value and management by incentives. For investors, this development may be more relevant than all the other factors relating to the situation of Western debtor states, which will anyway not change – they remain condemned to teeter on the brink of bankruptcy. For even when all the visible problems have been solved, the hidden pension liabilities remain, and these exceed the explicit state debts by multiples. Wise investors are aware of all the threats to their assets arising out of this

state of affairs. They will take their own, well thought-out precautionary measures, and turn to more agreeable matters.

2. Profit as a social obligation?

But what is so attractive about developments in a theory? Are theories at all relevant? We are all practitioners, and "all theory is grey, my friend". Goethe may have been right about the colour, but, as we know, he gives the saying to Mephistopheles, which might indicate that the real meaning is the precise opposite, as in: in the beginning was the theory, or, if you will, the idea. Which is (more or less) what we find in *Faust* (and elsewhere). Ideas are the basis for all the assumptions that we use to organise our lives, including our business and economics. So, when important ideas change, this is relevant. As long as mankind believed the Earth was as flat as a pancake no-one sailed to America.

One of the key ideas in economics over the last fifty years has undoubtedly been the concept of shareholder value. It generated emotions right from the start. Initially, shareholder value – that is, the maximising of economic profit for the investors in a company – was used correctly simply as a descriptive term. That is, as an economic concept to explain why companies exist at all as a form for the organisation of human life and human interaction; to describe the factors governing business success or failure; and to model the mechanisms (and mathematics) of a company. This descriptive usage was rapidly followed by a normative component, most strongly advocated by Milton Friedman, with his dictum that a company's sole social obligation lay in the maximisation of its profits. However right Friedman might have been – within the narrow boundaries of consistent economic logic – "profit maximisation as a programme" was no less disastrous for the subsequent course of the shareholder value debate.

For Friedman attracted the attention of the moralisers. For many, shareholder value became the key concept underlying all the evils of capitalism: egotism, greed, excess on the part of precisely those who did no work for the company, but "merely" made their money available as capital. The moralisers thus took the part of the so-called stakeholders in a company: the workforce, their (dependent) family members, the immediate and wider social environment, the exchequer (ever-hungry for corporate taxes), ecological concerns, even the competition. Long-banished concepts such as the labour theory of value enjoyed an intellectual resurrection (as demonstrated by the slim volume by Roger de Weck, recently elevated to the highest position in Swiss broadcasting, entitled *Nach der Krise. Gibt es einen anderen Kapitalismus?*). Indeed, since the establishment of the normative component of shareholder value, it has been an aspect of good form at management gatherings such as the World Economic Forum, to celebrate the litany of "values-oriented" companies and to abjure the naked greed for profits. Commitment to stakeholder value has become an ersatz religion, and, as with any satisfactory religion, the churches in which it is practised are doing all right financially.

In keeping with this line of thinking, people were quick to identify the cause of the financial crisis in the greed so openly manifest in banking circles. In greed, and the bankers' bonuses that fuel it, advocates of stakeholder value reached the zenith of their critique of capitalism, gratefully seconded by the media, intellectuals and politicians. That greed and bonuses are simply the consequences of a massive economic distortion has been deliberately overlooked. A distortion caused by the disastrous combination of the state and the financial system in the form of free and unlimited guarantees for the (big) banks. Criticising greed and bonuses proves more popular than any serious analysis of the situation. For such would rob the critique of capitalism of its basis, and come dangerously close to identifying the real cause of the financial crisis in the critics' own enmeshment in the political system.

The ever more improbable proposals for re-regulating the financial system, and ultimately the economy as a whole, that we have seen since the financial crisis are ultimately all based on this critique of capitalism. In the final analysis, the state emerges from the crisis still highly indebted, but as the winner, and with it the notion that values-orientation and social obligations dictated from on high must flow right into the finest capillaries of management, accounting and controlling principles. In economic terms (and thus for investors) this is all extremely relevant. For it renders compliance definitively more important than profitability, and throws the gates wide to moral duplicity and institutionalised CYA. Abandoning the aim of (objectively defined) economic efficiency results in high costs to national economies.

The modification to the shareholder value approach offers an opportunity to definitively defuse the unfortunate antagonism between investors and stakeholders; that is, the parties affected by the success (or failure) of a company. However, before we turn to this modification, let us also try to recover the honour of the previous

concept of shareholder value, by means of a rather more exact presentation.

3. Unresolved time patterns

It seems to us that much of the criticism of shareholder value is based on a truncation of its real content, or on a fundamental misunderstanding. From either a descriptive or a normative perspective, shareholder value makes no sense whatever if considered only in the short term. The price of stocks today and tomorrow, this years' dividend even, have very little to do with shareholder value. Nor was this ever meant to be the case in the theory.

Rather, under "profit maximisation" the theory has always understood the net present value of the sum of all future cash flows, including those still in the distant future. It may be that the high interest rates prevailing in the 1970s when the theory was launched meant that at the time the future was to some extent blanked out. For the lower the interest rates are, the greater the influence on the discount formula of cash flows far in the future[1]. When interest rates are high, what really counts is the present cash flow; then, maybe, next year's, and to a very limited extent, the year after's. In such circumstances on the financial and capital markets, the figure for current earnings represents an adequate approximation for determining shareholder value (whose maximisation is at the heart of the shareholder value approach). The lower the discount rate, however, the less significant is the present, and the more important the future. Low interest rates have now characterised the monetary environment for over a decade. Taking the shareholder value approach seriously would long have meant taking much more account of more distant cash flows.

However, the more important the future cash flows, the more dependent they become on factors beyond the control of simple management approaches. Exogenous factors, such as changes to the market environment, the political situation or the zeitgeist, are no less important than endogenous elements such as the ability to retain highly qualified personnel, or to keep the product pipeline fuelled by innovation and imagination. Everything that lies in the future is subject to probabilities and externalities. The more important the future becomes, the harder – that is, more relevant – the "soft" factors. These so-called soft factors are, however, basically aligned with the interests of the stakeholders. Satisfied employees are less likely to leave the company; researchers who feel themselves valued are more likely to keep the product pipeline filled; an environment treated with due consideration will be less of a threat than one that is treated with contempt, as the case of BP makes all too clear. On the basis of low interest rates for the discount formula, the opposition of shareholder and stakeholder interest should never have occurred. It is analytically wrong. In the long term there is substantial convergence between the interests of investors and those of many of the people involved in a company's operations.

The concentration on net present value measured by current figures, and its equation with shareholder value, have had a massive impact in practice. Anyone who has fought their way through the mountains of current financial analyses must be amazed at the effort devoted to the estimating of cash flows that are closer to the present than the future. The stock exchange seems to work the same way: if (short-term) analyst forecasts of quarterly results are not met, prices fall; should they be exceeded, though, there is rejoicing on the stock exchange. But we read relatively little in the financial press or in stock market reporting about the mood of a company's staff or the innovative energy of its researchers.

The triviality of the short-term approach is convenient not only for financial analysts, but particularly for the most important of all stakeholders – the management. For short-term figures can be manipulated. This is most easily done with the well-known Return on Equity (ROE). Even if profits are lower than expected, management is not without resources. A reduction in equity – i.e. a higher level of debt – is a relatively simple way of increasing the ROE. Such manipulation can be concealed by operationally unnecessary, but the more persuasively justified, restructuring measures at regular intervals, with everything possible being done to ensure that the figures are not comparable over time. This way, the board, the majority of financial analysts and, for a time, the stock exchange can be successfully conned. An opportunity to wind the meter back will be provided by the next crisis, which is undoubtedly coming, and will affect everyone, so that in the aftermath no-one is going to be asking questions about what was being fiddled during the good times. Survival is all that matters.

Companies' fixation on short-term indicators results in mis-allocations with far-reaching con-

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[1]
$$SV = \frac{FCF_1}{(1+r)^1} + \frac{FCF_2}{(1+r)^2} + \frac{FCF_3}{(1+r)^3} + \ldots + \frac{FCF_n}{(1+r)^n} = \sum_{i=1}^{n} \frac{FCF_i}{(1+r)^i}$$

SV= Shareholder value, r = Discount rate, FCF = Freely disposable funds at various points in time, n = Point in time in the distant future. The discount rate is heavily dependent on the generally prevailing interest rate.

sequences. Tendentially, investments in long-term projects that are not immediately profitable are neglected. On account of the convexity of the option price formula, the option-like character of long-term future projects means that their impact is to reduce the value of the short-term results. Long-term investments, however valuable they may be for the future development of the company, must often, on account of their low present value, be booked under "costs", thus reducing earnings. Every cost-oriented management (and which management would claim not to be cost-oriented?) will therefore take care to avoid excessive investment in this area. By contrast, comparatively "hard" investments, such as non-organic acquisitions of other companies, even at the cost of a hefty premium ("goodwill"), are preferred. Unlike internally generated goodwill, externally acquired goodwill can remain on the balance sheet, at least until the next crisis (see above) blows it away. This is then described as "impairment", by which is meant, in plain language, an end to self-deception.

But once again, and even more insistently: properly understood, shareholder value has nothing to do with any of these problems. It's just a pity that the proponents of the shareholder value approach have for far too long failed to stand up for their concept. But the thought of a debate with the sweet-talkers of the stakeholder-value persuasion was probably just too boring.

4. A risk-adjusted perspective

The proper application of the discount formula and the use of appropriate interest rates, with a correspondingly long-term calculation basis for enterprises, are not, of course, in themselves sufficient. There are businesses whose results oscillate like disco lights: blindingly bright one second, pitch-black the next. This is not in itself an argument against the company concerned. If the long-term average is satisfactory in terms of the risk involved, then there is nothing wrong with such a situation. What counts is a sort of "Sharpe ratio"; that is, a figure for the ratio of earnings to fluctuation spread. Investors, shareholders, are caught in a state of tension between risk and return. It is not the absolute amount of a single year's earnings that matters, but the extent to which results fluctuate over time. Of course, in the real world, the "total return" – that is, the stock price plus dividends – does not correspond exactly with the overall result achieved by a company over time, because a variety of exogenous factors also determine the stock price. But there is undoubtedly a relationship between the approach chosen by a company and the resulting spread of fluctuation on the stock exchange. The higher the debt level the greater the volatility of the earnings (and thus of the stock market capitalisation too).

The level of debt, or conversely the amount of equity available, generally indicates the disposition of a company and its management. Equity is nothing but a hindrance in optimising short-term performance indicators. We might indeed go further and say that under normal circumstances equity is quite unnecessary. However, its availability, in sufficient quantities, does mean that abnormal circumstances are highly unlikely to occur. In other words, companies hold equity in order not to use it. Equity is there for the most improbable worst-case scenario: to prevent bankruptcy. In this context, the shareholder value concept, properly applied, means both that the worst case is not excluded from the outset, but rather allocated a probability, and also that the available equity is regarded a as a positive factor, as a provision for the avoidance or management of the worst case. In this context, the cost of equity must be relativised. Disassociated from an assessment of worst-case risk, it is without significance.

With a long-term orientation, and enriched with a risk component, even the original concept of shareholder value is far removed from the notions of those who vilify it, and is also in an entirely different category to the incentive systems operated by most companies. These claim to optimise shareholder value, but in reality encourage only the enrichment of particular groups of stakeholders.

We need to look more closely at incentive systems. What follows is largely based on a recently encountered essay on a subject that seems to us of definitive importance. The article, by Prof. Ron Schmidt, who teaches at the University of Rochester (N.Y.), appeared under the title "Are Incentives the Bricks or the Building?" in the *Journal of Applied Corporate Finance* (Vol. 22, Nr. 1, 2010), published on the occasion of the 70th birthday of Michael Jensen, one of the originators of the shareholder value theory.

5. Incentive systems as a cost factor

Contemporaneously with the shareholder value theory, and closely related to it, another corporate theory emerged in the USA in the 1970s. This theory diverged substantially from the economic theory current in Europe. In contrast to European theory, it was based on an explicit model of human behaviour, with a continuous effort to derive consistent insights. That is to say,

when reference was made to leadership doctrines, organisational structures, or accounting and controlling processes, these were always based on the underlying model, and on a small number of principles derived from the microeconomics of Adam Smith. In its simplest version, the behavioural model was based on *homo oeconomicus*, the benefit optimiser. Individual benefits were defined axiomatically as various and not comparable. As money was the best medium of exchange between various benefit optimisers, money – that is, financial interest – became in this model the single currency that was to be maximised. In plain language, every employee, at every level, will strive to amass the largest possible amount of cash. The model is simple, on average generally applicable, but also often unsatisfactory in individual situations. For a vast number of human preferences cannot simply be represented by the lowest financial common denominator. Love, empathy, honour, hate, and the like, obviously play a major role in human behaviour. Accordingly, the simple model was expanded cautiously in the direction of psychosocial factors. These efforts gave birth to the well-known "Resourceful, Evaluative, Maximising Man" (REMM), first referred to by the economists Brunner and Meckling ("The Perception of Man and the Conception of Government", 1977, *Journal of Money, Credit and Banking*).

However inspired the imagination and however varied the preferences, ultimately corporate theory ends in organisational forms that bring individuals together – individuals who have to be instructed, monitored and, because they are basically inclined to pursue their own interests, rather than those of the collective, kept on the path of rectitude by ensuring that the interests are aligned. That's what the incentives are for. There is a vast amount of literature on the design of these incentives, particularly with regard to top management, probably because their behaviour is believed to stand in the strongest causal connection with the success of an enterprise. In other words, the better the top management is motivated, by means of incentives, to pursue the company's interests, the better for the shareholders. In theory.

Unsurprisingly, practice turns out to be much more problematic. For management by incentives assumes that the real causes of success are understood (which would, of course, necessitate a consistent definition of this success, something which, as sections 2 to 4 of this Investment Commentary have shown, is not that easy…). Success is well known to be the child of many parents; failure is an orphan. And when success is achieved, what is due to the team as a whole, and what to individuals' performance? How can the time-scale of business success (which is, as shown above, much longer-term than the prevailing fetish for short-term indicators, on which most incentive systems are based) be aligned with the short-term financial needs of individuals? How to prevent really outstanding contributions being overlooked, while the mere fulfilment of duties is gold-plated with bonuses? How to ensure that incentive schemes can be adapted to significant changes in the prevailing circumstances? Should incentives be so rigidly defined that they virtually become set in stone, as legal obligations? If payment is in stocks (or options), what is the impact of inherent market risks, that have nothing to do with the success of the business? Is there not a danger of the brilliantly talented being miserably rewarded in a market downturn, and the incompetent doing far too well in boom times?

Schmidt's list of critical questions concerning the common incentive systems is a long one. The concept is not rejected as a normative aim, but the point is made that the cost of maintaining incentive systems, as part of the so-called "agency costs", can be enormous, and may well be systematically underestimated as an element contrary to shareholder value. In the extreme case, a company becomes a sort of mercenary organisation, in which no-one is prepared to do anything without being specifically rewarded for it. Thus, the most minor activities have to be monitored, and controlling itself, we would add, will only function on an incentive-related basis, rendering absurd the concept of a company as a synergy-oriented organisation. Schmidt does not go that far, but simply states that, while it might be unwise to entirely reject management by incentives, it might well be still more unwise to think that incentives offer a sufficient basis for managing a company.

6. Trust is cheap

Also on the basis of observation, and without any normative intent, Schmidt subsequently contrasts the "mercenary organisation" with the "character-rich organisation". There are not a few companies – and by no means the least successful ones – that manage largely without complex incentive systems. How do they work, and why is it that their employees are often more motivated and committed than the mercenaries? Why are the costs of monitoring such decentral systems so low? Schmidt names two preconditions. Firstly, such a company must have the right employees. These need to be "character-rich", or, to put it

negatively, the company needs to have employees who do not respond primarily to financial incentives. People for whom well-being in the workplace, agreeable and respectful interactions, challenging tasks, consistent management and the strategic orientation of the company are more important than additional cash in the pay packet. Secondly, and this is obviously related to the quality of the available employees, such a company must be characterised by a phenomenon best described as "trust". Less supervision, and more self-monitoring; a small number of broadly-based instructions; the assignment of responsibilities rather than duties; no explicit financial promises for the achievement of specific targets, but deep intellectual and empathetic acceptance of targets across all hierarchic levels; accountability for actions and behaviour.

The advantages of the character-rich organisation are obvious enough: many "agency costs" disappear altogether, or are much lower than for the mercenaries. The character-rich organisation can be very decentral in its structure, without any need for the deployment of armies of supervisors and inspectors, or the installation of compulsion-based regimes. Complicated systems for measuring contributions to success (including the notorious profit-centre approach, which allocates success to specific units within the company) are unnecessary; all work together for the benefit of all. The flow of information, both top-down and bottom-up, is much more relaxed, and more candid, because bad news does not automatically have a negative impact on salaries. Nor does internal communication need to be continually artificially enhanced with cunning PR measures (which eventually no-one believes in anyway…). Trust, if genuinely achieved, has an immense advantage: it is effectively free.

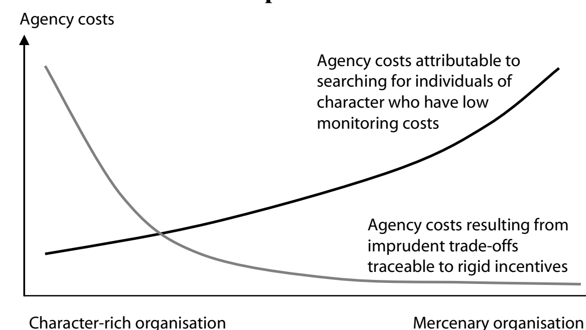
However, the costs of recruiting such employees are considerably higher. According to Schmidt, it is far more difficult to find people of real character than the human slot-machines who are entirely adequate for the mercenary organisations. And recruiting costs are not one-time costs, but recurring ones, as personnel fluctuation must be managed. To take Schmidt's considerations further, it might reasonably be claimed that the high costs of recruiting make it difficult for a fast-growing company to remain character-rich. The beneficial financial impact of the significantly lower fluctuation rate enjoyed by character-rich organisations is only felt in the medium to long term.

If we understand things correctly, Schmidt's analysis "contravenes" the axiom that individual benefits are not comparable. The character-rich employees in Schmidt's company have one quality in common: decency. They enjoy (in economic jargon: see as a benefit) doing things well, and feel guilty and ashamed when they fail to do so. In Schmidt's character-rich organisation, people do not behave like charged particles that move faster and more positively in the right direction the more (financial) energy they are charged with. Rather, they behave like people one might actually want to go on holiday with. It is predictable that this contravention of pure microeconomic theory will become the Achilles' heel of this new theory in dogmatic circles; we like the paradigm shift a lot.

7. The search for the optimum mix

Of course, for Schmidt both the "mercenary organisation" and the "character-rich organisation" are extreme constructions. The absolute versions are unlikely to be encountered in practice, for the agency costs would be too high on both sides. The mercenaries would ultimately become entirely preoccupied with monitoring, and probably with monitoring the monitors; the absolute version of the character-rich organisation would probably spend so much time on the assessment of particularly suitable employees that it would never get any work done. Nevertheless, it's worth considering the absolute versions so as to be able to draw the right conclusions for the real world.

Somewhere there's an optimum



Source: Schmidt, 2010, Are Incentives the Bricks or the Building?

There is probably an optimum somewhere between the two poles: significantly lower agency costs, from thinking in character-rich terms but also applying (simple) incentive systems. Then, neither will recruiting costs be excessively high, nor will monitoring costs get out of control. Schmidt attaches great importance to the realisation that the choice of which organisational form to favour is a strategic decision for the top management. We might add that it is probably the most important single strategic decision of all. For ultimately, on it rest both the choice of business model and the structures to be created.

In this context, it is worth thinking further. For example, the question arises, in our view, of whether the optimum between a mercenary and a character-rich organisation, once defined and perhaps achieved, is static or not. An argument in favour of a steady state is the matter of the "corporate culture" or "management style". Different types of style attract different types of employee. Frequent changes in matters of style give rise to disappointment, and thus to higher fluctuation, which means higher costs. However, in our view, too much stasis could also prove pernicious. For there are probably developmental phases or market shifts in which a tendency towards the one or the other organisational option will be clearly beneficial. Whether a tendency one way or the other really is an option requires further thought. It seems highly likely that it would be easier to equip a character-rich organisation with an incentive system than, vice versa, to make choirboys out of mercenaries. The mercenary organisation may have irreversible traits. And if that were so, then any move in that direction would need to be considered all the more carefully.

A band of mercenaries or a character-rich organisation: this will depend not least on what the company does. There are sectors that have traditionally always been organised on a strongly commission-driven basis – insurance sales, for instance. By contrast, banking advisory services have long been provided almost without incentives. Both activities are closely related, and yet they have for long followed entirely different approaches. Which is the right one? The question must remain unanswered. What experience does show is that the combination of two such diametrically opposed business models is highly problematic. Banking's increasingly unbalanced reliance on more and more bonuses has not done it much good. There seems to be a more fundamental pattern that determines the practice in a business area. Such patterns are, of course, not carved in stone for all eternity. A technological innovation (e.g. the internet) may give rise to radical change. Nevertheless, patterns and practices are often based on centuries of experience and wisdom. We do well to take them seriously.

8. Value can be increased!

So wherein lies the specific advantage of the modification to the shareholder value theory we have described? In our view, three elements stand out. Firstly, the article in question has, so to speak, put the stamp of academic approval on the organisational form used by companies that endeavour to manage with as few, and as straightforward, incentive systems as possible. And this has come precisely from those circles that have so far devoted all their efforts to applying a perfectionist approach to incentive systems. Henceforth, the character-rich organisation will be an object of serious academic interest and no longer treated, as has been the case so far, as a ridiculously outmoded special case. Decency, trust, empathy: these will be assigned an economic value. "Values" have collided with "value". This promises fascinating arguments, not least with the moralisers and the specialists in corporate ethics.

Secondly: it is self-evident that over the last thirty years the entire corporate environment has been pushed, by every possible means, in the direction of management by incentives. The incentives have often been so set that the optimum was attained not for the company as a whole, but for specific groups of stakeholders. The boards of directors responsible for compensation schemes, themselves a priori by no means devoid of self-interest, often capitulated quickly in the face of the complexity of the schemes. The management was able to exploit its asymmetric advantage with regard to information ("Where in the company are the indicators generated that are most beneficial for me? How can I best influence them?") most shamelessly precisely in the area of incentive schemes. Coupled with timescales that were systematically too short, this produced a cocktail that meant that companies operated far off from their economic optimum. In very many cases, particularly the listed companies most strongly influenced by the investment banks and the financial analysts, the agency costs are far too high, as a result of excessively complex and generous incentive systems. If economic value is really assigned to values like decency and trust, this will generate an improvement potential that should not be underestimated for probably almost all the companies that interest us as investors.

Thirdly: the tendency towards management by incentives was accompanied, logically enough, by a strong trend towards more centralised management. The CEO model, once one of many possible leadership models in business, has been victorious. The need for rigorous and elaborate monitoring that goes hand in hand with complex incentive schemes results almost inevitably in the concentration of responsibility in a single person. The band of mercenaries needs a strong commander. However, the CEO model also has significant disadvantages: the information deficit already mentioned, and the resulting impossibility of decentral growth. The (re)introduction of the "decent" company as an economically appropriate form of organisation opens up possibilities

for moving away from the CEO model. This will take a while, particularly in those sectors (such as banking) that are subject to supervisory authorities and thus sometimes malign bean-counters. Nevertheless: optimism is in order; the time is ripe for structural variety.

A greater range of structural options, lower agency costs, the resolution of the supposed dichotomy between values and economic value: this has to be – from a long-term perspective – good news. In the short and medium term, though, the problem remains that, even more than the business world, the political sector has moved away from character-orientation. Here too, and with good reason, we look for a reorientation.

KH, 28.06.2010

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