



The collapse of the multinational oil giant Enron has lent new force to the debate about the way we run and regulate large organisations. Whether they are oil companies, social enterprises or hospital trusts, organisations play a powerful role in our lives – yet the formula for making them both accountable and efficient has proved elusive. While opinions still differ about the virtues of nationalisation, few would argue that privatisation has been an unqualified success. The search for a new model continues.

In this NEF pocketbook, Shann Turnbull argues that the Enron debacle, and the failure of privatised entities such as Railtrack in the UK, are symptoms of a wider crisis in corporate governance. Top-down “command and control” hierarchies, the organisational model which is virtually synonymous with capitalism in the English-speaking world, have outlived their usefulness. They cannot cope with complexity or human diversity, they cannot regulate themselves and their centralised power structures make them vulnerable to corruption. A new breed of ecological organisation is needed, based on the way nature manages complexity, to decentralise decision-making, involve stakeholders in self-regulation and provide a way out of the sterile public-versus-private debate. Properly implemented, argues Turnbull, such “network governance” could humanise globalisation and make organisations, of all sorts, genuinely accountable.

Shann Turnbull is author of *Democratising the Wealth of Nations* and co-author of the first educational qualification for company directors. He has been a company promoter, chief executive officer and chairman of public corporations. He has an MBA from Harvard and obtained a PhD by showing how the science of governance can be applied to organisations.

The New Economics Foundation is the leading independent think-tank involved in the development of a fairer and more sustainable economy.

NEF Pocketbook 6

Price: £4.99



A New Way To Govern

Organisations and society after Enron

Shann Turnbull



A New Way To Govern



Shann Turnbull

NEF Pocketbook 6

**A NEF
Pocketbook**

The New Economics Foundation (NEF) was founded in 1986 by the leaders of The Other Economic Summit (TOES), which has forced issues such as international debt on to the agenda of the G7/G8 summit meetings. It has taken a lead in helping establish new coalitions and organisations, such as the Jubilee 2000 debt campaign, the Ethical Trading Initiative, backed by the Government and leading retailers, the UK Social Investment Forum and the Green Gauge “alternative” indicators of social and environmental progress.

NEF is a registered charity, funded by individual supporters, trusts, business, public finance and international donors, and acting through policy, research, training and practical initiatives to promote a “new” economy – one which is people-centred, delivers quality of life and respects environmental limits. Its strategic areas currently include the global economy, corporate accountability, community finance and participative democracy. It is now recognised as one of the UK’s leading think-tanks.

To become a NEF supporter, and receive its publications at a discount, contact Sue Carter at the address below.

New Economics Foundation

Cinnamon House, 6–8 Cole Street
London SE1 4YH, United Kingdom

Registered charity number 1055254

Tel: +44 (0)20 7089 2800

Fax: +44 (0)20 7407 6473

Email: info@neweconomics.org

Web: www.neweconomics.org

Executive Director: Ed Mayo

NEF Pocketbooks

Editor: David Nicholson-Lord

Design: *the Argument by Design*

ISBN 1 899 407 48 0

First published: 2002

Cover Picture: Several Circles, by Vasily Kandinsky, 1926
(Solomon R. Guggenheim Museum, New York.) © ADAGP, Paris
and DACS, London 2002

A New Way To Govern

Organisations and society after Enron

Shann Turnbull

Contents

Introduction – Enron and After	1
1 Where Governance Has Failed	5
2 Private or State?	11
3 Networks in Action	18
4 Design With Nature	27
5 Human Scale Organisation	32
6 A New Way to Govern	39
7 Network Governance – A Summary	47

Introduction: Enron and After

The disclosures following the collapse of Enron at the end of 2001 have sent a shock-wave round the world of corporate governance. Here was a corporation, one of the biggest and apparently most successful in the world, riding high in the Stock Markets and cited as a model in business schools, in which financial manipulation was endemic. Figures were fabricated, sham structures invented, profits and prospects massaged to boost the share price. Yet while thousands of employees were left with their pensions and retirement plans in ruins, many senior executives grew rich on stock options and share sales.

Enron is frequently described as a failure of regulation. Where were the accountants? What were the non-executive directors doing? Hence the calls to review the role of non-executive directors and tighten accounting procedures. But suppose the rot went deeper? Suppose, as Arthur Levitt Jr., former chairman of the US Securities and Exchange Commission, told the Senate investigating committee in January 2002, the problem was systemic?

This pocket book describes a new way for the State to govern society – based on a new method for the governance of bureaucracies, social enterprises and large, complex private corporations. It takes as its starting point the belief that the failure of Enron, and of many other firms around the world,

signifies a crisis in capitalism. In particular it signifies a crisis in the large “command and control” hierarchies – the top-down corporations with single unitary boards – that have become the dominant model of capitalism.

Command and control hierarchies are so ubiquitous that their shortcomings are accepted as part of the natural order of things. A key argument of this pocketbook is that these flaws are terminal. To that extent, questions of ownership are irrelevant.

It does not matter whether an enterprise is owned by the State – arms-length or otherwise – whether it is owned by investors, or whether it operates in the private sector or as a charity or non-profit organisation. All such organisations, if they are run as command and control hierarchies, will suffer identical problems.

These problems can be summarised briefly as: the tendency of centralised power to corrupt; the difficulty of managing complexity; and the suppression of “natural” – human – checks and balances. What we need now are organisations which recognise these failings and are designed to overcome them – organisations which break complexity down into manageable units, decompose organisational decision-making into a network of independent control centres and allow the private interests of executives to be harnessed to the public good. Command and control hierarchies, to sum up, must be replaced by something this pocketbook calls “network governance”. Where this includes stakeholders – not merely staff but customers, communities, suppliers or distributors –

a whole new dimension of economic, social and political benefit opens up. It also provides the foundation for institutions to become genuinely self-governing – whether they are business enterprises or social services.

As this pocketbook shows, these aspirations are grounded in practice as well as theory. The ideas put forward complement and develop some of the concepts of associative democracy articulated by Paul Hirst, the notion of a “customer corporation” described by John Kay and the “mutual state” suggested by Ed Mayo and Henrietta Moore (NEF Pocketbook 5). At the same time there are many organisations operating successfully along these lines – among them the credit card company Visa International, the Mondragón co-operatives of Spain and Keiretsu organisations of Japan. The name sometimes given to this philosophy of organisation – the “multi-stakeholder” approach – is not a pretty one; nevertheless, it is an approach that can clearly work.

Commercial success aside, there is growing evidence from natural processes and ecology – the role of DNA in creating self-regulating, self-replicating organisms, for example – to suggest that such organisations have a resilience and robustness conspicuously lacking in the Enrons of this world. Research into artificial intelligence, reported recently in *The Economist*, has shown there is “no pilot in the cockpit of the brain, directing body and mind”. Intelligence, instead, has been “rediscovered as the subtle interaction of many scattered parts. By itself, each part was stupid. Working

together, they achieved profound results. A single ant is not God's brightest creature. But as colonies, ants engage in food cultivation, temperature regulation, mass communication (using scent trails) and bloody, organised warfare. Ant colonies run themselves with an efficiency that outstrips human society. But no single über-ant manages the show."

Working through complex organisational networks, without an über- manager or a chief executive officer, ordinary people, as this pocketbook shows, can achieve – and have achieved – extraordinary results.

1 Where Governance Has Failed

Most people at some stage in their lives have played Chinese whispers. A message is passed down a line of people – and by the time it reaches the end of the line, four or five “whispers” later, it has changed out of all recognition. For most of us, it's something we do at parties. But it's also a remarkably accurate description of what happens in hierarchies.

Suppose that half the information obtained by a subordinate is passed to a superior. This is actually a generous assumption, since if managers have half a dozen or more people reporting to them, they are all likely to want to avoid information overload. Let's also assume, generously, that only 10 per cent of the true meaning is lost each time the information is passed on, and that biases and errors amount to only five per cent. Only 85 per cent of the true meaning is therefore communicated through each level.

The result, after passing information up through five levels of a hierarchy, is that 98 per cent of the information, when it finally gets to the top, is missing or wrong. Only 1.4 per cent of the original information survives and is correct.

Even these assumptions rely on the good faith of those concerned. In practice, it's unrealistic to expect that any

manager can obtain accurate information from a hierarchical chain of subordinates. To begin with, subordinates are often reporting on their own performance – and thus face an inevitable conflict of interest. In reality, executives survive by learning to establish their own more reliable, informal networks to cross-check and supplement formal channels of communication. The corollary is that the successful management of hierarchical enterprises depends upon individual idiosyncrasies – it’s virtually an accidental process. In organisations responsible for the life and safety of citizens or essential services, are these acceptable risks?

Corruption of power

The hierarchical command and control systems of governance that dominate society today suffer from three fundamental failings. First, concentration of power can corrupt both people and organisational performance. Second, the “contrary” characteristics in people that are nature’s checks and balances are suppressed. And third, as we have seen, information overload, biases and errors frustrate effective management.

Power, it has often been noted, corrupts – and absolute power corrupts absolutely. In politics the solution has been a division of power to introduce checks and balances. The democratic model of government attempts to separate the executive from the legislature. Appeal systems exist which arbitrate disputes – either between these two arms of

government or between them and citizens. The US constitution provides a classic division of power. The Congress makes the law, the executive implements the law and the courts mediate disputes between these institutions and citizens. Another crucial component is a free Press, acting as both a whistle blower and an agent for influencing voters and, through them, those elected to power.

Are such democratic principles relevant to organisations trying to survive in the jungle of ruthless international competition? Many business people will argue they are not remotely practical for corporations. Chapter 3 will attempt to show why these views are mistaken. In fact, sustainable employee-owned industrial firms documented in a 1980 world survey of workplace democratisation, contained the four key elements of democracy – executive, legislature, judiciary/mediator and independent information/media system.

Suppression of human nature

Command and control systems of management also depend upon subordinates being subservient and conformist. This is not the way human nature works, nor is it the way nature sustains self-regulation in social animals.

By trial and error over millions of years, evolution has honed survival instincts into the creation of social animals. In other words, it has built its own checks and balances into the behaviour of individuals. As a result people possess contrary

characteristics. At different times – even at the same time – they can be trusting and suspicious, co-operative and competitive, altruistic and selfish. Nature uses the contrary properties in materials to build both biological molecules and living bodies. It uses the minimum of materials to the maximum effect. The ability of the human body to be stable in many configurations, for example, is based on the use of materials with contrary characteristics. Bones withstand compression; muscles withstand tension. Either alone would provide limited stable configurations. Likewise the yin and yang characteristics of individuals are the most efficient way of achieving self-regulation with a minimum of communication.

Organisational networks, unlike command and control systems, can release the tensions inherent in the contrary nature of people. Properly designed, they can make use of these tensions to promote self-regulation and self-government.

By contrast, as we have seen, top-down systems tend to filter out diversity – and when this affects the supply of information, it can have dangerous consequences. A fundamental problem for any Government minister, company director or chief executive, for example, is that they simultaneously suffer from information overload – and a lack of crucial information. As we saw earlier, the information they do receive can be subject to bias and error as well as omission.

The greater the control of information by a hierarchy, the more difficult it is for whistle-blowers to alert stakeholders –

employees, customers, suppliers – to abuses. If those responsible for operations are also responsible for reporting operational problems, how likely is it that these problems get reported? Centralised control can also block out crucial external feedback – strategic information critical to the development of responsive and competitive products and services – and can thus jeopardise the very existence of an organisation.

No business can exist without employees, customers and suppliers – so these are described as “strategic” stakeholders. The health and competitiveness of a business depend upon frequent and rich feedback from these groups. If enterprises are to manage risks credibly, they need thorough and open dialogue with their strategic stakeholders – and that means, in turn, a process and a structure. Chapter 5 of this pocketbook describes what form these might take. At present, however, such processes are conspicuous by their absence – yet it is the failure to collect early warnings of disaster that explains a growing number of corporate collapses. In fact, in many of these – major examples in 2001 included Enron in the US, Independent Insurance Company in the UK, HIH Limited and One-Tel Limited in Australia – auditors actually provided an unqualified report.

Yet if current checks and balances fail to provide an adequate early warning system, the fault lies in the command structure as much as the communication processes. Orders sent down a hierarchy need to be interpreted and relayed at each level – introducing errors in command just as insidious as the errors in communication up the chain of authority. And as the next

chapter demonstrates, political ideology has little to do with it – these are failures common to both public and private sector organisations alike.

2 Private or State?

Capitalism as currently practised is unresponsive, unaccountable and unreformed – despite much recent tinkering. As a result it is inequitable, insensitive and inefficient. More than a century ago Karl Marx predicted that it would fail – a prediction that it has become fashionable to view with amusement. Without fundamental changes in the way capitalism works, Marx may yet have the last laugh.

Corporations developed in the 17th century as a way to privatise the cost of establishing the British Empire in India and North America. As colonists it may have seemed appropriate to rule through a command and control hierarchy. Today, this is emphatically not the case.

Boards of publicly traded corporations in Anglophone cultures have absolute power to determine how their own conflicts of interest are managed. They are also able to recommend, if not determine, what they should pay themselves and how they report on their performance. When there is no dominant shareholder to supervise or mediate such conflicts, boards determine their own composition and also the process by which they become accountable to shareholders.

Investors, whether institutions or other less powerful shareholders, mostly do not bother to attend or vote at shareholder meetings. At least part of the reason for this

is that meetings are controlled by the chairman of the board, who manipulates the processes for electing directors, counting the votes and taking (or not) questions from the floor.

Few would deny that this is an accurate characterisation of “shareholder democracy” or that it is a travesty of genuine accountability. In an ideal world, shareholder meetings would be controlled by an independent governance watchdog board – elected on the basis of one vote per investor to protect “minority” interests and guard against fraud. At the very least, to avoid unethical conduct at a meeting, no officer of the company should chair it. It’s hardly surprising, therefore, that the very concept of a unitary board has been questioned by leading governance experts. Boards of directors, according to critics, are “marking their own exam papers”. The rationale for a board is “suspect”. The scale, complexity, importance and risks of company activities “have overrun our existing institutions of governance”.

Directors “mark their own exam papers” because their performance is measured by profits – and it is the directors who determine the size of the profits, irrespective of whether the financial reports conform to accounting standards. Such a statement may surprise non-accountants – although less so since the collapse of Enron. It may also surprise government officials who spend much time promoting accounting standards in the mistaken belief that they protect investors. In reality, profits are determined by how much the value of assets increases over liabilities in an accounting period. The

value of most business assets – stock, debtors, fixtures, fittings, plant, machinery and property – are subjective, and subject to manipulation and biases. Liabilities may also be based on subjective assessments. This is why the power to determine the accounting processes – the setting of the exam paper, in other words – needs to be removed from directors and subjected to the scrutiny of shareholders, stakeholders, regulators and society.

An unqualified audit is frequently taken as a corporate bill of health. Since Enron, perhaps, we have a better idea of how companies may receive an unqualified audit – and still collapse. Auditors can be manipulated by the directors, for example. Or the directors may have influenced the so-called “independent” experts – valuers, actuaries, risk assessors and so on – who are selected and paid by the board and whose valuation of corporate assets forms the basis of the audit. The integrity of outside experts, including auditors, must inevitably be compromised as long as they are hired and paid by directors. As already noted, there is an alternative – the independent governance watchdog board which is found in sustainable employee controlled enterprises around the world. Nevertheless, such considerations explain why many experts mistrust the concept of a unitary board.

In practice, even when directors are forced to report that they have “failed their exam”, they may not become accountable to their “examiners” – the shareholders – because they control the annual general meeting. Indeed, so wide has the

accountability gap become that, even when directors have failed, they not infrequently increase their own pay.

Non-executive directors are sometimes described as “independent”. With a unitary board, this is an oxymoron. The information supplied to the board supposedly enabling them to direct, control, evaluate, remunerate and dismiss management is provided by management – in other words, it is not, and cannot be, independent. There is no systematic process to provide them with quality, objective information to carry out their fiduciary duties of monitoring management. Without this – without the wherewithal to carry out an informed SWOT-type analysis (strengths, weaknesses, opportunities, threats) of the business – much of the rationale for a board is lost.

Failures and reform

The inherent flaws of a unitary board resulted in a number of high profile business failures in the 1980s. Various attempts at reform have followed. In the UK the Cadbury committee examined the financial aspects of unexpected business collapses – a narrow remit which effectively vitiated the report it produced in 1992. The inadequacy of its recommendations, however, did not prevent them being widely promoted around the world, with the result that minority investors in listed companies were lulled into a false sense of security with the Anglophone form of capitalism that relies on a unitary board. The same basic flaw undermined

the Greenbury recommendations on directors’ pay in 1995, the review of the Cadbury proposals by the Hampel report in 1998 and the Turnbull report of 1999 on risk management and internal controls.

On board pay, the simple fact is that directors control shareholder meetings and voting. Securing shareholder approval for their pay, like obtaining shareholder approval for appointing auditors, is yet another ineffectual ritual. Similarly, Turnbull did not address the fundamental problem that directors cannot obtain information independently of management. Describing non-executive directors as “independent” is both false and misleading if they lack both independent sources of information and the will and power to act. In such circumstances, the reliance of governments and regulators on non-executive directors to protect investors, or even creditors, is naïve and dangerous. However, it suits boards and institutional investors to perpetuate the myth that they can protect shareholders. For executives, the benefit is that they are monitored by people who lack the knowledge or the authority to hold them to account. Institutional investors, meanwhile, are reluctant to hold directors to account because of business links; non-executive directors, for example, may sit on both boards.

Public ownership

A dominant shareholder can force directors and managers to be more accountable. However, dominant shareholders can also

exploit public corporations for private interest, at the expense of the public interest. State ownership largely eliminates this problem but replaces it with another – the abuse of state-owned enterprises for party or political gain. A much better solution, irrespective of the means of ownership, is to distribute control and build in transparency through checks and balances on management and corporate power elites.

Privatisation has also been justified on the basis that it will increase efficiency.

However, for enterprises to make enough profit to attract investors through privatisation, prices must rise to cover this cost – unless there is an increase in efficiency without a corresponding reduction in the quality of service. The belief that private ownership can produce increased efficiency is based on the assumption that private investors have more knowledge, incentive and capability to direct and control managers than government officials.

In fact, public sector enterprises are subject to external checks and balances that do not exist in the private sector. The method of estimating profit is normally not under the control of its executives; the auditor is typically appointed and controlled by Parliament, not by the shareholder-Minister. Public sector auditors have a much broader remit than their private sector counterparts as they are commonly required to give an opinion on probity and performance. Directors are prevented from being self-perpetuating because elections, and government reshuffles, bring changes in ministers.

This is not meant as an endorsement of public ownership. Indeed public-sector efficiency cannot be assured, given the realities of political interference. Public sector executives may be tempted to trade off efficiency for reliability to minimise political embarrassment for their minister.

Nevertheless, the additional checks and balances found in government enterprises throw an uncomfortable light on their private sector counterparts. If they are good for one, why not the other?

Moreover, it's clear that for all the attempts at reform in the 1990s, enterprises are still failing, as they were in the 1980s, for reasons to do with oversight and accountability. Indeed, if the scale of the Enron debacle is anything to go by, matters may be worse than two decades ago. There is a clear need for an alternative – for a form of capitalism that by introducing such checks and balances, actually makes private-sector capitalism not only more efficient but more durable. If Enronitis is the disease now raging through capitalism, the next chapter examines the cure.

3 Networks In Action

According to Dee Hock, the founding chief executive of Visa International – the credit card company that is also one of the world’s most innovative and successful businesses – there is a second law of the universe which applies particularly to organisations. He formulated it as follows: “Nothing can be made simpler without becoming more complex.” The stakeholder co-operatives around the town of Mondragón, in the Basque area of Spain, provide an excellent illustration of this rule.

Around 53,000 people work in the Mondragón Corporación Cooperativa (MCC) – a large organisation by anybody’s standards. But this scale is broken down into over 100 primary worker co-operatives, associated into 12 different groups serviced by half a dozen secondary co-operatives.

The MCC is the most outstanding example of network governance in action. It also illustrates the value of “compound” boards – not least the competitive advantage they bestow. A compound board can have control centres within a firm, or outside it: Mondragón firms have both. A network of over 1,000 boards or control centres governs the MCC, providing an rich and inclusive web of stakeholder participation. Annual sales of the MCC in 2000 were £4.3 billion – the bulk of them in exports. According to a study for the World Bank, the Mondragón co-operatives

“are more efficient than many private enterprises... there can be no doubt that the co-operatives have been more profitable than capitalist enterprises”. It went on to say: “During more than two decades a considerable number of co-operative factories have functioned at a level equal to or superior in efficiency to that of capitalist enterprise. The compatibility question in this case has been solved without doubt. Efficiency in terms of the use made of scarce resources has been higher in co-operatives; their growth record of sales, exports and employment, under both favourable and adverse economic conditions, has been superior to that of capitalist enterprises.”

The 53,000 people in the MCC are not organised in a hierarchy but in a self-governing network of firms kept mostly to a human scale of around 500 people. According to evolutionary biologist Robin Dunbar, 500 represents a “critical threshold beyond which social cohesion can be maintained only if there is an appropriate number of authoritarian officials”. Dunbar argues that the capacity of the human neocortex limits, to a maximum of around 150, the number of people an individual can establish social bonds and trust with. Whether coincidentally or not, this is also the limit of the work groups within the primary co-operatives of the MCC.

The organisational architecture of the MCC enables it to overcome information overload by breaking down decision-making into manageable units. In the process, it allows ordinary people to achieve quite extraordinary results. Each

co-op is divided up into work groups: these nominate representatives on a workers' social council. The social council is one of the four main components in the compound board within a co-op. The others are the supervisory board, the executive board, and a "watchdog" board. The social council (not, it should be noted, executives) determines factors such as working conditions and the job ratings that govern the relative wage rates of workers. The supervisory board appoints the executive board, including the chief executive – a common practice in European companies. The watchdog board oversees the processes that seek to ensure accountability and good governance, including the audit. It calls in help from elsewhere in the MCC if serious problems occur or constitutional change may be needed.

When a firm grows to more than about 500 employees part of it is spun off into a separate business that becomes a supplier or customer. In this way a network of firms grows organically, to form a group that is managed with its own compound board. At group level, this board replicates the functions of the compound board of an individual firm. Groups, which may contain a dozen or more firms, represent a self-governing component of the MCC, each with its own compound board.

Each co-operative is a self-governing unit. However, it is free to leave the MCC if it wishes – and some have. But the co-ops are also governed by the requirements of its group. In some circumstances, the interests of the group can be overridden in the collective interest of the MCC system.

These organisational patterns are replicated throughout the MCC. Compound boards, for example, operate in the half-dozen "secondary" co-ops – so described because they are owned by the primary co-ops and provide services such as venture capital, banking, social security, education, research and development and retailing. These service co-ops include representatives of strategic stakeholders – not only staff but customers and suppliers – in their compound boards as a means of increasing feedback and thus efficiency. A crucial secondary unit of the MCC system is a "Godfather" venture capital firm that creates new firms, "imprinting" the system's DNA on these offspring companies. A condition of obtaining finance for a new firm is the establishment of an internal compound board – another network firm is thus created. Again, the MCC Bank requires firms that grow too large to divide, amoeba-like, into two smaller units.

In this way the MCC grows organically, by cell division, not by take-overs or by unlimited growth in its component parts. The newly created offspring firm becomes part of a group of related firms that in turn becomes a self-governing component of the MCC. It's a process that mimics nature's way of creating and managing complexity. The most successful processes for the most efficient construction and operation of components are replicated. The DNA of this process is embedded in the constitution of each firm and its contract of association with the MCC's banker. As with DNA, and as the MCC illustrates, these basic documents allow many different species of firm to be formed. Similarly,

many different types of financial institution make up the components of VISA International Inc.

The self-financing, self-governing architecture of the MCC minimises the need for State intervention and maximises local self-determination – in line with the aspirations of the Basque culture that dominates the Mondragón region. The MCC, in short, is a potent combination of empowerment, autonomy and efficiency yet the principles on which it works can be, and are, applied elsewhere.

Business networks

A similar network of relationships between businesses is found in a Japanese Keiretsu, for example. A Keiretsu is a complex, layered association of firms based around a big industrial “parent” company – a Toyota or a Matsushita. Some are suppliers, others are sales and distribution companies; many have been “spun off” by the group and are engaged in related businesses. The associative relationships in a Keiretsu are formed by what has been described as the “standard practice among Japanese companies to exchange small amounts of stock with lenders and business partners as a gesture of goodwill, sincerity and commitment”.

The benefits of a Keiretsu is that the network feeds back quality information to its influential shareholders independently of management. Yet the architecture of the network is similar to that of the MCC. Like the MCC,

offspring firms become customers or suppliers of the “parent” business, forming a network of organic relationships. And if the future of a Keiretsu firm is threatened, it is forced to re-organise in a similar way to the MCC. Some operations may be transferred to a better managed firm in the group, others may be sold or wound up with surplus staff transferred to other firms in the network. In both cases, solidarity within the network promotes self-regulation, protects stakeholders and reduces the need for government regulation.

The third example of successful network governance is the credit card organisation, Visa International. Visa has been described as “an inside-out holding company in that it does not hold, but is held by, its functioning parts. The 23,000 financial institutions, which create its products, are, at one and the same time, its owners, its members, its customers, its subjects and its superiors”. It has “multiple boards of directors within a single legal entity, none of which can be considered superior or inferior, as each has irrevocable authority and autonomy over geographic or functional areas”. Visa’s innovative network architecture was designed as a conscious break with top-down power structures and has enabled it to compete successfully against intense local and global competition in an exceptionally tough financial market.

A key argument of this pocketbook is that the ability of a network to self-regulate and to compete, survive and sustain itself in a dynamic environment depends on its architecture following the design principles found in nature. These

principles have only been identified over the last 50 years with the development of the science of governance known as cybernetics. Most current business networks do not meet the conditions for self-regulation and self-governance. Typically, they do not provide adequate feedback, with the result that errors go uncorrected and competitiveness is impaired.

Networks of publicly traded companies exist in Germany, France and Italy where they are used to extend control by small elites of owners or managers. They are a means for resisting change, especially alien take-overs: as a result they are resistant to market forces and competitive pressures.

It's a similar story in south-east Asia, where business networks have become a device for preserving the power base of establishment families and their political cronies. Their capacity to resist incremental change exposes them to disruption when external forces become overwhelming, as happened in the South-East Asian financial crisis in the 1990s. Associative relationships, in other words, can be excessive or inappropriate – to succeed, they must meet some fundamental design criteria. What these design guidelines should be is described in the chapter that follows. In essence, however, they are a form of organisational DNA – a means by which, as in nature, successful self-government can be transmitted and replicated.

The MCC's compound board is an essential feature produced by its DNA. For centuries, advanced economies have been “exporting” their defective institutional DNA to the developing world. Institutional investors in the UK and US

are currently trying to transmit their defective form of corporate governance, with its codes of “best practice” as formulated by Cadbury, Greenbury, Hampel, Turnbull and so on. Given the dominance of imperial cultures, reversing this flow of ideas is not easy.

Nevertheless institutional DNA can be transferred across borders. In Australia, for example, I changed the constitution of a start-up company to establish a governance watchdog described as a “corporate senate” and modelled on the watchdog boards found in the MCC firms. The senate was given the power of private veto over any issue in which the directors faced a conflict of interest but which did not benefit the company as a whole. The veto could only be overturned through a vote of shareholders – which would mean making the issue public. Transparency and accountability together are powerful disincentives to exploitation.

Claims that the network governance architecture of the MCC is culturally specific are also disproved by the existence of stakeholder-controlled firms like Visa, which is based in the US, and the John Lewis Partnership and Scott Bader Commonwealth, which are UK-based. All these firms invented variants of the compound board, despite being part of an Anglophone culture where command and control systems dominate.

Network governance, it seems, can be custom-designed – not unlike genetic modification in plants and animals. Indeed its history is to a significant extent one of natural evolution.

According to Manuel Castells, an authority on networks and author of *The Internet Galaxy*, the network enterprise “evolved from the combination of various networking strategies. First, the internal decentralisation of large corporations, which adopted lean, horizontal structures of cooperation and competition, coordinated around strategic goals for the firm as a whole. Secondly, the cooperation between small and medium businesses, pulling together their resources to reach a critical mass. Thirdly, the linkage between these small and medium business networks, and the diversified components of large corporations. And, finally, the strategic alliances and partnerships between large corporations and their ancillary networks.”

If business is moving from hierarchies to networking, shouldn't governance do the same? Dee Hock, who not only founded Visa but designed its global organisational architecture, saw his organisation as the antithesis of top-down power structures. “Industrial Age, hierarchical command and control pyramids of power, whether political, social, educational or commercial, were aberrations of the Industrial Age,” he wrote. They were “antithetical to the human spirit, destructive of the biosphere and structurally contrary to the whole history and methods of physical and biological evolution. They were not only archaic and increasingly irrelevant: they were a public menace.”

How these systems can be reformed to provide a better way of governing is the subject of the next chapter.

4 Design With Nature

Who provides the ideas which create successful businesses? The people in research and development? The marketing department? Sales? These are the most obvious candidates, from inside a company, at least. But suppose the answer came from outside? What would that tell us about the way a truly successful enterprise – whether it's a commercial business or something with larger social aspirations – functioned?

In fact, according to research reported in the journal *Management Science*, 80 per cent of the ideas for product innovations come from customers. The feedback from people who at least in current corporate law have no interest in, or connection with, a business, apart from buying its goods and services, turn out to be an invaluable resource. Why don't organisations make more use of this resource?

The answer, as we saw in the last chapter, is that some do. Indeed, as reported in a recent issue of the *Harvard Business Review*, several companies have adopted a radically new approach to research and development, equipping their customers with tool kits to design and develop their own products. But to capture this customer value, the *Review* report makes clear, a tool kit by itself is not enough: a company must also revamp its business models and management mindset. So before we start drawing wider lessons from the success of the Mondragón co-ops and Visa

International, it's important to be clear about what makes them so effective.

Five basic principles were used to design Visa International; these principles also apply to the MCC. The principles established by Visa's founding CEO to "re-conceive" the role of a global organisation were:

- It must be equitably owned by all participants. No member should have intrinsic privilege. All advantage must result from individual ability and initiative.
- Power and function must be distributed as widely as possible. No function should be performed by any part of the whole if it could be reasonably be done by a more peripheral part. No power should be vested in any greater part if it might reasonably be exercised by a lesser part.
- Governance must be distributive. No individual or institution, and no combination of these, should be able to dominate deliberations or control decisions.
- It must be infinitely malleable yet extremely durable. It should be capable of constant, self-generated, modification of form or function without sacrificing its essential nature or embodied principle.
- It must embrace diversity and change. It must attract people and institutions comfortable with such conditions and provide an environment in which they can flourish.

The MCC, meanwhile, has nine "guiding principles" that do not necessarily apply to VISA. These are:

- Balance. Between interests and needs; technological imperatives and social needs; financial needs of the firm and economic needs of members; members and management; co-operative and co-operative groups; co-operative groups and the host community.
- Future orientation. Planning must be orientated towards a future well beyond the time when the immediate problem has been solved.
- Organisational self-evaluation. Nothing is ever perfect. Frequent self-critical evaluations need to be built into the structure.
- Openness and non-discrimination. Membership is open to any person who can contribute as a stakeholder.
- Pluralism in politics. There is no identification with any political party or ideology. Individual members can freely express their views.
- Freedom of information – for members on all matters relevant to decisions on their rights and responsibilities.
- Complementarity. Individual co-operatives should buy and sell to each other as long as this entails no serious sacrifice.

- Formation into groups. Co-operatives associate in groups to achieve economy of scale and reinforce solidarity.
- Size limitation. This is based on the premiss that it is difficult for an organisation to remain flexible, democratic and efficient when it grows beyond a certain size.

However, there is a deeper similarity in the information and control architecture of Visa and Mondragón not revealed above. Like a Japanese Keiretsu and the John Lewis Partnership in the UK, both Visa and Mondragón illustrate fundamental natural laws identified by cybernetics – the “science” of governance. First, decentralised, independent information channels minimise errors in communications. Second, decentralised decision-making through a compound board minimises policy and operational mistakes. Finally, control “agents” are needed in sufficient numbers to match the complexity of the variables that need controlling. Organisations with all three features embody a kind of ecological architecture – one that obeys the laws of nature and indeed is used by nature to create and manage complexity. Life itself, it has been said, “evolves by building on its own complexity”.

It’s also worth noting that ecological organisations do not need to be publicly traded to be efficient – a point equally well illustrated by Visa, MCC or the John Lewis Partnership. Organisational networks in turn need to be limited to a human scale of around 500 people. And to enable trusting and efficient working relationships to be established, the

number of people in their component parts should very broadly not exceed 150.

How does all this affect the organisations we deal with in our everyday lives? More broadly, how might it affect the way we govern ourselves, politically and socially? The next chapter looks at how organisations need to be made more complex – in order to be simplified.

5 Human Scale Organisation

Network organisations have much to offer society. Designed properly, they will allow us to replace economic forces and market competition with social forces and political competition. They will harness the private self-interest of executives to the public good. They will improve the self-regulation of organisations and, in the process, re-energise democracy. Inclusive stakeholder constituencies will replace ruling elites and alienating command and control hierarchies. Currently we seem to face a choice between state-run enterprise or state regulation of privatised and public interest companies. Stakeholder governance provides an alternative. It also makes for efficient and economically-run enterprises.

This chapter explains some of the basic principles for establishing network governance. It attempts to give a flavour of the procedures and structures involved but it is by no means exhaustive. Those wanting a fuller account will find references to this at the end of the pocketbook. The aim here is to provide a brief and accessible summary, and an explanation of some of the likely benefits.

The first priority is to introduce a division of power. Self-governance works where an organisation has sufficient internal checks and balances. This means that stakeholders start to play a more formalised role, joining together rather than acting as isolated agents. The means for them to do this already exist in

many organisations in the form of employee assemblies, customer forums and supplier panels. However, rather than existing only at the whim of the organisation, stakeholders would have rights to join together in this way, and to comment on the running of the organisation as a whole.

These “stakeholder panels” would clearly lend themselves well to operating over the internet, with ground rules to ensure an inclusive process. This would create a dynamic flow of communication. As we saw earlier, customers, in effect, generate 80 per cent of the ideas for new products – although the process happens “accidentally”. Harnessing such stakeholder interests – by integrating it formally into the governance of a business – would therefore increase efficiency and minimise risk. If self-governance is proved to work over time, it would also reduce the need for stakeholder protection to come primarily from laws, regulation and bureaucracy.

There is no need to specify too rigidly how stakeholder panels would operate. They would, of course, take up people’s time, but it would be time freely given. They would benefit from access to information, such as the financial, social and environmental reports increasingly required of organisations, but they will also contribute information. They would thus present a huge opportunity to enrich democracy. If genuine power and influence were seen to be shared with stakeholder panels, many people would be inspired to donate their time and energy to them – in the knowledge that they will be making a genuine contribution to society. The tens of

thousands of volunteers who contribute their services at summer and winter Olympics illustrate this potential.

So far, it should be noted, this is a voluntary process, albeit one that needs to be entrenched in the constitution and culture of the organisation. However, two commitments are required if an organisation is to transform stakeholder involvement from, as it were, a voice, to a fuller role in network governance. The first is a commitment to transparency. For larger organisations, the only way that stakeholders can come together is for the organisation itself to create a “transparency mechanism” that enable this to happen.

A parallel exists with the Citizen Utility Boards (CUBs) of the US. These were promoted by the consumer advocate Ralph Nader as a watchdog for the (regulated) utility companies, accused of inefficient practices, bloated expenses and excessive remuneration. Utility customers in the US have a right to use monthly invoices from the companies to send out requests for donations and support to other customers. The CUB initiative involved asking customers for contributions to the cost of a small secretariat, independent of management, which would provide a informed response to the utility regulator on submissions by companies to increase prices. Hundreds of thousands of customers responded – in effect subsidising other customers who did not. The initiative worked: many price rises were rejected and even those customers who contributed to the CUBs recouped their costs in lower bills.

The legal requirement, whether enshrined in the articles of association of an organisation or entrenched by policy-makers in law, is therefore for organisations to offer a means for stakeholders – or at least those who wish to – to identify each other. One way of doing this might be via an internet website. It would operate for each class of strategic stakeholders, subject only to the voluntary exclusion of stakeholders who did not wish to participate.

Protecting stakeholder interests

Large organisations would thus enable each class of strategic stakeholder to nominate and elect their own panel. In turn, these panels could play a role not just of scrutiny but of active involvement in the business of the organisation. So, for example, supplier panels and customer panels would help to establish, or refine, modern management processes such as Total Quality Management or Just in Time supplies.

Signs of failure in the Independent Insurance Company in the UK or HIH Insurance in Australia, for example, would almost certainly have been discovered a couple of years earlier if the manner in which these companies had reinsured their risks had been compared by their reinsurance agents. A stakeholder panel of re-insurance brokers would provide a highly cost-effective method, for insurance companies, of protecting the interests of all stakeholders. With most business failures, certainly in regulated industries, there have

been stakeholders who knew of the problems well in advance but lacked a forum to share their concerns with others.

The second commitment required of organisations is to establish an overarching stakeholder council, capable of bringing together the different stakeholders into one forum. This council would be elected from stakeholder panels, who are in turn elected from the stakeholders themselves. The stakeholder council would offer feedback and oversight on all aspects of the organisation.

In the case of privately owned companies, the stakeholder council would have no powers to direct those running the business. Directors thus have the opportunity to consider the views of all stakeholders but remain primarily accountable to one stakeholder group alone – the shareholders. However, there would be scope for a direct link between non-executive directors and the stakeholder council – giving the former access to information and feedback their conventional counterparts would be denied.

In the case of public or voluntary sector organisations without shareholders, the stakeholder council could take on powers similar to those of shareholders in a public company – appointing directors, for example. In the public sector, this would be a departure from the appointment of boards, and indeed senior staff, by central government. A stakeholder council would offer a means of maintaining, indeed enhancing, democratic legitimacy and accountability. And its “multi-stakeholder” nature ought to prevent its capture by

any single interest. Self-government, meanwhile, would offer greater entrepreneurial freedom to managers to run public services. Government, at the same time, can lay down safeguards – for example, through contracts for services that are paid for out of taxation.

For organisations with or without shareholders, there is also a case for stakeholder councils to elect “senators” to act as a kind of corporate trouble-shooter – appointing auditors and other advisers, mediating between stakeholders, vetoing board actions if they take the view that a conflict of interest is involved. Typically, the senate would be composed of three people; it might not even need to meet physically, resolving issues by phone or e-mail. Its power of veto would be subject to ratification by the council if the board requested it; its elections would be independent of management.

The final important element is a body that represents the community. The make-up of this is decided by whatever political body has set up the enterprise – it might well be central government, for example. Similarly, names will vary, depending on the precise mix of functions. Its job is to represent all those stakeholders who are not regarded as “strategic” stakeholders in the senses already defined. And because it is composed of people who are not strategic stakeholders it can take an independent, long-term view. As such, it becomes the “genetic engineer” of the organisation, changing the architecture and constitution to suit changing circumstances, correcting design flaws that inhibit self-regulation, dividing up an organisation that has become too

large and so on. It therefore has a key role in governance, feedback and monitoring and should supply the chair of both the senate and the stakeholder council. Its role is probably best encapsulated in the title “community governance board”.

This is the basic architecture of network governance. First, stakeholder panels, enabled by the organisation but free-forming. Second, a stakeholder council, constituted slightly differently depending on whether the organisation is shareholder-owned or not. Third, a small group of senators, to act as arbiters of due process and network governance. And finally, the community governance board, representing the “unofficial” stakeholders, with a key role in organisational design.

Beyond this would lie a range of creative options for building an inclusive and democratic organisational culture. Shareholders, for example, could also elect senators – but on the democratic basis of one vote per shareholder rather than one vote per share. Senators would chair shareholder meetings – allowing directors, no longer compromised by their control of the meeting, to become genuinely accountable. Stakeholder councils could have the right to speak at shareholder meetings, to nominate directors and to advise shareholders how to vote – while the power to vote would remain with shareholders.

6 A New Way to Govern

On the face of it, the proposals outlined in the last chapter may sound like an extra layer of complexity for businesses to contend with. In part, this is true – it is a more complex structure. But there is a good reason for this. A basic law of the science of governance is that complexity can only be regulated with matching complexity. Humans beings have a limited ability to receive, process and react to information. Indeed the sheer complexity of modern business means that the duties placed on directors by corporate law are simply unrealistic – it is no longer possible to carry them out.

Similarly it has become physically impossible, and economically impractical, for central government to monitor the dynamic complexity of modern business to ensure the protection of its citizens from financial loss. In all but the smallest companies it is not realistic for directors to carry out a SWOT analysis (strengths, weaknesses, opportunities, threats) of the management team and the business, independently of management, without quality inside information from the stakeholders.

Network governance, in that sense, *simplifies* an enterprise because it replaces an inefficient form of regulation with an efficient one. The senate, for example, takes over many of the board’s regulatory duties – allowing the board to concentrate on performance. Stakeholder councils provide a system of

monitoring to match the complexity of a company's operations. They introduce a variety of information and control channels and decision-making centres – not only supplying feedback but “feeding-forward” information through these channels.

Stakeholder councils thus become essential for the running of large or complex businesses. For directors, they would provide a legal defence that they have established processes for carrying out their fiduciary duties to shareholders with diligence and vigilance. For governments, particularly in the case of regulated industries, the most compelling argument for them is that they provide an early warning system for citizens who might be exposed to harm or loss.

Yet there are wider lessons from network governance. As already noted, it suits human beings better. The divisions of power of a compound board introduces interdependency in relationships – and thus a sounder basis for the development of trust. As a result, it creates what we now call “social” capital – the human relationships that play no part in the balance sheet but vitally affect the success or failure of enterprise. But just as importantly, such network relationships allow the innate contrary characteristics of humans – competitive/co-operative, trusting/suspicious, selfish/altruistic – to emerge. These natural checks and balances, built into social animals by evolution, are suppressed in command and control hierarchies.

More generally, such principles carry an important message for government – and suggest a new role, and a new challenge, for it. Instead of straightforward market regulation, or direct intervention through bureaucratic hierarchies, government should take a step back. It should act indirectly – by replicating and transmitting the DNA of successful organisations. In practice, this means converting social institutions into almost self-governing inclusive stakeholder network organisations.

In nature, DNA carries the information for creating complex living things that must self-regulate to survive and replicate. The genes in DNA determine the nature of the species. The characteristics of the species are determined by the chemical code in the genes. This highly complex code is constructed from different combinations of a few simple molecular elements. The challenge is to determine the basic design rules to create organisations that manage complexity along the same principles evolved in nature. The reason for doing this – for following the rules of nature to construct ecological organisations, in other words – is that these rules, outlined at the start of this chapter, have proved to be the most robust way to manage complexity.

An attempt at rethinking the model of public enterprises has been made in the latest proposals for Railtrack and Welsh Water. Both are a step in the right direction. The blueprint for the new not-for-profit Railtrack, replacing the old shareholder-owned Railtrack, envisages a company limited by guarantee without shareholders. It is likely to have a board

of 12–15 executive and non-executive directors, with shareholders replaced by members – these would include the Strategic Rail Authority, private sector organisations and, possibly, rail employees, passenger groups and construction companies. Glas Cymru, meanwhile, owns Welsh Water and is a company limited by guarantee, set up because the previous owner (Hyder) could not raise finance for investment. Glas has members appointed by the board from nominations made by an independent panel. Members “should reflect the broad range of stakeholder interests”.

The assets of Glas Cymru are owned by a non-profit company limited by guarantee – the same structure is envisaged for Railtrack. This means that prices do not need to be increased merely to keep equity investors happy – to raise dividends, for example. In that sense, the proposals are an advance on what happened before. But both models retain the old way of governing – a unitary board, a centralised command and control hierarchy.

Putting different types of strategic stakeholder together on a single board is likely to exacerbate rather than mediate conflicts. The design rules used to establish Visa International and the MCC, identified earlier in this chapter, are consistent with deeper criteria for managing complexity, establishing self-regulation and enriching democracy. The proposals for Railtrack and Glas Cymru fail to meet them. Indeed, there has already been criticism of Glas Cymru’s governance structure and its lack of accountability

Markets appear to be efficient in communicating information. This is because prices are a number – and numbers can be very economically transmitted. In this very limited sense, then, markets are “efficient”. In reality, however, numbers on their own are meaningless because they contain so little *information*.

Implications for capitalism

For markets to operate well, they require far more data than price alone can supply – for example, the nature of the goods or services, the details and integrity of the parties involved. These are qualitative considerations, much richer information systems are required to transmit them and some are best communicated in person. Hence the need for social institutions that recognise these needs.

An important theme of this pocketbook is that shareholders are not “strategic” stakeholders. Indeed a major step towards the creation of genuinely self-governing corporations, and the democratisation of wealth this would bring, is the phasing out of equity investors. This would have the added benefit of ending some of the more conspicuous inefficiencies of capitalism and giving a new meaning to the concept of sustainable business.

It’s worth briefly explaining how this would work. It’s true that in some situations – start-up businesses where finance of the kind supplied to the Mondragón co-operatives is not

available – equity funding may be necessary. And there’s no doubt, as Chapter 5 made clear, that investors fit into the network governance model – they are, after all, a form of stakeholder. But any “sustainable” business must by definition become self-financing: unless a business can provide a return *of* its investment – a return, in other words, of the funds invested – it can’t add value and thus create the profit needed to provide a return *on* the investment.

Over the longer term, in fact, companies simply don’t need shareholders. Yet the concept of self-financing business has been strangely neglected in economic theory – you will not find it described in leading economic textbooks, for example. Many economists thus argue that privatisation is required to provide finance for a business to expand. They are wrong – expansion can be financed for public interest enterprises through cash flows from customers.

Phasing out investors

Unless investors are phased out with privatisation, however, inequalities in the distribution of wealth are bound to worsen. Investors won’t commit their money unless they think they will get all of it back – plus enough profit to compensate for the risk of losing it all – in the foreseeable future. For equity investors, the “foreseeable future” is typically under ten years – the so-called investment “time horizon”. Beyond this horizon, most bets are off – the incentive to invest does not rely on investors getting any

money back once this period has elapsed. The corollary is that profits obtained after the time horizon are excessive – in the sense that they are in excess of the incentive to invest. Such surplus incentives represent surplus profits that make the rich, particularly in rich countries, richer, and poor countries poorer.

“Surplus profits” is not a concept with which many accountants, economists, business leaders or even politicians will readily identify. But by over-rewarding investors and exacerbating the maldistribution of wealth, they constitute a major inefficiency of capitalism – not to mention a major source of inequity. Phasing out the original shareholders, while ensuring that they are provided with a return *of* and a competitive return *on* their investment, would go a long way towards correcting it. Governments are currently financing many public interest enterprises in this way – but with the ownership returning to government. The new way to govern involves corporations becoming self-governing and competitive without – in the case of public interest enterprises, at least – any shareholders at all. For other types of business, the strategic stakeholders could be phased in, replacing shareholders – and providing a big incentive for strategic stakeholders to participate in network governance.

Such an approach would nurture and enhance wealth creation in ways that simply do not happen when corporations are owned by institutional investors, small shareholders and share traders. These are the business structures that surround us, and that many people take for

granted, but we are beginning to understand that the world works differently. In that sense, modern economic theories can be likened to the Newtonian laws of motion. When formulated, over three centuries ago, they were appropriate – they appeared to explain the universe as then perceived. Since Einstein and relativity theory, however, we have discovered that the old laws of motion are inadequate. Current economic theories, similarly, are tied to a world of markets and hierarchies. They are inadequate for understanding that society can be governed in other ways.

A new economics would recognise the inherently contrary and variable characteristics of people and the physical limitations they face in attempting to manage complexity. It would be grounded in physical reality, not artificially constructed monetary values. The new way to govern would complement this new economics – enriching democracy and countering the potentially alienating forces of globalisation. It would reduce the size and cost of government and turn multinational corporations into nested networks of stakeholder governed organisations accountable to local citizens. In those circumstances, globalisation could become a force for self-reliance, self-regulation and self-governance; social institutions, meanwhile, would be more deeply rooted in their environment, helping to nurture and sustain life on the planet.

7 Network Governance

To sum up...

The collapse of Enron, and the failure of many other firms around the world, signifies a crisis in capitalism. In particular it signifies a crisis in the large “command and control” hierarchies – the top-down corporations with single unitary boards – that have become the dominant model of capitalism.

The inherent flaws of a unitary board resulted in a number of high profile business failures in the 1980s. Various attempts at reform have followed, from the Cadbury report of 1992 to the Greenbury recommendations on directors’ pay in 1995, the review of Cadbury by the Hampel report in 1998 and the Turnbull report of 1999 on risk management and internal controls. All these studies were vitiated by their continued reliance on a unitary board structure.

Command and control hierarchies are so ubiquitous that their shortcomings are regarded as inevitable. They can be summarised as: the tendency of centralised power to corrupt; the difficulty of managing complexity; and the suppression of “natural” – human – checks and balances. What we need, instead, are organisations which break complexity down into manageable units, decompose organisational decision-making into a network of independent control centres and provide incentives to executives – competing to be reappointed, for

example – which harness their private interests to the public good. Command and control hierarchies must be replaced by “network governance” in both public and private sectors.

Successful businesses that operate according to the principles of network governance include Visa International and the Mondragón co-operatives of Spain’s Basque country. The Mondragón Corporación Cooperativa (MCC) is the most outstanding example of network governance in action. A network of over 1,000 boards or control centres governs the MCC, providing an rich and inclusive web of stakeholder participation. The 53,000 people in the MCC are not organised in a hierarchy but in a self-governing network of firms kept mostly to a human scale of around 500 people. According to a study for the World Bank, the Mondragón co-operatives “are more efficient than many private enterprises... their growth record of sales, exports and employment, under both favourable and adverse economic conditions, has been superior to that of capitalist enterprises”.

Network governance involves the election of stakeholder panels – representing, for example, suppliers, employees and customers – which in turn elect a stakeholder council and a small senate. In public-interest companies, the council has powers similar to those of shareholders in a private firm. The senators appoint auditors and other advisers, mediate between stakeholders, act as corporate ombudsmen and can veto board actions where these are illegal or inconsistent with the corporate charter or where conflicts of interest exist. The community governance board, representing “non-strategic”

stakeholders, would supply the chair of both the stakeholder council and the senate and would have a key role in organisational design. In shareholder-owned enterprises, the stakeholder panels’ main role is to generate feedback for managers; but a senator would chair shareholder meetings. Beyond this basic architecture of stakeholder panels, stakeholder council, senate and community lies a range of creative options for building an inclusive and democratic organisational culture.

The benefits of this structure are that directors are no longer able to “mark their own exam papers”. Stakeholders provide early warning of business problems. High-quality, independent information is fed back to board level. And human diversity is expressed and reconciled rather than suppressed or filtered out. Network governance matches operational complexity with regulatory complexity by replacing Government regulation with self-regulation. It thus simplifies an enterprise because it replaces an inefficient form of regulation with an efficient one.

Equity investors should be phased out as part of this approach. Investors are not strategic stakeholders and are not necessary in genuinely sustainable – that is, self-financing – businesses. The replacement of investors with stakeholders would represent a major step towards the creation of genuinely self-governing corporations and the democratisation of wealth. It would also correct one of the most serious inefficiencies of capitalism – the generation of surplus profits. The money that now ends up over-

compensating investors would instead be distributed to strategic stakeholders.

Network governance mimics the processes used in nature to create complex self-regulating organisms. It creates ecological organisations – because ecological processes are the most efficient and robust way of managing complexity.

Organisations designed as ecological networks provide a broader template for governing society – in particular for controlling the excesses of the free market, enriching democracy, nurturing an economics based on quality rather than quantity and countering the potentially alienating forces of globalisation. They provide a model not only for business enterprises but for public-interest organisations and social services such as health and education. Ultimately the size and cost of government could be reduced and multinational corporations turned into nested networks of stakeholder-governed organisations accountable to local citizens.

Acknowledgements

NEF is grateful for the support of the Oxford, Swindon and Gloucester Co-operative Society for this pocketbook.

The author wishes to thank Ed Mayo, director of NEF, and Andrea Westall, deputy director, for their valuable contributions to this pocket book, and David Nicholson-Lord, series editor, for his help in improving the presentation of the ideas.

Sources and References

An academic version of *A New Way To Govern*, with notes and references, can be downloaded with other related academic works of the author from:

http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=26239

The academic version is based on the concepts and organisational relationships discussed in three other articles that can also be located at the quoted web site:

1. "Why unitary boards are not best practice: A case for compound boards", presented to the First European Conference on Corporate Governance, Belgian Directors' Institute, Brussels, November 16, 2000.
2. "Design criteria for a global brain", The First Global Brain Workshop (Gbrain O), Vrije Universiteit Brussel, Brussels, Belgium, July 5, 2001

References

3. "The science of corporate governance", *Corporate Governance: An International Review*, Vol. 10, No. 4, September 2002.

Other related professional articles can be downloaded from the World Bank, Anti-corruption Strategies web site at:

http://www.worldbank.org/devforum/comm_anti-library.html

The Corporate Library at:

<http://www.thecorporatelibrary.com/special/turnbull/index.html>

and from the Ford Foundation sponsored Capital Ownership Group virtual library at:

<http://cog.kent.edu/library.html>

The full text of the author's first book *Democratising the Wealth of Nations*, The Company Directors' Association of Australia, Sydney, 1975, is posted in the virtual library at:

<http://cog.kent.edu/lib/TurnbullBook/TurnbullBook.htm>

A full bibliography is available at:

<http://briefcase.yahoo.com/bc/shanturnbull>

The NEF Pocketbooks

NEF's Pocketbook series was launched in May 2000 with the aim of generating ideas, stimulating debate and pencilling in new possibilities on the social and political agenda. They combine the virtues of a book and a good newspaper article – an incisive read on an important contemporary issue in a handy pocket-sized format, long enough to provide genuine insight into a subject but short enough to be read on a train or tube journey. Their scope, focus and format makes them a highly distinctive source of radical thinking – big ideas for small pockets.

Already published in the Pocketbook series:

Why London Needs Its Own Currency, by David Boyle (2000).

NEF Pocketbook 1, ISBN 1 899407 278

Have we got our currencies wrong? Does a "one size fits all" currency like the pound, or even the Euro, condemn large sections of society to exclusion and hopelessness? Alternative currency expert David Boyle, author of *Funny Money*, argues that the new London government should set up its own parallel currency – *the Thames*.

The Case for Community Banking, by Derek French (2000).

NEF Pocketbook 2, ISBN 1 899407 308.

With the Government's proposal for a universal bank in disarray, this pocketbook sets out a practical alternative – a network of community banks that can fight financial exclusion in beleaguered urban and rural neighbourhoods

Stakes not Shares: Curbing the Power of the Corporations, by Roger Cowe (2001). NEF Pocketbook 3, ISBN 1 899407 359.

Big business has never had such power over our lives as it has today, and yet has never been run with so little regard for democracy. Guardian writer Roger Cowe says a “New Model Company” is required, putting the needs of communities, staff, customers and the environment on an equal footing with those of shareholders.

An Environmental War Economy: The Lessons of Ecological Debt and Global Warming, by Andrew Simms (2001). NEF Pocketbook 4, ISBN 1 899407 391.

Climate change threatens to overwhelm the planet’s life support systems yet we have failed to respond to its challenge. Writer and campaigner Andrew Simms points to the wartime experience of reducing waste and conserving resources as an example of how the developed world could start paying off its environmental debt to the planet.

The Mutual State: How Local Communities Can Run Public Services, by Ed Mayo and Henrietta Moore. NEF Pocketbook 5, ISBN 1 899407 405. Ed Mayo is executive director of the New Economics Foundation and Henrietta Moore is professor of social anthropology at the London School of Economics. The authors set out a radical agenda for public service reform, looking at the scope for citizens’ involvement in mutual/non-profit social enterprises.

NEF Campaigns and Programmes

Corporate Accountability and Social Enterprise

NEF pioneered social auditing in the early 1990s and has developed a strong track record as an independent centre of research, consulting and policy development on corporate accountability, and policy and practical innovations around social enterprise. Current work takes a critical but solutions-oriented approach on issues ranging from company law and the “fat cat” ethos to social enterprise policy and the role of non-profits and mutuals in public services.

Publications include:

Corporate Spin: The troubled teenage years of social reporting (Deborah Doane). Challenges companies to demonstrate that their glossy social and environmental reports make a difference. The report has been greeted with protests from the PR industry but widespread acclaim from companies themselves.

Micro-entrepreneurs: Creating enterprising communities (Peter Ramsden, Andrea Westall and Julie Foley). This collaboration with IPPR, the public policy think-tank, highlights the unexpected economic success of micro-enterprises in disadvantaged areas and calls for much greater involvement by financial institutions. The Inner City 100 index of fast-growing enterprises is a direct outcome of this work.

The Civil Corporation (Simon Zadek) A compelling road map, written by an authority on corporate responsibility, on how business strategists can connect new initiatives on social responsibility with hard commercial reality.

The Competitive Inner City (Peter Ramsden, Gareth Potts, Ed Mayo and Polly Raymond) A landmark report, charting the economic competitiveness of inner cities and the success of the UK's inner-city entrepreneurs.

An Ethical Door Policy (Deborah Doane and Ed Mayo). Documents the erosion of ethics in parts of the Socially Responsible Investment industry and calls for an ethical standard to ensure quality.

To order these and other titles contact Central books:

Tel: 020 8986 5488

Fax: 020 8533 5821

Email: mo@centralbooks.com

NEF's Publications Package

This package, popular with hundreds of individuals, libraries and policy and research groups, costs £95 a year. It incorporates NEF's award-winning monthly newspaper *Radical Economics*, plus at least four pocketbooks and six in-depth research and policy reports - a saving of over 30%, posted to arrive on publication day. It is an ideal way of keeping up with the important and fast-moving debates on issues such as social exclusion, local enterprise, community self-help, globalisation and the green economy.