“Companies that Mimic Life: The New Profit Leaders”

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Author: Joseph H. Bragdon and Jeanne V. Bragdon
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> *In 2006, SoL published Profit for Life: How Capitalism Excels, by Joseph H. (Jay) Bragdon. The culmination of dozens of years of research, the book made a powerful argument for the connection between organizational learning precepts and business success. Reflections published an early exploration of this connection with “Living Asset Stewardship: How Organizational Learning Leads to Exceptional Market Returns”? (Jay Bragdon and Richard Karash, Vol. 4, No. 1) The following article, coauthored with Jeanne Bragdon, summarizes Profit for Life’s key premises, and updates and reaffirms the strong investment returns of the 60-company learning lab it featured, the Global LAMP Index®.*

In the past few decades, the business world has been quietly undergoing a radical change. Companies that mimic living systems have been gaining market share over more traditionally managed firms, which generally model themselves on mechanical systems. These two management styles affect people and nature in very different ways. And this largely explains the differences in their market performance.

Firms that mimic living systems have an existential awareness that they are living communities of people, committed to serving other people, and that they all depend on nature for their sustenance. These companies instinctively put a higher value on living assets (people and nature) than they do on non-living (capital) assets because they recognize living assets are the source of capital assets, and the reason for their existence as firms.

This fundamental recognition creates spontaneous demands within the firm to live harmoniously and respectfully with the larger living systems on which we all depend (biosphere, society, markets). This desire to affiliate with life is enormously appealing to people. It explains why these companies tend to attract the most committed employees and strategic partners, the most loyal customers and the most patient investors.

Firms that think of themselves as profit-making machines, by contrast, place a higher value on non-living capital assets than they do on living ones. This predisposes them to trivialize life: to treat people and nature as tradable commodities, replaceable machine parts or moveable factors of production. When companies act on such tendencies, people feel threatened and withdraw. Employee morale suffers. Customer service declines. Just as the living systems approach becomes a reinforcing cycle of positive consequences, the mechanistic approach yields a cycle of negative consequences.

The contrasts between these two mental models of business have become increasingly evident over the past few decades. The ill effects of corporate carelessness, many of which weren’t apparent until tipping points had been reached, are now startlingly obvious. Global climate change, toxic waste accumulations, ecosystem destruction, and related public health issues have altered the ways we live, and we don’t like it. When given a choice of where to work or shop, most of us would rather support firms that respect life than those that trivialize it. It’s that simple.

To paraphrase Abraham Lincoln, people who trivialize life, like those who once condoned slavery, “blow out the moral lights around us.”• [1] They create a “house divided against itself,”• [2] which cannot stand because disrespect for life ultimately ends in ruin. It is self-destructive. And we know it.

The eminent biologist, Edward O. Wilson says humanity longs for a vision of a "continuous and unending future."[3] This is what attracts us to life affirming companies. Beyond that, we are drawn to activities that allow us to move beyond our self-centered focus, to embrace and enhance the living communities of which we are a part. Involvement in such enterprise, and the lure of meaningful learning, excites our higher (quantum) thinking capacities. The synergies are magnified when we work and learn with others inspired by the same goals.

In researching *Profit for Life*, Jay constructed a learning lab of sixty companies, collectively called the global Living asset Management performance (LAMP) index®. Each firm in the index is a pioneer in its industry of "living asset stewardship" (LAS). This term, used throughout the book, states the obvious that firms must nurture and steward people and nature the source of all their other assets if they want to have a future.

LAMP's Exceptional Market Returns

Since publication of *Profit for Life*, we retained an independent consulting firm to analyze the global LAMP index® in-depth as a prospective investment fund. In doing so, we went beyond the tracking method used in the book, which was a simple average of index price changes with dividends added in. This time through, we wanted to pick up the value of spinoffs for example, the extra return Hewlett Packard stockholders received when hp spun off agilent as well as the compounding effects of reinvesting dividends.

Northfield Information Services, the firm that performed the in-depth analysis, is a global consultancy that advises many of the world's largest banks and institutional money managers on measuring and controlling portfolio risk. The following table is taken from their study of the LAMP 60, in which they reported investment performance on both a market capitalization-weighted basis (column 2) and on an equal-weighted basis (column 3) compared to four large capitalization stock indices (columns 4 7).

> *Firms that mimic living systems have an existential awareness that they are living communities of people, committed to serving other people, and that they all depend on Nature for their sustenance.*

This table covers the 10-year period illustrated in *Profit for Life* (1996 2005) as well as the most recent calendar year result (2006). It affirms the superior performance of the LAMP 60 by both standards of measurement in relation to the four major benchmarks. Taking a closer look at the data, we see the equal-weighted LAMP index delivered top results in both rising and falling markets. The LAMP 60, when market cap-weighted, performed at the high end of benchmark results in all but one year.

Northfield's detailed analysis also revealed that, between 1996 and 2005, the average annual return for the equal-weighted LAMP 60 was more than one percentage point higher than results presented in *Profit for Life*. While we expected returns cited in the book were mildly understated, we had no idea the disparity would be this large.

Year-by-Year Comparison of LAMP60 vs. Four Large Cap Equity Indices, 1996-2006						
Year	LAMP60 Market-Weight	LAMP60 Equal-Weight	S&P Global 100	FTSE World Index	S&P 500	S&P 100
1996	27.24	28.20	23.54	12.79	18.84	23.54
1997	26.55	33.84	31.49	15.52	30.15	26.27
1998	33.07	33.73	34.68	23.02	28.58	33.21
1999	40.08	46.25	25.82	25.99	21.04	32.79
2000	-8.86	3.73	-14.33	-11.07	-9.09	-12.56
2001	-7.10	-2.10	-14.03	-16.14	-11.88	-13.80
2002	-19.38	-13.33	-23.57	-19.06	-22.10	-22.59
2003	34.88	42.55	30.92	33.88	28.69	26.24
2004	10.65	18.07	10.14	16.08	10.87	6.44
2005	7.48	12.28	5.46	11.32	4.89	1.16
2006	17.09	21.07	20.4	21.46	15.79	18.46
Average	14.70	20.39	11.87	10.34	10.53	10.83
Volatility	19.88	18.90	20.81	17.82	17.98	20.15

We were also pleased to learn that the market cap-weighted LAMP 60 had positive alphas risk-adjusted measures of "excess return" in relation to benchmark indices ranging from 3.02 to 4.02. To put these results in perspective, most institutional investors are delighted to have a portfolio alpha of 1.00 because few managers consistently beat an index after subtracting out their fees and trading costs. In calculating the alphas on the LAMP 60, Northfield imputed management fees and trading costs to the index in order to make a level comparison. The alphas they attribute to the LAMP 60 are therefore very compelling.

Northfield ran additional tests to determine whether the alphas of the market cap-weighted LAMP 60 were random or statistically meaningful. Included in this analysis were additional tests for "survivorship bias" the tendency for failed companies to be excluded from performance studies due to the fact that they no longer exist. Here too results were affirming. The probability that the LAMP 60′s stock selection process had randomly produced such positive alphas was far less than one in a hundred.

In concluding its study, Northfield applied a "style analysis" based on a "combination of indices that best match the return of the LAMP 60." 4 this approach yielded an alpha of 3.13 and indicated that our "selection technique was able to add value at the 95% confidence level." [5]

In sum, Northfield's analysis of the LAMP 60 affirms our hypothesis that companies modeled on living systems are gaining market share from those that model mechanical systems. This, we believe, is an adaptive response by a group of leadership companies to the growing social and environmental damage resulting from traditional business practices. It is an expression of life's relentless urge to survive.

Why Don't All Companies Adopt the Living Systems Model?

If companies that model themselves on living systems are so much more successful than their peers, it is reasonable to ask: Why aren't the means of their success better known in the marketplace?

The simple answer is: inertia. The mechanistic model is deeply embedded in traditional business practices because it has produced so many successes. It is rooted in over five centuries of empirical thought, which lifted the modern world out of a dreary feudal agrarian past and into the prosperity of the scientific/industrial age. The flowering of empiricism during the renaissance and enlightenment also supported a newfound faith in human observation, which later became associated with the ideals of individual liberty and the american Declaration of independence. In these and so many related ways, empiricism is associated with progress and growth. Its belief in clear, rational scientific methods is so ubiquitous it underpins not only our capitalist orthodoxy, but the dialectical materialism of orthodox Marxism.

Today, most leaders in business and finance indeed most business schools are so captivated by empiricism and its material successes that few dare to question its linear thinking assumptions. The most egregious failures of their habitual mode of thinking have become evident only with long time lags. Global climate change, for example, has been decades in the making. Nevertheless, most business/ finance leaders believe rational, scientific thinking is the very key to solving the environmental and social problems they have created.

We believe such blind faith in linear cause-and-effect thinking is misguided and dangerous because the living world in which business operates, including the firm itself, often behaves in irrational, chaotic non-linear ways. People don't like to be treated like commodities or disposable machine parts, and either resist, quit or become depressed when managed that way. Living systems that economists regard as "externalities," such as the earth's atmosphere, forests, soils, and waters are not as robust as they once assumed. There is a limit to nature's regenerative capacity. When overstressed these ecosystems go into decline or push back as in the form of severe weather events and public health hazards with dangerous consequences for all who depend on them.[6]

Just as the worst effects of the mechanistic business model have been decades in the making, so too has been the development of the living systems model. Initially, it was hard to distinguish between the two

because they were both corporate, premised on capitalism and used similar vocabulary. But, as the living systems model matured and learned through the decision-making of its leading advocates, its core operating assumptions, cultural norms, practices and metrics became more distinctly different.

The operating leverage in companies that mimic life is hard for conventional business leaders and analysts to recognize because they don't have the intellectual tools. To understand this leverage, we have to think in holistic terms because the essential properties of living systems are properties of the whole. They are found in synergies mutually beneficial exchanges of information and services within the organization that make the whole more than the sum of its parts. This is how living systems operate. It is circular, with multiple feedback effects. And linear thinkers have a hard time seeing it.

Attributes of Companies that Mimic Life

In general, we see five distinct attributes of firms that mimic living systems. Not every company in the global LAMP index ® is a perfect exemplar of these, but each fits the model in important ways and displays best living asset stewardship (LAS) practices in their respective industry/sectors.

- They are highly networked to facilitate feedback and information exchanges within the firm and without. Many of these networks are informal, self-organizing consortia of employees, suppliers, and customers. When you layer these networks over one another and the firm's chain of command, you get a structure that looks much like a double helix. [7]
- They manage by means (MBM), understanding that people and relationships are the primary means by which they build network capacity and create value. 8 they strengthen and empower employees by practicing servant leadership. 9 they also give employees decision-making authority in their areas of competence and hold them accountable for results.
- They optimize their use of physical resources by "closing the loop" so the waste of one process becomes food for another. 10 in doing so, they aim for factor efficiencies by producing more value for customers with less input of energy and materials.
- They are exceptionally open in the ways they share information with employees and in their desire for stakeholder feedback. They know such openness builds trust, learning capacity and adaptability.
- They nurture the larger living systems of which they are a part (nature, society, markets) because they understand the inherent connection of all life.

These five attributes generally describe the make-up of LAMP companies, and the things we look for in our analytic work. For readers who wish to gain a deeper knowledge of LAS, illuminated by in-depth case studies, *Profit for Life*is a valuable resource.

Endnotes

1. Lincoln-Douglas debate of August 21, 1858 in Ottawa, IL.
2. Lincoln-Douglas debate of June 17, 1858 in Springfield, IL.
3. Edward O. Wilson, "Biophilia and the Conservation Ethic," in *The Biophilia Hypothesis*, Stephen R. Kellert and Edward O. Wilson, eds. (Washington, D.C.: Island Press. 1993). Page 35
4. The T-statistic for results of the LAMP 60′s stock selection process ranged from 3.21 (market cap-weighted results) to 4.32 (equal-weighted results). These statistics indicate standard deviations from the mean, which tells us the likelihood that the LAMP 60′s alphas would occur at random. A T-stat of 3.21 is 3.2 standard deviations from the mean, which occurs only rarely.
5. Sandy Warrick, "Evaluating the LAMP 60″ . (Northfield Information Services. April 26, 2007). Page 15.

6. For additional background, see: *Ecosystem Change and Public Health A Global Perspective*. Joan L. Aaron and Jonathan A. Patz, eds. (Baltimore, MD.: Johns Hopkins University Press. 2001).
7. The term "double helix management"• was coined by Professor Karen Stephenson. See:. Art Kleiner, "Karen Stephenson's Quantum Theory of Trust,"• *Strategy & Business*, Issue 39. Fourth quarter 2002. Kleiner says: "She sees organizations as a sort of double-helix system, with hierarchy and networks perpetually influencing each other, ideally co-evolving over time to become more effective."•
8. The term "management by means"• was coined by H. Thomas Johnson and Anders Broms in their book Profit Beyond Measure (New York: The Free Press. 2000).
9. The term "servant leadership"• was coined by Robert Greenleaf, and was defined in his essay, "The Servant as Leader"• first published in 1970 by the Paulist Press. (repr., Indianapolis, IN: The Robert Greenleaf Center. 1991)
10. The best current source on "closing the loop"• processes is the *Journal of Industrial Ecology* published by MIT Press. See: http://www.yale.edu/jie/

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