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# The Third-Generation Corporation

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To appear in:
Pratima Bansal and Andrew Hoffman
Oxford Handbook of Business and the Environmennt
Forthcoming (2011)

Markets and commerce are as old as our species. As John McMillan points out in his wonderful book, *Reinventing the Bazaar*, the urge to engage in "business" seems to be part of the human DNA. Indeed, throughout recorded history, humans have traded with each other and engaged in exchange relationships for mutual benefit. "Markets" and "bazaars" have flourished for thousands of years. The invention of money only accelerated this phenomenon, and made it easier to exchange value (MacMillan 2002).

The "corporation," however, is a much more recent social invention dating back only about 500 years, to the age of discovery. The concept of "capitalism" is even more recent, rising to prominence in the mid-nineteenth century (Braudel 1992). There have been two main stages in the evolution of the corporation, with the third just now emerging (see Figure 1). The "chartered" corporation was born during the Rennaisance as an instrument of colonial conquest and subjugation. Over-reach, greed, and corruption led to its ultimate demise. The second-generation "industrial" corporation arose in the 19th century, was granted personhood in post-Civil War America, and ignited the explosion of "capitalism" in the late 19th and 20th centuries.

Once again, however, over-reach, greed, and corruption appear to have infected the corporate world. And with mounting environmental destruction and growing social inequity, we now begin to see the contours of a third generation of corporation emerging for the 21st century—the "sustainable" corporation. With this third generation of corporation, we may also be witnessing the beginnings of a new more "inclusive" brand of capitalism. After a review of the first two corporate generations, I devote the balance of this chapter to considering the prospects for the third-generation corporation, including the important research questions relevant to this emerging domain.

## CORPORATE GENEOLOGY

Beginning in the 1200s, the feudal system began to give way to renewed enterprise and commerce in the towns and cities of Europe. Indeed, "burghers" thrived and "merchants" set sail to take advantage of the vast resources of other territories during the 1300s and 1400s. The aristocracy, however, was virtually handcuffed since its wealth was tied up in the massive landholdings it had accumulated during the Feudal era. By "enclosing" and selling land (and thereby uprooting rural peasants and forcing them into the wage labor market), the ruling aristocracy, in consort with the most successful merchants, forged a new investment vehicle—the corporation. Through limited partnerships which provided for passive participation, the nobility finally had a means for expanding investment beyond their own landholdings (Rushkoff 2009).

The first-generation corporations were thus "trading companies" chartered by monarchs for reasons that had very little to do with exchanging value or carrying out market transactions. Through the ingenious use of limited liability and joint stock ownership, kings could empower those merchants most loyal to them with permanent monopoly control over specific colonial territories and industries. In exchange for granting legally enforceable monopolies, monarchs reaped profits far exceeding the worth of any cash investment they could have made (Robins 2006).

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The 1500s and 1600s saw the formation of dozens of large trading companies such as England's Merchant Adventurers, Holland's United East India Company, and France's Companie des Indes. North America was colonized by trading companies such as the Virginia Company and the Hudson's Bay Company (Nace 2005). The corporation that truly changed the world, however, was the British East India Company, founded in 1600: It pioneered the shareholder model of corporate ownership and built the foundations for modern business administration that continue to this day. With a single-minded pursuit of profit, the company and its executives achieved market dominance in Asia for more than 200 years. However, the company also shocked many with the scale of its excesses and human oppression (Robins 2006).

By the late 1700s, many leading figures of the time condemned the practices of the chartered corporations. Adam Smith, Edmund Burke, and Karl Marx were all united in their critique—for quite different reasons—of this domineering, oppressive form of commerce. For Adam Smith, the corporation was one of the great enemies of the "free" market and his writings clearly reflected this view. Indeed, the American Revolution itself was less a revolt by colonists against the Britain than by small businessmen against the market dominance of chartered multinational corporations (Zinn 2003).

To ensure that corporations did not come to dominate "life, liberty, and the pursuit of happiness," the founding fathers drastically limited the reach and scope of corporate power in newly independent America: Corporations could only be chartered by states (not the Federal government), were required to demonstrate a specific public purpose other than making money (such as building a bridge), and were allowed to exist only for a specified period of time. Just like Adam Smith, the founding fathers detested big corporations, and envisioned a “free enterprise” system populated by small-scale firms and farmers, unencumbered by large, remotely-run monopolies (Korten 1999).

By the early 19th century, chartered corporations were in their waning days. However, there was a new form of corporation emerging—the industrial corporation—which would greatly surpass its predecessor in terms of size, scope, and global impact. It is noteworthy, however, that very few people at the time saw this coming. Neither Adam Smith nor Karl Marx, for example, foresaw the reemergence of the corporation as a dominant institution: Both were influenced mainly by the situation in Britain where virtually all the giant chartered corporations had collapsed and the English industrial revolution was flourishing under quite simple institutional forms, such as family-owned enterprises, partnerships, and unincorporated companies (Rushkoff 2009).

In America, the corporation had experienced a revival, but through the first half of the 19th century, the state charter system had functioned to prevent the emergence of large corporations like the East India Company in England. Beginning in the 1850s, however, lobbyists for the newly emerging railroad corporations began exacting concessions from state legislatures. First, the Pennsylvania Railroad convinced the Pennsylvania State Legislature to relax the long-standing prohibition of one corporation owning stock in another. After the Civil War, Union war hero Tom Scott was able to use this exception to pursue his vision of a nationwide railway system. Through the use of a “holding company” structure, Scott was able to purchase a controlling interest in several smaller railroad companies, especially those in the south and the west (Nace 2005).

Scott emerged as the key power broker in determining the outcome of the disputed 1876 Presidential election involving Rutherford B. Hayes and Samuel Tilden.

In what has come to be known as the Compromise of 1877, Republican Hayes was selected as President by a special commission of Supreme Court justices and Congressmen. In exchange for the votes of the southern electors—and tacit approval of Scott's plan to consolidate the southern railways--Hayes agreed to withdraw the remaining Federal troops from the South, which enabled the old southern establishment to reestablish itself and opened the door to the "Jim Crow" system of sharecropping and black disenfranchisement (Painter 1987).

Over the next 30 years, through a series of court decisions, the legal restrictions on corporations were steadily eliminated. By the turn of the century, incorporation had become a perfunctory act, life span limits had been removed, corporations were free to acquire other companies, and they could expand to other states as they saw fit. But perhaps most significantly, through a quirk in Supreme Court reporting of the *Santa Clara County v. Southern Pacific Railway Company* decision of 1886, corporations were granted the rights of "personhood." Under the Fourteenth Amendment to the U.S. Constitution, written to guarantee the rights of citizenship to former slaves, corporate lawyers were able to apply the phrase "person" to include companies as well. This gave corporations the same rights to "due process" and "equal protection" as any other American citizen (Nace 2005).

These and other changes opened the door to the "Gilded Age" and the emergence of the giant railroad, steel, oil, and financial trusts led by "robber barons" such as Jay Gould, Andrew Carnegie, John Rockefeller, and J.P. Morgan (Morris 2005). Much like the first-generation chartered corporations, these giant trusts were built to restrict competition and take advantage of monopoly power. The Tycoons of the Gilded Age, however, were able to exploit the Social Darwinism that was rampant at the time to convince people that they were simply the "winners" in a Darwinian struggle for survival (Trachtenberg 2007). The result was the rapid emergence of the second-generation industrial corporate form and the creation of the mass market, consumer economy. Indeed, it was during the second half of the 19th century and early part of the 20th century that most of the iconic corporations still in existence today were born—General Electric, Ford Motor Company, and Proctor & Gamble—to name just a few.

Economic historian Karl Polanyi labelled this period "The Great Transformation" (Polanyi 1944). Prior to the 19th century, economic activity had been "embedded" in the larger society, subordinated to politics, religion, and social relations. However, with the emergence of the "capitalist" system of the late 19th century, the economy became increasingly "disembedded," with society subordinated to the interests of the market. This led inevitably to social backlash and popular rebellion—what Polanyi called the "double movement"--to protect society from the excesses of the market. It is no coincidence, therefore, that the labor movement, the transcendentalists, the communist movement, and the anarchists all find their origins during this period. Riots, strikes, bombings, and assassinations became commonplace.

The labor and conservation reforms instituted by Theodore Roosevelt and the "progressives" in the early 20th century can therefore be seen as necessary palliative measures to enable the capitalist system to continue to function; they addressed the most egregious excesses, but did not institute any fundamental structural changes to the system. World War I served to distract the industrialized world from these fundamental problems. The result was the return to excess after the war with the "Roaring 20s" followed by the collapse of the system in 1929 and the Great Depression (Hofstadter 1955).

Fifteen more years of depression and another World War followed. Significant reforms under Franklin Delano Roosevelt redressed some of the fundamental imbalances associated with the Gilded Age. But with the return to prosperity after World War II, the U.S. was now the dominant economic force in the World. And American corporations were seen as the key to her success: "What's good for GM is good for America" was the slogan of the times. Friedrich Hayek was a tireless promoter of market liberalism in the U.S. and directly inspired influential followers like Milton Friedman, Margaret Thatcher and Ronald Reagan (see Hayek 1944).

However, as we will see, the unresolved problems associated with the industrial corporate model would reassert themselves in the 1960s. Growing concerns over environmental pollution, social injustice, and, ultimately, global poverty and inequity would foreshadow the rise of the third-generation "sustainable" corporation.

## THE RISE OF THE THIRD GENERATION CORPORATION

Just as the first-generation chartered corporations generated a backlash which ultimately brought them to their knees, so today, second-generation industrial corporations are experiencing the same resistance and may be reaching the end of their era of dominance. Indeed, I believe that we are now 40 plus years into the next "great transformation" which began during the 1960s environmental revolution. Fifty years from now, our progeny will look back on this time much as we now reflect on the rise of the industrial corporate model in the 19$^{th}$ century. I will not review the transformational path of the past 40 years, as this has been done very well by recent authors (Hart 2010; Hoffman 2001). I will, however, seek to illuminate the significant differences between the out-going second- and emerging third-generation corporate forms (see Table 1). Each of these features is discussed in more depth below, along with the relevant research questions for each.

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**Behaving as a Disrupter**

Given that clean technologies are almost always "disruptive" to existing second-generation corporate strategies, moving to an environmentally sustainable form of enterprise *means learning to think—and act—like a disrupter* (Christensen 1997). It means launching small-scale experiments with next-generation clean technologies and growing them from the ground-up, rather than continued dependence on large-scale solutions imposed from the top-down (Hart 2011). Industrial corporations concentrated on limiting competition and protecting their established positions as incumbents; third generation corporations will instead focus their energies on creating the future rather than consolidating control over what already exists.

Some key research questions for the future, therefore, include: What proportion of corporate activity should be focused on "exploiting" current markets and technologies versus "exploring" new ones? How do the skills associated with "eco-efficiency" differ from those for disruptive clean technology commercialization? Do existing industrial corporations have the capacity to behave disruptively, or will they necessarily cede the field to entrepreneurial start-ups?

**Scaling Distributed Solutions**

The industrial corporate model was based on a high fixed cost, capital intensive business model, centered around large-scale centralized production. Over the past few decades, however, the conventional wisdom that "bigger is better" has begun to come under fire. Distributed generation of energy, point-of-use water treatment, and point-of-care health technologies actually display *diseconomies* of scale—the smaller, the *more* cost-effective. As a result, third-generation corporations adopting these strategies and technologies hold the potential to: creatively destroy existing hierarchies; bypass corrupt governments and regimes; and usher in an entirely new age of capitalism that brings widely distributed benefits to the entire human community of 6.7 billion people (Hart 2010). The "base of the pyramid"—the four billion poor earning less than four dollars per day--may turn out to be the ideal place to incubate these distributed technologies of tomorrow since they do not compete against an existing, centralized infrastructure (Hart and Christensen 2002).

Some key research questions for the future, therefore, include: Can industrial corporations premised on economies of scale shift their focus to small-scale, distributed strategies? Will new formal systems, metrics, and measures be necessary to enable this shift to occur? Will corporations based in the emerging markets of the developing world be more likely to make the "leap" to distributed technologies and business models compared to large incumbent firms from the West?

## Embedding Business Back into Society

Unlike their industrial predecessors, third-generation corporations are developing fully contextualized solutions to real problems in ways that respect local culture and natural diversity. This means engaging in *"deep* dialogue" with local communities to co-create businesses that are truly *"embedded"* in the local context. Such companies will come to view the communities they serve as partners and colleagues, rather than merely as "consumers." This mindset shift requires the development of a new, "native capability" to complement competencies in global efficiency, local responsiveness, and learning-transfer that most corporations already possess (Simanis and Hart 2009).

Some key research questions for the future, therefore, include: What is the best way for industrial corporations to acquire this new capability? Can such "on-the-ground" skills be taught or is it necessary to "learn-by-doing"? Are there current employees who can rise to this challenge or is it necessary to look outside of the existing corporation to find people and organizations with the requisite motivation and skill set? How do we create incentives for people to step up to this challenge without derailing their careers?

## Making Meaning Through Purpose

There is a persistent myth that the ultimate purpose of business is to maximize profit for the investors. However, the maximization of profit is not a purpose; instead, it is an outcome. Indeed, it is now becoming clear that the best way to maximize profits over the long term is to *not* make them the primary goal (Mackey 2009). Profits are like happiness: a by-product of other things like having a strong sense of purpose, meaningful work, and deep relationships. Those who focus obsessively on their own happiness are usually narcissists--and end up miserable. Third-generation corporations, therefore, understand that you make money by doing good things rather than the other way around. First, you make meaning through purpose, then the money follows (Mourkogiannis 2006).

Some key research questions for the future, therefore, include: What is required to generate a strong sense of purpose within a corporation? Can purpose be “dictated” from the top-down, or must is also emerge from the collective aspirations of the people in the organization? How can the management of “human resources” be re-conceptualized to include the development of the whole person? Do corporations driven by a strong social purpose outperform those with more conventional financial or business missions and goals?

**Shattering Trade-Offs Through Inclusive Capitalism**

Truth be told, there is no inherent conflict between financial and societal performance. Third generation corporations therefore consciously seek to overthrow the tyranny of the “trade-off” mentality. The key is learning to jointly optimize the needs and desires of all stakeholders, rather than elevating one stakeholder above all others (Freeman 1984). Paradoxically, such companies can evolve competitively superior strategies that produce superior financial returns--the definition of a truly sustainable enterprise (Sisodia, Sheth and Wolfe 2007). The lesson: "hit and run" players like predatory lenders and Ponzi scheme artists can make lots of money in the short term by ignoring or even damaging some of their stakeholders. But eventually the negative feedback loops catch up to them. Sustainable enterprises--those interested in flourishing for the long term--learn to delight all their stakeholders.

Some key research questions for the future, therefore, include: Can stakeholders be effectively included in the development of corporate strategy? Is it possible to connect stakeholders' interests together so that they become mutually reinforcing rather than competing interests? How should a firm measure "stakeholder value" which would include the *total* value created for all the stakeholders by the company? Do firms that create more stakeholder value consistently outperform others on purely financial grounds?

## CONCLUSION

While many today instinctively turn to government for solutions, the third generation corporation may turn out to be our best hope for a "sustainable" future—economically, socially, and environmentally. Increasingly, corporations are *global* in scope, making them ideally suited to address trans-boundary problems and international challenges. It is not by happenstance, for example, that some multinational companies have lead initiatives to address climate change (e.g. the US Climate Action Partnership), loss of marine fisheries (e.g. the Marine Stewardship Council), and sustainable development (e.g. the World Business Council for Sustainable Development).

Even more significantly, third generation corporations may be better positioned than governments to understand—and respond to—emerging societal needs. Not the broad and abstract "public interest" trumpeted by enlightenment thinkers, but rather the fine-grained, on-the-ground, "micro" interests of actual individuals, families, and communities (human and natural). Getting "close to the customer" is, after all, the stock and trade of the corporate world.

The profit motive can *accelerate* (not inhibit) the transformation toward global sustainability, with civil society, governments, and multilateral agencies all playing crucial roles as collaborators and watchdogs. Through thousands (or even millions) of business-led initiatives, we can innovate our way into tomorrow's "clean" technology, and welcome the four billion poor at the "base of the pyramid" into the global economy.

Unfortunately, research on the emergence of the third generation "sustainable" corporation has only begun to scratch the surface: To date, most peer-reviewed work has focused on the eco-efficiency agenda, which is focused more on incremental improvement to the industrial model than to transformative change. Why? Because there are large-scale data bases to be analyzed which enable sophisticated quantitative, hypothesis testing work. What is really needed at this point, however, is more prospective, action-research work which pushes the state of the art. As I argued over a decade ago, we need to move "beyond greening" (Hart 1997). A similar call can be found in the other chapters in the final section of this volume.

Indeed, as clean technology and base of the pyramid strategies gather momentum in the world, the opportunities to advance management theory have never been greater. Each provides important pieces to the sustainable enterprise puzzle: the promise of "next generation" technologies with dramatically lower environmental impacts, and innovative new ways to reach and include all of humanity in the capitalist dream.

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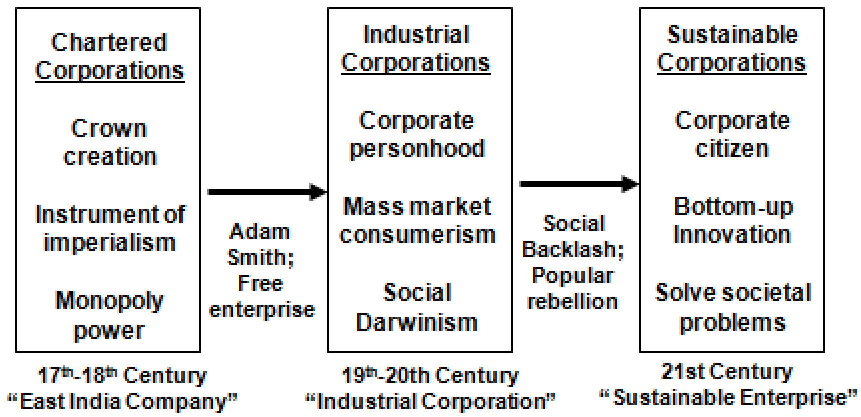
# Figure 1
# Three Generations of Corporations




# Table 1
# Comparing Corporate Models

- Industrial Corporation
  - Incremental; continuous improvement
  - Centralized; driven by economies of scale
  - Disembedded; tramples existing socio-cultural traditions
  - Extrinsic; motivated by fear or money
  - Extractive; practices zero-sum thinking
- Sustainable Corporation
  - Disruptive; change the rules of the game
  - Distributed; exploits diseconomies of scale
  - Embedded; builds on native traditions and knowledge
  - Intrinsic: motivated by meaning and purpose
  - Inclusive; shatters trade-offs among stakeholders