period of underperformance by U.S. corporations, writes Chancellor, assistant editor of Britain's *Breakingviews* financial commentary service.

After the Great Depression, "the priorities of leading businessmen shifted away from maximizing the profit of their companies, or their own fortunes; other goals, such as stability, continuity, and responsibility toward employees predominated." In 1984, Texas oil tycoon T. Boone Pickens upended the old order when he launched a takeover attempt of giant Gulf Oil, backed by innovative high-yield bonds floated by financial wizard Michael Milken. Pickens and later raiders promised to unlock the hidden values neglected by complacent "corpocrats."

Big business responded with the concept of shareholder value. The idea was to make managers more responsive to the interests of shareholders (who are, after all, the corporation's owners). Chancellor sees several consequences: "a focus on the core business; the use of financial engineering to reduce the corporate cost of capital; an emphasis on the business's ability to generate cash; the linking of managers' interests to those of outside shareholders through the use of executive stock options."

While there were benefits to the new approach, Chancellor believes many of them have been exaggerated. Did the reformed corporations invest capital more efficiently? Return on equity rose from 17 percent to 22 percent during the 1990s, suggesting that they did. But corporations took on piles of new debt in the 1990s (partly to buy back shares and boost stock prices). Add debt to equity, and the returns shrink to 13 percent. In this category, as in others, Chancellor argues, corporations actually did better in the 1960s.

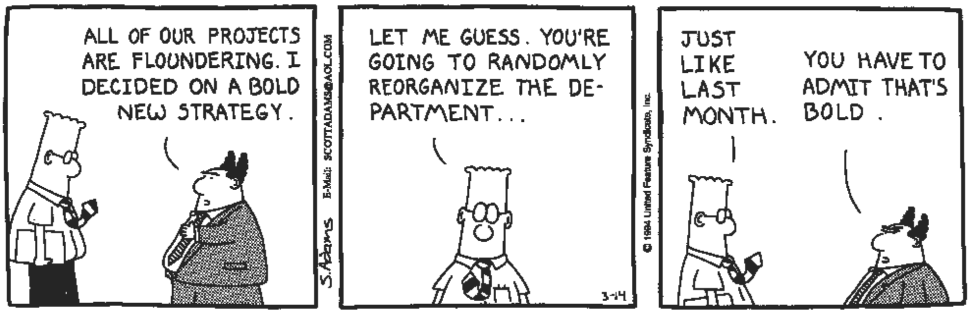
As we now realize, moreover, "the generous compensation of top executives with stock options has created an overwhelming incentive to manipulate earnings." It has had other effects: Unlike shareholders, options owners don't benefit from rising dividends, but they do benefit from rising share prices. "In 1995, the amount of money spent on [stock] buybacks exceeded outlays on dividends for the first time in history," Chancellor notes. On top of that, corporations with their eyes on short-term changes in the stock market made many bad long-term investments. The markets cheered as European telecommunications companies paid billions for licenses to operate new 3G mobile phone networks—never mind that demand was unknown and the technology untried. Today, many of those companies are basket cases. "Markets are constantly testing and discarding new ideas," Chancellor says. "The corporate world moves, or should move, at a much slower pace."

How to get corporations moving slowly again? Less emphasis on profits and shareholder value would help. "Great managers are motivated by the pride they take in their work" rather than by money, Chancellor thinks. Paraphrasing management expert Peter Drucker, he concludes that profit "is not the rationale of a business, just the test of its validity."

Strategic Dithering

"Tired of Strategic Planning?" by Eric D. Beinhocker and Sarah Kaplan, in *The McKinsey Quarterly* (2002, No. 2), available online at *www.mckinseyquarterly.com*.

In most big corporations plotting corporate strategy is a major production. Most have a top "strategy" executive with the usual bureaucratic accouterments, and put themselves through that elaborate and time-consuming annual ritual, the company-wide "strategic planning process." Yet in this respect, private-sector bureaucracies appear no more effective than that oft-derided administrative colossus, the federal government. Even CEOs and other high-level executives are cynical about the process. In reality, strategy is still made around the water cooler. "There is a lot of dancing, waving of feathers, and beating of drums" during the reviews, one executive told Beinhocker and Kaplan. "No one is exactly sure why we do



it, but there is an almost mystical hope that something good will come of it."

Based on their study of 30 companies, the authors (he's a principal at McKinsey & Co.'s London office, she's a former McKinsey staffer who is now a graduate student at MIT's Sloan School of Management) argue that the process can pay off in companies that manage it well. The trick is to avoid mounting empty "dog and pony shows" or hoping for brilliant ideas to strike like lightning. The best companies strive to create "prepared minds" rather than formulate concrete plans. "Success is more modestly measured by how well the review helps management forge a common understanding of its environment, challenges, opportunities, and economics, thus laying the groundwork for better real-time strategic decision making going forward," the authors write.

They have a number of other suggestions. For example, strategy sessions should be separated from talk about short-term financial issues, which almost always dominate such discussions. And "those who carry out strategy must also make it." A strategy concocted by the corporate strategy bureaucracy and outside consultants rather than by business unit heads and other frontline executives is doomed to irrelevance.

The Economics of Imperfection

"Behavioral Macroeconomics and Macroeconomic Behavior" by George A. Akerlof and "Information and the Change in the Paradigm in Economics" by Joseph E. Stiglitz, in *The American Economic Review* (June 2002), 2014 Broadway, Ste. 305, Nashville, Tenn. 37203.

If you were an undergraduate between the 1960s and 1980s, chances are that the name Paul Samuelson rings a bell. An economist at the Massachusetts Institute of Technology, Samuelson was the author of *Economics*, long the most widely used textbook in introductory college economics courses. *Economics* embodied something called "the neoclassical synthesis," the mainstream doctrine that arose out of the post-World War II effort to reconcile the ideas of John Maynard Keynes and those descended from Adam Smith. The fact that *Economics* is no longer the field's dominant textbook suggests what has become of the synthesis.

Akerlof and Stiglitz, of the University of California, Berkeley, and Columbia University's Graduate School of Business, respectively, shared the Nobel Prize in economics last year (along with Michael Spence) for work that has turned a good part of the economics discipline in a new direction. In their acceptance speeches, reprinted in *The American Economic Review*, they explain what happened.

The neoclassical synthesis—along with its updated successor, the New Classical economics—holds that markets always tend toward "general equilibrium." Whether the market is for factory workers or candy bars, in other words, supply and demand will eventually reach a perfect, albeit temporary, balance if left to their own devices.

In the real world, of course, that doesn't