

The Eightfold Path to Excellence in Corporate Accountability



Tachi Kiuchi, Chairman, The Future 500

A Guide to Corporate Governance and Accountability for Future 500 Companies

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The old ways that dominated thinking in the last century – the ways of the Fortune 500 – will not be sufficient to meet the needs of the future. Let me illustrate what I mean. In August 2001, Fortune Magazine – famous for the Fortune 500 – invited what they called “the smartest people we know” to a private conference in Aspen, Colorado, to talk about the future of business.

At the top of their invitation list was the Chief Executive Officer of a major energy company, Number Seven on the Fortune 500, and the Number One Best Managed and Number One Most Innovative on its Most Admired list.

That CEO was Ken Lay, then-CEO of Enron. The speech he gave that day gave only a hint of just how creative a company Enron had become.

Enron was not always built on deception. Originally, it was founded on a powerful and positive business model. It pioneered the new niche of energy management. It captured this solid business niche, and sales and profits exploded. Soon, Enron found it wasn't alone in its niche. Other companies copied its business model, but improved on it, shaving costs. At this point, if Enron had been adaptive, it would have responded to this competition by adapting.

Instead, it made a critical error. Enron shielded itself from true feedback. It created false feedback signals, its now-infamous off-the-books partnerships, and hid its losses there. Enron, it turned out, had learned to think not just outside the box, but outside the books.

Enron is not alone. Virtually every corporation – and our economy as a whole – represses key feedback signals. This creates comforting illusions in the short term. But without feedback, we fail to adapt. That puts our long-term health at risk.

I come to offer a different approach, one based not on the old ideas of the Fortune 500, but the emerging ways of what we call the Future 500. Eight steps, drawn from the examples of Future 500 companies, that I believe can advance the quality of corporate governance, avoid the Enron and WorldCom syndrome, and cultivate companies and corporate cultures of which we can be proud. Not all these steps are easy to take. In nature and business, adaptation is hard, but not as hard as the failure to adapt.

Some of my suggestions come from my experience as Chairman and CEO of Mitsubishi Electric America, and some come from my experience as a corporate Board Member and Officer for many years. Some I have learned from Future 500 companies such as Coca-Cola, Coors, General Motors, H-P, Mitsubishi, Nike, and others.

But my most important lessons about business and the governance of corporations did not come from these companies. My most important lessons about business I learned in the forest. Let me explain.

My first lesson in the forest happened 42 years ago, days after I graduated from the University of British Columbia. I was asleep when I got my lesson. This was unfortunate, because at the time I was driving a little British car through the forests of the Canadian Rockies. It is not advisable to drive a car through the Rockies when you are asleep. You might drive off a cliff, which is exactly what happened to me.

When I woke up in the hospital, I had plenty of time to reflect upon what I could learn from this incident. I remembered advice that my father had given me a few years before. He knew I was an adventurer, and a risk taker. He liked that, but he didn't want me to have too much of a good thing. So he took me aside and told me:

“Do whatever you want, but don't die.”

I wanted to call my father to tell him that I had taken his good advice. But my jaw was clamped shut. So I couldn't. He found out anyway. The Japanese Consul General saw an article on my adventure in the local newspaper, and sent it to him.

I have since passed along my father's advice to others. To me, this is what it means:

“Do what you want. Follow your purpose, but don't die.”

For a young man, driving off a cliff in the Rocky Mountains teaches a valuable lesson: stay alert; watch where you are going.

It seems to me that the global business community is driving quickly toward a cliff. As we speed forward, we close our eyes tight, and repeat our mantra, over and over:

“Maximize shareholder return, maximize shareholder return.”

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This mantra is like the wind against our faces. It is the stimulus that keeps us driving ever faster, rushing toward out destination, confident that our dreams will be fulfilled there.

The problem is, this mantra – to maximize shareholder return – does not provide us with an accurate sense of direction, to navigate the complex twists and turns that will enable us to avoid the cliff and reach a desirable destination.

Maybe that mantra worked fifty years ago, when business mostly traveled a straight road. When an economy is growing in a consistent and dependable direction – when we can predict our corporate future by extending a trendline from the corporate past – then running our companies like machines on autopilot can be functional.

But when an economy is changing in fundamental ways, when it impacts not just one culture but a global community of cultures, this single-minded focus can bring disastrous consequences.

Look at the debacles that destroyed Enron, Anderson, Adelphia, Tyco, WorldCom. Who can imagine that this multiple crash-and-burn is simply an anomaly affecting a few disreputable companies? Who can imagine that this does not suggest something systemic, that must command our full attention, to assure that we correct our course?

There is something big going on. Something fundamental is changing in our world. Andrew Grove, the former CEO of Intel, calls it an “inflection point in history”. After this time, nothing will be exactly the same as it was before.

It is dangerous to underestimate the challenge we face. A simplistic response, such as expensing stock options, will not get to its root. Yet I believe the true antidote is simple. It is to apply a principle that has driven the success of our companies for many generations. That principle is feedback-and-adaptation.

That may sound as simplistic as the idea of expensing stock options. But it is not. The success of the capitalist system is based on its capacity to harness marketplace feedback-and-adaptation.

Companies excel by driving in the direction that maximizes sales. That drives them to serve the needs of customers for higher quality and lower prices. And that delivers

higher returns to shareholders. Thus, in the past, shareholder return was a good indication that the company was creating value.

But no longer. Today, shareholder return is a less reliable indicator of the true creation of value, for two reasons. First, in an electronic age, it is too easy to foster manipulations that create the illusion of value. Enron is the most obvious example. Second, in a global economy, too many costs are externalized to people other than customers and shareholders, and never show up on the financial statements. As companies extend their reach thousands of miles from their headquarters, they become less and less tied to the communities they serve. They cut themselves off from feedback. They know nothing of their impacts on people, culture, health, or the environment. They subsist only on the shallowest feedback: direct internal financial returns.

This is dangerous. It leads, in effect, to false statements of corporate returns. These corporate statements ignore huge and growing cost categories. Because these costs are external, they build over time, to take dangerous and sometimes deadly forms.

Shareholders may not notice these unstated costs. But stakeholders do notice these costs. They notice the economic displacement when a new WalMart crowds out small local merchants. They notice the cultural shock when Coca-Cola, Disney, and McDonalds crowd out sacred cultural icons.

We only learn of the costs when they grow to explosive proportions: the Bhopal disaster in India, the Exxon Valdez in Alaska, Shell’s human rights tragedy, child labor issues for Nike, forest protection issues for Mitsubishi.

Consider the tragic events of September 11th. It is possible that these were in part a symptom of our blindness to feedback. We, the world’s wealthiest people, live in a bubble, shielded from daily contact with the three billion people on earth who subsist on less than \$3 per day. Three billion people! As global media and communications spread, these billions become ever more aware of the imbalance. Many become angry and hopeless. They become a base of support that can be manipulated by terrorist movements on behalf of their violent campaigns.

We cannot rely on governments to protect us. Wars may defeat today’s terrorist leaders, but more will follow them,

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fueled by what truly sustains their evil movements. That fuel is not petroleum. It is anger and hopelessness.

Global corporations are uniquely positioned to undermine the causes of terrorism, not directly, by military means, but indirectly, through sustainable economic development that binds the world together in the bonds of mutual self-interest and respect.

But the global corporation has a flaw that blinds it to the importance of this role. Its flaw is the common failure to get feedback at the local level.

So, the new Mantra for corporate America, Japan, and Europe needs to be this:

“Maximize stakeholder return; create value for every person we touch, anywhere in the world.”

And the new method must be this: monitor feedback from all corporate stakeholders along our path. As we grow more global in scale, our systems of feedback must become more local in focus. Only if we watch where we are going will we avoid the cliffs that we are otherwise blind to.

The old machine model of the Fortune 500 cannot do this. Instead, it is time to embrace a more advanced business model, one that will vest us with the agility, creativity, and responsiveness to navigate successfully the road ahead, the business model of the Future 500.

As many of you know, I believe this business model already exists. It is proven to be more innovative and adaptive than the traditional model. It is more capable of serving the interests of shareholders and stakeholders. It can monitor and adapt to feedback signals in our backyards, and across the planet, seamlessly. It is more motivating to our employees, more inspiring to our customers, more worthy of our life’s devotion, and it has stood the test of time.

Marshall McLuhan once said that he didn’t know who discovered water – but it certainly wasn’t a fish. In the same way, the new business model is all around us, so obvious that we do not notice it.

What is this better business model? It is, very simply, every person in this room. Life itself. The complex living system, with its extraordinary mastery of feedback-and-

adaptation—that is the business model of the Future 500. Imagine if our companies had the extraordinary adaptive capacities that we see in the complex adaptive systems of nature: in the rainforest, in the biosphere, and in ourselves.

I have eight specific recommendations to improve corporate governance and accountability, and help us master this new business model. Each step represents a shift from maximizing shareholder return, to maximizing stakeholder return. Each is already partially in place at companies like Coca-Cola, Coors, Dow, General Motors, Hewlett-Packard, Visa, and many of the companies in this room. But few companies have yet taken a systemic approach that includes all eight steps.

The first step is:

#1: Adopt a bold and visionary CORPORATE MISSION, one that envisions how your company will maximize the creation of value for your stakeholders, and through them, your shareholders.

Many companies already have a mission of this caliber, and know its power to drive performance. Coca-Cola is a recent example. It issued the Coca-Cola Promise, a pledge that it would benefit every person its company touched. The capacity of Coca-Cola to serve its stakeholders is immense. The company touches more than a billion people a day.

But a mission alone is not enough. The second step is:

#2: Conduct a regular ASSESSMENT of your success in maximizing return to stakeholders, and the benefits to shareholders.

Coca-Cola is again an example. In addition to its quarterly financial reports to shareholders, it measures its impacts on stakeholders. Coca-Cola North America has just begun to conduct what we call a Corporate Accountability gap analysis. I was the first CEO to commit to this gap analysis five years ago. The gap analysis ranks the performance of companies like Coke, General Motors, Matsushita, and Mattel against the criteria of twelve major stakeholder performance standards, including the Global Reporting Initiative (GRI), Dow Jones Sustainability Index, New York Stock Exchange governance, Goldman Sachs governance, Domini Social Index, Baldrige Quality Award, and others. It tells each company how much value it is creating for its work-

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force, communities, marketplace, and environment. If all these are satisfied, its shareholders will be too.

The third step toward excellence in accountability is:

#3: Develop INCENTIVE STRUCTURES that reward the creation of real stakeholder value on behalf of the corporate mission.

Within this category of INCENTIVES, I have three specific recommendations:

First, replace quarterly earnings announcements with six-month performance reviews. Today's system of quarterly earnings reports leaves too little time for true achievement. Even when accurate, quarterly reports are too easy to manipulate, through unwise acquisitions, cost cutting, or accounting. Six-month comprehensive reviews of corporate performance help focus executives on strategy and planning, not just spin.

My second recommendation for the corporate INCENTIVE structure is to compensate the CEO based on the company's gains in total productivity — labor, resource, and capital productivity — compared to competing companies. To the outside world, it often seems that the basis for executive compensation is to ask: how much money do we have left in the bank? We used to compensate CEOs based on gains in labor productivity. That made sense when we were industrializing, because labor productivity measured the gains from industrial machines and assembly lines. But today, total productivity is a better basis than labor productivity alone. In an information economy, the total productivity of energy, materials, capital, and labor all increase as we apply knowledge and information. Total productivity is often a good indicator that a company is creating value both for shareholders and stakeholders.

An excellent example is Coors Brewing Company. Former CEO Bill Coors developed what he calls the closed loop system, a corporate culture, backed by internal incentives and accounting, which focused on increasing the productivity of resources: materials, energy, chemicals, and so on. His closed loop system rewarded employees for every idea and innovation that drove consumption and waste toward zero. Hazardous waste dropped 90%, regulatory costs declined, the company became more cost-efficient, and its shareholder and environmental performance improved.

My third recommendation for corporate INCENTIVES is to encourage stakeholder performance up and down your whole supply chain. For example, when I was CEO, Mitsubishi Electric America specified that our suppliers could not provide us with paper or timber from old growth forests. Once we set the example, 400 other companies followed our lead. Together, our little effort saved four million acres of forest, and triggered what environmentalists call the biggest gain in North American forest protection in seventeen years.

This last action — being accountable up and down your supply chain — is vital. Companies like Mattel have established superb systems that monitor the human rights impacts of some of their most distant suppliers. This is an essential form of feedback that protects the company from reputation damage, but also helps serve stakeholders the company could not otherwise reach.

Recently, Future 500 companies initiated a new project to help us reduce risks associated with our supply chains. Through the Supply Chain Network, we help protect our companies from liability, insulate us from conflict, and most important, help us create value for our stakeholders. Please give me your business card if you may wish to participate in the Supply Chain Network.

Once your Incentive and Supply Chain structures are in place, the fourth step is:

#4: Adopt MANAGEMENT SYSTEMS to help you manage the company toward maximum stakeholder return, and measure your step-by-step progress.

The old Fortune 500 approach to management systems was to look for the one "best" management theory, and just apply that. But recently, we have begun to realize that different management theories work for different purposes. If we just want to grow — along a straight trend line — we can apply Fredrick Taylor's theories of Scientific Management, which fueled the success of Ford 100 years ago.

If we want to improve, and increase quality, variety, and efficiency, then we can apply Edward Deming's theories of Quality Management.

If we want to break apart bureaucracies and restructure, we might apply Michael Hammer's Re-Engineer-

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ing. If we need to reinvent our companies in a crisis, David Hurst's theories of innovation and renewal are effective.

Today, Future 500 companies realize we must apply all four major theories of management. We do this, in part, through new management systems. At Mitsubishi Electric America, for example, I committed our company to a system of Sustainability management that has now been adopted worldwide. WSP Group has developed a system of Integrity management. And many companies in this room have systems of Quality management and Environmental management.

But even most of these systems, which derive mostly from the ideas of Deming, lack one quality essential to corporate success in the future. They fail to generate feedback from stakeholders beyond our employee and customer base.

That brings me to step number five:

#5: Establish a STAKEHOLDER ENGAGEMENT SYSTEM, to monitor and solicit feedback from your stakeholders, and help you identify the opportunities to create real value.

Stakeholder engagement means active two-way communication between your company and all your stakeholder groups, local and global. This may sound like an enormous challenge, but it is manageable, and profitable. For example, Weyerhaeuser Canada's stakeholder engagement includes a joint venture with Native Americans. Together they do sustainable harvesting of timber in British Columbia. BP has regional stakeholder forums that draw the company into dialogue with stakeholders in its key locations, giving them both financial and political support. In Africa, ExxonMobil works with community stakeholders to fight malaria, and gains support when they seek local resource rights. Pfizer developed a treatment for the leading cause of preventable blindness. It donates the drugs, and helped fund the infrastructure to distribute them. Merck gives away its drug Mectizan, which cures the common affliction of river blindness. Dow and Dupont compete against one another for the most profitable stakeholder processes. Their programs deliver lower risk, lower regulatory costs, product improvements, and innovation.

So those are the first five steps: **Mission, Assessment, Incentives, Management Systems, and Stakeholder Engagement.** Each of these moves us further from the Machine model of business. Each moves us closer to the Living Systems model of business, where our companies are designed to support the living systems that support us. But alone, these steps are not sufficient. To illustrate the next steps we must take, toward a living economy, let me begin the last part of my talk with a short story.

Three years ago, several executives and I boarded a small plane in Costa Rica, and flew out over the dense tropical rainforests of Tortuguero, to begin an adventure we are still continuing today. Looking over the miles of green that stretched out below us, it was easy to imagine the rainforest as a place of great resource abundance. But it is not. The rainforest is constantly short of resources. Its soils are thin. Minerals are leached quickly by the rain. Even sunlight and water are scarce at the forest floor, blocked by the dense canopy above.

Yet despite this scarcity—or because of it—the rainforest is the most effective value-creating system in the world.

1. It is home to two-thirds of our biodiversity;
2. It is a catalyst for breakthrough innovation and continuous improvement;
3. And it is the kind of place that created all advanced life, even our own.

How does the rainforest develop this capacity? We began to understand when we stepped off our planes in Tortuguero, boarded small boats, and began winding our way along the river.

Around every turn, birds were standing, perched almost like statues, in the mangrove swamps along the edge of the water. Mangroves are pioneers. Ecologists call them r-Strategists, r for reproduction. Their survival strategy is simple: high fertility and fast growth. To support that growth, the mangroves have huge appetites. In fact, pioneers are among the least efficient plants on earth. But they do their job: the mangroves create a swamp.

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Now, oddly enough, a mangrove swamp is not a very friendly place for a mangrove plant. As they grow and die, the mangroves fall to the ground and create debris. The debris builds up to form soil, which strands the mangrove plants high and dry. There they die, atop the very soil they created.

But the mangroves have served their ecological purpose. They create homes, niches, secure places where creatures begin to appear. Insects, fish, plants, birds. These remain even after the mangrove move on.

The mangrove to me is a bit like today's industrial economy. The pioneer industrial economy exploded across our landscape, consuming huge amounts of resources, according to the classic r-strategist system: fast growth, high fertility. They create economies of scale, to replicate identical products by the billions. Like the mangrove, industry's pioneer phase will be short-lived. But if we learn the lesson of the mangrove swamp, we can now harness the fabric laid down by industry, and begin to cultivate a richer, more diverse and resilient human ecosystem as well.

So far, our learning has not been perfect. For example, by failing to account for its losses, Enron grew unsustainably. Then, because it failed to adapt, it collapsed.

Much of our Industrial economy has been operating on an accounting system much like Enron's. We too are blocking feedback. We are ignoring ecological and social costs and benefits that should appear on our balance sheets.

One way we do this is the way we account for hydrocarbons. When we buy hydrocarbons, we don't count the cost of creating them. We just count the cost of extracting them, ready made, from the bank—the earth. That's like valuing our life savings according to the cost of driving to the ATM to withdraw them. What is the difference between Enron's habit of hiding costs in off-the-books subsidiaries, and our economy-wide practice of hiding the loss of natural capital by keeping those off the books? The impact is the same as with Enron. There is no feedback.

No feedback, no adaptation. No adaptation, no innovation. We slow our response to change. We make ourselves vulnerable. Gradually, the feedback signals grow

louder, until we finally are forced to react to them. They take the form of Bhopal, Valdez, and global warming.

Now, in addition to ecological costs, new social costs are also beginning to become more obvious. Today we face the prospect of war, to fight terror and prevent the spread of weapons of mass destruction.

It is not acceptable for corporations to sit on the side as governments use the power of military threat and war to impose an insecure peace on the world. I suggest that we in the corporate world take an active role, and restore the tradition of business as an agent of betterment for humanity. We have the power to help bind together the diverse peoples of the world, sustainably, in mutual self-interest.

To begin to do so, the sixth step is:

#6: CREATE VALUE FOR THE POOREST IN THE WORLD, the stakeholders through whom the greatest mutual benefit can be delivered.

Follow the examples of Henry Ford, George Merck, Yataro Iwasaki of Mitsubishi, William McKnight of 3M and others, the inspired business activists who created some of the first great companies. Their greatness is not that they saw opportunity in selling to the already wealthy. Their greatness is that they saw opportunity in the poverty of the masses. The poor became their customer base, and ceased to be poor.

And here we are, gathered here today: To serve those stakeholders, and begin to share the blessings of our world, we must fully enter into theirs. We must see what they see, feel what they feel, value what they value. Then, we must act on the basis of this local feedback first.

This disrupts the rigid centralized machinery of the old Fortune 500 business model. Yet it is the essence of adaptability. Our choice is the same as it is for an organism in the rainforest: adapt or die.

Furthermore, this is the only worthy path to follow. Each dollar of economic development with the poor produces far greater incremental gains in quality of life than would a dollar created for the already wealthy. And, as Henry Ford and George Merck discovered, creating wealth for the poor creates health for the whole economy.

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Imagine what today might be like, if a generation ago we had begun to create opportunity for the poor in the Middle East and Africa. Imagine what it will be like a generation from now, if we do not do so starting today.

Many companies are beginning. At cafes in India, Ben and Jerry's Unilever can deliver ice cream for just two cents a portion because it has redesigned its refrigeration technology. A few steps away, at a kiosk set up by Hewlett-Packard's E-Inclusion unit, people who could never afford their own computer can access the Internet. Access means the capacity to learn, to start small businesses, to secure supplies at competitive prices, to break out of patterns of poverty. To serve the people who use these Hewlett-Packard Internet kiosks, Citigroup can now provide financial services to people in India with as little as \$25 to save and invest.

If the value created by these and other corporate programs for the poor and the suffering were added to our income statements, they might be among our most profitable endeavors. And, their positive Return On Investment might motivate us to expand them.

So, let's ADD those contributions to our annual reports. Step number seven is:

#7: Issue an ANNUAL REPORT TO STAKEHOLDERS that is as systematic as your annual report to shareholders.

Corporate leaders like Shell, BP, 3M, Dow, and GM already do so. The first group of stakeholder reports have a long way to go before they become the strategic compass that guides the corporate path. They often seem more like public relations documents than reflections of corporate priorities. But they are getting better. The current standard of excellence for Future 500 companies is what we call "GRI-Plus" reports, a system of annual reporting that meets the specifications of the Global Reporting Initiative, Dow Jones Sustainability Index, New York Stock Exchange, and Domini Social Index.

If your company is issuing Annual Reports that meet these standards, or would like to, please give me your card. We are working with Future 500 companies like ERM and Ecos Technologies on software to automatically compile reports that meet the expectations of each of the many different reporting agencies, from GRI to Domini and others. By reporting against the "GRI-

Plus" expectations, companies assure that they monitor feedback from a diverse and continually changing set of stakeholders.

For global companies, these stakeholders must include a special focus on the world's developing populations. Today, 600 million of the Earth's inhabitants – in Europe, Japan, and the United States – enjoy the material benefits of industrialism. Soon, 2.5 billion more – in China, India, and the former Soviet Republics – will join us. And after them, the final 3 billion will seek the same. More than a billion of our stakeholders survive on less than \$1 a day. Yet they demand and deserve to share in the benefits we enjoy.

To do that today, we need three planets. But we have only one. In the face of limits, how can the needs of the world be met?

The old way of thinking was that only the fittest survives. There is only one winner. This is the way of the mangrove jungle in nature and the way of the old Fortune 500 in the economy. In a simple, primitive system, only the one fittest survives. But in the rainforest, the law takes a different form. From these simple early forms, a complex ecosystem emerges, filled with a rich array of niches.

In the rainforest, the law is: Survival for all who fit. The same can be true in our economy. In a rainforest economy, it is not a question of who is most fit – west or east, north or south, industrial or developing, corporate or NGO. It is a question of where we all best fit.

If we in the corporate community fit – if we solve a social problem, fulfill a social need – we will survive and excel. If we only create problems, we will not.

I am often asked whether the needs of the corporation and the world are in conflict. I do not believe they are. In the long run, they cannot be.

Conventional wisdom is that the highest mission of a corporation is to maximize profits. Maximize return to shareholders. That is a myth. It has never been true. Profit is just money. And money is just a medium of exchange. You always trade it for something else. So profits are not an end. They are a means to an end.

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My philosophy is this: We don't run our companies to earn profits. We earn profits to run our companies. Our companies have meaning and purpose, a reason to be here.

People talk today about businesses needing to be accountable, as if this is something new we need to do, on top of everything else we do. But corporate accountability is not something that one should do as an extra benefit of the business. The whole essence of the business should be accountability. It must live for a purpose. Otherwise, why should it live at all?

That suggests my final recommendation, step number eight:

#8: LIVE the mission of your business. Make THAT – not your 90-day earnings report – the map to guide your course.

Listen to feedback from all your stakeholders, and constantly seek to create real value that serves each of them. For the Mission of Business – the Mission of Civilization – is to further the path of development that began in the rainforest, the same path that cultivated human civilization and supports us today: to develop the human ecosystem, sustainably, in all its diversity and complexity.

What I learned in the rainforest is easy to understand. We can use less, and have more. Consume less, and be more. It is the only way. For the interests of business, and the interests of environment, are not incompatible. They are the east and west, north and south, Islam and Christendom, yin and yang, product and process, economy and ecology, mind and spirit – two halves.

Only together can we make the world whole.

