

What is Right and Good Management?

m.o.m.®-Letter



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Prof. Dr. Fredmund Malik

## The Great Transformation 21

- Understanding the connections
- Recognizing patterns
- Economics alone means less and less

Keywords: Great Transformation

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## Foreword

The «**Great Transformation 21**» is seizing the Arab world with tremendous force. Traditional forms of organization are collapsing in the **burgeoning complexity** of the systems there.

In 2007, in my book «Corporate Policy», I wrote that knowledge is more important than money, and that information is worth more than authority. Compared to the **complexity of knowledge and information**, and the way they can be disseminated via modern communication systems, the wealth and previous authority of the regimes in parts of the Arab world appear to a large extent helpless.

However, in order to be able to function, the new governments now also need **new organizations and new methods** to manage the brutal transformation. Conventional democracy, the solution aimed for by many, will only be able to provide temporary hope for a very short time, if at all, because in its current «Western form» it is unlikely to work. What is needed is a **new organizational foundation**.

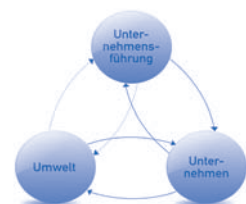
St. Gallen, in February 2011

Sincerely yours,

Prof. Dr. F. Malik



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## The Great Transformation 21

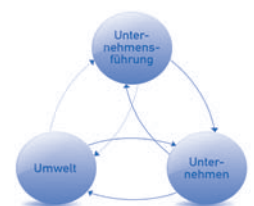
The economy and society are going through one of the greatest transformations in history. This transformation can best be understood as the transition from an old to a **New World**. What looks like an economic crisis on the surface is in reality the birth pangs of a New World in which nearly everything will be different from the way it was before.

Back in 1997, while writing my book on corporate governance, I selected the term «**Great Transformation**» to describe the fundamental change already emerging. At that time, one could recognize that most social organizations were facing radical change. The organizations that would cope successfully with it would transform their **management systems**, and therefore **the way they function**, in a fundamental way. All components of the management systems, such as strategy, structure, processes, culture, the skills of executives themselves, the policies and missions as well as the navigation systems, decision-making and problem-solving processes, and the communication systems would have to adapt and, to a large degree, would have to undergo radical and revolutionary change. This development is now in full swing and is currently accelerating faster and faster under the influence of **innovations** in almost every relevant field.

This transformation process is far from ending. In just a few years, many of today's global Fortune 500 companies will no longer exist, or not exist in their current form. To give you an example, in 2007, the Fortune 500 list in the U.S. included 11 house builders – today, there are none. Nearly all of the «masters of the financial universe»-companies, including the most distinguished disappeared overnight. Others will follow and new ones will emerge, but they will be completely different. Microsoft will have to undergo massive change in order to even think of holding on to its global position, and the pharmaceutical industry is going through an era of unprecedented restructuring worldwide.

Those are just a few examples because hardly any industry will escape. The **change related challenges** facing **public organizations** are even greater. Health and education, public transportation, the energy sector, unions and administration and Government cannot survive with their current structures, workflows and decision-making processes. Democratic institutions will experience the most far-reaching transformation since their emergence.

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The transformation from the 20th to the 21st century is more or less similar to the disappearance of the agricultural society and its replacement by the industrial society, or comparable to the displacement of the feudal society by the constitutional state and democracy. However, the changes that have already taken place, also demonstrate that Transformation 21 will be even bigger and more radical than previous social changes. Some of the most relevant differences compared to previous social transformations include the **new large-scale global dimensions**, the new degree of systemic interconnectedness worldwide and the new rapid pace of change. Previous superlatives, such as megachange, are already too understated to describe the new dimension of change.

Historically, until now, such far-reaching transformations have occurred approximately every 200 to 250 years. For instance, such a change took place in the 13th century with the emergence of the Gothic period, the modern city and the first universities as centers of intellectual life, in addition to the guilds as a dominant social structure.

Another similarly radical transformation took place between 1455 and 1517, beginning with the invention of printing and characterized by the Reformation. Milestones of transformational processes include the Renaissance, the discovery of the Americas, the development of the sciences, the revival of medicine and the spread of the Arabic counting system.

The most recent transformation of this kind began in the mid-18th century with the Enlightenment, and manifested itself in the US constitution, the steam engine and subsequent industrialization, the French Revolution and the Napoleonic wars. That transformation changed not only the political structure of Europe. It also created the modern university, parties and their ideologies, and brought with it a completely new European social structure.

The common element among these periods of transformation is that each one, within approximately 50 years, changed the society, even the world, of its respective contemporaries to such an extent that those born later literally no longer had any concept of the world of their parents.

A result of the Great Transformation 21 now taking place will be that we will experience a fundamental change in terms of nearly everything; **what we do, how we do it and why we do it**. In a certain way, who we are will even change. As a result, we will produce, consume, transport, distribute and finance things differently. Likewise, the way we com-



municate, learn and teach, and almost every other human activity will change. **Scientific findings** and **technological innovations** for a new era have already arrived, and a few of them have been in use for quite some time, which means that one recognizes their power to change. For instance, the Internet and smartphones are already changing people's lives, their ways of working, consuming and communicating, leading to the emergence of new motives and values. However, there is still quite a bit in the pipeline that will create more and ever-faster breakthroughs.

To cope with such changes, and simultaneously use them as driving forces, far-reaching changes in **management systems, organizational structures and strategies** are as necessary as in thought itself. The effects of the New World are beginning to appear in advanced knowledge enterprises. They include, among other things, dealing with **knowledge** as a new resource, as a tool and product, the special characteristics of knowledge workers and knowledge work, and the new functionality of knowledge organizations.

## The Old World is in decline because a New World is emerging

What is happening «out there» goes well beyond a traditional financial and economic crisis, especially one in which the world returns to its previous state after «overcoming» the crisis.

Already, changes have advanced to such a degree that it is neither possible nor desirable to turn back. Like the dramatic metamorphosis from a **caterpillar** to a **butterfly**, for whom practically nothing is as it originally was, only a few things in the New World will be as they were in the old world. For instance, the caterpillar is subject to the natural laws of geodynamics, whereas the butterfly has to hold its own in the entirely different world of aerodynamics. To do so, the butterfly needs a **different system for functioning** than that of the caterpillar. It needs different sensory organs, different nerve connections and a different biological navigation system. The laws of geodynamics are therefore certainly not inapplicable in the case of the butterfly, but their relevance for it changes entirely.

Similarly, the **Old World** was characterized primarily by the **laws of money and the economy**. The **New World**, on the other hand, will be

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dominated by the **laws of information, knowledge, perception, complexity and the dynamics of highly networked systems.**

Already now, and without any need for forecasting, one can attach that to numerous new realities that have already cropped up. Since the breakup of Soviet communism, at the very latest, those new realities have begun to pave the way to structures of global societies, and in doing so have changed the rules of social functioning, getting faster and faster as they do so. The collapse of communism was triggered, encouraged and accelerated by new realities which were becoming more effective at that time. It's true that the economic order also failed, but the **cybernetic forces of control and communication** were having a far greater impact. **Knowledge breaks down money, and information breaks down authority**, as I formulated in 2008 in *Unternehmenspolitik und Corporate Governance* (Corporate Policy and Corporate Governance).

And now we are at the center of a New World. One of its dominant features will be a proliferating complexity that grows exponentially.

## Megachanges to megasystems

For the time being I have categorized the **most important factors of influence for the Great Transformation** into five complex drivers: 1) **demography**; 2) the **knowledge and technology** complexity; 3) the **environment**; 4) the greatest **indebtedness** in history, contaminating everything, as the main factor of the economy; and 5) the **complexity** that results from the interplay of these four major areas.

All of these factors interact with, and intensify, each other.. That alone continually produces a new complexity that poses ever-greater surprises for more and more organizations. **Malfunctioning is becoming the new normality.** This will occur in politics, among other areas, which will increasingly pose more of a problem than a solution in an ever-greater number of countries due to the proliferating complexity and adherence to outdated methods. With the new methods, on the other hand, that would change abruptly.

Enormous risks are associated with these drivers, particularly the economic danger of one of the most severe **deflationary periods** with an extensive collapse of real values due to the mountains of debt worldwide. I therefore place particular emphasis on this one aspect in the economic



situation because it is the decisive economic point. On the other hand, embedded in these drivers is also the knowledge and power to diminish and overcome this crisis and to allow a new society to emerge with a **new functional order**.

An essential part of the new solutions are **wholistic and modular management systems**, like the ones we have constructed at Malik Management based on the models of the most highly developed control and guidance systems in nature, within which we have also incorporated the **laws of natural functioning**. The solutions lie there, among other reasons, because the traditional management mindset is failing under the weight of the rapidly changing conditions of the New World. The new management systems are fundamentally different to the previous ones, much like the nervous system and brain of humans differ from the simple synapses of lower organisms.

## Crisis as the birth pangs of the New World

Whether, with these conditions, the **birth of the New World** will be smooth or difficult lies largely in our own hands, because it will depend to a large extent on how the new challenges are dealt with. It depends on the mindset, knowledge, instruments and methods that one employs as solutions. A new understanding of the network of social organizations is required and new management of those organizations as complex, dynamic, networked, and unforeseeable systems. This couldn't be more different from traditional management ideas with their dominant orientation towards economic categories, short-term profits and, generally speaking, financial control variables.

Complex systems have their own laws of nature. In my book *Strategie des Managements komplexer Systeme*<sup>1</sup> (Management Strategy for Complex Systems), among other places, I demonstrated exactly that, by explaining that the logic of a **strategy capable of handling complexity** has to be evolutionary, the strategy itself has to be a strategy of evolution. If one has the requisite knowledge of the fundamental laws of complex systems, one can begin to understand them at a meta level, a higher perspective, as well as to control, design and steer them. Yet, to do so, one needs an entirely new set of knowledge, a **wholistic system** for a completely new

<sup>1</sup> Malik, Fredmund: *Strategie des Managements komplexer Systeme*, 10th revised edition, Bern/Stuttgart 1984, 2008.





management, which I described for the highest level of corporate policy in my book *Unternehmenspolitik und Corporate Governance* (Corporate Policy and Corporate Governance).

## Economics is insufficient for understanding the global economic crisis

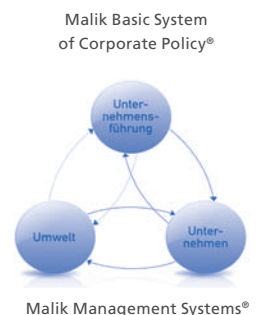
The direct **financial and economic dimensions** of the Great Transformation cannot be overestimated in terms of their significance and risk potential. They will shape events for many years because the most difficult phases of the crisis are not behind us, as most people seem to believe and as is reinforced by the media. On the contrary, the truly big turbulences are still ahead of us.

But that will not lead to **inflation**, as most people fear. Rather, it will lead to **one of the most severe deflations in history** if only traditional economic means continue to be employed. The drastic government austerity programs alone have a deflationary, economy-strangling effect in part.

On top of that, the already **poor performance of many public organizations** due to their lack of funds will become even worse as a result of the austerity measures. Old systems cannot be improved by austerity measures; they can only get worse. In the traditional way of thinking, there is no alternative to that. The new methods, on the other hand, empower organizations **to function even twice as well with half as much money**. If one therefore accepts that the crisis is much more than just an economic one, even though on the surface it may appear to be economic and is interpreted thus, and that it is a **crisis of functioning**, then entirely different and more powerful solutions will come into view.

That the crisis is not primarily an economic crisis is also proven by the fact that almost the entire economy did not see the collapse of September 2008 coming, although it had been reflected in the US stock exchanges since the summer of 2007 at the very latest. With the proper tools, the looming dangers were even apparent much earlier, in part even as early as the 1990s, as I published in my book *Die Neue Corporate Governance: Richtiges Top Management, Wirksame Unternehmensaufsicht* (Effective Corporate Oversight) in 1997, as well as in my monthly management letters, in other books of mine and in numerous lectures.<sup>2</sup>

<sup>2</sup> Newly revised and expanded under the title of *Die richtige Corporate Governance* (2008) (The Right Corporate Governance), also, among other things, Volume 1 of my



As early as the summer of 2008, three months before the Lehman debacle, 98% of American economists, in addition to the German-language economic institutes, forecast, practically in unison, economic growth of between 2.5 and 3.5% for 2008. Nowhere could an indication be heard of the storm that had already been brewing for quite some time and was on the verge of breaking out.<sup>3</sup> However, the **blindness to the debacle** that, three months later, would shake the world was hardly the failure of the economy, as is often claimed. Much more, it is an indication that at the core something entirely different is happening, something that cannot be seen at all with the resources of the traditional economy.

In the next issue, I will expound on this topic and demonstrate how Anglo-Saxon corporate governance managed to develop into an **instrument of economic destruction** over the course of a few years and how it brought about the current crisis situation.

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series entitled *Management: The Essence of the Craft* (2010) and the DVD *Die richtige Corporate Governance* (2002). (The Right Corporate Governance)

<sup>3</sup> Exceptional economists who offered timely warnings include Robert Prechter, Paul C. Martin, Gunnar Heinsohn and Otto Steiger.

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