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It's a Small, Small Business World

Commentary by Charlie Grantham and Jim Ware

“Don't stop thinking about tomorrow” – Fleetwood Mac
(<http://www.youtube.com/watch?v=-ODVfREMS8s>)

Winter is hard upon us, even in early March. Just ask our friends in the upper Midwest. So as we sit and ponder what it will feel like in warmer times it's a good time for reflection. We start most of our presentations with the tantalizing belief that our societies are in the early stages of a fundamental transformation. This article will focus on that belief and bring forward some evidence that we are not totally daft.

And even if we *are* daft, we're not alone:

Like it or not, the world is in the early stages of powerful, deep running and pervasive changes that will transform its economics, its cultures and people's understanding of who they are and what they stand for.

(That's from *The Power of Unreasonable People: How Social Entrepreneurs Create Markets that Change the World*, by John Elkington and Pamela Hartigan, Harvard Business School Press. 2008.)

We couldn't have said it better ourselves (though we wish we *had* said it ourselves). The authors of that statement (John Elkington and Pamela Hartigan) believe that social entrepreneurs are the next wave of wealth creators. You might debate that assertion, but the point is that entrepreneurial energy today are evolving away from being purely motivated by the profit motive to focusing on a larger emphasis on creating new products – and even new markets – that matter by making a difference in the quality of people's lives, in the health of the planet, and in the ways we relate to each other.

But before we delve into the nitty, gritty economics of this development, we offer an observation. It's harder than you think to raise money for starting a socially responsible business. That's a fact that we can personally attest to.

And that isn't just a self-interested gripe on our part. Investors want to see a hard return on their dollars – and quickly, we might add. Social entrepreneurs seeking long-term, systemic changes in societies can't articulate those gains very well (partly because, as we suggested last month, [There's No Accounting For It](#); it's very difficult to measure the social value of those new products and markets).

But that too is changing. The first evidence we can see of the change is the emergence of the “triple bottom line” approach to measuring of corporate performance.

As Wikipedia (our reliable source of insight on matters like this) puts it:

In practical terms, triple bottom line accounting means expanding the traditional reporting framework to take into account [environmental](http://en.wikipedia.org/wiki/Environmental_performance) and [social](http://en.wikipedia.org/wiki/Social_performance) performance in addition to financial performance (http://en.wikipedia.org/wiki/Triple_bottom_line).

Incidentally, the phrase “Triple Bottom Line” was actually coined by the senior author of *Unreasonable People*.

Again, there are arguments on both sides, but the idea is catching on that firms should somehow be held responsible for the impact they have on the environment and the communities they exist within. We believe that as the environmental impact of an industrial world based on petrochemicals becomes more and more apparent, the idea of the “triple bottom line” will move to the fore of investors’ minds.

Indeed, the economic argument runs something like this:

As the systemic effects and costs of environmental impacts become visible in the global economy, markets will begin to calculate those costs in their valuations and investment risk decisions. When those costs are weighed against the benefits they produce the decisions that result will differ from what you would expect if a pure profit motive were all that mattered.

Two examples may help to explain this perspective.

First, coping with carbon emissions. If the carbon emissions impact of a product or service can be measured accurately, then the larger societal costs of mitigating that impact can be built into the transaction costs for the product. Let’s assume for a moment that we can calculate the CO₂ impact of a Hummer over its average lifetime. Who pays for those costs in terms of pollution control, health costs, and climate impact? Without a “triple bottom line” approach those costs accrue to society at large and are diffused, unrecognized, across the entire economy. However, what if those environmental and social costs were bundled into the initial product cost? We’re pretty certain that market behaviors and decisions would change dramatically.

Second, apply similar thinking to tobacco. It’s taken a few decades but at least in the United States there is now a clear realization that tobacco products have an adverse social impact (as well as on the individual health of smokers). Tobacco use causes higher rates of disease (and therefore health care costs) for consumers who smoke (or chew, for that matter).

Pricing mechanisms have come into play recently that dramatically increases the cost of tobacco products. A portion of that increased revenue is now being re-invested in smoking cessation programs, early education, and other preventive measures. The true cost of the product on society is becoming more visible, and that visibility does change market behavior (<http://www.lungusa.org/site/pp.asp?c=dvLUK9O0E&b=39860#11>).

So how do “triple bottom line” accounting and social entrepreneurship relate to the fundamental, systemic changes in our economy that we began with? First there is a linkage

to some important economic theory and then, more recently, there's also observational evidence that we have moved from theory to action in the practical landscape of everyday life.

Let's start with the theory.

This insight comes from the work of Robert Coase: http://en.wikipedia.org/wiki/ronald_coase

Coase suggested that firms (as formal organizations) emerge when a formal structure of agreements and processes can produce a product or service at a lower cost than a loosely affiliated group of independent producers can achieve in an open marketplace. So firms arise when they can produce what they need, such as knowledge and control mechanisms, more cheaply than "contracting out" the work in the broader marketplace. However, this cost aggregation has its limits, and at some point organizations become so large they lose the efficiencies that come with economies of scale (in essence, the costs of maintaining the internal bureaucracy become so great that the open market can get it done at a lower cost).

And this is exactly where we are today in many industries. The cost of organizing and managing many large firms has reached a point of clear inefficiency. The rapidly decreasing costs of technology enable many small businesses to operate as efficiently as larger ones.

At the same time increasing real estate costs, along with escalating infrastructure costs such as energy and transportation networks, make it far less attractive to aggregate large numbers of people within one organization. And human resource support costs like health care, retirement funding, and staff development are also escalating almost beyond control.

Put it all together, and we've reached the cross-over point in Coase's model. And, we might add, the increasing movement to triple bottom line accounting increases these organizational costs even further.

Those basic economic facts are driving the shifts in how we organize to do work. We repeat:

Like it or not, the world is in the early stages of powerful, deep running and pervasive changes that will transform its economics, its cultures and people's understanding of who they are and what they stand for."

(Again, that's from *The Power of Unreasonable People: How Social Entrepreneurs Create Markets that Change the World*, John Elkington and Pamela Hartigan, Harvard Business School Press. 2008.)

So how do we cope with these challenges? We believe, as we think Coase would, that the answer lies in the growing number of smaller firms that can help the larger firms move the essentially fixed costs of their strategic assets like human resources, technology, and real estate to variable costs. An example exposition of this insight can be found in a study published recently by the [Institute for the Future](http://www.institute-for-the-future.com) and sponsored by Intuit Corporation (www.intuit.com/futureofsmallbusiness).

That report predicts the rise of a "barbell economy" in which there are a few large firms and thousands of small ones, with very few mid-sized firms. The few remaining large organizations will be those in which economies of scale still prevail, where the underlying

technology continues to require large capital investment or high-volume usage (think of power generation, oil exploration and production, global telecommunications networks, and – for now, anyway – automobile manufacturing). But it's important to realize that even those very large firms actually subcontract out a surprisingly high proportion of their business activities, even today.

Small businesses currently employ over 50% of the U.S. private-sector workers and account for about 75% of all new jobs created. We expect to see a continuing explosion of small business in the next decade, driven by the economics that underlie the theories of Robert Coase.

We believe there will be more than 30 million of these smaller firms by 2018. Small businesses will become the engine of wealth creation; and we'll return once again to an economy filled with agile, sustainable businesses (not unlike the world in the 1800's, before the Industrial Revolution that led to the growth of mega-corporations).

In a richly interconnected, technology-driven world the advantages of size and large capitalization have become almost a disadvantage to further innovation and creation. As technology allows our societies to become more atomized – and, paradoxically, more connected at the same time – we will change how we work.

As we have suggested elsewhere ([Proceedings of the ACM SIG on Computer Personnel Research, Chicago, IL, pp. 47-60, April 2000](#)) these new organizations will look more like “guilds” being led by “producers.” They will coalesce, disband, and re-form with almost lightening speed. The masters of the new business universe will be those who have perfected the “black arts” of networking and community-building. Success will be just as much about creating markets as about product development.

And lastly we believe that they (these new businesses) will be characterized by a social entrepreneurial spirit because they will be very closely connected to the communities within which they “live” and they will have an extreme sensitivity to their environmental costs and impacts. That's exactly what Elkington and Hartigan believe is happening.

What does tomorrow look like from this perspective? First of all, we already have a global economy where the true, full costs of production are becoming evident, spurred along by Triple Bottom Line Accounting that makes those costs visible (not just to management but to customers and society as a whole).

This development, coupled with rapidly lowering transaction costs, drives the decline of the large firm and the growth of many more smaller, more nimble businesses. Instead of a few large entities we'll see the emergence of a network of many smaller ones.

Of course, as with any societal change, there will be leaders and laggards. The leading industries will be the “fringe” ones like information-based and conceptual industries like finance, education, and even health care. The laggards will be those still dependent on the old capital-intensive infrastructures and technologies like transportation and telecommunications. We are left to wonder, then, where organizations such as business services, government, and agriculture will fall. That's an open question that we intend to watch closely.

Send us your comments to comments@thefutureofwork.net. We look forward to learning from you!

About the Work Design Collaborative and *Future of Work Agenda*

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