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Throughout history, the structure of companies and the role of business in society have continually evolved to meet the demands of the global economy. The 17th century ushered in the first joint-stock company. In the 18th century, the global insurance market was born. In the 19th century, we formalized the rules for stock exchanges.

Now, in the 21st century, capitalism must take another evolutionary leap forward to adapt to rapidly changing conditions in the global economy. Today, capitalism is under considerable stress, brought on largely by an excess of short-term thinking. I meet with CEOs every day, and I am struck by the relentless pressure that executives of public companies feel—from the markets, shareholders and sometimes their own boards—to deliver short-term results. In the long-run, this approach is at the expense of other stakeholder interests and hurts value creation.

For capitalism to thrive, it urgently needs reform in three areas: moving from quarterly measures of performance to much longer timeframes; shifting from a narrow focus on shareholders to a broader community of stakeholders; and adopting more of an 'owner-based governance' model aimed at building companies with high longevity.

Why is this the moment to rethink how capitalism works? I believe that centuries from now, people will look back at the next few decades as one of the most significant periods of transition in human history. This is because of several huge waves of change transforming the world economy. The largest and most significant of these shifts is the rapid shift of economic power from the West to the East and South. Three billion people in Asia and Africa will join the middle class by 2030—a population of new consumers on a scale we have never seen before. To put that in perspective, the Industrial Revolution was a thousandth the scale in terms of speed and number of people affected.[1]

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[1] McKinsey Global Institute. "Winning the $30 trillion decathlon: Going for gold in emerging markets." Aug. 2012.

The second huge shift involves technology. Technological innovation is advancing faster than management can respond, causing both positive and negative disruptions in every industry. The scale of this disruption is immense—the McKinsey Global Institute estimates the annual economic impact of 12 key technologies at up to $33 trillion per year by 2025. [2] Some of these technologies, such as next-generation genomics, advanced robotics and 3D printing, were the stuff of science fiction only a decade ago, but are now changing the skills needed in the workforce and the way companies do business. Companies unable to adapt are being sideswiped by more nimble rivals, a fact that we can see in businesses' shrinking lifespans. In the 1930s, the average S&P 500 company could expect to exist 90 years; today, that average is 18 years.[3]

Growing resource constraints are yet another new challenge. Those three billion people moving into the middle class will all want to buy phones, refrigerators and cars, and will have a significant impact on the need for food, energy and water. While I am confident that technological advances will help meet our expanding resource needs, we are already beginning to reach the limits of human ingenuity on that front. For example, if we stay on the current trajectory of water usage, and even accounting for technological innovation, demand for water globally will exceed supply by 40%, within two decades.

These shifts will lead to more volatility, more 'winners and losers' and considerable displacement in the world. Businesses, government and the social sector will need to 'up their game' to ensure humanity thrives throughout this period of change and volatility.

The warning signs that the existing capitalist system may not be fit to address these challenges are already before us. For one, trust in business, particularly in the West, has been on a steep decline that accelerated further after the financial crisis, reaching record lows. In 1966, when Gallup first started polling the American public on this issue, that trust stood at 55%. In 2012, it was down to 21%. Another warning sign is the rise in income inequality. In 1970, the top 1% of the population in the OECD countries earned about 7% of the income. By 2009, that top percentile had doubled its share, to 14%. Meanwhile, the bottom 10% slid from having 4% of total income to 3%.[4] Escalation in income inequality amps up pressure on the system, making people wonder if capitalism is fair and creates opportunities for all.

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[2] McKinsey Global Institute. "Disruptive Technologies: Advances that will transform life, business and the global economy." May 2013.
[3] McKinsey analysis.
[4] OECD. "Divided We Stand: Why Inequality Keeps Rising." 2011.

So capitalism's problems are daunting, no doubt. But there are things we can do to improve it. I would suggest three areas in particular on which we should focus. The first is a shift away from short-term thinking. The current obsession with quarterly performance leads many public companies and their executives to shy away from longer-term, but more lucrative investments.

Short-term thinking is all around us, particularly in the West. Surveys indicate that 55% of CFOs will reject an investment with a positive net present value if making it means missing next quarter's consensus earnings.[5] Other research shows similar myopia. Private companies that go public invest 2.8 times less after their IPOs.[6] Stock prices of public companies regularly have a discount rate that is five to ten percentage-points too high applied to them, based on future earnings and dividends achieved.[7]

These patterns have huge consequences on company performance and on returns for investors over time. They also have a dramatic impact on economies at large. The McKinsey Global Institute estimates that global annual spending on long-term investment was about $11.7 trillion in 2010. To achieve moderate economic growth on the order of 2% to 2.5%, that spending should be $18.8 trillion by 2020. In all the discussions about economic troubles in Europe and elsewhere, we often ignore the role of private-sector investment, even as corporations in Europe and the U.S. sit on the sidelines with huge amounts of cash on their balance sheets.

The second area is around who constitute the relevant stakeholders for a business. For the past four decades, the conventional view, first articulated by Milton Friedman, has been that "The role of business is business"; or "There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game."[8] In today's economy, this single-minded focus is outdated.

I believe that business needs to remind itself that it requires a 'license to operate' in any community. And it will only get this license if its operations benefit that community. However, it is important to note that this is not just

[5] Graham, John R. et al. "Value Destruction and Financial Reporting Decisions" (Working Paper). Sep. 6, 2006.
[6] Asker, John et al. "Comparing the Investment Behavior of Public and Private Firms" (NBER Working Paper no. 17394). Sep. 2011.
[7] Haldane, Andrew G. "The Short Long." 29th SUERF. Brussels, 2011.
[8] Friedman, Milton. Capitalism and Freedom. Chicago: University of Chicago Press, 1962.

an issue of corporate social responsibility, but is also good for business profitability. With growing resource constraints and global supply chains, large corporations are now finding their fortunes inextricably linked to those of their local communities.

Coca-Cola's water usage is one such example. The company used to use three liters of water to make one liter of Coke.[9] Naturally, this was a challenging proposition for its operations in areas of India, China and western United States that suffer from water scarcity. It was also a problem that was growing each year. In response, the company has set up a program to reduce its water usage and has cut its consumption from three liters to two.[10] Coca-Cola is doing this because it is a valuable environmental measure, because it enables it to have bottling plants even in regions where water is scarce, and because it is good for its bottom line.

Many other companies have realized that helping local communities benefits them as well, creating symbiotic relationships. The mining corporation Rio Tinto is passionate about education in Africa. The company chose that particular cause because it needs educated people to operate its machinery and drive its trucks, and the local schools were unable to supply them in sufficient numbers.[11] Or consider what Paul Polman, CEO of Unilever, has been trying to do since 2010. He set out on a rather outrageous mission: to double revenues while cutting Unilever's carbon footprint in half.[12] The company's successful work on sustainable agriculture and strong bottom-line performance suggests Polman's aspiration may not be so far-fetched. As business leaders, we have to jettison the idea that shareholder value is *all* that matters. The question is: how do you measure the value created for the other relevant stakeholders important to one's business? On that, we have much work to do.

The third area of reform is around owner-based governance. Boards spend far too much of their time on fiduciary issues. Surveys by executive-search firms have found that between 75% and 80% of directors' time is spent on protecting the company from financial risk, while only 4% of public company boards even *have* a long-term strategy committee.

Public companies also need more of their directors' time. My colleague Conor Kehoe has compared the amount of time non-executive directors who sit on

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[9] "Coca-Cola: In Hot Water." The Economist. Oct. 6, 2005.
[10] Coca-Cola. 2011-2012 Sustainability Report.
[11] Rio Tinto website.
[12] Ashton, James. "Chief executive Paul Polman is a boss with more on his plate than sales figures." The Independent. Jun. 8, 2013.

the boards of *both* publicly listed companies and private-equity companies, spend on those respective duties. He discovered that they devote double or triple the amount of time to private equity-related firms than they do to public companies: 54 days a year versus 12 to 20 days. It is difficult to provide a lot of input if you are not taking the time. Finally, form has overtaken function in the boardrooms of many large corporations. There are plenty of rules and regulations, checklists and hoop-jumping, but these do not necessarily translate into potent actions. What we need is boards to adopt more the mindsets of owners and devote more time to advancing long-term strategic goals.

The opportunities in front of our world over the next two decades are immense with the mega-shifts underway, but so too are the challenges. I believe that capitalism and business remains the best way to take billions of people to a higher standard of living. But business needs to broaden its role and perspective on society, and take a more long-term view. One of my Chinese clients put it well when he said of the 21st century: “I think it will be a wonderful century for humanity, if we get through the first 30 years.”