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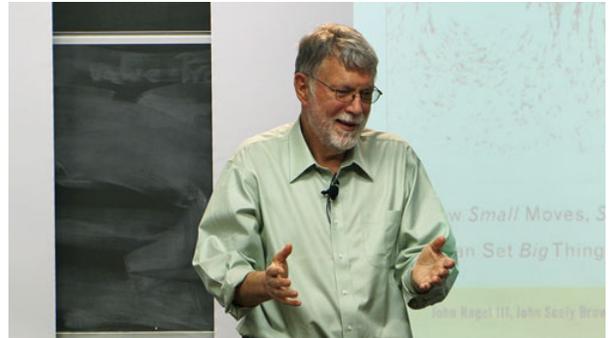
### The Old Institutions are Broken

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Video URL: <http://ecorner.stanford.edu/videos/2426/The-Old-Institutions-are-Broken>

Over the last 65 years, returns on assets have decreased about 75 percent; indicative, says Deloitte Center for the Edge Independent Co-Chairman John Seely Brown, that the old guard of doing business is no longer viable. Whereas companies used to be guaranteed longevity if they made it into the S&P500, nowadays many survive there only five or ten years. The 21st century is qualitatively different, says Seely Brown, with new technological institutional mechanisms forcing new business practices.



#### Transcript

So let me just start off with a very simple observation. Our old institutions suck, as we'd say, in some place. They ain't working very well. Something is broken. Maybe something fundamental is broken and nothing to do with the current financial crisis, maybe something much more fundamental. Getting to the root of that, may open up a view that really says there's a whole new set of opportunities for our entrepreneurs. But why do I think they're broken? Why don't - I could spend the entire talk on that and you'd be too deeply bored, but just two mild observations. We have at the center been computing not return on equity - because if you look at return on equity, it is possible to play an infinite amount of financial games through debt financing that can disguise as we now know almost anything. We've been looking at hard assets and return on assets, and if you look at the last 65 years, return on assets have plummeted 75%, and there's absolutely no sign that this is going to change. In fact, it keeps going down and down.

There are no tricks on this graphic. We could talk about how the top quartile rather than the bottom quartile is performing blah, blah, blah. There'd be a whole talk on this game. That's not what I want to do but I will mention one curious sin for the economist's economically-inclined students. If you take this to where it crosses zero, which means our corporations have gone out business, it happens to be ironically at the same point that the debt equals the gross domestic product. We don't think those things are correlated but it's an interesting observation. To me, more interesting is in the old days, you do a start up, you do really well, the company will build, build, build, build, build, and you eventually make it in the S&P500. And if you made it in the S&P500, you would live there for a really long time, 75, 85, 95 years. We've been able to kind of compute these business cycles. How long companies that make it into the S&P500 - success that is called - how long do they last before they get toppled, before they die, or are quiet? Not that acquisition is quite the same as death but it's an interesting question.

And we're looking at getting down to a point where, basically, people in the S&P500 might last only five or ten years. You got to ask what the hell is going on, or as I sometimes say, depending on where I am, "Why are we paying CEOs so much?" It's a different story. Here's an observation that at the least underlies some of this game. Alfred Chandler got us to understand in the 20th century, basically, there is a fundamental infrastructure that enabled us to transport goods with amazing efficiency and organizational architectures built up to leverage the fundamental infrastructure of the 20th century. And that's kind of a gloss. But one of the most interesting things about this infrastructure is, first of all, it's a simple S-curve. I mean, for a short period, there are tremendous disruptions. Think about electrification as another example of that. It's a period of which things change and then they stabilize out for a pretty long time. Basically, if this is the infrastructure, the key to success, by and large, is the notion of scalable efficiency.

Build a lot, use transportation mechanisms to distribute it, blah, blah, blah. But for this to work, you have to live in a predictable world. You've got to be able to predict ahead of time what to build. Build a lot of it. Store it. Ship it out. Obviously, that also means because of scalable efficiency, you want a hierarchy, you want control, and if you study organizational theory, almost anywhere, basically, think about organizational routines. They define what a corporation is. And we all know that the game is how to minimize variants and that's kind of the picture of almost all notions of how the 20th century firms really worked. And by the way, almost everyone in this room had the same impression or the same experience coming through K through 12 schools.

Our K through 12 schools are built on scalable efficiency, a factory model. Basically, we can predict for you what things you're going to need five or ten or 15 years away, and we're going to build up a stock of assets for you to learn, to acquire so that eventually, you get to use them, very much like how corporations have to work. The catch is, today's world, the 21st century is qualitatively different. We no longer have an S-curve. We could argue, especially on this campus, about this curve here but basically, the digital infrastructure. The technology underlying the digital infrastructure looks like it's going to continue to follow an exponential. It may not be Moore's Law. We're going to change architectures. We're going to change algorithms. We're going to change a lot of things, but this exponential curve may be slowing down but it is marching on.

And the technological infrastructure, we're going to build things around. It is of course more than just technology. It's a socio-technical system and so you get interesting kind of institutional mechanisms creating in order to be able to make this stuff work.