

# Strategic Chronicle™

*A Newsletter for Clients and Associates of KLM, Inc.*

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## Social Capital and Economic Growth

“Social capital” is a term that refers to the goodwill, trust, and cooperation evident in any particular organization or society. Social capital has been informally recognized in the worlds of management and government for some time, however little has been written on the subject or its practical applications. Today, many believe that social capital is an under-leveraged intellectual capital asset which could be powerfully mobilized within both organizations and communities to deliver benefit.

The theory behind social capital is that, just as ill will drives the occurrence of many unfortunate things, goodwill causes good things to happen. This may sound simplistic, but clearly, goodwill, or the presence of social capital, builds trust that leads to cooperation and the synergy that is necessary to build businesses and communities. Workers and managers, citizens and public officials, who

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experience ill will toward one another, do not enjoy trust, the benefits of teamwork and community, the free play of ideas, or the greater productivity and value-creation that drives economic growth.

### **The Driver of Economic Growth**

What is the relationship between social capital and economic growth? For most contemporary theorists,

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social capital is broadly recognized as a driver of economic growth, while wealth and financial capital, the results of economic growth, are seen as enabling factors. Social capital is seen as an asset that can be leveraged to create deals, relationships, build teams and community, moderate disagreement, inspire innovation and change, enter new markets, and attract businesses and citizens to a community.

Some may reply that it is the wealth produced by modern day capitalism that is improving society. Our enhanced standard of living, educational achievement, widespread private and corporate philanthropy, and the vast availability of venture capital for funding promising businesses, all may suggest that it is economics that drives social capital. However, the concentration of financial capital, per se, never drives the development of social capital. Without the trust, the cooperation, and the visionary goodwill necessary to put financial capital to work, nothing can be accomplished. It is the strength of social capital, in the form of leadership, partnerships, esprit de corps, and community spirit that drives economic growth and development.

### **Leveraging Social Capital**

How can we leverage social capital to drive economic growth? Adam Smith, the famous 18th century Scottish philosopher and author of *The Wealth*

*of Nations*, argued that the pursuit of our economic and social self-interest was simultaneously the pursuit of the general welfare of the society. In *The Wealth of Nations*, he said:

“Every individual necessarily labors to render the annual revenue of the society as great as he can. He generally indeed neither intends to promote the public interest, nor knows how much he is promoting it,... He intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.”

- *The Wealth of Nations* (1776)

Vol. 1, book IV, chapter 2

Adam Smith’s argument appears primarily to be an argument for economics driving social capital. Because we all pursue our interests, work to earn a living, and make our contributions to our society,

**...social capital, understood as goodwill and cooperation, can be consciously applied by us each,.. to drive... the public good, prosperity, and well-being.**

and they are all motivated by our individual goodwill, those efforts create a civic culture within our society, which in its vibrancy, eventuates and delivers our individual and mutual well-being and prosperity.

But Adam Smith knew that self-interest and markets were not enough to build the ideal society. The economic dimension was only part of the larger creation of a good society. Civic and organizational institutions, with their cultures, form the structures within which we pursue our life and livelihood. Social capital grows within these formal institutions, the rule of law, rationality, a liberal democracy, and the cultural accomplishments of our civilization. A vibrant civic culture is essential, and the resultant network of family, school, religion, community,

work, and our voluntary daily associations drives and creates, or destroys, the social capital which makes it all possible.

Adam Smith believed that by understanding the interdependency and the inseparable links between social capital and its economy we could enjoy a more ideal society. He believed that our economy encouraged our social well-being, and our social interactions enriched our economy.

### **Managing Social Capital**

During Adam Smith’s day the concept of “social capital,” while implied within his work, was not articulated per se. Then it was “the greatest good for the greatest number,” while today we may speak of the “public good.”

The contemporary discussion about social capital can enhance our awareness of the importance of goodwill, and allow us to more consciously deploy this social goodwill to drive economic development, and its reciprocal, the direction of financial capital, as “social responsibility,” to benefit the society.

Today, social capital is broadly recognized as an intangible asset of considerable value that resides within our many respective societies in the workplace, the community, and in our nation. Many believe, social capital, understood as goodwill and cooperation, can be consciously applied by us each, and thus used to drive effectiveness within organizations, economic development at the civic or state levels, and, as the natural result, the generation of the public good, prosperity, and well-being.

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## Uncertainty and Scenario Planning

Uncertainty is permeating every aspect of modern life and work. The clashes of civilizations and cultures, geopolitical volatility, unpredictable markets, and rapidly shifting situations on every front have made a rational and planned approach to affairs increasingly difficult and possibly even impossible.

### The Reinvention of Planning

During the 1990s, under the influence of a booming economy in the Western world, rapidly expanding globalization, and the new rhetoric of business models, even respected business gurus propounded the idea that, because everything was changing so quickly, “planning was dead.”

In many respects, this was true – narrow, ponderous, set-in-stone, five year central planning did die during the 1990s. But many organizations threw wisdom out with their abandonment of “large notebook planning,” forgetting they still needed intelligent, thought-through, guidance for their enterprises. Rapid change and ongoing uncertainty requires planning no less, but a different approach to such planning. Yet, when we are faced with such uncertainty, and all of the rules are changing, we often do not know how to think about it effectively.

Executive management cannot abdicate on the responsibility of leadership just because the planning of the past has become ineffective. Leaders still need to successfully negotiate the future.

How can we identify the new ways to think and plan? One way is by studying the responses of leadership in the enterprises that are most challenged to successfully adapt to uncertainty, and then scale and adapt their responses to our, possibly, lesser needs.

Large, global enterprises are exposed to the greatest

levels of uncertainty and risk as they span cultures and vast geopolitical tensions. One of the tools increasingly used within such organizations to study and prepare for the future is “scenario planning.”

While originally founded during the middle of the 20th century under the specter of nuclear war and superpower brinksmanship, scenario planning was a sophisticated form of strategic planning reserved for complex situations. As the threat of nuclear war passed, scenario planning largely fell into disuse. Today, as the playing field for business spans the globe, and becomes hopelessly complex, blindsiding us again and again with its uncertainty, scenario planning may be coming back into its own.

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### What Is Scenario Planning?

Scenario planning is a practice for managing through uncertainty, and now, all times are uncertain times.

Founded by Pierre Wack at Royal Dutch Shell in London, and Herman Kahn at the Rand Corporation in

southern California, “scenario planning” is a sophisticated strategic planning practice employed by many successful organizations and enterprises of all sizes.

Scenario planning originally referred to the systematic examination of the various ways or “scenarios” in which situations could develop. It was intended to encourage more insightful decision-making and planning for the long-range future. It was based upon two important realizations about long-term planning:

- 1) That many different futures are possible at any one moment in time, contingent upon how various elements work out in any given situation.
- 2) That planning generally is about what we want to happen, and is accomplished with

inadequate regard to the complexities of the situation.

For Wack, Kahn, and their associates, scenario planning was an every day, all day, constant deliberation and study of the market, the industry, the environment, the surrounding politics, and whatever had any appreciable impact upon the business or the situation. It was a very ambitious, full-time undertaking with a total belief in how much rational study could uncover about the future. In its original form, it was an enterprise continued until the mid-late 1980s, when the nascent post-modern uncertainty began to replace all forms of long-term planning with the absence of planning characteristic of the 1990s.

Today, in a less think tank format, scenario planning can be employed as a technique for achieving the 360 degree due diligence that is necessary to provide the most complete perspective possible and from which to plan and decide. While it was originally a tool for modeling answers to the biggest of

questions, today it can be used to see into the future, insofar as such a thing is possible, and to inculcate organizational flexibility and resilience.

## **Negotiating the Future**

An image that is helpful in understanding scenario planning is to think of the organization as a pack of wolves, with executive leadership at the front of the pack. The wolves in front are continuously looking, watching, sniffing, scouting out developments, moving in tune with the environment, and telepathically signaling the rest of the pack, who, on their part, are ready to move and change and adapt in both broadly scripted and unscripted ways. The wolves that are at the front of the pack are those who are best at seeing into the future. Because they have modeled innumerable scenarios, and considered the likely and the unlikely, they possess the talent and acuity, the intuition and prescience to ensure the flexibility and resilience of the organization. The wolves that follow, have been rehearsed on the most likely scenarios, and understand in an instant how to respond,

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## **Why Does Planning Fail?**

The biggest obstacles to the success of planning are usually located within the organization itself. They are:

- 1) The failure to have a plan, or to successfully communicate it to others.
- 2) Elevating the imperative to grow to a level that includes sacrificing differentiation and competitive advantage.
- 3) The failure to position the enterprise in the marketplace and establish a brand.
- 4) The failure to understand market saturation and the law of diminishing returns.
- 5) The failure to manage change.
- 6) The failure to have a contingency plan and to act upon it.
- 7) The failure of leadership to lead and make hard choices.

improvise, and change in new ways to remain competitive and viable and to recover from discontinuous change to adapt again.

Thus, scenario planning involves the development of “scenarios,” or images of the future, that included the best-case and worst-case, likely and unlikely options. The scenarios are then organized with next steps and plans to move the organization forward, ever remaining flexible and resilient.

Today, after both its historical ebb and flow, scenario planning is re-emerging as a technique for enhancing the effectiveness of strategic action and long-range thinking. Increasingly, it is being adopted within corporations, governments, NGOs, and non-profit organizations to explore the future and derive what prescience is available for those who fly far enough above the landscape to grasp the true significance of situations and opportunities. Scenario planning is a practice which should matter to those who desire to survive successfully in today’s increasingly discontinuous world.

Many may say, “Isn’t that what leaders already do?” The truth is that few leaders or executives actually achieve such acuity, or if they do, it is only for a short time, possibly during the “annual planning cycle.” While better at any time, than not at all, the real benefit of scenario planning is found in always being ready for uncertainty. The strength scenario planning imparts is that, in having thought about some of the shapes change and uncertainty may take, an organization gains flexibility in the face of uncertainty, and becomes resilience in its aftermath. Being able to negotiate uncertainty provides a competitive advantage, and a greater likelihood of surviving than rivals may possess.

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### Changing Global Demographics

During the 18th century, the now well-known political economist, Thomas Malthus, in his famous work, *Essay on the Principle of Population* (1798), expounded the theory that world population would grow unendingly without the natural constraints of war, famine, and disease.

Recent trends in global demographics, now reveal new factors limiting population growth, and suggest that by 2075 global population will have peaked and begun a substantial decline.

#### Falling Birth Rates

Throughout the 20th century, population predictions portended explosive global population growth and eventual Malthusian disaster. During the 1990s, it was feared that global population would reach 12 billion. Today, new population studies indicate that the present global population of 6 billion will level off by 2050 at 9 billion, and that by 2075 it will have declined by 500 million.

The global fertility rate, the rate at which a population replaces itself (with women bearing 2.1 children), is falling toward 1.85 children according to new United Nations predictions. Asia, Latin America, and both Western and Eastern Europe have been experiencing declining birthrates for years. Interestingly, birthrates are falling in virtually every country in the world today, with the exception of the U.S and France.

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In many countries, fertility rates have declined because of an interconnected set of reasons that include:

- 1) The availability of contraception which has allowed women to achieve higher levels of education, enhanced opportunities for employment, and greater individual financial independence.
- 2) The trend toward urbanization which makes it harder to support more than one or two children.
- 3) Governmental initiatives to limit family size in countries like China and Iran.

Ironically, in some nations such as Australia, Estonia,

Singapore, and Scandinavia, postponing and minimizing birthrates has reached such a peak, that those governments have been led to devise incentives to increase childbearing to ensure national survival.

The U.S. population continues to expand, experiencing birthrates at the replacement rate of 2.1, plus the continuing influx of immigration. Even with greater hurdles to immigration, the foreign-born population in the U.S. increased by 5% during 2002. The U.S. population is expected to expand from the present 280 million to 400 million over the next 50 years, with 80% of that growth consisting of either immigrants or the descendants of immigrants.

### **Economic Implications**

Population growth and sustained consumption are necessary to fuel the continued development of modern capitalism, both to provide a constant work force to drive productivity, and to ensure ongoing marketplace demand. The predicted population changes will, therefore, have profound implications for both business and the economy.

In general, prosperity reduces birthrates, which limits the work force, and leads to an increase in the elderly population. In Germany, Japan, and many of the developing world nations, the declining work forces are becoming unable to either maintain the necessary levels of productivity, or to support their rapidly increasing elderly populations.

In the U.S., where the over-85 population is expected to increase from the present 5 million to over 18 million by 2050, this increase is offset by a stable work force and increasing immigration from the developing nations. Globally, the youth of

many nations continue to immigrate to the U.S. and Western Europe in search of opportunity. These immigration trends continue within the U.S., despite the recent difficult economy and new, terrorism-related hurdles to immigration.

Economically and socially it is hard to predict what these complex demographic shifts will mean for either the domestic or the global economy. In the U.S., and to a lesser extend in Western Europe, both consumption and the work force are likely to continue to grow, with marketplace demand realigning along changing demographic lines. This suggests continually changing markets and shifting target audiences, presenting new challenges to both marketing and selling operations as they become more demographically targeted in their activities.

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