

CHAPTER ONE

WHAT IS VALUE?

“Oh Happiness! our being’s end and aim!”

– Alexander Pope, English poet, 1688–1744,
An Essay on Man, Epistle 4

What does the word “value” mean to you? In a business context, perhaps you define it as your company’s share price, or the book value on your corporate balance sheet. If you’re a marketer, you may think of it in terms of market share or customer satisfaction. As a parent, spouse, friend, or shopper, you may consider it a measure of something decidedly more personal.

With so many competing notions of value, and with the temptation to interpret value as whatever notion is most convenient for us at the time, how can anyone confidently talk about “managing for value”?

In the pages that follow, we offer a perspective on value and value creation that we hope clears away the confusion over these much-abused terms. What makes our definition of value different from the myriad of others is that our notion of value is not a social construct. It is not specific to time, place or context. It has nothing to do with anyone’s opinion. It is an idea driven by nature through an instinctive, collective process.

Value creation has nothing to do with beliefs – yours, ours, or anybody else’s. You may be familiar with the expression, *“Fifty million Frenchmen can’t be wrong.”* Well, yes they can. The same goes for 300 million Americans, a billion-plus Chinese, and so on. After all, it is entirely possible that every person working for Enron thought that their company was creating value when, in fact, it wasn’t. Tens of thousands or even

tens of millions of people believing that they are creating value does not make it so. Value creation, when properly understood, is not simply someone's ethical perspective on how to manage a company. Value creation is a self-generating, self-governing, basic planetary imperative based on nature itself, and if you don't uphold it, the planet will shut you down every time.

Consider a continuum of value where on one end we have the most basic of raw materials, and on the other, the consumers of these materials. Whether we're drilling for oil, pumping gas at the local service station, or driving the latest Jaguar, we are all participants somewhere within this value chain which rules the globe.

The reason it rules the globe is simple. Beyond our basic drives of food, shelter, and sex, we are driven to try to make each day of our lives a little better than the day before. To do so means finding ways to become happier, and that, at its most basic level, means taking the resources available to us and using them to create value. No matter what products or services we strive to create, our overall purpose is the same: delivering happiness to ourselves and creating ongoing value in our lives.

Value, in other words, is really just another word for happiness, at least from the perspective of the consumer. Consumption is a non-stop process that occupies every moment of our existence, whether we're conscious of it or not. Happiness is the cognitive experience that dominates our waking lives. As Richard Layard writes, "*We are programmed to seek happiness.*"

However, he also writes that, "*Generally, what makes us happy is good for us, and has therefore helped to perpetuate the species.*"¹ In other words, the creation of a system for delivering value – we call it business – was no accident. It was inevitable. We will say much more about this later, but for now, let's talk further about the basic value imperative by which we are all instinctively governed.

For humans, again, value equals happiness. To help deliver this happiness to ourselves, we at some point created businesses that could generate the products and services to make us a little happier each day. "Happier" might mean more comfortable. It might mean more excited or

¹ Richard Layard, *Happiness: Lessons from a New Science*, revised edition, (London: Penguin Books, 2011), p. 224.

interested. It might mean more entertained. It might mean better able to dust high window ledges. Business was the means of delivery. For any business to survive, not only must it deliver happiness that customers are willing to pay for (the “*cash applause of consumers*” as one observer puts it)², but the cash it receives must also be sufficient to cover that needed to pay its own suppliers, while at the same time ensuring a competitive return on the capital invested. From the perspective of business, we can therefore express value a different way. Later, we will introduce this other definition of value, and using it as a basis we will assert the concept of blue line management, the core thesis of this book. Blue line management is an approach that uncompromisingly focuses talent, energy, and decision-making on the sole objective of creating value. Every decision a company makes has an impact on value; it either creates value or destroys it. To put it in the starkest terms, blue line companies last because they are focused on long-term value. Other companies, which we refer to as red line companies, inevitably die because they are focused on other misguided definitions of value.

We Want Our Stuff

Allow us to talk a bit more about the concept of happiness. Since humans created business for the purpose of delivering happiness, and since this book is about what we are calling the value creation imperative, which stems from humankind’s overarching desire to be happy, happiness matters. A lot.

Happiness is relative, of course. What satisfies our needs, and therefore motivates us, may not satisfy yours. Some people may think of clean drinking water as their greatest need. Others might not feel happy unless presented with three different options for sparkling bottled water at a fancy restaurant. If you’re a subsistence farmer in Southeast Asia and you survive the winter, you’re happy. If you’re a middle manager who hits the targets and gets that coveted promotion, you’re happy. If you’re Warren Buffett giving away 99% of your wealth (currently estimated at

²Deidre N. McCloskey, “A Kirznerian Economic History of the World”, *The Annual Proceedings of the Wealth and Well-Being of Nations*, Upton Forum, 2010, p. 58.

\$47 billion)³ to good causes, and succeed in persuading a bunch of other billionaires to do likewise,⁴ you're likely to be very happy. What you seek, what helps you survive, what motivates you, is happiness.

Since what makes us happy is different from what makes you happy, what enables happiness for all of us – and anyone else – is choice. We are not made happy by the same things, so we deeply appreciate the chance to pick and choose the sources of our happiness from among a great variety of possibilities. The massive growth of consumerism, particularly in the last century, has today given us unprecedented amounts of choice. There really are umpteen different types of bottled water to choose from. We can buy bacon-flavored chocolate, and possibly even chocolate-flavored bacon, and if you're in the market for a new cell phone, well, the options are seemingly endless.

In the 1980s, a Canadian doctor we know took a group of visitors from Leningrad (now Saint Petersburg) on a tour in Canada, including a visit to a regular grocery store. The Russians were astonished at the huge number of choices available, in particular the dozens of varieties of breakfast cereal. They commented that back home in Leningrad, they had but two. Their Canadian host pointed out that he really only liked two of the cereals on display, so he didn't understand the need for so many. But he realized that while other customers at the store might also enjoy only two of the cereals on offer, their two favorites would probably be different from his. Perhaps this crazy plethora of cereals was needed after all, at least according to the definition of our collective happiness.

A similar story was told by heavyweight boxing champion Vitali Klitschko on describing the shock he felt during his first visit to an American supermarket: *"I thought there was only one type of cheese, you know, the thing we'd always called 'cheese,' and in a grocery store, I saw a hundred kinds of cheese! It was amazing."*⁵ Why a hundred cheeses? It's the only way to accommodate everyone's taste.

³T. Leonard, "The dinner that cost Bill Gates, Warren Buffet and other celebrities billions", *Daily Telegraph* online, 2010, <http://www.telegraph.co.uk/news/world-news/northamerica/usa/7929657/The-dinner-that-cost-Bill-Gates-Warren-Buffett-and-other-celebrities-billions.html>

⁴<http://givingpledge.org/>

⁵http://www.grantland.com/story/_/id/7128487/vitali-wladimir-klitschko

Naturally, it doesn't stop with cereal and cheese. We want choice for everything we desire. “*‘Desire’ as a fundamental aspect of the self,*” wrote historian Jan de Vries, “*is not a product of modern industrial capitalism; its origins are to be found earlier.*” It began, he asserts, in Western Europe in the seventeenth century, during a process he termed the “*Industrious Revolution,*” when increased consumption of luxury goods led to a desire for more income, changing people's working habits and spurring the creation of faster, more efficient production methods.⁶

We could go back even further. What we desire has always driven our decisions regarding where and how to direct our time and energy. But as we'll see shortly, it is only within the last few centuries that an efficient, shared method for really improving our lives has emerged, changing the landscape forever.

So what does all this conversation about happiness and choice have to do with you as a business leader? Everything. As consumers, we value, and are therefore willing to pay for, the products and services that make us happy, whatever our definition of happiness is. The only job of any business is to figure out what makes people happy and then try to deliver that happiness at a price the consumers find reasonable, while at the same time earning a competitive return on invested capital. If a business can do that sustainably, it is value-creating.

But if it can't find out what makes people happy, or if it thinks it has figured it out but is wrong, or if it figures it out but charges too much for that happiness, or, finally, if it has figured out what makes people happy and charges the right amount for it but can't make enough profit to adequately compensate for its own capital outlay, it will die. This may take some time, but the inevitable will happen eventually. We as consumers will kill the business because it is not creating value in our lives.

Sometimes we don't know what we want of course, and that can make your job very tricky. When Gillette released their MACH3 three-blade razor in 1998, it was an enormous success. Soon after, the company surveyed its customers to see if they might prefer a four-blade razor. The majority said no, they were quite content with the three blades, so Gillette decided not to develop a new razor.

⁶J. De Vries, *The Industrious Revolution: Consumer Behavior and the Household Economy, 1650 to the Present*, (New York: Cambridge University Press, 2008), p. 43.

In 2004, rival shaving company Wilkinson Sword (Schick in the US) released a four-blade razor, the Quattro. Consumers embraced the Quattro, buying it in droves. Had Gillette's customers lied? No – they simply didn't know what they wanted. (This particular battle is far from over. Gillette introduced the five-bladed Fusion razor in 2006.)

Not only are there differences between what makes us happy and what makes you happy; even more important, what makes any of us happy today may not make us happy tomorrow. As shown above, we don't even know whether we prefer three razor blades or four. How can we be expected to decide on the really important stuff? Did we know we wanted the iPad before it arrived? Did we know we needed cameras in our cell phones? No.

The only thing certain is that companies need to constantly innovate in order to keep providing us with the things that make us happy, and therefore create value. As Steve Jobs explained, *"It's not about fooling people, and it's not about convincing people that they want something they don't. We figure out what we want. And I think we're pretty good at having the right discipline to think through whether a lot of other people are going to want it, too. That's what we get paid to do."*⁷

It's hard enough for companies to figure out what makes us happy when we ourselves don't always know what we want. Making matters worse, market researchers and others who research the customer psyche can't necessarily be relied upon to accurately reveal what we find valuable. The French vilify McDonald's, yet there are now over one thousand McDonald's, or McDo, as they are called locally, in France – including one in the Louvre. Even worse for the naysayers, the McDonald's on the Champs-Élysées is the most profitable in the world.⁸

Behavioral researchers have begun to question whether all of this choice is really good for us – whether, in the grand scheme, it really serves to create value for humanity.⁹ According to one observer, *"Choice*

⁷<http://www.investinganswers.com/a/50-quotes-genius-behind-apple>

⁸http://www.huffingtonpost.com/2009/10/05/mcdonalds-to-open-a-resta_n_309453.html

⁹"The Tyranny of Choice", *The Economist*, December 18, 2010, pp. 111–113.

*no longer liberates, but debilitates. It might even be said to tyrannise.*¹⁰ It is suggested in some circles that such a bewildering array of choice in just about everything we buy leads to confusion, indecision, panic, buyer's regret, and anxiety. Researchers at McKinsey & Company estimate that if one were to add up all the different sizes, shapes, colors, and flavors of all the products on offer in a major economy such as New York or London, it would come to over ten billion distinct items.¹¹

Does this panoply of choice cause us to feel overwhelmed at times? Sure. But it's the unavoidable by-product of human innovation driven by human desire for happiness, that is, value.

Consider for a moment the alternative. Humans have been struggling for millennia to reach a state in which we ourselves, and not others, get to make the critical choices in our own lives. What's more, since our wants and desires are so varied, the only way they can all be accommodated is by the vast range of choice we are only now beginning to witness – no doubt there is still a long way to go. For practically the whole of human existence, most people on the planet had no choice but to defer to their social betters in terms of what level or status they could aspire to – or even, more simply, what stuff they were entitled to get. It's a good bet that our ancestors, observing our lives today, would have little sympathy for the plight of having too much choice.

Trader Joe's is a fast-growing retail grocery chain in the US. The average Trader Joe's carries only about 10% of the stock-keeping units of a typical supermarket, and most of those products carry one of the company's own brands. For example, if you're looking for Frito Lay corn chips, you won't find them at Trader Joe's. You will find instead a store brand of pita chips made in a Frito Lay factory. If you're seeking a full range of snack foods, or branded products in any food group, you'll have to visit a more conventional grocery store.

Yet Trader Joe's is one of the fastest-growing retailers in the US. Friendly, high-quality service is one reason. But another is that some shoppers apparently prefer the limited range, preferring to ask for guidance

¹⁰Ibid., p. 112.

¹¹Tim Harford, *Adapt: Why Success Always Starts with Failure*, (New York: Farrar, Straus and Giroux, 2011), p. 3.

from the merchandise buyers at Trader Joe's instead of making decisions themselves.

But there's an important point here that we shouldn't forget. Shopping at Trader Joe's is itself a choice. Outsourcing some of your shopping decisions to the people at Trader Joe's? That's a choice too, and a pretty powerful one. Should the habitual Trader Joe's clientele occasionally duck out to a Safeway or Winn-Dixie to get that must-have brand that they can't find at their favorite grocer, well, that's a third choice. Yes, we can rant all we want about the tyranny of choice, but again, don't try to play that card with your subsistence-driven ancestors who would probably want to stick a mastodon bone in your eye.

For business managers, the practical consequence of all this choice is simple, yet challenging. Choice is, as we said, about giving customers what they want, for a price they are willing to pay, while making a profit.

Let's focus on the first two parts of that statement: giving customers what *they* want, for a price *they* are willing to pay. You don't dictate these choices; they do. Every decision, from initial product development to final packaging, must be made with a view toward ensuring that the cost of adding features is less than what the customer is willing to pay. If you can accomplish this, you are reaching blue line nirvana: increasing both the customer's happiness and your company's value.

You can only deliver benefit to customers in two ways: by providing higher quality products and services – that is, increased happiness – at the same cost, or by providing the same products and services at a lower cost – increased happiness by a different name. Both equate to a bump-up in happiness without a corresponding increase in the resources required to deliver it. Value creation, and therefore the long-run survival of your business, depends on the achievement of at least one of the two versions of this feat.

Business history is littered with stories of companies that suffered because they failed to heed this lesson. Xerox insisted on adding more and more features to their copiers without any regard to whether these features were the ones their customers saw as important. When Canon then entered the fray with simpler machines that did what the customers really wanted them to do – namely copy documents well – without any bells and whistles, Xerox sales collapsed. As Peter Drucker reminds

us, *“Quality in a product or service is not what the supplier puts in. It is what the customer gets out and is willing to pay for. A product is not quality because it is hard to make and costs a lot of money, as manufacturers typically believe. This is incompetence. Customers pay only for what is of use to them and gives them value. Nothing else constitutes quality.”*

We are particularly fond of Toyota’s approach to value. The Toyota Production System, as described by Professor Jeffrey Liker, *“starts with the customer by asking, ‘What value are we adding from the customer’s perspective?’ Because the only thing that adds value in any type of process – manufacturing, marketing, development – is the physical transformation of that product, service, or activity into something the customer wants.”*¹² This philosophy points to the almost religious significance Toyota places on squeezing waste from the system anywhere it can. Toyota believes steadfastly that every activity the company performs must contribute to value for the customer. Everything else counts as squandered resources.

As we said above, what makes us happy can also be what helps us survive. Our “stuff” is more than just expensive water in restaurants or razors with extra blades, to be sure. It’s also what keeps us warm, feeds us, or helps make us better when we get sick.

This wasn’t always the case, of course. Human history suggests it’s only relatively recently that we started to make a noteworthy dent in the problems of basic survival, let alone becoming the technologically-indulged creatures we are today. For reasons we’ll explain in a bit, true value creation is a relatively recent human phenomenon, with virtually all of the improvements in our living standards taking place over the last 400 years.

Sustained value creation is even more recent than that. The Industrial Revolution may have begun in earnest sometime around the middle or latter part of the eighteenth century, but it didn’t translate to overnight value creation. Noticeably improved living standards among the working

¹²Jeffrey K. Liker, *The Toyota Way*, (New York: McGraw-Hill, 2004), p. 9–10.

classes were not evident for at least another 75 years. We haven't been getting our stuff for very long.

Centuries of Subsistence

*"Throughout recorded history, most people in Europe – as elsewhere in the world – had possessed just four kinds of things: those they inherited from their parents; those they made themselves; those they bartered or exchanged with others; and those few items they had been obliged to purchase for cash, almost always made by someone they knew."*¹³

– Tony Judt, historian, 1948–2010

Until a few hundred years ago, the human experience had changed very little. Over the millennia since we first became upright, people reliably died young, cold, hungry, and of what we now think of as trivial diseases. This was a function of how human groups evolved, from hunter-gatherer bands of 10 to 100 people to larger tribes, chiefdoms, and eventually empires. As the size of our groups increased, we went from being able to share our catch and fires with our nearest kin, in what one scholar calls "evolutionary egalitarianism,"¹⁴ to being part of a hierarchical system that concentrated economic power among a relative few. This left the rest of the population impoverished, and with negligible chance of changing their lives for the better.

Until we could find a way to circumvent this problem, we were stuck with subsistence, a condition that afflicted much of humanity well into the nineteenth century. In France and other parts of Europe, people even developed a form of hibernation, where they would virtually shut down their existence for half the year, focusing strictly on staying alive. They had nothing to do, no fields to till, and not enough food to sustain them if they were to go out and be active during the cold months. Writing in

¹³Quote taken from Tony Judt, *Postwar: A History of Europe since 1945*, (New York: Penguin Books, 2005), p. 337.

¹⁴M. Shermer, *The Mind of the Market*, (New York: Henry Holt and Company, 2008), p. 18.

the *New York Times*, Graham Robb pointed out that “*Villages and even small towns were silent, with barely a column of smoke to reveal a human presence.*”¹⁵ He also cited a 1900 edition of *The British Medical Journal* describing how peasants in Pskov, Russia, similarly slept for half the year: “*At the first fall of snow, the whole family gathers round the stove, lies down, ceases to wrestle with the problems of human existence, and quietly goes to sleep. . . . After six months . . . the family wakes up . . . and goes out to see if the grass is growing.*”¹⁶

A Matter of Power

The past was a simpler time undeniably, but undeserving of the nostalgia often ascribed to it. Many people in the old days had more “leisure time” than we have today, but when we speak of leisure in this context, it’s far from the idea of leisure we have today. It’s not the time we take to pursue cultural, sporting, and social activities. Well into the nineteenth century, the great majority of people on earth lived lives that were little better than those of our Stone Age ancestors. Often lacking the calories needed for a full and productive life and the consumer goods that offer pleasure and comfort, they did little more than survive.

Sometimes, not even that. Even in relatively rich countries like France, large swathes of the population were never more than one bad harvest away from famine. Indeed, the lingering effects of this threat and the persistent fear of hunger could be found in the many proverbs and ritual phrases in use well into the twentieth century: “*Don’t eat everything at once,*” “*You’ve got to stretch things out,*”¹⁷ and so on.

Even as conditions improved, entrenched habits of conservation and frugality died hard. Historian Eugen Weber noted that many peasants in France around the turn of the twentieth century continued to eat inferior barley bread even as white bread became more plentiful and less expensive.

¹⁵G. Robb, “The Big Sleep”, *New York Times*, 2007, <http://www.nytimes.com/2007/11/25/opinion/25robb.html>

¹⁶*Ibid.*, <http://www.nytimes.com/2007/11/25/opinion/25robb.html>

¹⁷Eugen Weber, *From Peasants to Frenchmen: The Modernization of Rural France, 1870–1914*, (Stanford (CA): Stanford University Press, 1976), p. 137.

They feared they would eat the white bread “*with too much pleasure, and hence consume too much.*”¹⁸

In the Netherlands, old habits linger even to this day, despite the fact that the country has for centuries been one of the world’s richest. The Dutch are still reluctant to light candles until after sunset, evoking a cultural memory in which saving candles mattered. What’s more, they still re-use teabags and coffee grounds as a matter of course.¹⁹ Tony Judt reminds us that for “*the overwhelming majority of the [west] European population up to the middle of the twentieth century, ‘disposable income’ was a contradiction in terms.*”²⁰ It’s jarringly easy to forget just how recently the grinding routines of material scarcity held sway over every aspect of human life.

People were less economically active in pre-modern societies in part because there was so little to buy – assuming one could even get one’s hands on some money. Why was there so little stuff available? Two reasons. First, in most societies, multiple unseen forces were marshaled against change to the prevailing social order. Second, and critically for this book, there was no mechanism to enable the people with the ideas and inventions to help us survive and make us happy – today we call them entrepreneurs – to get the financial backing they needed to see their ideas to fruition.

Put more simply, there was no way to make sure we got our stuff. Historians tend to ignore the role consumers played in human development, but we see it differently. Consumerism, by spurring the desire for us to earn money, was powerful enough to subvert a traditional hierarchy that had lasted for centuries and generate an endless upward spiral of improvement in the human condition as entrepreneurs and companies became able to provide us with what we needed to make our lives better.

What sort of forces had conspired to keep humankind in servitude? For many centuries, entrepreneurs, at least the sort that tried to com-

¹⁸Ibid.

¹⁹Deirdre N. McCloskey, *The Bourgeois Virtues: Ethics for an Age of Commerce*, (Chicago: University of Chicago Press, 2006), p. 425–426.

²⁰Tony Judt, op cit., p. 337.

mercialize innovations and make them available to the wider public, were frowned upon. There are only two ways to make money. The first is to improve the world and take a cut in the process. The second is to rip people off. Let us call the first method Productive Entrepreneurship and the second Conscious Fleecing. For a long time, it stood to reason that Productive Entrepreneurship was not viewed as a reasonable path to riches or status. Economist William Baumol pointed out that for the Romans, “*As long as it did not involve participation in industry or commerce, there was nothing degrading about the wealth acquisition process.*”²¹ Those who did acquire their wealth via industry or commerce were typically freedmen – former slaves – and therefore socially stigmatized.

In medieval Europe, it wasn’t that enterprise was frowned on; it was merely considered a waste of time unless it helped promote warfare or aided in capturing a neighbor’s castles and lands. Ideas for better siege machines or more sophisticated weaponry had a good chance of seeing the light of day, but those ideas aimed at improving the lot of the common man made little headway.

The ancient Chinese had a similarly unenthusiastic view of commerce. Instead of inventing things and working to make everyone’s lives better, thousands of men sought advancement by sitting the imperial examinations and becoming bureaucrats. If they passed, they moved into a position of power with access to tax and other legal and not-so-legal revenues. Even in the twenty-first century, such behavior is not uncommon. Practices similar to those of the Chinese mandarins have emerged in Russia, where government officials – dubbed “*bureaucrat-entrepreneurs*” by *The Economist* – exploit a weak Russian state through a combination of racketeering and outright theft of budget revenues.²²

Throughout history, sumptuary laws – laws regulating consumption – were also used to restrict what certain people could buy or wear, therefore maintaining social rank, privilege, and discrimination. The Romans had

²¹W.J. Baumol, “Entrepreneurship: Productive, Unproductive, and Destructive”, *Journal of Political Economy*, 1990, 98(5), part 1., p. 899.

²²“Frost at the Core”, *The Economist*, December 11, 2010, pp. 25–28.

rules about how many stripes you could have on your toga and who was allowed to don silk. In ancient Greece, only prostitutes could model embroidered robes in public. In Imperial China, only those of noble blood were permitted to wear yellow. Even in late nineteenth-century France, the bourgeoisie and intellectual classes frequently expressed contempt for those peasants and working-class folk who tried to emulate the dress of their social betters.

But history teaches us something else: that laws or social norms designed to try to control what people can do or get, don't work. Human ambition and the drive for entrepreneurship will come to the fore time and time again. Did Prohibition in the United States work? Of course not. Creating rules that prevent people from getting access to the stuff they want doesn't stop them from wanting it. Or from finding ways to get it.

The problem throughout all these generations was that though entrepreneurship is a relentless human drive, it requires a system to make it work. While it is romantic to think that money doesn't make the world go round, it does. If innovative ideas can't get funded, they can't transform from ideas into reality – they never become the stuff that makes our lives better.

For thousands of years, the chances of an entrepreneur realizing his dreams were extremely limited. Capital allocation – funding – was driven purely by relationships. Because assessing the true value of an idea was so difficult, investors made decisions based not on whether an idea had merit but whether they thought the person behind the idea was trustworthy.

But there was a larger problem. For most of our history, in most places where we existed, the wealth was held by a select few, and these few were very hard to reach, unless you had the right contacts. For those with innovative ideas, procuring the funding necessary to create their new machine or product was next to impossible. The investment environment was, in other words, extraordinarily inefficient. The funds that were available systematically went to the wrong people because they were the relatives, friends, or friends of friends of those in power; or because they were politically shrewd; or because they were good at passing exams; or because they were good at killing more people than the next man, or perhaps the right people at the right time.

In such environments, the vast majority of new, potentially worthwhile ideas failed to acquire the resources they needed. The result? Thousands, possibly millions, of opportunities to improve the lot of humankind remained in the shadows. In the pre-modern world, personal connections and the circumstances of one's birth mattered much more than the inherent value of an idea.

Not only did the possibility of getting money for your idea depend mostly on who you knew or were related to, even if you somehow got your hands on some funds, the risks of borrowing were big. From the moment the Babylonian King Hammurabi announced his famous codes of law nearly 4,000 years ago, being in debt became a seriously dangerous proposition. If the debtor wasn't able to pay off what he owed, the lender was entitled to three years hard labor from him – although in fairness to Hammurabi, the debtor did have the option of sending his wife or child instead.

It wasn't just a matter of paying back what you had initially borrowed. Interest rates on personal loans were huge because the risks of lending were so high. First, there was the possibility that the idea might not work. Second, books like the Bible, the Torah, and the Qur'an all spoke out against lending and charging interest, calling it usury (which still exists today under Islamic law), meaning that those who lent money could not legally charge interest.

There was a way around this however. Expressions such as "*Thou shalt not lend upon usury to thy brother*"²³ could be interpreted to mean that interest *could* be charged on money lent to other tribes, for instance by Jews to Gentiles – hence the *banchi* or benches on the Rialto in Venice, where Jewish moneylenders operated and where Shakespeare's Antonio (*The Merchant of Venice*) came to borrow money from Shylock. Jews who charged interest on loans to fellow Jews faced social exclusion. That was bad enough, but the moneylenders also risked their lives lending to non-Jews, because as a minority, they were that much more vulnerable to persecution, or even death, should things not go smoothly. There was no institution of law to protect lenders, contributing again to

²³King James Bible, Deuteronomy 23:19.

what was a wildly inefficient, illogical system. Small wonder interest rates were astronomical.

If borrowing privately was fraught with risk, trying to borrow from a bank wasn't much better. The banks had long operated on a simple, ancient business model: those who managed to scrape together enough savings could give the bank some money to protect it, as long as they were willing to pay for the favor. The banks' attitude was this: just as a primitive man might try to save some corn over the winter but would naturally expect there to be less of it when he went back to it later because of climate, other hungry animals, and so on; surely depositors would not expect all of their money back after depositing some of it for protection?

Quite secure in this logic, the banks would lend the deposited money out to those it felt were better able to repay it – typically, their friends, or those who didn't really need the money in the first place. The banks were far less than the efficient facilitator of funds society needed; they were part of the problem instead.

A further impediment to the realization of entrepreneurial ambition was the absence of “free incorporation.” Until the nineteenth century, incorporation in most countries required the consent of the ruling elites – the monarch, parliament, or whoever else sat at the head of the proverbial table. In England, for example, not until 1844 could corporations be formed without state permission. Not surprisingly, incumbent corporations used these rules to their advantage by limiting competition and maintaining a bigger share of the pie.²⁴

Finally, for those entrepreneurs who actually gained an opportunity, the decision to pursue it wasn't so easy. We all know the experience of hoping for the chance to do something only to feel extremely intimidated and anxious once that chance presents itself. Entrepreneurship in any age carries risk, and for many in the pre-modern world, the risk was too great. As the American historian Eugen Weber reminds us in his work on late nineteenth-century French peasantry, “*The narrower the margin, the*

²⁴Timur Kuran, *The Long Divergence: How Islamic Law Held Back the Middle East*, (Princeton: Princeton University Press, 2011), p. 121 and p. 319 (n.13).

*less the chance of experiment. Only the rich took chances – or the irresponsible.*²⁵

In short, if the poor wanted to survive, they had little choice but to work with what they had and think no bigger. Even if you did have a great idea for changing the world, was it worth investing the time and energy, and assuming the risk, to try to make it work? Probably not. Even for the boldest or most innovative thinkers among the poor (i.e., most people), to try and fail didn't just mean dusting yourself off and trying again; in most cases it meant starving, and quickly.

Weber goes on to say that “*Subsistence farming – raising a bit of everything and making one's own bread and clothing – was a matter not of blind routine but of calculated necessity.*”²⁶ This autarkic existence made it virtually impossible for peasants to accumulate any surplus or savings. In those instances where a bit of accumulation was possible, it was swiftly taxed away, seized by rapacious lenders charging usurious interest, or spent on adjoining land. Precious little was left for trying to make the world a better place.

The Rise of the Consumer

“Every man is a consumer, and ought to be a producer. He fails to make his place good in the world, unless he not only pays his debt, but also adds something to the common wealth. Nor can he do justice to his genius, without making some larger demand on the world, than his subsistence.”

– *The Conduct of Life*, Ralph Waldo Emerson,
American philosopher and poet, 1803–1882²⁷

As Emerson so sensibly points out, our roles as consumers go hand in hand with our roles as producers. We produce things to consume; and because we want to consume, we produce.

²⁵Eugen Weber, op. cit., p. 480.

²⁶Ibid., p. 481.

²⁷<http://classiclit.about.com/library/bl-etexts/rwemerson/bl-rwemer-conduct-3.htm>

This wasn't always the case. Renaissance Europe may have had many fine things – art, architecture, gold, jewels – but it wasn't what we would today consider a consumerist society, at least not in the collective sense. Luxuries were the exclusive domain of the aristocracy – the landed rich – and remained to the common man as out of reach as flying to the moon. Because of this vast gulf between the haves and the have-nots, our subsisting, hibernating peasants felt no incentive to work harder in the fields than they already did, or to make wares in their spare time to sell, since there wasn't much they could spend any extra money on, anyway.

Still, they felt the desire to reach beyond, to do more. They felt the powerful urge to produce and invent – to somehow enhance the comforts of their life and find ways to bring what is sometimes called “old luxury” within the grasp of more than just a privileged few. Though they may not have described the urge this way, they were striving to create “new luxury” that could be available, ideally, to everyone.

We can trace the beginnings of what we think of today as consumerism – a system that encourages the purchasing of goods and services in ever-greater amounts – back to the seventeenth century. The clearest evidence of these beginnings can be seen in the trading activities initiated by the Dutch and British East India companies. When their ships started returning from their overseas voyages, they brought back with them products and materials – spices, coffee, tea, silk, porcelain – that were available to anyone who had the means. As a result, people were encouraged to find new ways to make money. Even women and children were allowed to participate in the new system, which has been termed proto-industry.

Suddenly, from having no incentive to earn more money or produce anything different – or having much spare time to do it anyway – people had a reason to use any time not spent surviving, to try to make more money so they could buy the fantastic things coming back from unknown, faraway places. The result was predictable and remarkable. The output of the average person rose dramatically and only in part because of technological progress. This change came about largely for a much simpler reason: people wanted to earn more so they could buy things. It was a simple but powerful chain of logic. Because these things were being produced in large quantities for the first time, they were becoming

available to anyone who could make enough extra money to buy them. This opportunity – the opportunity to consume – encouraged people to work their tails off.

Was their desire to buy blind, aimless, or irrational? Hardly. People wanted to buy the things that the ships were bringing in because they were acutely aware that those things would improve their lives. In England, for instance, the arrival of lightweight calico from India and gingham from the Far East meant people could discard the traditional, home-grown thick linens and wools in summer. In Holland and elsewhere, the arrival and quick dissemination of tea transformed it from being a drink of the elite to a universal comfort and pleasure. People suddenly had ways to access the lifestyle of the previously untouchable rich. They drank coffee, smoked tobacco, ate chocolate. It made them feel good. It made them feel important.

And, once they got the taste for it, it made them want more. The Dutch East India Company at first imported a few thousand plates, bowls, vases, and the like from Asia. By the end of the eighteenth century that number had grown into the millions, and because of this mass production and mass availability, fewer and fewer items remained as the exclusive domain of the elite class. As consumerism exploded, social distinction eroded. What might be sold to the aristocracy as a high-quality, high-priced product was soon being produced in volume and sold cheaply to the masses. Jan de Vries traced this pattern by assessing the different quality of Delft tiles found in canal houses and more humble abodes throughout Holland. While the rich continued to enjoy the most expensive wares produced in Delft's workshops, various gradations of quality (and the resulting lower prices) made it possible for others to enjoy the decorative and aesthetic pleasures that came from owning such products.

The pattern continues today of course. Cheap versions of the latest Chanel bag or Hermès scarf are never far away. Even the iPad didn't last long as the only tablet on the market, with Samsung, Amazon, LG, and other manufacturers rushing to offer lower-priced versions and capture those consumers unwilling, or unable, to pay Apple prices.

Commentators from Jean-Jacques Rousseau in the eighteenth century to John Kenneth Galbraith in the twentieth lamented these developments, equating mass consumerism with an exploitative form of capitalism that

loses sight of the greater good and creates an underclass that can't distinguish between what it wants and what it needs. This, they claim, leads people to want to emulate those socially higher than themselves, rather than support innovation that truly meets their needs and desires. Thus, the argument goes, this type of consumerism must be bad for people.

But as the great economist Joseph Schumpeter wrote, "*The capitalist achievement does not typically consist in providing more silk stockings for queens, but in bringing them within the reach of factory girls in return for steadily decreasing amounts of effort.*"²⁸ Three centuries of innovation spurred by the need to provide what consumers want has given us not only cheaper commodities and all the gadgets that help us organize our time and maintain our social networks, but also the telephone, MRI scanners, and key-hole surgery. It is of course true that some of the things we come up with don't provide happiness or create value, but these inventions don't last. Eventually, enough of us reject them and they go away.

Alleviating the burden of survival did more than allow people to breathe more easily. It also gave them the chance to think – to focus outside their immediate environment, to consider society as a whole, the way it worked, what it might do better. Without a drastic change in the way society functioned, from feudalism to greater self-determination, and with what economic historian Joel Mokyr referred to as "*a conscious belief in the possibility of continuous betterment of society,*"²⁹ we would never have had the Age of Enlightenment of the eighteenth century. In addition, humankind might never have questioned the way societies operated and we might never have developed the scientific method. Consumerism also gave the English, Napoleon's so-called "nation of shopkeepers," an economic strength that enabled campaigners to establish the political will to abolish slavery. Our desire for happiness is a powerful collective force. It weeds out the ideas that don't truly create value and supports

²⁸Thomas K. McCraw, *Prophet of Innovation: Joseph Schumpeter and Creative Destruction*, (Boston: Harvard University Press, 2007), p. 9.

²⁹Joel Mokyr, *The Enlightened Economy: An Economic History of Britain 1700–1850*, (New Haven and London: Yale University Press, 2009), p. 33.

the ones that do. The drive to create stuff that makes our lives better comes not from a selfish, aimless, or counterproductive instinct but from a communal sense of value that over time, impels economic, social, and political change in ways that few people, if any, understand.

In order to have the things we want, we need people and businesses to have good ideas, be able to convert those ideas into stuff, and then to figure out a way to get that stuff to us. This has always been the necessary equation for the creation of value, but until a few hundred years ago, it wasn't possible. Whether our most pressing wants are represented by basic survival, Asian porcelain, or gold-plated faucets, each part of this chain – the original idea, the ability to turn it into something, and a method of delivery – must be satisfied. But consumerism couldn't become a reality until a mechanism surfaced that would enable it. It's time to talk about what kick-started society into the explosion of innovation that makes our lives today longer, easier, and happier than those of our ancestors. It's time to talk about the capital markets.

