In Praise of Ecological Rationality: The Return of Practical Wisdom to Management

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By David K. Hurst

This article examines some developments over the last fifty years in management thought and practice. It highlights what the author believes to be the need for the formal return of practical wisdom to the field in the form of "ecological rationality". The article is based upon his new book, The New Ecology of Leadership: Business Mastery in a Chaotic World (Columbia University Press, 2012).

The Professionalization of Management

Just over fifty years ago in America a concerted attempt was made to professionalize the field of management and set it on the path toward becoming a science in the mould of economics. Executives and their war stories were expelled from the academy and gradually replaced with freshly-minted PhDs in functional disciplines, like finance, accounting, production, marketing, statistics and so on. Business experience was no longer regarded as necessary for researchers, as the hunt began for context-free management principles. The “gold-standard” for management rationality was instrumental and oriented towards the pursuit of effective means to achieve desirable ends. The economists called them “rational-agents”. Management, it was hoped, could aspire to become a profession, like the law or medicine.[1]

Initially this emphasis on the functional disciplines seemed to serve the business schools and their clients well. America was the only large industrial economy to come through World War II with its infrastructure intact. The widely anticipated post-War slump failed to materialize and a baby and consumer boom ensued. The war had spurred numerous technological developments that now began to play their way out into the consumer sector. The priorities of the largest American corporations were growth, economies of scale and the production of more of the same.

This does not mean that all was smooth sailing in the management academy. Periodic oscillations between “left” and “right” wing views of human nature have been a feature of the field since the beginning of the 20th century and the emergence of a formal “scientific” approach in the late 1950s did not change this. There was constant friction between the proponents of “rigour” and the champions of “relevance”. Indeed the field has recently been described as a “battleground” between radically different views of human nature.[2]

Change in the 1970s

Everything began to change in the 1970s. German, Japan and other advanced industrial nations had rebuilt their economies with the latest technologies and were now competitive in many areas. The oil crises undermined the cheap energy on which the American economy had been founded, disrupting a slew of industries. At the same time, a fight broke out for the control of corporate America. Critics charged that complacent corporate managers were feathering their own nests at the expense of their shareholders. New rigorous financial frameworks, such as the Capital Asset Pricing Model (CAPM) and concepts such as the Efficient Market Hypothesis (EMH) encouraged a far more data-driven approach to areas that has hitherto had been seen as requiring executive judgement. The Shareholder Value (SHV) model, which contended that the sole purpose of managers was to maximize profits, began its long rise to ascendancy. At the business schools, the finance function became top dog.

At roughly the same time as the rise of the SHV and the ascent of finance, another “left wing” revolt broke out in the management academy. This was the leadership movement, which eventually emerged as a distinct discipline. Its critics contended that the concept of leadership was poorly defined and that the discipline was far from rigorous. Its proponents argued that at least it was relevant and that it addressed real issues that managers and their organization faced. The debate has continued until this day.

Doubts And Revelations

Everything began to change again in the field of management with the financial crash of 2008 and the "Great Recession" or "Great Stagnation" (depending on your point of view) that followed it. The crash was not supposed to happen. If markets were self-equilibrating, the way most economists assumed they should be, and investors were rational in the logical sense of the term, it shouldn't have. Some diehards have contended that the problem was that the markets weren't free enough, but few will find these arguments persuasive. There is now a profound distrust in the ability of markets for financial assets to regulate themselves. At the firm level, the SHV model and the stock-based incentive schemes that accompanied it have come in for severe criticism.[3] Multiple management shenanigans to game the system have made some despair over ever making management a profession. There is a feeling that things can never be the same again: some commentators have described what they see as a loss of faith in Anglo-Saxon capitalism.

Onto this conflicted scene have come new findings about human nature from many different fields, including anthropology, behavioural economics, evolutionary biology, evolutionary psychology and neuroscience. There are two takes on these revelations. The first is psychologist, Daniel Kahneman's work on human nature, entitled "heuristics and biases."[4] Kahneman identified two fictional systems in the mind (fictional because they do not actually exist as separate systems). System 1 is an automatic, fast-acting, associative system that is continually searching for familiar patterns. System 2 is a slow, effortful, logical system that can make complex calculations. It is this system that we associate with the economists' concept of managers as rational-agents.

Kahneman's development of prospect theory, together with the late Amos Tversky, earned him a share of the 2002 Nobel Prize for Economics. Unfortunately the pejorative "biases", together with his failure to outline a concept of rationality of his own, has resulted in a "glass half-empty" view of rationality. It has left the gold standard for rationality with the management scientists and the economists by default.

There is, however, a second, more optimistic take on the new discoveries about human nature. This "glass half-full" view is the concept of "ecological rationality", which also featured in the 2002 Nobel Prize for economics, but in the acceptance speech from the other recipient, economist Vernon Smith.[5] Ecological rationality does not regard the human mind as a general-purpose computer, as we thought it might be fifty years ago. Instead it sees it as a collection of myriad special-purpose "apps", cobbled together by evolution. Our minds have evolved to extract cues to action from the contexts in which we find ourselves. We can "think" about the world *in just as many ways as we experience it!* Thus context matters and history matters.

Ecological Rationality and Management

My book, *The New Ecology of Leadership: Business Mastery in a Chaotic World*, uses disciplined analogies between natural ecosystems, like forests, and human organizations to understand how organizations are conceived in passion, born in communities of trust, grow through the application of reason and mature in power. The ecological framework allows one to understand how an organization's strengths can gradually become weaknesses in changing circumstances, but why its executives might refuse to recognize this, cling to their strategy and be quite unable to change and renew either the organization or themselves.

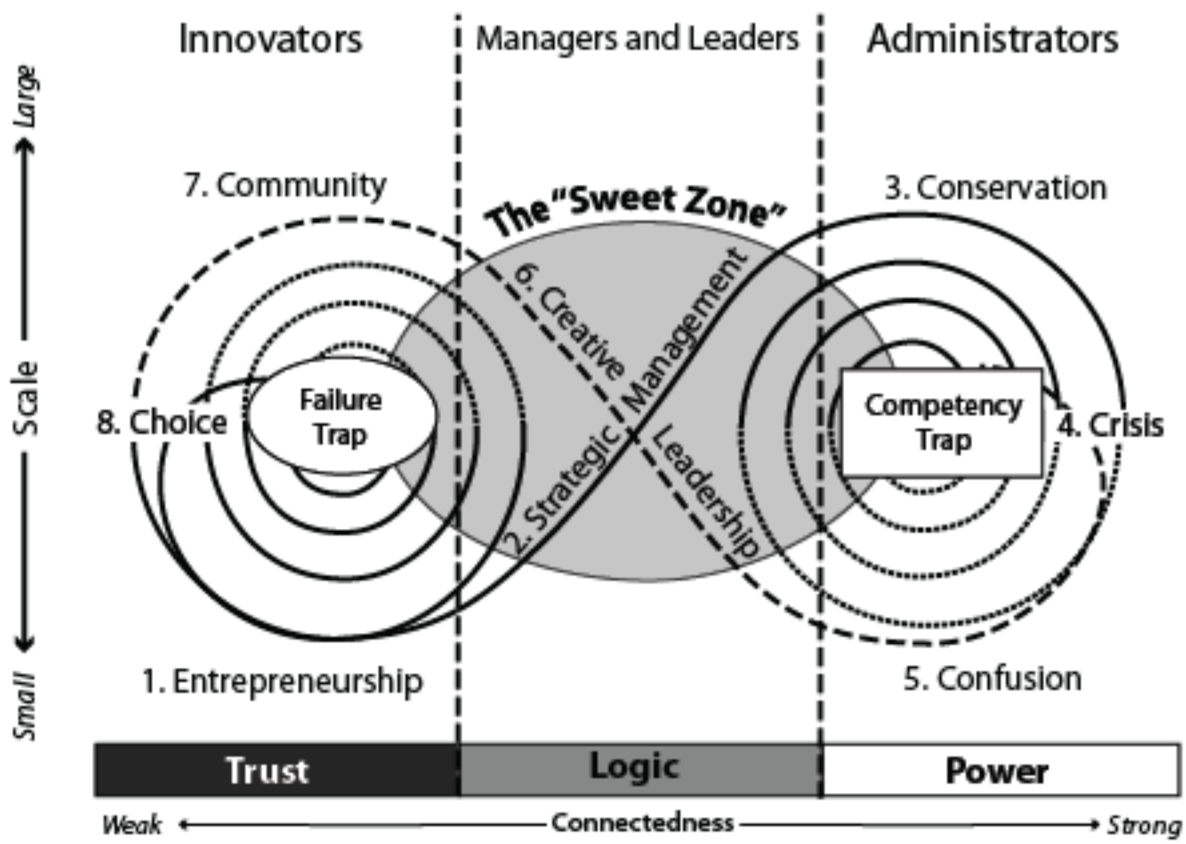

Diagram 1: The ecocycle showing two loops and traps, three contexts and the sweet zone

The central dynamic of this new approach is the so-called "ecocycle" which is the ecosystem equivalent of the familiar life cycle.[6] Individual organisms are born, grow to maturity and then die. But we are all part of complex systems – families, communities, firms, tribes, societies, nations, even a species – where individuals come and go, but the collectivity, the system keeps on going. The ecocycle captures this continual cycle in the form of a dynamic with the shape of an infinity loop. The cycle has a number of interesting features:

The vertical dimension is scale – large is “up” and small is “down”. The horizontal dimension is the degree of connectedness of the system: left is weakly-connected, right is strongly-connected. The “front” half of the loop (solid line) is the familiar S-shaped life cycle or logistics curve. Passionate entrepreneurs typically found their organizations in communities of trust (top left). Their initial efforts are unlikely to be successful and often they will find themselves spinning in the left hand spiral of the failure trap. This trap is familiar to everyone; it’s when one tries a number of approaches to achieve something, but nothing seems to work. Escaping the trap usually requires tremendous persistence, fueled by high levels of so-called intrinsic motivation and feedback that leads to rapid learning.

If they are to escape the failure trap and thrive, successful organizations must develop a recipe for success – a strategy – by connecting effective means with their desired ends. This is the strategic management phase marked by the application of logic, as the discovered recipe for success is fully articulated and elaborated upon. It sets the stage for what can be massive growth in scale.

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As the organization grows in scale, becomes hugely successful and matures in power, however, circumstances will gradually change. As cautious administrators try to preserve their success, the organization runs the risk of being caught in a stability or competency trap. This is very common in large, successful organizations. General Motors is an excellent example. It cycled in a competency trap for about forty years, during which time it was quite unable to forsake its strengths of muscle and scale and change the structures and processes that had once made it so successful. The means to success and power had become ends in themselves. Cars had long ceased to be objects of passion for the senior executives: at the top of the organization they were regarded as nothing more than vehicles for making money. The glossy brochures talked about cars and customers and the financial reports spoke to the interests of shareholders. But by now the *de facto* purpose of GM was ensuring a comfortable life for its senior executives.

The result in GM was a Jekyll and Hyde performance, with apparent recoveries punctuated by continual crises and confusion. In the cyclical downturn of 2008, shortly after celebrating its centenary, the company was overwhelmed and forced to go through the fires of Chapter 11 bankruptcy.

Many organizations do not escape the competency trap and are destroyed. Lehman Brothers was a good example of an organization that became addicted to its recipe for success. Some firms are actually liquidated, but others are acquired or merged into larger organizations and become part of their acquirers' trajectories. Those that do come through the ordeal intact find themselves on the back loop (dotted line) of the ecocycle. This is the less-familiar, reverse-S shape of a cycle of renewal. It takes creative leadership to bring an organization out of crisis and confusion. Leadership is all about the making of meaning. Its effectiveness is based on humankind's default ecological rationality and our hunger for narrative truth. The role of leadership now is to take the often-dispirited survivors of a once-successful organization and to create a *movement* with a renewed sense of mission and purpose. If this effort is successful it will recreate communities of trust in which choices will emerge and entrepreneurship will be reborn. The organization is ready to traverse ecocycle again.

The Sweet Zone of Sustainability

The key difference between an ecological and an economic perspective is the emphasis on sustainability rather than maximization. This can be seen by the presence of a sweet zone between the twin traps. Extricating an organization from either trap can be so challenging, that it is best for successful organizations to avoid them altogether – once they have escaped from the initial failure trap, of course. This they can do by constantly "navigating" between means and ends as the organization grows in scale.

We need to do one further zoom in on the sweet zone to look at the tools and settings (mini-contexts that you control) available to managers and leaders in the sweet zone:

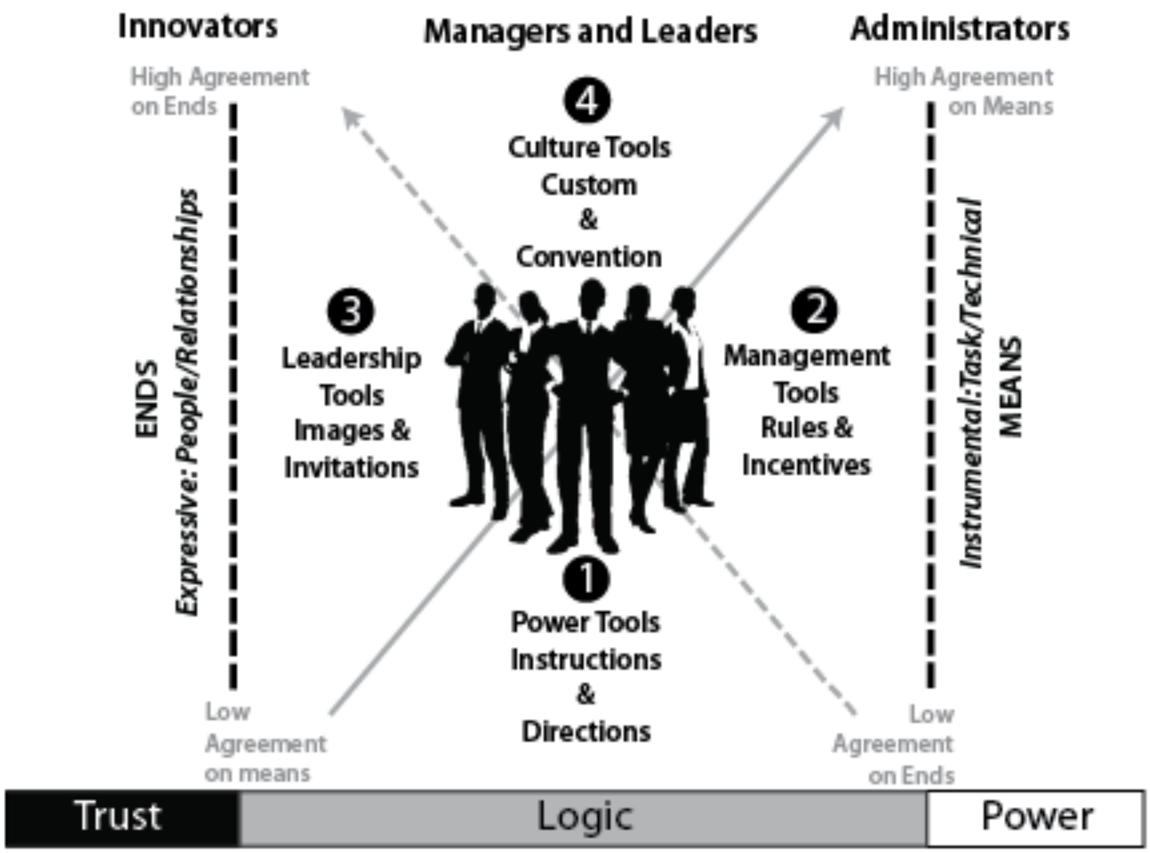

Diagram 2: The organization in the centre of the sweet zone with four sets of "navigation" tools

Diagram 2 is the core of the new mental model and repays close study. First you should notice that it places managers and leaders *inside* the model, not outside as many of them have been taught to be. Secondly, take a look at the left and right hand sides of the model. On the left are concerns with the organization's ends, so-called expressive needs that have to do with people and relationships. On the right are the concerns with the organization's means – instrumental, task matters.

The sweet zone contains an ongoing dialogue between ends and means. Conceived in passion and born in trust, organizations typically have a high consensus on their ends, but low agreement about the means to their realization. As the means are discovered and the organization grows in size, it will hire people for their technical expertise and begin to care less about whether they "buy in" to the organization's ends. By the time the organization is large and successful and matures in power, its ends may have been long forgotten. Now there is consensus on means and little agreement on ends, which may have morphed into "maximizing shareholder value". The organization is headed for decline and crisis, as its strengths become weaknesses in changing circumstances. It's time for renewal.

This brings us the third aspect of the diagram. You will notice that a 2×2 matrix, with four different sets of "navigation" tools, has been rotated a quarter-turn to the left and dropped into the centre of the sweet zone. The matrix itself is well-known. It was developed by Harvard Business School Professor Howard Stevenson.[7] It contains four categories of "navigation" tool – power, management, leadership and culture.

In *The New Ecology of Leadership* I add the terms "settings" to the word "tools" to reflect the reality that tools are always used in mini-contexts or settings that are under the control of the user. A well-chosen setting can enhance the use of a tool; a poorly-selected one can dull or even nullify the effectiveness of a tool.

Here is a brief guide to the features of the navigation tools and their settings – in the book each of them is explored in much greater depth:

1. Power tools and settings: instructions and directions: these are the direct, fine-grained tools and power settings that individuals control directly. Power is derived from a variety of characteristics ranging from immediate physical presence to positional power, granted by virtue of one's rank in an organization and one's status in its informal networks, especially the core group that runs the organization. Power settings are the immediate physical environment, the layout of your office, the clothes you wear, and so on. When there is little agreement on either where the organization should go or how it is going to get there, these power tools are essential.

Power tools and settings help you move the organization *left* or *right* and *down*, reflecting the small scale at which they function effectively.

2. Management tools and settings: rules and incentives: these are features of formal systems, such as organizational structures, standard operating procedures, and control systems that typically reward certain activities of people within the organization, while constraining others. They are the essence of the means, the methods that have proved successful in the past, and they represent the embodiment of power in impersonal systems. When there is little agreement on how the organization should operate, the development of these tools is essential.

Management tools and settings help you move the organization *up* or *down* and to the *right*, reflecting their emphasis on tasks and discipline and the pursuit of *means*.

3. Leadership tools and settings: images and invitations: leadership is about people and relationships; it is the appearance of power as a social phenomenon that results in the creation – development – of purpose and meaning within a group. Leadership relationships can exist at all levels in an organization, and in some organizations the relationship between leaders and followers can switch as circumstances dictate. When there is little agreement on the purpose of the organization, why it should exist, these leadership tools are critical for its discovery and development.

Leadership tools and settings help you move the organization *up* or *down* and to the *left*, reflecting their emphasis on people and purpose and the pursuit of *ends*.

4. Culture tools and settings: customs and conventions: these are the most diffuse of the tools and the most difficult to wield. They are the often-tacit customs and conventions within an organization that determine how things are done. When a high degree of agreement on ends and means has been reached in an organization and the organization appears to be "running on rails," then it is usually culture tools that are playing a significant part.

Culture tools and settings help you move the organization *left* or *right* and *up*, reflecting their ability to function on very large scales. Although the preceding list clarifies the distinctions among the tools, they all overlap to some extent; power overlaps with leadership and management, and all three interact with culture. Thus, it is impossible to use the tools separately. Their use always has to be integrated, so that they support each other.

"To reinvent our economies, our institutions and ourselves, what we need is a new framework based upon our default ecological rationality and practical wisdom."

Breaking the Cake of Custom

Staying within the sweet zone creates a constant challenge to managers to use these "navigation" tools and settings in the continual search for a dynamic balance between means and ends in a changing environment. Peter Drucker (1910-2005), the man who invented modern management, was concerned with this balance between conservation and innovation for his entire career. In this matter he identified most closely with Walter Bagehot (1826-1877), the founder of *The Economist*, who coined the term "the cake of custom". Bagehot noted that while forming virtuous habits was a great achievement, breaking them in order to improve the system was even more difficult: "The great difficulty which history records is not that of the first step, but that of the second step. What is most evident is not the difficulty of getting a fixed law, but getting out of a fixed law; not of cementing … a cake of custom, but of breaking the cake of custom; not of making the first preservative habit, but of breaking through it, and reaching something better."[8]

Breaking the "cake of custom" is now the challenge faced by Western management practice and thought. The habits of the last fifty years served us well for a while, as we perfected the skills necessary to build large-scale repetitive businesses. Now the challenge is to reinvent our economies, our institutions and ourselves. The static, equilibrium-based framework of neoclassical economics cannot help us here, neither can its impoverished view of human nature. What we need is a new framework based upon our default ecological rationality and practical wisdom.[9] In short, we need a new ecology of leadership.

About the author **David K. Hurst** is a speaker, consultant, writer, and management educator with extensive experience as a senior executive and an encyclopedic knowledge of management thought. He is an Adjunct Professor at the University of Regina's Graduate School of Business, associated with the Center for Creative Leadership, and a contributing editor at *Strategy+Business*. His latest book, *The New Ecology of Leadership: Business Mastery in a Chaotic World*, is published by Columbia University Press in spring 2012.

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