





HOW SHOULD
CAPITALISM
EVOLVE TO
MEET THE
CHALLENGES
OF THE NEW
CENTURY?

CAPITALISM 3.0

EXPLORING THE FUTURE OF CAPITAL
INVESTING AND VALUE CREATION

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It's time for capitalism to mutate again. We're due. Here's why: "Release 1.0" — the original model — created not only wealth, but also a blizzard of economic, social, and environmental costs. In succeeding in its mission, it also exploited the world's resources and peoples as if there were no tomorrow.

"Release 2.0" — evolving since the late 1960s — has been increasingly regulated and "civilized" as it has attempted to keep pace with increasing awareness of its costly "side effects." But Release 2.0 has hit a plateau in its efforts to build wealth and at the same time make deposits in the bank of social value. Layering regulations over regulations, and social initiatives over more social initiatives, just isn't going to result in the hoped-for economic, social, and environmental returns.

The problem is that even the most forward-thinking corporations are still driven by a mindset that is obsolete. That mindset is drawn in black and white and says that for-profit entities create economic value and nonprofit organizations create social value. It also says that while it is (of course) a good thing for corporations to engage in social programs (the terms CSR and SRI are increasingly mainstream familiar), they can and should do so as an ancillary activity, taken on separately from their existing business model, which is centered on the creation of shareholder value.

Reality has long since left that mindset behind. Most people would agree that for-profit entities create a great deal of social value as well as economic value. By creating jobs, paying taxes, and providing products and services to consumers, they are inherently contributing to the "social" stratosphere. And most people would also agree that nonprofits create economic value as well as social value; in the U.S. alone, NGOs represent 7 percent of the national GDP. Yet because we created two legal forms (the nonprofit 501(c)(3) and the for-profit LLC or other corporate form) to accommodate these entities "way back when," we seem stuck in an approach that seems increasingly skewed.

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It seems that the best we can do, within those parameters, is engage in a practice that is commonly called “blurring,” in which nonprofits engage in certain activities that were formerly the province of the for-profit world, and vice versa. Blurring has offered up some positive results on the social front, but ultimately, the concept lives up to the definition of the word itself. A “blur” has the connotation of something having gone astray, or something that has been distorted. It is fundamentally the wrong way to think about or approach what is happening in the world, which is, at its core, value creation by organizations and those that provide capital to them (in whatever form and with whatever expectation of returns). “Blurring,” however well-intended, and however potentially positive the results, places a significant limit on the potential of value creation because it encourages people to continue to look at the world through their existing lens rather than rising above the present framework to understand the emerging, deeper shift in the nature of how all organizations operate and need to operate.

What’s needed is the next iteration of capitalism — a new model that stems from an understanding that our common goal should be to maximize our value potential. The model should be based on a common understanding of what value is (to our minds, it should be a blend of economic, environmental, and social factors). And, it should be implemented with the common understanding that maximizing value, regardless of whether one is the “customer of” or the “investor in” the entity, requires taking all three elements into account.

Capitalism 3.0, as we’re calling it, represents an opportunity to break existing frameworks and create a model of accountability that addresses the realities of the world we’re living in. It represents an opportunity to step out of the limits we’ve created for ourselves and find a common way to understand the nature of value and organize to maximize value. (The authors encourage readers to review the Blended Value Proposition to further explore the concept of blended value¹. The authors also encourage readers to review the Blended Value Map, which seeks to “locate” the hundreds of resources that encompass the body of knowledge upon which the model for Capitalism 3.0 might be refined.)² We’ve all been guided by an approach that embraces the notion that you can bifurcate value. We have been operating with the understanding that “how you make your money” can be different from how you—or the organizations of which you are a part—are in the world. A host of factors — not the least of which is the pace of technological change — have made the dissonance of a bifurcated-value proposition increasingly apparent, and untenable for the organizations and individuals caught in the middle (and that is an ever-growing number of organizations, founded on “for-profit” and on “nonprofit” business models.)

Under Capitalism 3.0, the rules will shift to ease the dissonance. In the realm of the new model, then, if you want to maximize economic value by generating financial returns for investors, you should no longer be able to do it without taking into account how your execution of a business strategy is effected by social and environmental factors. And if you want to achieve greater social and environmental justice in the world, you shouldn’t be able to unless you understand the economics of modern business. Over coming decades we will have a window of opportunity to significantly decrease poverty—and create more sustainable (in every sense of the term!) enterprises, companies driven to maximize their full value potential. To do so, however, we must advance a new understanding of how we invest in value creation and manage corporations to capture their full value potential.

We do not know exactly what Capitalism 3.0 will look like. This article doesn’t propose to offer a blueprint. What we can do, how-

ever, is offer what we think are the building blocks of Capitalism 3.0 and our thoughts on how those building blocks might be created and aligned.

TO BREAK EXISTING FRAMEWORKS

It’s easy to ask for-profits and nonprofits to “disconnect” from their business models and find a common approach to value creation. It’s easy to call for a new way of assessing value as a blend of economic returns and performance mixed with social and environmental impact. And, it is, of course, much more difficult to do, in large part because the potential level of change is so enormous that the concept can quickly become overwhelming.

Our sense, then, is that the most useful first step toward Capitalism 3.0 is to identify and consider the areas of common interest and concern that exist among the current major areas of socially responsible activity. While those managing corporations (either for-profit CSR firms or nonprofit social-enterprise firms) and capital investors (whether those pursuing market rate returns, below market rate or philanthropic) share much in common, they are largely aligned in silos along specific lines of activity, each being relatively isolated from the others. We’ve identified five fundamental silos of related activity. They are:

- 1 CORPORATE SOCIAL RESPONSIBILITY
- 2 SOCIAL ENTERPRISE
- 3 SOCIAL INVESTING
- 4 STRATEGIC PHILANTHROPY
- 5 SUSTAINABLE DEVELOPMENT

Within each of those silos, there are particular “issues under discussion.” These issues, while specific to the silo in question, are strikingly similar across silos. What are the implications of this shared ground? Are these commonalities worth building upon? And, most importantly, do they hold the potential elements of Capitalism 3.0?

CROSSCUTTING THEMES

Four major crosscutting challenges appear to be front and center in the minds of those engaging in socially conscious business or organizational activity.³ They are: the capital challenge; measurement and performance metrics; leadership and organizational development; and government policy/regulation/tax codes. Taking each in turn...

The Capital Challenge Simply stated, capital is the fuel that allows for the creation of organizations capable of creating value within a given market. It is the resource that enables entrepreneurs to build organizations, both nonprofit and for-profit, that can bring services to clients and customers, and it is the necessary element that permits businesses to grow and prosper.

Like any other market, the social capital market requires efficiency, transparency and measurable outcomes for sustained growth. Various authors have addressed the inefficiencies of this market; the key concerns focus on the following set of considerations:

- 1 HIGH TRANSACTION COSTS
- 2 LACK OF ADEQUATE INFORMATION FLOW
- 3 LACK OF MARKET RESPONSIVENESS
- 4 LACK OF CONNECTION BETWEEN ORGANIZATIONAL PERFORMANCE AND CAPITAL ALLOCATION

5 LACK OF COMMON STANDARDS AND DEFINITIONS

6 LACK OF INTERMEDIATION

7 LACK OF COMMON UNDERSTANDING OF RELATION BETWEEN RISK AND VARIOUS RETURNS

Another key component of capital-market inefficiency is the lack of appropriate financial instruments. In general, capital markets can support any variety of for-profit enterprises, but when it comes to investing in social value we have only grants or loans—with few options for creating real capital investment to expand ventures that aren't clearly creating either social or economic value. This lack of instruments inhibits the efforts of managers pursuing blended value, whether in mainstream corporations, emerging for-profit social ventures or social purpose enterprises attempting to scale their ventures.⁴

What might be done to forward the concept of Capitalism 3.0? The building blocks might include:

- 1_** Mapping the total social capital market in terms of types of returns, terms of investment, and risks associated with them.
- 2_** Defining the market for a new asset class focused on blended returns. This research should explore investor motivation and risk profiles.
- 3_** Exploring the policy environment that shapes both domestic and international capital markets to better advance policy frameworks supportive of practitioner needs and investor interests.
- 4_** Encouraging viable strategies for capital diversification (e.g., investors may not know that they can receive a full market return on securities offered by nonprofit organizations such as Habitat for Humanity).
- 5_** Expanding the role of funding intermediaries. By taking greater part in funding, capacity building, and field development roles, such entities can help connect work at the local, regional, and international levels.
- 6_** Calling for foundations to take the lead, in working with grantees, to create and introduce investment instruments structured to generate multiple returns for both the investor and practitioner.
- 7_** Creating new forms of collaboration capable of creating greater efficiencies, balancing risk profiles, mobilizing significant amounts of new investment capital, and sharing emerging practices.
- 8_** Diversifying corporate capital (a move that might be spurred by increasing the financial sophistication of managers and finance officers).
- 9_** Creating an international fund to provide secondary financing

to funds that provide micro-financing, community loans, and other such services. Foundations could take the lead in working with the World Bank, the Inter-American Development Bank, and other providers of capital to create such a “fund of funds.”

10_ Expanding the definition of “fiduciary responsibility” to encompass not only financial stewardship, but also economic, social, and environmental performance.

Measurement and Performance Metrics_ In the research that



led us to create the original Blended Value Proposition, and in subsequent research, we have been surprised to find little consensus across the five silos concerning how best to approach the creation of a single, commonly endorsed set of metrics by which to assess the performance of nonfinancial aspects of both organizations and funds.

Key issues that arose as we explored the world of measurement and performance metrics include the lack of consistently effective approaches and common tools for measuring and reporting social value, and the lack of confidence in what is measured.

What might be done to improve metrics in general and bridge

the silos here? This is far from a definitive list, but just to name a few of the more innovative examples we've encountered:

Several organizations, such as the Roberts Enterprise Development Fund (REDF), the Urban Institute, and SustainAbility have advanced and documented their various social outcome measurement processes. Working together with these parties to determine a common understanding with regard to language, terms, and standards of practice could be a first step in developing a commonly endorsed set of metrics.

The CDFI⁵ Data Project, a data-collection and management system for community-development financial institutions launched in 2000, and the Annie E. Casey Foundation's work to evaluate its community initiatives over long periods of time could both be teaching examples in exploring how best to create a practical data-gathering methodology that does not place undue burden upon those attempting to gather and track that data.

Many have emphasized the importance of understanding the costs involved in measuring social outcomes. Involving investors

ingful investment and effort:

Develop strategies and policies to attract and retain senior management of the highest caliber in social ventures, social enterprises and corporations working to build and capture full value. While important for all levels of management—from CEOs to finance and marketing positions—research indicates that it is especially crucial at the highest levels.

Encourage management-training programs to integrate social and environmental issues directly into curriculum content. According to a 2001 survey of MBA programs reported in *Beyond Grey Pinstripes*⁶, "there remains a lack of integration of social and environmental issues into the core MBA curriculum." We believe these issues should be viewed as integral to the core practices of effective management.

Provide more money to build internal operating capacity of both nonprofit and for-profit organizations. At this point, both sets of investors working with both types of organizations commonly believe capacity is equivalent to overhead and that it is an excess

FROM OUR RESEARCH, IT APPEARED THAT MANY OF THE NECESSARY ELEMENTS FOR THE SILOS TO ACHIEVE GREATER ORGANIZATIONAL CAPACITY ARE ALREADY IN PLACE.

in discussions about the costs of data-tracking systems could itself be a way to get capital providers to recognize these costs and ultimately to be willing to help pay for these systems.

Experiences such as those of the Greater Kansas City Community Foundation suggest that any process by which standards are set and reporting goals established should be one in which practitioners are intimately involved. Understanding and disseminating the lessons learned could help reinforce that metrics exist not only to assure investors, but also to provide practitioners with information they need to be most effective and efficient.

Leadership and Organizational Development Few areas of human inquiry have as long a history as the study of leadership. But often it's not possible to simply click-and-drag on existing best practice from areas like the military or Wall Street and apply them in the five silos discussed here. That said, questions of developing core leadership, improving management skills, and achieving financial sustainability are not limited to any particular silo but are common to the whole. In general terms, achieving organizational capacity involves a number of related areas, including leadership and management, financial sustainability, governance, strategic planning, scale, and funding capacity building.

From our research, it appeared that many of the necessary elements for the silos to achieve greater organizational capacity are already in place. (Do silo-dwellers see them, too?) The steps that follow seem straightforward, but progress will require mean-

element that should not be supported.

Support the infrastructure of these efforts. This, too, will take money. It is not enough to build capacity at the organizational level if we are not also making investments in the field as a whole. Funding must be made available to create and implement improved reporting and accountability systems capable of documenting the full value being created by an organization.

Government Policy/Regulatory/Tax Codes While there is significant debate regarding the appropriate role of government in creating a "level playing field," the fact remains that governmental regulations, policies, and tax code have a significant (perhaps primary) effect upon the degree to which market forces are allowed to work to create blended value. However well the case is made to companies and their investors, many among the mainstream corporate community might well predict that initially it will be the stick and not the carrot that will get them to act on these issues.

Challenges in this area include developing a common advocacy agenda, then lobbying for that agenda and against initiatives that oppose it. If we are to be successful in moving an effective policy agenda to support healthy corporations, communities, and ecosystems, we first need to bring the larger set of players together from across their silos. In these discussions, areas of common interest and policy development could be explored, and specific policy initiatives could be developed.

A discussion of policy initiatives would help better define those

areas in which actors from various silos can support a common policy agenda. Among the questions that could be asked:

- 1_ Should policy development address issues related to private capital investment? Public funding initiatives? Tax frameworks to support emerging areas of work?
- 2_ Should the policy agenda be broadened to include such areas as community and economic development (including public-investment practices, land use, and economic-development policies)?
- 3_ What mechanisms are needed to ensure participation in the development of policy agendas by those within these various silos?
- 4_ Who are the key actors, and where are the most effective leverage points in advancing core parts of this policy agenda?

At present, there are only a modest number of “silo-wide” opportunities to come together—and virtually none that are focused on convening the commons as a whole. We understand that, even as we offer our thoughts for “next steps.” It’s relatively easy for us to bring our questions and suggestions to the table, however rigorous our research. It is much more difficult to take the next steps. Initiating this dialogue and enabling its participants to advance a shared policy agenda may take a significant investment of both time and money—but as we have witnessed in other sectors of interest, the payoffs may be quite significant. It is critical that regulatory and policy development efforts be firmly connected to actual experience and interests. In the same way that research is irrelevant if not embedded in practical application, the interests and priorities of practitioners should set the agenda for policy development and advocacy. Organizations such as PolicyLink and others are key in advancing this strategy of building policy from practice. Consideration should be given to supporting such efforts.

ADVANCING CAPITALISM 3.0

Ultimately, the implications of our research for the broader field, we believe, are threefold: collaborating across sectors, value networking, and building an international infrastructure.

Cross-Sector Collaboration. Collaboration is difficult to engage in for a number of reasons. First, conflicting incentives and motivations can inhibit collaboration. Second, while foundation resources will be important to funding efforts to bring various actors together and to achieving cooperation, a preference toward funding “unique” programs may unintentionally encourage grantees to focus on individual priorities versus common challenges. Third, the silos are fragmented to a point that consolidation and collaboration may be very difficult to achieve even within an area of work. Fourth, cross-silo engagement requires different skills, orientations, and leadership styles than may suffice within a single silo of activity.

The challenges of effective collaboration are great. Yet the successes of initiatives at the corporate, nonprofit, and foundation levels show that the benefits are even greater. A new collaborative could unite and coordinate efforts across silos to address commonly defined challenges. Take capital markets: Actors interested in increasing market efficiency could together support projects that tailor mainstream financing instruments to investors seeking a blend of social, environmental, and economic returns. Or consider performance metrics. Already, many managers are working to advance more useful ways to assess performance—especially extra-financial performance. Many for-profit corporations are exploring how to track their own and others’ social performance. Funding those working together to address this common challenge could well benefit both managers and investors.

Such collaborations could bring together key public and private

investors in a better understanding about the specific funding areas that others are supporting. This would also help funders establish a unified strategy to support the creation of an international infrastructure needed for these investments to be brought into a more effective whole.

Value Networking. Success in this new phase of collaboration across silos to advance Capitalism 3.0 will require the development of new skills. It will require more than simply cultivating a desire to work together—it will require a fundamental change in the understanding of how organizations link to each other and to investors in the field as a whole.

Nonprofits tend to approach collaboration as a tactic to achieve a given project goal, not as part of an overall strategy to attain their broader goals. While of obvious limited benefit, this approach is stunted in its potential to create long-term value on the terms sought by actors across silos.

Treating collaboration as a process of value creation requires looking forward and out instead of looking inward and back. Unfortunately, much collaboration in the nonprofit sector takes the latter approach. By contrast, consider the most successful for-profit firms of the current age. Among others, Cisco Systems and eBay recognize opportunity, organize resources to respond to that opportunity, and then reconfigure relationships to capitalize upon the next wave of opportunity.

Understanding the need to build value networks also has implications for how we build capacity of firms and nongovernmental organizations. Enhancing the capacity of individual organizations must be a key part of any effort to build common activity, but it is not the only way to create meaningful change across silos. We certainly need to build strong, well-functioning firms and institutions capable of acting upon their value propositions. For collaboration and networking to be successful, an infrastructure must exist for individual groups to network and convene. Adequate resources for practitioners to participate in these supported dialogues and shared work projects will be required.

Building an Infrastructure for Capitalism 3.0. How do we more effectively leverage these separate parts in support of pursuing our common whole? We must recognize that our ultimate goal is not to build any individual silo or organization, but rather to create a world in which all organizations are best positioned to maximize the total value possible—value that is the outcome of a blend of economic, social, and environmental performance.

This will be achieved by making use of our best skills and tools—taking what business has to offer and combining it with the best public policy and community/social enterprise practice. We should combine the financing tools of the marketplace, the market acumen of mainstream business leaders, the investing potential of the foundation community, and the human assets of social entrepreneurship to provide a new generation of leaders.

This will not happen of its own accord. While actors have potential to self-organize to advance shared aspects of this agenda, a “network orchestrator” might well be a necessary catalyst, providing support for what could easily be a complex global dialogue.

While the link among these various actors may primarily be their interest in pursuing multiple returns and blended value, those invited to participate in this process should not be exclusively limited to “the converted.” For example, corporate social responsibility practitioners could learn a great deal from mainstream nonprofit managers who have labored to build information systems to track social performance (regardless of economic value), while tools developed in mainstream accounting (such as the Balanced Scorecard) could directly inform those whose work attempts to go beyond traditional applications of such tools.

Let us simply conclude by stating:

- 1_ What is needed is the creation of a vehicle for this new collaboration.
- 2_ What is needed is an international infrastructure capable of orchestrating networks of blended value investing, enterprise creation, and true sustainability at all levels of capital and organization—which combined will advance the new form of Capitalism 3.0.

RECOMMENDATIONS FOR ADVANCING CAPITALISM 3.0

It would be overreaching in this initial article to propose a unified vision and strategy for the various communities pursuing a blend of social, environmental, and economic value. But based on the conversations and readings of these past months, we do think it is worthwhile to present what we could propose as general parts of a larger strategy to create a common field of practice that builds upon the many individual efforts already underway which

those already doing the work can create new partnerships to connect and jointly solve commonly defined challenges. The Internet and other networking technologies can facilitate contact, but they cannot substitute for face-to-face meetings and other personal opportunities for relationship building.

Fourth, find ways to move beyond the current capital chasm that prevents blended value ventures from achieving scale and blocks potential investors from moving new forms of capital into the market. This capital question will best be addressed through its own focused strategy. However, it is obvious that new investment instruments are required, new syndication opportunities needed, and an evolved, integrated capital market must be brought into reality—a market that pursues economic performance with social and environmental benefits.

Fifth, create new market intermediaries capable of providing both capital and capacity-building support to blended value ventures around the world.

... VALUE COMES NOT ONLY IN FINANCIAL TERMS BUT ALSO IN ENVIRONMENTAL AND SOCIAL TERMS. THE INTERSECT OF THESE THREE CONSTITUTES THE REAL VALUE POTENTIAL OF COMPANIES.

together promise to advance a new form of capitalism.

The following summarizes our research findings for how best to advance the broad work presently taking place around the world:

First, build coordinated, long-term support for existing groups from within each silo to work together. The component parts of a strategy are already in place; what is missing is cohesion.

Second, create a new, international knowledge development and management strategy. Analyze the best ways to foster knowledge development and to improve tools such as performance metrics and investment instruments. Build a global network of resource persons capable of filling the gaps between strategy, tools, and practice. The wisdom of the field does not rest solely in papers and emerging research, but rather in the experience of those who have in many ways gone ahead. We need to support and make available the knowledge of those leaders of the field who have already had success.

We hesitate to suggest examples of the type of collaborative network we might collectively create. However, existing examples that may be instructive include the Society for the Advancement of Socio-Economics, the Society for Organizational Learning, and the Mayo Clinic. The latter functions largely as a massive information clearinghouse that tracks work taking place in a wide range of related areas, while assisting those actors working in a specific arena to know both what is occurring in other areas of work and how those advances might inform their own efforts.

Third, discuss how to help individual groups connect with one another. By organizing around common issues of shared concern,

Sixth, put forth a new, dynamic strategy for leadership development at all levels. This will need to build upon existing business and nonprofit management programs already active in this linked field of connected activity. However, we also need to create fellowship and learning programs to support existing leaders in expanding their worldviews and learning new skills of leadership and management. And we need to support deeper opportunities for cross-sector and interdisciplinary inquiry and learning.

Seventh, proactively address public-policy implications of our work. Governmental tax, regulatory, and framing policies set the context within which our work takes place. The creation of policies that allow our work to succeed is central to the ability of any individual, organization, or association to successfully advance its goals. Today's corporations have lobbying bodies to vigorously protect their policy interests. Those advancing Capitalism 3.0 must be active at regional, national, and international levels in promoting the policies that set the context of our work. We must work together to define an appropriate policy agenda, and then we must work to advance that agenda around the world.

IMPLICATIONS FOR INDIVIDUALS

While creating an enabling environment that allows individuals and organizations to more effectively pursue and capture the full blended value of their work is key, what it all boils down to is individual action and impact.



For leaders of corporations seeking to maximize their full value potential, the challenge is to consistently promote a broader vision of the value proposition for the firm. Companies move from marginal profitability to sustainable economic performance as a function of not focusing upon the parts, but rather the total value they have the potential to create. This value comes not only in financial terms but also in environmental and social terms. The intersect of these three constitutes the real value potential of companies.

For those structuring research into how blended value functions within companies, a multidisciplinary approach to developing and executing research strategies becomes key. The traditional emphasis upon discrete areas of research that seldom interconnect will not provide the breadth of perspective required to understand the full continuum of finance, organizational behavior, general management theory and so forth required. As increasing numbers of firms attempt to apply concepts of blended value in practice, opportunities for tracking real-time experiences of managers and investors will only grow, providing additional information and data based on real market experience.

Individual investors will need to recalibrate their calculations of return and value creation in order to take these new considerations into full account. Indeed, those seeking sustainable, long-term returns will need to assess before making an investment the degree to which any given company attempts to manage its “nonfinancial value” in order to generate financial returns.

Finally, a new, expanded set of commonly endorsed, extra-financial metrics are required if we are to be able to not simply

evaluate nonfinancial performance of companies, but also conduct accurate valuations of extra-economic value within companies and investment firms. These metrics will marry quantitative and qualitative data—yet will help advance “apple to apple” comparison of both firm performance and capital returns.

A WINDOW OF OPPORTUNITY

The concepts of blended value and an evolved form of capitalism—plus the number of those seeking to bring both into reality—are advancing faster than the eye can see or the mind absorb. We have before us—at this very moment—a historically unique opportunity to both change markets and evolve organizations (whether for-profit or nonprofit) capable of capturing full blended value within those markets. But this is a window of opportunity—not a fait accompli. We are realistic about the scale of the challenges we face in the coming decades, but we are also optimistic that we can now find the commitment to create real, sustained change and the collaborative action required to achieve it. We will explore some of the paths to Capitalism 3.0 in future issues of *Value*. ■

THIS ARTICLE DRAWS DIRECTLY UPON THE EXECUTIVE SUMMARY OF THE BLENDED VALUE MAP PROJECT (PLEASE SEE WWW.BLENDEDVALUE.ORG), AS WELL AS A CHAPTER TITLED “THE BLENDED VALUE MAP: EXPLORING THE IMPLICATIONS OF VALUE CREATION BY CORPORATIONS AND INVESTORS,” BY JED EMERSON AND SHEILA BONINI INCLUDED IN THE NEW SERIES, *THE ACCOUNTABLE CORPORATION*, PUBLISHED BY GREENWOOD PUBLISHING GROUP, WESTPORT, CT, DECEMBER, 2005.