



# Systems Thinking Using a Multi-Capital Model

Driving profits and prosperity with integrated reporting and thinking

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## The Blind Men and an Elephant

The fable of the Blind Men and the Elephant appears in [many Eastern traditions](#) but in the West, it's best known through a poem written in the 19<sup>th</sup> century by an Englishman, John Godfrey Sachs. As you can see from the excerpt here, it involves a group of blind men experiencing an elephant by touching different parts of it. They each draw different conclusions, none of them even close to the truth of the whole elephant.

This poem is a great metaphor for the difficulty of systems thinking. And a good way to describe the dilemma facing modern businesses as complexity and speed of change continue to increase. The resources to succeed in today's environment are hard to see with the naked eye so many business tools fall short in painting a complete picture.

To understand this dilemma, you only have to go back a few decades to our industrial past when the value of a business resided in tangible assets like equipment, factories and land. These were easy to see and easy to measure using financial statements. You could figure out the value of a company by looking at the net tangible assets on its balance sheet. In fact, according to calculations by [Ocean Tomo](#), these tangibles explained 83% of the corporate value of the companies listed in the S&P 500 in 1975.

Today, that portion has flipped completely. Most of the value creation by companies is now hidden inside peoples' heads and their computers. And a lot happens outside of the company's walls in the natural environment or in society. As a result, **84% of the corporate value in the S&P 500 is now intangible**. These intangibles are hard to see individually, let alone as a system.

Excerpts from *The Blind Men and the Elephant*  
by John Godfrey Sachs

It was six men of Indostan  
To learning much inclined,  
Who went to see the Elephant  
(Though all of them were blind),  
That each by observation  
Might satisfy his mind...

*[One touching the body, thinks it's a wall  
The tusks, thinks it's a spear,  
The trunk, thinks it's a snake  
The leg, a tree trunk  
The ear, a fan  
The tail, thinks it's a rope,]*

...And so these men of Indostan  
Disputed loud and long,  
Each in his own opinion  
Exceeding stiff and strong,  
Though each was partly in the right,  
And all were in the wrong!...

[Read full version of the poem](#)



## Many Businesses Have the Elephant Problem

This is the dilemma of modern businesspeople gathered around conference tables across the globe. Each person represents a different role or function for the business. Each function is important. But many of the functions are invisible. And it is rare for everyone to have the same picture of the elephant in mind. This can lead to significant challenges such as:

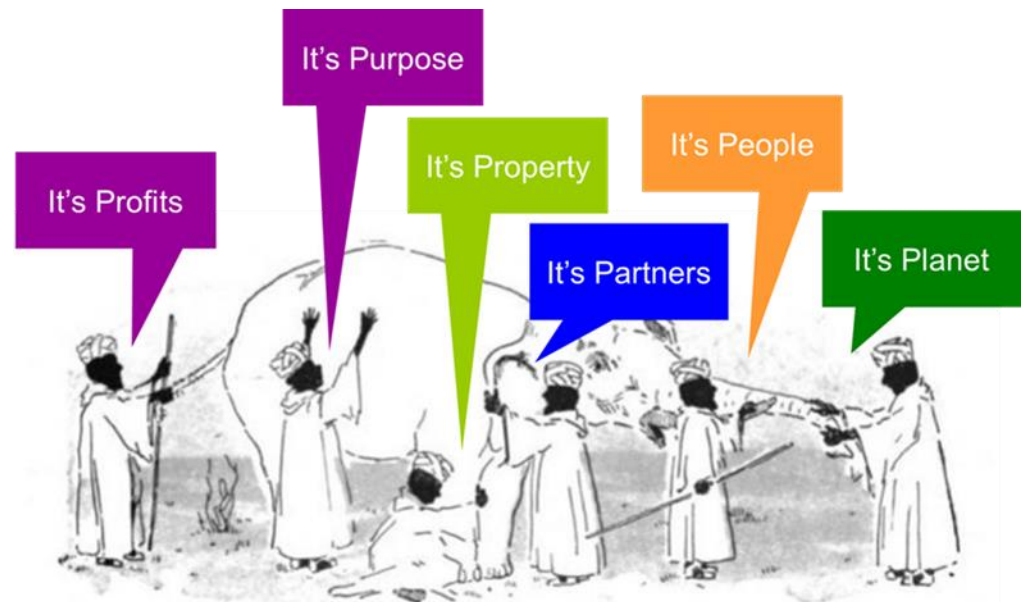
**Lack of internal alignment** – When the members of a system don't have a shared mental model of the whole elephant, it's hard to work together to ensure its overall health. This translates into inefficiencies, lack of innovation and sub-par performance.

**Inability to tell an effective story to the marketplace** – If you can't explain how all the key drivers of performance and value fit together and drive the financial bottom line, the marketplace isn't going to understand it either. This can block access to capital or lead to inaccurate valuations.

**Failure to attract the right stakeholders** – Businesses need customers, employees and many other partners to succeed. If you don't present a transparent and compelling picture of your overall value creation system—your elephant—you might not be able to attract the right partners.

**Failure to appreciate external risks and opportunities** – Increasing numbers of corporate stakeholders are concerned about the health of the global environment. And even “traditional” businesspeople understand that issues like carbon, water and energy are creating significant business risks and opportunities.

The solution to these challenges is systems or integrated thinking, finding ways of understanding both the parts of and the whole elephant.



## Systems Thinking

Systems thinking is a great way to “see the elephant.” It is a rich field of study that focuses on **complex organizational and societal systems** ([great S+B primer](#)). Its basic premise is that you need to look at both the components and the whole to be able to understand how things work. There are two aspects of systems thinking that make it especially relevant to businesses with the elephant problem:

**Natural Ecosystems** –Systems thinking explains the [workings of complex systems](#) through the example of nature. Natural ecosystems are marked by complex interactions of humans, animals, plants and their environments. This thinking gives us new ways to understand the workings of companies. It also makes clear the direct, literal connection between human organizations and their environment.

**Learning and Knowledge** – Systems thinking endeavors to not only understand the workings of ecosystems but also how they change through learning and adaptation. Thus, the study of systems thinking is closely tied to the concept of the [learning organization](#) and the work of Peter Senge. Common practical manifestations of this thinking are **continuous improvement** models like Plan, Do, Check, Act ([PDCA](#)) and the Toyota approach to [Kaizen](#).

**These concepts help connect the dots** between financial, natural, human and other knowledge intangibles. When you see the world through a systems lens, it becomes increasingly obvious that everything is connected—and that profits and prosperity are critical and inter-dependent goals for business.

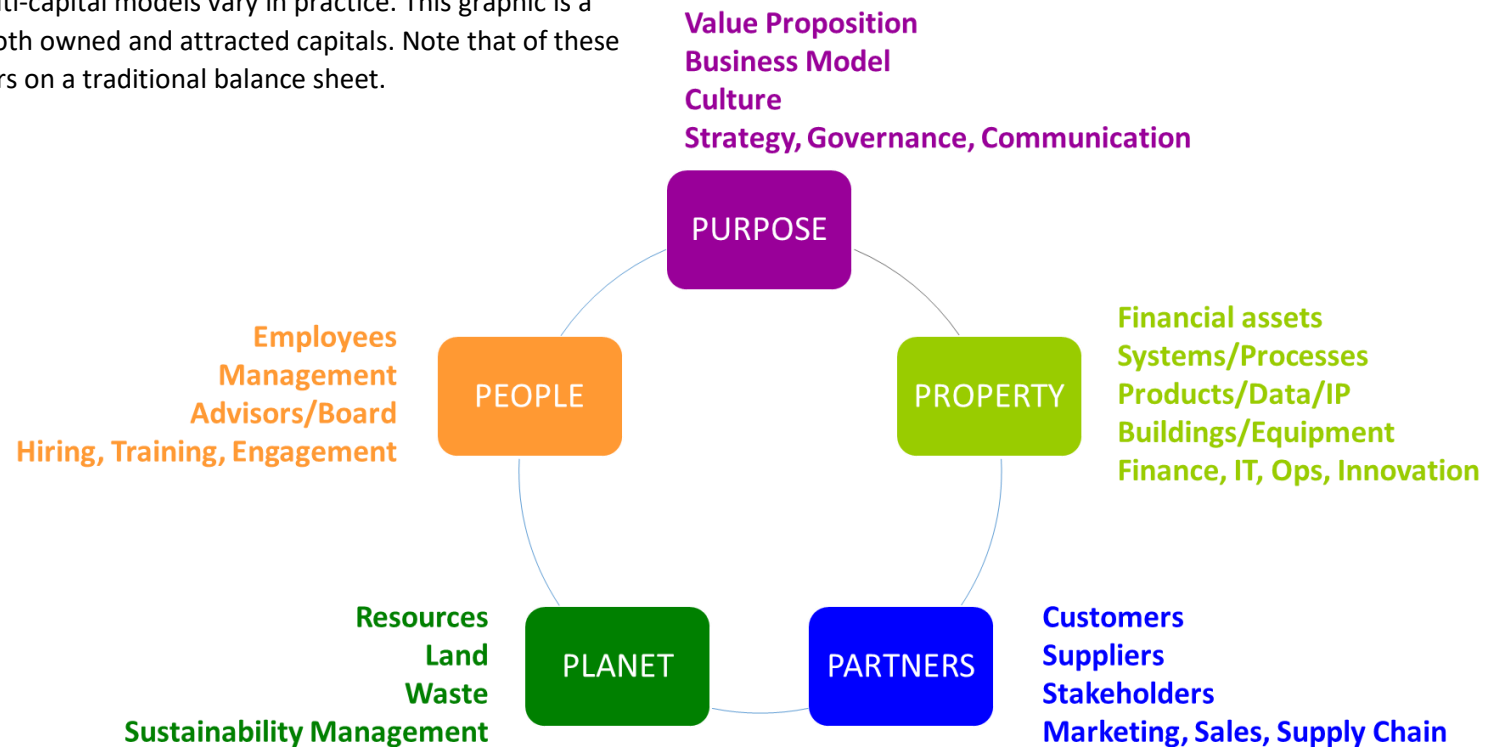


## The Multi-Capital Model

One of the primary goals of the integrated reporting movement led by the International Integrated Reporting Council (IIRC) is promotion of what they call “integrated thinking.” The concept is an application of systems thinking and is explained in detail in the Council’s 2013 paper on [Connectivity](#). The paper makes that case that integrated thinking and integrated reporting are linked, that it is impossible to achieve good external reporting without good internal thinking and action.

One of the key tools in the IIRC Framework movement for systems thinking is the multi-capital model which recognizes the diverse set of resources that companies use to create value over time for their shareholders and stakeholders.

The exact components of multi-capital models vary in practice. This graphic is a simple model that includes both owned and attracted capitals. Note that of these capitals, only property appears on a traditional balance sheet.



## Example: Clorox

We can see the integrated and systems thinking concepts in action through the public reporting of companies like Clorox. Their [2015 Integrated Annual Report](#) which combines financial, environmental, social and governance performance. The theme is Good Growth which they define as:

Growing Profitably by delivering meaningful innovation and superior value to consumers. Growing Responsibly by making the right choices for our people, planet and communities. That's Good Growth – and that's good for all our stakeholders.

The Report provides the graphic seen here to illustrate the company's full strategic ecosystem. The content is organized around strategic goals:

1. Engage our people
2. Increase investments behind our brands
3. Expand our brands into new categories and sales channels and in existing countries
4. Cut waste in our work, products and supply chain to fuel growth

Each section contains narrative, metrics and stories. The report also includes a multi-capital scorecard using the following categories: Performance, People, Products, Planet and Community.

This report is front and center on the company's home page, its sustainability sections and is what you get when you click on the link for its annual report in the investor section of the website. This is a marked difference from most companies, which segregate financial and sustainability reporting.

This report is also remarkable for its length at just 28 pages. This means that the report is not a substitute for more detailed reporting. It is a way of putting the company's strategy, activities and financials into a bigger context—and helping its stakeholders see, one could say, the entire elephant.



## Example: ArcelorMittal

ArcelorMittal is a global steel and mining company that issues annual and sustainability reports in multiple jurisdictions. This year, they issued a separate [integrated report for their U.S. operations](#), explaining:

In the United States, ArcelorMittal is reporting on our corporate responsibility and sustainability outcomes for the seventh time. This year, we take a major step toward integrated thinking and reporting in the U.S. This means all levels of the ArcelorMittal business are working to incorporate sustainability – both in the traditional and financial sense and into annual strategic planning processes and discussions. This integrated approach ensures ArcelorMittal does what is right - for our business, our people and our planet.

The table from the report shown on the right makes a specific reference to the IIRC’s capitals and ties them to its key areas of strategic focus. The report also includes multiple years of metrics for many of the key capitals, an example of which is shown below.

IIRC’s Six Capitals, intersections with our business strategy

Strategic focus	IIRC’s Six Capitals					
	Financial	Manufactured	Intellectual	Social and relationship	Human	Natural
Optimize assets	●	●	●		●	●
Effectively utilize financial resources	●	●				
Achieve high capacity utilization on our most productive assets	●	●			●	●
Invest in assets for long-term viability	●	●			●	
Deliver high value add products for our customers	●			●		
Recruit and retain talented employees to drive optimum productivity	●		●	●	●	
Gain market share	●			●		
Achieve positive cash flow	●					

	Topic	Description	Indicator	Performance				
				2011	2012	2013	2014	2015
People	Lost time injury frequency rate percent change (per million hours worked)	Number of injuries which resulted in employee or contractor having to miss at least one day of work as a result of the accident, per million hours worked	GRI G4-LA6 SASB NR0302-18	2.4% increase (3.35)	42% reduction (1.92)	18% reduction (1.58)	1% reduction (1.57)	15% reduction (1.33)

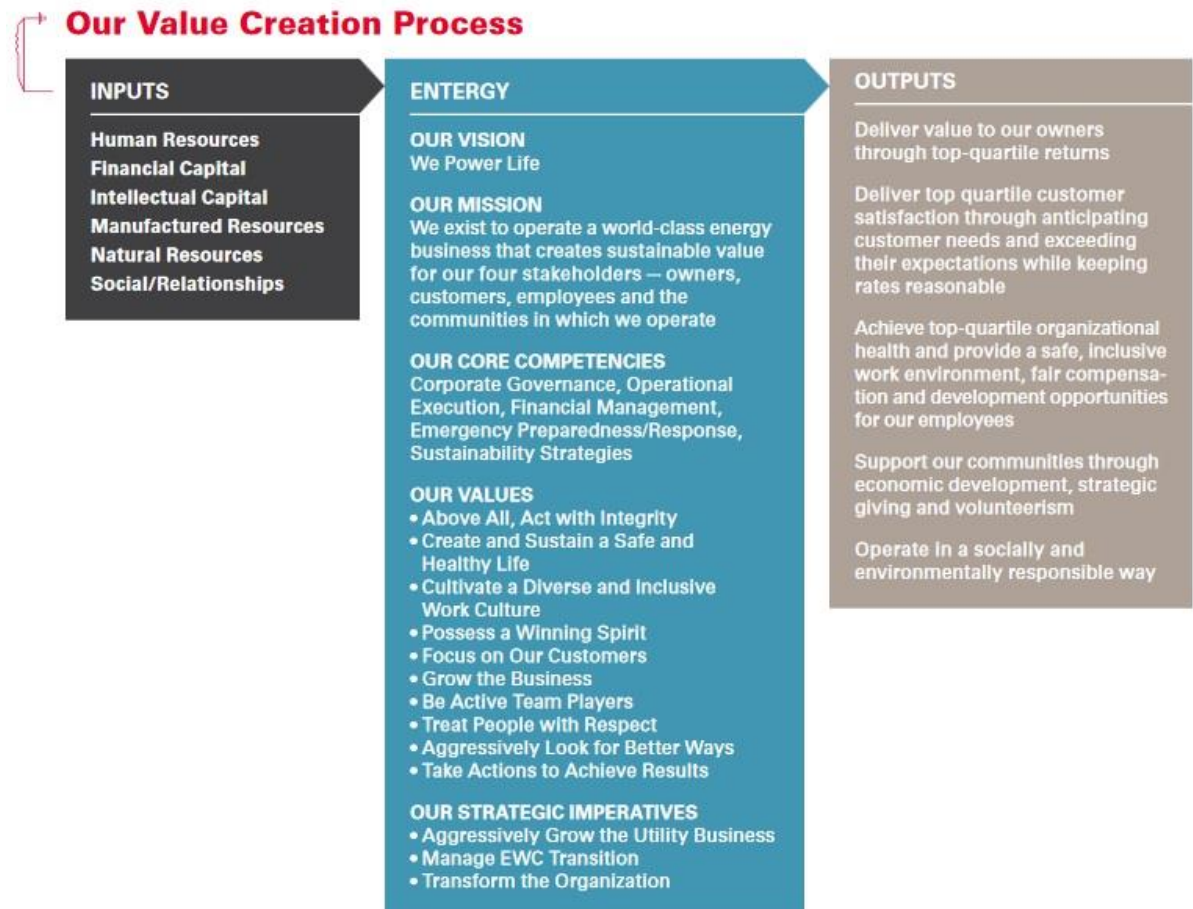


## Example: Entergy

Entergy produces and distributes electric power in the Southern U.S. Their 2015 Integrated Report includes discussion of the company’s economic, environmental, social and governance results. It includes full financials, KPI’s and this graphic which ties its capitals to its value creation process. The report explains:

“We exist to operate a world-class energy business that creates sustainable value for our four stakeholders – owners, customers, employees and the communities in which we operate. This is our mission.

- For our owners, we create value by aspiring to provide top-quartile returns through the relentless pursuit of opportunities to optimize our business.
- For our customers, we create value by delivering top-quartile customer satisfaction through anticipating customer needs and exceeding their expectations while keeping rates reasonable.
- For our employees, we create value by achieving top-quartile organizational health; providing a safe, rewarding, engaging, diverse and inclusive work environment, fair compensation and benefits; and opportunities to advance their careers.
- For our communities, we create value through economic development, philanthropy, volunteerism and advocacy and by operating our business safely and in a socially and environmentally responsible way”





## Conclusion

Sachs' poem ends with the Moral:

So oft in theologic wars,  
The disputants, I ween,  
Rail on in utter ignorance  
Of what each other mean,  
And prate about an Elephant  
Not one of them has seen!

The complexity and intangibility of today's businesses demands new forms of thinking and reporting. The incredibly large intangible information gap creates a lot of uncertainty and arguments about elephants we cannot see. The integrated and systems thinking models provide valuable insights for the journey toward solving this uncertainty and making sense of the complexity. The multi-capital model promoted by the IIRC provides a practical and powerful tool for applying this approach.

The work of companies like Clorox, ArcelorMittal, Entergy and many others demonstrated that it is possible to connect the many threads of value creation and promote integrated and systems thinking. Here's to helping each other see the whole elephant and making sense of the challenges facing us.

*Smarter-Companies recently published a brief called [The Three Big Ideas behind Integrated Reporting: How to start measuring, managing and communicating about your business in an integrated way](#)*

[Read The Three Big Ideas](#)

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