



*Managing in a Time
of
Great Change*

Peter F. Drucker, 1995

Book Review

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The legendary Peter Drucker has combined articles and essays published in the 1990's into his latest look, *Managing in a Time of Great Change*. The overall theme of the book deals with changes that have already occurred. He urges that in consideration of the changes, executives can and must take action for the future. Drucker's main thoughts are in the areas of management, the information-based organization, the economy, and society.

Drucker says that "what" to do is the central challenge of big business today. Every company has its own theory of business from which it operates. The theory is based on assumptions about the environment, mission, and core competencies. Drucker offers four criteria for a valid theory of the business: (1) Assumptions about the environment, mission and core competencies must fit reality. (2) The assumptions must fit one another. (3) The assumptions must be communicated and understood. (4) The theory of the business must be tested. Drucker also offers his ideas on the "Network Society" and changes in management. Management theories, assumptions, policies, and practices of the past may not apply in the future.

The information-based organization or "Network Society" is based on knowledge, the executive's principal resource. Specialized knowledge integrated into a task becomes productive knowledge. This also requires decentralization so that decisions can be made quickly. To accommodate modern organizations with knowledge specialists, Drucker believes that the team concept is more appropriate than the traditional boss-subordinate relationship. All members of the team must see themselves as "executives".

In his discussion about the economy, Drucker comments on the world economy, changes in trade and investment, the relationship between the world economy and the domestic economy, and trade policy. He says that a lesson learned from the last 40 years is that there is a direct relationship between increased participation in the world economy and increased domestic economic growth. Drucker provides insight into the Pacific Rim countries and the world economy, highlighting China and Japan. The new world economy has changing centers of power and new growth markets.

The transformation of society has changed from that of a farming society to blue-collar workers and then knowledge workers. Formal education is essential for the knowledge worker.

Drucker comments on the success of nonprofit organizations and the experience of volunteerism. He offers that the federal government would do well by conducting performance reviews of federal agencies and programs. The federal government has had successes and failures, both of which we can learn from.

Peter F. Drucker's book is easy to read and provides clear insight about changes that have taken place in management, information, the economy, and society in major countries of the world. He emphasizes that knowledge and teams are the keys for the future. Drucker's latest book should be required reading for all managers and executives.



The Theory of Business

For a long time now, there have been many new major management techniques such as downsizing, outsourcing, total quality management, economic value analysis, benchmarking, re-engineering, etc. each is a powerful tool. But with the exceptions of outsourcing and re-engineering, these tools are designed primarily to do differently what already is being done. They are 'how to do' tools. Yet 'what to do is increasingly becoming the challenge facing management, especially that of big companies that have enjoyed long term success. The story is familiar one: a company that was super star yesterday finds itself stagnating and frustrated, in trouble and, often, seemingly unmanageable crisis. This phenomenon is by no means confined to the United States, it has become common in Japan and Germany, the Netherlands and France, Italy and Sweden. And it occurs just as outside the business – in labour unions, government agencies, hospitals, museums, and churches. In fact it seems even less tractable in those areas.

The root cause of nearly every one of these crises is not that things are being done poorly. It is not even that the wrong things are being done. Indeed, in most cases, the right things are being done – but fruitlessly. What accounts for this paradox? The assumptions on which the organizations have been built and is being run, no longer fit the reality. These are the assumptions that shape the organizations behavior, dictate its decisions about what to do and what not to do, and define what the organization considers meaningful results. These assumptions are about the markets. They are about the customers and competitors, their values and behavior. They are about technology and its dynamics, about the company's strengths and weaknesses. These assumptions are about what the company gets paid for. They are what Drucker calls a company's theory of business.

The theory of business explains both the success of companies and the challenges they face. In fact, what underlies the current malaise of so many large and successful organizations worldwide is that their theory of business no longer works. Every big, successful company throughout history, when confronted with surprises, has refused to accept it. As a result the reality has changed, but the theory of the business has not changed with it.

A theory of business has three parts:

1. There are assumptions about the environment of the organization: society and its structure, the market, the customer, and technology.
2. There are assumptions about the specific mission of the organization.
3. There are assumptions about the core competencies needed to accomplish the organization's mission.

There are four specifications for a valid theory of business:

1. The assumptions about environment, mission and core competencies must fit reality.
2. The assumptions in all three areas have to fit one another.
3. The theory of business must be known and understood throughout the organization.
4. The theory of business has to be tested constantly.



Planning for uncertainty

Uncertainty – in the economic, society, politics – has become so great as to render futile, if not counterproductive, the kind of planning most companies still practice: forecasting based on probabilities.

Unique events, such as the Perot phenomenon or the dissolution of the Soviet Empire, have no probabilities. Yet executives have to make decisions that commit to the future current resources of time and money. Worse, they have to make decisions not to commit resources – to forgo the future. The lengths of such commitments are steadily growing: in strategy and technology, marketing, manufacturing, employee development, in the time it takes to bring a new plant on stream or in the years until a commitment to a store location pays for itself. Every such commitment is based on assumptions about the future. To arrive at them, traditional planning asks “What is most likely to happen? Planning for uncertainty asks, instead “What has already happened that will create the future?”

The answer to the question - “What has already happened that will create the future?” - define the potential of the opportunities for a given company or an industry. To convert this potential in to reality requires matching the opportunities with the company’s strengths and competence. It requires ‘strength analysis’ and what now is coming to be known as analysis of “core competence”.

Strength analysis shows both what the company can do and what it should do. Matching the company’s strengths to the changes that have already taken place produces, in effect, a plan of action. It enables the business to turn the unexpected in to advantage. Uncertainty ceases to be a threat and becomes an opportunity.

There is however, one condition: that the business creates the resources of knowledge and of people to respond when opportunity knocks. This means developing a separate futures budget. The 10 per cent or 12 per cent of annual expenditures needed to create and maintain the resource for the future must be put into a constant budget maintained in a good year and bad. These are investments, even though accounts and tax collectors consider them operating expenses. They enable a business to makes its future – and that, in the last analysis, is what planning for uncertainty means.



The five deadly business sins

The past few years have seen the downfall of one once-dominant business after another: General Motors, Sears, and IBM, to name just a few. But in every case the main cause has been at least one of the five deadly business sins – avoidable mistakes that will harm the mightiest business.

The first and easily the most common sin is the worship of high profit margins and of premium pricing. The lesson to be learnt here is that the worship of premium pricing always creates a market for the competitor. And high profit margins do not equal maximum profits. Total profit is profit margin multiplied by turnover. Maximum profit is thus obtained by the profit margin that yields the largest total profit flow, and that is usually the profit margin that produces optimum market standing.

Closely related to this first sin is the second one: mis-pricing a new product by charging ‘what the market will bear’. This, too, creates a risk-free opportunity for the competition. It is a wrong policy even if the product has a patent protection. Given enough incentives, a potential competitor will find a way around the strongest patent.

The third deadly sin is cost driven pricing. The only thing that works is price driven costing. Most businesses arrive at their prices by adding up costs and then putting a profit margin on top. Their argument – “to recover their costs and make profit”. This is true but irrelevant: customers do not see it as their job to ensure that manufacturers make a profit. The only sound way to price is to start out with what the market is willing to pay – and thus, it must be assumed, what the competition will charge – and design to that price specification. To be sure, to start out with price and then whittle down costs is more work initially. But in the end it is much less work than to start out wrong and then spend loss-making years bringing costs in to line – let alone far cheaper than losing a market.

The fourth of the deadly sins is slaughtering tomorrow’s opportunity on the altar of yesterday.

The last deadly sin is feeding problems and starving opportunities. In most of the businesses, the performers are assigned to problems i.e. to the old business that is sinking faster than been forecast; to the old product that is being outflanked by a competitor’s new offering; to the old technology. Almost invariably, the opportunities are left to fend for themselves. All one can get by ‘problem solving’ is damage containment. Only opportunities produce results and growth. And opportunities are actually, every bit, as difficult and demanding as problems are. First draw up a list of the opportunities facing the business and make sure that each is adequately staffed (and adequately supported). Only then should you draw up a list of problems and worry about staffing.



Managing The Family Business

The majority of businesses everywhere are family-controlled or family-managed. Yet management books and courses deal almost entirely with the public owned and professionally managed company – they rarely as much as mention the family-managed business. Of course, there is no difference whatever between professionally managed and family-managed businesses in respect to all functional work. But with respect to management, the family business requires its own and very different rules. These rules have to be stringently observed. Otherwise the family managed business will not survive, let alone prosper.

The first rule is that family members do not work in the business unless they are at least as able as any non-family employee, and work at least as hard. But, interestingly in a family-managed business, family members are always ‘top management’ whatever their official job or title.

The second rule is equally simple: no matter how many family members are in the company’s management, and how effective they are, one top job is always filled by an outsider who is not a family member. There is a need in the family company for one senior person – and a highly respected one – who is not family and who never mixes business and family.

The third rule is that family-managed businesses, except perhaps for the very smallest ones, increasingly need to staff key positions with non-family professionals. The knowledge or the expertise needed, whether in manufacturing or in marketing, in finance, in research, in human resources management have become far too great to be satisfied by any but the most competent family member no matter how well intentioned he or she may be. And these non-family members have to be treated as equals. They have to have ‘full citizenship’ in the firm; otherwise they simply will not stay.

Even the family-managed business that faithfully observes the preceding three rules tends to get into trouble – and often breaks up – over management succession. There is only one solution – entrust the succession decision to an outsider who is neither part of the family nor part of the business. More and more family-managed businesses, now try to find the right outside arbitrator long before the decision has to be made and, ideally, long before the family members have begun to disagree on the succession.

The controlling word in “family-managed business” is not ‘family’. It has to be ‘business’.



Six Rules for Presidents

Peter Drucker, in this discussions focuses the conversation around the rules that needs to be followed by the president of the United States. But the conversation can be extended to the president of any business organization. He has suggested six rules.

The first rule for a president is to ask: What needs to be done? He must not stubbornly do what he wants to do, even if it was the focus of his campaign.

Concentrate, don't splinter yourself is the second rule. There are usually half a dozen right answers to 'What needs to be done?' yet unless a president makes the risky and controversial choice of only one, he will achieve nothing. The president's top priority has to be something that truly needs to be done. If it is not highly controversial, it is likely to be the wrong priority. It has to be doable – and doable fairly fast – which means that it has to be a limited objective. But it also has to be important enough to make a difference if done successfully.

Don't ever bet on a sure thing is rule three. It always misfires. It is extremely crucial that the president tests his assumptions before announcing or giving a green signal to his plans

An effective president does not micromanage is rule four. He tasks that a president must do himself are already well beyond what any but the best-organized and most energetic person can possibly accomplish. Whatever the president does not have to do he therefore must not do. Presidents are much too far away from the scene of action, much too dependent on what other people tell them or choose not to tell them, and much too busy to study the fine print and to micromanage successfully.

A president has no friends in the administration was Lincoln's maxim and is rule five. No one can trust 'friends of the president'. Whom do they work for? Whom do they speak for? To whom do they really report? At best, they are suspected of running around their official superiors and to their Great Friend; at worst, they are known as the president's spies. Above all, they are always tempted to abuse their position as a friend and the power that goes with it.

The sixth rule is the advice Harry Truman gave the newly elected John F Kenney: 'Once you're elected you stop campaigning'.



Managing in the Network Society

For well over a hundred years developed countries were moving steadily towards an employee society of organizations. Now this trend is reversing itself. The developed countries are fast moving towards a network society – in respect to the relationship between organizations and individuals who work for them, and in respect to the relationships between different organizations.

Relations between organizations are changing just as fast as relations between organizations and the people who work for them. The most visible example is ‘outsourcing’, in which a company, a hospital, a government agency, turns over an entire activity to an independent firm that specializes in that kind of work. In another ten or fifteen years, organizations may have outsourced all work that is ‘support’ rather than ‘revenue producing’ and all activities which do not offer career opportunities into senior management. This would mean that in many organizations a majority of people who work for it might not be its employees but employees of an outsourcing contractor.

More important even may be the trend towards Alliances as the vehicle for business growth. Downsizing, disinvestment, mergers, and acquisitions – these dominate the headlines. But the greatest change in corporate structure – and in the way the business is being conducted – may be the largely unreported growth of relationships which are based not on ownership but on partnership: joint ventures, minority investments cementing a joint marketing agreement or an agreement to do joint research; semi-formal alliances of that sort. So, the basic structures of the organizations and of employment are changing rapidly.

Even twenty years hence the majority of managers and professionals will still be employees of the organization they work for, the psychology of the workforce – and especially of the knowledge workforce – will largely be determined by the large minority who are not employees of an outsourcing firm, of a partnership organization or half independent contractors. For the organization and their top management this means that they will have to earn the trust and loyalty of the people who work for them, whether these people are their employee or not. Equally novel are the demands partnership and alliances make on managing a business and its relationships. Executives are used to command. They are used to think through what they want and then to get acceptance of it by subordinates. But in a partnership – whether with an outsourcing contractor, with a joint venture partner, with a company in which one holds a minority stake – one cannot command. One can only gain trust.

This new organization and its society is what Peter Drucker calls the “Network Society”.



PART II – THE INFORMATION BASED ORGANIZATION

The New Society of Organizations

Every few hundred years throughout Western history a sharp transformation has occurred. In a matter of decades, society altogether rearranges itself – its world view, its basic values, its social and political structures, its arts, its key institutions. In this society called the knowledge society, knowledge is the primary resource for individuals and for economy overall. Land, labour, and capital – the economist’s traditional factor’s of production – do not disappear, but they become secondary. They can be obtained and obtained easily, provided there is specialized knowledge. At the same time, however, specialized knowledge by itself produces nothing. It can become productive only when it is integrated in to a task. And that is why the knowledge society is also a society of organizations: the purpose and function of every organization, business and non-business alike, is the integration of specialized knowledges in to a common task.

Society, community, and family are all conserving institutions. They try to maintain stability and to prevent or at least slow, change. But the modern organization is a destabilizer. It must be organized for innovation and innovation is ‘creative destruction’. And it must be organized for the systematic abandonment of whatever is established, customary, familiar, and comfortable, whether that is a product, a service, or a process; a set of skills; human and social relationships; or the organization itself. In short, it must be organized for constant change. It is the nature of knowledge that it changes fast and that today’s certainties always become tomorrow’s absurdities. It is by no means only science or technology that creates new knowledge and makes old knowledge obsolete. Social innovation is equally important and often more important than scientific innovation. The greatest change of all is probably that in the last forty years, purposeful innovation – both technical and social- has itself become an organized discipline that is both teachable and learnable.

For managers, the dynamics of knowledge impose one clear imperative: every organization has to build the management of change into its very structure. On the one hand, this means that every organization has to prepare for the abandonment of everything it does. Indeed, organizations increasingly will have to ‘plan’ abandonment rather than try to prolong the life of a successful product or service.

Every organization has to draw on three systematic practices. The first is continuing improvement of everything the organization does. Second, every organization will have to exploit its knowledge, that is, to develop the next generation of applications from its own successes. Finally, every organization will have to learn to innovate – and innovation can now be organized – and must be organized – as a systematic process. And then, of course, one comes back to abandonment, and the process starts all over. The need to organize for change also requires a high degree of decentralization. That is because the organization must be structured to make quick decisions. All this implies, however that the organization of the post-capitalist society must constantly upset, disorganize, and destabilize the community. They must change the demand for skills and knowledges.

The modern organization must be ‘in’ a community but cannot be ‘of’ a community. The organization cannot submerge itself in the community or subordinate itself to the community’s ends. Its ‘culture’ has to transcend community. It is the nature of the task, not the community in which the task is being performed, that determines the culture of an organization. In addition, each organization has a value system that is determined by its task.



The issue of social responsibility is also inherent in the society of organizations. The modern organization has and must have social power – and a good deal of it. It needs power to make decisions about people: whom to hire, whom to fire, whom to promote. It needs power to establish rules and disciplines required to produce results. The power of the organization can be restrained by political power. It can be made subject to due process and to review by the courts. But it must be exercised by individual organizations rather than by political authorities. This is why post-capitalist society talks so much about social responsibilities of the organization. Unless power is balanced by responsibility, it becomes tyranny. Furthermore, without responsibilities power always degenerates in to non-performance, and organizations must perform. So the demand for socially responsible organizations will not go away; rather, it will widen.

Unlike communities, societies or families, organizations are purposefully designed and always specialized. An organization is effective only if it concentrates on one task. Diversification destroys the performance capacity of an organization. Because modern organization is composed of specialists, its mission must be crystal clear. Only a focused and common mission will hold the organization together and enable it to produce. It can be all too easy for managers to forget that joining an organization is always voluntary. Likewise, it may be difficult to leave an organization – the mafia for instance. But it is always possible. And the more the organization becomes an organization of knowledge workers, the easier it is to leave it and move elsewhere. Therefore, an organization is always in competition for its most essential resource: qualified, knowledgeable people.

Because the modern organization consists of knowledge specialists, it has to be an organization of equals, of colleagues and associates. No knowledge ranks higher than another; each is judged by its contribution to the common task rather than by any inherent superiority or inferiority. Therefore, the modern organization cannot be an organization of boss and subordinate. It must be organized as a team.



There's three kinds of teams

'Team-building' has become a buzzword in American business. The results are not overly impressive. One reason – perhaps the major one – for the failures is the all-but-universal belief among the executives that there is just one kind of team. There are three – each different in its structure, in the behavior it demands from its members, in its strengths, its vulnerabilities, its limitations, its requirements, but above all, in what it can do and should be used for.

The first kind of team is the baseball team. The players 'on' the team; do not play 'as' a team. They have fixed positions they never leave. The surgical team performs an open heart operation and Henry Ford's assembly line, are both 'baseball teams'.

The second kind of team is the 'football team'. The players on the football team, like those on the baseball team, have fixed positions. But on the football team, players play as a team; the whole team moves together (except the goalie) while individual players retain their relative positions. The Japanese car makers' design teams, is an example of football team. To use an engineering term, the designers, engineers, manufacturing people, and marketing people work 'in parallel'.

Third, there is the 'tennis doubles team'. On the doubles team, players have primary rather than fixed position. They are suppose to 'cover' their team-mates, adjusting to their team-mates' strengths and weaknesses and to the changing demands of the 'game'.

Business executives and the management literature have little good to say about the baseball-style team, whether in the office or on the factory floor. There is even a failure to recognize such teams as teams at all. But this kind of team has enormous strength. Each member can be evaluated separately, can have clear and specific goals, can be held accountable, and can be measured. And because the members do not have to adjust to anybody else on the team, every position can be staffed with a 'star', no matter how temperamental, jealous, or limelight-hogging each of them might be. But he baseball team is inflexible. It works well when the game has been played many times and when the sequence of its actions is thoroughly understood by everyone.

The football team does have flexibility, but it has far more stringent requirements than baseball team. It needs a 'score' – such as the play the coach signals to the huddle on the field. The specifications with which the Japanese begin their design of a new car model are far more stringent and detailed and they are far more closely adhered to.

Even more stringent are the requirements of the doubles team. The team must be quite small, with five to seven members at most. The members have to be trained together and must work together for quite some time before they fully function as a team. There must be one clear goal for the entire team yet considerable flexibility with respect to the individual member's works and performance. And in this kind of team only the team 'performs'; individual members 'contribute'.

All three of these kinds of teams are true teams. But they are so different that they cannot be hybrids. One kind of team can play only one way. And it is very difficult to change from one kind of team to another. Gradual change cannot work. There has to be a total break from the past, however traumatic it may be. Teams, in other words, are tools. As such, each team design has its own uses, characteristics, requirements and limitations. Teamwork is neither 'good' nor 'desirable' – it is a fact. Which team to use for what purpose is crucial, difficult, and risky decision that is even harder to unmake. Managements have yet to learn how to make it.



The Information Revolution In Retail

Most of the earlier retailers (in the 1950s and 1970s) who went multinational tried to improve slightly on what retailers in their 'host' countries were already doing quite well. But the new multinationals are revolutionaries, rejecting the very assumptions that most retailers still consider holy writ. During the past half-century, 'shopping centre' has become almost synonymous with 'successful retailing'. And the bigger, the better. But the new retailers shun the shopping centres. They build free standing stores or go into 'minimalls' that contains only a handful of shops. And the new retailers aim at a sharply profiled personality and clear market niche.

The new retailers rarely speak of 're-engineering' – to them it sounds too much like manufacturing. But they constantly redesign operations. Indeed, many redefine the entire business. Wal-Mart's success, for example, rests in large measure on its redefining retailing as the 'moving' of merchandise, rather than its sale. This led to the integration of the entire process – all the way from the manufacturer's machine to the selling floor – on the basis of 'real time' information about customer purchases. As a result, Wal-Mart could out three tires of warehouses and a full third of the costs of traditional retailing. But Wal-Mart still carries a full assortment of goods, and that means thousands of items.

Everybody retailing talks of 'service' as the key to success, if not survival. So do the new retailers. But they mean something different. For traditional merchants, service means salespeople who personally take care of the individually customer. But the new retailers employ very few salespeople. Service to them means that the customer do not need a salesperson, do not have to spend time trying to find one, do not have to ask, do not have to wait. It means that the customers know where the good are the moment they enter the store, in what colours and sizes, and at what price. It means providing 'information'. But service for the new retailer also means getting customers out of the store as fast as possible once they have made their purchases.

Retailers now talk of 'shopping without a stores' through interactive TV. They talk of 'virtual reality' in which the customer in her own living room 'walks' through a simulated shopping centre on her computer screen, 'tries on' a blouse, and orders y pushing a few buttons. The technology for all this is available and is increasingly less expensive. And there are signs that a substantial number of customers are becoming receptive to it.

Shopping without a store is thus no longer science fiction. But it is still speculation (and a lot of hype). But even without any new technology, retailing has already changed. The changes are having profound effects on advertising, n consumer-goods manufacturers, and on the structure of the economy. Retailing – rather than manufacturing or finance – may be where the action is now.



Be data literate; know what to know

Executives have become computer-literate. But not many executives are information-literate. They know how to get data. But most still have to learn how to use data. A ‘database’, no matter how copious, is not information. It is information’s ore. For raw material to become information, it must be organized for a task, directed towards specific performance, applied to a decision. Raw material cannot do that itself. Nor can information specialists. They can cajole their customers, the data users. They can advise, demonstrate, and teach. But they can no more manage data for users than a personnel department can take over the management of the people who work with an executive.

Information specialists are tool makers. The tool users, whether executive or professional, have to decide what information to use, what to use it for, and how to use it. They have to make themselves information-literate. This is the first challenge facing information users. But the organization, too, has to become information-literate.

What a business needs the most for its decisions – especially its strategic ones – are data about what goes on outside of it. It is only outside the business where there are results opportunities and threats. So far, the only data from the outside that has been integrated into most companies’ information systems and into their decision making processes are day to day market data. Few businesses have tried to get information about their non-customers, let alone have integrated such information into their databases. Yet no matter how powerful the company is in its industry or market, non-customers almost always outnumber the customers. When it comes to non-market information – demographics, technology, economics – there are either no data at all or only the broadest of generalizations. How to obtain this data; how to test them; how to put them together with the existing information system to make them effective in a company’s decision making process – this is the second major challenge facing information users today.

Finally the most difficult of the new challenges: we will have to bring together the two information systems that businesses now run side by side – computer-based data processing and the accounting system. At least we have to make the two compatible. The practitioners have different backgrounds, different values, and different career ladders. They work in different departments and for different bosses. The two systems increasingly overlap. They also increasingly come up with what look like conflicting – or at least incompatible – data about the same events; for the two look at the same event quite differently. Until now this has created little confusion. Companies tended to pay attention to what their accountants told them and to disregard the data of their information system, at least for top-management decisions. But this is changing as computer-literate executives are moving into decision-making position.

Computer people still are concerned with greater speed and bigger memories. But the challenges increasingly will be not technical; rather they will be to convert data into information that is actually being used.



We need to measure, not count

Most needed – and totally lacking – are measurements to give us business control. Financial accounting, balance sheets, profit and loss statements, allocation of costs, and so forth are an X-ray of the enterprise's skeleton. But much as the diseases we most commonly die from – heart disease, cancer, Parkinson's – do not show up in a skeletal X-ray, a loss of market standing or a failure to innovate does not register in the accountant's figures until the damage has been done.

We need new measurements – call them a 'business audit' – to give us effective business control. We need measurements for a company or industry that are akin to the 'leading indicators' and 'lagging indicators' that economists have developed during the past half century to predict the direction in which the economy is likely to move and for how long. For the first time, big institutional investors, including some of the very large pension funds, are working on such concepts and tools to measure the business performance of the companies in which they invest.

These are only beginnings. And so far, each of these areas is being worked on separately. Indeed, the people working in one field – for example, pension funds – may not even be aware of the work done in other areas.

It may take many years, decades perhaps, until we have the measurements we need in all these areas. But at least we know now that we need new measurements, and we know what they have to be. Slowly, and still gropingly, we are moving from counting to measuring.



The information executives need today

Concepts and tools, history teaches again and again, are mutually interdependent and interactive. One changes the other. That is now happening to the concept we call a business and to the tools we call information. The new tools enable us – indeed, may force us – to see our businesses differently, to see them as

- Generators of resources, that is, as the organizations that convert costs into yields
- Links in an economic chain, which managers need to understand as a whole in order to manage their costs
- Society's organs for the creation of wealth
- Both creators and creatures of a material environment, which is the area outside the organization, in which opportunities and results lie but in which the threats to the success and survival of every business also originates

This chapter deals with the tools executives require to generate the information they need. And it deals with the concepts underlying those tools.

From cost accounting to yield control

Many businesses have shifted from traditional cost accounting to activity-based costing. Traditional cost accounting measures what it costs to 'do' something, for example to cut a screw thread. Activity-based costing also records the cost of 'not doing', such as the cost of machine down time. Activity-based costing therefore, gives not only much better cost control but, increasingly, it also gives 'result control'.

From legal fiction to economic reality

Knowing the cost of your operations, however, is not enough. To compete successfully in an increasingly competitive global market a company has to know the costs of its entire economic chain and has to work with other members of the chain to manage costs and maximize yield. Companies are therefore beginning to shift from costing only what goes on inside their own organizations to costing the entire economic process, in which even the biggest company is just one link. Failing to do so, the most efficient company will suffer from an increasing cost disadvantage.

Information for wealth creation

Enterprises are paid to create wealth, not to control costs. But the obvious fact is not reflected in traditional measurements. Enterprises have to be managed as going concerns, that is, for wealth creation. To do that requires information that enables executives to make informed judgments. It requires four set of diagnostic tools: foundation information, productivity information, competence information, and information about the allocation of scarce resources.

Where the results are

Those four kinds of information tell us only about the current business. They inform and direct 'tactics'. For 'strategy' we need organized information about the environment. Strategy has to be based on information about

- Markets
- Customers and Non-customers
- Technology in one's own industry and others



- Worldwide finance
- Changing world economy

For that is where the results are. Inside an organization there are only cost centers. The only profit center is the customer whose cheque has not bounced

Our traditional mindset – even if we use sophisticated mathematical techniques and impenetrable sociological jargon – has always somehow perceived business as buying cheap and selling dear. The new approach defines a business as the organization that adds value and creates wealth.



PART III – THE ECONOMY

Trade lessons from the world economy

There are important lessons in four areas:

- i. The structure of the world economy
- ii. The changed meaning of trade and investment
- iii. The relationship between world economy and domestic economy
- iv. The trade policy

The structure of the world economy

Twenty years ago no one talked of the ‘world economy’. The term then was ‘international trade’. The ‘international economy’ traditionally had two parts: foreign trade and foreign investment. The world economy also has two parts – but they are different from those of international trade. The first part consists of flow of money and information; the second, trade and investment, rapidly merging into one transaction, and actually only different dimensions of the same phenomenon, namely, the new integrating force of the world economy, cross-border alliances. While both of these segments are growing fast, money and information flows are growing the fastest.

The changed meaning of trade and investment

For practically everybody, international trade means merchandise trade, that is, import and export of manufactured goods, farm products, and raw materials such as petroleum, iron ore, etc. But increasingly, international trade is services trade. But even merchandise trade is no longer what practically everybody, including economists and policy makers, assumes it to be. It is not a ‘transaction’ that is a sale or a purchase of individual goods. It is a ‘relationship’ – either structural or institutional – in which the individual transaction is only a ‘shipment’ and an accounting entry. And both services trade and relationship trade behave differently from transactional merchandise trade. Similarly, ‘investment’ is now becoming something markedly different. Portfolio investment has mutated into money flows, which aren’t investments at all. But now ‘direct investment’ – investment abroad to start a new business or to acquire an existing one – is also beginning to change, and fast.

The relationship between world economy and domestic economy

The distinction between domestic and international economy has ceased to be economic reality. The one unambiguous lesson of the last forty years is that increased participation in the world economy has become the key to domestic economic growth and prosperity. There is one to one correlation between a country’s domestic economic performance in the forty years since 1950 and its participation in the world economy. Conversely, there is no correlation at all between domestic economic performance and policies to stimulate the domestic economy. The world economy has become the engine of growth, prosperity, and employment for every developed country. Every developed economy has become world-economy led.

The trade policy

The World Bank studied eight East Asian ‘superstars’: Japan, South Korea, Hong Kong, Taiwan, Singapore, Malaysia, Thailand and Indonesia. Each of the eight countries does things in its own and different way. But all of them follow the same two basic policies: first, provide the right



economic climate at home through stressing the fundamentals of monetary stability, an educated and trained workforce, and a high saving's rate; and second, make performance in the world economy the first priority of economic and business policy. Exactly the same lessons are being taught in the west.

Conclusion

What the last forty years teach is that 'free trade' is not enough. We have to go beyond. Protectionism can only harm. But not to be protectionist is not enough. What is needed is a deliberate and active, indeed an aggressive, policy that gives the external economy, its demands, its opportunities, its dynamics, priority over domestic policy demands and problems.



The US economy power shift

Power in economics of developed countries is rapidly shifting from manufacturers to distributors and retailers. The large distributors are becoming less and less dependent on manufacturer's brands. Today computers provide instant market information which can be integrated with the manufacturing schedule and delivery. Now that we have real time information on what goes in the marketplace, decisions will increasingly be based on what goes on where the ultimate customers, whether housewives or hospitals, take 'buying' decision. These decisions will be controlled by people who have the information – retailers and distributors. One implication of this is that producers will have to structure their plants for 'flexible manufacturing' - the buzzword for production organized around the flow of market information. There is another important implication. When, during the past ten or fifteen years, companies began to organize themselves internally around the flow of information – we now call it 're-engineering' – they immediately found that they did not need a good many management levels. Some companies have since cut two-thirds of their management layers. Now that we are beginning to organize around external information, we are learning that the economy needs far fewer intermediaries. We are eliminating wholesalers.

But the biggest implication is that the economy is changing structure. From being organized around the flow of things and the flow of money, it is becoming organized around the flow of information.



Where the new markets are

According to Drucker, the new markets are not consumer goods markets. Nor are they traditional producer-goods markets, that is, markets for machinery and factories. Rather, three of the new markets are for various kinds of 'infrastructure', that is, for facilities that serve both consumers and producers. And the fourth new market is for things that are neither 'products' nor 'services' in any traditional meaning of those terms.

The most immediately accessible of the new markets involves communication and information. The second of the new market – call it the 'environmental market' – may end up presenting even greater opportunity than the first. It has three separate components, all rapidly developing:

- i. The market for equipment to purify water and air.
- ii. The agro-biology market.
- iii. The energy market.

The third new market is not really new at all. It is growing need in developed and developing countries alike to repair, replenish, and upgrade physical infrastructure, especially transportation systems. And then there is the fourth new market, the one created by demography. It is the market for the investment 'products' to finance survival into old age.



The Pacific Rim and the world economy

The next few years will decide how Asia Pacific Rim will integrate itself into a rapidly changing world economy. But, whichever way the decision goes, it will profoundly change Asia as well as the world economy and world politics. And the decision is being forced on the Asian countries of the Pacific Rim both by development outside, that is, in the West, and by their own economic growth. This calls for something totally new: Asian leadership in trade policy. So far, Asian countries have reacted to the trade policies of the developed countries. Even Japan's trade policy so far has been in large measure skilful exploitation of America's trade policy. Now Asian action is needed. For only Asians can integrate a rapidly developing Asia into the world economy. But where will this leadership be coming from?

China's growth market

Coastal China has been the world's fastest growing economy over the past decade. But now it, and the rest of the country, face formidable problems. To prevent runaway inflation, thousands of unproductive and unprofitable state enterprises must be dismantled. Social tensions are mounting as peasants stream into over crowded cities where there is no housing, no healthcare, and far too few jobs. And a nationwide power struggle has begun in anticipation of the octogenarian leadership's passing.

Drucker presents a few points with regard to China.

- i. Within the next ten years, as much as half of China's population might be employed in factories. Whatever can be made in China will be made there – and that means most manufactured products.
- ii. The biggest opportunities for 'foreigners' in fast-growing China are not in manufacturing but in services. For instance, education. Higher education might one day become America's biggest 'export' to China. Healthcare offer similar opportunities. Financial services, the circulatory system of a modern society, provide yet another major market opportunity. Besides all these, China also needs telecommunications and information services on a massive scale. The same applies to its last development need: transportation.



A century of social transformation

No century in human history has experienced so many social transformations and radical ones as the twentieth century. Far smaller and far slower social changes in earlier periods triggered violent intellectual and spiritual crises, rebellions and civil wars. The extreme social transformations of this century have hardly caused any stir. They proceeded with a minimum of friction, with a minimum of upheavals and indeed, with altogether a minimum of attention from scholars, politicians, the press and the public.

The social structure and its transformations

Before the First World War, the largest single group in every country were farmers. But in all developed free-market countries – including Japan – farmers today are, at most 5 per cent of population and workforce. The second largest group in population and workforce in every developed country around 1900 were live-in servants. Eighty years later, the live-in servants in developed countries have become practically extinct. The century also witnessed the rise and fall of the blue collar worker.

The rise of the ‘class’ succeeding the industrial blue-collar worker is not an opportunity to him. It is a challenge. The newly emerging dominant group is that of ‘knowledge workers’. The new jobs require, in great majority, qualifications the blue collar worker does not possess and is poorly equipped to acquire. The new jobs require a good deal of formal education and the ability to acquire and to apply theoretical and analytical knowledge. They require a different approach to work and a different mindset. Above all they require a habit of continuous learning. Knowledge workers will not be the majority in the knowledge society. But in many countries, if not most developed countries, they will be the largest single group that gives the emerging knowledge society its character, its leadership, its social profile.

That knowledge in the knowledge society has to be highly specialized to be productive implies two new requirements:

- i. Knowledge workers work in teams.
- ii. Knowledge workers have to have an access to an organization. If not employees they, at least, have to be affiliated with an organization.

The old communities – family, village, parish, and so on – have all but disappeared in the knowledge society. Their place has largely been taken by the new unit of social integration: the organization. The task of the social sector organizations is to create human health. They create citizenship.

In sum the priority tasks are as follows:

- We will have to think through education
- We need systematic work on the quality of knowledge and the productivity of knowledge
- The policy of any country will have to give primacy to the country’s competitive position in an increasingly competitive world economy.
- We need to develop an economic theory appropriate to the primacy of a world economy in which knowledge has become the key economic resources and a dominant source of comparative advantage
- We must begin to understand the new integrating mechanism: organization
- The function of government and its functioning will increasingly become central to political thought and political action.



If the twentieth century was one of social transformations, the twenty first century needs to be one of social and political innovations.

It is often said today that the democracies have lost their bearings with the collapse of Communism. They no longer have a policy, no longer have priorities, no longer have criteria for what to do and what not to do. To be sure: the old policies, priorities, criteria do not make sense now that there is no longer a 'public enemy'. But there is a new policy, a new priority, a new necessity: the promotion of civil society as a goal of international policy. A civil society is not a panacea. It is not the 'end of history'. It does not by itself guarantee democracy, and not even peace. It is, however, a prerequisite to these, and equally to economic development. Only if civil society worldwide becomes their goal, can the democracies win the peace.