

# Loving the corporation, 50 years on

## Scott Hargreaves

'Peter Drucker is probably the best-known writer in the world on the philosophical and practical aspects of industrial management.'

So wrote the editor of the *IPA Review* in 1956 when introducing a piece written by Drucker for the IPA on 'The Management Horizon'. Over succeeding decades, Drucker's reputation grew to the point where he was dubbed the 'father of modern management'. His writings are required reading for thousands of MBA students.

With Drucker's death in November last year, it is timely to focus on some of what the *IPA Review* called his thoughts on the *philosophical* aspects of management. Questions about the role of the corporation and management in society are as relevant today as they were then.

### Another Viennese Polymath

Born into the famous cosmopolitan milieu of Vienna in 1909, Drucker attended numerous intellectual soirées when still a youth and obtained publication of his first article of economic analysis at just eighteen.

After leaving school, curious about

the world and unwilling to commit either to a profession or to the narrow focus of an academic discipline, he entered commercial life in Frankfurt, which included a period as a securities analyst. Simultaneously, he enrolled in the law faculty at Frankfurt University which offered a wide-ranging programme which allowed him to indulge his interests across law, economics and political science. Throughout his life he was a believer in mixing work and education. He poured scorn on the notion that someone could earn a qualification in management without having first gained some experience of life inside an organisation.

Like his countryman Freud—whom Drucker's father once pointed out to his son while they were dining in the same restaurant—he created not so much 'theories' as intuitive models based on wide reading, acute observation, and practical experience.

But, as was also the case with Freud, his academic credibility suffered for want of 'falsifiability' of his theories (like Freud's theories, Drucker's could not be proven wrong)—but at least he could point to clients who had prospered from his counselling. Jack Welch of GE always gave credit to Drucker for posing the challenge: 'If you weren't already in a business, would you enter it today? And if the answer is no, what are you going to do about it?', which led to the famous strategy to divest businesses where GE could not be either number 1 or number 2 in the market.

### The Crisis of Modernity

In Frankfurt in the early 1930s, Drucker could hardly miss the rise of fascism, which he grouped with communism as a failed response to modernity. The modern industrial age had shattered the social structures of the early nineteenth century and the great 'isms'

were merely the most extreme form of the 'progressive' assumption—namely, that the State must expand to fill the empty space. Similarly, in later years, he saw the failures of 'the Great Society' in the US as fundamental and systemic rather than failures of implementation or 'good will'.

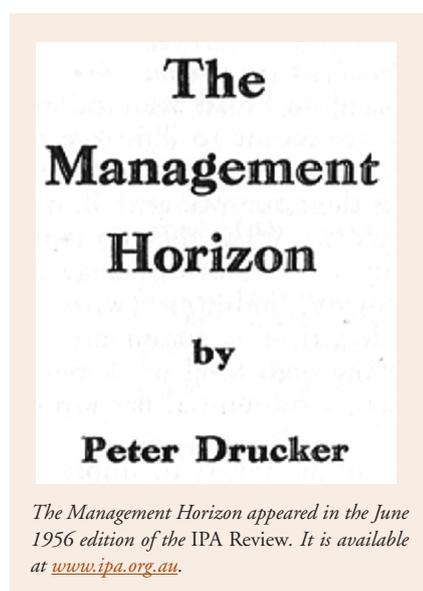
Drucker adapted his PhD for his first book, which was promptly banned by the Nazis for the implied criticism of the regime; reason enough to head for London and then the USA.

### Learning to Love the Corporation

Drucker's first big idea was the 'emergence of Big Business...as a social reality' which 'is the most important event in the recent social history of the Western World'. Corporations don't just manage economic transactions, they have become the pre-eminent institution of society itself. Like Atlas shouldering his burden, business had to acknowledge responsibility for the power it now had, and understand that powerful institutions have to **constantly renew their legitimacy**. Similarly, the rise of the corporation meant that the leading social type was now the professional manager, who had to take a leading role.

*The End of Economic Man*, 1939, poured scorn on the notion that legitimisation of the state of affairs could rely on the notion of *homo oeconomicus*, rationally pursuing profit and thus automatically benefiting society. Indeed, he rejected the notion of basing economics on the assumption of a so-called 'profit motive' as the explanation for individual behaviour and the *a priori* explanation for the emergence of capitalism. While this criticism also

*Scott Hargreaves is an occasional contributor to the IPA Review.*



appears in critiques from the Left, Drucker did not disdain profit. Rather, he saw it as the necessary and hopefully natural result of a well-managed corporation (he used the analogy that even if corporations were run by angels, they would still need to make a profit to survive and prosper). As someone who believed in free enterprise, he cringed when businessmen half-heartedly defended profit as a 'necessary evil'.

Drucker's position was humanist and democratic. To ensure legitimacy, corporations should define their purpose and ensure their objectives are congruent with the objectives of the society in which they live: 'the enterprise exists on sufferance and exists only as long as the society and the economy believe that it does a necessary, useful and productive job'.

This philosophical approach links seamlessly to Drucker's famous 1954 formulation of 'management by objectives', by which corporate management must clearly define and communicate the purpose and objectives of the enterprise, and ensure each subsidiary manager is given defined objectives consistent with those of the corporation itself.

### Constitutionalism and General Motors

The splash created by Drucker's *The End of Economic Man* led, in 1943, to a remarkable invitation to view and research the inner workings of General Motors which, under the leadership of the famous Alfred P Sloan (remembered for his claim that 'what's good for General Motors is good for America'), had become the world's largest corporation.

Drucker's analysis moved beyond the traditional focus on 'efficiency' to the structures of power, authority and decision-making. GM had grown by the acquisition of entrepreneurial businesses (for example, Chevrolet), but had managed to co-ordinate the operations while maintaining the distinctiveness of the individual brands. The decentralised structure that Drucker



**The mass-production revolution of yesterday converted the unskilled labourer who had nothing to contribute but his muscle into the semi-skilled machine operator of today—with a tremendous jump in income, in employment security and social status. It converted the skilled worker of yesterday into the foreman, technician or professional employee of today.**

discerned and described in 1946 in *The Concept of the Corporation* became the standard model for industrial organisation for decades to come.

Drucker drew explicit parallels between GM's structure and the federal structure of the US constitution. This 'constitutionalism' was a recurrent theme in his writings, such as stating that Management by Objectives 'ensures performance by converting objective needs into personal goals. And this is genuine freedom, freedom under the law'.

Drucker and Sloan differed over the social role of the corporation, with Sloan arguing that managers could only be experts in their field of endeavour and could not take on social roles. Drucker said that it was vital to understand the social impacts for corporations and for corporations to understand the extent and limits of their power.

While maintaining that firms must manage their social impacts, in later years Drucker admitted he erred by envisioning the corporation as an institutional alternative to the overweening State, with the capacity to maintain a sense of community. He reached the position that the decline of autonomous social institutions could be reversed and that the creation of social networks and social benefits was better driven by the voluntary 'third sector'. Sixty years on, as a near-bankrupt General Motors groans under the weight of New Deal-era employee health care and pension schemes costing more

than US\$1,500 per vehicle, the notion of corporate paternalism looks even more problematic.

Similarly, the New Deal had brought unions into the heart of the US corporation—and Drucker did not deny them their legitimate place—but:

unions are in inception and basic nature negative: they are anti-bodies. They were designed to protect the worker against management, against society. What is needed however is an integration of the worker as a partner in the industrial system and as a citizen in society.

Corporate social responsibility for Drucker is not about apologising for making a profit or capitulating to internal or external stakeholders who asserted the moral authority to change the direction of the enterprise. Rather, it is something embedded in the way the corporation defines its purposes and seeks to identify, create and service markets.

In his 1986 book, *Frontiers of Management*, he argued 'the first responsibility of business is to make enough profit to cover the costs for the future. If this social responsibility is not met, no other social responsibility can be met'. He then went on to argue that '...the proper social responsibility of business ... is to turn a social problem into economic opportunity and economic benefit, into productive capacity, into human competence, into well-paid jobs, and into wealth'.

**Automation means a new increase in the importance of management—and a new growth in the number of management people. It will make management even more important a leading group in our society than it is today. It will also mean that managerial decisions will have even more impact on our society and economy than they already have today. For these reasons, if for no other, the integrity and responsibility of management will become more important—and more will be demanded of them.**

### Limits to Government

By the 1980s, Drucker had tired of theoretical debates about what Government should do to manage the economy and deliver services because they missed the point that there was little that government could do competently ('most post World War II social government programs have been disasters'). He claimed to have coined the phrase 'privatisation' in 1967, was an early fan of Mrs Thatcher, and supported contracting-out by government agencies. Governments, he said, rarely abandon any activity no matter how anachronistic or failed, partly because the programme (for example, the provision of electricity) inevitably takes on a 'moral' rather than an economic dimension and considerations of rational resource allocation go out the window.

### The Knowledge Society

Drucker's 1956 *IPA Review* article examined the bogey of automation and its supposed threat to employment. He pointed out that automation meant not mass unemployment but rather a shift in the type of work that people did, with more technicians required to manage the new machines, and more managers to organise the work flow. This anticipated his description of *The Knowledge Society*, in which the dominant societal type becomes the semi-autonomous knowledge worker. Just at the point where traditional blue-collar

unions reached the apogee of their political influence, the form of industrial organisation from which they had sprung was becoming obsolete.

The Corporation in the knowledge society cannot be the caricature of the oppressive and depersonalised monolith, for it is run by semi-autonomous knowledge workers, and because individual accountability has

shifted from *efficiency* to *effectiveness*. Industrial workers must *do things right*, but for a knowledge worker, the key is to *get the right things done*. Knowledge workers must be free to do their jobs, and neither intelligence nor personality type is a simple guide to managerial effectiveness or organisational leadership.

Organisations do not 'kill' creativity but rather (should) create innovation by systematic organisational processes, managed as with any other objective. Drucker heaped particular scorn on those who equated innovation with invention, a process he dismissed as 'gadgeteering'.

### Drucker's Two Cheers for Capitalism

The *IPA Review* published Drucker in 1956 even though he was given to make comments such as this: 'I have serious reservations about capitalism as a system because it idolises economics as the be-all and end-all of life'. That such statements appeared even within these pages in the mid-twentieth century shows how far the political and economic debate has travelled in the last 50 years.

During the Cold War, it wasn't the principles behind the battling ideologies which were winning the majority of hearts and minds, but rather expectations of the outcomes between the two systems (hence the systematic

Stalinist abuse of GNP statistics). It is hard to believe now, but from the time Lincoln Steffens first returned from the Soviet Union in 1921 and declared 'I have seen the future and it works', the feeling that communism offered the prospect of superior economic outcomes could be found as much on the Right as on the Left.

Drucker disliked the intellectual propositions of those such as Hayek, who were against central planning but seemed to admit that it could be achieved in practice. In 1956, Khrushchev famously banged his shoe on the desk at the UN and screamed to Harold Macmillan 'We will bury you!', and the concern that this could be accomplished was as much about economic performance as military superiority. Drucker was trying to establish that capitalism could be managed to achieve superior economic outcomes, while also achieving societal objectives and maintaining the dignity of the individual worker.

Seen in the that context, one can better understand Drucker's despairing comments in the 1980s and 1990s about inflated CEO salaries and corporate restructuring driven by the needs of the investment banks rather than the enterprise itself. Notions of a 'market for talent' and 'market for control' would have no appeal for Drucker, because his concern was the lack of alignment between the behaviour of corporations and the expectations of society. Given the tensions created between social expectations and economic realities, reactionary efforts such as the post-Enron Sarbanes-Oxley legislation are hardly surprising.

Pragmatic to the end, at the age of 93 Drucker maintained the position he had reached as he left the Nazi regime behind: 'I am for the free market. Even though it doesn't work too well, nothing else works at all'.

**IPA**