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DRUCKER

PEOPLE *and* PERFORMANCE

THE BEST OF PETER DRUCKER ON MANAGEMENT

HARVARD BUSINESS SCHOOL PRESS

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Harvard Business School Press
Boston, Massachusetts

Printed in the United States of America

10 09 08 07 06 5 4 3 2 1

Library of Congress cataloging information forthcoming
ISBN 978-1-4221-2065-1

The paper used in this publication meets the minimum requirements of the American National Standard for Information Sciences—Permanence of Paper for Printed Library Materials, ANSI Z39.48-1992.

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ACKNOWLEDGMENTS

Grateful acknowledgment is made to the publishers for permission to reprint the material specified:

"Fifty Years of Management—A Look Back and a Look Forward," paper no. 60-W-46 (part of the report "Ten Years' Progress in Management, 1950–1960"). Reprinted with permission of the American Society of Mechanical Engineers.

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PART I

What Is Management?

Why Managers?

MANAGERS ARE THE BASIC resource of the business enterprise. In a fully automated factory—such as already exist in a few places, modern oil refineries for instance—there may be a few highly skilled technicians and professionals, but almost no other workers at all. But there will be managers! In fact, there will be many more managers than there used to be in yesterday's factory filled with semi-skilled machine operators. Where the foreman on the assembly line supervises fifty people, managers in automated plants rarely have more than two or three people on their team—and each of them has greater autonomy, more responsibility and far more decision-making power than the foreman in the traditional mass-production plant.

Managers are the most expensive resource in most businesses—and the one that depreciates the fastest and needs the most constant replenishment. It takes years to build a management team; but it can be depleted in a short period. The number of managers as well as the capital investment each manager represents—both in the investment of society's capital in his education (which runs upward of $40,000 for each college graduate) and in the employer's direct investment in the managerial job (which in the U.S. today ranges from $50,000 to $500,000 for each managerial job, dependent on industry and function, e.g., whether in the research lab, in manufacturing or in accounting)—are bound to increase steadily as they have increased in the past half century. Parallel with this will go an increase in the demands of the enterprise on the ability of its managers. Today's manager, even at a fairly low level, is, for instance, expected to know a good deal both about analytical and quantitative methods, and about human behavior; both were "advanced" subjects less than a generation ago. These demands have doubled in every generation; there is no reason to expect a slowing down of the trend during the next decades.

How well managers manage and are managed determines whether business goals will be reached. It also largely determines how well the enterprise manages worker and work. For the workers' attitude reflects, above all, the attitude of their management. It directly mirrors management's competence and structure. The workers' effectiveness is determined largely by the way they are being managed.

During the last quarter century managers everywhere have subjected themselves to a steady barrage of exhortations, speeches, and programs in which they tell each other that their job is to manage the people under them, urge each other to give top priority to that responsibility, and furnish each other with much advice and many expensive gadgets for "downward communications." But I have yet to sit down with a manager, at any level or job, who was not primarily concerned with upward relations and upward communications. Every vice-president feels that relations with the president are the real problem. And so on down to the first-line supervisor, the production foreman, or chief clerk, all of whom are quite certain that they could get along with their people if only the "boss" and the personnel department left them alone.

This is not a sign of the perversity of human nature. Upward relations are properly a manager's first concern. To be a manager means sharing in the responsibility for the performance of the enterprise. A person who is not expected to take this responsibility is not a manager. And the individual contributors, the research engineer, the tax accountant, the field salesperson, who are expected to take such responsibility for the results and performance of the enterprise are, in effect, managers even though they are not "bosses," have no subordinates and manage only themselves.

The Rise, Decline and Rebirth of Ford

The story of Henry Ford, his rise and decline, and of the revival of his company under his grandson, Henry Ford II, has been told so many times that it has passed into folklore. The story is

- that Henry Ford, starting with nothing in 1905, had built fifteen years later the world's largest and most profitable manufacturing enterprise;
- that the Ford Motor Company, in the early twenties, dominated and almost monopolized the American automobile market and held a leadership position in most of the other important automobile markets of the world;
- that, in addition, it had amassed, out of profits, cash reserves of a billion dollars or so;
- that, only a few years later, by 1927, this seemingly impregnable business empire was in shambles. Having lost its leadership position and barely able to stay a poor third in the market, it lost money almost every year for twenty years or so, and remained unable to compete vigorously right through World War II; and

- that in 1944 the founder's grandson, Henry Ford II, then only twenty-six years old and without training or experience, took over, ousted his grandfather's cronies in a palace coup, brought in a totally new management team and saved the company.

But it is not commonly realized that this dramatic story is far more than a story of personal success and failure. It is, above all, what one might call a controlled experiment in mismanagement.

The first Ford failed because of his firm conviction that a business did not need managers and management. All it needed, he believed, was the owner with his "helpers." The only difference between Ford and most of his contemporaries in business, in the U.S. as well as abroad, was that Henry Ford stuck uncompromisingly to his convictions. The way he applied them—e.g., by firing or sidelining any one of his "helpers," no matter how able, who dared act as a "manager," make a decision, or take action without orders from Ford—can only be described as a test of a hypothesis that ended up by fully disproving it.

In fact, what makes the Ford story unique—but also important—is that Ford could test the hypothesis, in part because he lived so long, and in part because he had a billion dollars to back his convictions. Ford's failure was not the result of personality or temperament but first and foremost a result of his refusal to accept managers and management as necessary and as grounded in task and function rather than in "delegation" from the "boss."

GM—The Countertest

In the early twenties, when Ford set out to prove that managers are not needed, Alfred P. Sloan, Jr., the newly appointed president of General Motors, put the opposite thesis to the test. GM at that time was almost crushed by the towering colossus of the Ford Motor Company and barely able to survive as a weak number two. Little more than a financial speculation, stitched together out of small automobile companies that had been for sale because they could not stand up to Ford's competition, GM did not have one winning car in its line, no dealer organization, and no financial strength. Each of the former owners was allowed autonomy, which in effect meant that he was allowed to mismanage his former business his own way. But Sloan thought through what the business and structure of GM should be and converted his undisciplined barons into a management team. Within five years GM had become the leader in the American automobile industry and has remained the leader ever since.

Twenty years after Sloan's success, Henry Ford's grandson put Sloan's hypothesis to the test again. The Ford Motor Company by then was nearly bankrupt: the entire billion dollars of cash assets it had held in the early twenties had been poured into paying for the deficits since. As soon as young Henry Ford II took over in 1946, he set out to do for his company what Sloan had done for GM two decades earlier. He created a management structure and a management team. Within five years the Ford Motor Company regained its potential for growth and profit, both at home and abroad. It became the main competitor to General Motors and even outstripped GM in the fast-growing European automobile market.

The Lesson of the Ford Story

The lesson of the Ford story is that managers and management are the specific need of the business enterprise, its specific organ, and its basic structure. We can say positively that enterprise cannot do without managers. One cannot argue that management does the owner's job by delegation. Management is needed not only because the job is too big for any one person to do alone, but because managing an enterprise is something essentially different from managing one's own property.

Henry Ford failed to see the need to change to managers and management because he believed that a large and complex business enterprise "evolves" organically from the small one-man shop. Of course, Ford started small. But the growth brought more than a change in size. At one point quantity turned into quality. At one point Ford no longer ran "his own business." The Ford Motor Company had become a *business enterprise*, that is, an organization requiring different structure and different principles—an organization requiring managers and management.

Legally, management is still seen as delegation from ownership. But the actual doctrine that is slowly evolving is that management precedes and indeed outranks ownership, at least in the large enterprise. Even total ownership of such an enterprise is dependent on proper management. If the owner does not subordinate himself to the enterprise's need for management, his ownership—while legally unrestricted—will in fact be curtailed, if not taken away from him.

This idea was probably first laid down as an emerging legal doctrine by the U. S. Air Force in the early fifties in dealing with Howard Hughes and the Hughes Aircraft Company. Hughes owned the company, lock, stock, and barrel. He refused to let professional managers run it and insisted on running it himself the way Ford, thirty years earlier, had run the Ford Motor Company. Thereupon the Air Force, the company's main customer, gave Hughes an ultimatum: either you put your shares into a trust and let professional management take over, or we put the company into bankruptcy and force you out altogether. Hughes retained ownership title through one of his foundations but relinquished control entirely.

The next case also concerns Howard Hughes. As all but complete owner of one of America's major airlines, TWA, he, it is alleged, subordinated TWA's interests to those of other companies of his. For an owner this is perfectly legitimate behavior; he is supposed to do with his property as he pleases. But TWA management sued Hughes for $150 million in damages. It lost the suit only in

1973 in the Supreme Court—having won it in two lower courts—on a technicality; the Supreme Court ruled that this was a matter for the Civil Aeronautics Board over which the ordinary courts had no jurisdiction. But the principle that even the owner has to act as a manager, at least in a large company, was not disputed.

Genetically, so to speak, management did not evolve out of the small owner-managed firm and as a result of its growth. From its very beginning, management was designed for enterprises that were large and complex.

The large American railroad which covered vast distances—and which wrestled with the complex interplay between the engineering task of building a railbed, the financial task of raising very large sums of capital, and the political-relations tasks of obtaining charters, land grants, and subsidies—was the first enterprise that can be called "managed." Indeed, the management structure designed shortly after the Civil War for the first long-distance and transcontinental American railroads has essentially remained unchanged to this day. In continental Europe, at about the same time, management was designed for the first banks founded expressly to be national rather than local banks. And in faraway Japan, the builders of the so-called "Zaibatsu" (the great business groups) of the Meiji Period—Mitsui, Sumitomo, and Iwasaki's successors at Mitsubishi—using traditional Japanese approaches in a new manner, also fashioned a management system for the large and complex enterprise.

It was not until thirty or forty years later, some time around the turn of the century, that the concept of management was transferred from the enterprise that started out large to the enterprise that had grown large. At about that time, Andrew Carnegie and John D. Rockefeller, Jr., introduced management into the steel and petroleum industries respectively. A little later still, Pierre S. du Pont restructured the family company (E.I. du Pont de Nemours & Co.) and gave it a management, both to make it capable of growth and to preserve family control. The management structure Pierre du Pont built in his family company between 1915 and 1920 became, a few years later, the starting point for the General Motors structure of "professional management" after the du Ponts had acquired control of the near-bankrupt and floundering automotive conglomerate and had put Alfred P. Sloan, Jr., in as president.

Management as a "Change of Phase"

The change from a business which the "boss" can run with "helpers" to a business enterprise that requires a management is what the physicists call a "change of phase" such as the change from fluid to solid. It is a leap from one state of matter, from one fundamental structure, to another. Sloan's example shows that the change can occur within one and the same organization. But Sloan's restructuring of GM also shows that the job can be done only if basic concepts, basic principles, and individual vision are changed radically.

One can compare the business which the older Ford tried to run and the business which Sloan designed to two different kinds of organisms—the insect, which is held together by a tough, hard skin, and the vertebrate animal, which has a skeleton. The English biologist D'Arcy Thompson showed that animals supported by a hard skin can reach only a certain size and complexity. Beyond this, a land animal has to have a skeleton. Yet the skeleton has not genetically evolved out of the hard skin of the insect; it is a different organ with different antecedents. Similarly, management becomes necessary when a business reaches a certain size and complexity. But management, while it replaces the "hard-skin" structure of the owner, is not its successor. It is, rather, its replacement.

When does a business reach the stage at which it has to shift from "hard skin" to "skeleton"? The line lies somewhere between 300 and 1,000 employees in size. More important, perhaps, is the increase in complexity of the business; when a variety of tasks have all to be performed in cooperation, synchronization, and communication, a business needs managers and a management. Otherwise, things go out of control; plans fail to turn into action; or, worse, different parts of the plans get going at different speeds, different times, and with different objectives and goals, and the favor of the "boss" becomes more important than performance. At this point the product may be excellent, the people able and dedicated. The boss may be—indeed often is—a man of great ability and personal power. But the business will begin to flounder, stagnate, and soon go downhill unless it shifts to the "skeleton" of managers and management structure.

Henry Ford wanted no managers. But the only result was that he mismanaged, misdirected, and misorganized his company and stunted or broke management people. The only choice for an institution is between management and mismanagement. But managers are inevitable. And the job of management cannot be evaded. Whether it is being done right or not will determine largely whether the enterprise will survive and prosper or decline and ultimately fall.

Management: Its Roots and Its Emergence

DURING THE LAST FIFTY years, society in every developed country has become a society of institutions. Every major social task, whether economic performance or health care, education or the protection of the environment, the pursuit of new knowledge or defense is today being entrusted to big organizations, designed for perpetuity and managed by their own managements. The performance of modern society—if not the survival of each individual—increasingly depends on the performance of these institutions.

Only seventy-five years ago such a society would have been inconceivable. In the society of 1900 the family still served in every single country as the agent of, and organ for, most social tasks. Institutions were few and small. The society of 1900, even in the most highly institutionalized countries, still resembled the Kansas prairie. There was one eminence, the central government. It loomed very large on the horizon—not because it was large but because there was nothing else around it. The rest of society was diffused in countless molecules: small workshops, small schools, the individual professionals—whether doctors or lawyers—practicing by themselves, the farmers, the craftsmen, the neighborhood retail stores, and so on. There were the beginnings of big business—but only the beginnings. And what was then considered a giant business would strike us today as very small indeed.

The octopus which so frightened the grandparents of today's Americans, Rockefeller's giant Standard Oil Trust, was split into fourteen parts by the U.S. Supreme Court in 1911. Thirty years later, on the eve of America's entry into World War II, every single one of these fourteen Standard Oil daughters had become at least four times as large as the octopus when the Supreme Court divided it—in employment, in capital, in sales, and in every other aspect. Yet, among these fourteen there were only three major oil companies—Jersey Standard, Mobil, and Standard of California. The other eleven were small to fair-sized, playing little or no role in the world economy and only a limited role in the U.S. economy.

While business has grown in these seventy years, other institutions have grown much faster. There was no university in the world before 1914 that had much more than 6,000 students—and only a handful that had more than 5,000. Today the university of 6,000 students is a pygmy; there are even some who doubt that it is viable. The hospital, similarly, has grown from a marginal institution to which the poor went to die into the center of health care and a giant in its own right—and also into one of the most complex social institutions around. Labor unions, research institutes, and many others have similarly grown to giant size and complexity.

In the early 1900s the citizens of Zurich built themselves a splendid City Hall, which they confidently believed would serve the needs of the city for all time to come. Indeed, it was bitterly attacked as gross extravagance, if not as megalomania. Government in Switzerland has grown far less than in any other country in the world. Yet the Zurich City Hall long ago ceased to be adequate to house all the offices of the city administration. By now, these offices occupy ten times or more the space that seventy-five years ago seemed so splendid—if not extravagant.

The Employee Society

The citizens of today in every developed country are typically employees. They work for one of the institutions. They look to the institutions for their livelihood. They look to the institutions for their opportunities. They look to the institutions for access to status and function in society, as well as for personal fulfillment and achievement.

The citizens of 1900, if employed, worked for a small family-type operation; the small pop-and-mom store employing a helper or two; the family household; and so on. And of course, the great majority of people in those days, except in the most highly industrialized countries—such as Britain or Belgium—worked on the farm.

Our society has become an employee society. In the early 1900s people asked, "What do you do?" Today they tend to ask, "Whom do you work for?"

And management is the specific organ of the new institution, whether business enterprise or university, hospital or armed service, research lab or government agency. If institutions are to function, managements must perform.

The word "management" is a singularly difficult one. It is, in the first place, specifically American and can hardly be translated into any other language, not even into British English. It denotes a function but also the people who discharge it. It denotes a social position and rank but also a discipline and field of study.

But even within the American usage, management is not adequate as a term, for institutions other than business do not speak of management or managers, as a rule. Universities or government agencies have administrators, as have hospitals. Armed services have commanders. Other institutions speak of executives, and so on.