HANDBOOK OF BUSINESS PLANNING AND BUDGETING

FOR EXECUTIVES WITH PROFIT RESPONSIBILITY

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VNR VAN NOSTRAND REINHOLD COMPANY
NEW YORK CINCINNATI TORONTO LONDON MELBOURNE

Library of Congress Catalog Card Number: 82-8341
ISBN: 0-442-22188-6

Manufactured in the United States of America

Published by Van Nostrand Reinhold Company Inc.
135 West 50th Street, New York, N.Y. 10020

Van Nostrand Reinhold Publishing
1410 Birchmount Road
Scarborough, Ontario M1P 2E7, Canada

Van Nostrand Reinhold
480 Latrobe Street
Melbourne, Victoria 3000, Australia

Van Nostrand Reinhold Company Limited
Molly Millars Lane
Wokingham, Berkshire, England

15 14 13 12 11 10 9 8 7 6 5 4 3 2 1

Library of Congress Cataloging in Publication Data
Handbook of business planning and budgeting for
executives with profit responsibility.

Bibliography: p.
Includes index.
1. Planning. 2. Corporate planning. 3. Budget in business. I. Dudick, Thomas S. II. Gorski, Robert V.
HD30.28.H364 1983 658.4'102 82-8341
ISBN 0-422-22188-6 AACR2

Editorial Advisory Board

Preface

Executives with profit responsibility, whether engaged in marketing, research, production, or finance, are faced with increasingly complex and difficult problems in managing the businesses for which they are responsible. The technical competence of these executives within their own disciplines is without question. However, the ability of this assortment of disciplines to work together as a coordinated team is subject to question in many companies. It is the purpose of this book to discuss the key disciplines in a manner that will make the problems of each discipline clear to executives in the other disciplines. The book also discusses solutions to these problems for the purpose of improving interdisciplinary understanding and cooperation.

This handbook is broken down into nine sections. The first of these is an overview of business planning and budgeting. In the first chapter of this section, William Agee, chairman, president, and chief executive officer of the Bendix Corporation, emphasizes the importance of early warning systems through monitoring and forecasting—to continually highlight major risks and soft spots that could defer the attainment of company goals.

David N. Judelson, president of Gulf + Western Industries, explains how he achieved good control in his company through the use of the flash forecast and flash actual. In his chapter, he walks the reader through the early warning procedures and the steps that he follows in assuring effective controls as well as achieving better interdisciplinary coordination.

The debilitating effect of inflation on profitability prompted four executives from Main Hurdman & Cranstoun to write a chapter explaining how business performance can be improved during inflationary times.

C. Gadzinski, president of Capital Management Corporation, tells executives with profit responsibility how they can avoid pitfalls in business planning, while James W. Taylor, management consultant, lists the ten commandments for realistic planning.

Section II, dealing with strategies in business planning, lays the groundwork for discussing product planning and new markets. One of the characteristics of American business in past decades has been a pattern of unrelenting growth, achieved by acquisitions as well as internal expansion. In the early years of this century, some 125 individual automobile companies have 'shaken out' to only four. The same trend occurred with other products—radios, television sets, and cameras, to name a few. Included in this section is a chapter by Andrew Clapp of Arthur D. Little, Inc., in which he emphasizes the need for inclusion of diversification as part of the strategy for effective planning.

Professor Philip Kotler discusses market strategy from the point of view of the market leader, the challenger, and the follower. He discusses such strategies as "head-on," "back door," and "guppy."

Peter Lorange, Associate Professor of Management of the Wharton School, outlines the need for effective regeneration of optimum allocation of funds, people, and technology in designing a strategic planning system.

Cortlandt Cammann, of the Institute for Social Research, concentrates on strategies for control. In his chapter, he deplores the fact that subordinates frequently do not contribute to organizational goals as expected. He also points out that conflicts among these subordinates waste substantial amounts of energy and resources, and describes the elements of the control strategy that should be developed.

Section III, Planning for Products and New Markets, is devoted to the importance of changing trends and the need for increasing the productivity of new-product research as well as the marketing organization.

Charles Reed, a retired senior vice-president of General Electric Company, discusses the wide variety of trends, crises, and concerns that have combined to make the process of national planning an active issue on the political agenda of the United States. Mr. Reed explores the adequacy of our response to this challenge.

Carl Barnes, Vice-President 3M Company (Ret.), an expert in new-product research, discusses the reduced productivity of product research in our country while such countries as Japan and Germany continue to outpace us in new products and new technology.

James Hind, vice-president of planning at R. J. Reynolds Tobacco Company, compares the intuitive approach to the market place versus the disciplined, deliberate approach of examining the facts, considering the alternatives, and determining the best strategy.

The product life cycle is well understood by many, but Sonia Yuspeh, senior vice-president of J. Walter Thompson Company, points out the fallacy in the common belief that all products follow a regular life-cycle pattern in its familiar four predictable stages.

J. Herbert Holloman, director, MIT Center for Policy Alternatives, explains the social and political changes now taking place that provide opportunities and what these changes portend.

Porter Henry, of Porter Henry & Company, Inc., deals with problems of selling. In his first of two chapters in this section, he demonstrates the various yardsticks that can be used for measuring and improving productivity of the sales force. In the second, he discusses methods for scheduling sales calls for products and customers to produce the maximum profit per call.

Dr. Sam R. Goodman, executive vice-president of Magnuson Computer Systems, proposes mathematical models for use in eliminating much of the wasteful expenditure of money in new-product strategy.

Section IV supplements the previous section with two case examples. The first of these examples demonstrates a well-structured approach to making up a marketing plan for a new consumer product. The second case example outlines the steps of a marketing plan for a new business.

Emphasis on the need for good control of assets is the subject of Section V. The better the controls, the lower the assets and therefore the higher the return on these assets.

Purchasing is no longer a stocking function to assure that the company would not run short of material. With material making up 50% or more of the manufacturing cost in many companies, purchasing is an important source of improved profits.

Inventory control policy and the forecasting of inventory are the topics of the next two chapters in this section. Sound inventory policies are an important prerequisite to good purchasing policy.

Jacob Brooks, vice-president, and Breaux Castleman, vice-president, of Booz Allen & Hamilton, discuss materials management problems in widely distributed operations in hostile environments.

Paul Maranka, director of materials management at Incom, International, Inc., explains the master schedule and its importance in the manufacturing business plan.

Earl Corriveau, manufacturing accounting manager at Wang Laboratories, explains the various steps in the implementation of a sound capital expenditures control program—using actual examples.

John T. Hagan, director of quality management at ITT, explains that the most important goal of quality management is to assure that quality standards not be eroded each time there are excessive pressures. He believes in the old adage "Tell it like it is"—and he tells it in Section VI.

In our highly competitive business community, it behooves the executive with profit responsibility to be aware of what competitors are doing. This is discussed in two chapters making up Section VII. The first of these is titled "Industry Statistics as a Management Tool." Analysis of Company Weaknesses, the second chapter in this section, demonstrates how a group of key executives can review the operating statement, make comparisons with industry statistics, and determine the reasons for their company's shortfall in profits.

Section VIII deals with Product Costing and Pricing. It is a logical follow-up to the previous section, in which it has been determined where the company's excessive costs are occurring.

Phillip J. Wingate, retired vice-president of E. I. DuPont de Nemours & Company, discusses pricing in a free economy. In his down-to-earth chapter, he points out that pricing decisions are made in relatively narrow limits. He discusses the factors that cause variations in these limits and provides illustrations.

In recognition of the fact that unit costs of products are greatly influenced by the capacity level at which the company is operating, the next chapter in this section discusses five methods for arriving at capacities and demonstrates the impact on unit costs for each of the methods.

Raymond B. Jordan, retired administrator—cost systems and studies for General Electric, explains the concept of the learning curve, an important and sometimes overlooked tool for reducing costs.

The final section, Section IX deals in methods for improving profit performance.

William T. O'Neill, executive vice-president of Newport News Shipbuilding and Dry Dock Company, points out how the success or failure of a company depends on how well the manufacturing operation manages the resources under its scope of responsibility. He further points out that this is dependent upon the degree of coordination between manufacturing and the various support functions within the company.

Hugo Swan, vice-president of operations, Clausing Corporation, cautions against using budgetary controls as a substitute for other operational controls. He describes the steps required in an intelligently prepared budget.

Thomas G. Hardy of McKinsey & Company and John E. Neuman of Dewey, Ballantine, Bushby, Palmer & Wood discuss the wastefulness of providing overhead services without regard to the cost involved in creating them.

In the selection of contributing authors for this handbook, we recognized that every executive has his or her special field of expertise—a field that comes naturally to him or her. We also recognized that no single author could possibly write authoritatively on the range of topics covered in the book. For these reasons, we recognized that the selection of the authors was crucial in the development of recommended techniques for improving the performance of a company. It is the opinion of the editors that the authors have done their work well.

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SECTION I
OVERVIEW OF BUSINESS PLANNING AND BUDGETING

1
Futurism—A Lesson From The Private Sector

William M. Agee
Chairman, President, and Chief Executive Officer
The Bendix Corporation

Mr. Agee urges that executives recognize the need for early warning systems through continuous monitoring and forecasting in order to highlight major risks and soft spots that could defer the attainment of goals.

It is axiomatic that all human beings get a delayed report card. Indeed, it is biblical. As Paul said, ". . .whatsoever a man soweth, that shall he also reap." I'm also partial to Satchel Paige's wisdom: "Never look back. Something might be gaining on you."

Both of these lessons apply to corporate managers, who take charge of an ongoing business knowing that the first few annual reports they sign will be the results of what their predecessors did and did not do. Luckily for me, Mike Blumenthal left the Bendix Corporation in splendid shape. But the outcome of the 1980s is mostly up to those he left behind when he moved up to bigger budgets. The dim shape of the 1980s is what I spend most of my time thinking about.

I think the first point is that what will happen to business in the 1980s will be even less divorceable from what happens to the rest of the country than it is now. I make this statement because of a common tendency to talk about the American economy as a collection of sectors, separate and discrete. Examples are business, labor, government, and in recent decades, an independent sector, composed of foundations, charities, and voluntary organizations. These categories have their uses as catch phrases or verbal shorthand, but we must keep in mind that they are just that.

GOVERNMENT'S PAPERWORK DEMANDS ON MODERN BUSINESS

The world may well have looked so organized to the entrepreneur Vincent Bendix when he launched his company. It was his, or largely his, and he ran it in the manner of his day. He was tough, authoritarian, and he had no trouble living with decisions as long as they were his. His job, as he saw it, was to see the demands of the market economy and satisfy them. And he was good at it. His company was renamed Bendix Aviation at a time when only 8% of the company's business had anything to do with the promising new machine called the airplane. He saw the future coming, a theme upon which I want to elaborate.

I believe that Vincent Bendix would find the present unthinkable. He would find *his company* living with reams of paper to be filled out daily because the government needs them, regulated by a blizzard of laws on such issues as the environment, safety, pricing, taxation, and equal opportunity, perceived as a public institution responsible not only for profit and shareholder value, but for a subtle list of obligations that have more to do with sociology than economics, and doing well in an age when you need more than a quick look to find out who *owns* it.

The complicated fact is that the climate in which business now operates has little to do with the world Vincent Bendix knew. That is not to confess Mr. Bendix's shortcomings. He was very right for his time. The question before the managers of the 1980s is: Will they be right for theirs?

Vincent Bendix died in 1945, just as the pent-up demand of the war years began to create the consumer society we know today. So he missed the soaring economy of the late 1940s and early 1950s, and the relative quiet of the Eisenhower years. He missed the time when the business sector shriveled in the public mind from being the cornerstone of our economic well-being to an object of ridicule and suspicion. He did not see Rosa Parks refuse to turn her seat on the bus over to a white man, and he missed the nonviolent dream of Martin Luther King. He might have applauded John Kennedy's decision to skirt Keynesian dogma and try a tax cut that *did* get this country moving again. He did not hear the first shots in the war on poverty, or see the trickle of advisors to Vietnam grow to the size of an army. He probably would have liked Lyndon Johnson, but still would have told him that it was a mistake to think an already overheated economy could generate guns, butter, and rapid social change without producing an intractable kind of inflation.

Well, it is human to define your own glimpses of public events as the broad sweep of history. The environment in which business goes about the business of business will never be the same. There has been a generalized failure of the belief of Americans in our institutions, and business is not alone in that. If it makes us feel any better, the press may also be included.

CYNICISM OF THE 1960s AND 1970s

We have lived through the early 1970s in self-criticism, self-hatred, and cynicism. The 1960s and 1970s were the time in which it became fashionable to question everything—every value we previously held, every perception of what it takes to be a responsible citizen, every ethic of work and reward. There emerged what social scientist Daniel Yankelovich named *the psychology of entitlement*. As belief in institutions—government, business, labor, and the rest—dove downward, our citizens turned to themselves as the place to find trust and happiness. Now, I believe strongly that the road to personal happiness lies in conscious control of your own life. That idea squares with my values. Self-reliance, hard work—you can fill in the rest. But what seemed too different about this turning to the self—if Yankelovich's formulation is right—was the vague, individual feeling that somehow the good things in life are *owed*, and are a birthright. You would see social science surveys in which people would say that their city, state, or even the whole country was heading for economic, nuclear, or environmental disaster. And they would go right on, in the same survey, to report that their own futures were right on track, with more money, more promotions, more leisure time just about assured. Well, this is where I get off that train of thought. What happens to all of us happens to each of us.

ARE AMERICANS DOOMED TO CONSTANT TURMOIL?

I sometimes think we Americans are doomed to turmoil because we take on so much. It seems to be downright American to figure that every domestic problem we face can be taken on and solved. We are doers. And that is, or certainly has been, the source of our greatness. We can focus, if we wish, on how various dreams of social change are less than fully realized. But for myself, I am more struck by how much we do get done. There is not another government on the face of this earth, for instance, that could have survived the anguish of Watergate. As Gerald Ford said, "The system works." The Congress and the Supreme Court lived up to their responsibilities. It was a painful triumph, one I wish we had never experienced, but it *was* a triumph.

I hope that we Americans never give up trying to make our lives better. But I think there is a huge amount of room for change in the way we do it. Just about every time we embark to change our laws to improve matters, we do it in an atmosphere of crisis.

It doesn't take much to start a crisis. A Gallup Poll will do it, especially one that says 67% of the American people are worried about a problem. Our communications media roll the drums with headlines, interviews, and rapid-fire analysis. Congress and the Administration respond with legislation. I would laugh—if it didn't hurt so much—over the charges of the radicals of the 1960s that our government is not responsive. It responds, my friends, with fury.

I doubt there is a person who is willing to advocate a dirty environment, dangerous factories, or cheating consumers. But the crisis orientation of our legislative process means that we approach social problems as if we are at war. And a war, we understand, is for winning. It is a poor patriot who stops to count the cost, or who asks what else winning that war will mean.

Garret Hardin, a biologist and human ecologist, offers an elegant statement: "You can never do merely one thing." And there is the rub. For instance, American industry is currently producing well below its capacity, yet we do not see the elimination of inflation we could hope for and expect. I believe that an important reason can be found in the new costs levied on business by such regulatory efforts as the Environmental Protection Act and the Occupational Safety and Health Act. It has been estimated that "the cost of capital investment for all pollution control requirements of the Environmental Protection Agency will reach over $100 billion." That is $100 billion that will not go for research and development or for increases in productivity. It is quite clear to me now. In a few years, it will definitely be apparent to all that we started on a project that was manifestly worth doing, and then let our crisis orientation make us overspend grossly.

AMERICAN BUSINESS MUST RECLAIM SELF-RESPECT

Now, it is usual to stand in forums and *fulminate* about the government. It is an infuriatingly large target. But the managers of the 1980s will have to do more than that. They will have to be politically involved people, as aware of social currents as of output on the production line, as well-read as the academician testifying before Congress.

I believe that just about now, American business has the beginnings of a chance to reclaim its position as a respected American institution. For years now, we have been losing the rhetorical battles with our critics, and part of the reason lies in our own behavior. We must not only *appear* to be credible when we take part in talking about upcoming legislation, we must *be* credible. It does little good, for instance, to swear that we cannot live with a given piece of legislation—cannot accomplish it physically—if we then magically pull off what the law demands after the President signs it.

Take the matter of equal opportunity. It is the law that there be no discrimination about race or sex, and all of us can give a glib speech about how we believe in the law. But too many businessmen have failed to express the next obvious thought about righting these social wrongs. It is that aggressive, ambitious people of any color or either sex are priceless assets. We do not say often enough that bigotry and sexism are expensive. We do not speak loudly enough to say that there is no conflict between our moral sense and our economic sense.

We have to take those next logical steps in the direction of social change; it would be far better if we took them on our own. It is now Bendix policy that when it comes time to award financial incentives to our managers, we look not only at bottom-line results, but also at the manager's record of success in affirmative action, management development, and safety.

That is only one example of social responsibility that makes good business sense—along with being the right thing to do. I think it is a particularly good point that economic and social interest will often marry, if we stop grousing and convincing each other that change should not be brought up in the first place.

We have no time for merely complaining about the social and political forces that make such an impact on our businesses. We have to use the thought processes and analytical tools—the ones we know how to use better than anyone else—to help with solving public problems and to reeducate our crisis-bent legislators on how this system really works.

LEGISLATING IN CRISIS AND REGRETTING AT LEISURE

I sometimes think that we need a "Secretary of the Future" in government, as an antidote to our current practice of legislating in crisis and regretting at leisure. It is certainly true that businessmen are the natural futurists in this country. If we ran our businesses the way government makes laws, there would be a lot of resumes flying through the mails. I see this Secretary of the Future as being responsible for weighing *all* the implications of a particular piece of legislation, so that Congress makes an informed decision instead of a hasty one. The additional responsibility would be to announce—well in advance—that there's a problem on the way.

Does anyone doubt that there was plenty of time to see the energy crisis coming? And yet, the program to deal with it had to be originated when Americans found themselves lined up in their cars at gas stations. In a result typical of crisis reaction, we are worse off for our efforts. If you will recall, after the Arab embargo of 1973, this nation proclaimed its intention to become energy independent. The program was launched with predictable hullabaloo, tied to the patriotism of the Bicentennial celebration and named, appropriately, Project Independence. Without detailing all that happened, let me point out that before we embarked on this program, we imported 35% of our oil. Shortly thereafter, we imported about 50% of the oil we use—and sent $45 billion to other countries to pay for it. If we had been as successful when we launched the first Project Independence in 1776, we'd still be paying taxes to the King of England.

THE COMING PENSION CRISIS

There is another crisis on the way, and it will impact the 1980s in a way that will get our full attention. I'm talking about pension funding, particularly about Social Security. Congress passed a $227 billion Social Security tax increase, which was the largest peacetime tax increase bill in American history. Once more, it was done in haste, and I will bet that many or most Americans think that bill solved the problem. True, there has been a great deal of feedback to Congress that the voters aren't thrilled with the tax increase. But their annoyance now won't be a patch on the public rage that will rise if and when the system stops issuing the pensioners' checks. The beneficiaries will rage because a promise has been broken. Those active in the work force will rage because it will be their job to pay the new taxes. Consider that the unfunded liabilities of the Social Security system total about *$2 trillion.* Social Security may well face bankuptcy before the end of the 1980s because the new legislation is based on some assumptions that are, in my opinion, too optimistic. Social Security is only one part of the pension-funding pyramid. The unfunded liabilities of government pension plans—on the local, state, and federal levels—are in similar financial straits.

FREE ENTERPRISE IS NOT DEAD

I have dealt at some length with the political atmosphere in which our businesses operate because I am convinced that there will be little change in the future—in the direction of less regulation or less public expectation that business has a social role to play. The free enterprise that we speak of so fondly is not dead, but is a mutation of the type of free enterprise practiced before the Depression. Because I see no practical possibility of revising the rules of this society so that we would return to those simpler days, I think businessmen have no choice but to take full and vigorous part in the affairs of the larger society. They want to participate. They have much to contribute. They must, in their own self-interest.

MANAGING IN THE COMING YEARS

I will be surprised if the manager of the 1980s is confronted with the sweet but *disconcerting* problem of enormous growth. The managers of the 1960s had plenty of chances at that giddy experience, and there was a time when it was hard to find an investment manager who didn't look pretty smart on paper. But recessions have a way of letting the water down from the ships of our industry so that all can see the barnacles.

I think the 1980s, as never before, will be a rich opportunity for managers who are sophisticated in their use of financial planning and control techniques. It is one thing—and a pleasant one—to manage a business that is rocketing ahead in all measures of growth. It is another to be able, as Vincent Bendix so often was, to see the future coming and react before it arrives.

At Bendix, our planning and control mechanism includes what we call the "early warning system." Principally, we get an early warning of future conditions through monitoring and forecasting, on a monthly basis, key balance sheet and income statement data as compared to the yearly financial plan and five-year, long-range plan and the previous forecast.

Aside from the quantitative tools of business, there remains the question of leadership and what sorts of people the managers of the 1980s will be trying to lead and how they will try to do it.

I noted earlier the cynicism about everything—not just business—that has been a fact of American social life for the last decade or better. What strikes me is that it comes most vividly from those who have benefited most from the truly astonishing performance of the American economic system over the last 100 years. The challenge to our economic system does not come from what the nineteenth-century Marxists called "the wretched of the earth," but rather from those who were moving up, the middle classes, the intellectuals, the professional people—and many of their children.

We should not be surprised by this. Cynicism is a luxurious commodity. It cannot flourish beside gut-level despair and desperation. In any case, I think we have seen the worst manifestations of it. There is strong evidence for instance, that our young people are moving strongly into quite traditional and reassuring courses of study at the college level. But let's not be fooled into thinking that the political turbulence of the 1960s didn't change anything. It changed any number of values—toward sex, marriage, the role of America as a world power, and what it means to be a complete human being. Allow me the oversimplification of thinking that, as with previous radical movements, our society took some of the better ideas from this last one, and dropped the chaff by the wayside.

If I am right about that, it means the people that managers will be leading in the next ten years will be quite insistent that the jobs they do have personal meaning to them, and that the businesses they work for act in ways commonly called moral. There will be very little gratitude simply because they were hired. They will expect personal growth and a sense of power and achievement in their jobs.

They will respect power wisely used, but they won't fear or follow a traditional authoritarian.

PARTICIPATING MANAGEMENT

At Bendix, we talk about "participatory management," and sometimes we observe the ideals of it in the breach. Put baldly, our tendency is toward getting more and more people into the act when we are planning or thinking about general policies. We try to draw into the process all those who have something to contribute and most assuredly those who will be responsible for doing what we decide.

I am not suggesting that there is a huge room at Bendix where hundreds of managers collect to vote corporate policies up or down. Our top executives are paid to decide, and they do. I feel that a greater degree of participation in decision making is the right way to go.

Most of us are already at the point where the easy jobs are no longer available. By easy jobs, I mean those that you can do yourself. The tougher ones are those that others must do for you and with you.

Our fiction is full of corporate leaders who seem to have gotten by on being glib, telling lies, and manipulating other people. I am glad those stories are much more often fiction than fact. There are at least two reasons you cannot base a career in management on the idea that you can manipulate other people:

1. All people, and particularly the young ones coming along, are too smart. They will catch you at it. They feel your contemptuous disrespect, and your battle to lead is lost.
2. Time is too short to make an enterprise—of whatever size—operate on deceit.

Notice that I have given pragmatic reasons for being honest with people. There is a third reason: You won't sleep very well if you do otherwise.

I am glad there is not a dirty little secret or a trick to bounding up the corporate ladder. I'm glad there is not a particular way of acting, or seeming to be, that is rewarded in the long run.

Finally, I suppose, it comes to this: from the viewpoint of human relationships and leadership, you will get from your organization and your people just about what you expect from yourself.

The coming years will be the time when wise managers can win back for business the reputation that was tarnished in the 1960s and 1970s. We can do that if we see that the interests of business and the larger society are very often convergent. We can do it even though the prospect is for more legislation and regulation—if we use our skills as futurists to take vigorous part in debates over the nation's future. We can do it if we will drop the defensive tone that makes us sound unprogressive. We are so much better than that, and have too much to be proud of.

Within our companies, the successful managers of the 1980s will be those who can manage a slower rate of growth and react very quickly to changing opportunities. Pinpoint control and forecasting will be the key. And although the discipline of profit will still govern, the leadership of our businesses will depend to a greater extent on the informed consent of those we lead, and how well employee aspirations for personal fulfillment and growth fit corporate goals. The day of the autocratic taskmaster is over.