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PREFACE

Do the essays in this volume have anything in common except the author? At first sight they may look like random scatter without underlying theme or unifying thesis. An essay on "The New Markets," which treats the financial fads and follies of the 1960s as symptoms of structural change in economy and society, may seem a strange bedfellow for an essay on Kierkegaard, surely the least "market-oriented" thinker of the modern West. An evocation of Henry Ford as the "Last Populist," and simultaneously the fulfillment and the denial of the nineteenth century's agrarian and Jeffersonian dreams, might seem very far away from the internal stresses of the Japanese "economic miracle" or the pathos and bathos of "This Romantic Generation," today's educated young people.

Yet all these pieces, despite the diversity of their topics, have a common subject matter and a common theme. They are all essays in what I would call "political (or social) ecology."

This term is not to be found in any university catalogue. But the only thing that is "new" about political ecology is the name. As a subject matter and human concern, it can boast ancient lineage, going back all the way to Herodotus and Thucydides. It counts among its practitioners such eminent names as de Tocqueville and Walter Bagehot. Its charter is Aristotle's famous definition of man as "zoon politikon," that is, social and political animal. As Aristotle knew (though many who quote him do not), this implies that society, polity, and economy, though man's creations, are "nature" to man, who cannot be understood apart from and outside of them. It also implies that society, polity, and economy are a genuine environment, a genuine whole, a true "system," to use the fashionable term, in which everything relates to everything else and in which men, ideas, institutions, and actions must always be seen together in order to be seen at all, let alone to be understood.

Political ecologists are uncomfortable people to have around. Their very trade makes them defy conventional classifications, whether of politics, of the market place, or of academia. Was de Tocqueville, for instance, a "liberal" or a "conservative"? What about Bagehot? "Political ecologists" emphasize that every achievement exacts a price and, to the scandal of good "liberals," talk of "risks" or "trade-offs," rather than of "progress." But they also know that the man-made environment of society, polity, and economics, like the environment of nature itself, knows no balance except dynamic disequilibrium. Political ecologists therefore emphasize that the way to conserve is purposeful innovation—and that hardly appeals to the "conservative."

Political ecologists believe that the traditional disciplines define fairly narrow and limited tools rather than meaningful and self-contained areas of knowledge, action, and events—in the same way in which the ecologists of the natural environment know that the swamp or the desert is the reality and ornithology, botany, and geology only special-purpose tools. Political ecologists therefore rarely stay put. It would be difficult to say, I submit, which of the chapters in this volume are "management," which "government" or "political theory," which "history" or "economics." The task determines the tools to be used: but this has never been the approach of academia.

Students of man's various social dimensions—government, society, economy, institutions—traditionally assume their subject matter to be accessible to full rational understanding. Indeed, they aim at finding "laws" capable of scientific proof. Human action, however, they tend to treat as *nonrational*, that is, as determined by outside forces, such as their "laws." The political ecologist, by contrast, assumes that his subject matter is far too complex ever to be fully understood—just as his counterpart, the natural ecologist, assumes this in respect to the natural environment. But precisely for this reason the political ecologist will demand—like his counterpart in the natural sciences—responsible actions from man and accountability of the individual for the consequences, intended or otherwise, of his actions.

An earlier volume of essays of mine, *Technology, Management & Society* (published in 1970), centered on what used to be called "the material civilization": business enterprise, its structure, its management, and its tools; technology and its history, and so on. The present volume is more concerned with economic, political, and social processes: the early diagnosis of fundamental social and economic change; the relationship between thought—economic, political, or social—and actions; the things that work and don't work in certain traditions, whether those of America or those of Japan; or the conditions for effective leadership in the complex structures of industrial society and giant government. But in the last analysis, the present essays, and those in the earlier volume, have the same objective. They aim at an understanding of the specific natural environment of man, his "political ecology," as a prerequisite to effective and responsible action, as an executive, as a policy-maker, as a teacher, and as a citizen.

Not one reader, I am reasonably sure, will agree with every essay; indeed, I expect some readers to disagree with all of them. But then I long ago learned that the most serious mistakes are not being made as a result of wrong answers. The truly dangerous thing is asking the wrong questions. I do hope that readers, whether executives in a business or administrators in a government agency, parents or their children, policy-makers or citizens, teachers or students, will agree that this volume addresses itself to right questions. And even the reader who disagrees heatedly with the author's prejudices, opinions, and conclusions will, I hope, find these essays enjoyable reading.

—Peter F. Drucker
Claremont, California
Spring, 1971

CONTENTS

CHAPTER ONE

The New Markets and the New Entrepreneurs

I

THE THIRD MERGER wave to wash over the American economy in this century is receding fast. It leaves behind a landscape changed even more fundamentally in economic structure than its predecessors did, sixty-five and forty years ago.

The first merger wave, the one that reached its climax between 1900 and 1910, was the merger wave of the "tycoons," with J. P. Morgan's U.S. Steel and John D. Rockefeller's Standard Oil Company as their prototypes. In these mergers a dominant industrialist or financier tried to gain and occupy a commanding height in the economy by obtaining control of a major material or a major industry. They were "offensive" mergers.

The second merger wave, in the twenties, was, by contrast, one of "defensive" mergers. Its prototype, indeed its earliest example, was General Motors, put together between 1910 and 1920 as a merger of medium-sized car companies for common defense

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against Henry Ford's near monopoly. The aim of these "defensive" mergers was to create a "number two" who would be able to hold its own against the giants which the first merger wave had spawned. And while a good many of the creations of this period—such as General Motors itself—in turn became the leading company in their industry, the defensive mergers made for less concentration of power in the country's major industries and for more vigor and equality in competition. It often resulted in "oligopoly"; but it more often thwarted "monopoly."

The third merger wave, the one which has now peaked, began with defensive mergers, very similar to those of the twenties. Typical are the railroad mergers, such as the one which created the Penn-Central, and the new railroad system in the Northwest between Chicago and Seattle. It is no coincidence that the plan for these railroad mergers is forty years old, that it goes back to the period of defensive mergers in the twenties. But the mergers among the major New York banks in the late forties and early fifties—such as the merger that put the Chase Bank and the Bank of Manhattan together into the Chase Manhattan Bank, the National City Bank and the First National into the First National City, or the Chemical Bank and the New York Trust Company into Chemical New York—were also defensive. As a result, commercial banking in New York—and commercial banking internationally—has become far more competitive. There are fewer players, to be sure, but they are far stronger and far more aggressive. These defensive mergers of the last twenty years aimed, as did the mergers of the twenties, at creating enterprises large enough for a national or international market and strong enough to withstand competition on a national (or, as in the case of the banks, an international) scale. Mergers of this kind have been taking place also in manufacturing industry. The merger between two medium-sized forest products companies, Champion Paper and U.S. Plywood, created, for instance, a billion-dollar business producing all kinds of forest products, from saw timber and plywood veneer to fine paper. Still, the combined company is considerably smaller than the country's largest paper company, International Paper, itself created by mergers before World War II.

The Diversification Merger

But the typical mergers of the postwar period, and especially of the last ten years, resemble neither the offensive merger of 1900 nor the defensive merger of 1925.

To begin with, there were two very different and yet "typical" kinds. In the "diversification merger" which dominated the early years of the period, say, through 1964 or so, a large company, though distinctly not one of the leaders in its industry, merges with companies of the same kind, but in totally different lines of business. One leader in this kind of merger activity has been ITT—the initials standing for International Telegraph and Telephone. Originally this was a company operating telephone businesses abroad, especially in the Latin-speaking countries. It also manufactured telephone equipment for these companies. It was, in fact, originally the foreign counterpart to the American Telephone and Telegraph Company, the Bell System. During the last forty years, the company gradually gave up or lost one operating telephone company after the other. It became instead a world-wide manufacturer of electronics, very large in its total, but no better than third or fourth in every one of its markets or technologies. And then, in the last ten or fifteen years, it expanded through the acquisition increasingly of businesses that have nothing to do, at least at first glance, with its main business. It acquired Avis-Rent-A-Car, the Sheraton hotel chain, and Levitt, the country's largest mass-builder. It also acquired Hartford Fire Insurance, one of the large casualty insurance companies (though the antitrust division is still trying to undo this merger).

In a similar "diversification through merger," American Radiator & Standard Sanitary Corporation, an old and large, but stagnant, producer of plumbing and heating equipment, merged first with Westinghouse Air Brake, a large, and also rather stagnant, producer of railroad brakes and signals, then with Mosler Safe, a medium-sized and rapidly growing company, making mostly equipment for banks, and then with Lyons, a California-based mass-builder. In the process the company became "American-Standard."

Two of the many hundreds of diversification mergers exemplify the phenomenon. One of these is the merger in which Montgomery Ward, a large retail and mail-order chain, came together with Container Corporation of America to form a new company, Marcor. The other example is the acquisition of the country's second-largest medium-term finance company, Commercial Credit, by Control Data, the one computer manufacturer other than IBM (and very much smaller) who has so far shown any profits making computers. At first sight Montgomery Ward and Container Corporation have nothing in common, and the merger makes no economic sense. But both companies, while absolutely very large, are no more than "also-rans" in their respective industries with less than one-third of the sales of the industry leader (Sears, Roebuck and American Can, respectively). In their problems, their opportunities, and their strategic decisions, they may therefore be akin to each other. Similarly, producing big computers and providing installment loans to automobile buyers have, it seems, nothing in common. But the central problem of the successful computer manufacturer is to finance his machines which, as a rule, are leased rather than purchased. The central problem of a finance company, especially the smaller and weaker one, is a dependable and steady supply of high-quality borrowers. Again, there is a high degree of "fit" even though the respective businesses are as diverse as can be.

The Takeover Merger

Diversification mergers, though continuing right through the sixties, passed their peak around 1964 or 1965. From then on, for five years until the end of 1969, the mergers that made the headlines were something quite different, "merger by takeover." This merger is forced upon a reluctant, and often loudly resisting, management by organizing a stock-holders' revolt against it. And the one who "takesover" is almost invariably a very much smaller company, a total outsider, indeed, typically a brash newcomer who did not even exist a few years earlier. In the diversification mergers, both parties plighted their troth with the promise of "synergism" which would somehow make the combined business be more productive than the two alone. But in the takeover, the slogan is "asset management," that is, the maximization of the value of the shareholders' equity through financial management. In effect, the takeover is far less a merger of businesses than a *coup d'état.* A guerilla leader, himself owning practically no part of the company he acquires, gets the outside shareholders of large publicly owned companies to oust their own entrenched "professional business management" and put him into the saddle instead. And the more successful ones of these new corporate guerilla captains went from one takeover to another. Starting with nothing, they built within a few years "conglomerates" showing total revenues in the billions.

Among the takeover victims have been some of the oldest and best-known companies in the country—companies run by entrenched "professional management." They include two of the world's largest steel companies, Jones & Laughlin and Youngstown Sheet & Tube, both with sales around the billion-dollar mark. They were taken over, respectively, by Ling-Temco-Vought, controlled by James Ling and built by him in a few years from a small electronics shop into a medium-sized aerospace company with sales around $160 million, and by Lykes Bros. Steamship Company, a New Orleans-based shipping line which never in all its forty years of history had had sales of more than $70 million.

In another bitterly fought takeover, AMK, a company of whom a few years earlier nobody had ever heard of, took over the old United Fruit Company in Boston—a company with over $400 million in assets and almost $400 million in sales. This was AMK's second leap; in the first one a year earlier, it had taken over one of the oldest meatpackers, Morrell—but its base had been a small company making industrial machinery. The United Fruit shareholders sided with the raider, not because management had failed, but because it had been so successful in its attempt to turn around and save an old and ailing enterprise that it had accumulated a large amount of cash. The most spectacular of these takeovers would have been the takeover of the country's sixth largest bank, Chemical New York, with assets of $9 billion, by a company called Leasco which was not even mentioned in the financial handbooks of 1966, two years before it made the attempt (albeit an unsuccessful one) to engulf a huge commercial bank into what had started out, a few years earlier, as a small computer leasing operation without any capital to speak of.

There thus came into being a whole new group of entrepreneurs. They are not "owners," but they know how to mobilize the vast multitude of shareholders of big publicly owned companies against management. They have been able again and again to unseat "professional management" in the name of "asset management," that is, by promising to maximize financial returns. And their aim is not the "synergism" (whatever that may mean) of "diversification." It is the "conglomerate" built by financial manipulation and based on financial control.

The New Growth Companies

Perhaps even more significant, however, is another development, and one that never before coincided with a wave of mergers. It is the emergence of yet another group of new entrepreneurs far more numerous than the asset managers, but perhaps a good deal sounder, though neither as colorful nor as spectacular. These are the men who have been building new "growth" businesses in very large numbers. New businesses are, of course, being started all along. But these new businesses were started as growth businesses, and from the beginning with large investments from the capital market. In every year from 1965 to 1969, eight to ten thousand brand-new businesses got going. Many new entrepreneurs went to the capital market for anything up to a million dollars before their business had even been started, produced its first product, or made its first sale. A year or two later most came back for another substantial sum of money, ranging from $1 million to $10 million apiece. These companies were still sufficiently small and their investors sufficiently few in number—and also what the securities laws call "sophisticated investors" (that is, primarily investment institutions)—not to have to register their securities with the Securities Exchange Commission. Yet they were sufficiently large already to have to apprise the Commission of their existence. All told, these new businesses raised about $5 billion to $10 billion each year from the "sophisticated investors" during the last five years.

"Science-based" companies, most nonfinancial readers will probably say. Indeed the science-based companies that sprang up in the fifties around Boston on Route 128 or on the Peninsula south of San Francisco were the forerunners. But while science-based industries such as "learning" or computer application are to be found among the new growth ventures of the sixties, they constitute a small fraction of the total. Among the "glamour" stocks for which the sophisticated investors bid were franchise restaurants, magazine and book publishers, nursing homes and hospitals, manufacturers of prefabricated housing and of mobile homes, and many others.

Some of these new growth companies are even to be found in finance, both on Wall Street and as managers of investment trusts. The first of these financial growth ventures—and the most successful one to date, Donaldson, Lufkin & Jenrette—was started ten years ago by a group of young business-school graduates and had become by 1969 the seventh largest Stock Exchange firm. Then it singlehandedly achieved what Franklin D. Roosevelt, with all the power of the United States government behind him, had failed to bring about thirty years earlier: to force the Stock Exchange out of being a "private club." When Donaldson, Lufkin & Jenrette outgrew its capital base in 1969 and threatened to quit the Exchange unless permitted to sell shares to the public—something always strictly forbidden by the rules which, in effect, limited investment in Stock Exchange firms to wealthy individuals—it had become so important that the Stock Exchange had to give way. Donaldson, Lufkin & Jenrette raised $12 million by selling shares to the public in April 1970.

Very few of these new companies can be compared with Xerox, the growth company par excellence of the American economy in post-World War II—a company having barely $1 million in sales as recently as 1950, still having less than $50 million in sales in 1960, and, in 1969, reporting sales of $1.5 billion. But a good many of these new companies grew, within a very short period, to very respectable middle size—$50 million, $60 million, $70 million, sometimes even $100 million in sales. An even larger number grew to the point where their founders could sell them at a considerable capital gain to older, staid, and less "dynamic" companies bent on "diversification," or could, in a few cases, become "takeover entrepreneurs" in their own right. Not since the railroad and banking ventures of the Age of Jackson has there been any comparable explosion of new ventures getting, from the start, broad financial support in very large amounts.

The Developments That "Could Not Have Happened"

And neither the takeover merger nor the new growth ventures could really have happened, according to "what everybody knows" about the structure of the American economy. This is brought out clearly by the cleavage between the actual developments and the magisterial announcement regarding what could happen—just when the actual developments were approaching their peak.

Nineteen sixty-seven was the year in which takeovers exploded and in which also the largest number of "new growth" businesses appeared on the capital market. It was also the year, however, which produced the all-time best seller by an American academic economist, John Kenneth Galbraith's *The New Industrial State.* The book has two fundamental theses. One, professional management in the big corporation is so firmly entrenched that it cannot be challenged, let alone be overthrown from inside or outside. The dispersed "public" stockholder is completely disenfranchised, to the point where management need not, and indeed does not, aim at maximizing profitability, but can run the business comfortably to perpetuate itself in power. Second, new businesses simply cannot come into existence in this economy of large corporations which manipulate the market, both that of goods and that of capital. Small new businesses certainly cannot possibly grow. So said *The New Industrial State.*

What makes the contrast between the theses of this best-selling book and the reality of the very moment when it appeared particularly significant is, however, that Galbraith in this book is not the innovator, the iconoclast, and the exploder of the conventional wisdom which he had been in his earlier books. The two theses of *The New Industrial State,* however provocatively phrased by Galbraith, were the most conventional and most widely accepted theses regarding American economic structure. They go back, indeed, to the years before World War I, when John R. Commons, the father of American institutional economics, first propounded them. They underlay, of course, Veblen's work in the years of World War I. They were given full documentation in the classic on American corporate structure, Berle and Means' *The Modern Corporation and Private Property,* which came out in 1932. They were restated in the three books which initiated, one way or another, the tremendous interest in and study of the American business corporation the last twenty-five years: James Burnham's *The Managerial Revolution* (1941) and my own books *Concept of the Corporation* (1946) and *The New Society* (1950). For once, in other words, Galbraith, in *The New*