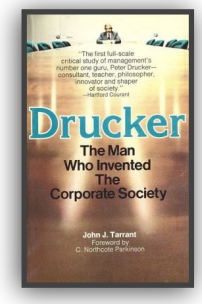
8. The Theory of the Business

by Peter Drucker



How is it possible ↓

to works toward horizons ↑ ↓

that aren't on your mental radar –

at the right point in time? ↓

↑ larger

Thinking Broad and Thinking Detailed ↑ ↓

Intelligence, Information, Thinking

Realities: Business, Results, Resources, Efforts, Cost, Market, Knowledge, Making the Future, Executive realities

- "Most of the mistakes in thinking are **mistakes in perception**.
  - ❖ Seeing only part of the situation – broad
  - ❖ Jumping to conclusions
  - ❖ Misinterpretation caused by feelings" – Edward de Bono
- Awareness without **action** is useless

The MEMO they – the enemies of the future – don't want you to SEE

«§§§»

[New major management techniques–"how to do" tools]

Not in a very long time–not, perhaps, since the late 1940s or early 1950s–have there been as many new major management techniques as there are today:

- downsizing,
- outsourcing,
- total quality management,
- six-sigma,
- activity-based costing,
- economic value analysis,
- benchmarking,
- reengineering.

Each is a powerful tool.

But, with the exceptions of outsourcing and reengineering, these tools are designed primarily to do differently what is already being done.

They are "how to do" tools.

["What to do" – addressing the unmanageable crisis]

Yet "what to do" is increasingly becoming the central challenge facing managements, especially those of big companies that have enjoyed long-term success.

The story is a familiar one: a company that was a superstar only yesterday finds itself stagnating and frustrated, in trouble, and, often, in a seemingly unmanageable crisis.

This phenomenon is by no means confined to the United States.

It has become common in Japan and Germany, the Netherlands and France, Italy and Sweden.

65 And it occurs just as often outside business—in labor unions, government agencies, hospitals, museums, and churches.

66 In fact, the phenomenon seems even less tractable in those areas.

67 [The root cause— assumptions no longer fit reality]

68 The root cause of nearly every one of these crises is not that things are being done poorly.

69 It is not even that the wrong things are being done.

70 Indeed, in most cases, the right things are being done—but fruitlessly.

71 What accounts for this apparent paradox?

72 *The assumptions on which the organization has been built and is being run no longer fit reality*.

73 [Assumptions drive everything]

74 These are the assumptions that shape any organization's behavior, dictate its decisions about what to do and what not to do, and define what the organization considers meaningful results.

75 These assumptions are about markets.

76 They are about identifying customers and competitors, their values and behavior.

77 They are about technology and its dynamics, about a company's strengths and weaknesses.

78 These assumptions are about what a company gets paid for.

79 They are what I call a company's *theory of the business*.

80 [Every organization has a theory of the business]

81 Every organization, whether a business enterprise or not,

has a theory of the business.

82 Indeed, a valid theory that is clear, consistent, and focused is extraordinarily powerful.

83 The theory of the business explains both the past successes of Companies like General Motors and IBM, which dominated the U. S. economy for the latter half of the twentieth century, and the challenges they have faced since.

84 In fact, what underlies the current malaise of so many large and successful organizations worldwide is that their theory of the business no longer works

85 *IBM Agility*

86 Whenever a big organization gets into trouble—and especially if it has been successful for many years—people blame sluggishness, complacency, arrogance, mammoth bureaucracies.

87 Plausible explanations?

88 Yes.

89 But rarely the relevant ones or correct.

90 Consider the two most visible and widely reviled bureaucracies among large U.S.companies that have recently experienced trouble. ...

91 Since the earliest days of the computer, it had been an article of faith at IBM that the computer would go the way of electricity.

92 The future, IBM knew, and could prove with scientific rigor, lay with the central station, the ever-more-powerful mainframe into which a huge number of users could plug.

93 Everything—economics, the logic of information, technology—led to that conclusion.

94 But then, suddenly, when it seemed as if such a central-station, mainframe-based information system was actually coming into existence, two young men came up with the first commercial personal computer.

95 Every computer maker knew that the PC was absurd.

96 It did not have the memory, the database, the speed, or the computing ability necessary to succeed.

97 Indeed, every computer maker knew that the PC had to fail—a conclusion reached by Xerox only a few years earlier, when its research team had actually built the first PC.

98 But when that misbegotten monstrosity—first the Apple, then the Macintosh came on the market, people not only loved it, they bought it. ...

99 Every big, successful company throughout history, when confronted with such a surprise, has refused to accept it.

100 Most mainframe makers responded in the same way.

101 The list was long:

102 Control Data, Univac, Burroughs, and NCR in the United States; Siemens, Nixdorf, Machines Bull, and ICL in Europe; Hitachi and Fujitsu in Japan.

103 IBM—the overlord of mainframes, with as much in sales as all the other computer makers put together and with record profits—could have reacted in the same way.

104 In fact, it *should* have.

105 Instead, IBM immediately accepted the PC as the new reality.

106 Almost overnight, it brushed aside all its proven and time-tested policies, rules, and regulations and set up not one but two competing teams to design an even simpler PC.

107 A couple of years later, IBM had become the world's largest PC manufacturer and the industry standard setter. ‟

108 There is absolutely no precedent for this achievement in all of business history it hardly argues bureaucracy, sluggishness, or arrogance.

109 Yet despite this unprecedented flexibility, agility, and humility, IBM was floundering a few years later in both the mainframe and the PC businesses.

110 It was suddenly unable to move, to take decisive action, to change.

111 *GM Had Strength*

112 The case of GM is equally perplexing.

113 In the early 1980s—the very years in which GM's main business, passenger automobiles, seemed almost paralyzed—the company acquired two large businesses:

114 Hughes Electronics and Ross Perot's Electronic Data Systems.

115 Analysts generally considered both companies to be mature and chided GM for grossly overpaying for them.

116 Yet, within a few short years, GM had more than tripled the revenues and profits of the allegedly mature EDS.

117 And ten years later, in 1994, EDS had a market value six times the amount that GM had paid for it and ten times its original revenues and profits. ‟

118 Similarly, GM bought Hughes Electronics—a huge but profitless company involved exclusively in defense—just before the defense industry collapsed.

119 Under GM management, Hughes actually increased its

defense profits and became one of the few big defense contractors to move successfully into large-scale nondefense work.

120 Remarkably, the same finance-oriented people who had been so ineffectual in the automobile business—thirty-year GM veterans who had never worked for any other company or, for that matter, outside of finance and accounting departments—were the ones who achieved these startling results.

121 And in the two acquisitions, they simply applied policies, practices, and procedures that had already been used by GM. ...

122 This story is a familiar one at GM.

123 Since the company's founding in a flurry of acquisitions in 1908, one of its core competencies has been to overpay for well-performing but mature businesses—as it did for Buick, AC Spark Plug, and Fisher Body in those early years—and then turn them into world-class champions.

124 Very few companies have been able to match GM's performance in making successful acquisitions, and GM surely did not accomplish these feats by being bureaucratic, sluggish, or arrogant.

125 Yet what worked so beautifully in those businesses that GM knew nothing about failed miserably in GM itself.

126 *Paralyzed IBM*

127 What can explain the fact that at both IBM and GM the policies, practices, and behaviors that worked for decades—and in the case of GM, are still working well when applied to something new and different—no longer work for the organization in which and for which they were developed?

128 The realities that each organization actually faces today are quite dramatically different from those that each still assumes it lives with.

129 Put another way, reality has changed, but the theory of the business has not changed with it. ...

130 Mainframe computers and PCs are no more one entity, in fact, than are electric generating stations and electric toasters.

131 The latter, while different, are interdependent and complementary.

132 In contrast, mainframe computers and PCs are primarily competitors.

133 And in their basic definition of information, they actually contradict each other:

134 for the mainframe, information means memory—for the PC, it means software.

135 Building generating stations and making toasters must be run as separate businesses, but they can be owned by the same corporate entity as General Electric did for decades.

136 This was not the case for IBM. ...

137 IBM tried to combine mainframe computers and PCs.

138 But because the PC was the fastest-growing part of the business, IBM could not subordinate it to the mainframe business while simultaneously competing successfully in the PC market.

139 And because the mainframe was still the cash cow, IBM could not divest it in order to capture a leadership position in the PC market. ...

140 In the end, IBM shifted its strategy to one of providing information solutions and accepted the premise that "over

time, the information technology industry would be service-led, not technology-led."

141 [Who Says Elephants Can't Dance]

142 *Patching GM*

143 GM had an even more powerful, and successful, theory of the business than IBM had, one that made GM the world's largest and most profitable manufacturing organization.

144 The company did not have one setback in seventy years—a record unmatched in business history.

145 GM's theory combined in one seamless web assumptions about markets and customers with assumptions about core competencies and organizational structure. ...

146 Since the early 1920s, GM assumed that the U.S. automobile market was homogeneous in its values and segmented by extremely stable income groups.

147 The resale value of the "good" used car was the only independent variable under management's control.

148 High trade-in values enabled customers to upgrade their new-car purchases to the next category—in other words, to cars with higher profit margins.

149 According to this theory, frequent or radical changes in models could only depress trade-in values. ...

150 Internally, these market assumptions went hand in hand with assumptions about how production should be organized to yield the biggest market share and the highest profit.

151 In GM's case, the answer was long runs of mass-produced cars with a minimum of changes each model year,

resulting in the largest number uniform yearly models on the market at the lowest fixed cost per car. ...

152 GM's management then translated these assumptions about market and production into a structure of semi-autonomous divisions, each focusing on one income segment and each arranged so that its highest-priced model overlapped with the next division's lowest-priced model, thus almost forcing people to trade up, provided that used-car prices were high. ...

153 For seventy years, this theory worked like a charm.

154 Even in the depths of the Depression, GM never suffered a loss while steadily gaining market share.

155 But in the late 1970s, its assumptions about the market and about production became invalid.

156 The market was fragmenting into highly volatile "lifestyle" segments.

157 Income became one factor among many in the buying decision, not the only one.

158 At the same time, *lean manufacturing* created an *economics of small scale*.

159 It made short runs and variations in models less costly and more profitable than long runs of uniform products. ...

160 GM knew all this but simply could not believe it.

161 (GM's union still doesn't.)

162 Instead, the company tried to patch things over.

163 It maintained the existing divisions based on income

segmentation, but each division now offered a "car for every purse."

164 It tried to compete with lean manufacturing's economics of small scale by automating the large-scale, long-run mass production (losing billions in the process).

165 Contrary to popular belief, GM patched things over with prodigious energy, hard work, and lavish investments of time and money.

166 But patching only confused the customer, the dealer, and the employees and management of GM itself.

167 In the meantime, GM neglected its real growth market, where it had leadership and would have been almost unbeatable: light trucks and minivans.

168 *The Three Assumptions*

169 A theory of the business has three parts.

170 [Assumptions about the environment of the organization]

171 First, there are assumptions about the environment of the organization:

172 society and its structure,

173 the market,

174 the customer, and

175 technology.

176 [Assumptions about the specific mission of the organization]

177 Second, there are assumptions about the specific mission of the organization.

178 Sears, Roebuck and Company, in the years during and following World War I, defined its mission for itself as being the informed buyer for the American family.

179 A decade later, Marks & Spencer in Great Britain defined its mission as being the change agent in British society by becoming the first classless retailer.

180 AT&T, again in the years during and immediately after World War I, defined its role as ensuring that every U. S. family and business have access to a telephone.

181 An organization's mission need not be so ambitious.

182 GM envisioned a far more modest role—as the leader in "terrestrial motorized transportation equipment," in the words of Alfred P. Sloan, Jr.

183 [Assumptions about the core competencies needed to accomplish the organization's mission]

184 Third, there are assumptions about the core competencies needed to accomplish the organization's mission.

185 For example, West Point, founded in 1802, defined its core competence as the ability to turn out leaders who deserve trust.

186 Marks & Spencer, around 1930, defined its core competence as the ability to identify, design, and develop the merchandise it sold, instead of as the ability to buy.

187 AT&T, around 1920, defined its core competence as technical leadership that would enable the company to improve service continuously while steadily lowering rates.

188 [Roles that each set of assumptions plays]

189 The assumptions about environment define what an organization is paid for.

190 The assumptions about mission define what an organization considers to be meaningful results; in other words, they point to how it envisions itself making a difference in the economy and in the society at large.

191 Finally, the assumptions about core competencies define where an organization must excel in order to maintain

leadership.

192 [Creating a valid theory takes years of hard work]

193 Of course, all this sounds deceptively simple.

194 It usually takes years of hard work, thinking, and experimenting to reach a clear, consistent, and valid theory of the business.

195 Yet to be successful, every organization must work one out. ...

196 What are the specifications of a valid theory of the business? There are four.

197 *The Four Specifications*

198 What are the specifications of a valid theory of the business? There are four:

199 1. The assumptions about environment, mission, and core competencies must fit reality.

200 When four penniless young men from Manchester, England, Simon Marks and his three brothers-in-law, decided in the early 1920s that a humdrum penny bazaar should become an agent of social change, World War I had profoundly shaken their country's class structure.

201 It had also created masses of new buyers for good-quality, stylish, but cheap merchandise like lingerie, blouses, and stockings—Marks & Spencer's first successful product categories.

202 Marks & Spencer then systematically set to work developing brand-new and unheard-of core competencies.

203 Until then, the core competence of a merchant was the ability to buy well.

204 Marks & Spencer decided that it was the *merchant, rather than the manufacturer, who knew the customer*.

205 Therefore, the merchant, not the manufacturer, should design the products, develop them, and find producers to make the goods to his design, specifications, and costs.

206 This new definition of the merchant took five to eight years to develop and make acceptable to traditional suppliers, who had always seen themselves as "manufacturers," not "subcontractors."

207 2. The assumptions in all three areas have to fit one another.

208 This was perhaps GM's greatest strength in the long decades of its ascendancy.

209 Its assumptions about the market and about the optimum manufacturing process were a perfect fit.

210 GM decided in the mid-1920s that it also required new and as-yet-unheard-of core competencies: financial control of the manufacturing process and a theory of capital allocations.

211 As a result, GM invented modern cost accounting and the first rational capital-allocation process.

212 3. The theory of the business must be known and understood throughout the organization.

213 That is easy in an organization's early days.

214 But as it becomes successful, an organization tends increasingly to take its theory for granted, becoming less and less conscious of it.

215 Then the organization becomes sloppy.

216 It begins to cut corners.

217 It begins to pursue what is expedient rather than what is

right.

It stops thinking.

It stops questioning.

It remembers the answers but has forgotten the questions.

The theory of the business becomes “culture.”

But culture is no substitute for discipline, and the theory of the business is a discipline.

4. The theory of the business has to be tested constantly.

It is not graven on tablets of stone.

It is a hypothesis.

And it is a hypothesis about things that are in constant flux—society, markets, customers, technology.

And so, built into the theory of the business must be the ability to change itself.

Preventive Care

Some theories of the business are so powerful that they last for a long time.

But being human artifacts, they don’t last forever, and indeed, today they rarely last for very long at all.

Eventually every theory of the business becomes obsolete and then invalid.

That is precisely what happened to those on which the great U.S. businesses of the 1920s were built.

It happened to the GMs and the AT&Ts.

It has happened to IBM.

235 It is clearly happening today to Deutsche Bank and its theory of the universal bank.

236 It is also clearly happening to the rapidly unraveling Japanese keiretsu.

237 [Put One's Head in the Sand and Pretend That Nothing Is Happening]

238 The first reaction of an organization whose theory is becoming obsolete is almost always a defensive one.

239 The tendency is to put one's head in the sand and pretend that nothing is happening.

240 [The Next Reaction Is an Attempt to Patch]

241 The next reaction is an attempt to patch, as GM did in the early 1980s or as Deutsche Bank is doing today.

242 Indeed, the sudden and completely unexpected crisis of one big German company after another of which Deutsche Bank is the "house bank" indicates that its theory no longer works.

243 That is, Deutsche Bank no longer does what it was designed to do: provide effective governance of the modern corporation. ...

244 But patching never works.

245 [At the First Signs: Start Thinking Again]

246 Instead, when a theory shows the first signs of be coming obsolete, it is time to start thinking again, to ask again which assumptions about the environment, mission, and core competencies reflect reality most accurately—with the clear premise that our historically transmitted assumptions, those with which all of us grew up, no longer suffice. ...

What, then, needs to be done?

There is a need for preventive care—that is, for building into the organization systematic monitoring and testing of its theory of the business.

There is a need for early diagnosis.

Finally, there is a need

✓ to rethink a theory that is stagnating and

✓ to take effective action in order to change policies and practices, bringing the organization's behavior in line

- with the new realities of its environment,
- with a new definition of its mission and
- with new core competencies to be developed and acquired.

[Preventive measures]

There are only two preventive measures.

But, if used consistently, they should keep an organization alert and capable of rapidly changing itself and its theory.

[Abandonment]

The first measure is *abandonment*.

Every three years, an organization should challenge every product, every service, every policy, every distribution channel with the question, *If we were not in it already, would we he going into it now?*

By questioning accepted policies and routines, the organization forces itself to think about its theory.

It forces itself to test assumptions.

It forces itself to ask, Why didn't this work, even though it looked so promising when we went into it five years ago?

Is it because we made mistakes?

266 Is it because we did the wrong things?

267 Or is it because the right things didn't work? ...

268 Without systematic and purposeful abandonment, an organization will be overtaken by events.

269 It will squander its best resources on things it should never have been doing or should no longer do.

270 As a result, it will lack the resources, especially capable people, needed to exploit the opportunities that arise when markets, technologies, and core competencies change.

271 In other words, it will be unable to respond constructively to the opportunities that are created when its theory of the business becomes obsolete. ...

272 The failure to incorporate preventative care—to follow and continually update their theory of the business—led Marks & Spencer to become vulnerable to a take-over bid, one which the company did successfully defeat.

273 Marks & Spencer had so completely moved into complacency and away from what made them successful that the business itself was threatened, both internally and by competitive pressures.

274 It took this threat for the company to refocus on the customer, on providing quality, value, service, innovation, and trust.

275 It took near-failure to reinvest themselves in their people, to shift from their former reliance on outside consultants and on a demoralizing strategy-hopping approach.

276 To regain their focus, they had to evaluate all aspects of their theory of the business and incorporate systematic abandonment (for a complete account see "Back in Fashion: How We're Reviving a British Icon" *Harvard*

Business Review, May 2007).

277 [Study What Goes on Outside the Business and Especially to Study Noncustomers]

278 The second preventive measure is to study what goes on outside the business and especially to study noncustomers.

279 Walk-around management became fashion-able a few years back.

280 It is important.

281 And so is knowing as much as possible about one's customers—the area, perhaps, where information technology is making the most rapid advances.

282 But the first signs of fundamental change rarely appear within one's own organization or among one's own customers.

283 Almost always they show up first among one's noncustomers.

284 Noncustomers always outnumber customers.

285 Wal-Mart, today's retail giant, has 20 percent of the U. S. consumer-goods market.

286 That means 80 percent of the market is noncustomers.

287 In fact, the best recent example of the importance of the noncustomer is U. S. department stores.

288 At their peak over thirty years ago, department stores served 30 percent of the U. S. nonfood retail market.

289 They questioned their customers constantly, studied them, and surveyed them.

290 But they paid no attention to the 70 percent of the market who were not their customers.

291 They saw no reason why they should.

292 Their theory of the business assumed that most people who could afford to shop in department stores did.

293 Sixty years ago, that assumption fit reality.

294 But when the baby boomers came of age, it ceased to be valid.

295 For the dominant group among baby boomers—women in educated two-income families—it was not money that determined where to shop.

296 Time was the primary factor, and this generation's women could not afford to spend their time shopping in department stores. ...

297 Today the department stores' prototypical customer has a paying job, if not a career.

298 She has many occasions to choose or to make decisions, most of which are more interesting than what to cook for dinner.

299 And even if she never leaves the house, she has unlimited access to the outside world through the telephone and computer screen.

300 Shopping is no longer a satisfaction to her.

301 It's a chore. ...

302 Because department stores looked only at their own customers, they did not recognize this change until a few years ago.

303 By then, business was already drying up.

304 And it was too late to get the baby boomers back.

305 The department stores learned the hard way that although being customer driven is vital, it is not enough.

306 An organization must be market driven too.

307 *The Warning Signs*

308 To diagnose problems early, managers must pay attention to the warning signs.

309 [A theory of the business becomes obsolete when an organization attains its original objectives]

310 A theory of the business always becomes obsolete when an organization attains its original objectives.

311 Attaining one's objectives, then, is not cause for celebration; it is cause for new thinking.

312 By the mid-1950s, AT&T accomplished its mission to give every U.S. family and business access to the telephone.

313 Some executives then said it was time to reassess the theory of the business and, for instance, separate local service—where the objectives had been reached—from growing and future businesses, beginning with long-distance service and extending into global telecommunications.

314 Their arguments went unheeded, and a few years later AT&T began to flounder, only to be rescued by an antitrust settlement, which did by fiat what the company's management had refused to do voluntarily.

315 [Rapid growth is another sure sign of crisis in an organization's theory]

316 Rapid growth is another sure sign of crisis in an organization's theory.

317 Any organization that doubles or triples in size within a fairly short period of time has necessarily outgrown its theory.

318 Even Silicon Valley has learned that beer bashes are no

longer adequate for communication once a company has grown so big that people have to wear name tags.

319 But such growth challenges much deeper assumptions, policies, and habits.

320 To continue in health, let alone grow, the organization has to again ask itself the questions about its environment, mission, and core competencies.

321 [The unexpected success and unexpected failure]

322 There are two more clear signals that an organization's theory of the business is no longer valid.

323 One is unexpected success—whether one's own or a competitor's.

324 The other is unexpected failure—again, whether one's own or a competitor's. ...

325 At the same time that Japanese automobile imports had Detroit's Big Three on the ropes, Chrysler registered a totally unexpected success.

326 Its traditional passenger cars were losing market share even faster than GM's and Ford's were.

327 But sales of its jeep and its new minivans—an almost accidental development—skyrocketed.

328 At the time, GM was the leader of the U.S. light-truck market and unchallenged in the design and quality of its products, but it wasn't paying attention to its light truck capacity.

329 After all, minivans and light trucks had always been classified commercial rather than passenger vehicles in traditional statistics, even thou most of them are now being bought as passenger vehicles.

330 However, had it paid attention to the success of its weaker competitor, Chrysler, GM might have realized much

earlier that its assumptions about both its market and its core competencies, were no longer valid.

331 From the beginning, the minivan and light-truck market was not an income-class market and was little influenced by trade-in prices.

332 And, paradoxically, light trucks were the one area in which GM, twenty-five years ago, hid already moved quite far toward what we now call lean manufacturing.

333 Unexpected failure is as much a warning as unexpected success and should he taken as seriously as a sixty-year-old man's first "minor" heart attack.

334 Seventy years ago, in the midst of the Depression, Sears decided that automobile insurance had become an "accessory" rather than a financial product and that selling it would therefore fit its mission of being the informed buyer for the American family.

335 Everyone thought Sears was crazy.

336 But automobile insurance became Sears's most profitable business almost instantly.

337 Twenty years later, in the 1950s, Sears decided that diamond rings had become a necessity rather than a luxury, and the company became the world's largest—and probably most profitable-diamond retailer.

338 It was only logical for Sears to decide in 1981 that investment products had become consumer goods for the American family.

339 It bought Dean Witter and moved its offices into Sears's stores.

340 The move was a total disaster.

341 The U.S. public clearly did not consider its financial needs to be "consumer products."

342 When Sears finally gave up and decided to run Dean Witter as a separate business outside Sears stores, Dean Witter at once began to blossom.

343 In 1992, Sears sold it at a tidy profit. ...

344 Had Sears seen its failure to become the American family's supplier of investments as a failure of its theory and not as an isolated incident, it might have begun to restructure and reposition itself ten years earlier than it actually did, when it still had substantial market leadership.

345 For Sears might then have seen that the Dean Witter failure threw into doubt the entire concept of market homogeneity—the very concept on which Sears and other mass retailers had based their strategy for years.

346 *Decisive Action*

347 Traditionally, we have searched for the miracle worker with a magic wand to turn an ailing organization around.

348 To establish, maintain, and restore a theory, however, does not require a Genghis Khan or a Leonardo da Vinci in the executive suite.

349 What is required is not genius; it is hard work.

350 It is not being clever; it is being conscientious.

351 It is what CEOs are paid for. ...

352 There are, indeed, quite a few CEOs who have successfully changed their theory of the business.

353 The CEO who built Merck into the world's most successful pharmaceutical business by focusing solely on the research and development of patented, high-margin breakthrough drugs radically changed the company's

theory by acquiring a large distributor of generic and nonprescription drugs.

354 He did without a "crisis," while Merck was ostensibly doing very well.

355 Similarly, a few years ago, the new CEO of Sony, the world's best-known manufacturer of consumer electronic hardware, changed the company's theory of the business.

356 He acquired a Hollywood movie-production company and, with that acquisition, shifted the organization's center of gravity from being a hardware manufacturer in search of software to being a software producer that creates a market demand for hardware. ...

357 But for every one of these apparent miracle workers, there are scores of equally capable CEOs whose organizations stumble.

358 We can't rely on miracle workers to rejuvenate an obsolete theory of the business any more than we can rely on them to cure other types of serious illness.

359 And when one talks to these supposed miracle workers, they deny vehemently that they act by charisma, vision, or, for that matter, the laying on of hands.

360 They start out with diagnosis and analysis.

361 They accept that attaining objectives and rapid growth demand a serious rethinking of the theory of the business.

362 They do not dismiss unexpected failure as being the result of a subordinate's incompetence or as an accident but treat it as a symptom of "systems failure."

363 They do not take credit for unexpected success but treat it as a challenge to their assumptions. ...

364 They accept that a theory's obsolescence is a

degenerative and, indeed, life-threatening disease.

365 And they know and accept the surgeon's time-tested principle, the oldest principle of effective decision making: a degenerative disease will not be cured by procrastination.

366 It requires decisive action.

367 *Summary – The Theory of the Business*

368 A theory of the business has three parts:

369 1. Assumptions about the environment of the organization. These define what the organization expects it can be paid for.

370 2. Assumptions about the specific mission of the organization. These define how the organization intends to make a difference in society and what results are meaningful.

371 3. Assumptions about the core competencies needed to accomplish the mission. These define in which areas the organization must excel in order to achieve its mission.

372 These three assumptions must fit one another and reality.

373 The theory of the business must be understood throughout the organization.

374 When an organization takes its theory for granted, it stops thinking and questioning the very premises of its existence.

375 And every theory eventually becomes obsolete.

376 Without systematic abandonment, an organization will squander its scarce resources on what it should not do and deprive itself of resources it needs to exploit opportunities.

377 One of the most effective ways to test the validity of a theory is to study the behavior of noncustomers.