

# 1 Management's New Paradigms

2 by [Peter Drucker](#) in [The Essential Drucker](#)

3 **Basic assumptions about reality** are the **paradigms** of a social science, such as management.

4 They are usually held subconsciously by the scholars, the writers, the teachers, the practitioners in the field, and are incorporated into the discipline by their various formulations.

5 Thus those assumptions by this select group of people largely determine what the discipline assumes to be reality ...

6 The discipline's basic assumptions about reality determine what it focuses on.

7 They determine what a discipline considers "facts," and indeed what the discipline considers itself to be all about.

8 The assumptions also largely determine what is being disregarded or is being pushed aside as an "annoying exception." ...

9 Yet, despite their importance, the assumptions are rarely analyzed, rarely studied, rarely challenged—indeed rarely even made explicit. ...

10 For a social discipline such as management, the assumptions are actually a good deal more important than are the paradigms for a natural science.

11 The paradigm—that is, the prevailing general theory—has no impact on the natural universe.

- 12 Whether the paradigm states that the sun rotates around the earth or that, on the contrary, the earth rotates around the sun has no effect on sun and earth.
- 13 A natural science deals with the behavior of objects.
- 14 But a social discipline such as management deals with the behavior of people and human institutions
- 15 Practitioners will therefore tend to act and to behave as the discipline's assumptions tell them to.
- 16 Even more important, the reality of a natural science, the physical universe and its laws, do not change (or if they do only over eons rather than over centuries, let alone over decades).
- 17 The social universe has no "natural laws" of this kind.
- 18 It is thus subject to continual change.
- 19 And this means that assumptions that were valid yesterday can become invalid and, indeed, totally misleading in no time at all. ...
- 20 What matters most in a social discipline such as management are therefore the basic assumptions.
- 21 And a change in the basic assumptions matters even more. ...
- 22 Since the study of management first began—and it truly did not emerge until the 1930s—**two sets** of assumptions regarding the realities of management have been held by most scholars, most writers and most practitioners:
- 23 One set of assumptions underlies the **discipline** of management:
- 24 1. Management is **business** management.

25 2. There is—or there must be—**one** right *organization*  
structure.

26 3. There is—or there must be—**one** right way to *manage*  
*people*.

27 Another set of assumptions underlies the **practice** of  
management:

28 1. Technologies, markets and end uses are *given*.

29 2. Management's scope is *legally* defined.

30 3. Management is internally focused.

31 4. The economy as defined by national boundaries is the  
"ecology" of enterprise and management.

## 32 ***Management Is Business*** ***Management***

33 For most people, inside and outside management, this  
assumption is taken as self-evident.

34 Indeed management writers, management practitioners,  
and the laity do not even hear the word "management";  
they automatically hear **business management** ...

35 This assumption regarding the universe of management is  
of fairly recent origin.

36 Before the 1930s the few writers and thinkers who  
concerned themselves with management—beginning with  
Frederick Winslow Taylor around the turn of the century  
and ending with Chester Barnard just before World War  
II—all assumed that business management is just a  
subspecies of general management and basically no  
more different from the management of any other  
organization than one breed of dogs is from another. ...

- 37 What led to the identification of management with business management was the Great Depression with its hostility to business and its contempt for business executives.
- 38 In order not to be tarred with the business brush, management in the public sector was rechristened "public administration" and proclaimed a separate discipline—with its own university departments, its own terminology, its own career ladder.
- 39 At the same time—and for the same reason—what had begun as a study of management in the rapidly growing hospital (e. g., by Raymond Sloan, the younger brother of GM's Alfred Sloan) was split off as a separate discipline and christened "hospital administration." ...
- 40 Not to be called "management" was, in other words, "political correctness" in the Depression years. ...
- 41 In the postwar period, however, the fashion turned.
- 42 By 1950 "business" had become a "good word"—largely the result of the performance during World War II of American business management.
- 43 And then very soon business management became "politically correct" as a field of study, above all.
- 44 And ever since, management has remained identified in the public mind as well as in academia with business management. ...

- 45 Now, we are beginning to unmake this sixty-year-old mistake as witness the renaming of so many business schools as schools of management," the rapidly growing offerings in "nonprofit management" by these schools, the emergence of "executive management programs" recruiting both business and nonbusiness executives, or the emergence of departments of "pastoral management" in divinity schools. ...
- 46 But the assumption that management is business management still persists.
- 47 It is therefore important to assert—and to do so loudly—that management is **not** business management—any more than, say, medicine is obstetrics. ...
- 48 There are, of course, differences in management among different organizations—mission defines strategy, after all, and strategy defines structure.
- 49 There surely are differences in managing a chain of retail stores and managing a Catholic diocese (though amazingly fewer than either chain stores or bishops might believe); in managing an air base, a hospital, and a software company.
- 50 But the greatest differences are in the terms individual organizations use.
- 51 Otherwise the differences are mainly in application rather than in principles.
- 52 There are not even tremendous differences in tasks and challenges. ...
- 53 The first conclusion of this analysis of the **assumptions** that must underlie management to make productive both its study and its practice is therefore: ...

54 **Management is the specific and distinguishing organ of any and all organizations.**

55 ***The One Right Organization***

56 Concern with management and its study began with the sudden emergence of large organizations—business, governmental civil service, the large standing army—which was the novelty of late nineteenth-century society. ...

57 And from the very beginning more than a century ago, the study of organization has rested on one assumption: ...

58 There is—or there must be—one right organization. ...

59 What is presented as the “one right organization” has changed more than once.

60 But the search for the one right organization has continued and continues today. ...

61 It was World War I that made clear the need for a formal organization structure.

62 But it was also World War I that showed that Fayol’s (and Carnegie’s) functional structure was not the one right organization.

63 Immediately after World War I first Pierre S. Du Pont (1870-1954) and then Alfred Sloan (1875-1966) developed the principle of *decentralization*.

64 And now, in the last few years, we have come to tout the team as the one right organization for pretty much everything. ...

- 65 By now, however, it should have become clear that there is no such thing as the one right organization.
- 66 There are only organizations, each of which has distinct strengths, distinct limitations, and specific applications.
- 67 It has become clear that organization is not an absolute.
- 68 It is a *tool* for making people productive in working together.
- 69 As such, a given organization structure fits certain tasks in certain conditions and at certain times. ...
- 70 One hears a great deal today about "the end of hierarchy."
- 71 This is blatant nonsense.
- 72 In any institution there has to be a final authority, that is, a "boss"—someone who can make the final decisions and who can expect them to be obeyed.
- 73 In a situation of common peril—and every institution is likely to encounter it sooner or later—survival of all depends on clear command.
- 74 If the ship goes down, the captain does not call a meeting, the captain gives an order.
- 75 And if the ship is to be saved, everyone must obey the order, must know exactly where to go and what to do, and do it without "participation" or argument.
- 76 "Hierarchy," and the unquestioning acceptance of it by everyone in the organization, is the only hope in a crisis. ...
- 77 Other situations within the same institution require deliberation.
- 78 Others still require teamwork and so on. ...

- 79 Organization theory assumes that institutions are homogeneous and that, therefore, the entire enterprise should be organized the same way. ...
- 80 But in any one enterprise—probably even in Fayol’s “typical manufacturing company”—there is need for a number of different organization structures coexisting side by side. ...
- 81 Managing foreign currency exposure is an increasingly critical—and increasingly difficult—task in a world economy.
- 82 It requires total centralization.
- 83 No one unit of the enterprise can be permitted to handle its own foreign currency exposures.
- 84 But in the same enterprise servicing the customer, especially in high-tech areas, requires almost complete local autonomy—going way beyond traditional decentralization.
- 85 Each of the individual service people has to be the “boss,” with the rest of the organization taking its direction from them. ...
- 86 Certain forms of research require a strict functional organization with all specialists “playing their instrument” by themselves.
- 87 Other kinds of research, however, especially research that involves decision-making at an early stage (e. g., some pharmaceutical research), require teamwork from the beginning.
- 88 And the two kinds of research often occur side by side and in the same research organization. ...

- 89 The belief that there must be one right organization is closely tied to the fallacy that management is business management.
- 90 If earlier students of management had not been bunkered by this fallacy but had looked at nonbusinesses, they would soon have found that there are vast differences in organization structure according to the nature of the task. ...
- 91 A Catholic diocese is organized very differently from an opera.
- 92 A modern army is organized very differently from a hospital. ...
- 93 There are indeed some "principles" of organization. ...
- 94 One is surely that organization has to be transparent.
- 95 People have to know and have to understand the organization structure they are supposed to work in.
- 96 This sounds obvious—but it is far too often violated in most institutions (even in the military). ...
- 97 Another principle I have already mentioned: Someone in the organization must have the authority to make the final decision in a given area.
- 98 And someone must clearly be in command in a crisis It also is a sound principle that authority be commensurate with responsibility. ...

- 99 It is a sound principle that one person in an organization should have only one "master."
- 100 There is wisdom to the old proverb of the Roman law that a slave who has three masters is a free man.
- 101 It is a very old principle of human relations that no one should be put into a conflict of loyalties—and having more than one "master" creates such a conflict (which, by the way, is the reason that the "jazz combo" team, so popular now, is so difficult—every one of its members has two masters, the head of the specialty function, for example, engineering, and the team leader).
- 102 It is a sound, structural principle to have the fewest layers, that is, to have an organization that is as "flat" as possible—if only because, as information theory tells us, "every relay doubles the noise and cuts the message in half." ...
- 103 But these principles do not tell us *what to do*.
- 104 They only tell us what not to do.
- 105 They do not tell us what will work.
- 106 They tell us what is unlikely to work.
- 107 These principles are not too different from the ones that inform an architect's work.
- 108 They do not tell him what kind of building to build.
- 109 They tell him what the restraints are.
- 110 And this is pretty much what the various principles of organization structure do. ...
- 111 One implication: *Individuals* will have to be able to work at one and the same time in different organization structures.

- 112 For one task they will work in a team.
- 113 But for another task they will have to work—and at the same time—in a command-and-control structure.
- 114 The same individual who is a “boss” within his or her own organization is a “partner” in an alliance, a minority participation, a joint venture, and so on.
- 115 Organizations, in other words, will have to become part of the executive’s toolbox. ...
- 116 Even more important: We need to go to work on studying the strengths and the limitations of different organizations.
- 117 For what tasks are what organizations most suitable?
- 118 For what tasks are what organizations least suitable?
- 119 And when, in the performance of a task, should we switch from one kind of organization to another? ...
- 120 One area in which research and study are particularly needed is the **organization of top management** ...
- 121 And I doubt that anyone would assert that we really know how to organize the top management job, whether in a business, a university, a hospital, or even a modern church. ...
- 122 One clear sign is the growing disparity between our rhetoric and our practice.
- 123 We talk incessantly about “teams”—and every study comes to the conclusion that the top management job does indeed require a team.

- 124 Yet we now *practice*—and not only in American industry—the most extreme “personality cult” of CEO supermen.
- 125 And no one seems to pay the slightest attention in our present worship of these larger-than-life CEOs to the question of how and by what process they are to be succeeded—and yet, succession has always been the ultimate test of any top management and the ultimate test of any institution. ...
- 126 There is, in other words, an enormous amount of work to be done in organizational theory and organization practice—even though both are the oldest areas of organized work and organized practice in management. ...
- 127 The pioneers of management a century ago were right.
- 128 *Organizational structure is needed*
- 129 The modern enterprise—whether business, civil service, university, hospital, large church, or large military—needs organization just as any biological organization beyond the amoeba needs structure.
- 130 But the pioneers were wrong in their assumption that there is—or should be—one right organization.
- 131 Just as there are a great number of different structures for biological organizations, so there are a number of organizations for the social organism that is the modern institution. ...
- 132 Instead of searching for the right organization, management needs to learn to look for, to develop, to test ...

- 133 **The organization that fits the task.**

134 ***The One Right Way to Manage  
People***

135 In no other area are the basic traditional assumptions held as firmly—though mostly subconsciously—as in respect to people and their management.

136 And in no other area are they so totally at odds with reality and so totally counterproductive.

137 *There is one right way to manage people—or at least there should be.*

138 This assumption underlies practically every book or paper on the management of people.

139 Its most quoted exposition is Douglas McGregor's book *The Human Side of Enterprise* (1960), which asserted that managements have to choose between two and only two different ways of managing people, "Theory X" and "Theory Y," and which then asserted that Theory Y is the only sound one.

140 (A little earlier I had said pretty much the same thing in my 1954 book *The Practice of Management*.)

141 A few years later Abraham H. Maslow (1908-1970) showed in his *Eupsychian Management* (1962; new edition 1995 entitled *Maslow on Management*) that both McGregor and I were dead wrong.

142 He showed conclusively that different people have to be managed differently. ...

143 I became an immediate convert—Maslow's evidence is overwhelming.

144 But to date very few people have paid much attention. ...

- 145 On this fundamental assumption that there is—or at least should be—one and only one right way to manage people, rest all the other assumptions about people in organizations and their management. ...
- 146 One of these assumptions is that the people who work for an organization are *employees* of the organization, working full-time, and dependent on the organization for their livelihood and their careers.
- 147 Another such assumption is that the people who work for an organization are *subordinates*.
- 148 Indeed, it is assumed that the great majority of these people have either no skill or low skills and do what they are being assigned to do. ...
- 149 Eighty years ago, when these assumptions were first formulated, during and at the end of World War I, they conformed close enough to reality to be considered valid.
- 150 Today every one of them has become untenable.
- 151 The majority of people who work for an organization may still be employees of the organization.
- 152 But a very large and steadily growing minority—though working for the organization—are no longer its employees; let alone its full-time employees.
- 153 They work for an outsourcing contractor, for example, the outsourcing firm that provides maintenance in a hospital or a manufacturing plant, or the outsourcing firm that runs the data-processing system for a government agency or a business.
- 154 They are “temps” or part-timers.
- 155 Increasingly they are individual contractors working on a retainer or for a specific contractual period; this is particularly true of the most knowledgeable and therefore the most valuable people working for the organization. ...

- 156 Even if employed full-time by the organization, fewer and fewer people are "subordinates" even in fairly low-level jobs.
- 157 Increasingly they are "knowledge workers."
- 158 And knowledge workers are not subordinates; they are "associates."
- 159 For, once beyond the apprentice stage, knowledge workers must know more about their job than their boss does—or else they are no good at all.
- 160 In fact, that they know more about their job than anybody else in the organization is part of the definition of knowledge workers. ...
- 161 Add to this that today's "superiors" usually have not held the jobs their "subordinates" hold—as they did only a few short decades ago and as still is widely assumed they do. ...
- 162 A regimental commander in the army, only a few decades ago, had held every one of the jobs of his subordinates—battalion commander, company commander, platoon commander.
- 163 The only difference in these respective jobs between the lowly platoon commander and the lordly regimental commander was in the number of people each commands; the work they did was exactly alike.
- 164 To be sure, today's regimental commanders have commanded troops earlier in their careers—but often for a short period only.
- 165 They also have advanced through captain and major.
- 166 But for most of their careers they have held very different assignments—in staff jobs, in research jobs, in teaching jobs, attached to an embassy abroad and so on.

- 167 They simply can no longer assume that they know what their “subordinate,” the captain in charge of a company, is doing or trying to do—they have been captains, of course, but they may have never commanded a company. ...
- 168 Similarly, the vice president of marketing may have come up the sales route.
- 169 He or she knows a great deal about selling, but knows nothing about market research, pricing, packaging, service, sales forecasting.
- 170 The marketing vice president therefore cannot possibly tell the experts in the marketing department what they should be doing, and how.
- 171 Yet they are supposed to be the marketing vice president’s “subordinates”—and the marketing vice president is definitely responsible for their performance and for their contribution to the company’s marketing efforts. ...
- 172 The same is true for the hospital administrator or the hospital’s medical director in respect to the trained knowledge workers in the clinical laboratory or in physical therapy. ...
- 173 To be sure, these associates are “subordinates” in that they depend on the “boss” when it comes to being hired or fired, promoted, appraised and so on.
- 174 But in his or her own job the superior can perform only if these so-called subordinates take responsibility for *educating* him or her, that is, for making the “superior” understand what market research or physical therapy can do and should be doing, and what “results” are in their respective areas.
- 175 In turn, these “subordinates” depend on the superior for direction.

- 176 They depend on the superior to tell them what the “score” is. ...
- 177 Their relationship, in other words, is far more like that between the conductor of an orchestra and the instrumentalist than it is like the traditional superior/subordinate relationship.
- 178 The superior in an organization employing knowledge workers cannot, as a rule, do the work of the supposed subordinate any more than the conductor of an orchestra can play the tuba.
- 179 In turn, the knowledge worker is dependent on the superior to give direction and, above all, to define what the “score” is for the entire organization, that is, what are its standards and values, performance and results.
- 180 And just as an orchestra can sabotage even the ablest conductor and certainly even the most autocratic one—a knowledge organization can easily sabotage even the ablest, let alone the most autocratic, superior. ...
- 181 Altogether, an increasing number of people who are full-time employees have to be managed as if they were *volunteers*.
- 182 They are paid, to be sure.
- 183 But knowledge workers have mobility.
- 184 They can leave.
- 185 They own their “means of production,” which is their knowledge. ...
- 186 We have known for fifty years that money alone does not motivate to perform.

- 187 Dissatisfaction with money grossly demotivates.
- 188 Satisfaction with money is, however, mainly a “hygiene factor,” as Frederick Herzberg called it all of forty years ago in his 1959 book *The Motivation to Work*.
- 189 What motivates—and especially what motivates knowledge workers—is what motivates volunteers.
- 190 Volunteers, we know, have to get *more* satisfaction from their work than paid employees, precisely because they do not get a paycheck.
- 191 They need, above all, challenge.
- 192 They need to know the organization’s mission and to believe in it.
- 193 They need continual training.
- 194 They need to see results. ...
- 195 Implicit in this is that different groups in the work population have to be managed differently, and that the same group in the work population has to be managed differently at different times.
- 196 Increasingly “employees” have to be managed as “partners”—and it is the definition of a partnership that all partners are equal.
- 197 It is also the definition of a partnership that partners cannot be ordered.
- 198 They have to be persuaded.
- 199 Increasingly, therefore, the management of people is a “marketing job.”
- 200 And in marketing one does not begin with the question, What do *we* want?
- 201 One begins with the questions, What does the other party want?

- 202 What are its values?
- 203 What are its goals?
- 204 What does it consider results?
- 205 And this is neither "Theory X" nor "Theory Y," nor any other specific theory of *managing* people. ...
- 206 Maybe we will have to redefine the task altogether.
- 207 It may not be "managing the work of people."
- 208 The starting point both in theory and in practice may have to be "managing for performance." ...
- 209 The starting point may be a definition of results—just as the starting points of both the orchestra conductor and the football coach are the score. ...
- 210 The productivity of the knowledge worker is likely to become the center of the management of people, just as the work on the productivity of the manual worker became the center of managing people a hundred years ago, that is, since Frederick W. Taylor.
- 211 This will require, above all, very different assumptions about people in organizations and their work:
- 212 **One does not "manage" people.**
- 213 **The task is to lead people.**
- 214 **And the goal is to make productive the specific strengths and knowledge of each individual.**

## 215 ***Technologies and End Uses Are Fixed and Given***

- 216 Four major assumptions, as stated above, have been underlying the **practice** of management all along—in fact for much longer than there has been a **discipline** of management. ...
- 217 The assumptions about technology and end uses to a very large extent underlie the rise of modern business and of the modern economy altogether.
- 218 They go back to the very early days of the Industrial Revolution. ...
- 219 When the textile industry first developed out of what had been cottage industries, it was assumed—and with complete validity—that the textile industry had its own unique technology.
- 220 The same was true in respect to coal mining, and of any of the other industries that arose in the late eighteenth century and the first half of the nineteenth century.
- 221 The first one to understand this and to base a major enterprise on it was also one of the first men to develop what we would today call a modern business, the German Werner Siemens (1816-1892).
- 222 It led him in 1869 to hire the first university-trained scientist to start a modern research lab—devoted exclusively to what we would now call electronics, and based on a clear understanding that electronics (in those days called “low-voltage”) was distinct and separate from all other industries, and had its distinct and separate technology. ...

- 223 Out of this insight grew not only Siemens's own company with its own research lab, but also the German chemical industry, which assumed worldwide leadership because it based itself on the assumption that chemistry—and especially organic chemistry—had its own unique technology.
- 224 Out of it then grew all the other major companies the world over, whether the American electrical and chemical companies, the automobile companies, the telephone companies, and so on.
- 225 Out of this insight then grew what may well be the most successful invention of the nineteenth century, the research laboratory—the last one almost a century after Siemens's, the 1950 lab of IBM—and at around the same time the research labs of the major pharmaceutical companies as they emerged as a worldwide industry after World War II. ...
- 226 By now this assumption has become untenable.
- 227 The best example is of course the pharmaceutical industry, which increasingly has come to depend on technologies that are fundamentally different from the technologies on which the pharmaceutical research lab is based: genetics, for instance, microbiology, molecular biology, medical electronics, and so on. ...
- 228 In the nineteenth century and throughout the first half of the twentieth century, it could be taken for granted that technologies outside one's own industry had no, or at least only minimal, impact on the industry.
- 229 Now the assumption to start with is that the technologies that are likely to have the greatest impact on a company and an industry are technologies outside its own field. ...

- 230 The original assumption was of course that one's own research lab would and could produce everything the company—or the company's industry—needed.
- 231 And in turn the assumption was that everything that this research lab produced would be used in and by the industry that it served. ...
- 232 This, for instance, was the clear foundation of what was probably the most successful of all the great research labs of the last hundred years, the Bell Labs of the American telephone system.
- 233 Founded in the early 1920s, the Bell Labs until the late 1960s did indeed produce practically every new knowledge and every new technology the telephone industry needed.
- 234 And in turn practically everything the Bell Labs scientists produced found its main use in the telephone system.
- 235 This changed drastically with what was probably the Bell Labs' greatest scientific achievement: the transistor.
- 236 The telephone company itself did become a heavy user of the transistor.
- 237 But the main uses of the transistor were outside the telephone system.
- 238 This was so unexpected that the Bell Telephone Company, when the transistor was first developed, virtually gave it away—it did not see enough use for it within the telephone system.
- 239 But it also did not see any use for it outside it.
- 240 And so what was the most revolutionary development that came out of the Bell Labs—and certainly the most valuable one—was sold freely to all corners for the paltry sum of twenty-five thousand dollars.

- 241 It is on this total failure of the Bell Labs to understand the significance of its own achievement that practically all modern electronics companies outside of the telephone are based. ...
- 242 Conversely, the things that have revolutionized the telephone system—such as digital switching or the fiberglass cable—did not come out of the Bell Labs.
- 243 They came out of technologies that were foreign to telephone technology.
- 244 And this has been typical altogether of the last thirty to fifty years—and it is increasingly becoming more typical of every industry. ...
- 245 Today's technologies, unlike those of the nineteenth century, no longer run in parallel lines.
- 246 They constantly crisscross.
- 247 Constantly, something in a technology of which people in a given industry have barely heard (just as the people in the pharmaceutical industry had never heard of genetics, let alone of medical electronics) revolutionizes an industry and its technology.
- 248 Constantly, such outside technologies force an industry to learn, to acquire, to adapt, to change its very mind-set, let alone its technical knowledge. ...
- 249 Equally important to the rise of nineteenth- and early twentieth-century industry and companies was a second assumption: End uses are fixed and given.
- 250 For a certain end use, for example, to put beer into containers, there may have been extreme competition between various suppliers of containers.

- 251 But all of them, until recently, were glass companies, and there was only one way of putting beer into containers, a glass bottle. ...
- 252 This was accepted as obvious not only by business, industry, and the consumer, but by governments as well.
- 253 The American regulation of business rests on the assumptions that to every industry pertains a unique technology and that to every end use pertains a specific and unique product or service.
- 254 These are the assumptions on which antitrust legislation was based.
- 255 And to this day antitrust advocates concern themselves with the domination of the market in glass bottles and pay little attention to the fact that beer increasingly is not put into glass bottles but into cans (or, vice versa, they concern themselves exclusively with the concentration of supply in respect to metal containers for beer, paying no attention to the fact that beer is still being put into glass bottles, but also increasingly into plastic cans). ...
- 256 But since World War II, end uses are not uniquely tied anymore to a certain product or service.
- 257 The plastics of course were the first major exception to the rule.
- 258 But by now it is clear that it is not just one material moving in on what was considered the "turf" of another one.
- 259 Increasingly, the same want is being satisfied by very different means.
- 260 It is the *want* that is unique, and not the means to satisfy it.  
...

- 261 As late as the beginning of World War II, news was basically the monopoly of the newspaper—an eighteenth-century invention that saw its biggest growth in the early years of the twentieth century.
- 262 By now there are several competing ways to deliver news: still the printed newspaper; increasingly, the same newspaper delivered online through the Internet; radio; television; separate news organizations that use only electronics—as is increasingly the case with economic and business news—and quite a few additional ones. ...
- 263 And then there is the new “basic resource” information.
- 264 It differs radically from all other commodities in that it does not stand under the scarcity theorem.
- 265 On the contrary, it stands under an abundance theorem.
- 266 If I sell a thing—for example, a book—I no longer have the book.
- 267 If I impart information, I still have it.
- 268 And in fact, information becomes more valuable the more people have it.
- 269 What this means for economics is well beyond the scope of this book—though it is clear that it will force us radically to revise basic economic theory.
- 270 But it also means a good deal for management.
- 271 Increasingly basic assumptions will have to be changed.
- 272 Information does not pertain to any industry or to any business.
- 273 Information also does not have any one end use, nor does any end use require a particular kind of information or depend on one particular kind of information. ...

- 274 Management therefore now has to start out with the assumption that there is no one technology that pertains to any industry and that, on the contrary, all technologies are capable—and indeed likely—to be of major importance to any industry and to have impact on any industry.
- 275 Management similarly has to start with the assumption that there is no one given end use for any product or service and that, conversely, no end use is going to be linked to any one product or service. ...
- 276 Some implications of this are that increasingly the noncustomers of an enterprise—whether a business, a university, a church, a hospital—are as important as the customers, if not more important. ...
- 277 Even the biggest enterprise (other than a government monopoly) has many more noncustomers than it has customers.
- 278 There are very few institutions that supply as large a percentage of a market as 30 percent.
- 279 There are therefore few institutions where the noncustomers do not amount to at least 70 percent of the potential market.
- 280 And yet very few institutions know anything about the noncustomers—very few of them even know that they exist, let alone know who they are.
- 281 And even fewer know why they are not customers.
- 282 Yet it is with the noncustomers that changes always start. ...
- 283 Another critical implication is that the starting point for management can no longer be its own product or service, and not even its known market and its known end uses for its products and services.

- 284 The starting point has to be what *customers consider value*.
- 285 The starting point has to be the assumption—an assumption amply proven by all our experience—that the customer never buys what the supplier sells.
- 286 What is value to the customer is always something quite different from what is value or quality to the supplier.
- 287 This applies as much to a business as to a university or to a hospital. ...

288 **Management, in other words, will increasingly have to be based on the assumption that neither technology nor end use is a foundation for management policy; They are limitations.**

289 ***The foundations have to be customer values and customer decisions on the distribution of their disposable income.***

290 ***It is with those that management policy and management strategy increasingly will have to start.***

## 291 ***Management's Scope Is Legally Defined***

292 Management, both in theory and in practice, deals with the legal entity, the individual enterprise—whether the business corporation, the hospital, the university, and so on.

293 The scope of management is thus *legally* defined.

294 This has been—and still is—the almost universal assumption. ...

295 One reason for this assumption is the traditional concept of management as being based on command and control.

- 296 Command and control are indeed legally defined.
- 297 The chief executive of a business, the bishop of a diocese, the administrator of a hospital, have no command and control authority beyond the legal confines of their institution. ...
- 298 Almost a hundred years ago, it first became clear that the legal definition was not adequate to manage a major enterprise. ...
- 299 The Japanese are usually credited with the invention of the "keiretsu," the management concept in which the suppliers to an enterprise are tied together with their main customer, for example, Toyota, for planning, product development, cost control, and so on.
- 300 But actually the keiretsu is much older and an American invention.
- 301 It goes back to around 1910 and to the man who first saw the potential of the automobile to become a major industry, William C. Durant (1861-1947).
- 302 It was Durant who created General Motors by buying up small but successful automobile manufacturers such as Buick and merging them into one big automobile company.
- 303 A few years later Durant then realized that he needed to bring the main suppliers into his corporation.
- 304 He began to buy up and merge into General Motors one parts and accessories maker after the other, finishing in 1920 by buying Fisher Body, the country's largest manufacturer of automobile bodies.
- 305 With this purchase General Motors had come to own the manufacturers of 70 percent of everything that went into its automobiles—and had become by far the world's most integrated large business.

- 306 It was this prototype keiretsu that gave General Motors the decisive advantage, both in cost and in speed, which made it within a few short years both the world's largest and the world's most profitable manufacturing company, and the unchallenged leader in an exceedingly competitive American automobile market.
- 307 In fact, for some thirty-odd years, General Motors enjoyed a 30 percent cost advantage over all its competitors, including Ford and Chrysler. ...
- 308 But the Durant keiretsu was still based on the belief that management means command and control—this was the reason that Durant *bought* all the companies that became part of General Motors's keiretsu.
- 309 And this eventually became the greatest weakness of GM.
- 310 Durant had carefully planned to ensure the competitiveness of the GM-owned accessory suppliers.
- 311 Each of them (except Fisher Body) had to sell 50 percent of its output outside of GM, that is, to competing automobile manufacturers, and thus had to maintain competitive costs and competitive quality.
- 312 But after World War II the competing automobile manufacturers disappeared—and with them the check on the competitiveness of GM's wholly owned accessory divisions.
- 313 Also, with the unionization of the automobile industry in 1936-1937, the high labor costs of automobile assembly plants were imposed on General Motors's accessory divisions, which put them at a cost disadvantage that to this day they have not been able to overcome.
- 314 That Durant based his keiretsu on the assumption that management means command and control largely explains, in other words, the decline of General Motors in the last twenty-five years and the company's inability to turn itself around. ...

- 315 This was clearly realized in the 1920s and 1930s by the builder of the next keiretsu, Sears, Roebuck.
- 316 As Sears became America's largest retailer, especially of appliances and hardware, it too realized the necessity of bringing together into one group its main suppliers so as to make possible joint planning, joint product development and product design, and cost control across the entire economic chain.
- 317 But instead of buying these suppliers, Sears bought small minority stakes in them—more as a token of its commitment than as an investment—and based the relationship otherwise on contract.
- 318 And the next keiretsu builder—and probably the most successful one so far (even more successful than the Japanese)—was Marks & Spencer in England, which, beginning in the early 1930s, integrated practically all its suppliers into its own management system, but exclusively through contracts rather than through ownership stakes or ownership control. ...
- 319 It is the Marks & Spencer model that the Japanese, quite consciously, copied in the 1960s. ...
- 320 In every case, beginning with General Motors, the keiretsu—that is, the integration into one management system of enterprises that are linked economically rather than controlled legally has given a cost advantage of at least 25 percent and more often 30 percent.
- 321 In every case, it has given dominance in the industry and in the marketplace. ...
- 322 And yet the keiretsu is not enough.
- 323 It is still based on power.

- 324 Whether it is General Motors and the small, independent accessory companies that Durant bought between 1915 and 1920; or Sears, Roebuck; or Marks & Spencer; or Toyota—the central company has overwhelming economic power.
- 325 The keiretsu is not based on a partnership of equals.
- 326 It is based on the dependence of the suppliers. ...
- 327 Increasingly, however, the economic chain brings together genuine *partners*, that is, institutions in which there is equality of power and genuine independence.
- 328 This is true of the partnership between a pharmaceutical company and the biology faculty of a major research university.
- 329 It is true of the joint ventures through which American industry got into Japan after World War II.
- 330 It is true of the partnerships today between chemical and pharmaceutical companies and companies in genetics, molecular biology, or medical electronics. ...
- 331 These companies in the new technologies may be quite small—and very often are—and badly in need of capital.
- 332 But they own independent technology.
- 333 Therefore *they* are the senior partners when it comes to technology.
- 334 They, rather than the much bigger pharmaceutical or chemical company, have a choice of with whom to ally themselves.
- 335 The same is largely true in information technology, and also in finance.
- 336 And then neither the traditional keiretsu nor command and control work. ...

337 What is needed, therefore, is a redefinition of the scope of management.

338 *Management has to encompass the entire process.*

339 For business this means by and large the economic process. ...

340 **The new assumption on which management, both as a discipline and as a practice, will increasingly have to base itself is that the scope of management is not legal. ...**

341 ***It has to be operational.***

342 ***It has to embrace the entire process.***

343 ***It has to be focused on results and performance across the entire economic chain.***

## 344 ***Management's Scope Is Politically Defined***

345 It is still generally assumed in the discipline of management—and very largely still taken for granted in the practice of management that the domestic economy, as defined by national boundaries, is the ecology of enterprise and management—and of nonbusinesses as much as of businesses. ...

346 This assumption underlies the traditional "multinational." ...

347 As is well known, before World War I, as large a share of the world's production of manufactured goods and of financial services was multinational as it is now.

348 The 1913 leading company in any industry, whether in manufacturing or in finance, derived as large a share of its sales from selling outside its own country as it did by selling inside its own country.

349 But insofar as it produced outside its own national boundaries, it produced within the national boundaries of another country. ...

350 One example: ...

351 The largest supplier of war materiel to the Italian Army during World War I was a young but rapidly growing company called Fiat in Turin—it made all the automobiles and trucks for the Italian army.

352 The largest supplier of war materiel to the Austro-Hungarian army in World War I was also a company called Fiat-in Vienna.

353 It supplied all the automobiles and trucks to the Austro-Hungarian army.

354 It was two to three times the size of its parent company.

355 For AustriaHungary was a much larger market than Italy, partly because it had a much larger population, and partly because it was more highly developed, especially in its western parts.

356 Fiat-Austria was wholly owned by Fiat-Italy.

357 But except for the designs that came from Italy, Fiat-Austria was a separate company.

358 Everything it used was made or bought in Austria.

359 All products were sold in Austria.

360 And every employee up to and including the CEO was an Austrian.

- 361 When World War I came, and Austria and Italy became enemies, all the Austrians had to do, therefore, was to change the bank account of Fiat-Austria-it kept on working as it had all along. ...
- 362 Even traditional industries like the automotive industry or insurance are no longer organized that way. ...
- 363 Post-World War II industries such as the pharmaceutical industry, or the information industries, are increasingly not even organized in "domestic" and "international" units as GM and Allianz still are.
- 364 They are run as a worldwide system in which individual tasks, whether research, design, engineering, development, testing and increasingly manufacturing and marketing, are each organized "transnationally." ...
- 365 One large pharmaceutical company has seven labs in seven different countries, each focusing on one major area (e. g., antibiotics) but all run as one "research department" and all reporting to the same research director in headquarters.
- 366 The same company has manufacturing plants in eleven countries, each highly specialized and producing one or two major product groups for worldwide distribution and sale.
- 367 It has one medical director who decides in which of five or six countries a new drug is to be tested.
- 368 But managing the company's foreign exchange exposure is totally centralized in one location for the entire system. ...
- 369 In the traditional multinational, economic reality and political reality were congruent.

370 The country was the “business unit,” to use today’s term.

371 In today’s transnational—but increasingly, also, in the old multinationals as they are being forced to transform themselves—the country is only a “cost center.”

372 It is a complication rather than the unit for organization and the unit of business, of strategy, of production, and so on. ...

373 Management and national boundaries are no longer congruent.

374 The scope of management can no longer be politically defined.

375 National boundaries will continue to be important. ...

376 But the new assumption has to be: ...

377 **National boundaries are important primarily as restraints.**

378 **The practice of management—and by no means for businesses only—will increasingly have to be defined operationally rather than politically.**

379 ***The Inside Is Management’s Domain***

380 All the traditional assumptions led to one conclusion: *The inside of the organization is the domain of management.* ...

381 This assumption explains the otherwise totally incomprehensible distinction between management and entrepreneurship. ...

- 382 In actual practice this distinction makes no sense whatever.
- 383 An enterprise, whether a business or any other institution, that does not innovate and does not engage in entrepreneurship will not survive long. ...
- 384 It should have been obvious from the beginning that management and entrepreneurship are only two different dimensions of the same task.
- 385 An entrepreneur who does not learn how to manage will not last long.
- 386 A management that does not learn to innovate will not last long.
- 387 In fact, business—and every other organization today—has to be designed for change as the norm and to create change rather than react to it. ...
- 388 But entrepreneurial activities start with the outside and are focused on the outside.
- 389 They therefore do not fit within the traditional assumptions of management's domain—which explains why they have come so commonly to be regarded as different, if not incompatible.
- 390 Any organization, however, that actually believes that management and entrepreneurship are different, let alone incompatible, will soon find itself out of business. ...
- 391 The inward focus of management has been greatly aggravated in the last decades by the rise of information technology.
- 392 Information technology so far may actually have done more damage to management than it has helped. ...

- 393 The traditional assumption that the inside of the organization is the domain of management means that management is assumed to concern itself with *efforts*, if not with *costs* only.
- 394 For effort is the only thing that exists within an organization.
- 395 And, similarly, everything inside an organization is a cost center. ...
- 396 **But results of any institution exist only on the outside. ...**
- 397 It is understandable that management began as a concern for the inside of the organization.
- 398 When the large organizations first arose—with the business enterprise, around 1870, the first and by far the most visible one—managing the inside was the new challenge.
- 399 Nobody had ever done it before.
- 400 But while the assumption that management's domain is the inside of the organization originally made sense—or at least can be explained—its continuation makes no sense whatever.
- 401 It is a contradiction of the very function and nature of organization. ...
- 402 Management must focus on the results and performance of the organization.
- 403 Indeed, the first task of management is to define what *results* and *performance* are in a given organization—and this, as anyone who has worked on it can testify, is in itself one of the most difficult, one of the most controversial, but also one of the most important tasks.

- 404 It is therefore the specific function of management to organize the resources of the organization *for results outside the organization.* ...
- 405 The new assumption—and the basis for the new paradigm on which management, both as a discipline and as a practice, has to be based—is therefore: ...
- 406 **Management exists for the sake of the institution's results.**
- 407 **It has to start with the intended results and has to organize the resources of the institution to attain these results.**
- 408 **It is the organ to make the institution, whether business, church, university, hospital, or a battered women's shelter, capable of producing results outside of itself.**
- 409 This chapter has not tried to give answers—intentionally so.
- 410 It has tried to raise questions.
- 411 But underlying all of these is one insight.
- 412 The center of a modern society, economy, and community is not technology.
- 413 It is not information.
- 414 It is not productivity.
- 415 *It is the managed institution as the organ of society to produce results.*
- 416 And management is the specific tool, the specific function, the specific instrument to make institutions capable of producing results.

417 This, however, requires a **final** new management paradigm.

418 Management's concern and management's responsibility are everything that affects the performance of the institution and its results—whether inside or outside, whether under the institution's control or totally beyond it.