The Business Realities

• The dimensions of the economic task
  
  There are three different dimensions to the economic task
  
  The present business must be made effective.
  
  The present business's potential must be identified and realized.
  
  It must be made into a different business for a different future.

  Each task requires a distinct approach.
  Each task asks different questions.
  Each comes out with different conclusions.

  Yet they are inseparable.
  All three have to be done at the same time: today
  All three have to be carried out…
    with the same organization
    with the same resources
      men
      knowledge
      money
    and in the same entrepreneurial process
The future is not going to be made tomorrow
It is being made today
    and largely by the decisions and actions
taken with respect to the tasks of today.
What is being done to bring about the future
directly affects the present.
The tasks overlap.
They require one unified strategy.
Otherwise, they cannot really get done at all.

To tackle any one of these dimensions,
    let alone all three together,
requires an understanding of the true realities
    of the business as an economic system
    of its capacity for economic performance and
    of the relationship between available resources and
possible results

Otherwise, there is no alternative to the "rat race"

This understanding never comes ready made
It has to be developed separately for each business.
Yet the assumptions and expectations that underlie it
are largely common.
    Businesses are different
    but business is much the same regardless of
    size and structure
    products
    technology
    markets
    culture and managerial competence.

There is a common business reality
There are actually
two sets of generalizations
that apply to most businesses
most of the time.
Together they lead to
a number of conclusions
regarding the nature and direction
of the entrepreneurial job.

The generalizations regarding results and resources
• Results and Resources exist outside the business.
  There are no profit centers within the business;
  there are only cost centers.
The only thing
one can say with certainty
about any business activity
is that it consumes effort and
thereby incurs cost.

Results depend
not on anybody within the business
nor on anything within the control of the business.
They depend on the customer
who decides
whether the efforts of a business become
economic results or
whether they become so much waste and scrap.

The same is true
of the one and only distinct resource
of any business: knowledge.
Other resources,
money or physical equipment, for instance,
do not confer any distinction.
What does make a business distinct and
what is its peculiar resource
is its ability to use knowledge of all kinds—
scientific, technical, social, economic, and
managerial.
It is only in respect to knowledge
that a business can be distinct,
can therefore produce something
that has value in the market place.
Yet knowledge is not a business resource.
It is a universal social resource.
It cannot be kept secret
for any length of time.

Business can be defined as
a process
that converts an outside resource,
namely knowledge,
into outside results,
namely economic values.

• Results are obtained by exploiting opportunities,
  not by solving problems.

Resources, to produce results,
must be allocated to opportunities
rather than to problems.

One cannot shrug off all problems,
but they can and should be minimized.

The "maximization of opportunities"
is a meaningful, indeed a precise,
definition of the entrepreneurial job.
It implies that effectiveness
rather than efficiency
is essential in business.

The pertinent question
is not how to do things right
but how to find
the right things to do,
and to concentrate
resources and efforts on them.

▼ Economic results are earned only by leadership, not by mere competence.

• Leadership and profits
  Profits are the rewards
  for making a unique, or
  at least distinct, contribution
  in a meaningful area;
  and what is meaningful
  is decided by market and customer.

  Profit can only be earned
  by providing something
  the market accepts as value
  and is willing to pay for as such.
  And value always implies
  the differentiation of leadership.

• Leadership and market standing
  This does not mean
  that a business
  has to be the giant
  of its industry
  nor that it has to be first
  in every single
  product line,
market, or
technology
in which it is engaged.

To be big
is not identical with leadership.
In many industries
the largest company
is by no means
the most profitable one,
since it has to
carry product lines,
supply markets, or
apply technologies
where it cannot do a distinct,
let alone a unique job.

The second spot, or
even the third spot
is often preferable,
for it may make possible
that concentration
on one segment of the market,
on one class of customer,
on one application of the technology,
in which genuine leadership often lies.

In fact, the belief of so many companies
that they could—or should—have leadership
in everything within their market or industry
is a major obstacle to achieving it.

• To have leadership
But a company which wants
economic results
has to have leadership
in something of real value
to a customer or market.

It may be in
one narrow but important aspect of the
product line,
its service,
its distribution or
its ability to convert ideas into salable
products on the market
speedily and
at low cost.

• On being marginal
  Unless it has such a leadership position,
a business, a product, a service,
becomes marginal.
It may seem to be a leader,
may supply a large share of the market,
may have the full weight of
momentum, history, and tradition behind it.
But the marginal is incapable of survival
in the long run, let alone of producing profits.
It lives on borrowed time.
It exists on sufferance and through the inertia
of others.
Sooner or later,
whenever boom conditions abate,
it will be squeezed out.

▼The implications for business strategy.
  • Playing catch up with a competitor.
  • Defensive research trying to slow down obsolescence

• Any leadership position is transitory and likely to be
short-lived.
No business is ever secure
in its leadership position.
The market in which the results exist,
and the knowledge which is the resource
are both generally accessible.
No leadership position is more than
a temporary advantage.

In business
energy always tends toward diffusión.
Business tends to
drift from leadership to mediocrity.
And the mediocre is
three quarters down the road to being marginal.
Results always drift from
earning a profit
toward earning, at best, a fee
which is all competence is worth.

It is the executive's job
to reverse the normal drift.
It is his job to
-focus the business on opportunity and
-away from problems,
-re-create leadership and
counteract the trend toward mediocrity,
-replace inertia and its momentum
-by new energy and new direction.

▼The generalizations regarding efforts within the
business and their cost.
▼What exists is getting old.
• Executive spend most of their time on the
problems of yesterday.
• Trying to unmake the past.

What exists today is of necessity the product of yesterday.

The business itself—
  its present resources,
  its efforts and their allocation,
  its organization as well as
  its products,
  its markets and
  its customers—
express necessarily decisions and actions taken in the past.

Its people, in the great majority,
grew up in the business of yesterday.
Their attitudes, expectations, and values
were formed at an earlier time;
they tend to apply the lessons of the past
to the present.

Indeed, every business regards what happened
in the past
as normal,
with a strong inclination
to reject as abnormal
whatever does not fit the pattern.

No matter how
  wise,
  forward-looking, or
  courageous
the decisions and actions were
when first made,
they will have been overtaken by events
by the time they become normal behavior and the routine of a business.

No matter how appropriate the attitudes were when formed, by the time their holders have moved into senior, policy-making positions, the world that made them no longer exists.

Any human decision or action starts to get old the moment it has been made.

It is always futile to restore "normality". "Normality" is only the reality of yesterday.

• The job
  Is not to impose yesterday's normal on a changed today;

  but to change the business, its behavior, its attitudes, its expectations—as well as its products, its markets, and its distributive channels—to fit the new realities.

▼What exists is likely to be misallocated.
▼Business enterprise is not a phenomenon of
nature but one of society.

In social situations
events are not distributed
according to the "normal distribution"
of a natural universe.

In a social situation
a very small number of events
at one extreme—the first 10 per cent or 20 per
cent at most—
account for 90 per cent of all results.

- Products
- Orders
- Customers
- Markets
- People

The other 85-90% of the phenomena produce
nothing but costs.

- Relationship between Result and Events

![Graph showing the relationship between Events and Results]

The implications

- Results and costs stand in inverse relationship
to each other.

While 90 per cent of the results
are being produced by the first 10 per cent
of events,
90 percent of the costs are incurred by the remaining and resultless 90 per cent of events.

Economic results are directly proportionate to revenue while costs are directly proportionate to the number of transactions. Except for purchased materials and parts

- The inverse relationship between results & costs

▼Resources and efforts will normally allocate themselves to ...

  90 percent of the events that produce practically no results.

They will allocate themselves to the number of events rather than to results.

▼Highly trained people will tend to misallocate themselves the worst.
  - Pride in doing the difficult.

▼Examples
  ▼Technical Service Group
    - Work on
    - While ignoring
Salesmen
• Work on
• While ignoring
• Research departments, design staffs, market development efforts
• Advertising effort

The way in which these efforts tend to be allocated
• by transactions rather than by results
• by what is difficult rather than by what is productive
• by yesterday’s problems rather than by today’s and tomorrow’s opportunities.

Revenue money and cost money are rarely the same money stream.
Most businessmen see in the mind’s eye—and most accounting presentations assume—that the revenue stream feeds back into the cost stream which then, in turn, feeds back into the revenue stream. But the loop is not a closed one.

Revenues obviously produce the wherewithal for the costs. But unless management constantly works at directing efforts into revenue-producing activities, the costs will tend to allocate themselves by drifting into nothing-producing activities, into sheer busyness.

The need for constant reappraisal and
There is a need for constant reappraisal and redirection and the need is greatest where it is least expected: in making the present business effective. It is the present in which a business first has to perform with effectiveness.

It is the present where both the keenest analysis and the greatest energy are required.

Yet it is dangerously tempting to keep on patching yesterday’s garment rather than working on designing tomorrow’s pattern.

• The need for real understanding and an overall view

A piecemeal approach will not suffice. To have real understanding of the business, the executive must be able to see it in its entirety. Its resources and efforts as a whole, their allocation to products and services markets, customers, end-uses distributive channels Which efforts go into problems and
which onto opportunities. The executive must be able to weigh alternatives of direction and allocation.

Partial analysis is likely to misinform and misdirect. Only the over-all view of the entire business as an economic system can give real knowledge.

Concentration is the key to economic results. The concentration requirements

- Concentration on result areas
  Economic results require that managers concentrate their effort on the smallest number of products, product lines, services, customers, markets, end-uses that will produce the largest amount of revenue.

Managers must minimize the amount of attention devoted to products which produce primarily cost because, for instance, their volume is too small or too splintered.

- Concentration of staff efforts
  Economic results require that staff efforts be concentrated
on the few activities
that are capable of producing significant business results.

• Concentration of cost control efforts
  Effective cost control requires
  a similar concentration of work and effort
  on those few areas where
  improvement in cost performance
  will have significant impact on business performance and results—
  that is, on areas where
  a relatively minor increase in efficiency
  will produce a major increase in economic effectiveness.

• Concentration of human resources
  Human resources must be concentrated on a few major opportunities.

• We need "deadening standardization" and "planned obsolescence"

▼The Market Realities part of Results and Resources exist outside the business.

• Only the customer "knows"
  What business people think they know about the customer and market
  is more likely to be wrong than right.

  There is only one person
  who really knows: the customer.
Only
   by asking the customer,
   by watching him,
   by trying to understand his behavior
can one find out
   who he is,
   what he does,
   how he buys what he buys,
   what he expects,
   what he values,
   and so on.

• The customer buys satisfaction not a product.
   Nobody can make or supply
   satisfactions as such—
   at best, only the means
   to attaining them can be sold and delivered.

• Competition is rarely adequately defined.
   Competition is really
   the alternative means
   of obtaining the same satisfaction.

• Quality is defined by the consumer
   not by the difficulty or expense of the producer.
   The customer wants to know:
   What does this do for me?

• The customer's rationality is defined by
   the customer's situation
   not the producer's.
   The customer makes the most
   of its economic conditions.

• Customers don't see or care about the company.
   The market is a harsh employer
   who will dismiss
even the most faithful servant
without a penny of severance pay.

• **The customer is the one who determines the buying decision.**
  Ultimate buyer.
  Distribution channel.
  What if no identifiable customer can be found for a business or an industry?
  Then the starting point is markets and end-uses.

• **Needs change in the act of being satisfied.**
  (not part of the original list).

▼**The Knowledge Realities (part of Results and Resources exist outside the business)**
  Knowledge is the business fully as much as the customer is the business.

  Physical goods and services are only the vehicle for the exchange of customer purchasing-power against business knowledge.

  Business is a human organization, made or broken by the quality of its people. Labor might one day be done by machines to the point where it is fully automated. But knowledge is a
specifically human resource.
It is not found in books.
Books contain information.

Whereas knowledge is the ability
to apply information
to specific work and performance
through
use of the brain and
skill of the hands.

- **For business success it must be meaningful to customers.**
  Knowledge must first be meaningful to customers
  in terms of satisfaction and value.

  Knowledge per se is useless;
it is only effective through
the contribution it makes
outside of the business—
to customers, markets, and end-uses.

- **For business success it must be excellent.**
  To be able to do something
  as well as others
  is not enough either.

  It does not give the leadership position
  without which a business is doomed.

  Only excellence earns a profit;
  the only genuine profit is that of the innovator.

- **For business success it must be different.**
  Economic results
  are the results
  of differentiation.
The source of this specific differentiation, and with it of business survival and growth, is a specific, distinct knowledge possessed by a group of people in the business.

- **The distinction between knowledge and technology**
  Technology—that is, the application of the physical sciences to work—is one form of knowledge. In no business is it the only necessary knowledge. There are many successful businesses in highly technological fields that do not excel in technology. They have to be technologically competent, of course. But their specific strength lies elsewhere.

▼ **Five fundamentals**
- A valid definition sounds simple.
  A valid definition of the specific knowledge of a business sounds simple—deceptively so.

  One always excels at doing something one considers so obvious that everybody else must be able to do it too.

- It takes practice to do a knowledge analysis well. The first analysis may come up with embarrassing generalities.

  Or the other extreme, one may come up with
a twenty four volume encyclopedia of the physical sciences.

No one can excel at universal knowledge—
one probably cannot even do moderately well at universal information.

• Knowledge is a perishable commodity. It has to be reaffirmed, relearned, and repracticed. One has to work constantly at regaining one's excellence.

   How can one work at maintaining one's excellence unless one knows what it is?

• Every knowledge becomes the wrong knowledge. It becomes obsolete. What else do we need? Or do we need something different?

• Requires concentration

   No company can excel in many knowledge areas. A business may be able to excel in more that one area. A successful business has to be at least competent in a good many knowledge areas in addition to being excellent in one. And many businesses have to achieve beyond the ordinary in more than one area.
But to have real knowledge
of the kind for which the market
offers economic rewards
requires concentration
on doing a few things superbly well.

• **Knowledge has to progress to remain knowledge.**
  Knowledge is like a world record in athletics.
  For years it stands, apparently immovable.
  Then one sprinter runs the mile
  a little faster
  and suddenly other athletes repeat the feat
  and have acquired a new dimension of performance.

▼ **The Future**

▼ **We know only two things about the future:**
  • It cannot be known.
  • It will be different from what exists now and from what
    we now expect.

• **The Implications**
  Any attempt
to base today’s actions and commitments
on predictions of future events
is futile.
The best we can hope to do
is to anticipate future effects
of events which have already
irrevocably happened.

Precisely because the future
is going to be different and
cannot be predicted,
it is possible to
make the unexpected and unpredicted come to pass.

• **On Risk**
  
  To try to make the future happen is risky;
  but it is a rational activity.
  And it is less risky than
  coasting along on the comfortable assumption that nothing is going to change,
  less risky than following a prediction as to what "must" happen or what is "most probable".

• **The one thing that man can try**
  
  is to find, and occasionally to create,
  the right risk and to exploit uncertainty.

  The purpose of the work on making the future is not to decide what should be done tomorrow, but what should be done today to have a tomorrow.
The Effective Executive by Peter Drucker

\begin{itemize}
  \item The executive's time belongs to everyone else.
  \item Executives are forced to keep "operating"
    unless they take positive action
    to change the reality
    in which they live.
    Unless he changes it by deliberate action,
    the flow of events
    will determine
    what he is concerned with
    and what he does.
    The flow of events
\end{itemize}
are not the real problem
nor even the symptoms of the real problem.
Need criteria
which enable him to work on
the truly important (contribution and results).
The criteria are not found in the flow of events.

- **Executives are effective only if and when...**
  other people make use of what he contributes.
Usually the people
who are most important
to the effectiveness of an executive
are not people
over whom he has direct control.

▼**The executive is within an organization**
and therefore removed from
the only reality that matters—the outside.

- The organization.
  Is an abstraction.
  Mathematically, it would have to be
  represented as a point—
  that is, as having neither
  size nor extension.

Even the largest organization
is unreal
compared to the
reality of the environment
in which it exists.

Specifically, there are no results
within the organization.
All the results are on the outside.
The only business results,
for instance, are produced by
a customer
who converts the costs and efforts
of the business
into revenues and profits
through his willingness
to exchange his purchasing power
for the products or services
of the business.
The decision maker is
outside rather than inside the business.

What happens inside any organization
is effort and cost.
The less an organization has to do
to produce results,
the better it does its job.
That it takes 100,000 employees
to produce the automobiles or the steel
the market wants
is essentially gross engineering imperfection.

• The environment
  which is the true reality
  is well beyond effective control
  from the inside.
  At the most
  results are codetermined,
  as for instance in warfare,
  where the outcome is the result
  of the actions and decisions
  of both armies.
  In business, there can be attempts
to mold the customer's
preferences and values
through promotion and advertising.

• The danger of inside focus
  But it is the inside of the organization
  that is most visible to the executive.  
  It is the inside
  that has immediacy for him.  
  Its relations and contact,
  its problems and challenges,
  its crosscurrents and gossip
  reach him and touch him at every point.

  Unless he makes special efforts
  to gain direct access
  to outside reality,
  he will become increasingly inside-focused.
  The higher up in the organization
  he goes, the more will his attention
  be drawn to problems and challenges
  of the inside
  rather than events on the inside.

• The truly important events
  on the outside
  are not the trends.
  They are changes in the trends.
  These determine ultimately
  success or failure
  of an organization and its efforts.
  Such changes, however, have to be
  perceived:
  they cannot be counted, defined, or classified.

Ted Levitt : Marketing
▼ Requisites of competitive success
Purpose of a business is to create & keep a customer.

- To Do that you have to
  - Produce & deliver goods & services that people want & value
  - at prices & under conditions that are reasonably attractive relative to competition
  - To a proportion of customers large enough to make those prices & conditions possible.

- To Continue to do that the enterprise must
  - Produce revenues in excess of costs to attract & hold investors in the enterprise
    - in sufficient quantity
    - with sufficient regularity
  - Stay abreast and sometimes ahead of competitive offerings.

This Requires

- Clarity of
  - Purposes
  - Strategies
  - Plans
- In large organizations:
  - Written down
  - Clearly communicated
  - Frequently reviewed by senior members of the enterprise.
- Appropriate system of rewards, audits, and controls,
  - To assure that what's intended gets done & rectified when not.

This also requires knowing what attracts and drives customers