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THE DRUCKER CENTENNIAL

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"The Next book Peter Drucker would have written:
Federalism and Management as a Liberal Art"
based on the article
by
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Drucker's Next Book: Federalism and Management as a Liberal Art

- Drucker believed in humanity's capacity to manage complex organizations for betterment of individuals and society <u>but</u> never lost sight of darker forces of human nature—esp. greed and lust for power

- Organizations should be structured to counteract, minimize, or redirect these forces

- Apply Principles of Political Federalism to Corporate Federalism within larger management framework of "Management as a Liberal Art" to construct a society of organizations that function at reasonable level. Propose:
  - sound leadership principles
  - small decentralized units to create transparency
  - rules of behavior for and checks and balances on individual and organizational behavior
  - appropriate performance measures and controls &
  - effective organization of top management and the board

Drucker's Next Book: Federalism and Management as a Liberal Art

Drucker's View of Human Nature & Impact on Organizations

- Drucker's readers <u>often miss more pessimistic</u> side of Drucker's views
  - He did not discuss his complex philosophical framework in every book—leading Kanter and others to charge Drucker as <u>overly optimistic</u> about what is possible in management of society's institutions
    - by presenting utopian view of human nature and organization practice
    - by not considering the "frailty that interferes with the implementation of ideal practice"
  - readers often unaware of other books— *End of Economic Man* (1939) which analyses rise of evils of totalitarianism or *Post-Capitalist Society* (1993) which analyzes failures of modern government ("nanny state") creating the "Pork-Barrel State"

Drucker's Next Book: Federalism and Management as a Liberal Art

Drucker's View of Human Nature and Federalism

- Organizations in all sectors need re-structuring to counteract menacing forces of human nature—especially greed and lust for power

- Federalism—complex, not entirely coherent, view of role of centralized power and nature of individual rights

- Drucker applied many principles of Federalism & Constitutionalism to managing Democratic pluralistic institutions to counteract darker forces of human nature
  - involves organizing distribution of power to minimize abuses
  - but he did not believe Federalism provided total relief from abuse of power & corruption

- Analyzing Drucker's work in terms of his Concepts of Federalism and Constitutionalism refutes critique of Drucker as a naïve utopian

Federalism and the Effective Organization of Power in Organizations

"The only thing that works [to counter evil in society's organizations]-admittedly only with indifferent success-is the other great tradition of Western political thought, the one that also goes back to Plato (or at least to Aristotle) and is known as "Constitutionalism" -limiting power by power, making sure that the units of power are kept small (for example, through decentralization), containing the danger of megalomania and of the lust for power through countervailing forces (for example, through a strong board of directors or through a three-person top management team), and, above all, through making objectives and performance the touchstones rather than personality and 'charisma.'"

Peter F. Drucker, "You on Me," *New Management*, winter 1985, pp. 31-32

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<u>Influence of Federalist Papers on Drucker's Management Ideas</u>

- Five topics in *The Federalist Papers* directly informed Drucker's management ideas
  - legitimacy of power
  - need for virtue in leadership
  - nature of sovereignty
  - danger of unchecked majority power—suspicion of human nature
  - separation of powers

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Legitimacy of Leadership—legitimate power

- Aims of legitimate leadership include fulfilling group needs for status and function—e.g., Plant Community idea for knowledge workers including technologists & service workers—managerial attitude & responsibility

- Legitimate Leadership serves property rights of shareholders, knowledge workers, pension funds and society

- Requires virtue: integrity is the essence, strength of character, leadership as responsibility, sacrifice and service to the mission

  - Drucker assumed very essence of management to be integrity in leadership

  - also insisted on safeguards to abuses of power, found in federalism and constitutionalism

  - combined closer to a pragmatic solution

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<u>Constitutionalism—balance power with power—competing centers</u>

- James Madison—Federalist Papers—argued for stabilizing benefits of diversity among states
  - preventing "tyranny of the majority"

  - Drucker argued for diversity of interest groups to serve society well—separation of powers

- New Pluralism as challenge to government power—private, social and governmental sectors with specific functions
  - Problem—special interest lobbies impede missions

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Constitutionalism—balance power with power—competing centers

- Government control of business
  - Anti-trust, regulation, stiff penalties including imprisonment
  - Evidence supports positive change to internal controls from Sarbanes-Oxley Section 404 requirements

- Business primary challenge to governmental power—Re-privatization—attempt to shrink government—outsourcing government services to social and business sector
  - Problem—clash of economic sovereignty with political sovereignty in global economy

  - Problem—business and government closely linked through procurement—subsidies—joint projects—promotion of trade
    - "too big to fail"—result: consolidation of power of banks

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<u>Federal Decentralization—keep units small for transparency</u>

- Convert organizational units away from power based to result-and-responsibility based—three principles:
- <u>Principle of Subsidiarity</u>—any function that can be performed by a lower entity should be—power and authority is *assumed to belong at the lowest possible level* of an organization at which it can be carried out—reverse empowerment
- <u>Principle of Interdependence</u> —no reason for decentralized units to be a part of a federation unless federation contributes to decentralized units
- <u>Coordinated Controls and Corporate Governance</u>
- Handy— "'monitoring and governance'" of a business seeks to serve as the equivalent of the *separation of powers* in democratic governments."

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Federal Decentralization at General Motors—early case

- General Motors
    - an "essay in federalism—on the whole, an exceedingly successful one"
    - "attempts to combine the greatest corporate unity with the greatest divisional autonomy and responsibility;
    - and like every true federation, it aims at realizing unity through local self-government and vice versa [responsibility]."

- Sloan designed a federal organization structure– "decentralized operations with coordinated control"

- Conflicting principles of independence of divisions and interdependence of federation

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<u>Federal Decentralization at General Motors (cont.)</u>

- Reduce potential negative effects of factions within divisions:
  - through central monitoring, and

  - factual basis for calculating performance—cost accounting methods for measuring *efficiency* and marketing methods for calculating market share and measuring *effectiveness*

  - "*To give autonomy, one must have confidence.* And this requires controls that make opinions unnecessary. To manage by objectives, one must know whether goals are being reached or not, and this requires clear and reliable measurements."

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<u>Managerial Controls for Decentralized Units—make judgments of performance fairly accurate</u>

- factual basis for calculating performance—cost accounting methods for measuring *efficiency*

- marketing methods for calculating market share and measuring *effectiveness* and

- by Management by Objectives & Self-Control

  - clear objectives & appropriate performance measures allow top management to independently evaluate performance of *persuasive personalities* and *charismatic leaders*–dealing with potential negative effects of charisma

Federalism and the Effective Organization of Power in Organizations

Management by Objectives and Self Control

- Drucker developed MBO as a philosophy of management as integral part of GE's reorganization from <u>departments</u> to <u>federally decentralized units</u>*

- Management by objectives (MBO) coupled with self-control—overall managerial philosophy proposed by Drucker for resolving tension between individual freedom and the authority—especially between executives of central units and divisions

- in knowledge society, MBO with self-control is the best solution we have to advance individual freedom in organizations

*Drucker— "I didn't invent the term 'Management by Objectives'; actually Alfred Sloan used it in the 1950s. But, I put it in a central position, whereas to him it was just a side show." Tarrant, *The Man Who Invented the Corporate Society*, 1976, p. 77.

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Management by Objectives and the H-P Way

- Bill Packard, one of the two founders of Hewlett-Packard, on MBO:

- "No operating policy has contributed more to Hewlett-Packard's success … MBO … is the antithesis of management by control. The latter refers to a tightly controlled system of management of the military type … Management by objectives, on the other hand, refers to a system in which overall objectives are clearly stated and agreed upon, and which gives people the flexibility to work toward those goals in ways they determine best for their own areas of responsibility." *

*The *Economist*, web only, October 21, 2009, http://www.economist.com/businessfinance/management/displaystory.cfm?story_id=14299761, accessed October 27, 2009.

Federalism and the Effective Organization of Power in Organizations

Organization of Top Management—distribute work and provide checks and balances

- turnover of CEO's of 2,500 largest global companies set a record in 2005
- rate of failure suggests unworkable job— "widow maker"
- hints as to direction restructuring of CEO psition
  - three person top-management team –allow each member of team to provide candid advice, and checks and balances on CEO
  - provide visibility of team to Board of Directors & provide checks and balances on conduct of CEO
    - essential to the principles of corporate federalism and constitutionalism

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<u>Organize the work of the board for effectiveness</u>

- Needed—Board of Director's to assume fiduciary responsibility, organize work and perform their duties effectively
- position of a Board Member in US also unworkable—needs restructuring

- Recommendations for work of the board:
  - set the agenda for the board so as to focus on the *areas critical to the success of the corporation*
  - *have appropriate information flows to board to permit board to set agenda and organize their work*
  - assess *performance of top management* and *individual board members*
  - *set compensation levels* reflecting responsibilities and performance against the responsibilities of top management

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Work of the Board (cont.)

- designate subcommittee of the board for succession issues
- establish culture of integrity extending to compliance
- actively participate in formulation of major strategies--monitor effectiveness of management's implementation
- ensure financial statements accurately reflect economics of business
- identify critical success drivers—review status of drivers—identify present & potential risk factors facing corporation
- provide justification for incentives and compensation levels

Federalism and the Effective Organization of Power in Organizations

Federalism in Networks and Alliances

- alliances and networks—an extreme form of decentralized corporate federalism—requires high levels of responsibility
- central authority very weak–burden of managing these organizations is placed upon *a system of leaders* from various units of organization on inter-organizational team

Requirements for Managing the System Structure

- clear vision shared by all members
- vision converted to concrete objectives
- strong interpersonal relationships—strong interpersonal relationships substitutes for formal authority—each *member assumes responsibility for success of the project*

Federalism and the Effective Organization of Power in Organizations

- <u>Summary—the Role of Federalism in Drucker's Work</u>
- Drucker's teachings are pragmatic for a diverse society of institutions & seek a model for a tolerable society of <u>diverse organizations</u>
  - considers both the *nature of man* and *organizational realities*
  - like Federalists he struggled to find blueprint for organizations to curb worst tendencies in humankind while liberating potential of people for good
  - extended idea of federalism to curtail power within industrial organizations focus on results of decentralized units within corporation & society would
  - believed separation of powers and moderate abuses of power and authority
- Framers sidestepped conflicts between state & federal government—creating ambiguity & Drucker recognized similar conflict between decentralized units and central administration—ambiguity by design