The Essential Drucker
The Information Executives Need Today
Focus on Contribution
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Summary

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### 1 Chapter 7 The Information Executives Need Today

At the beginning when data-processing tools were emerged thirty to forty years ago, most of the businessmen over or underrated the importance of dataprocessing and information in an organization.

Some of them thought that computer generated business models could run most of the business but today we know that this was just an illusion and does not work at all. So the greatest contribution of data-processing capacity has not been to management but to operations e.g the software that architects use to solve structural problems in buildings.

Furthermore Peter Druckers says that concepts and tools, as history us tells, are mutually interdependent and interactive. So this means that they belong together and one changes the other. Peter Durcker says that with those tools we can see businesses differently:

- Generators of resources, that is, as the organizations that convert costs into yields.
- Links in an economic chain, which managers need to understand as a whole in order to manage their costs.
- Society’s organs for the creation of wealth.
- Both creators and creatures of a material environment, which is the area outside the organization in which opportunities and results lie but in which the threats to the success and survival of very business also originate.

Chapter 7 deals with this tools that executives require to generate the information they need and it also deals with the concepts underlying those tools.
1.1 From Cost Accounting to Yield Control

In the first section of this chapter P. Drucker describes the differences between the old traditional cost accounting and the activity based costing and why activity based costing gives much better cost control, and increasingly, also better result control. Let us start with the traditional one, the cost accounting. It was first developed by General Motors seventy years ago. It postulates the manufacturing costs are the sum of individual operations and nothing more. It only measures what it costs, to do something. Furthermore it says that the operations have to be done and where it is being done now. Activity based costing is more flexible and represents both a different concept, especially for manufactures and different ways of measuring. This means it takes care of the cost of the total process. Not only of the manufacturing costs also of those things that happen before and after finishing a product, for examples lots of organization also provide a customer service or make the installation of their product on their own. It also records the cost of not doing, this could be the time when machines are turned off. Activity–based–costing integrates:

- Value analysis
- Process analysis
- Quality management
- Costing

It also shows us that cost accounting has made wrong assumptions for service companies and therefore this concept has not worked for them. Those companies could not start with cost accounting of individual operations, because there is only one cost that of the total system. Furthermore P. Drucker says that you cannot make a distinction between fixed and variable costs because this does not make sense in services. If companies want to keep their customers in all kinds of business they have think about costing in services! But this is not the whole truth. So lets come to another point that is very important for companies and for their survival in the global market.

1.2 From Legal Fiction to Economic Reality

To compete successfully in a global market, a company has to know the costs of the whole economic chain and has to incorporate with other members of the chain to manage costs and maximize yield. Companies are therefore beginning to shift from costing only what goes inside their own organizations to costing the entire economic process, in which even the biggest company is just one link. P. Drucker mentions in this chapter a company, Toyota, that is in his mind the best-publicized example of a company that knows and manages the costs of its suppliers and distributors. Through this network, Toyota manages the total cost of making, distributing, and servicing its cars as one cost stream, putting work where it costs the least and yields the most. Another concepts which is used by more and more companies is the price-led-costing. The traditional cost-led-pricing, where companies started with costs and added a profit margin on top, is substituted in which the prize the customers is willing to pay determines the allowable costs. But, companies can only practice price-led costing if they
know and manage the entire cost of the economic chain and this is still painful for most businesses. Doing so requires a compatible accounting system at companies along the entire chain and this also means that the companies have to share information across them. And how should this work if it does yet not really work well within the same company.

1.3 Information for Wealth Creation

Enterprise are paid to create wealth, not to control costs. But that obvious fact is not reflected in traditional measurements. Businesses have to managed as going concern, that is, for wealth creation To do that requires information that enables executives to make informed judgements. It requires four sets of diagnostic tools:

1. foundation information
2. productivity information
3. competence information
4. information about the allocation of scarce resources

The oldest and most widely used set of diagnostic management tools are cash-flow and liquidity projections and such standard measurements as the ration between dealers’ inventories and sales of new cars; the earnings coverage for the interest payments on a bond issue; and the ratio among receivables outstanding more than six months, total receivables, and sales. This measurements indicate a problem that needs to be treated when they are abnormal. Those measurements might be called foundation information.

The second set of tools for business diagnoses deals with the productivity of key resources. The oldest of them measures the productivity of manual labor. Now slowly developing measurements for the productivity of knowledge-based and service work. But we need data, not only of service workers etc, instead for the total-factor productivity.

EVA - Economic Value-added Analysis - is based on something what we generally call profits. Until a business returns a profit that is greater than its cost of capital, it operates at a loss. By measuring the valued added over all costs, including the cost of capital, EVA measures, in effect, the productivity of all factors of production. It does not by itself, tell us why a certain product or service does not add value or what to do about it. EVA should also be used to determine what works. It does show which product, service, operation, or activity has unusually high productivity.

The most recent of tools used to obtain productivity information is benchmarking - compare one’s performance with the best performance in the industry or business. Together, EVA and benchmarking provide the diagnostic tools to measure total-factor productivity and to manage it.

A third set of tools deals with competences. Ever since C.K. Prahalad and Gary Hamel’s path breaking article "The Core Competence of the Corporation" (Harvard Business Review, May-June 1990), we have known that leadership rests on being able to do something others cannot do at all of find it difficult to do even poorly. It rests on core competencies that meld market or customer value with a special ability of the producer or supplier.

But how does one identify both the core competencies one has already and those the business needs in order to take and maintain leadership position? How does one find out whether one’s core competence is improving or weakening? Or whether it is still the right
core competence and what changes it might need?
To measure and manage core competencies, you first have to keep careful track of one’s own and one’s competitors’ performance, looking especially for unexpected successes and for unexpected poor performance in areas where one should have done well. The success demonstrate what the market values and will pay for. The non-success should be viewed as the first indication either that the market is changing or that the company’s competencies are weakening.
Core Competencies are different for every organization; they are so to speak, part of an organization’s personality. But every organization - not just business - needs one core competence: innovation. And every needs a way to record and appraise its innovative performance. First you have to careful record the innovations in the entire field during a given period and then raise questions analyzing the innovative performance of the entire field.
The last area in which diagnostic information is needed to manage the current business for wealth creation is the allocation of scarce resources:

- capital
- performing people

Those two convert into action whatever information management has about its business. They determine whether the enterprise will do well or poorly. Today practically every business has a capital-appropriations process, but few use it correctly. Companies typically measure their proposed capital appropriations by only one or two of the following four yardsticks:

1. ROI - Return on Investment
2. payback period
3. CF - Cash Flow
4. discounted present value

To understand a proposed investment, a company needs to look at all four.
Most serious, however, is that most capital-appropriations processes do not even ask for two vital pieces of information:

- What will happen if the proposed investment fails to produce as promised as do three out of every five? Would it seriously hurt the company, or would it be just a flea bite?
- If the investment is successful - and especially if it is more successful than we expect - what will it commit us to?

Capital, however, is only one key resource of the organization, and it is by no means the scarcest one. The scarcest resource in any organization are performing people. Since WWII, the U.S. military - and so far no one else - has learned to test its placement decisions. It now thinks through what it expects of senior officers before it puts them into key commands. It then appraises their performance against these expectations. In business, by contrast, placement with specific expectations as to what the appointee should achieve
and systematic appraisal of the outcome are virtually unknown. In the effort to create wealth, managers need to allocate human resources as purposefully and as thoughtfully as they do capital.

1.4 Where the Results are

The four kinds of information tell us only about the current business. They inform and direct tactics. For strategy, we need organized information about the environment. Strategy has to be based on information about markets, customers, non-customers; about technology in one’s own industry and others; about worldwide finance; and about the changing world economy. For that is where the results are. Inside an organization, there are only cost centers. The only profit center is a customer whose check has not bounced.

Major changes also start outside an organization. A retailer may know a great deal about the people who shop at its stores. But no matter how successful it is, no retailer ever has more than a small fraction of the market at its customers; the great majority are non-customers. It is always with non-customers that basic changes begin and become significant.

At least half the important new technologies that have transformed an industry the past fifty years came outside the industry itself. For example commercial paper, which has revolutionized finance in the USA, did not originate with the banks.

Not all the information about the outside is available, to be sure. A serious cause of business failure is the common assumption that conditions - taxes, social legislation, market preferences, distribution channels, etc. must be what we think they are or at least what we think they should be. A few multinationals have been working hard on building a system to gather outside information. But in general, the majority of enterprises have yet to start the job.

Even big companies, in large part, will have to hire outsiders to help them. To think through what business needs requires somebody who knows and understand the highly specialized information field. Most of the information of what enterprises need to know about the environment is obtainable from outside sources - data banks and services, business journals etc..

Another reason why there is need for outside help is that the information has to be organized so as to question and challenge a company’s strategy. What we need are services that make specific suggestions about how to use the information, ask specific questions regarding the user’s business and practices, and perhaps provide interactive consultation. That is the radically different view of the meaning of and purpose of information: as measurement on which to base further action rather than as a postmortem and a record for what already happened. The command-and-control organization that first emerged in the 1870s might be compared to an organism held together by its shell. The corporation that is now emerging is being designed around a skeleton: information, both the corporation’s new integrating system and its articulation.

Our traditional mind set - even if we use sophisticated mathematical techniques and impenetrable social jargon - has always somehow perceived business as buying cheap and selling dear. The new approach defines a business as a organization that adds value and creates wealth.
2 Chapter 14 Focus on contribution

2.1 Focus on Contribution

The effective person focuses on contribution. He asks himself, what can I personally contribute to improve the performance of the whole company. The focus on contribution is the key to effectiveness: in one’s own work (its content, standard.. ) in one’s relation with others and in the use of the tools of the executive. A lot of people focus downwards they worry about their own position in the company and how much authority they should have.

The man who focuses on efforts and who stresses his downward authority is a subordinate no matter how exalted his title and rank. But the man who focuses on contribution and who takes responsibility for results, no matter how junior, is in the most literal sense of the phrase, ”top management.” He holds himself accountable for the performance of the whole.

2.2 Own Commitment

If a person focuses on contribution his attention will turn away from his own speciality and his own department toward the performance of the whole ( company ). He thinks through what effect his work his skills and his department have on the performance of the company.

He will come to think in the terms of a customer, who is the ultimate reason why a company exists. As a result what he does and how he does it will be totally different to what he would do if he would focus on efforts or not be focused on contribution.

2.3 The Knowledge worker

Contribution may mean different things. Every organisation needs performance in three major areas: direct results, building of values and their reaffirmation, and building and developing peo- ple for tomorrow. If a company or organization fails in one of those areas it will decay and die. Therefore all three of them have to built in into the contribution of a knowledge worker. The importance of each of those three areas varies with the position of the worker as well as with the needs of the organization.

2.3.1 direct results

The direct results are directly visible and always come first. If there is confusion what the direct results should be there will be no results at all.

2.3.2 building of values

The organization needs to build values and reaffirm them. There has something this organization stands for. Ina business the value commitment may to be the technically leader or something like that. But like direct results value commitments are not unambiguous.
2.3.3 building people for tomorrow

An organization which is not able to perpetuate itself has failed. Therefore the people who will run the organization tomorrow have to be build up today. An organization should steadily upgrade its human resources. The next generation should take the high standards of their predecessors as a baseline and establish own, even higher standards.

Focus on contribution by itself is a powerful force in developing people. People adjust to the level of the demands made on them. One who sets his sights on contribution raises the sights and standards of everyone with whom he works. The most common cause of failure is inability or unwillingness to change with the demands of a new position. The knowledge worker who keeps on doing what he has done successfully before he moved is almost bound to fail.

2.4 contribution of knowledge

or the knowledge worker to focus on contribution is very important Knowledge workers do not produce anything real. A knowledge worker is usually a specialist. In fact he can only be effective if he has learned to do one thing very well, if he has specialized. His output has to be put together with the output of other specialists before he can produce results. To be effective as a specialist he must think through who is to use his output and what the user needs to know and to understand to be able to use his specialist output.

The knowledge worker is responsible that his work is understood by others. Effective knowledge workers know this.

2.5 The Right Human Relations

The only valid definition of good human relations are productive relationships. Warm feelings and pleasant words are meaningless, if there is no achievement in what is, after all, a workfocused and taskfocused relationship.

The four basic requirements of effective human relations are:

- Communications
- Teamwork
- Self-development
- Development of others

2.6 Communications

After 20 years of improvement of communications we are beginning to understand why this massive communications effort cannot produce results. We have been working at communications downward from management to the employees, from the superior to the subordinate. But communications are practically impossible if they are based on the downward relationship.

But knowledge workers who take responsibility for contribution in their own work will as a rule demand that their subordinates take responsibility, too. They will tend to ask their subordinates: What are the contributions for which this organization and I, your
superior, should hold you accountable? The objectives set by subordinates for themselves are almost never what the superior thought they should be. But any discrepancy between their conclusions and what their superior expected will stand out strongly. Who is right in such a difference is not as a rule important. For effective communication in meaningful terms has already been established.

2.7 Teamwork

The focus on contribution leads to communications sideways and thereby makes teamwork possible. The question, *Who has to use my output for it to become effective?* immediately shows up the importance of people who are not in line of authority, either upward or downward, from and to the individual executive. The effective work is actually done in and by teams of people of diverse knowledges and skills.

2.8 Self–development

Individual self–development in large measure depends on the focus on contributions. The man who asks of himself, What is the most important contribution I can make to the performance of this organization? asks in effect, What self–development do I need?

2.9 Development of others

The executive who focuses on contribution also stimulates others to develop themselves, whether they are subordinates, colleagues, or superiors. He sets standards that are not personal but grounded in the requirements of the task. People in general, and knowledge workers in particular, grow according to the demands they make on themselves.