

Management

Revised Edition

Peter F. Drucker
With Joseph A. Maciariello

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The Theory of the Business

Learning Objectives

After successfully completing this lesson, you will be able to explain:

- The assumption that support the theory of the business
- The four specifications required to build a theory of a business
- The warning signs

Contents

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1. Introduction

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

The root cause of nearly every one of these crises is not that things are being done poorly. It is not even that the wrong things are being done.

In most cases, the right things are being done—but fruitlessly.

2. Theory of the Business

What accounts for this apparent paradox? The assumptions on which the organization has been built and is being run no longer fit reality.

A theory of the business has three assumptions:

- The environment of the organization: society and its structure, the market, the customer, and technology
- The specific mission of the organization
- The core competencies needed to accomplish the organization's mission

The Three Assumptions

- The **environment** defines what an organization is paid for
- The **mission** defines what an organization considers to be meaningful results; in other words, they point to how it envisions itself making a difference in the economy and in the society at large
- The **core competencies** define where an organization must excel in order to maintain leadership

3. The Four Specifications

Specifications of a valid theory of the business:

1. The assumptions about environment, mission, and core competencies must fit reality
2. The assumptions in all three areas have to fit one another
3. The theory of the business must be known and understood throughout the organization
4. The theory of the business has to be tested constantly

4. Preventive Care

Eventually every theory of the business becomes obsolete and then invalid

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

The next reaction is an attempt to patch

When a theory shows the first signs of becoming obsolete, it is time to ask again which assumptions reflect reality most accurately—with the clear premise that our historically transmitted assumptions, those with which all of us grew up, no longer suffice

Two Preventive Measures

There are only two preventive measures. But, if used consistently, they should keep an organization alert and capable of rapidly changing itself and its theory

- The first measure is abandonment. If we were not in it already, would we be going into it now? Why didn't this work?
- The second preventive measure is to study what goes on outside the business, and especially to study *noncustomers* - An organization must be market driven too

5. The Warning Signs

A theory of the business always becomes obsolete when an organization

- *Attains its original objectives*
- *Rapid growth* is another sure sign of crisis in an organization's theory
- *Unexpected success*—whether one's own or a competitor's
- *Unexpected failure*—again, whether one's own or a competitor's

6. Decisive Action

CEOs who are able to transform their business:

- Start out with diagnosis and analysis
- They accept that attaining objectives and rapid growth demand a serious rethinking
- They do not dismiss unexpected failure as being the result of a subordinate's incompetence or as an accident but treat it as a symptom of "systems failure"

Decisive Action (cont.)

- They do not take credit for unexpected success but treat it as a challenge to their assumptions
- They accept that a theory's obsolescence is a degenerative and, indeed, life threatening disease. And they know it requires decisive action

Summary

A theory of the business has three parts:

- Assumptions about the environment of the organization. These define what the organization expects it can be paid for
- Assumptions about the specific mission of the organization. These define how the organization intends to make a difference in society and what results are meaningful
- Assumptions about the core competencies needed to accomplish the mission. These define in which areas the organization must excel in order to achieve its mission

Summary

- These three assumptions must fit one another and reality. The theory of the business must be understood throughout the organization.
- Every theory eventually becomes obsolete. Without systematic abandonment, an organization will squander its scarce resources on what it should not do and deprive itself of resources it needs to exploit opportunities.
- One of the most effective ways to test the validity of a theory is to study the behavior of noncustomers

