THE STRATEGIC DRUCKER

GROWTH STRATEGIES AND MARKETING INSIGHTS FROM THE WORKS OF PETER DRUCKER

ROBERT SWAIM

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Robert W. Swaim

Student, Colleague and Friend of Peter F. Drucker for 30 Years

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Working together to bring Drucker's teachings to China.
Claremont, California 2001

Robert W. Swaim & Peter F. Drucker

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Preface

Peter F. Drucker (1909–2005)

THE FATHER OF MODERN MANAGEMENT

Peter F. Drucker is known throughout the world as the *Father of Modern Management*, and countless articles have been written since he passed away in 2005, relative to his extensive contributions to management and society. I had the good fortune of knowing Peter first as a teacher, then as a colleague and also as a friend for almost 30 years. I also devoted nearly five years to working with Peter to develop the Drucker MBA and Drucker Executive Development Programs that are now offered in China. The programs I eventually developed and taught in many cities in China included nine fully US-accredited MBA courses that were based on the nearly 40 books and thousands of articles he had written on management and other related topics. The reader will therefore find a number of references to China in this book; however, the concepts presented will apply nearly everywhere.

In working together, we had numerous conversations in which he shared additional insight on a number of topics that he had previously not written about. Many of these pertained to his views on strategy and, in particular, on sales and marketing. I therefore feel uniquely qualified to share some additional insight relating to his work as well as to some of his omissions, or what I call "Drucker gaps". Also, we have to go beyond Drucker to implement a number of these concepts today.

The Strategic Drucker and Beyond

One of the Drucker MBA courses I developed was "*Strategy and the Purpose of a Business*" and was based on his views on strategy, marketing and other related topics that were contained in, sometimes sandwiched in, his numerous books and countless articles. Throughout Peter Drucker's many books he discussed the importance of strategy; however, he never devoted an entire book to the subject although he claimed, "I developed the first book on what is now called 'strategy,' *Managing for Results*, which appeared in 1964."[1] To this day, he is still not known to be a strategist like more notable contributors such as Michael Porter, known in particular for his "*Five Competitive Forces Model*" as described in his 1980 book *Competitive Strategy*[2] and Henry H. Mintzberg of McGill University in Montreal, who has written extensively on the subject.[3]

Richard Koch in his 1995 book, *The Financial Times Guide to Strategy*, commented, "Considering his long innings and large tally of books, and the appropriately high esteem in which he is held, it is salutary to reflect that Drucker actually says remarkably little about strategy. His main contribution is the idea of the *Theory of the Business*. The fit of this theory with the business environment—that is, the degree to which the firm's theory of the business strikes a market and economic chord—may be as important to the firm's success as the strength of its core competencies or its market position. Drucker did not exactly say this but he would have done, had he ever deigned to write a book on strategy."[4]

I would disagree with Koch's observations that Drucker's main contribution to strategy was his *Theory of the Business*, and furthermore this book suggests that there actually is no "theory" in the *Theory of the Business*. However, Drucker's views on the Purpose of a Business, the importance of Mission and Vision, his focus on the Customer, Non-customers and Going Outside (known today as the Voice of the Customer), and on what he considered to be the two most important functions of the organization, Marketing and Innovation, are far more significant contributions than the "theory." However, Koch is correct in suggesting that Drucker never wrote a book that was entirely devoted to strategy. On the other hand, contained in many of his 39 books and thousands of articles are *possibly* the critical ingredients for such a book. This book therefore attempts to consolidate many of Drucker's observations and writings on strategy and other topics related to business growth, such as sales, marketing, innovation, mergers and acquisitions, and strategic alliances into one source, just as I had to do when conducting the research for the development of the Drucker Strategy Course. Even then, the reader will find in a number of cases Drucker's views to be incomplete, leaving omissions or gaps that need to be filled. Also, to understand the application of a number of his concepts today, or if they are still valid, we must sometimes go beyond Drucker.

What Are Drucker Gaps?

Peter Drucker was very good at describing *what* should be done, often suggesting the right questions management should be asking itself (Drucker's Strategic Thinking), as will be seen in the chapter, "Strategy and the Purpose of a Business," but he often neglected to mention *how* to do it. I have therefore included my observations on a number of Drucker's concepts on strategy and related topics. Although I am not the first to identify these gaps, perhaps I am among the first to attempt to close them, at least in the area of strategy, with this book. As an example, William Clarkson, a former CEO of Graphic Controls, a subsidiary of Times-Mirror, in calling attention to the gap between academic theory and its practical application, wrote in 1985, "Yet a major gap exists between academia's theoretical and conceptual understanding of management and industry's ability to use this body of knowledge in a practical, relevant, and cost-effective way." In reference to Drucker, he added, "On one side of the gap, we have Drucker, the seer. On the other side of the gap, we have the US manager, knowing that the Management Bible (Drucker's 1973 classic book, *Management: Tasks, Responsibilities, Practices*) has been written by Drucker, but not quite knowing how to have this knowledge become a part of her or his behavior and practice. His writings have been read by more managers than those of any other single author, living or dead. Yet there is that troubling gap between his theory and the practice of US managers."[5]

This book therefore also includes *practical guidelines* on how some of these gaps can be closed and how a number of Drucker's concepts on strategy can be applied in one's own organization. This is largely accomplished by referencing and including the work of other contributors to strategy and the other disciplines Drucker commented on that are required to fully understand the application of his concepts. The reader will also find a number of application tools included in Appendix A.

A Focus on Growth

This book will focus on Drucker's views on strategies to achieve business growth, both organically through sales and marketing, and innovation; and then external growth through mergers, acquisitions, and strategic alliances. Drucker's Strategic Thinking Process will also be covered in detail, outlining the essential steps that must be taken in order to arrive at the appropriate strategies for growth. Chapter 2, "Strategy and the Purpose of a Business," will cover most of Drucker's views on strategy and marketing in a unique hypothetical setting: Your company has retained him to provide you with advice on how to compete more effectively in the global economy. The interview you and your management team will have with him and the topics discussed and the questions asked by him lay the foundation for the other chapters that follow. This chapter illustrates Drucker's Strategic Thinking Approach to strategy and illustrates the right questions that need to be asked—according to Drucker.

His views on the key roles that senior management and planners must play in the strategic planning process are also reviewed as well as the importance of executive decision making. Drucker's observations on changing demographics and global trends in society that offer opportunities for innovation and growth help to reinforce some of his views on marketing and marketing research.

Summary: Who Was Drucker?

Nearly 30 years ago, I asked Peter, "How would you classify yourself—as a Professor of Management?"

He replied, "No Bob, I am a social scientist."[6]

Some 20 years later, he apparently rebranded himself as a social ecologist in *The Daily Drucker* (2004): "I consider myself a 'social ecologist,' concerned with man's man-made environment the way the natural ecologist studies the biological environment. The term 'social ecology' is my own coinage."[7] In *The Daily Drucker* he also cited a reference to *The Age of Discontinuity*, a book he wrote in 1969 as the first time he wrote about social ecology"[8] Webster's

New World Dictionary defines "ecology" from a sociology perspective as, "*Sociology* the study of the relationship and adjustment of human groups to their geographic environment."[9] Drucker did not see himself as a visionary, but rather as an astute observer of society, hence his initial classification as a social scientist. He did not predict the future, but called attention to what was happening today that would impact the future. As an example, he was ahead of most in identifying the issues of declining birthrates, aging populations, and shrinking populations, particularly in the developed world—trends to assist us in identifying possible opportunities for innovation and growth.

My descriptions of Drucker gaps are not intended to be a criticism of his work, but merely to provide some additional tools for the implementation of many of his concepts and teachings. In other cases, where his concepts were incomplete, the contributions of others were included to close the loop. Drucker wrote in his 1986 book, *The Frontiers of Management*, "I have never slighted techniques in my teaching, writing, and consulting. Techniques are tools; without tools, there is no 'practice,' only preaching."[10] I have taken the position that although this might have been the case, there were situations where more than tools were necessary to close some gaps—it was necessary to go beyond Drucker enlisting the contributions from experts (I have called them pundits) in various disciplines such as strategy, marketing and innovation.

Needless to say, it was a pleasure to have known and worked with Peter. Working with Peter on the China Programs was one of the highlights of my career.

Robert W. Swaim
Beijing, China

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Drucker on Managing Growth

THE NEED FOR BUSINESS GROWTH AND STRATEGY

Growth will continue to be a desirable and indeed a necessary business objective.[1]

Peter F. Drucker[*]

I start the journey of exploring Peter Drucker's views on strategy and strategic management with a discussion of growth. After all, what is the purpose of developing a strategy if it is not to provide the direction for the future growth of the firm? As Drucker stated in *Management* (1973), "Growth will continue to be a desirable and indeed a necessary business objective." He went on to add, "In a growing economy there is plenty of room. Industries that have passed their peak decline slowly and are being held up by the overall buoyancy of the economy. New industries can grow well and grow more by accident than by management. But when the economy as such does not grow, changes in the economy are bound to be abrupt and sharp. Then indeed a company or an industry that does not grow will decline. Then there is even more need for a strategy that enables a management to plan for growth and to manage growth."[2] Needless to say, the banking and mortgage industries need a strategy.

[*] All chapter opening quotes are from Peter Drucker unless noted otherwise.

In his discussions of the need for marketing, Drucker also spoke about what contributed to a growth company. The quotation below is just one aspect of what Drucker suggested needed to be asked of customers and non-customers. (Non-customers is a term he came up with to describe those who are not buying from your company.)

> *Management has to ask which of the customer's wants are not adequately satisfied by the products or services offered him today. The ability to ask this question and to answer it correctly usually makes the difference between a growth company and one that depends on the rising tide of the economy or of the industry. But whoever contents himself to rise with the tide will also fall with it.*[3]
>
> Peter F. Drucker*

The Falling Tide

As the first decade of the 21st century draws to a close, the US economy can be best described as having no growth, or only marginal growth, depending on whose numbers we are given, or as Drucker once commented on statistics, "Tell me what you want to prove and I will develop the numbers."[4] This lack of economic growth can be attributed to many factors including the credit crisis as a result of the greed and stupidity of those who ventured into the subprime mortgage market (as lenders, investors and customers)—compounded by the collapse of the housing market and the highest number of home loan foreclosures since the Great Depression; oil; the falling value of the dollar against most currencies; the huge national debt increasing every day with the cost of US military commitments in lraq and Afghanistan, and a volatile capital market witnessing triple digit swings in the stock markets depending on what day it is, to name but a few factors.

Despite the weak economy, the "Street" (the Wall Street analysts) is still ever critical of the companies that do not meet their growth expectations. Take as an example a report by Reuters (April 25, 2008) with the headline, "3M revenue growth disappoints, shares

* All quotes are from Peter F. Drucker unless noted otherwise.

fall." The article cited 3M's first-quarter growth increased 8.9 percent of which foreign currency translation accounted for 6.1 percent. According to Adam Fleck, a Morningstar analyst, "A lot of the growth of this quarter was from currency translation. That's positive for the company but not as positive as true organic growth."[5] The article went on to add that 3M's first-quarter net income was $988 million, or $1.38 per share, beating analysts' average forecast of $1.35 per share. Despite these results Reuters concluded that although "3M reported better-than-expected quarterly profit on Thursday, its shares fell amid investor concern that the weak dollar accounts for too much of the company's growth." 3M shares did fall 86 cents in that afternoon's trading to $79.95, down 17 percent from their 52-week high of $97.

In this article we see the typical short-term expectations of the "analysts." Although the company (3M) beat its first-quarter 2008 net income expectations of $1.35 per share with actual results of $1.38 per share, analysts were disappointed with the firm's "organic growth" of only 2.8 percent compared with 6.1 percent in currency translation, or a total of 8.9 percent. Can you place yourself in the 3M headquarters conference room the following Monday morning when the chairman states to all the executives present, "We beat the quarterly sales forecast by 2.8 percent and earnings per share expectations by 2 percent. What are we going to do in the second quarter?" Never mind discussing whether the strategy is appropriate for the current environment and asking some of Drucker's key questions, which we will review in the next chapter. Who is the competition here—the analysts?

Dimensions of Business Growth

The following is a brief description of the elements of a business that can contribute to growth. These include both Organic and External Growth Dimensions.

Organic Growth Dimension: An increase in sales revenues attributed to sales and marketing, including price increases, and innovative efforts of the firm in developing new products or services. This will be covered in Chapters 2 through 5.

External Growth Dimension: An increase in sales revenues as a result of mergers and acquisitions. Horizontal acquisitions include expanding geographically or acquiring new products to complement the firm's present product line. Backward vertical acquisitions involve acquiring a source of supply, while forward vertical acquisitions involve acquiring a part of the marketing channel to reduce sales and marketing expenses as well as get closer to the customer. Strategic alliances, both formal and informal, also provide opportunities for growth. Divestitures will show a temporary increase in revenues as a result of a business unit's sale but will also result in a decline of product sales of that business unit. M&A and alliances as a growth strategy will be covered in Chapter 6.

Other External Dimension: Currency Translations will result in a gain or loss in revenues depending on the exchange rate between local currencies the firm is charging for its products and the eventual exchange into US dollars.

Table 1.1 is a snapshot of 3M's 2007 SEC 10-K Report and the *Dimensions of Business Growth* as reported by the company. This is an excellent example of being able to quickly ascertain how the company is growing in each of these dimensions.

As can be seen in Table 1.2, a significant percentage of the firm's growth was attributed to currency translations as a result of a weaker dollar compared to the euro in the EU, the pound in the UK and the yen in Japan.

The reported *Dimensions of Business Growth* for the firm coupled with the criticism from the "analysts" forced George Buckley, the chairman and CEO of the firm to respond with the following statements at the firm's May 13, 2008 shareholder's meeting.

"The US is by far the largest single market for us. And so it's obvious that for 3M to meet its long-term growth aspirations, the US business has to grow faster. It's increasingly clear to all of us that driving growth in the United States will continue to be challenging in the near term."[6] To achieve this growth, Buckley commented that "3M will try harder to differentiate its products from competition, innovate more, and improve service to squeeze growth out of its US markets." The article went on to comment on 3M's international business that comprised 63 percent of its sales in 2007 and could be 70 percent by 2010. Also, of this, 30 percent, or $7 billion,

Table 1.1 3M Results of Operations

Net Sales	US	International	Worldwide
Net sales (US$ millions)	$8,987	$15,475	$24,462
% of worldwide sales	36.7%	63.3%	
Components of net sales change:			
Volume: organic	1.6%	7.4%	5.1%
Volume: acquisitions	3.1	2.1	2.4
Price	1.0	(1.1)	(0.2)
Local currency sales (including acquisitions)	5.7	8.4	7.3
Divestitures	(4.2)	(3.6)	(3.8)
Translation	–	5.2	3.2
Total sales change	1.5%	10.0%	6.7%

Source: 2007 SEC 10-K Report

Table 1.2 3M Dimensions of Business Growth

Dimensions of Growth	Component	Results	% Total Company
Organic Growth	Sales & Marketing	Increase Sales	5.1
		Price Increases	(0.2)
	Innovation	New Products & Services	
External Growth	Mergers & Acquisitions	Horizontal Acquisitions (expand geographically, product extensions)	2.4
		Vertical Acquisitions (backward—acquire source of supply; forward—acquire channel to become closer to customer)	
	Strategic Alliances	Formal Alliances (joint ventures, license & patent agreements)	
	Strategic Alliances	Informal Alliances (marketing & distribution agreements)	
	Divestitures	Loss of Unit's Sales	(3.8)
Other External	Currency Translation	Gain/Loss on Conversion of Local Currency to US dollars	3.2
Total Growth			6.7%

Source: Developed by Robert W. Swaim (2006) came from emerging markets where sales were growing at nearly 20 percent per year. The article added that, "3M shares fell 49 cents to $77.18 Tuesday."

As an added note, 3M was selected as an example in our discussion of growth since 63.3 percent of its total revenues were derived from outside the US, the firm reports its growth in accordance with the *Dimensions of Business Growth,* it is a Fortune 500 company, and also a component of the firms that comprise the Dow Jones Industrial Average. The chairman's comments in the last article on the need for differentiation and innovation tie directly into Drucker's views on the two most important functions of the organization, *marketing* and *innovation,* and will be covered in detail in this book.

Despite the chairman's positive outlook relative to the firm's future growth opportunities, apparently the "analysts" were not impressed, and the firm's shares price declined. The question here is—does 3M need a better investor relations manager or a better strategy? Drucker's and others' views on the important role the CEO plays in strategy and strategic planning is covered in more detail as well.

Drucker on Growth

Growth is the result of success.
A company grows because it is doing a good job.
Its products meet with increasing demand.[7]

In Drucker's earlier writings, his discussions on growth were directed more on the *size* of the organization and how it transitioned from the small entrepreneurial organization to the larger organization. This also included his views on the need to change the attitude and behavior of top-management people, including the structure of management and very often, to replace the owner-founder with professional management. A short discussion of organizational lifecycle theory is included in this book, since it presents a more comprehensive strategic approach and a less anecdotal approach than Drucker's to complement this important element of business strategy.

Growth is not automatic. It does not follow from success.[8]

Approximately 20 years later, Drucker changed his views on what contributed to growth and in particular, he no longer believed that success was a contributing factor. How to sort out these different views?

The Need for Growth Objectives

Drucker commented in *Management* (1973) that "It is not enough for a management to say, 'We want growth.' Management needs a rational growth policy."[9] He stressed that management needs to establish a rational growth policy with both *minimum* and *optimum* objectives. He also stressed that "growth in the context of a business is an economic rather than a physical term. Volume by itself is irrelevant." He added, "A business grows in economic performance and economic results. To want to be a "billion-dollar company" is not a rational growth objective. Growth objectives have to be economic objectives rather than volume objectives."[10] Unfortunately in *Management,* and what will be a recurring theme throughout this book, Drucker did not provide us with any insight on how to establish *optimum objectives*. He did, however go on to expand on this in *Managing in Turbulent Times* (1980) with a rule that "any growth which, within a short period of time, results in the overall increase in the total productivities [not defined] of the enterprise's resources is healthy growth."[11]

Drucker on the Need for Management

The normal cause of business growth is able and competent management.[12]

The above quote by Drucker, although made over 50 years ago in *The Practice of Management* (1954), is still directly applicable in today's environment and focuses more on success or business performance and results rather than size. Matthew Kirdahy writes in a *Forbes.com* article, "A snapshot of recent corporate history shows that CEOs have always been in danger of losing their jobs in a heartbeat. These days, it's proven that they are spending less time in the office because of an intense business environment and super-competitive global marketplace. It's the kind of job that doesn't appeal to everyone, despite the fantastic paycheck. As it stands, the average tenure is about six years; however, there are those who haven't even hit that short mark, whether it was their choice or not."[13] This short tenure as described by Kirdahy can largely be attributed to the often conflicting demands being placed on the CEO for short-term results in the form of quarterly earnings per share and the longer-term strategic direction of the business.

Porter on the Need for Leadership

Michael E. Porter is known as one of the major contributors on strategy and a number of his views, as well as those of others, are included in this book when it is felt we need to go "beyond Drucker" on a key point. Here, Porter speaks of the need for leadership, not management in terms of crafting the business's strategy.

> *In many companies, leadership had degenerated into orchestrating operational improvements and making deals.*[14]
>
> Michael E. Porter

Porter expanded on the above quote by stressing the need for executive leadership to define and communicate the business's strategy, identify which industry changes and customer needs the company will respond to, which target customers the company should serve, and so forth, as well as making choices of what the business will not do. The role of the CEO and others in strategic planning will be addressed in this book including the views of Drucker and other contributors such as Porter.

An Opposing View: "The Growth Trap"

In his *Harvard Business Review* article, "What Is Strategy?" (1996), Porter also took a somewhat different view on the importance of growth when he wrote, "Among all other influences, the desire to grow has perhaps the most perverse effect on strategy."[15] What did Porter mean by this and what kind of growth is desirable?

His more recent views on strategy describe the importance of strategic positioning, making trade-offs, and forging a fit among activities. He also differentiated between operational effectiveness and strategic positioning by stating, "Operational effectiveness means performing similar activities better than rivals perform them (obtaining efficiency and the use of such tools as: Best Practices, Total Quality Management, Zero Defects, and Six Sigma). In contrast, strategic positioning means performing different activities from rivals or performing similar activities in different ways." Porter commented that operational effectiveness cannot be used as a basis of competition over an extended period of time since competitors can quickly imitate management techniques, new technologies, input improvements to the company's value chain, and so forth.

Porter commented, "Competitive strategy is about being different and deliberately choosing a different set of activities to deliver a unique mix of value." This he considered to be the essence of strategy. According to Porter, "the essence of strategic positioning is to choose activities that are different from rivals." He then identified the sources of where the firm might choose to be different: *variety-based positioning* (based on the choice of product or service varieties and distinctive sets of activities, rather than customer segments); *needs-based positioning* (a more traditional approach of targeting a segment of customers with different needs), and *access-based positioning* (segmenting customers that are accessible in different ways—geography, customer scale—or of anything that requires a different set of activities to reach customers in the same way).[16]

With respect to strategic positioning, Porter also stressed that it requires trade-offs, that is, one cannot be all things to all people. Senior management/leadership, as previously noted, needs to make clear they are choosing to compete in one way and not another. Here he stated, "Trade-offs are essential to strategy. They create the need for choice and purposefully limit what a company offers." Porter also discussed the importance of "fit" or how activities relate to each other and considered it as a central component of competitive strategy. Drucker also spoke of the importance of "fit" in his discussion of "The Theory of the Business," although he places it in a different perspective than Porter, which will be covered in the next two chapters. Porter classified "fit" as first-order fit or *simple consistency* between each activity (function) and the overall strategy. Second-order fit is when *activities are reinforcing* with consistency in the firm's functions while third-order fit is classified as *optimizing of effort,* such as coordination and exchange of information across activities to eliminate redundancy and minimize wasted effort. Porter then went on to emphasize that fit among many activities is fundamental to both competitive advantage and the sustainability of that advantage. Here he also stressed that, "Strategic positions should have a horizon of a decade or more, not of a single planning cycle." This he attributed to fit among a company's activities, which also creates pressure to improve operational effectiveness thus contributing to continuity and sustainability. Drucker disagrees with this view in his discussion of "What will our business be?" since it is impacted by changes that take place in the organization's external environment requiring adjustments to the organization's strategy. This will be covered in the next two chapters.

Returning to the issue of growth, Porter described the "growth trap" as consisting of management's concern that trade-offs appear to constrain growth (serving one group of customers and excluding others) and places a real or imagined limit on revenue growth. As such, management is tempted to abandon the business's strategic position. Porter felt that "compromises and inconsistencies in the pursuit of growth will erode the competitive advantage a company had with its original varieties or target customers." He added that attempting to compete in several ways at once creates confusion and undermines the organizational focus. This will essentially result in decreasing profits with more revenue (growth) seen as the answer, often leading to more acquisitions. Positive growth on the other hand can be achieved by concentrating on deepening a strategic position rather than broadening and compromising it. Deepening according to Porter means making the company's activities more distinctive, strengthening fit, and communicating the strategy better to those customers who should value it. He went on to add that "a company can often grow faster—and far more profitably—by penetrating needs and varieties where it is distinctive than by slugging it out in potentially higher growth arenas in which the company lacks uniqueness."[17]

Rather than just offering theory, Porter provided some potential solutions to achieving growth, such as through globalization, that are consistent with strategy and open up large markets (such as China and India) for a focused a strategy. He contrasted this with companies seeking growth through broadening domestically. He did suggest, however, that seeking domestic growth within their industry, such as our example of 3M, can overcome some of the risks to strategy by creating stand-alone units, each with its own brand name and tailored activities.

At general management's core is strategy: defining a company's position, making trade-offs, and forging fit among activities.[18]

Michael E. Porter

Porter later attempted to reconcile this newer version of strategy as compared to his original "generic" strategies, which will be covered later in Chapter 3.

Chapter Summary

The focus of this chapter is on the need for growth that can be achieved through "organic growth" attributed to sales, marketing, and innovation, and "external growth" through mergers and acquisitions and strategic alliances. Another perspective on growth was also presented based on Michael Porter's views. His views on strategy were introduced early in the book to illustrate how other contributors build on Drucker's concepts and often go "beyond Drucker."

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