

PETER DRUCKER SETS US STRAIGHT

The 94-year-old guru says that most people are thinking all wrong about jobs, debt, globalization, and recession.

YOU CAN ALWAYS COUNT ON PETER Drucker to provide a new way of looking at things. After all, he is the man who first recognized that management is a discipline worthy of deep and formal study. Long before anyone else—in the early 1950s, no less—he predicted how computer technology would one day thoroughly transform business. In 1961 he presciently called attention to the rise of Japan as an industrial power, and two decades later he warned of its impending economic stagnation. And we can thank him for coining the concepts of “privatization,” “knowledge workers,” and “management by objective.”

At 94, Drucker is still full of insights that seem to elude others, and he is as opinionated as ever. His interests range from economics to psychology to philosophy to opera to Japanese art; his experiences include consulting with literally hundreds of companies, governments, small businesses, churches, universities,

hospitals, arts organizations, and charities. To this day, leaders of all stripes make the pilgrimage to California to learn from the master, who continues to lecture at the management school that bears his name at Claremont Graduate University.

Drucker recently invited FORTUNE editor-at-large Brent Schlender to spend the better part of a day at his home in Claremont. It was two days before his birthday, and the professor was in fine fettle. You could tell, because the first thing he said was that he could certainly improve upon the list of questions and topics submitted beforehand ...

You say that the U.S. economy today suffers from profound misperceptions. Can you give some examples of what you mean?

The structure of the U.S. economy is remarkably different from what everybody thinks. Nobody seems to realize

NOW HEAR THIS!
Drucker (at home) still consults and teaches.

PETER DRUCKER

that we import twice or three times as many jobs as we export. I'm talking about the jobs created by foreign companies coming into the U.S. The most obvious are the foreign automobile companies. Siemens alone has 60,000 employees in the U.S. We are exporting low-skill, low-paying jobs but are importing high-skill, high-paying jobs.

But isn't it true that labor costs are much higher in the U.S., and that moving more manufacturing abroad harms our balance of trade?

Wage cost is of primary importance today for very few industries, namely ones where labor costs account for more than 20% of the total cost of the product—like textiles. I don't know what proportion of the cost of a typical American product is attributable to labor, but it's a small and shrinking one. Take automobile parts. Because of my consulting, I happen to know the internal cost structure for one of the world's biggest auto parts makers. They tell me that it is still very much cheaper to produce in this country—or maybe in conjunction with a *maquilladora* plant along the Texas-Mexico border—than to import, because the parts, while labor-intensive, are also very skill-intensive to design and make. When that's the case, you're still better off producing in this country. So the belief that labor costs are a main reason for producing outside the U.S. is justified for only a very small segment of industry.

Consequently, the industries that are moving jobs out of the U.S. are the more backward industries. The U.S. remains the cheapest place in the world to produce for many of the more advanced industries. I say that not because our wages and salaries are so low. They aren't. But employee benefits are much cheaper than in Europe, and American workers are more flexible. I don't just mean you can move people out of accounting and into engineering here; I mean physically moving people from Chicago to Los Angeles. Don't you dare try that in Germany. They won't go. That's one of the absurd byproducts of their huge and restrictive employee benefits: It's cheaper to allow someone to remain unemployed in the Ruhr than to move him to Stuttgart for a real job. The same thing is true in Japan.

So what I call "invisible" costs are quickly beginning to be more significant than direct labor costs. These are pension costs, benefits and health-care costs, and especially something nobody has yet assessed, which I call "reporting" costs, which are basically associated with complying with regulations, taxation, labor relations requirements, and the like.

What about the widespread impression that the U.S. has an unemployment problem?

Nobody seems to realize that we have the highest proportion of our population in the workforce by far than any other country in the industrialized world. We have the lowest long-term unemployment rate in the West. Most of the unemployment we do have is not the long-term kind, but the short-term kind when people are between jobs for at most a few months. And we have easily the highest availability of good jobs for educated people who want to enter the labor force. We basically have no unemployment for college graduates, as they do in much of Europe. Now they all may not get the job they would like, and they may not get \$70,000 a year the first year, but they get employed. And finally, when you think about it, in less than three decades we absorbed all the women who wanted to work into the workforce with no upheaval. It's quite remarkable.

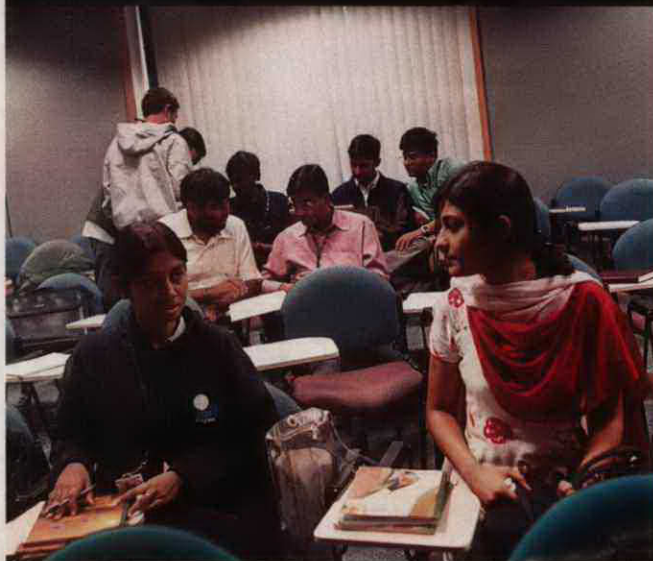
Let's talk about the productivity of the U.S. economy. The numbers measuring productivity keep going up and up, even in this period of sluggish growth.

I don't think you can trust all the productivity improvement figures that we see. But there's no doubt that in manufacturing we're seeing some basic changes in philosophy and in systems that may be comparable to the industrial revolution of the 1920s. The changes are coming, not by computerizing and automating production in the literal sense, but by systematizing production. In the past, the way to increase your produc-

tivity was to specialize. Today we design manufacturing and to some extent distribution not so much to maximize it but to optimize it. And the new manufacturing systems build flexibility into the system, which may actually result in a loss of immediate productivity by the way we currently measure it.

You see, these figures measure the productivity when work is being done, but they do not measure the loss of productivity when work cannot be done, such as when you're setting up a plant to make something different. I would suspect that the productivity increases are actually greater than all the figures we see because the new, more flexible manufacturing processes practically eliminate setting-up time, when manufacturing has to cease. In some cases this setting-up time has come down from three hours to four minutes. This does not show up in our productivity figures. Nor do the figures address the value of being able to change the mix of production, because they focus on the pure output of traditional mass-production industries. We don't quite know yet how to measure productivity in some of our newer industries.

"The economic dominance of the U.S. is already over. What is emerging is a world economy. India is becoming a powerhouse very fast."



WORLD CLASS: Students at Bangalore's Institute of Technology

CHRIS ANDERSON—VII

How can the productivity of knowledge workers be measured and improved?

Nobody has really looked at productivity in white-collar work in a scientific way. But whenever we do look at it, it is grotesquely unproductive. As you know, most of my work these days is with universities and hospitals and churches, which are three of the biggest knowledge-worker employers, and their productivity is dismal. In part this is because knowledge work by definition is highly specialized, and that means that the utilization of the knowledge worker tends to be very low.

The inefficiency of knowledge workers is partly the legacy of the 19th-century belief that a modern company tries to do everything for itself. Now, thank God, we've discovered outsourcing, but I would also say we don't yet really know how to do outsourcing well. Most look at outsourcing from the point of view of cutting costs, which I think is a delusion. What outsourcing does is greatly improve the quality of the people who still work for you. I believe you should outsource everything for which there is no career track that could lead into senior management. When you outsource to a total-quality-control specialist, he is busy 48 weeks a year working for you and a number of other clients on something he sees as challenging. Whereas a total-quality-control person employed by the company is busy six weeks a year and the rest of the time is writing memoranda and looking for projects. That's why when you outsource you may actually increase costs, but you also get better effectiveness.

Many high-tech CEOs are worried about the higher-education system in the U.S., and especially the fact that there are fewer people studying technology. Does this concern you?

That's perfectly true. But there are two things they forget. We are the only country that has a very significant continuing-education system. This doesn't exist anywhere else. And we are the only country in which it is easy for the younger people to move from one area at work to another. That's impossible in Japan. If you're an accountant, you're an accountant. That's equally impossible in Europe. But here it is easy.

Consequently, our most important educational system in the U.S., unlike Europe, is in the employee's own organization. I'm conscious of that because my European friends, when they move into this country, are overwhelmed by the expectations they face. Look at the career path for many people here. Jeffrey Immelt, the CEO of GE, worked in about half a dozen different categories—in sales, in design, in different product groups. In contrast, the head of Siemens never held a job outside Germany until he became CEO.

What do you make of the recent so-called recession?

What we have been going through these past three years is most definitely not a recession. It's a transition—a transition with a lot of incongruities. Let me tell you a simple incongruity. We are going to have both fewer young people because of our own birth rate, and yet more young people because of immigration. For educated American young people there is no recession. But the immigrants have a mismatch of skills: They are qualified for yesterday's jobs, which are the kinds of jobs that are going away.

This also is especially hard on uneducated urban American blacks. Their great ladder of opportunity since World War II is going away. When Mr. Bush talks about the manufacturing crisis, that's what he's talking about. But it doesn't touch anybody else. And in reality there is no crisis: Manufacturing production in this country has doubled in the past ten years, even as factory employment has gone down. So our productivity improvement has to do with the shift from the old way of manufacturing to the new, more systematized form that happens to require less unskilled labor.

You sound fairly sanguine about the state of the U.S. economy. Do you see any danger signs?

Oh, yes. The biggest problem I see is our total dependence on foreign money to cover our government debt. Never before has a major debtor country owed its debt in its own currency. It is unprecedented in economic history. Japan, by contrast, owes all its foreign debt in dollars. Now if you devalue

the dollar, the Japanese economy benefits, because their imports become much cheaper. And the value of their debt goes down also. The individual Japanese companies that invest in dollars would lose, but the overall Japanese economy gains. But we have no experience about what will happen here when we owe so much debt in our own currency and we're forced to devalue the dollar. Sooner or later, we're going to find out.

What's more, there is an enormous amount of surplus capital in the world for which there is no productive investment. The supply greatly exceeds the demand. So there is a very jittery body of excess money that is desperately in need of returns, and it could become panic-prone. We have no economic theory or model for this.

Does the U.S. still set the tone for the world economy?

The dominance of the U.S. is already over. What is emerging is a world economy of blocs represented by NAFTA, the European Union, ASEAN. There's no one center in this world econ-

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NISSAN'S PLANT in Mississippi employs 4,000 people.

SHIZU AKITAWA—BLUENBERGLAND/NOVA

omy. India is becoming a powerhouse very fast. The medical school in New Delhi is now perhaps the best in the world. And the technical graduates of the Institute of Technology in Bangalore are as good as any in the world. Also, India has 150 million people for whom English is their main language. So India is indeed becoming a knowledge center.

In contrast, the greatest weakness of China is its incredibly small proportion of educated people. China has only 1.5 million college students, out of a total population of over 1.3 billion. If they had the American proportion, they'd have 12 million or more in college. Those who are educated are well trained, but there are so few of them. And then there is the enormous undeveloped hinterland with excess rural population. Yes, that means there is enormous manufacturing potential. In China, however, the likelihood of the absorption of rural workers into the cities without upheaval seems very dubious. You don't have that problem in India because they have already done an amazing job of absorbing excess rural population into the cities—its rural population has gone from 90% to 54% without any upheaval.

Everybody says China has 8% growth and India only 3%, but that is a total misconception. We don't really know. I think India's progress is far more impressive than China's.

What is the most important impact of information technology on business?

Information technology forces you to organize your processes more logically. The computer can handle only things to which the answer is yes or no. It cannot handle maybe.

It's not the computerization that's important, then; it's the discipline you have to bring to your processes. You have to do your thinking before you computerize it or else the computer simply goes on strike.

This enforced discipline has some disadvantages, because it often forces people to oversimplify. Also, the process of arriving at business decisions isn't always systematic enough to be supported by computers. You have to take the assumptions out of the mind of the decision-maker and put them explicitly into the process, along with a method to check them, and only then can a computer help you manage it. Older executives find it excruciating to have to be that explicit, because they just don't want to be. Besides, as we all know, many decisions are ultimately made by the hydrostatic pressure in the boss's bladder.

Given all these systemic changes in how businesses plan and operate, do you think the role and status of the CEO is changing too?

In every boom there is a tendency toward hero-worship of

CEOs. The smart CEOs methodically build a management team around them. But many of those celebrity CEOs who are so highly regarded don't know what a team is. Moreover, the compensation inflation for CEOs has done very real damage to the concept of the management team. In an executive program I have at Claremont, the typical students are general managers of major divisions at very large companies, and they are very well paid. But it's fair to say they are contemptuous of the excessive pay that many of their CEOs receive. J.P. Morgan once said the top manager of a company should have a salary 20 times that of the rank-and-file worker. Today it is more like 400 times that. I'm not talking about the bitter feelings of the

people on the plant floor. They're convinced that their bosses are crooks anyway. It's the midlevel management that is incredibly disillusioned. And so the present crisis of the CEO is a serious disaster. Let me again quote J.P. Morgan, who said, "The CEO is just a hired hand." That's what today's CEOs have forgotten.

Looking back on your career, is there anything you wish you had done that you weren't able to do?

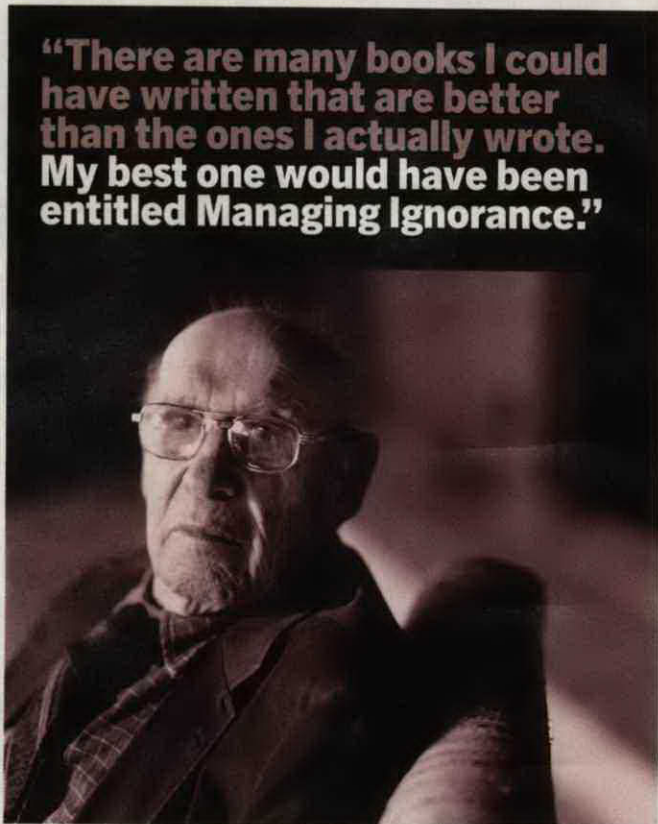
Yes, quite a few things. There are many books I could have written that are better than the ones I actually wrote. My best book would have been one titled *Managing Ignorance*, and I'm very sorry I didn't write it.

I don't regret turning down Henry Luce when he asked me to be foreign editor of *Time* magazine, and later to be managing editor of *FORTUNE*. I wanted to keep teaching, and I wanted to do my own writing, which you can't do when you're working for a publication.

I'm also glad that another job I was supposed to have didn't materialize. After teaching at Bennington College, I planned to work with a friend at Columbia University who was starting a department of American studies. Dwight Eisenhower, who was then the president of Columbia, vetoed the funding. He was a cost cutter. I had already been approved by the trustees and already had a contract. All it needed was Eisenhower's signature.

On the day I was told I didn't have the job, I left Columbia and was going into the subway at 116th Street when I ran into another old friend, who taught at New York University. He told me he was going to Columbia to look for some teachers to help him staff a graduate school of management at NYU. Before I even got on the subway, I had signed up. And that is how I became a professor of management. So in retrospect I'm exceedingly glad the job at Columbia fell through. ■

FEEDBACK bschlender@fortunemail.com



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THE LONG VIEW Drucker doesn't regret the jobs he passed up.

THOMAS BRENNING