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Sloan School Convocation on the Management of Social and Technological Change
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Remarks by Clay T. Whitehead: Public Sector, Private Sector;
Can the Politicians Manage Both?

Most of the current discussion of social and technological change focuses on the rapidity of change in recent times as the reason our government, industry, and other institutions are finding it so difficult to deal with the changes we all see around us. I think it is more useful, however, to distinguish between two qualitatively different kinds of change which I shall call "incremental" change and "systemic" change.

Incremental change includes shifts in production processes, factor prices, resources availability, and consumer preferences. It includes new modes of transportation, changes in workforce composition, and variations in the costs of capital, changing tastes in culture and entertainment, and trends toward shorter workweeks and improved working conditions.

Systemic change, on the other hand, is a significant shift in the structural framework of incentives, checks, and balances by which our social, technological, economic, and political system maintains its equilibrium. Some examples of systemic change are: the adoption of widespread income maintenance through programs of the Federal government; extensive Federal regulation of prices, investments, and markets; large shifts in monetary, fiscal, and tax policies; and the use of predominantly national news media. The most important systemic change is probably the trend toward statutory and regulatory intervention by the Federal government in short-term management decisions of private enterprise, as for example in automobile pollution controls, petroleum pricing and supply, and access to television time.

The distinction between incremental and systemic change needs better definition, and there are of course many gray areas of overlap. But for purposes of analyzing our current problems of governmental leadership and corporate management of social, technological, or economic change, the distinction is both useful and important. Systemic change can occur slowly as the accumulation of more or less coherent incremental adaptations, as for example the English common law evolved over several centuries. But the advent of frequent systemic change that is impressed upon our socioeconomic system rather than evolving from within it is a new phenomenon. For a variety of reasons, the United States appears to be at the vanguard of such change, with few good models abroad or in history from which to draw many directly useful lessons.

If this analysis is approximately correct, then we must learn more about the implications of such change if we aspire to "manage" it rather than have it overcome us. It is the nature of systemic change that the role of government is greatly expanded; for only the Federal government has the power and authority to impose such changes earlier than they would evolve if the free market and other social institutions were left to their own devices. This expansion of governmentally imposed systemic change has numerous consequences.

As a result of the social welfare programs of the 60's, the sizable increase in regulation of business, the aftermath of the Vietnam war, and the lingering "social issue," we have much less resilience in our economic system and in our social fabric; both are stretched tighter now, with less room for accommodation or to allow for bad decisions by government or industry.

Moreover, the imposition of systemic change presents a higher order of complexity than does incremental change, for we must take into account not only the direct consequences of changed policies, but also the reactions of other parts of the socioeconomic system to the change and the incentives for future behavior that also have been changed. Along with this complexity, particularly with increased detail of governmental intervention in social and economic institutions, goes more areas of interaction between government and industry, between government and the individual, that inevitably produces more frequent conflict. One need only look at bussing, tax litigation, Medicaid, and the energy "crisis" to see some good examples.

It is a fact of life that many of our current public concerns are with matters not traditionally considered part of the public sector. Pension standards, occupational safety and health, equal employment opportunities, and pollution, for example, would have been considered matters for corporate management decision not too many years ago. But they have become national policy issues, and the Federal government has begun dealing with such issues through the corporation. As a consequence, the Federal government is acquiring more and more management control over individual corporations.

So not only have the traditional public sector functions like law enforcement, education, defense, and welfare expanded in the budget and in managerial complexity, but the Federal government is now engaged more and more in the management of the private sector. This blurring of the distinction between the private sector and the public sector is not necessarily all bad, but it creates some real problems that we must attempt to understand, not the least of which is the feasibility of managing both sectors via the political process.

The language of business is efficiency, competition, and capital; but the language of government is equity, power, and wealth. Government is notoriously inefficient; but it is not usually efficiency that society seeks when the government becomes involved. In a sense government is concerned with the inefficient: the investment the private sector won't make; the people business doesn't hire; the safety standards corporations cannot adopt unilaterally and remain competitive. Some of this government involvement is necessary for the functioning of a healthy society, for equity can be no less important than efficiency, and for all its successes the economically motivated modern corporation cannot be expected be all things to society.

But there clearly can be too much government involvement in the private sector, and there must be better and worse ways for government to promote social objectives. The Soviet Union, England, and New York City offer examples of the consequences of excessive or unwise governmental involvement in the private sector. Not only does the efficiency of the private sector suffer, but worse, the ability of the socioeconomic system to adapt is reduced, important public services are slighted, and civil liberties are constrained. The difficulty in designing imposed systemic change is in knowing how much and what kinds of government control are appropriate and what the corporation might do differently in society's and its own longer-term best interest.

These questions are more complicated than we once thought them to be. Philanthropy is not a sufficient answer to the modern corporation's social responsibility. And socialism and capitalism are not the sole clear-cut alternatives for our economic system. Instead, we have a poorly understood diffusion of ownership, control, accountability, and responsibility involving both the private and public sectors that seems to be edging toward unresponsiveness and instability.

Why is the public allowing this trend in government to go on? It is hardly unperceived, and yet despite the lack of any good examples of success abroad or at home, despite the generally high standard of living private enterprise has produced, the trend continues toward more and more ambitious public sector management of both the public <u>and</u> the private sector. Such a trend can persist only if the public perceives such control through political processes to be in their best interest. And that is a disturbing thought, since the American public's confidence in their political leaders and institutions is remarkably low according to most polls. If the public feels they stand to gain from political management of the private sector, then pretty clearly something is wrong with the way our corporations are fulfilling their role (even if it is a substantially changed role that is hard to perceive).

The theory of corporate profit-maximization as an indicator of social benefit via the "invisible hand" is at the root of corporate legitimacy in the free enterprise system. Yet that concept is crumbling at the microeconomic level just as the GNP can no longer be considered an adequate indicator of economic performance at the macroeconomic level. With the multiplication of externalities that accompanies the growing complexity of government-industry relationships, the structural assumptions of the economist underlying the theory of corporate behavior as a basis for social weal are no longer as appropriate as they once were. Business clearly has a problem, and while it would be presumptuous of me to attempt to be very definitive about its causes, I believe some of the factors can be identified. They are mostly structural and include:

1. The separation of ownership and management, and the rise of the professional managerial class.
2. The preeminence of short-term revenue and profit growth as criteria for executive promotion.
3. Inflated and hyperbolic advertising rhetoric (not unlike the vacuousness of much political rhetoric).
4. Substantial achievement of material well-being for the middle class worker/consumer so that quality of life begins to supercede (at least on the margin) industrial production in the consumer's calculus.

5. Accounting conventions and definitions of profit, investment, cost, and so forth that confuse debate about the role and performance of industry.

6. A paucity of business executives who can contribute knowledgeably and constructively in the public debate over the directions of national policy.

The problems of management at the higher levels of the coporation today are less clearly perceived and more complicated than the problems of management we are used to. Like the changes in government and society and the world economic order, the problems are systemic rather than incremental. How should we be organized? What business should we be in? What pension plans will benefit business in the long run? Should some subsidiaries be spun off before an antitrust suit is invited? Should the firm "lobby" in Washington for protection from competition? Will that backfire in the longer run? How should it deal with the media?

Incremental change can be managed; American industry does a good job of it, and our business schools teach it (or at least the principles of it) tolerably well. But systemic change cannot be "managed," at least not as routinely as an open-loop system, for the process, techniques, and considerations are different than those involved in the incremental decisions we usually think of as management. If we attempt to apply standard management and cost-benefit techniques to systemic change, we run the risk of forgetting the checks and balances in the marketplace and in politics that keep our socioeconomic system robust. The types of decisions involved here for top management are generally lumped into a single course on business policy in the management schools, reflecting how little we know about how to deal rigorously with such issues.

It seems to me that we need a new theory of management including a new theory of corporate incentives to deal with the problems that new kinds of change are presenting. This is not to say that we merely need to learn how to do more sophisticated cost-benefit analyses, nor is it to say that we need ten years of basic research in psychology, economics, and philosophy before we can arrive at some useful changes. Rather, we need to rethink the reasons behind the principles of management previously arrived at and supplement them with new principles more in line with the new structure of business and society. This should include:

1. Indices of managerial performance for pay and esteem.
2. Short-run vs. long-run incentives for managers.
3. Impact of industry structure on corporate incentives.
4. Different accounting conventions for different purposes.
5. Education for top management perspective.
6. Traditions of business morality and leadership.
7. Management of private and public non-profit organizations.

But better principles for corporate management are only part of the answer. We also need a new theory of how government should treat the private sector. Neither economic theory nor political theory today provide the principles of governmental regulation of business and intervention in the management of industry that we need. Neither the conservative ("leave business alone") nor the liberal ("soak the rich corporations") political movements offer any intellectual or practical basis for establishing principles of government for the kind of world we now live in or want to live in for the future. Our political processes are not surfacing very thoughtful nor broadly competent candidates for public office; and we seem embarked upon the continued growth of a degree of political control over the management of the private sector that is so complex that even the most competent and responsible politicians could not exercise effectively.

I suspect that the impetus will have to come from outside business and outside politics, even though many corporate and political leaders recognize the need for such developments. Schools of economics, law, government, and management seem the most likely sources of the needed new ideas if they can overcome the well known disciplinary barriers that exist among and within academic departments. And only in part because we are here at the Sloan School of Management do I suggest that schools of management in particular should take the initiative. Schools of government for the most part are too historically oriented; law schools too procedurally oriented; and economics schools almost exclusively quantitatively oriented. Many of the better management schools, on the other hand, are normatively oriented and encompass at least passable familiarity with the related disciplines of law, economics, and government.

Wherever the task is undertaken, it will not be easy. There is a great temptation to see the problems through the filter of a specific intellectual discipline. (I am reminded of the philosopher who observed that the economists, lawyers, scientists, and operations researchers reminded him of a small boy with a hammer: It just so happens that everything he encounters needs pounding.) I am a firm believer in being well grounded in an academic discipline, but the task we face in "managing" social and technological change in the complex world of public and private sector institutions and controls we have built requires something broader and more integrative than any single discipline.

In a sense, we must return to the development of the field of political economy. But whatever we call it and wherever we develop it, the new principles of management and political leadership we need must be intellectually sound, pragmatic and action-oriented. They must command our spirit as well as our intellect. They must inspire that which is best, rather than merely checking that which is worst. They must remain true to the freedom and worth of the individual as well as guide the institutions through which we act collectively.

We need some new kind of political leadership that includes:

1. Recognition that the modern large corporation is neither the exploiter of consumers and workers, nor is it qualitatively the same as small entrepreneurial businesses. It has to be viewed as a new type of socio-economic institution with many facets, purposes, and incentives that can be intelligently shaped.

2. Broader recognition of the role of profits and the effect of our accounting and tax conventions on jobs, production, innovation, and consumer satisfaction.

3. Regulation through responsible changes in structural constraints and incentives, rather than ad hoc meddling in management decisions reflecting incentives government itself once established or sanctioned.

4. New approaches to antitrust that emphasize prospective accommodation and the promotion of competition rather than retrospective prosecution and punitive remedies.

5. Serious attention to the consequences for our civil liberties of increased governmental control of private enterprise.

New principles of management and political leadership will not arise overnight. Given a long enough time, trial and error may produce many of the needed changes, as they have in the past in the United States; but such an approach is not likely to serve us so well into the future, because of the complexity of our institutional relationships and because the suspension of checks and balances may rigidify both government and industry to the point that any change short of the revolutionary becomes infeasible even if we knew what would be desirable. (One need only look at the plight of England to see the possibility.) We should be wise enough to find a surer and less costly way toward the new principles we need.

We already know a considerable amount about the building blocks of such new principles, if only we can manage to put them all together to fit our changed circumstance and our new levels of accomplishment. It seems to me we ought to be able to do so, and we ought to give it a try. For it would be sad indeed if historians wrote of the American experience that we faltered in managing our success because we were smart, but not wise.

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Prospects for Research

We need two kinds of research. One is the development of new theories of how all the disciplinary considerations fit together and interact in order to construct new theoretical frameworks for viewing the business-government relationship. The other is empirical research on what it is organizations really do and how their activities serve various social and personal objectives.

It seems quite probable that we need to get away from the classical "Scientific" research model of detached outside ex post observation and hypothesis testing. The data that is available for such model testing is too gross for the kind of understanding we need. The interweaving of cause and effect, the importance of free will in many decisions, and the subtle time-dependence of many phenomena that drive business and government all limit the applicability of classical cause-and-effect scientific hypothesis testing that has been so successful in the physical, biological, and engineering sciences. Unfortunately, we have not evolved any rigorous methods of studying and understanding social and organizational and economic systems that permit the degree of simplification and predicition that "scientific" theory demands.

It is difficult to set out any systematic rationale for what the research to produce better understanding of business-government relationships ought to be. I suspect that the research will be most productive that seeks primarily to understand and explain; the research to identify "useful" prescriptions for action will have to come later. Some thoughts that come to mind for new kinds of research are: