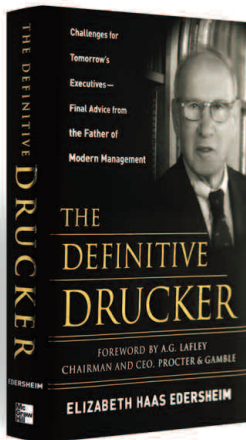




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by Elizabeth Haas Edersheim

Challenges for Tomorrow's Executives — Final Advice From the Father of Modern Management

THE DEFINITIVE DRUCKER

THE SUMMARY IN BRIEF

Peter Drucker, widely regarded as the father of modern management, gave Elizabeth Haas Edersheim unprecedented access for the 16 months prior to his death. At Drucker's request, Edersheim spoke with him about the development of modern business throughout his life and how it continues to grow and change at an ever-increasing rate.

Peter Drucker is credited with inventing the discipline of management. He wrote 39 books that have been translated into dozens of languages. Drucker is also known for single-handedly counseling the chairmen of GM and Ford, advising the president of the World Bank and the CEO of GE and reportedly telling Margaret Thatcher to privatize the entire British mining industry.

The Definitive Drucker captures his visionary management concepts; applies them to the key business risks and opportunities of the coming decades; and imparts Drucker's views on current business practices, economic changes and trends — many of which he first predicted decades ago.

Delivering keen analysis and revealing insights into business, *The Definitive Drucker* is a celebration of this extraordinary man and his life work, as well as a unique opportunity to learn Drucker's final lessons on how to strategize, compete and triumph for the long term.

IN THIS SUMMARY, YOU WILL LEARN:

- How to succeed in a Lego world, where the business organizations are pieced together, pulled apart and reassembled.
- How to determine whether your customers' perception of value aligns with your own.
- How to innovate like GE, as well as when to abandon fundamental assumptions before they derail the company.
- How to structure a successful collaboration.
- How to invest in people and knowledge for your organization.
- How the CEO sets the tone for a company.

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THE COMPLETE SUMMARY: THE DEFINITIVE DRUCKER

by Elizabeth Haas Edersheim

Doing Business in the Lego World

The staid world of business has been turned upside down by a silent revolution. Change came gradually and predictably to businesses in the period following World War II through the early 1990s. But then the revolution struck, taking place on five fronts:

- 1. Information flew.** Since the expansion of the Internet, information travels instantaneously. In the globally integrated economy, management must make decisions at all hours of the day and night.
- 2. The geographic reach of companies and customers exploded.** Companies and their customers now have an astounding geographical reach. Even small firms can scour the world for resources.
- 3. The most basic demographic assumptions were upended.** To managers, the biggest effect of demographic changes is that new populations with new demands drive societies, markets and workplaces.
- 4. Customers stepped up and took control of companies.** Customers are engaged with companies in ways that would have astounded Henry Ford or Thomas Watson.
- 5. Walls defining the inside and outside of a company fell.** These days, a company draws on capabilities outside of its own walls in ways that would have been unheard of just a few years ago.

Drucker observed that we are now in another critical moment: the transition from the industrial to the knowledge economy. We should expect radical changes in society as well as business.

The Lego World

The management world is flat only if you take an industrial perspective. If you just want the lowest cost, the capabilities exist virtually every place in the world to get the lowest cost. But if cost is not your only concern and you recognize that the industrial world has given way to an information- and knowledge-driven world, you will see that the world is not flat and that Indiana and India are not interchangeable. Indeed, the ability to put together and connect the pieces in different ways and with the cus-

tomers all the time defines an enterprise's performance.

In the 21st century, businesses exist in a Lego world. Companies are built from Legos: People Legos, Product Legos, Idea Legos, Real Estate Legos and so on. Everything is visible to everyone all the time. These pieces are constantly being put together, pulled apart and reassembled. In an organization, we can connect individuals' strengths, minimizing their weaknesses. And across organizational boundaries, we can connect strengths of each corporation and provide the customer with far greater value than can any single enterprise.

Dell is a classic example of a Lego manufacturer. It has configured its offering so that customers can custom build computers to meet their individual needs. Michael Dell claims that the firm's important capabilities are the management and integration of information and the ability to quickly build a computer to a customer's specifications. Dell's Product Legos include anything from processor and memory capacity to screen size. However, Dell's recent performance underscores the need to constantly reconfigure in the Lego world. Michael Dell has stepped back and is shifting the Legos and the consumer connections, as the requirements have changed.

In the retailing arena, Amazon exemplifies the Lego

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The author: Elizabeth Haas Edersheim is a strategic consultant who works with both Fortune 500 companies and private equity investors. Prior to founding her own firm, New York Consulting Partners, Edersheim was one of the first female partners at McKinsey & Co. Her previous book, *McKinsey's Marvin Bower*, illustrates the business life and ideals of the founder of McKinsey, her mentor, who was a close friend and peer of Peter Drucker.

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Doing Business in the Lego World

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approach; it connects with other vendors that have expertise in making everything from textbooks to toys.

A New Solution Space

The most significant trends affecting business transcend all companies and all industries. Business as we know it is disappearing. Companies aren't selling products; they're selling experience. Relationships have gone far beyond the roles of buyer and seller. According to Drucker, there are no longer competitors, just better solutions and more choices that can be put together in more ways. Companies focused on competitors are focused on the past, not a future full of technological and demographic opportunities.

The evolution of cell phones into instruments capable of doing much more than handling voice communication — capturing and transmitting still and moving digitalized images, connecting with the Internet, even functioning as a TV — not only means serving a wide range of consumer needs, but also guarantees that customers will upgrade to a new device frequently because they want the latest version with new and enhanced capabilities.

Implications for Managers

One of Drucker's talents was his ability not just to see trends but also to shed light on their implications so that managers could act on them. According to Drucker, there are three consequences of the silent revolution:

1. Financial markets now value knowledge more highly than they value hard assets, underlining the emergence of the knowledge economy. Drucker noted the developments that drove this shift to soft assets — intellectual property, patents and connections. Old companies, such as Boeing, were being revalued as their physical assets took a backseat to their knowledge, relationships and ability to connect. Innovative companies such as Google, Yahoo! and craigslist were launched in cyberspace with very little in the way of physical assets, providing services that had never existed before.

2. The U.S. economic engine is facing the gravest threat of the past 100 years: the need for corporations to be strategic collaborators rather than unilateral superstars. America's institutions are designed for the individualism of an industrial economy, not a Lego world. However, the game has changed. Americans will have to play as equals, something that's not easy when you've spent a good part of the century as the undisputed No. 1.

3. Strategy has become a crucial ongoing activity for management, not simply an annual planning

exercise. Strategy has to move and be refined at a speed comparable to what used to be called tactics; it has to be in real time. You don't have six months, or even three months, to create a master plan.

As Drucker maintained for more than 70 years, businesses are the critical engine of a thriving and sustainable society that values individuals and rewards achievement, with management effectiveness the determining factor in keeping the engine running. Business isn't just business. It's the economic engine of democracy. ■

The Customer: Joined at the Hip

On paper it seems like the most obvious notion: The customer is in the driver's seat. And yet few organizations, busy with all they are doing inside their own walls, are truly focused on the outside world of the customer. If you are in business, beware. The silent revolution of technology and demography has given each customer his or her own handy remote control.

Everything has changed about your customers and your relationships. You've never had as many people around the globe to reach. Customers aren't just in the driver's seat these days; they're gassing up the vehicle, doing some of the service and controlling a fair amount of the traffic on the road.

Connecting With Your Customer

When Drucker talked about the customer, he had four classic themes that he came back to repeatedly. He asked every one of his clients:

1. Who is your *customer*?
2. What does your customer consider *value*?

After long discussions answering those two questions, he would then ask:

3. What are your *results* with customers?
4. Does your customer *strategy* work well with your business strategy?

Rethinking the answers with Drucker changed how the clients thought about the businesses they were in. Southern Pipe, a regional plumbing company, redefined its customer; instead of serving contractors alone, its branches began serving local communities and homeowners as well.

Customer Versus Competitor?

In this networked world, your customer often turns out to be a competitor as well. In some cases, your product may be packaged with others and sold as an integrated unit. Those sales may increase your revenue

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The Customer: Joined at the Hip

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but decrease your brand identity, because the final product may not carry your brand.

It is becoming increasingly difficult to tell friend from foe. In the online business world, the line between competition and cooperation is especially blurred and constantly changing. In our new world, where relationships have proliferated, the customer you are ultimately serving can change from transaction to transaction. The question needs to be asked again and again.

Does Your Customers' Perception of Value Align With Your Own?

In this data-rich world, firsthand emotional intelligence still matters. That is why, on any given day, you may find Procter & Gamble president and CEO A.G. Lafley in the kitchen of a Venezuelan housewife or walking around in the most dangerous parts of Sao Paulo and Rio de Janeiro, Brazil, to see firsthand how consumers are buying and using P&G products. The analysis can be delegated, but not the customer contact.

How do connectivity and relationship influence value? Beyond the significance of the product itself, the value perceived by a customer increasingly depends on his or her relationship with the company and control of the end result. That has remained true even as face-to-face interactions have given way to cyberspace transactions.

Sumerset Houseboats boosted online sales dramatically by more directly engaging the customer in the process of building a boat. In the 1970s, Sumerset was a neighborhood company, and locals would come in daily to see their boats taking shape. When Sumerset's online business took off, it wanted online customers to have the same opportunity as locals. Today, Sumerset customers go online to customize the plans for their boats and to view photos of their boats being built. This is a way to empower customers and create a sense of community. ■

Innovation and Abandonment

Nobody was better at defining and helping companies capture opportunities than Drucker. He often said, "Tomorrow is an opportunity." For Drucker, if you don't understand innovation, you don't understand business theory. Starbucks exemplifies what he considered to be true innovation. Beginning with a single store in 1971, Starbucks grew to more than 12,000 locations in 37 countries in 2006. Starbucks didn't just offer a better cup of coffee than the average restaurant; it delivered instant community — a shared experience. Much of

Starbucks' innovation has to do with marketing, not product, and it is fundamental, not incremental.

Creating Your Tomorrow

Drucker wrote about innovation for decades — long before anyone heard of Starbucks, or even the Internet. It fascinated him. By the Vietnam War years, he was predicting that technology would change everything about the way we do business. Drucker felt that finding a balance was crucial to business survival. "You can't throw everything out, or you'll have anarchy," he said. "You can't hold on to everything, or you'll die."

Drucker understood from personal experience the difficulty of innovating for the future while hanging on to the past. In 1935, he left London to make his first trip to the United States. He'd decided then and there to leave Europe. "America," he wrote, "was starkly different from Europe. In America, people were looking to tomorrow. In Europe, they were trying to re-create yesterday."

When discussing innovation with businesses, Drucker had four basic questions:

1. What fundamental assumptions do you have to abandon to create room for innovation?
2. Do you systematically seek opportunities?
3. Do you use a disciplined process for converting ideas into practical solutions?
4. Does your innovation strategy work well with your business strategy?

In many organizations, innovation is stymied by excessive loyalty to the old products and to the old ways of doing things. Drucker put it this way: Most companies hang on to the business they have and are hugely reluctant to loosen their grip. This prevents them from innovating and determining their own destiny. Kodak built a legendary film business, but it finally had to abandon this mainstay in order to invest talent and resources in the digital imaging business.

How Innovation Enables GE's Longevity and Valuation

GE is innovative to the core, has outperformed the overall market and has adopted a Druckerian approach to innovation. The company was founded on technological brilliance and has developed into a huge global technology conglomerate. From 1995 to 2005, GE grew 7.9 percent per year, at almost three times the profit margins of 10.2 percent of the average net profit markets.

GE has innovation in its DNA. It evolved from the legacy of its founder, Thomas Edison — not only a brilliant inventor but also a customer-driven innovator. He sounded

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Innovation and Abandonment

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a lot like Drucker: “I never perfected an invention that I did not think about in terms of service it might give others.”

As GE found out early on, no company is immune to changes in the environment. GE was almost bankrupt a year after its founding, during the panic of 1893 when central power stations could no longer afford to purchase new materials. To survive this crisis, the company completely changed its strategy, shifting to an innovative focus on solving customer problems. However, Edison was not as good a manager as he was an inventor. He was asked to leave by J.P. Morgan, who replaced him with professional managers.

Despite the near disaster, GE remained focused on its products and created a culture that encouraged innovation. Drucker worked with every GE CEO from Gerald Swope through Jack Welch, helping them create an innovative culture that challenged the status quo. ■

For additional information about GE's innovation, go to: <http://my.summary.com>

Collaboration and Orchestration

Peter Drucker's vision of collaboration remains immensely relevant today. He believed that to give your customers what they need, you must follow two rules: play to your strengths and collaborate with other players — sometimes those you consider competitors.

Three Drucker Questions

When discussing collaboration and orchestration with businesses, Drucker was known to ask three groups of fundamental questions:

1. What are the goals of your collaboration? What are the shortcomings of the traditional business model? What are the needs that it leaves unfilled? And what is the prize a collaborative business model could deliver?

2. How should the collaboration be structured? What will be your front room? What does your company do best? And what organizations or individuals are best at the other activities necessary to fill your customers' needs?

3. How do you orchestrate and operate a successful collaboration? What is the best way to set up your enterprise to be agile and cost-effective and to work with your backroom partners as one well-orchestrated whole? Can you manage down the risk that the partnership will backfire or be derailed by competitive issues?

Drucker on Collaborations

To succeed in the Lego world, you must collaborate. You must tap into resources outside your organization — no business can isolate itself. Drucker identified the following characteristics of successful collaborative organizations:

1. A reputation as a place to work that attracts the best and the brightest.
2. A flexible, easily adaptable infrastructure and a highly variable cost structure.
3. Pragmatic political and logistical solutions that convert potential adversaries into allies.
4. Influence that flows from setting industry standards that shape the expectations of end users.
5. Identification with their local communities through holistic branding.

As you consider these three groups of questions for your company, imagine you are just now leaving college and setting up your company from scratch. That's Drucker's way of looking at the viability of a corporation — if you weren't in this business, would you enter it today? And if so, what would it look like?

Structuring a Collaboration

The first step in structuring collaboration is to identify your company's front room, which Drucker defined as your strength, or the activity that is most important for you to do — that which stirs your passion and shows off your excellence. Everything else is your back room. One of Drucker's famous quotes is “The only thing you have to do is marketing and innovation.”

In the traditional model, a business would add to its front room an array of ancillary activities needed to meet its customers' needs. The quality of those activities might not have been first-rate, or the activities might have been relatively high-cost, but the company had to have them in place to meet customer needs. The level of communication and coordination needed to team up with another organization made any approach impossible for most companies.

In the new world, however, you can eliminate many of these ancillary activities and do a better job of meeting customer needs via collaboration. Collaboration is not just an option but an imperative in the new world. It is critical that you do only what you do best, that you eliminate or minimize your back room by teaming up with another organization. With the greater transparency typical of the new world, the customer sees everything and knows your flaws and strengths. And you can con-

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Collaboration and Orchestration

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nect to and use someone else's front room, thereby better meeting customer needs and streamlining your operation in the process.

Technology Collaboration

In the world of high technology, the classic example of collaboration is Linux, an open-source operating system. It has revolutionized the way software is made and has emerged as a powerful model of successful decentralized collaboration. Linus Torvalds wrote the beginning, or kernel, of the operating system in 1991 and made it available to everyone, inviting others to improve on it. His front room is the original kernel and the decision authority built into the software to accept changes. The back room is executing all the changes.

As the collaboration has expanded, more of the review process has been delegated and automated, but the fundamental idea remains the same. Top tech competitors such as IBM and Hewlett-Packard work together with distributors such as Red Hat on setting development priorities, offering their programmers' time on projects and protecting Linux from potential intellectual property claims. The tech companies, in turn, make money not from selling the operating system, but from selling services and software around the system. Thus everyone (with the exception of other operating system creators such as Microsoft) benefits from this cooperative ecosystem of global technology talent. ■

People and Knowledge

Drucker stressed that businesses, including nonprofits, always had to put people first — employees and customers, as well as shareholders and stakeholders. According to Paul O'Neill, the former Treasury secretary, retired CEO and chairman of Alcoa and a former Drucker student, a test of an organization's potential for greatness is whether every person in that organization can say yes to three questions every day without any reservation or hedging or stopping to think:

1. Are you treated every day with dignity and respect by everyone you encounter?
2. Are you given the things you need — education and training and encouragement and support — so that you make a contribution?
3. Do people notice that you did it?

Investing in People and Knowledge

People are the business. They are your front room,

your connection to others and to the customer. They are your knowledge and your access to changing opportunities and resources. Drucker said, "What differentiates organizations is whether they can make common people perform uncommon things — and that depends primarily on whether people are being placed where their strengths can perform."

Given this dynamic, it is critical to constantly ask five Drucker questions:

1. Who are the right people in your organization?
2. Are you providing your people with the means to achieve their maximum effectiveness and contribute to the organization's success?
3. Do your structure and processes institutionalize respect for people and investment in human capital?
4. Are knowledge and access to knowledge built into your way of doing business?
5. What is your strategy for investing in people and knowledge?

Building Knowledge Into Business

In Drucker's writings, he did not separate knowledge from people. He wrote about the knowledge worker, about applying knowledge to what the knowledge worker does and about the real impact of information. Every enterprise must build knowledge into its value proposition, harnessing knowledge in every aspect of the way it does business.

In order to do this, you must ask if knowledge and access to knowledge are built into your way of doing business. For example:

1. Is knowledge built into your customer connection? Building knowledge into the product or service a company takes to market increasingly creates real value for customers. For example, an "intelligent" oil drill that bends its way to extract more oil from the pockets of underground oil formations commands more than twice the price of a standard drill.

2. Is knowledge built into your innovation process? Simply to remain competitive, the organization must continually scan related fields for changes that could affect its competitive landscape.

3. Is knowledge built into your collaborations? Collaborations are often the product of shared objectives and knowledge. In this age of the Internet, collaboration is more important than ever. The Internet is the perfect medium for sharing information and creating online communities, both of which enhance knowledge.

4. Is knowledge built into your people and knowl-

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People and Knowledge

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edge management? Perhaps the most direct use of knowledge within an organization is to build its own capabilities. From Drucker's perspective, this ability to apply knowledge to knowledge will be the critical factor in productivity moving forward. The challenge is in sorting through and prioritizing the knowledge.

In the new world of the knowledge worker, attracting and retaining high-talent people is at least as important as anything else a company does. "The first sign of decline of a company is loss of appeal to qualified, able and ambitious people," Drucker says. What attracts them is work that is truly interesting and the chance to make a contribution that is truly significant.

But as highly skilled and independent professionals, knowledge workers are highly mobile. Despite their migratory nature, the knowledge organization invests in them and seeks to retain them by fostering an excellent working environment — a culture that respects and values them as knowledge professionals and that sets them up to win.

Google's 10 Golden Rules for Knowledge Workers

In early 2005, Drucker commented on Google and how powerful online communities were and would be, and how managing these more autonomous workers to be productive and innovative is a challenge. Eric Schmidt, CEO at Google, commented that the team at Google has more in common with professional basketball players than with traditional workers. In his view, there are 10 golden rules to operating the business:

- 1. Hire by committee.** Everyone's opinion counts.
- 2. Cater to their every need.** As Drucker says, the goal is to "strip away everything that gets in their way."
- 3. Pack them in.** Almost every project at Google is a team project.
- 4. Make coordination easy.** In addition to physical proximity, all Googlers e-mail a snippet once a week to their work group describing what they have done in the last week.
- 5. Eat your own dog food.** Google workers use the company tools intensely.
- 6. Encourage creativity.** Google engineers can spend up to 20 percent of their time on a project of their choice.
- 7. Strive to reach consensus.** "We adhere to the view that 'the many are smarter than the few' and solicit a broad base of views before reaching any decision."
- 8. Don't be evil.** "Much has been written about

How People Make the Difference at Edward Jones

The investment firm Edward Jones was one of Drucker's last clients, and he consulted with it as late as April 2005, at the age of 95. The relationship started in 1980. Over the years, Drucker met regularly with Edward Jones management groups to discuss questions raised by the team. He sometimes jokingly referred to himself as an "insultant" who had the pleasure of "scolding clients and getting paid for it" rather than a consultant, based on his habit of challenging prevailing assumptions.

Edward Jones has quietly built one of the largest, fastest-growing retail brokerage networks in the world, with more than 9,000 offices. Central to the company's success is finding the right people for the organization. Jones "looks for people with passion, confidence, independence and a belief in doing what's expected. We like to hire people who understand and can embrace our 'unfashionable' approach to investing." In many ways, Edward Jones epitomizes the knowledge organization that liberates its people to pursue its mission.

Google's slogan, but we really try to live by it, particularly in the ranks of management."

9. Data drives decisions. At Google, almost every decision is based on quantitative analysis.

10. Communicate effectively. Every Friday, Google has an all-hands assembly, allowing management to stay in touch with what knowledge workers are thinking and vice versa. ■

For information on the four types of knowledge strategy, go to: <http://my.summary.com>

Decision Making: The Chassis That Holds the Whole Together

According to Drucker, "A decision is a judgment. It is a choice between alternatives. It is rarely a choice between right and wrong. It is often a choice between two courses of action, neither of which is provably more nearly right than the other."

For that reason, it takes smart decisions and execution to traverse the new landscape, even with a strategy or map. That means the right colleagues, right collaborators and strong customer connections — everything that helps spur innovative thinking. Drucker called this the

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Decision Making: The Chassis That Holds the Whole Together

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chassis — the organization’s ability to make well-informed decisions about what needs to be done and its resolve to get it done. He was passionate about management effectiveness — setting priorities, managing time and making effective decisions. His internationally best-selling book *The Effective Executive* is very much about getting the right things done. The days of the gray-suited micromanager hovering over his employees’ desks are over.

Decision Making: The Right Risks

Certainly, risk taking has always been in the nature of business. Companies that took greater risks made it harder or riskier for their competitors to keep up with them. Today’s greater uncertainty along with a smaller room for error mean that decision makers confront even more risk. Managers need to move forward while taking the *right* risk, not necessarily the *least* risk. This involves making decisions at the right level of the organization and having a disciplined, fact-based process for evaluating alternatives, making decisions and acting upon those decisions. ■

The 21st Century CEO

In the last years of his life, Drucker focused like a laser on what had increasingly fascinated him — the role of the CEO. As corporations grew more unwieldy, worldwide competition sharpened and customers and shareholders became more litigious, Drucker rightly saw CEOs as more important than ever. They had to provide leadership — strategic leadership, moral leadership, human leadership — and balance. Today’s rate and magnitude of change leave little room for leadership error.

Drucker believed that the CEO role was the next area of management research. Good or bad, the CEO sets the tone for an organization, its mission and culture and its actions and results during his or her tenure. As a consultant and adviser, Drucker worked with hundreds of CEOs and observed a remarkable diversity of leadership personalities in action, from Jack Welch at GE to Frances Hesselbein, head of the Girl Scouts of America.

When exploring the role of CEO, Drucker defined three characteristics unique to that leadership position:

1. A broad field of vision and the ability to ask and answer what needs to be done.
2. His or her thumbprint on the organization’s character and personality.

3. The influence he or she has on people — individually and collectively.

The CEO Brand

Every CEO, whether at a small family company or a multinational, leaves an imprint.

For example, at Campbell Soup Co. there was the Dr. John Dorrance era — when condensed soup was invented and introduced to the mass market — and condensed soup remains the identity of the company today. The James McGowan era saw Campbell expand into key ingredients. The William B. Murphy era was defined by the company expanding internationally, and the Doug Conant era is known for revitalizing the business.

As the CEO nurtures and forms an organization’s personality, inevitably his or her own personality, or brand, rubs off on the place. Drucker saw this thumbprint as being of the utmost importance to the next generation’s leading organizations. He wrote, “In the next society, the biggest challenge for the large company — especially for the multinational — may be its social legitimacy: its values, its mission and its vision.”

Each of Us as CEO

What can the self-managing knowledge worker learn from these three characteristics — vision, organizational personality and influence — as CEO of his or her own career? Maintaining a broad field of vision requires having a sense of where you are going and what you are building. Organizational personality or brand is about knowing yourself and what gives you passion. Finally, the knowledge worker is influenced by and influences others. We are influenced by the CEO — the premier role model who lives the purpose, values and principles of the organization.

Successful careers are not planned, they are managed. Each of us is a CEO. The way we manage our careers — switch from company to company, or become consultants or contractors, or start our own businesses — will be the next revolution.

Peter Drucker has left our physical world but kept his promise to “be there” — his influence is embedded in our management past, our management present and our management future. ■



If you liked *The Definitive Drucker*, you’ll also like:

1. *The Starfish and the Spider* by Ori Brafman and Rod Beckstrom. The authors provide a look at the decentralized companies that are taking the business world by storm.
2. *What Got You Here Won’t Get You There* by Marshall Goldsmith with Mark Reiter. The corporate world is filled with executives, but only a handful of them will ever reach the pinnacle.
3. *Good to Great* by Jim Collins. Collins provides a guide to business improvement that ranks company culture as the leading factor in success.