DOING GOOD MAKES CENTS

Social problems can be solved – but only when they are turned into profitable business opportunities.

By Peter F. Drucker

In the early years of this century, two Americans—independently and, in all probability, without knowing of each other—were among the first businessmen in the world's history to initiate major community reforms. Andrew Carnegie preached and financed the free public library. Julius Rosenwald fathered the county farm-agent system and adopted the infant 4-H Clubs. Carnegie was already retired from business and one of the world's richest men. Rosenwald, who had recently bought a near-bankrupt mail-order firm called Sears, Roebuck & Co., was only beginning to build both his business and his fortune.

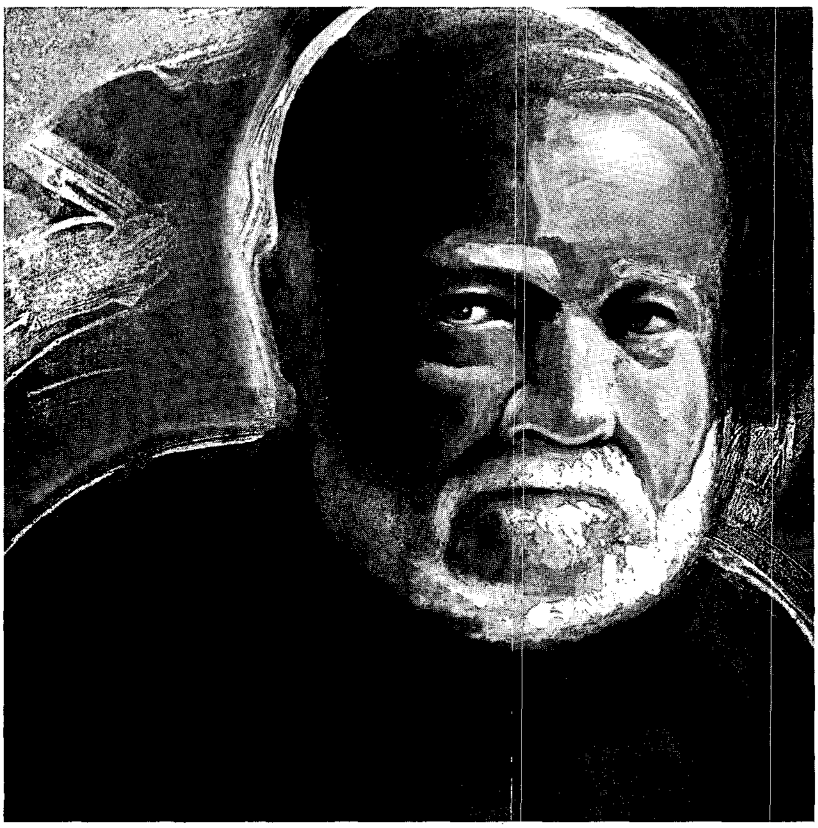
Both men were radical innovators. Successful businessmen up to their time, beginning with the Florentine Medicis in the 15th century, had aimed at becoming aristocrats. Carnegie and Rosenwald became social reformers. The monuments that earlier businessmen had erected for themselves were cultural: museums, opera houses, universities. In Carnegie's and Rosenwald's own time the leading businessmen—A. Leland Stanford, Henry E. Huntington, J. P. Morgan, Henry C. Frick, and, a little later, Andrew Mellon—still followed this tradition. Carnegie and Rosenwald instead built communities and citizens—their performance, capacity, and productivity.

But there the similarity ends. The two held basically different philosophies. Carnegie, whose philosophy is well presented in Burton J. Hendrick's *The*

Life of Andrew Carnegie, shouted his from the housetops: The sole purpose of being rich is to be a philanthropist. God, Carnegie asserted, wants us to do well so that we can do good. Rosenwald—modest, publicity-shy, unassuming—never preached; but his deeds spoke louder than his words. "You have to be able to do good to do well," was Julius Rosenwald's credo—and, I believe, a far more radical one than that of the anarchist steelmaster from Pittsburgh. Carnegie believed in the social responsibility of wealth. Rosenwald believed in the social responsibility of business.

Rosenwald deeply believed in the need to develop the competence, productivity, and income of what was then still a desperately poor and backward American farmer whose skill and productivity were well below that of the competent farmers of western Europe. As explained by Boris Emmet and John E. Jeuck in *Catalogues and Counters: A History of Sears, Roebuck & Co.,* Rosenwald saw the need to make effective the enormous funds of scientific farming knowledge and farming skills that decades of systematic study of agronomy and farm marketing had brought together. In 1900 or 1910, these were still largely theory rather than practice and inaccessible to all but a tiny minority of large and wealthy agriculturalists.

Rosenwald's motives clearly were "philanthropic," that is, the love of his fellow men. But he also saw—as no businessman, American or European, had seen before—that Sears, Roebuck's prosperity depended on the prosperity of its customer, the farmer, which in turn depended on the farmer's skill, productivity, and competence. The county farm agent—and Sears, Roebuck for almost a decade single-handedly supported this innovation of Rosenwald's until the US government took it over—and the 4-H Club were clearly philanthropy. But they were also Sears, Roebuck's corporate advertising, public relations, and, above all, market and customer development. Their success explains in large measure why the near-bankrupt Sears, Roebuck that Rosenwald had bought became within 10 years the first of the country's truly national retailers, the biggest of the world's great merchants, and one of the country's most profitable and fastest-growing enterprises.



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Less than a generation separated Carnegie (born in 1835) from Rosenwald (born in 1862), but Carnegie was still a "rich man"; Rosenwald was an "executive." Carnegie still saw a business as ownership; Rosenwald saw a business as a trust. The one was an owner, the other a manager.

In its view of "social responsibility," much of American business and the American public still follow Carnegie. They accept as he did that wealth and economic power entail responsibility for the community. They may not share his vision of the rich man as social reformer, but they accept, at least in theory, Carnegie's assertion that doing well commits one to doing good. Carnegie's innovation has become a uniquely American institution: the foundation, with one after the other of the super-rich, from Rockefeller to Ford, following Carnegie's example. And Carnegie also set the tone for what is now known as "the social responsibility of business."

Julius Rosenwald has had far fewer followers, though they may have had more profound impacts than the followers of Carnegie. The best known is probably Rosenwald's own successor as head of Sears, Roebuck, General Robert E. Wood. Even greater perhaps was the impact of James Couzens, co-founder of the Ford Motor Company, for 10 years Henry Ford's partner as the company's financial and administrative head, then mayor of Detroit, and finally, from 1922 to 1936, US senator from Michigan and, though nominally a Republican, one of the intellectual fathers of the New Deal. Couzens introduced skill training into American industry as a social responsibility of business. A few years later, in 1913, he established, over Henry Ford's strenuous objections, the famous "five dollar a day" wage, both out of deep compassion for the suffering of an exploited work force and as a highly successful and indeed immediately profitable cure for rates of absenteeism and turnover so high as to threaten Ford's competitive position in the marketplace.

But, in the years to come, the most needed and the most effective—perhaps the only truly effective—approach to social responsibility will increasingly be that exemplified by Rosenwald. Only if business, and especially American business, learns that to do well it has to do good, can we hope to tackle the major social challenges facing developed societies today. Government, the agency to which the generations after Carnegie and Rosenwald increasingly came to look for the solution to social problems, cannot tackle these challenges. They can be solved only if seen and treated as opportunities. And the economic realities ahead are such that social needs can be financed increasingly only if their solution generates capital—that is, generates a profit. This, governments cannot do. But it is precisely what business is being paid for.

Why shouldn't government do these tasks and tackle these problems? Governments have had to concern themselves with "social problems" since time immemorial. There were the reforms of the Gracchi in republican Rome in the second century A.D. and the Poor Laws of Elizabethan England. But as part of a systematic theory of government, the idea that the solution of social problems is permanently a task of government and one for which no other social institution is fitted dates back only 200 years. It is a child of the Enlightenment of the 18th century; it presupposes a modern civil service and a modern fiscal system. It was first expressed and practiced in the most enlightened of the "enlightened despotisms" and, so to speak, their "development lab"—the Hapsburg Grand Duchy of Florence, where, between 1760 and 1770, the first countrywide hospital system, the first countrywide public-health planning, and the first European countrywide system of free compulsory schooling were established.

The 19th century saw the blossoming of this new idea. From the British Factory Acts of 1844 to Bismarck's social-security legislation in the 1880s, one social problem after another was tackled by governments—and solved triumphantly.

The 20th century and especially the last 50 years elevated this idea to an article of faith, to the point where a great many people consider it practically immoral and certainly futile for a social need to be tackled any way *other* than by a government program and where a substantial majority, only a few years ago in the heady Kennedy and Johnson years, was convinced that *any* social problem would almost immediately yield to attack by government program. But the last 10 or 15 years have brought increasing disenchantment. There is now no developed country, whether free-enterprise or communist, in which people still expect government programs to succeed.

One reason is surely that government is doing far too many things. By itself, a social program accomplishes nothing except the expenditure of money. To have any impact at all, such a program requires above all the hard work and dedication of a small number of first-rate people. First-rate people are always in short supply. There may be enough for a very few social programs at any one time.

But government is also congenitally unsuited to the time dimensions of social programs. Government needs immediate results—especially in a democracy where every other year is an election year. It took 80 years before America's program of agricultural education and research began to revolutionize American farming and farm productivity. It took 20 years before every American at work was covered by Social Security. Would the American electorate have waited 20, let alone 80, years before seeing major results from President Johnson's "War on Poverty"? And yet we know that learning has a long lead time before it shows massive results. Individuals, not classes, learn; and there has to be built up, one by one, a large stock of individuals who have learned, who serve as examples, as multipliers, as leaders, and who give encouragement.

Paradoxically, government, which finds it hard to start small and to be patient, finds it even harder to abandon. Every program immediately creates its own constituency, if only the people who are employed by it. It is easy, all too easy, for modern government to give. It is all but impossible for it to take away. The rule for failures is therefore not to bury them but to redouble the budget and to divert to them the able people who might, if employed on more-promising opportunities, produce results.

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Furthermore, it is all but impossible for government to experiment. Everything it now does has to be nationwide from the start, and everything has to be finite. But that, in anything new, is a guarantee of failure. It is surely no coincidence that practically all successful New Deal programs had been "piloted" as small-scale experiments in states and cities over the preceding 20 years. The two total New Deal failures, the NRA and the WPA, were also the only genuine inventions without prior experiment at the state or local level.

Equally important as an explanation for the inability of government to tackle successfully the kind of social problems we face is that they are "hard problems," ones in which there are so many constituencies that it is difficult, if not impossible, to set specific goals and targets. It is perhaps here that the social problems of the mid-20th century differ most, and most fundamentally, from those of the 18th and 19th centuries. But the problems we face in the decades ahead will be even harder than those with which we do so poorly now. Each of them has powerful constituencies with radically different—indeed, mutually exclusive—goals and values, which practically guarantees that government could not succeed in solving them.

"Reindustrializing America," for instance, means to the labor union preserving traditional blue-collar jobs in traditional industries in traditional industrial central cities—or at least slowing the shrinkage of traditional jobs to the fullest extent possible. However, if reindustrializing America means restoring the country's capacity to increase the output of manufactured goods and to compete internationally, it unambiguously means the fastest possible automation of traditional processes and in all probability a shift to new and decentralized locations. It means, for example, liquidating Big Steel in Pittsburgh and Chicago and shifting to mini-mills near customers.

The first definition is politically acceptable for a short time, but it can only lead to failure, as the British (or the Polish) example shows. But can any *government* program embrace the second definition? Even the Japanese, who reportedly invest in "winners" and starve "losers"—at least according to a currently popular American myth—are finding that it cannot be done politically. Indeed, the Japanese have found that they cannot give up support of a retail distribution system that everyone in Japan knows to be obsolete and frightfully expensive—but the only social security for a fairly small group of older people.

Nongovernmental institutions, whether business or institutions of the rapidly growing nonprofit "third sector," can, however, direct themselves to a single objective. They can break down hard problems into several easy problems, each capable of solution or, at least, of alleviation. And because nongovernmental institutions can and do compete with each other, they can develop alternative approaches. They can experiment.

The increasing inability of government to "do"—to tackle effectively the social needs of contemporary developed society—creates a major opportunity for nongovernmental institutions, and especially for the most flexible and most diverse of nongovernmental institutions, business. Increasingly, even in countries organized on what are proclaimed to be "socialist" principles, we will have to reprivatize, turning activities over to profit-making businesses or to nongovernmental, nonprofit institutions (which are equally "private"). We will, in other words, have to create conditions under which a task is outlined by government and under which the means to perform the task are provided for either by government or by "third-party payors," but under which the actual performance of a task is done by nongovernmental institutions, especially business, and is done locally and on a competitive basis.

A good example is the American communication system, in which the tasks done exclusively 50 years ago by the post office are now increasingly carried out by a host of agencies competing with each other and with the Postal Service. Quite clearly garbage removal, health care, and many other services will become reprivatized in such a way that the service itself is grounded in public policy and law (if only through tax advantages), while the performance is the task of competitive private business enterprises.

This, rather than the traditional "mixed economy," is likely to be the true mixed economy of the future. It will consist of three parts rather than of the two that the economist talks about traditionally. There will be a private sector, in which government limits itself to protection against fraud, extreme exploitation, collusion, unsafe working conditions, deprivation of civil rights, and so on. There will be a true public sector—for example, defense (excluding procurement) or justice, in which government will both specify the job and do it. And there will be a mixed sector—the best example I know is the American hospital system. It is primarily a private system. Nonprofit community hospitals, church-affiliated hospitals, and proprietary for-profit hospitals are increasingly organized in large and growing chains. All then compete for patients, yet most of their income is public money—whether it comes direct from the government via the tax system or through compulsory private health insurance plans. Another example is defense procurement.

In most of the present discussion of the social responsibility of business it is assumed, if only by implication, that making a profit is fundamentally incompatible with social responsibility or is at least irrelevant to it. Business is asked to do things because it earns, or seems to earn, a "profit," which enables it to do "good" even if it does not obligate it to do so. In most discussions of social responsibility, business is seen as the rich man who should, if only for the good of his soul, give alms to the less fortunate.

"To do good in order to do well"—that is, to convert social needs and problems into profitable business opportunities—is rarely considered by today's advocates of social responsibility—even by those, such as Milton Friedman, who deny that business has any social responsibility. Most of the people who discuss social responsibility, including its opponents, would be exceedingly suspicious of any business that asserted—as does, for instance, William Norris, the founder and chief executive officer of Control Data Corporation—that it is the purpose of business to do well by doing good. To those hostile to business, who believe that profit is a rip-off, this would appear the grossest hypocrisy. But even to those who are pro-business and who then, as Andrew Carnegie, demand that business, the rich man, give alms and become a philanthropist, doing good in order to do well would not be acceptable. It would convert what is seen as virtue into self-interest. And for those who counsel business to stick to its last and to leave social problems and issues to the proper authorities, which in fact means to government, the self-interest of business and the public good are seen as two quite separate spheres. But in the next decade it will become increasingly important to stress that business can discharge its social responsibilities only if it converts them into self-interest, into business opportunities.

The first social responsibility of business in the next decade will be one not mentioned in the discussion of the social responsibilities of business today. It is the increasingly important responsibility for creating the capital that alone can finance tomorrow's jobs. In fact, the oldest and perhaps the only truly valid definition of economic progress is the shift to jobs requiring more capital investment per worker. The demand for capital formation will be as great as the demand was a hundred years ago when today's modern industries emerged, and when capital investment per worker over 20 or 30 short years at least tripled and probably quadrupled.

And there will be equal need for a "surplus" to pay for the research and development needed when technology, as well as the world economy and society, is rapidly changing.

In all countries today, whether communist or capitalist, highly developed or barely developing, capital formation is low. This is in part because of the economic orthodoxies of the last 50 years, which put consumption into the center, asserting—without any shred of evidence, by the way—that consumption will automatically, through a "multiplier," lead to investment and thereby to the formation of jobs. This assertion has, I would say, by now been exploded and disproven.

But also it is becoming clear that we have entered a new stage in the evolution of our economy, in which old industries are still declining or are being restructured, but, more important, in which new industries are exploding—information, communication, biochemistry, bioengineering, and genetic medicine. And with them emerge other totally new industries, such as the continuing education of already well-educated adults, which may well be the major growth industry of the next 10 years and which increasingly is not in the hands of traditional educational institutions such as colleges and universities, but in the hands of entrepreneurs, associations, private companies, educational movie makers, and so on.

This new stage makes great demands on capital formation. But what does "capital formation" actually mean, especially in a modern society in which the traditional incentives to personal savings have largely been eliminated? Different countries have different savings habits, with America traditionally fairly low in its savings rates. But savings rates in all countries tend to go down with two factors: (1) an increase in the proportion of the population past retirement age, who as a rule do not tend to save but who primarily consume; and (2) the degree to which Social Security takes care of the risks and contingencies for which individuals traditionally have been saving.

One example is, of course, the United States, where savings rates have gone down in direct proportion to both the aging of the population and the extension of social services to cover such risks as retirement, illness, and unemployment. Another is Japan. In the last 10 years the savings rate in Japan has been going down steadily—although it is still high. It is now widely predicted that the rate will go down very sharply in the next 10 years as Japan becomes as old a society as the societies of the West (whereas only 10 years ago it was still a very young society in its age structure and younger than any other developed society).

Furthermore, we now have conclusive proof that rising income levels for wage-earning families do not materially increase the savings rate. A hundred years ago, when labor economics first began, the standard argument of the "liberals" was that rising income of the working class as a result of unionization would rapidly raise the savings rate of the lower-income earner. This was considered nothing but an extension of one of the best-proven laws of economics, Engels' Law, according to which the rate of *consumption* of commodities in relation to income does not increase once incomes go above the subsistence level but stays level and eventually declines. Conversely then, it was argued, savings must increase disproportionately.

"You have to be able to do good to do well," was Julius Rosenwald's credo.

But this has not happened. Consumption of traditional commodities—such as bread and today, in developed countries, automobiles—does not go up but at first levels and then tends to decline. But, as we also know, new consumer needs, rather than investment, then take over. So—and this is one of the most important discoveries and totally unexpected—rising income levels by themselves do not lead to rising savings rates, just as rising consumption does not by itself lead to rising investment.

As a result, in a modern economy the main source of capital formation is *business profits.* Indeed, we now know that the term *profit* is misunderstood. There are only costs—costs of the past and costs of the future, the costs of economic, social, and technical change and the costs of tomorrow's jobs. Present revenues must cover both, and both costs are likely to go up sharply in the next 20 years.

The first social responsibility of business is, then, to make enough profit to cover the costs of the future. If this social responsibility is not met, no other social responsibility can be met. Decaying businesses in a decaying economy are unlikely to be good neighbors, good employers, or socially responsible in any way. When the demand for capital grows rapidly, surplus business revenues available for noneconomic purposes, especially for philanthropy, cannot possibly go up. They are almost certain to shrink.

Naturally, this argument will not satisfy those who believe that today's businessman should become the successor to yesterday's prince—a delusion to which businessmen unfortunately are only too susceptible. But princes were able to be benefactors because they first took it away—mostly, of course, from the poor.

There are also those, again especially among businessmen, who believe that to convert problems into business opportunities is prosaic and not particularly romantic. They see business as the dragon slayer—and themselves as St. Georges on white chargers. But the proper social responsibility of business is to *tame* the dragon: to turn a social problem into economic opportunity and economic benefit, into productive capacity, into human competence, into well-paid jobs, and into wealth.

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viewpoint

By Bruce Evoy

Broken Promises in The Great White North

In September 1984, Conservative Party candidate for prime minister Brian Mulroney was swept into office in the greatest landslide in Canadian history. His party won 211 of a possible 282 seats in Ottawa's House of Commons, while the powerful and traditionally dominant Liberal Party won just 40 seats.

Mulroney's smashing triumph brought to an end the stormy 16-year rule of Liberal Pierre Elliott Trudeau, a man who once listed his heroes as Machiavelli, Mao, and Castro, though not necessarily in that order. In his youth, Trudeau had belonged to a small socialist party and spent his time excoriating liberals as "idiots" and "nonentities." Realizing that he would never become prime minister as an overt socialist, Trudeau eventually joined the idiots.

His career took off like a rocket. He was appointed minister of justice in 1967, and one year later Canada, in a fit of "Trudeaumania," elected him prime minister. Trudeau retired after 16 years of trying "to discover how much socialism the people of Canada can be made to accept at any given point in time." There ensued a bitter struggle among his would-be heirs.

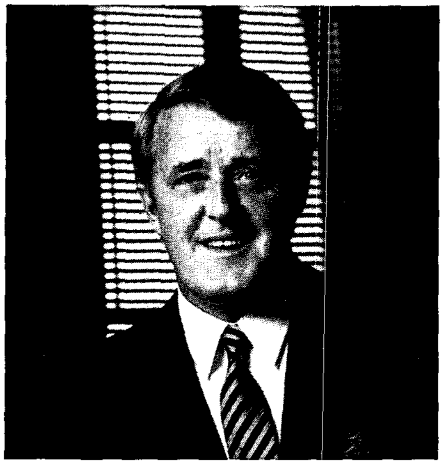
Former Minister of Finance John Turner emerged from a contentious convention the winner in a field of seven. But in the general election, the bland Turner was no match for the magnetic Mulroney, who won easily even in the Liberal stronghold of Quebec.

Mulroney's pre-election promises were legion. He would, he promised:

- slash Canada's Yankee-like budget deficit (it is 7.1 percent of its gross national product, compared with 4.4 percent in the United States),
- strengthen the feeble dollar, down to 72 cents against the US greenback,
- sell off many government-owned enterprises,
- repeal a Trudeau-sponsored law mandating the metric system, and
- curtail Canada's outrageous patronage and sinecure system.

Once safely in office, however, Mulroney retreated from his pledges.

In just one year the deficit has jumped from $36 billion to $40 billion. The dollar's US exchange rate appears in danger of falling below 70 cents. But as the economy weakens, the Conservatives increase the size of the Cabinet and send foreign aid to dictators in Nicaragua, Tanzania, and Mozambique.



Brian Mulroney: Voters hoped he had the right stuff.

There has been *no* success on the privatization front, either. Government-owned corporations such as Petro Canada, the Canadian Broadcasting Company, Canadair, and de Havilland Aircraft remain in the state's hands. Whether any private firm would even want these debt-laden dinosaurs is another question—Canadair lost $1.7 billion in only two years, while de Havilland was comparatively profitable with losses of just $500 million.

Mulroney's response to the populist outcry against metric tyranny was similarly limp. Metric is to stay the official measurement. Businesses, he said, may advertise in both metric and imperial (the traditional measurement)—but not in imperial only.

The battle over mandatory use of the metric system has been fierce and, I think, underreported in the United States. The cause célèbre of the anti-metric crowd involved two gas station owners who defied the Trudeau government's dictates and sold gasoline in both liters and gallons so their "customers could have a choice." The feds came and sealed their pumps; the two protesters promptly cut the seals and were immediately issued felony warrants.

Their legal costs ran into the thousands of dollars, and a fund was set up to help defray these expenses. Sympathetic Canadians staffed picket lines at both gas stations, demanding that the government rescind the metric law and allow Canadians freedom of choice. Tens of thousands of signatures against forced metric were gathered, and bumper stickers were ubiquitous.

The two took their case all the way to the Supreme Court of Canada and won. The Trudeau government appealed the decision, thus denying court-ordered recompense to the two rebels for the months, or perhaps years, that the case will remain in the courts.

When Mulroney took office and reneged on his commitment to make metric voluntary, he left the renegades in that legal limbo. He could simply order the government to drop the appeal, but he hasn't. So much for voluntary metric.

Mulroney was a vehement critic of liberal abuses of patronage when he was an opposition leader, but he seems to have undergone a change of heart since the election. In one year in office he has appointed more than 1,200 of his Tory friends and political supporters to high-salaried positions. It makes the poor Liberals look like pikers!

Canadians have always been a proud, hardy people, but 16 years of Trudeau's socialism have taken their toll. The purchasing power of the Canadian dollar has fallen by 69 percent. Monthly housing payments have skyrocketed 380 percent. The number of government employees has soared by 39 percent. Bankruptcies are up 315 percent. Canada is choking on excessive government regulation of the economy, and her spirit is flagging.

Many Canadians hoped that Brian Mulroney had the right stuff to halt Canada's decline. But the buoyant prime minister has betrayed those hopes in his first year in office. It's business as usual in Canada, and that's not good news.

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