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The End of Management

Corporate bureaucracy is becoming obsolete. Why managers should act like venture capitalists

By ALAN MURRAY

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An office pool in the 1950s.

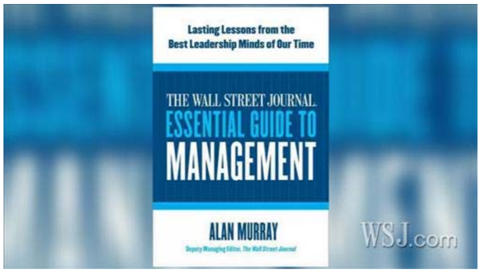
Business guru Peter Drucker called management "the most important innovation of the 20th century." It was well-justified praise. Techniques for running large corporations, pioneered by men like Alfred Sloan of General Motors and refined at a bevy of elite business schools, helped fuel a century of unprecedented global prosperity.

But can this great 20th century innovation survive and thrive in the 21st? Evidence suggests: Probably not. "Modern" management is nearing its existential moment.

Corporations, whose leaders portray themselves as champions of the free market, were in fact created to circumvent that market. They were an answer to the challenge of organizing thousands of people in different places and with different skills to perform large and complex tasks, like building automobiles or providing nationwide telephone service.

In the relatively simple world of 1776, when Adam Smith wrote his classic "Wealth of Nations," the enlightened self-interest of individuals contracting separately with each other was sufficient to ensure economic progress. But

100 years later, the industrial revolution made Mr. Smith's vision seem quaint. A new means of organizing people and allocating resources for more complicated tasks was needed. Hence, the managed corporation—an answer to the central problem of the industrial age.



WSJ Deputy Managing Editor Alan Murray discusses some of the lessons new managers can learn from his new book, "The Wall Street Journal Essential Guide to Management."

For the next 100 years, the corporation served its purpose well. From Henry Ford to Harold Geneen, the great corporate managers of the 20th century fed the rise of a vast global middle class, providing both the financial means and the goods and services to bring luxury to the masses.

In recent years, however, most of the greatest management stories have been not triumphs *of* the corporation, but triumphs *over* the corporation. General Electric's Jack Welch may have been the last of the great corporate builders. But even Mr. Welch was famous for waging war on bureaucracy. Other management icons of recent decades earned their reputations by attacking entrenched corporate cultures, bypassing corporate hierarchies, undermining corporate structures, and otherwise using the tactics of revolution in a desperate effort to make the elephants dance. The best corporate managers have become, in a sense, enemies of the corporation.

The reasons for this are clear enough. Corporations are bureaucracies and managers are bureaucrats. Their fundamental tendency is toward self-perpetuation. They are, almost by definition, resistant to change. They were designed and tasked, not with reinforcing market forces, but with supplanting and even resisting the market.

Yet in today's world, gale-like market forces—rapid globalization, accelerating innovation, relentless competition—have intensified what economist Joseph Schumpeter called the forces of "creative destruction." Decades-old institutions like Lehman Brothers and Bear Stearns now can disappear overnight, while new ones like Google and Twitter can spring up from nowhere. A popular video circulating the Internet captures the geometric nature of these trends, noting that it took radio 38 years and television 13 years to reach audiences of 50 million people, while it took the Internet only four years, the iPod three years and Facebook two years to do the same. It's no surprise that fewer than 100 of the companies in the S&P 500 stock index were around when that index started in 1957.

Google

A foam-brick-filled bathtub in the 'water lounge' at Google's Zurich office.

Even the best-managed companies aren't protected from this destructive clash between whirlwind change and corporate inertia. When I asked members of The Wall Street Journal's CEO Council, a group of chief executives who meet each year to deliberate on issues of public interest, to name the most influential business book they had read, many cited Clayton Christensen's "The Innovator's Dilemma." That book documents how market-leading companies have missed game-changing transformations in industry after industry—computers (mainframes to PCs), telephony (landline to mobile), photography (film to digital), stock markets (floor to online)—not because of "bad" management, but because they followed the dictates of "good" management. They listened closely to their customers. They carefully studied market trends. They allocated capital to the innovations that promised the largest returns. And in the process, they missed disruptive innovations that opened up new customers and markets for lower-margin, blockbuster products.

The weakness of managed corporations in dealing with accelerating change is only half the double-flanked attack on traditional notions of corporate management. The other half comes from the erosion of the fundamental justification for corporations in the first place.

British economist Ronald Coase laid out the basic logic of the managed corporation in his 1937 work, "The Nature of the Firm." He argued corporations were necessary because of what he called "transaction costs." It was simply too complicated and too costly to search for and find the right worker at the right moment for any given task, or to search for supplies, or to renegotiate prices, police performance and protect trade secrets in an open marketplace. The corporation might not be as good at allocating labor and capital as the marketplace; it made up for those weaknesses by reducing transaction costs.

Mr. Coase received his Nobel Prize in 1991—the very dawn of the Internet age. Since then, the ability of human beings on different continents and with vastly different skills and interests to work together and coordinate complex tasks has taken quantum leaps. Complicated enterprises, like maintaining Wikipedia or building a Linux operating system, now can be accomplished with little or no corporate management structure at all.

That's led some utopians, like Don Tapscott and Anthony Williams, authors of the book "Wikinomics," to predict the rise of "mass collaboration" as the new form of economic organization. They believe corporate hierarchies will disappear, as individuals are empowered to work together in creating "a new era, perhaps even a golden one, on par with the Italian renaissance or the rise of Athenian democracy."

That's heady stuff, and almost certainly exaggerated. Even the most starry-eyed techno-enthusiasts have a hard time imagining, say, a Boeing 787 built by "mass collaboration." Still, the trends here are big and undeniable. Change is rapidly accelerating. Transaction costs are rapidly diminishing. And as a result, everything we learned in the last century about managing large corporations is in need of a serious rethink. We have both a need and an opportunity to devise a new form of economic organization, and a new science of management, that can deal with the breakneck realities of 21st century change.

The strategy consultant Gary Hamel is a leading advocate for rethinking management. He's building a new, online management "laboratory" where leading management practitioners and thinkers can work together—a form of mass collaboration—on innovative ideas for handling modern management challenges.

What will the replacement for the corporation look like? Even Mr. Hamel doesn't have an answer for that one. "The thing that limits us," he admits, "is that we are extraordinarily familiar with the old model, but the new model, we haven't even seen yet."

This much, though, is clear: The new model will have to be more like the marketplace, and less like corporations of the past. It will need to be flexible, agile, able to quickly adjust to market developments, and ruthless in reallocating resources to new opportunities.

Resource allocation will be one of the biggest challenges. The beauty of markets is that, over time, they tend to ensure that both people and money end up employed in the highest-value enterprises. In corporations, decisions about allocating resources are made by people with a vested interest in the status quo. "The single biggest reason companies fail," says Mr. Hamel, "is that they overinvest in what is, as opposed to what might be."

This is the core of the innovator's dilemma. The big companies Mr. Christensen studied failed, not necessarily because they didn't see the coming innovations, but because they failed to adequately invest in those innovations. To avoid this problem, the people who control large pools of capital need to act more like venture capitalists, and less like corporate finance departments. They need to make lots of bets, not just a few big ones, and they need to be willing to cut their losses.

The resource allocation problem is one Google has tried to address with its "20%" policy. All engineers are allowed to spend 20% of their time working on Google-related projects other than those assigned to them. The company says this system has helped it develop innovative products, such as Google News. Because engineers don't have to compete for funds, the Google approach doesn't have the discipline of a true marketplace, and it hasn't yet proven itself as a way to generate incremental profits. But it does allow new ideas to get some attention.

In addition to resource allocation, there's the even bigger challenge of creating structures that motivate and inspire workers. There's plenty of evidence that most workers in today's

Granger Collection

Alfred P. Sloan of General Motors

complex organizations are simply not engaged in their work. Many are like Jim Halpert from "The Office," who in season one of the popular TV show declared: "This is just a job....If this were my career, I'd have to throw myself in front of a train."

The new model will have to instill in workers the kind of drive and creativity and innovative spirit more commonly found among entrepreneurs. It will have to push power and decision-making down the organization as much as possible, rather than leave it concentrated at the top. Traditional bureaucratic structures will have to be replaced with something more like ad-hoc teams of peers, who come together to tackle individual projects, and then disband. SAS Institute Inc., the privately held software company in North Carolina that invests heavily in both research and development and in generous employee benefits, ranging from free on-site health care and elder care support to massages, is often cited as one company that could be paving the way. The company has nurtured a reputation as both a source of innovative products and a great place to work.

Information gathering also needs to be broader and more inclusive. Former Procter & Gamble CEO A.G. Lafley's demand that the company cull product ideas from outside the company, rather than developing them all from within, was a step in this direction. (It even has a website for submitting ideas.) The new model will have to go further. New mechanisms will have to be created for harnessing the "wisdom of crowds." Feedback loops will need to be built that allow products and services to constantly evolve in response to new information. Change, innovation, adaptability, all have to become orders of the day.

Can the 20th-century corporation evolve into this new, 21st-century organization? It won't be easy. The "innovator's dilemma" applies to management, as well as technology. But the time has come to find out. The old methods won't last much longer.

—Adapted from "The Wall Street Journal Essential Guide to Management" by Alan Murray. Copyright 2010 by Dow Jones & Co. Published by Harper Business, an imprint of HarperCollins Publishers.

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