

# STOP MANUFACTURER'S SHRINKING PREROGATIVES

*Speech before the Salisbury Chamber of Industries in Salisbury by Prof. G. Marais, Director of the School of Business Leadership, University of South Africa.*



Prof. G. Marais

In modern society the role of manufacturing industries and their real contribution to society is being questioned by governments, consumers and workers, that means by nearly the entire public. Not many years ago the businessman, especially the manufacturer, was the blue-eyed boy of society. Today the feeling is that the manufacturer with his main objective of making profits is, in the process of attaining this objective destroying the environment, exploiting labour and forcing the consumers into a pattern of over-consumption or a distorted consumption pattern. The results are the destruction of natural resources, pollution, poverty, ghettos and slums which create an environment of crime and violence. Is this objective of profits and, following from this, the race to show the highest growth rate, not the reason for the world's present political instability?

## MANUFACTURER'S PROFIT MOTIVE CAUSES POLITICAL INSTABILITY

- \* The Arab nations state that one of the main reasons for the increase in the price of oil is that the oil companies are making double the profits that they, the Arabs, receive per barrel.
- \* The coal miners in Britain compare their wages with those of labourers in other industries and state that indirectly subsidize manufacturing industries with low-priced power.
- \* The Americans are criticising Japanese manufacturers for dumping their products on the American market at such low prices that they cannot compete. This dumping they relate to "the fact" that the American manufacturers are paying their workers far more than the Japanese manufacturers pay theirs.
- \* In the United States a group at Yale Law School came up with the ingenious suggestion that the Justice Department should prevent the motor industry from introducing substantial annual or

semi-annual model changes. According to them this constitutes unfair competition.

- \* Under the auspices of the United Nations, world conferences on the problem of pollution are organised. Manufacturers dump their effluent in rivers and the sea, killing vegetation and sea-life. Some rivers are regarded as fire hazards because of all the oil and other chemicals in the water.
- \* In South Africa, the Natal manufacturers were blamed for causing the strikes in Durban in 1973 because they payed their Bantu labour such low wages.
- \* Politicians also like to say that South African manufacturers try to sabotage the Government's policy of separate development and to side-step job reservation. They locate their factories in our main cities, so increasing the social cost to the Government, but making no direct contribution to this cost.
- \* Companies like Anglo American, Rembrandt and Unilever are criticised because their profits run into millions. It is said that some of their profits should be diverted from shareholders to those in need of education, nutrition and housing.
- \* It is also stated that the high profits in manufacturing industries demonstrate the manufacturing industries' important contributions to inflation by their asking too high a price for their products.

In summary, governments, labour unions and consumers are all coming to hate and, what is more, to actively resist this concept of profits and growth.

Paul A. Samuelson 1) said, "It is obvious that in the years ahead, the so-called private corporation will find itself increasingly subjected to external constraints never dreamed of at the Harvard Business School." He continues, "Not only will the corporation president find he cannot

follow policies that will pollute the atmosphere; he will also discover the hundreds of traditional ways of making business decisions will simply no longer be available to him. Society will expand business's responsibilities and take increasing part in deciding how they are to be met." The businessman must accept, according to Samuelson, the fact that his prerogatives are shrinking.

### **ECONOMIC CONSTRAINTS ON MARKETING TOOLS**

The first action against manufacturing industries constituted constraints placed on their use of marketing tools: price, product development, promotion and physical distribution.

The most important constraint on the use of marketing tools occurs via price control. This is supplemented by increased demands for higher wages, by health and safety, and anti-pollution regulations.

For instance, in the South African fertilizer industry, the prices of the finished product and most of the raw materials are controlled by the Government. Fertilizer companies get no patent rights on new products developed. The physical distribution of fertilizers is in the hands of agricultural co-operatives who are financed by the Land Bank.

If the present two main South African fertilizer companies were in the United States of America, they would also have to cope with anti-trust laws. At the same time, Nader would fight for the consumers and the environmental fanatics would prevent them from emitting smoke into the atmosphere. Simultaneously, the labour unions would be deciding the wages and salaries and, if in Italy, also the number of people to be employed. It is even possible that these manufacturers would not be allowed to become insolvent.

This makes one think of the notice stating that the management regrets that its employees who are dying on the job are failing to fall down. Maybe in some of our developed countries we have reached the stage where we can no longer distinguish between the death and the natural growth of an organisation.

### **ECONOMIC CONSTRAINTS LEAD TO MANIPULATION**

As a result of all these economic controls, many companies were forced to make use of less savoury political strategies. By political strategy, I mean manipulation and accommodation. Manipulation was done through inducement, coercion, persuasion (advertising) and obligation. The use of personal inducement (bribes) and coercion (by gaining control over clients' alter-

natives) further blackened the image of the manufacturer.

### **ARE WE WALKING INTO A FUR-LINED TRAP?**

With the increased action against manufacturing industries, we have to ask ourselves if we are not moving into Parkinson's 2) "Fur-lined Mousetrap"?

Three mice were studying a mousetrap, the floor of which was covered with expensive-looking fur. The steel wires were also lined with the same costly material.

The senior mouse, who had a conservative dark grey coat, started on a note of warning as he referred to a similar structure he had encountered a few years previously. However, the two structures were not identical. While he was considering the previous structure, a contemporary pushed him aside and approached the cheese inside. This mouse was killed instantly. The senior mouse continued: "The work of racists who practice genocide. I would advise you, my friends, to leave it alone."

The second mouse, who was a white mouse with red eyes, said he would like to differ as there was no steel wire in this structure that could fall on them.

The third mouse was pink, excitable in manner and emphatic in his views. "What you have said, comrade", he cried, "is no more than the truth. I should myself describe this piece of furniture as functional and even modernistic; not to the taste, perhaps, of the elderly. Prejudice apart, however, the design is successful. More than that, the fur-lining appears to be mink — or, anyway, musquash — and my guess is that the cheese is Stilton or, possibly, Camembert. Forward, comrades, to the mouse millenium!"

So the three mice entered, only to discover that the cheese was a variety from a co-operative store. Then the cage door fell with an ominous click.

"Mice are useful to the scientists but they are not among the more intelligent animals, even the most astute of them being intellectually inferior to man." Parkinson 2) continues, "we should be surprised therefore, if we were to hear of mankind falling readily into the sort of trap which ensnared the mice. Human beings, we feel, are too sophisticated for that." However, Parkinson 2) concludes, "If such a trap should exist today its framework would consist of economic realities and it would be baited with the promise of social security.

### **THE BAIT ON OUR MODERN TRAP**

Let us look at the bait in our modern trap. The

ecologists see the world as a stationary state where natural resources must be preserved. According to them, this requires better resources management and rehabilitation, better energy conversion systems and better market research. Market research is required to aggregate the needs of the consumers which will be satisfied without creating profits. We think in terms of the need for clean air, clean water, mass transit or medical services. This market information could provide more flexibility, speedy corporate response to social change and indicate where unsatisfied and potential public needs exist. In attaining the ecologists' objectives, companies or industrial activities with large dis-economies will have to close down because they have to take their dis-economies into consideration in their cost accounting. The chemical factory will have to increase its price to cover the cost of cleansing the polluted air and nearby rivers. The ecologist will therefore attempt to create a stationary economy without increasing production and population — all will live under a blue sky and inhale clean air 3).

The socialist's bait is that every individual should receive an income, not according to his productivity, but to give him a good standard of living.

The consumer's bait is that, through price control, firms make smaller profits and are forced to become more efficient and better quality products are sent into the marketplace.

### THE ECONOMIC REALITY IN THE TRAP IS DECLINING INVESTMENTS

What is the economic reality? The economic reality of the above dreams is that increased control and shrinking profits are resulting in a relative decline in productive investment, resulting in a shortage of goods.

Let us first look at the effect of the controls initiated by the ecologists.

In the United States 4) pollution control legislation has cut deeply into funds otherwise available for new capacity or refurbishing of old plant and equipment. In the paper industry in 1973, it is estimated that 43% of the capital outlay went for pollution control expenditure, 22% in non-ferrous metals and 10% in petroleum.

In the case of electric utilities, pollution control expenditure increased from \$100 million in 1967 to \$1,1 billion in 1972. In the USA another inroad into the investment funds comes from the Occupational Safety and Health Act. In 1973 it was estimated that outlay on this item would be \$3,1 billion against \$62 billion on productive capital assets in 1973 (based on 1958 prices). The productive capital assets for 1973 were only 7%

more than in 1972 and only 22% more than in 1965. During the same period, real GNP grew by nearly 36%.

Looking to the future, the First National Bank expects increased expenditure on pollution control, occupational safety and health. Business Week 5) estimates that this expenditure will increase from 10,1 per cent of capital spending in 1973 to 10,9 per cent in 1976.

The other baits for the consumer and labourer result in a government policy of price control. This is an important factor causing declining profits and deterring investment. The First National Bank 4) states, "One deterring factor is price control which, in many industries, has kept prices and profits from rising to levels that would justify heavy investment in a new capacity".

In South Africa, it is unbelievable how few government officials, politicians and farmers believe in the efficient working of the marketing mechanism. The prices of most agricultural and basic industrial raw materials are controlled.

Is it not one of the reasons why we have constant shortages of steel, cement and bricks where prices are at too low a level and a surplus of agricultural products where prices are at too high a level? Consider for example the butter situation.

If you have declining profits because of price control and you have to spend an increasing percentage of your retained profits on pollution control measures, you will invest less in production capacity.

### DECLINING INVESTMENT LEADS TO SHORTAGES AND DISTORTED INVESTMENT PATTERNS

What is the effect of the relative decline in productive investment?

We have two effects — a decline in investment leading to shortages and a distorted investment pattern. On the first, the First National Bank 4) said the following: "However, the industries that have shown the poorest track record for new investment in productive assets over the past five years turn out to be those same industries where the most severe shortages are occurring now."

Where you have shortages you must have price increases and this destroys the main objective of price control.

The second distorting effect is the flow of investment to less productive industries where you have less control.

In any healthy economy, investment must be correctly balanced between different industries.

We have three groups of industries: primary, secondary and tertiary industries. The attack of ecologists and social welfare experts has con-

centrated on the first two because historically these two sectors were the powerful groups. Huge profits and exploitation became associated with these sectors. Wages in these two groups are generally lower than those in the tertiary industry. These two groups are also more associated with pollution and waste of natural resources. Over the years the strong power position of manufacturing industries has been steadily eroded by the public attention focussed on them. The tertiary sector has gone by largely unnoticed. The primary sector, particularly agriculture, has the advantage of a strong voters' support and thus the support of governments.

It is inherent in a person in the Western culture to promote growth but, because of the constraints put on manufacturing industries resulting in lower profits, more and more capital and labour are flowing to the tertiary industries. Everybody now wants to be a medical doctor or a lawyer, or to work in banks and insurance companies. It is interesting that the word profit is not always associated with these professional people.

#### **THE NET POWER POSITION OF MANUFACTURING FIRMS MUST BE RESTORED**

It is important that any organisation remains in a net power or surplus position in relation to its environment. This means that the benefit received from the environment in the form of supply of raw materials, capital, labour, entrepreneurship, must be more than the price the organisation has to pay for these benefits. Any organisation must therefore develop a surplus in some form. Usually it is in the form of profits required to survive and grow. If this net power or surplus is not in proportion to the risk or is depleted for example by pollution control expenditure or price control, or labour unions force the wages of labourers to such a level that this surplus is absorbed, the organisation stops growing or may even close down. Investments then flow to other industries. Political manipulation by management cannot stop it.

To restore growth and confidence in manufacturing industries, the first prerequisite is to restore the net power and thus the profit position of manufacturing industries. The economic realities of no growth in our fur-lined trap will in the long-run not be acceptable to society.

Walter Heller 6) concludes: "..... we can't stop growth in output per man hour." "It is hard to believe that the public would accept the tight controls, lowered material living standards and large income transfers required to create and manage the stationary state." What our ecologists and socialistic friends don't appreciate is that growth is not the route to environmental evil, but is

one of the prerequisites for success in restoring the environment. Growth is necessary for social stability.

#### **STEPS TO RESTORE MANUFACTURING INDUSTRIES' ECONOMIC FREEDOM**

Gentlemen, at present we are with all our controls moving in the direction of what Schumpeter called "capitalism in an oxygen tent". We are trying to kill the goose that lays the golden egg. We must return to an economic policy in which emphasis is again on growth in our primary and secondary industries, especially the secondary industries. To promote growth, manufacturing firms must obtain more economic freedom and there must be less constraints on their using their marketing tools.

The first step to promote growth is a change in the views of what is a reasonable profit. With the rapid changes in technology and erosion in the value of money, we still have popular notion that even in the case of capital intensive industries, a 10%—15% profit is reasonable.

Let us return to a more realistic figure of between 20% and 25% on total assets after tax. My experience with profitmaking organisations is that high liquidity is one of the best ways to motivate management to expand and diversify.

The second step, closely related to the first, is for governments to be careful with price control. It seems that a temporary tool is becoming a permanent instrument against inflation. Firms should be allowed to first adjust their prices for inflation and after the adjustment they should have to prove their case to the controlling bodies. In determining profits, the controlling bodies must allow higher depreciation allowances to enable firms to replace assets. At present a firm must almost reach a level of zero profits before adjustments are made.

The third step is to accept the fact that we have and need big companies. The fact that a company is big in terms of turnover does not say that it makes monopolistic profits and distorts competition.

A fourth step is to prevent labour unions or any monopolistic organisation which can include big companies, agricultural unions, etc., from misusing their power position.

A fifth step is to maintain better control over government expenditure. To be popular with the voters, governments tend to overspend on welfare projects and we may then get a misallocation of resources. What are needed are growth budgets and not welfare budgets.

A sixth step is to be careful in allowing the free imports of manufactured goods to fight inflation. In many cases this does lead to unfair competition

and decline in investment, but seldom to a change in the inflation rate.

However, loosening up the present constraints on manufacturing industries also requires

responsibility to our society on the part of our managers. *Freedom can be appreciated only by the mature.*

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