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TO WHOM DO I REPORT?

by Gary North

And Abraham was old, and well stricken in age: and the LORD had blessed Abraham in all things. And Abraham said unto his eldest servant of his house, that ruled over all that he had, Put, I pray thee, thy hand under my thigh: And I will make thee swear by the LORD, the God of heaven, and the God of the earth, that thou shalt not take a wife unto my son of the daughters of the Canaanites, among whom I dwell: But thou shalt go unto my country, and to my kindred, and take a wife unto my son Isaac. And the servant said unto him, Peradventure the woman will not be willing to follow me unto this land: must I needs bring thy son again unto the land from whence thou tamest? And Abraham said unto him, Beware thou that thou bring not my son thither again. . . . And the servant put his hand under the thigh of Abraham his master, and sware to him concerning that matter (Gen. 24:1-5, 9).

The question of human authority is always the question of hierarchical representation. Whenever we seek to understand the operations of any hierarchy, we must first discover accurate answers for these two questions: Who is the sovereign authority in the organization? Who represents this ultimate authority in the daily operations of the institution?

Abraham's servant swore **covenantally** to Abraham that he would find a wife for Isaac in the land of Abraham's relatives. The woman had to come to Isaac; Isaac was not to return to that land. So, the servant represented Abraham, who in turn acted on behalf of Isaac. Abraham was the servant's master, yet so was Isaac, on whose behalf the servant, under Abraham's general authority, was acting. "And Isaac came from the way of the well Lahai-roi; for he dwelt in the south country. And Isaac went out to meditate in the field at the eventide: and he lifted up his eyes, and saw, and, behold, the camels were coming. And Rebekah lifted up her eyes, and when she saw Isaac, she lighted off the camel. For she had said unto the servant, What man is this that **walketh** in the field to meet us? And the servant had said, It is my master: therefore she took a veil, and covered herself" (Gen. 24:62-65). Isaac was the master who was being represented by the servant. The servant reported directly to Isaac: "And the servant told Isaac all things that he had done" (Gen. 24:66). Nevertheless, the servant had originally "cut the covenant" (hand placed beneath the master's thigh) with Abraham. Thus, Isaac did not question the judgment of the servant; he immediately moved **Rebekah** into his mother's tent (Gen. 24:67), a visible sign that Abraham had passed the inheritance to Isaac.

The servant had also acted on Rebekah's behalf, and on her family's behalf. "And the servant brought forth jewels of silver, and jewels of gold, and raiment, and gave them to **Rebekah**: he gave also to her brother and to her

mother precious things" (Gen. 24:53). Thus, as an entrepreneur – **which** is what a match-maker always is – he had to **fit** together **into** a mutually agreeable settlement the **goals** of all parties concerned: Abraham, Isaac, Rebekah, and her relatives. He had to represent all of them to each other.

Complex Representation

The question of institutional **responsibility** is always **complex**. There may be a vertical hierarchy of bureaucratic power or judicial appeal, but this vertical structure of authority is complex. Its relationships are not always explicitly stated; indeed, they are seldom explicitly stated. What we know is that there is always someone at the top of any hierarchy. Again and again, however, we find that this senior official acts legally in someone else's name, or for another person's interests. He has the final "say," yet his authority is not exercised solely on behalf of himself. He is a steward.

This was surely true of Jesus' ministry on earth. He acted on behalf of His Father's interests. "All that the Father giveth me shall come to me; and him that **cometh** to me I will in no wise cast out. For I came down from heaven, not to do mine own will, but the will of him that sent me" (John 6:37-38). Or, more famously, "And he said unto them, How is it that ye sought me? wist ye not that I must be about my Father's business?" (Luke 2:49). Clearly, Jesus was God's representative on earth. Even to see Jesus was to see God the **Father**:

If ye had known me, ye should have known my Father also: and from henceforth ye know him, and have seen him. Philip saith unto him, Lord, shew us the Father, and it sufficeth us. Jesus saith unto him, Have I been so long time with you, and yet hast thou not known me, Philip? he that hath seen me hath seen the Father; and how sayest thou then, Shew us the Father? Believest thou not that I am in the Father, and the Father in me? the words that I speak unto you I speak not of myself: but the Father that dwelleth in me, he doeth the works. Believe me that I am in the Father, and the Father in me: or else believe me for the very works' sake (John 14:7-11).

Those who believe in Jesus as God's representative in history will themselves be empowered to represent the Father: "Verily, verily, I say unto you, He that believeth on me, the works that I do shall he do also; and greater works than these shall he do; because I go unto my Father" (John 14:7-12). Thus, the Father is at the top of the institutional hierarchy; Jesus was beneath the Father in this hierarchy; the Holy Spirit is sent by both Father and Son to empower members of the church to spread the gospel and exercise authority in history. It is all somewhat confusing.

Does this mean that Jesus is ethically or **ontologically** inferior to the Father? Orthodox Christianity has always denied such a doctrine, from its war against Arianism in the fourth century down to the present battle against the cults. Does this mean that Jesus is functionally **subordinate** to the Father in relation to the creation? Yes. Furthermore, the Holy Spirit is subordinate to both Father and Son in His work in history.

And I will pray the Father, and he shall give you another **Comforter**, that he may abide with you for ever; **Even the Spirit of truth; whom the world cannot receive, because it seeth him not, neither knoweth him: but ye know him; for he dwelleth with you, and shall be in you I will not leave you comfortless: I will come to you (John 14:16-18).**

But the Comforter, which is the Holy Ghost, whom the Father will send in my name, he shall teach you all things, and bring all things to your remembrance, whatsoever I have said unto you (John 14:26).

But when the Comforter is come, whom I will send unto you from the Father, even the Spirit of truth, which proceedeth from the Father, he shall testify of me (John 15:26).

So, the Holy Spirit is sent in Jesus' name by the Father to help men remember Jesus' words, which in turn manifested the will of His Father. The Holy Spirit represents the Father and the Son, yet He is Himself an equal member of the Godhead: "For there are three that bear record in heaven, the Father, the Word, and the Holy Ghost: and these three are one" (1 John 5:7).

If we take seriously the hierarchical ordering of the Trinity **itself**, we should also take seriously the hierarchical structure of the business firm.

Hierarchies and Repraentation

A profit-seeking organization offers to buy and sell products or services. It buys wholesale and sells retail. Yet organizations do not actually make offers; their representatives do. Thus, we face the question of representation, both legal and economic.

Usually, a salesman of goods and services makes an initial contact with a potential buyer, i.e., seller of money. The salesman, like Abraham's servant, must bring the parties of the arrangement together. He must see to it that the wants of all participants are met. If he cannot do this, he will not make the sale. His task is analogous to Abraham's match-making servant.

Who is being represented by the salesman? Legally, the firm is. If it is a corporation, the salesman is acting on behalf of the firm's shareholders. But they have delegated this representative function to the firm's senior management. So, the salesman legally and economically represents his department, which in turn is represented to senior management by a designated person (middle manager) in the divisional hierarchy. The more levels of hierarchy in a firm, the greater the complexity of managing it. Some firms are today striving to reduce the number of these **levels** to as few as three. This is creating a revolution in American business. Middle **managers are** threatened by this revolution. Their numbers are dwindling.

In a free market system, the firm is not economically sovereign. **The consumer is sovereign.** The firm prospers only to the extent that it can meet consumer demand at competitive prices. Thus, the salesman has a difficult task: he must represent the firm to the consumer in both a legal and economic sense, yet he must also represent the consumer economically to the firm. Legally, he is the Firm's authorized agent; economically, he is equally the con-

sumer's authorized agent. If he cannot make the firm's case – "Buy from **us!**" – to a sufficient number of consumers, he must then make the consumers' case to the firm. If the consumers refuse to change, then the firm must. If the firm sells some item only in the color black, but consumers want other colors, the salesman must persuade the firm's senior managers of this fact. This was literally the case with Ford's Model T automobile in the 1920s, when General Motors began offering cars in colors other than black. Henry Ford refused to listen to his salesmen soon enough, and consumers demoted the once-awesome Ford Motor Corp. to second place behind GM, where it remains even today.

Salesmen as Brokers of Information and Motivation

Let us consider a familiar example. A real estate salesman is legally the agent of the seller. Economically speaking, he is the agent of both parties. **Without** a signed contract, the property seller's legal authority remains limited. Thus, the salesman is a dual agent economically. He must bring together a seller of property with a seller of money, a buyer of money with a buyer of property.

We can see this in the **activities** of the real estate salesman. (Observation: rural property, undeveloped land, and commercial property in the U.S. will almost always be handled by a male broker, since men buy such property. Homes are brokered by men and women, but generally most successfully by women, since wives generally make the final decision regarding housing, and saleswomen tend to listen carefully to what wives want, while salesmen tend to push whatever they think is best for their egos and commissions.) He moves back and forth between buyers and sellers, making offers and counter-offers until the deal is acceptable to both parties. He informs both sides about the offers, desires, and alternatives available to each side. It is above all in his capacity as a broker of information that he performs his service.

The agent is usually the employee of a real estate firm. He has to be given extensive authority over the transactions, since the detailed and highly specific knowledge necessary in each transaction is not available to those higher up in management, let alone in some distant city, in the case of a franchised firm. **The more specific the required knowledge, the more authority possessed by the local agent.** Furthermore, the more detailed the required knowledge, the more likely that the agent will work on commission. With responsibility comes the opportunity for rewards proportionate with performance: sanctions.

The commission structure places economic authority where it belongs: in the hands of buyers and sellers. The less authority possessed by managers to impose sanctions, positive or negative, the greater the authority possessed by the actual participants. A profit-seeking firm will delegate economic authority as far down as possible whenever the knowledge necessary for completing transactions is available only at the local level. Thus, a real estate firm will be structured very differently from, say, a public utility.

De-regulation tends to decentralize markets and therefore decentralize firms. So does advancing technology. When IBM was selling **multimillion** dollar computers to large corporations, the proper structure of the firm was more management intensive. Now, however, firms like Dell Computer and other microcomputer firms are consumer-driven. They employ hundreds of salesmen who talk on the telephone all day asking consumers what they want. Production lines are **re-scheduled** daily to meet shifting consumer demand: more peripherals one day, more high speed "boxes" the next day. Flexibility has replaced corporate predictability as computer prices have fallen. The risk of buying a **not-quite-**

right **computer with interchangeable parts is much** lower than buying a **multimillion** dollar computer with reduced or nonexistent substitutability. Corporate predictability (i.e., **bu-reaucracy**) in this market is therefore not nearly so valuable today as it was in 1975 because of rapid changes in technology. The result: IBM's market share is steadily shrinking, and its profit margins are thinning.

We are watching the same thing happen to Japanese firms as price-competitive imports from Taiwan, Hong Kong, and South Korea flood the world markets. The "once hired, never fired" policy of the large Japanese corporations is now producing losses. Idle workers are too expensive to keep on the shop floor and the payroll. The consumer is winning the battle against corporate inflexibility. When he changes his mind, he finds a greater number of firms ready and willing to meet his demand.

This does not mean that firms must become deliberately disorderly or chaotic. On the contrary, they must strive to create a sense of institutional order. This sense of internal order must be the basis of its creative flexibility in response to shifting consumer demand. It operates from a **base, and the base had better be stable, i.e., predictable.** This is why capitalism's profit-and-loss system is basic to the creation of order: it provides all participants with performance guidelines.

The Buck Stops Here

President Harry Truman had a sign on his desk, "The Buck Stops Here." The buck – or dollar bill – is a symbol of personal responsibility. "Passing the buck is a common phrase that describes people's attempt to pass responsibility to someone else.

The fact that the U.S. currency unit has become a symbol of responsibility testifies to the market-oriented origin of American thought and culture. The possession of money does indeed imply the possession of responsibility; this fact is recognized by this popular slogan. But what the slogan also points to is people's desire to avoid responsibility. It reinforces another familiar slogan, "Success has a hundred fathers; failure is an orphan."

Those who receive payment also receive responsibility. Those who make payment also become responsible. How can both facts be true? Because buyers are also sellers. Each party to a voluntary transaction receives payment; each is therefore a responsible economic agent. Responsible to whom? To the buyer. The seller must not use fraud to make the sale.

The **source of funding in any organization is** assumed to be the sovereign agent. Whenever an investigator seeks to discover the locus of sovereignty in any organization, he should first answer the question: "What is the source of its funding?"

Civil government is financed through compulsory taxation. While the citizen is technically sovereign, in most cases (excepting revolutions and major political shifts) the sovereign agent is the unit of government that disburses the tax money. Thus, civil government is inherently a **top-down bureaucracy.**

The profit-seeking business is governed ultimately by the decisions of consumers to buy or not to buy. Consumers are the source of a firm's funding, but they do not exercise their authority directly. As in political life, these **legally** sovereign agents need authorized representatives. In politics, these sovereign representatives are elected or appointed by those who are elected. In business, those who own the company are the economically sovereign representatives of consumers.

The owners of the firm (e.g., shareholders) may delegate management responsibilities to hired managers. These managers **are legally the representatives of the own-**

ers, but **economically** they are also the representatives of the consumers. Owners have the legal authority to hire and fire senior managers, but profit-seeking owners will be heavily influenced by the "votes" submitted by consumers: profits or losses. It is true that senior managers are not easily fired, but to the extent that corporate take-overs are possible through the purchase of shares by "raiders," the sovereignty of consumers is maintained. Their decision not to buy the firm's output at profit-generating prices is registered forcefully by the decline of share prices in the market.

Thus, shareholders inevitably face the problem that the buck stops with them. The fewer the bucks that get to them, the more obviously they have to do something to change corporate management, either by co-operating with other shareholders to force the necessary changes or by selling their shares to someone who will.

And We Thank You

The profit-seeking firm may appear to be a top-down hierarchy, analogous to a military organization, but in fact **business is established in terms of a very different structure.** It is a two-way structure based on criteria of profit and loss. Those at the top of the legal pyramid are merely economic representatives of those at the bottom: consumers. The goal of shareholders and their legal agents, senior managers, is profit. Profits come in a free market society through serving the interests of those who have money to spend: consumers. Without their support, the firm cannot survive. The enormously successful television commercials for **Bartles & James** wine coolers always end with the "bumpkin" saying: "And we thank you for your support." Economically, this is exactly the case. Repeat business is the life blood of the vast majority of profit-seeking firms.

The goal of the profit-seeking firm must be to meet the demands of consumers at a price they are willing to pay. This is the only basis for repeat business. To do this, they must forecast future demand and future supply. The economic representatives of the consumers, senior managers, must plan the future of the production process, from beginning to final sale. They must estimate costs and revenues. They must estimate market demand at suggested prices. They must predict the responses of their competitors. They also have to predict government policies and their consequences. They must do all this in the name of the consumer, for their incomes depend on the decisions of **consumers.**

The entrepreneur is better able to make these plans than consumers are. Few consumers make shopping lists two years in advance. They assume that their wants will be taken care of by others, just so long as they have money to spend. Thus, consumers can safely delegate planning decisions to entrepreneurs, who have the advantage of being able to make plans in terms of the law of large numbers. The entrepreneur does not know what each individual consumer will buy, but he has a good idea of what a large group of them are likely to buy.

The consumer need not thank the entrepreneur. Money spent on his product or service is all the thanks he expects. But the seller had better do his best to persuade the consumer to make another purchase sometime. He needs continued support.

The Predictability of performance

The goal of the profit-seeking firm is to get repeat sales from existing customers. It costs too much in advertising to attract each new customer; far more cost-effective is selling the existing customer another service. This means that the customer must become somewhat dependent on the

firm. He must learn to trust the firm's performance. He decides not to test the services or products of another competing firm because he is satisfied with the performance of the first firm. Searching out new alternatives is expensive for the consumer; if existing service is high and predictable, he can save this expense. Furthermore, it becomes that much more expensive for rival firms to lure him away.

To the extent that a firm's consumers want predictable service, to that extent should the firm's management strive to create a sense of permanence. Another firm may be faced with a market that is geared to technological innovations. In this case, consumers drive the firms into innovation. It is much more difficult to defend a market by means of institutional continuity. In those fields such as food service, where tastes are relatively fixed, predictability is paramount. In those fields where being "the first of your block to own one" is a strong underlying motivation, innovation and change are paramount. But even in this case, predictable service, especially repairs, is important. Only where innovation is so rapid that the repairs cost more than buying a new replacement product will predictability be replaced by innovation. There are not many markets like this.

Most firms therefore have an over-riding incentive to offer predictable services with high standards. McDonald's revolutionized American eating habits by standardizing food quality in every outlet. Only after careful testing does the company launch a new **product** line, such as salads. The company's goal today is to create a universally predictable product line internationally, despite the high employee turnover rates experienced by the industry (3009' per annum). **There is continuity of high performance to undergird the corporation's limited flexible** responses to changes in consumer demand. The management recognizes that there is no surer way to lose business than to tamper with a successful formula.

The franchise revolution, of which McDonald's is the premier example, rests on the ability of those who create a corporate manual to standardize employee performance. Everything is broken down into simple, repeatable steps. This is the way, in Michael Gerber's words, to call forth extraordinary results from ordinary people. The operations manual provides the rules for integrating the hierarchical organization. We shall discuss this in greater detail in the third section of this study of the covenantal structure of business: "What Are the Rules?"

Conclusion

The basis of all ownership is stewardship. God owns this world. "For every beast of the forest is mine, and the cattle upon a thousand hills. I know all the fowls of the mountains: and the wild beasts of the field are mine" (Ps. 50:10-11). Thus, all power over property is ultimately based on a system of legal subordination under God. This is as true of business as of all other forms of property management.

In political theory, modern democratic theory says that politicians and bureaucrats are public servants. The people, in their status as voters, are legally sovereign. In economics, modern free market economic theory asserts the

same thing for the business firm. The people, in their status as consumers, are economically sovereign. Owners and managers are necessarily servants of the consumers, except when civil government intervenes and replaces private consumers, either by buying the output of firms or by regulating them in the name of the electorate. Both systems, politics and business, are necessarily hierarchical.

At each level of any profit-seeking hierarchy, the individual needs to keep in mind how his own efforts can best serve the needs of the final consumer. He must see himself as a representative economic agent of the consumer. He must pass on to his superiors relevant knowledge with **respect to consumer demand. He must motivate subordinates to implement the policies of senior management, who are also acting as agents of the consumers. Only** to the extent that the hierarchy creates economic incentives for its members to pass accurate and effective information upward and downward along the chain of command, in order to meet consumer demand, can the firm's members expect to survive the pressures of market competition. The more accurate the information and the more responsive the organization is to shifts in consumer demand, the more profitable the firm can be.

The problem for any hierarchy is to make sure that the firm's legally sovereign owners are diligent in hiring managers who will pay attention to consumer demand, including demand that the consumers do not yet know they will register. To design a structure that facilitates sharing of information and voluntary co-operation is not easy. The key is the generation of information and appropriate incentives to act on behalf of the consumer.

There can be no institutional authority apart from hierarchy. This is an inescapable reality because of the **inescapable** nature of responsibility and the inescapable reality of the division of labor. No one can know everything and do everything; thus, tasks must be delegated. While God knows everything and can do everything, we see the division of labor and hierarchy even within the Godhead, as an example to man.

The successful organization is the one that makes possible above-average performance from average people. It is, to use the description of the British Navy, an organization designed by geniuses to be run by morons. It is predictable and orderly to an extreme, yet also flexible enough to continue to upgrade services and meet new consumer demand. But orderly performance counts more than innovation for existing low-technology firms. This is why great firms in a particular market tend to dominate it for generations, unless wholly new technologies are developed elsewhere that make its product **or** its market obsolete. Good examples are Campbell soup and Arm & Hammer baking soda. Service organizations that are well managed and which produce predictable high service remain dominant for long periods of time.

The businessman reports to the owners of the firm in the name of consumers. Then he reports back to consumers in the name of the owners, who seek to represent the consumers economically. There must be two-way reporting in a profit-seeking business. The consumer, however, is the final earthly authority. His will be done, under God.