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The Overhead Industry



One of the most significant problems facing industries, in developed (service/knowledge-oriented) countries, is that they are subject to intense pressure from "service organisations" and "service people" that tend to provide end-products which are little more than an overhead to the core industrial sector. Overheads are a part of any business but, in the past, the objective was always to minimise these overheads and the demarcation line between overheads and services was considerably clearer.

In many developed societies, service providers have become a formidable force and, since their objective is (perhaps justifiably) to increase market share (or their position within an organisation), they have developed sophisticated strategies to muddy the waters and obscure the demarcation between service and overhead. In other words, there has been a concerted effort to increase overheads for industry, in developed countries, while at the same time portraying this as an increased level of service.

A significant factor behind the increase in overheads is that, in developed countries, most large industries are so complex and multidimensional that they run as "open-loop" systems. In other words, there is no accurate feedback of how specific decisions, related to overhead providers, affect the productivity of an organisation. Even if such feedback could be provided, to an acceptable level, it is doubtful that any realistic mechanisms could be put into place to correct many of the problems that have arisen. In simple terms, there is too much fat in the system and, until the fat disappears (i.e., penury or recession), little can be done to address the imbalances that arise from the enormous range of overheads that are introduced into developed societies. History tells us that in most developed societies (Greek, Roman, etc.), complacency can become so chronic that the societies eventually disintegrate in one way or another. In the past, this was primarily due to military conflict. In the future it will more probably come about as a result of economic competition. Overheads and complacency, therefore, tend to be two sides of the same coin.

In developing countries, there are far fewer service providers and the emphasis in industry is in obtaining a higher market share through cost-competitiveness. The chains of command between the *doers* and the *how-to-doers* are (by economic necessity) much shorter and the controls much tighter because industry in developing countries needs to compete on cost if it is to flourish. The combination of overhead minimisation and cost-competitiveness in industry tends to lead to a rapid rise in national

productivity. Developing countries are therefore more closely attuned to the fundamental concepts of industry as a business than are developed countries.

The childhood prose that contains the line "*to market to market to buy a fat pig...*", encapsulates one of the fundamental tenets of business. That is, people go to the market to buy a specific end-product and nothing more. The rhyme doesn't mention going to the market to buy a fat pig and:

- 12 pages of color-glossy brochure
- 11 pork management consultants' time
- 10 second advertising segments on national television
- 9 hours of marketing consultants' time
- 8 total quality management (TQM) specialists
- 7 computer systems analysts specialising in pork simulation
- 6 lawyers specialising in pork legislation
- 5 accounting executives
- 4 executive presidents
- 3 French chefs
- 2 pork sales executives and a partridge in a pear tree.

The rhyme probably doesn't include these items because they are all overheads to the pork-buying process and, that being the case, they can be excluded, by artistic licence, from childhood rhyme. One can only ponder, therefore, on why such overheads have been allowed to gain such prominence within industries in developed societies.

There are a number of reasons why service industries, and service people, proliferate in developed societies to the extent where they become a burden on the industrial sector. The most obvious one is the perception that manufacturing (doing) is an "unclean" activity, while the provision of services

(*how-to-doing*), such as marketing, management consulting, etc. is perceived to be "clean". The other factor is that humans are still basically animals and the animalistic "domination" characteristic tends to spur them on to seeking management positions, within the pyramidal corporate structure of an organisation, in much the same way as other animals jostle for top position in a herd. In many developed countries, the apex of the corporate pyramid is also more closely aligned with *how-to-doing* activities than it is with doing activities.

In older schools of thought in business, it was accepted that in order to become the leader of the industrial herd, one had to gain experience by getting one's hands "dirty". However, that notion was eroded in many developed countries when universities began issuing certificates that, in effect, stated that an individual could by-pass the "doing stage" in an industrial organisation by completing a course in management, marketing, etc. - thereby getting to the top of the industrial herd without getting his/her hands dirty:

Dear Industrialist

This degree in management certifies that Johnny should be excused from getting his hands dirty (because he gained immeasurable experience by reading a book on the subject) and should be promoted to a senior executive level as soon as possible...

Signed

Johnny's University

The "*get-to-the-top-of-the-herd*" courses, run by universities around the world, are not necessarily harmful in themselves but, rather, in the messages that they portray within society and to the students which they purport to educate. In general, commercially-oriented courses tend to teach a range of subjects related to administrative procedures within an organisation - venture capital acquisition, industrial relations, cash-flow analysis, etc. These administrative procedures are then packaged and sold to potential students under the seductive title of "management", as though such an abstract and unscientific concept could ever be mathematised and converted into a series

of lectures, tutorials and examinations that would make one capable of running an organisation.

The seriousness of this problem cannot be underestimated because, in developed societies, somewhere in the order of 30-40% of all university graduates will leave the system with the illusion that they are "management material". Given that, the majority of a developed society (in the order of 80%) may receive (or expect to receive) a university education, within the early decades of the 21st Century, nearly one quarter of the population will perceive themselves to be "managers" and the overwhelming majority of society will perceive themselves as being *how-to-doers*. The danger, for developed countries, is that companies will create management (overhead) positions in order to placate staff who see management as a career opportunity. This sequence of events is a serious departure from the older schools of thought where, first one had to learn to do; then do; then learn how to manage; then manage; then become a manager.

The crux of the problem is that, unlike the more traditional university courses of architecture, engineering, medicine and science, the "management" courses tend to be somewhat vacuous because they impart *how-to-do* concepts to people that, in the main, have no "*doing*" concepts. Moreover, a person with a university degree, who has been led to believe that they are "management material", is less likely to want to get their hands dirty by "doing" than is a tool-maker, fitter-and-turner, engineer or even a scientist.

To some extent, people in the management field would argue that the administration of cash flow, venture capital acquisition, etc. is "doing" and that they are therefore an essential part of the industrial process. This argument has some merit but, again, it must be remembered that customers buy physical products not overheads. A can-opener purchased from a manufacturer that has no venture-capital specialists, marketing analysts, etc. may be considerably better and cheaper, in the eyes of the consumer, than a can-opener purchased from a manufacturer with all the above *how-to-doers*. In other words, the consumer has no interest in the areas to which many modern industries ascribe a great deal of value.

Teaching "management" is akin to teaching someone about the pain level of a broken leg - nothing can compare to the real experience. And so, one of the greatest failings of business courses in universities around the world is that they simply don't expose students to the realities of the market-

place. Perhaps, if all business, marketing, accounting and economics students were required to spend a semester running a fruit and vegetable stand in a traditional market, then industries in developed countries could dramatically reduce their overheads, once these enlightened souls graduated and rose to prominent positions.

A traditional market is an enlightening place for managers that are accustomed to the traditional corporate pyramid. A vendor purchases a box of bananas from a supplier and places them on a stand. Any purchaser, who wishes to buy a banana (or bananas), hands over some money and, in exchange, the vendor hands over the banana (or bananas). Purchasers make their choice of banana vendor based on the price of the banana, the quality of the banana and the way in which these relate to other banana vendors. The simple market-stall exchange should, in fact, be the fundamental principle of all business:

"banana - money and money - banana".

Everything else is, in the mind of the purchaser, an overhead. Management is an overhead, not a productive part of business; marketing is an overhead; advertising is an overhead; accounting is an overhead; cleaning is an overhead, and so on. All these overheads need to be minimised or, preferably, eliminated. People eat bananas, not managers, marketers, advertisers or cleaners. People open cans with can-openers, not with color brochures that contain seductive pictures of can-openers.

The reduction of overheads in industry has become a complex task in most developed societies. One of the reasons for this is that the people who run organisations are, themselves, amongst the most significant overheads. So, the tendency is to only ever reduce overheads that occur below the level of those reducing the overheads. For example,

"First-class air travel for the chief executive officer (CEO) is an essential part of doing business, but the cost of toilet paper in the factory-floor bathrooms is crippling us..."

In the older school of business (and that practised in countries such as post-war Japan), managers were former *doers* and had a greater appreciation of the end-product, and the way it was perceived by the customer, in relation to the overheads that went into that end-product. In pre-war-developed countries,

however, the movement away from old-school managers to new-school managers led to a proliferation of overheads both within and without the industrial environment - primarily because those who were, themselves, overheads, within the environment, could relate to (and sympathise with) the services provided by those who were overhead providers inside and outside their environment.

In developed societies (or more specifically, Western societies), the transition from the old-school managers (who arose from *doers*) to the newer school (who were bred as *how-to-doers*) came about because there were problems with "old-school" managers. Typically, the old-school managers were unskilled at the administrative procedures that became commonplace subjects in university business/management courses. As a consequence of the inadequacies of the old-school management, companies were often unable to acquire venture capital; to manage their cash-flow; to control bargaining processes in industrial relations and so on. Hence, the need arose for a new breed of manager who could address all these issues. A logical way to redress the problem would have been to educate "old-style" managers with modern business administration procedures. However, the serious mistake made in pre-war-developed countries was to reverse the old situation and to elevate management (i.e., an overhead) into a professional entity in its own right - divorced from the productive sectors of the organisation. The former approach could have created real managers, with real industrial knowledge and administrative knowledge - the latter approach led to administrators attempting to run industries that they could never be expected to understand.

The complex web of overheads that was created to support and/or pander to people, who were already an overhead to the industrial process, reached absurd levels in the latter decades of the 20th Century. To begin with, there were the more obvious overheads of secretarial and administrative staff and the essential overheads of office accommodation, computer and communications services and so on. However, there were also the less visible overheads associated with staff who were already overheads. These included the accounting/payroll and personnel staff and recruitment agencies associated with increased staff levels. These overheads were common to most organisations but, even less visible, were the overheads imposed by the more insidious aspects of the modern management profile.

The introduction of the so-called "package", for senior staff in an organisation, imposed many invisible burdens which were ultimately reflected

in an organisation's product costs. The concept of the "package" was that senior employees could substitute a portion of their notional salary for in-kind goods and services. The most common example was the car, and other items, such as mortgage repayments, tuition fees for offspring, etc. were also a part of the so-called "modern" business. Conceptually, the idea of packaging had merit from a number of perspectives. In some countries, packaging of salaries led to tax reductions for the company and/or the employee because it replaced cash transactions with a form of bartering.

From a company perspective, the other key benefit of packaging was an invisible cage built around employees to prevent them from leaving, in the event that employees became useful to the company (or, more aptly, useful to competitor companies). The package inextricably linked as many personal aspects of an employee's life as possible into the company (the mortgage, the car, school/university fees, etc.). The package also made it possible for employees to indulge themselves with exorbitant personal items (such as luxury cars, membership of clubs, etc.) without having to justify the indulgence to their spouses. The objective was to make it as difficult as possible for an employee to negotiate a comparable arrangement with another organisation and, hence, the package was intended to produce loyalty as an outcome.

The problem with engendering loyalty, through salary packaging, was that financial rewards were only a part of what professional staff viewed as their motivation for remaining with an employer. Packaging did not address the other important aspects associated with engendering loyalty. For example, a salary package, no matter how large, could not compensate for lack of job satisfaction for more than a transient period. Moreover, it could not compensate for the traditional concept of loyalty emanating from the company itself. Many senior employees became only too aware that the lucrative "modern" packages were a replacement for the older style "packages", where one received reasonable levels of pay and some notional security that the employer would not immediately seek to retrench, in the event of an economic down-turn.

Many employees would now accept the view that, in most countries, employers need to retrench, during periods of recession, without making any significant attempts to maintain staffing levels. Despite union rhetoric to the contrary, there is a sense of inevitability that this is a feature of modern business management (cost-cutting) throughout the developed world. In some

organisations, there is also a sense that one's own employees are never as good as those that can be acquired from elsewhere (the grass is always greener) and so, there is no compunction to retain existing employees ("*we can always find someone better when things improve...*"). This has resulted in organisations becoming little more than an amalgam of individual companies (the "*me incorporated*" syndrome) where the philosophy is for everyone to acquire as much as they can, as quickly as they can, because the game ends when the recession starts or when penury occurs. At a lower level, this became part of the collective bargaining process with unions. At a higher level, it became known as salary packaging.

By the end of the 20th Century, the old-fashioned notion that profits could solely be returned to share-holders (because they were the financial risk-takers) eroded because employees, in the modern business environment, became contractors ("*me incorporated*") that also took a significant risk in working for a company:

- "*How long will this organisation remain in business?*"
- "*How applicable will my skills be, elsewhere, if this organisation ceases to exist?*"

This changing, and unstable, environment was a far-cry from the two-way loyalty arrangements that existed, in many developed countries, in the middle of the 20th Century. As a result, in exchange for flexibility, the resulting overhead was a loss of loyalty and a more-mercenary attitude from the employees, who became defacto companies in their own right. The issue of "fair" pay also became somewhat meaningless because the role of "*me incorporated*" was to maximise earnings for a given number of hours of service.

For some companies, the establishment of a myriad of "*me incorporated*" organisations (within) could be managed because the entire corporate pyramid moved towards an "outcome-oriented" approach. However, for those companies that persisted with the fixed-working-hours approach, and the idea that employees would be loyal enough to provide additional services, gratis, there was a belated recognition that staffing flexibility created significant overheads of its own.

Once organisations devolved into an amalgamation of "*me incorporated*" departments, then the processes of salary packaging and collective bargaining became akin to out-sourcing of services. The basic philosophy, in packaging, was to indulge employees as much as possible during periods of high economic activity (in order to maintain the best staff); retrench them during periods of low activity and then hire new ones during the next growth cycle.

The overheads associated with the "*hire, indulge, fire, re-hire, re-indulge*" cycle were almost impossible to calculate, so it was difficult to determine how management could have pursued this philosophy on the basis that it provided cost benefits to industry. Given all the hidden overheads, associated with the cost of acquiring staff, training, learning curves, etc. it was quite possible that the modern business ethic actually cost considerably more than the older approach of maintaining reasonably-paid loyal staff over longer periods. However, the rather narrow perception was that a company that applied the "*hire, indulge, fire, re-hire, re-indulge*" philosophy appeared to be leaner and more efficient (flexible) during periods of recession. By the end of the 20th Century, many companies were not structured to survive a recession without retrenchments and, yet, their pyramidal management structures were still founded on the mid-20th Century concepts of loyalty emanating from staff. From the perspective of "*me incorporated*", however, the objective was to ensure that the interests of "*me incorporated*" were protected and that average earnings (over a life-time) remained high. Who then can tell whether the modern approach to management reaped any genuine rewards, given the visible and invisible overheads that were created?

Salary packaging is just one example of many indulgent activities, in developed countries, that imposes significant administrative overheads onto industry. For the most part, these overheads become invisible because they tend to be incremental. If one employee receives a package, then the administrative burden of acquiring vehicles, paying bills, etc. can probably be absorbed by existing staff. However, as the number of packages (and their complexity) increases, the number of support staff also has to increase and these increases are quantum. Hence, the cost of the package can become significantly greater than the monetary value that it was intended to replace. Moreover, the new cost is another invisible overhead. The fact that companies, in many developed countries, have inextricably linked personal indulgence items with salary means that in many large organisations, it is

impossible to differentiate between legitimate and relevant business expenses and those which are simply overheads.

Business travel is another fundamental element in the indulgence of modern employees and is one of the more significant overhead industries established in recent years. During the 1980s, airlines around the world established a series of indulgence/bribery schemes to seduce the "business traveller". These were very carefully targeted at those endeavouring to get to the apex of the corporate pyramid. Predominantly, airlines utilised the seductive *"you're a very important person, you work very hard and you deserve to be indulged and rewarded"* theme to snare prospective customers. This resulted in special club facilities for business travellers and, when combined with the airline-loyalty programs (frequent-flier, bonus-buying points, etc.), served to muddy the waters between legitimate business and overhead. In the latter decades of the 20th Century, the marketing strategy of major airlines appeared to be to create a convoluted process to purchasing a flight-ticket and boarding a plane, and then pretending to resolve the problem (which was normally of the airlines' own making) by creating a better class of travel (for the VIP) and by allocating special lounges / club facilities that became another expense for industry.

It is self-evident that the business travel phenomenon, engendered in the 1980s, was intended to boost business travel (particularly unnecessary business travel) and yet it crept into the normal way of doing business because it was an incremental incursion. Despite the best of intentions, it was unlikely that airlines had any interest in whether passengers were better served - other than the way in which this manifested itself upon financial returns for the airlines. In inducement programs, there was clearly a significant benefit to airlines, which not only recouped the cost of the programs but also boosted their core level of business. As a result of carefully-designed marketing strategies, the indulgent non-essential elements, which were built into business travel, blurred the demarcation line between overhead and service and also (intentionally) enhanced the airlines as an overhead industry. The sequence of events was generally as follows:

- An executive employee decided that business travel was tedious and that he/she therefore deserved special treatment when travelling on business

- The employer funded a higher class of travel and the executive employee took the opportunity to use airline (loyalty) inducement programs
- The airlines pandered to executive employees by lavishing attention on them and leaving the employees with the feeling that they were more important (than they may actually have been to their organisation)
- Executive employees realised that they could personally benefit from making use of the business travel, firstly, by being indulged by the airline and secondly, by gaining free personal flights and/or goods from the airline
- Executive employees convinced themselves, either consciously or subconsciously, that they were really doing all their travel for the good of their organisation
- Executive employees convinced their organisation that they needed to travel more, naturally, for the good of the organisation ("*that last trip to Paris saved us a fortune...*").

The overheads in the travel example arose from three sources, one visible and two invisible. The first, and most visible, was the increased cost of travel and accommodation (the latter cost generally being much greater than that of the air-fares in any case). The second was related to unnecessary travel initiated by employees. The third overhead was the least visible and was the one generated by the lowering of company morale that occurred whenever senior staff were seen to be abusing corporate privileges.

The lowering of company morale was also one of the overheads imposed by the "*hire, indulge, fire, re-hire, re-indulge*" cycle that came into operation in many developed countries. The fact that senior staff were seen to be indulging themselves with items, that were not related to the core business (e.g., travel and cars), promulgated the old "*what's sauce for the goose is sauce for the gander*" philosophy. If leaders were seen to be indulging themselves (or, in many instances, blatantly abusing corporate privileges, without apparent redress from senior management), then the perception (whether valid or not), at a lower level, was that stealing from the company was an acceptable part of doing business - after all, it was only

another type of overhead. In other words, if it was acceptable for senior staff to use company vehicles or airline incentives, acquired at company expense, for personal benefit, then the use of nuts and bolts from the factory floor (or sick-leave entitlements or stationery from the stationery cupboard), for personal benefit, was also indirectly sanctioned. Regardless of how senior staff endeavoured to rationalise their behaviour, relative to that of the shop floor staff stealing nuts and bolts or stationery, the fact of the matter was that many organisations had put into place regimes where it was seen to be acceptable to use company funds for purposes that had only personal benefits to specific employees. This was considerably different to simply "paying" a higher salary because it pertained to the way in which people viewed the behaviour of others in the organisation.

In the above instances, we have seen that overheads often generate other invisible overheads, some of them direct and some of them indirect. The above example is, in fact, another illustration of the overheads imposed by the proliferation of *how-to-doers* in organisations whose profits are, in practice, generally only dependent upon sales of the output of the "*doing*" phase. The real overhead of having pure *how-to-doers* in management positions is that they can never become true leaders, any more than a dog, chasing a car, can ever learn how to drive it. A lack of true leadership is an enormous overhead that costs far more than salary and airline tickets. It has immeasurable costs pertaining to morale, productivity and the very attitudes with which employees enter the work-place on each and every working day.

An appurtenant example of the *how-to-do* style of management, and the way it impinged upon productivity and morale, occurred during the 1980s in a relatively large company that manufactured plumbing fittings. For many years, the production lines had been staffed by long-serving employees, who were so familiar with the idiosyncrasies of the production equipment, that they could adjust a screw or knob and keep the line going with minimal down-times. However, a new breed of *how-to-do* management was appointed by the board to "*improve efficiency*". The new breed managers noted that the staff on the production line were essentially unskilled workers, who had reached relatively high pay levels as a result of their longevity. It was decided to retire these workers and replace them with new unskilled workers at much lower pay levels - this, it was decided, would reduce overheads. Needless to say, the productivity of the lines dropped immediately as downtime increased. The loss in productivity was many times greater than the reduction in shop-floor pay levels. However, after commissioning a

consultant (who may well have earned more than the incremental cost of retaining the experienced employees for several years), the new breed management was able to report to the board that overheads had been reduced but, as a result of "ageing equipment", productivity had dropped and more money would need to be invested in new production lines. The board accepted the rationale and was pleased that overheads had been reduced.

There are also many other examples of overheads, within industry, that continue unchecked because those that control various industries are the recipients of the benefits. A key problem area arising, within the business and industrial sectors of many developed countries, is the self-ascribed value that overhead providers appear to be able to place on their services with, seemingly, few people capable of questioning or moderating their demands. This is not surprising because of the inherent traits of the corporate management pyramid and because it is almost impossible to accurately determine the dollar benefit of an overhead. At executive level, for example, it is common to leverage salary levels by applying the adage that "*if you pay peanuts, you get monkeys*". On the other hand, few executives are able to explain what is expected from monkeys in the event that they have been paid real dollars.

The issue of executive (overhead) salaries in industry is a contentious one. It isn't the emotive/political questions of fairness or social equity that should even be considered here but, rather, those of reasoning and common-sense. In the 1980s, in the United States, for example, the CEO of an automobile company could earn in the order of 200 times the salary of a shop-floor worker that, say, attached wheels to vehicle bodies. There were two basic arguments that were used to derive the CEO salary. One was the supply and demand principle (if you pay peanuts, you get monkeys). The other was the intrinsic value of the work being performed (i.e., the skill being applied or the returns to the company for each hour of work provided). However, neither of these arguments were altogether convincing, when the ratio of CEO to shop-floor salaries was so extraordinarily high, and at a time when Japanese CEOs were running their own companies (far more successfully) at 20% of the US equivalent salary.

Firstly, in support of their earnings, the CEOs could argue that, say, an automobile company could not function without their skills but then, neither would the company be likely to function by selling cars without wheels. Secondly, the board of directors would probably argue that unless they were

able to pay a CEO salary, comparable to international levels, then they would be unable to secure a suitable person for the position. This is another contentious point. Boards of directors in large companies have never been known for wild experimentation in the choice of CEOs and would not be in a position to accurately assess whether or not a "wheel-fitter" from the shop-floor (who was paid at their existing salary) could do a better or worse job at running an organisation than the traditional types of CEO (that were paid 200 times a shop-floor salary). Some of the world's largest and most successful corporations were started by people with no significant formal management education. Perhaps, the wheel-fitters could even do a better job - after all, experiments conducted in Sweden illustrated that chimpanzees, arbitrarily selecting shares for investment, were able to generate better returns than so-called expert stock-brokers. So, there is some evidence that paying peanuts, and hiring monkeys, is not necessarily a poor course of action.

There is no suggestion that all employees should be paid the same amount (a lesson well-learned from the failure of Communist and Socialist regimes). Such an approach clearly leads to a total lack of motivation and innovation. The larger issue is whether or not salaries should be dependent upon positioning within the, rather dated, management pyramid that tends to give remuneration preferences to *how-to-doers* over *doers*. The net overhead is, again, immeasurable but results in a general scuffle to move up the pyramid, rather than in a lust to excel in "*doing*" functions (that are, ultimately, responsible for income). Moreover, the management pyramid becomes unworkable if every successive layer insists upon a higher remuneration than the layer below and the layers below suddenly acquire a high value. For example, if a designer is found to be extremely valuable to a particular organisation, and every layer above the designer insists upon higher remuneration, then those at the apex of the pyramid can end up with artificially high salary levels that make an organisation uncompetitive.

One of the most common arguments used by boards to justify high salaries is that they prevent poaching of top staff. However, if a senior executive had so little loyalty to a company that they would move to another company for, say, a 10-20% remuneration increase, then one could only wonder whether they really had any great value to the original company. In terms of CEO salaries in industry, one would also have to seriously question why an individual, who made an ambit claim to earn 200 times a shop-floor salary, was not running his/her own company (rather than applying to be an employee), given the skills that they allege to have in their possession.

Finally, a CEO might argue that his/her salary package is based upon performance and that his/her influence on the company can be measured in "real dollar" terms. This is one of the most simplistic arguments used in many developed countries to secure high salary packages. The factors affecting the fortunes and profitability (or otherwise) of any large organisation are so complex and multidimensional that to attribute them to any individual cause (or particularly to a person who is an overhead) would be extremely difficult, if not impossible. For example, the profitability of a car company could accidentally sky-rocket because of a fickle, fashion trend (such as a radical new design), which inexplicably becomes a fashion statement, as much as it could for the actions of any individual within the organisation.

Another problem with a pyramidal corporate structure is that the role of management becomes more and more vague and generalised as one approaches the apex of the pyramid. One therefore has to accept, as an overhead of such a structure, that those most senior in an organisation have the greatest scope for accepting credit, allocating blame or abrogating responsibility - the *buck* generally doesn't stop at the apex. For example, when a company does well, a CEO can attribute it to "restructuring", "cost-cutting measures", "aggressive marketing strategies" and other factors that reflect well on the CEO. When a company does poorly, it can be related back to "government policies", "exchange rates", "poor productivity levels" and "industrial relations problems arising from weak government policies".

Large (dinosaur) companies also have an enormous level of inertia which makes them relatively insensitive to the actions of any one individual, even at CEO and board level. The fact that the CEO and board of many large organisations are so far removed from shop-floor level (and the fact that most of them have never actually been *doers* themselves) means that they often get highly distorted pictures of how their policies affect the lower levels of the corporate pyramid. Once a command (e.g., for restructuring) is issued, and it permeates through multiple levels of management, the feedback is almost meaningless. Lower and middle management levels (who have a vested interest in the outcome of their reports) tend to report back to say that everything is going well, and then selectively produce the data to substantiate their assertions. In many instances, it is little wonder that CEOs command large salaries because the feedback from lower levels is nearly always positive. In the final analysis, the only real feedback comes from the

profitability of the organisation but even this is almost impossible to scientifically quantify in terms of individual internal decisions.

One therefore needs to accept that the size of an organisation is also an overhead because it diminishes accountability and increases the number of dimensions available for people to conceal their performance. The other overhead cost of a large organisation pertains to its tendency towards a regimented structure of management and promotion. The structure and procedures often become of greater significance than the core output of the company:

"Will John Smith stay if we promote Bill Brown to Manager? Why don't we just create two departments and make John Smith manager of black-pencil sharpening and Bill Brown the manager of red-pencil sharpening?"

The structure, politics and pay-offs, that are an inherent part of any pyramidal structure, are a very real overhead in large organisations but their cost is extremely difficult to ascertain. The root cause of the problem is that remuneration levels are traditionally tied to levels in the corporate pyramid - the higher the level, the higher the remuneration. And, while paying people more, to stay at their existing level, is generally frowned upon (because it increases overheads), the alternative is to create a scuffle towards positions closer to the apex of the pyramid. The overhead cost of the alternative, in terms of artificially-created departments and empires, is seldom discussed or contemplated.

The overheads caused by the pyramidal-scuffle are not just restricted to large organisations. In some smaller "knowledge-based" companies (such as software houses, consulting firms, etc.), where there is an abundance of professionals, it is not uncommon to find extraordinarily high levels of management, relative to the number of actual "*doers*" (e.g., one manager for every two *doers*). Sometimes, these overheads arise simply because those entrusted with leading the organisation feel that a sound structure is required for future growth:

"When we grow from our current team of ten employees to our expected 500, then we have to make sure that the management structure is right..."

The overheads therefore tend to emanate from well-intentioned planning and from preparing for a future that may never eventuate (often because of the overheads created by the planning and preparing). The alternative (i.e., living with no structure and existing through disorganised cooperation) has limited appeal, in a *how-to-do* society, because of an inherent fear of being left out of *how-to-do* positions if they eventuate. Hence, there is a natural tendency to create, from disorder, a structured pyramid for an organisation that may never need the structured pyramid because it is consumed with unnecessary overheads in its formative years.

The same lack of logic (i.e., structure and seniority above core function) that is applied in many organisational environments is also applied to other overhead services such as marketing. People with a vested interest in the outcomes (the marketers), tend to commission market research which invariably shows that:

- Marketing strategies are working (and that more money therefore needs to be invested in marketing)
- Marketing strategies are not working (and that more money therefore needs to be invested in marketing).

Marketing tends to proliferate as an overhead because there is, again, no real closed feedback loop despite the ever growing presence of market researchers (who are also an overhead to industry). Once people are aware of the existence of a product, such as a laundry detergent or a car, it becomes extremely difficult to scientifically quantify the logic behind their purchase, or non-purchase, of a specific item. In many instances, it may be that the consumers either don't know or won't admit to the particular reasons for their choice. Market research is therefore not only an overhead but, also, very much a black-art form, that tends to look convincing because it is filled with statistics, but is ultimately dependent upon the willingness of the consumer to provide accurate data. It isn't simply a question of consumers being dishonest but, rather, a question of the skewed data that results from market research. For example, people who are benevolent enough to spend an hour filling out survey forms may be more likely to give responses which they feel will satisfy the researcher - in other words, market researchers can rarely provide information from random samples because their samples are generally composed only of people who will respond to a questionnaire (i.e., not a representative sample).

In the first instance, the usual example of market research for industry is to survey people to determine whether they would buy a new product, brand X, if it was cheaper and better than the competitive products - to which the standard reply is (not surprisingly) yes. So, for the most part, pre-development market research doesn't tell industry much more than they should already know if they have senior management in tune with public requirements - that is, that people prefer products which they believe are better and/or cheaper than competitive products.

The key problem with subsequent market research, as an overhead, is that accurate quantification of what is required from a product is extremely difficult and costly to acquire. For example, many software users may respond to a survey by saying that they would like an "XYZ" feature included in their package. However, most surveys would not ask whether users would prefer to retain their existing package, rather than spending time and money upgrading to a newer version, even if it had an "XYZ" feature. Again, the results are skewed because the questions are based on the assumption that there is something that a company can do to win over more customers - perhaps, customers simply don't want any new products.

The fickle nature of consumerism is also a good reason for examining market research as an overhead. For example, consumers might overwhelmingly respond to a survey by saying that they would prefer to buy red cars instead of silver cars - however, once they are forced to sign on a dotted line, they ultimately revert back to the more conservative decision. Similarly, people who are asked why they purchased a particular car may respond by saying that it was because of safety and performance, when in reality it was solely because of price or, more likely, appearance.

In the 1980s and 1990s, many detailed surveys were commissioned by software houses to assess the decision-making processes associated with the acquisition of software. The results tended to indicate that consumers preferred software that:

- Came in suitably colored boxes

- Came in boxes that weighed more than the competitor's boxes (i.e., appeared to give better value for money).

Were the consumers really that stupid? The answer is that one can never really quantify the outcomes of market research because of the number of dimensions to the problem. And, the fact that people essentially like to appear as intelligent decision makers, when they provide feedback (despite the fact that their decisions are not always based on intelligent assessments), means that the feedback paths, derived from market research, are very dubious.

It isn't the fault of the marketers or the market researchers that they cannot accurately quantify consumer-based decision making. However, in developed societies, the tendency to present statistics, which generally leave much to be desired in terms of their scientific merit, as a proof that more needs to be spent by industry on other overheads, is representative of the way in which providers tend to muddy the demarcation between service and overhead.

On the positive side of the marketing equation, there were numerous instances where marketing and market research were extremely valuable in the wealth creation process and were applied as a "doing" tool, rather than a "how-to-doing" overhead. In particular, this occurred when a market was created for products through sheer industrial stealth and saturation advertising (or more appropriately, market conditioning). Generally, this occurred when there was no significant difference between a range of products and they were, by definition, commodity items. Typical examples, in the 1980s and 1990s, included the multinational fast-food chains, soft-drink companies and major computer software houses. In these cases, commodity products (often of mediocre quality) were sold in enormous volumes to consumers who were told (through massive conditioning advertising) exactly what they needed and why they should like it. Ignoring the moral arguments against such business philosophies, the problem with using marketing in this pro-active form (i.e., selling people things they neither need nor necessarily want) was that it was generally restricted to commodity level items. The same philosophy did not tend to work with higher value items because the decision-making process was far more complex.

As the complexity of products increases, the entire marketing process devolves into understanding the thinking of customers and this can often only

arise after years of experience in dealing with those customers. However, the illusion, created by marketers, is that such an understanding can be turned on and off in an instant (through market research) and packaged into a *how-to-do* service. In many cases, the package is a Pandora's Box of overheads with outcomes that are difficult to quantify.

Management and marketing are two of the more obvious overheads in developed countries that have an obscured sense of value. The legal profession is another well-known overhead industry in developed countries, whose value is difficult to ascertain, particularly in an industrial sense, where the primary emphasis is on the protection of patents and copyrights and litigation against breaches of the same. Many companies are goaded into attempting to protect their industrial/intellectual property through legal channels, only to discover that the cost of legal protection is often significantly greater than the value of the property or the loss that would be sustained when that property is poached by other organisations. This is particularly true in the modern industrial world, where markets are global, and the lack of commitment, in some countries, for protecting patents and copyrights makes any legal redress impractical at an international level.

Patenting and intellectual-property protection are not only an overhead, but also an anathema in the modern industrial world, where the window of opportunity, which exists from the time a product is first released to the time which it becomes superseded, is ever decreasing. Therefore, the intrinsic value of a company is not in the knowledge or design, vested in one product, but, rather, in the ability of that company to continually develop new products that gain market acceptance. This value cannot be protected through patents, copyrights or confidentiality clauses in employment contracts but only through the retention of key staff and the development of new staff that can continue the research, design and production process. This philosophy is, however, in direct contravention of the "*hire, indulge, fire, re-hire, re-indulge*" ethic that is used in modern business "to reduce overheads".

Another significant problem in reducing overheads, in developed countries, is that few, if any, companies know exactly how much it costs them to produce products. Most companies have estimates of product costs that generally do not take into account the myriad range of visible and invisible overheads involved in running an organisation. Part of the problem is that product costing is an extremely complex task and part of the problem is associated with the fuzzy horizons that management has to place on their

production equipment and product life. Production equipment, computers, software, etc., that were intended to last for four years may be redundant in two years because of technical or marketplace changes. For this reason, the lifespan of major production/computing equipment is very difficult to estimate and the overhead industries aim to ensure that the lifespan continues to decrease.

The fact that a buggy-whip production line is still in good working order, after a hundred years of service, is of little value to a company who has determined that there is no market for buggy-whips. Similarly, if a company costs its products, based on staff salaries that are incurred during recession, then it may find that not only do salaries increase in prosperous times but so too do the overheads associated with increased staff turnover, as staff leave to look for lucrative packages elsewhere.

Many executives would argue that the ultimate indicator of how much products cost to produce is reflected in the profitability of the company. Again, however, these figures are not meaningful on an annual basis because, for example, a company may be living off old production equipment which (when redundant) would cost more to replace than the profits generated, from its entire output, over the previous decade. This may seem a rather extreme example, but it is a commonly occurring phenomenon in industry (all the more common when the "production equipment" is human knowledge). Moreover, since it is difficult to forecast product life, it is also difficult to even determine the time-frame over which a company could assess whether or not it was genuinely profitable to produce a particular product. Hence, the need for caution in accepting the claims made by those at the apex of the corporate pyramid, in terms of their individual contributions to the fortunes of an organisation.

In terms of overall product costing, the cost of maintaining inventory is another overhead whose value is difficult, if not impossible, to calculate. In the 1980s, many companies strove to minimise inventory by adopting the philosophy of "just-in-time (JIT)", where the objective was to only acquire or manufacture components as they were needed. This, it was thought, would reduce inventory. Amongst the largest proponents of this scheme were Japanese automotive companies who, despite their astute management skills, claimed that they had minimised their inventory to remarkably low levels. The problem with reducing (or, in the extreme, eliminating) inventory is that suppliers and/or divisions within a company must have the production

flexibility and responsiveness to produce components on demand - a relatively naive idea which is often not feasible for numerous technical reasons.

In the Japanese automotive scenario (and in many other instances), the concept of JIT was somewhat illusory because automotive companies were essentially just assembly depots that largely bought components from around the world and pieced them together into vehicles. In a sense, the Japanese automotive manufacturers reduced their inventory levels by pushing off their problems to smaller suppliers, who then pushed their problems down to smaller suppliers and so on. In effect, all the suppliers, at the end of the chain, had been left with the task of maintaining inventory when they couldn't push their problems further down the line. The automotive manufacturers, who were at the head of the chain, appeared to have reduced their inventory but were still paying for it through the built-in costs provided to them by their suppliers. This is another example where company management had seemingly reduced overheads but, in reality, had done little more than convert them into another form. It is altogether analogous to the situation, noted earlier, where companies presume that the "*hire, indulge, fire, re-hire, re-indulge*" concept is more cost effective than the maintenance of a steady reasonably-paid loyal work-force.

The same narrow-band approach to overheads is applied world-wide when companies expect their suppliers to provide them with goods on credit. By way of example, one high technology company actually claimed that it was "saving on interest" by not paying its invoices until its 30 or 60 day deadline. Rather smugly, it also revealed how it could extend this period by telling suppliers that invoices had not been received and so on ("*the cheque is in the mail*" syndrome). However, discussions with suppliers revealed that the company was always charged a considerably higher price for goods because of their slowness in paying. In instances where suppliers had a monopoly on specialised components and services, they had charged the company several times the normal cost in order to recoup their interest and to cover the nuisance value of having debts settled. In effect, the high technology company was paying interest rates many times higher than if it had borrowed the money from a bank and paid its suppliers in cash. The specialised nature of many industries means that market forces are seldom able to drive down such costs. In the broader picture, all companies have to recoup their interest costs and their debt collection costs in one way or another. The point here is that one gets nothing for nothing and attempting to

do so, in a corporate sense, only tends to convert visible overheads into invisible overheads that are more difficult to find and eliminate.

Another common overhead-conversion phenomenon that tends to occur, in many developed countries, with relatively high rates of taxation (generally related to high levels of infrastructure, health and education), is in the area of tax minimisation and/or avoidance. Companies often seek to minimise or avoid taxes by making use of experts (*how-to-doers*) in taxation law and accounting. In the short-term, companies can benefit from lower taxes. In the longer-term, governments inevitably create more bureaucracy (overheads) for all companies by creating more-complex taxation laws that seek to close loop-holes. However, an even greater danger for the companies, that go to extraordinary lengths to minimise their taxes, is the fact that staff/consultants are specially employed to distract the company from its core objective. This objective should be to derive sufficient income from product/service sales to pay outgoings, provide a profit and pay the appropriate levels of taxes. The fact that a company can survive, or profit, by exploiting dubious loop-holes within a taxation system is hardly a sound basis for a long-term business activity. Worse still, the internal overheads, involved in minimising tax, are often invisible because the *how-to-doers*, that have backgrounds in exploitation of loop-holes, minimisation and avoidance, are the ones entrusted to provide feedback to the CEO or board.

Given all the invisible overheads that accumulate in any modern organisation, and the complexities associated with product costing, some of the new-breed, *how-to-do* managers by-passed the costing process and endeavoured to instil their own logic into the system to reduce overheads. For example, an automotive manufacturer endeavoured to cut costs by reducing the number of jets in each windshield washer from two to one. This involved purchasing cheaper plastic nozzles which were moulded with only one hole instead of two. The overhead saving per washer would have only been measurable in fractions of a cent (and there were only two washers per car), and yet it was extremely doubtful that the company could have accurately costed the production of the vehicle to within several hundred dollars. In other words, it was altogether likely that, if the exact cost of the vehicle could have been determined (a very complex task), then that cost could have been substantially reduced by other means (e.g., extending the production run or by changing shift times, etc.) with no noticeable impact on the consumer.

In the 1990s, the phenomenon of removing every component in a product, that the customer didn't appreciate that he/she was getting, became known as "value-added-value-engineering". In principle, it was a good idea because of the difficulties involved in accurately costing products. Whatever the products cost, if parts could be removed then they ended up costing that much less. In practice, of course, it was a recognition that reducing overheads, in a complex environment, was an extremely difficult task because of the danger of converting visible overheads into invisible overheads.

A number of companies recognised the difficulty of reducing overheads in large organisations and considered that the task would be considerably simplified if the organisations could be divided into autonomous departments. This had the potential to work extremely well, provided that the departments became defacto organisations, in their own right, and had the ability to sell outside the organisation - and, more importantly, that other departments had the ability to buy from outside the organisation (rather than from other departments). The latter part was crucial to making the devolution of a large organisation workable - otherwise the individual departments merely became empire-builders, creating new overheads and new corporate pyramids, because they had a monopoly on sales to other departments.

In recent years, a new overhead issue has entered into the industrial sphere in the guise of "environmental accounting". This new entity has increased the difficulty of product costing and, in developed societies, is shifting a cost, which was originally borne by government (i.e., tax-payers), back to industry. In simple terms, environmental accounting means that industry can no longer cause environmental pollution or damage during production and then conveniently close down, leaving behind an enormous clean-up bill which has to be funded by tax-payers. In some cases, such as the timber industries, in developed countries, environmental accounting has already been in practice for many years. However, over the coming decades, most industries, in developed countries, will need to factor in the costs of environmental rectification before they can accurately cost their end-products. In some cases, these overhead costs could dwarf those basic costs associated with the creation of a product.

The one overhead industry which has not been discussed, thus far, is perhaps the most obvious - that is, government. It has been left until now because it is one of the more complex overheads and its influence doesn't necessarily correlate with the capacity of a country to produce. For example, the poorest countries often have the most significant portions of GDP expended on government, largely because these tend to be war-mongering dictatorships that spend disproportionate amounts of meagre funds on military supplies. Conversely, developed countries sometimes have relatively efficient governments because media scrutiny of government activity is very high.

In developed countries, it is sometimes speculated that, for every paper clip in the civil service, there are three civil servants employed to supervise its purchase, distribution and usage. However, there are hidden societal advantages in such, seemingly extravagant, expenditure. During the economic growth of the 1950s and 1960s, many developed countries maintained large civil service sectors in which employees were paid relatively small amounts in exchange for tenure and poor productivity. To borrow a politically correct euphemism from the 1990s, government departments acted as sheltered-workshops for the motivationally disabled. There was some acceptance of the philosophy that a portion of society simply wasn't suited to a cut-throat business environment that demanded high productivity in exchange for high levels of pay. So, despite the large post-war economic growth, and the absence of unemployment in the private sector, a part of society chose to remain in the civil service. The problem was that, during the 1970s, in a period noted for militant unionism, civil service salaries in countries such as Australia, Britain, Canada and New Zealand rose considerably - not only did this have the obvious effect on government spending but it also drew people away from the "doing" sectors of society.

The inevitable redress for the civil service came about in the 1980s and 1990s, as governments around the world were forced to slash expenditure and to make their civil service more "productive". This resulted in increased unemployment, with an underlying part of society that was simply unwilling or unable to accept jobs in a competitive industrial environment. Governments then chose to address this problem by considering a range of "work for unemployment benefits" schemes, where people were paid low wages to do minimal amounts of work in societally-useful areas - a remarkably similar arrangement to that originally known as the civil service during the 1950s and 1960s. In developed countries, the influence of

government as an overhead to industry is therefore difficult to ascertain. An "efficient" public sector can lead to high unemployment costs, high crime rates and other societal costs. An "inefficient" public sector can lead to high taxes but lower unemployment, crime and so on. The question of whether one formula or the other actually changes the burden on industry is one that has been debated for as long as there have been politicians and voters who were free to elect them.

Leaving aside the issue of government, and looking strictly at the industrial sector of society, all our discussions, thus far, lead us to summarise the key reasons for the existence of overhead industries and overhead people in developed countries:

- In a traditional corporate pyramid, overheads increase towards the apex and, yet, the responsibility for minimising and removing overheads is increasingly vested with those at the apex. Moreover, as the apex is associated with generalists, and each successively-lower level associated with increasing specialisation, there is a tendency for lower levels (intent on moving upward) to provide inaccurate feedback (positive feedback) and, as a result, for upper levels to make poor decisions about overheads in specialist areas
- The lifespan (window) for a product or service is generally unknown at the time it is being produced. It is therefore extremely difficult to exactly determine the cost of a product or service, particularly where the product is, in itself, complex (e.g. a car) and involves many different facets
- It is extremely difficult, if not impossible, to exactly determine why people buy particular products or services, particularly when those products are complex
- Since we do not know exactly how much products and services cost; the reasons why people buy them and their effective lifespan, we cannot separate the overheads from the real costs.
- Overheads, by their very nature, are always extremely difficult to directly relate to income and so, overhead providers have an enormous lee-way in costing their services.

Perhaps, we should consider that overheads, in developed societies, are like energy and can neither be created nor destroyed but only transformed from one form to another.

In developed societies, the expectations associated with employment are such that fewer and fewer people wish to involve themselves in "doing" activities. For this reason, industries in developed countries are highly automated and these countries can require considerably fewer workers than undeveloped or developing countries. So, whereas in an undeveloped country, some 80% of the population needs to carry out meaningful work in order for the population to survive, in a developed country only, say, 20% of the population needs to do meaningful work. In a developed society, this leaves a surplus (overhead) of 80% of the population that needs to be funded by the 20% that "do" useful work. The non-*doers* could be given an existence allowance by using the taxes from those who do work to fund unemployment benefits for the 80% who don't work, so that they could remain on a permanent vacation. This is deemed to be socially unacceptable and, so, developed societies, or more specifically, people in developed societies, tend to create "non-essential" and often "unnecessary" jobs to transfer money from the societal "*doers*".

There are many non-essential activities that take place in developed societies that have little, or no, place in undeveloped countries. The arts, sports, environment, entertainment, tourism, government, university research, marketing, interior-decorating, management consulting, landscape gardening, gourmet restaurant reviewing and many other activities are mechanisms that transfer the monies, generated by the *doers*, to the remainder of society. In other words, they transform overheads from one form to another (through the taxation system and through the acquisition of services from overhead providers). In some instances, the overheads are deemed to add value to a society at an altruistic level, as is the case with sports and arts, for example. So, as a general principle, there is nothing conceptually wrong with the idea of having a small number of *doers* fund a large number of *how-to-doers* in society. The problems really only arise when the *how-to-doers* become such a burden on the *doers* that the *doers* can no longer remain competitive or generate sufficient wealth to keep the society operational.

In the period between the mid 1940s and the early 1980s, the general trend was that developed countries, utilising the latest production technology,

could generate so much wealth, with so few workers, that they could sustain the large number of *how-to-doers*, who were overheads. However, the *doers* in developed societies have since realised that they can build the same automated factories in undeveloped or developing countries and produce the same value-added products, without incurring the large overhead costs associated with the *how-to-doers* in a developed society. What we have therefore witnessed, since the 1980s, is a rising tide of "development" sweeping throughout Asia, South America, the Middle-East and, in the future, through the poorest nations in Africa.

In the long-term, when all these regions develop, one assumes that they will be just as burdened by the overhead industries as the existing developed countries and so, notwithstanding any radical military or environmental catastrophes, the world will most probably move to a form of global equilibrium. However, in the short and medium term, the undeveloped and developing countries act as a vacuum and draw the bulk of the "doing" industries away from the developed countries, leaving them with the task of generating wealth with fewer and fewer *doers* and burdened by the overheads created by more and more *how-to-doers*.

