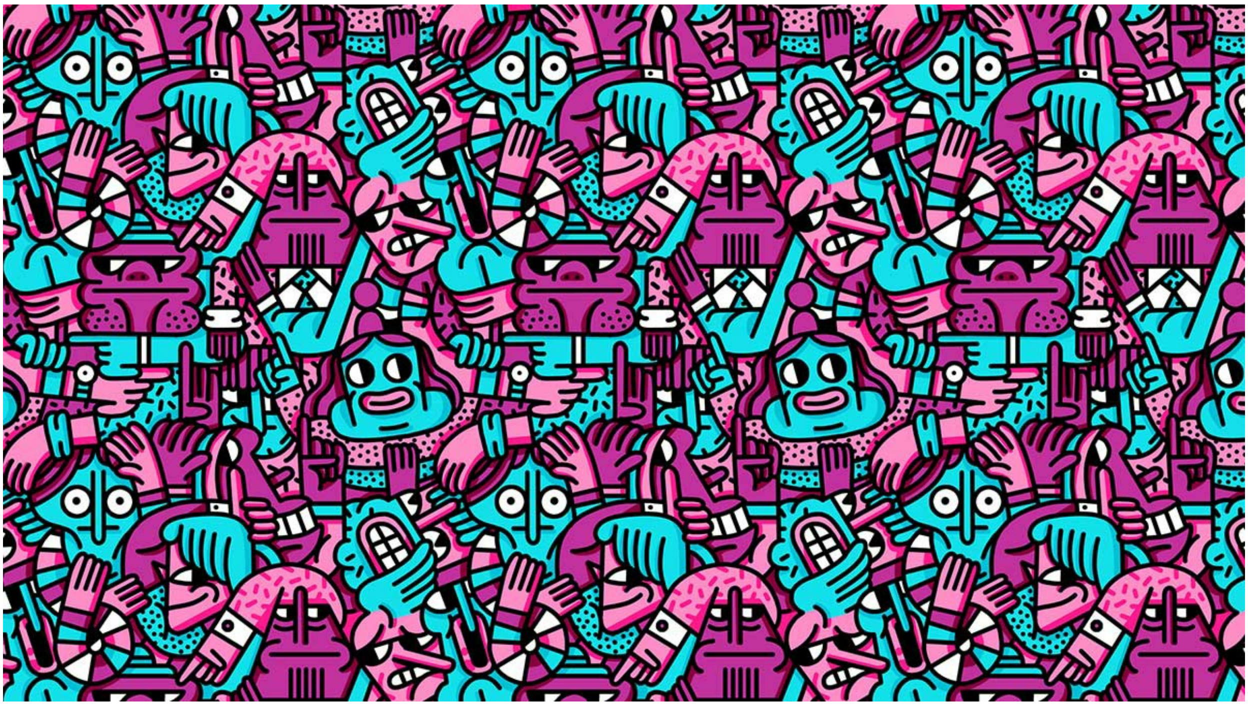
Excess Management Is Costing the U.S. $3 Trillion Per Year

hbr.org/2016/09/excess-management-is-costing-the-us-3-trillion-per-year

Gary Hamel &Michele Zanini, *Harvard Business Review*, September 05, 2016



Juan Díaz-Faes for HBR

More people are working in big, bureaucratic organizations than ever before. Yet there's compelling evidence that bureaucracy creates a significant drag on productivity and organizational resilience and innovation. By our reckoning, the cost of excess bureaucracy in the U.S. economy amounts to more than $3 trillion in lost economic output, or about 17% of GDP.

Here's the arithmetic. According to our analysis of occupational data provided by the U.S. Bureau of Labor Statistics, there were 23.8 million managers, first-line supervisors, and administrators in the American workforce in 2014. (This figure includes both the public and private sectors but does not include individuals in IT-related functions.) That works out to one manager and administrator for every 4.7 employees. Overall, managers and administrators made up 17.6% of the U.S. workforce and received nearly 30% of total compensation.

How many of these 23.8 million overseers do we actually need? We can get an answer by looking at the management practices of a small but growing number of post-bureaucratic pioneers. Their experience suggests it's possible to run complex businesses with less than half the managerial load typically found in large companies.

Among the vanguard are Nucor (America's most profitable steel maker), Morning Star (the world's largest tomato processor), W.L. Gore (a $3 billion high-tech company famous for its Gore-Tex fabrics), Svenska Handelsbanken (a Stockholm-based bank with more than 800 branches across Northern Europe and the UK), Sun Hydraulics (a class-leading manufacturer of hydraulic components), Valve (a pioneering developer of online games), and General Electric's jet engine plant in Durham, North Carolina.

The case of Svenska Handelsbanken is illustrative. Its return on equity has surpassed that of its European peers every year since 1971. In the organization of 12,000 associates, there are only three levels. Operating decisions are almost entirely decentralized. Each branch makes its own loan decisions, sets its own pricing on loans and deposits, controls its own marketing budget, runs its own website (on a shared platform), and serves all customer segments — from individuals to multinationals — within its catchment area. Nearly all of these practices run counter to conventional banking wisdom, which holds that to be efficient a bank must consolidate operational activities and centralize decision making on matters like pricing and lending. Svenska Handelsbanken has consistently posted industry-beating cost-to-income and loan-loss ratios.

The average span of control in these and other vanguard organizations is more than double the U.S. average. GE's Durham plant, to take a dramatic example, employs more than 300 technicians and a single supervisor: the plant manager. The facility is more than twice as productive as its sister plants in GE Aviation.

The experience of the vanguard suggests it should be possible to double the ratio of employees to managers and administrators, from 4.7:1 to 10:1. Doing so would free up 12.5 million individuals for other work that is more creative and productive.

There would be indirect savings as well. A myriad of studies have documented the time lost to low-value management processes, from budgeting to the performance review. On the basis of this evidence (further discussed here), it's reasonable to assume that as much as 50% of all internal compliance activity is of questionable value. If we assume that the 111 million Americans workers who are not managers, supervisors, and administrators (or unincorporated self-employed) are spending roughly 16% of their time on internal compliance (an estimate from a Deloitte Economics study) and that half of that time is wasted, this translates into an annual waste of about 8.9 million worker years.

In total, then, there are 21.4 million employees in the U.S. workforce — 12.5 million managers and the equivalent of 8.9 million individual contributors, who, through no fault of their own, are creating little or no economic value. This means the U.S. could achieve current levels of economic output with 15% fewer people in the labor force. That would, in effect, boost GDP per worker from $120,000 to $141,000.

The goal, of course, isn't to put 21.4 million people out of work, but to redeploy them into value-creating activities. If these individuals were contributing an average of $141,000 each to economic output each year, rather than adding nothing, U.S. GDP could grow by $3 trillion — and the actual figure would likely be higher. Managers and administrators tend to be better educated than the workforce at large and typically possess technical or functional skills. Given that, we should expect them to deliver better than average output per capita once reassigned to more productive, and potentially more satisfying, work.

Then there are the large but difficult-to-quantify benefits that would come from a newly empowered workforce that is no longer paralyzed by process. More freedom and responsibility would mean more initiative, innovation, and institutional flexibility — which would further boost productivity. These side benefits are far from trivial. For example, a number of highly respected leaders in the pharmaceutical industry have argued that the only way to raise R&D productivity, and thereby reduce the soaring costs of drug discovery, is to dismantle bureaucracy. Roger Perlmutter, the president of Merck Research Laboratories, suggested that a good start would be to "scrape off the top five levels of management, including myself."

Three trillion dollars represents 17% of U.S. GDP. If this burden was reduced by half over the next 10 years, productivity growth would increase by a compounded rate of 1.3% annually, essentially doubling the post-2007 productivity growth rate.

The productivity bonanza would be even larger outside the U.S. In 2014 the combined GDP of the 35 countries that make up the OECD amounted to $49.7 trillion, of which the non-U.S. share was $32 trillion. If bureaucracy is as ubiquitous in these economies as it is in the U.S., and there's little reason to believe it isn't, cutting the number of managers in half would save another $5.4 trillion — an amount that exceeds the value of the entire Japanese economy.

Many of the world's largest economies are in a prolonged productivity slump. In Europe and the U.S., stagnating incomes and diminished economic hopes are feeding a growing appetite for protectionism and spawning divisive, us-versus-them political forces. While some hold out hope that robots, genomics, and the internet of things will one day yield a productivity bonanza, we believe a concerted effort to reverse the rising tide of bureaucracy offers a more immediate and less speculative route to enhanced economic performance.