

## **EFFICIENCY - OR SIMPLY MEASURING COST?**

“Engineering is the professional and systematic application of science to the efficient utilization of natural resources to produce wealth.”

(T J Hoover and J C LK Fish (1941))

Searching through numerous quotations for a spark to ignite the subject I came across only one that honestly acknowledged the fact that efficiency or being efficient is in fact related to the business of making or saving money possibly because the only way of measuring efficiency appears to be related to measuring costs and then poring over and comparing those costs, where possible, with other companies.

The Concise Oxford Dictionary defines efficiency, among others, as, "ratio of useful work done to total energy expended; and, Collins defines efficient as, "working or producing effectively without wasting effort, energy or money". Therefore, it is reasonable to assume that when one refers to efficient or efficiency, it actually means getting the most out of an organization through whatever goals a company chooses to set; in other words to gain the greatest benefits, for which read profits, at minimum cost.

The following quotation from Robert Benchley seems to suggest that this was the case with senior business men at the beginning of the 20<sup>th</sup> century, probably driven by the work of Frederick Taylor and his stopwatch measurements of factory production workers, and in the middle of the 20<sup>th</sup> century; and, noting the number of books written by former Chief Executives on leadership and how they succeeded, senior businessmen at the beginning of the 21<sup>st</sup> century think along the same lines,

“One of the necessary qualifications of an efficient business man in these days of industrial literature seems to be the ability to write, in clear and idiomatic English, a 1,000-word story on how efficient he is and how he got that way.... It seems that the entire business world were devoting its working hours to the creation of a school of introspective literature.”

(Robert Benchley (1889–1945), U.S. writer, humorist. “From Nine to Five,” Henry Holt (1921))

However, given a choice I suspect that most of us would choose to work for a company or an organization that had a good reputation for best business practice, that was known for taking an interest in the efforts and output of their employees and remuneration levels were good; and, that accepted a degree of responsibility and accountability on ethical, social and environmental issues. Further, that the organization was structured and managed in such a way as to be efficient and effective in the provision of goods or services in meeting the demands of customers thus enhancing the reputation of the company and its employees. I also suspect not one of us would really choose to work in an inefficient or ineffective organization or company, unless the rewards were so great that we might be foolish to ignore the opportunity. Or have I got that wrong?

So, how do we measure efficiency and what are the drivers that determine how efficient a company is bearing in mind that no two organizations function or are managed in exactly the same way or work to achieve the same goals? Well, as I mentioned the primary driver appears to be one of measuring costs for everything, in other words determining value for money in the provision of goods or services from other companies and then measuring the costs of producing or providing goods and services to customers. And, can this be applied equally to public service companies as to public limited companies owned by shareholders?

Why don't we take a look at some every day examples of products that we use and also look at different types of organizations, attempt to define what they do or provide and try to determine if they are efficient or not?

Many of us, depending on a variety of factors not least our financial circumstances, drive a motor car and probably have some idea if the machine is efficient or even cost effective. The factors that we might consider when making that decision are, fuel efficiency, how many miles do we get to the gallon or litre; does it meet our requirements in terms of seating arrangements, that is, does it cater for our particular demands; is the car provided with an air-conditioning unit, in summer time is it efficient and does it decrease the miles per gallon or litre; how much does it cost to replace worn or broken parts; how much does it cost for a regular service; and, overall, is the machine reliable. As you can see, everything is related to cost.

How about washing machines? Is the machine big enough to cater for our needs, that is how many people will be using the machine and how often will the machine be used over a given period of time; is the machine both water and fuel efficient, that is how much electricity does it use to complete a wash cycle; is the machine made by a reputable and reliable manufacturer who is known for employing quality control standards; how much will it cost to replace worn or broken parts and is there a warranty for 1, 2 or 3 years on parts and labour? And, how much does it cost to buy the machine and what is the cost of a replacement?

Education is a popular area of politics so is it possible to measure the efficiency of a school? How big is the school, how many children attend the school and more importantly, how many teachers and support and maintenance staff are there and how much does it cost, in terms of salaries, to operate manage the school; what does it cost to provide services such as heating, lighting, ventilation and supplies to run equipment and machinery such as computers, video machines, recorders; and, what is the output from the school, in terms of qualifications that students achieve? Bearing in mind that we now have school league tables, is it possible to determine if a school is efficient or inefficient and what can really be done to improve matters without resorting to the age old standard of throwing more money at a problem?

How about a company? Choose any one you like and sit and think how it operates, either from experience or from perception. Is it expanding through organic growth, or does it pursue an aggressive policy of buying out the competition through mergers or acquisitions, or is it in the doldrums, profits are poor, morale is poor and it has become a possible take-over target? What are the company products or services like? Are they high quality, well made or well presented and value-for-money or are they of poor quality, badly made and is customer service poor or even bad? Are there enough employees to meet day-to-day demands of customers?

How does the company treat its employees, are remuneration levels bad, poor or good and what are the opportunities for advancement and promotion? How much does it re-invest in the business to increase efficiency and effectiveness, not just through the use of greater automation and information technology but in providing good, clean work areas, safe working conditions and training programmes for employees? How much does the company spend on research and development and do many of the projects and products come to fruition? What is the company's stance on environmental and social issues and does it apply such programmes as Customer Relationship Management (CRM) and Corporate Social Responsibility (CSR)?

Most companies operate a system of pay banding where people are paid a salary for a particular position and level within a company and annual pay rises are based on appraisals by line managers, or performance-related pay. However, many employees are not enamoured with this system especially when the vexed subject of efficiency determines salary increases or bonus levels. For example, if a company decides, after appropriate measurements are taken, that productivity has increased by say 15 per cent, suggesting improvements in efficiency, then why do senior managers end up with the lion's share of bonuses and employees get very little?

What about the performance and attitude in the biggest organization in Europe, Britain's National Health Service (NHS) system. Think about your local hospital and the service they provide to the local community. Is it efficient; is it effective, does it meet the demands of its owners and customers, the tax-paying British public? Does it provide value for money, or is it too big, too unwieldy and inefficient? How good is it at providing proactive diagnosis and treatment instead of reactive responses to medical conditions? Does the hospital have enough staff and doctors covering every area of medicine?

It is not unreasonable to suggest that for a hospital to be classed as being efficient then patients, customers, should be seen by consultants or surgeons in the shortest possible time when a problem is identified. How long do you have to wait for such appointments and how does that compare to other hospitals? How long do you have to wait, for example, for an MRI scan or other form of diagnostic imaging and is the most efficient use being made of such equipment or does it lay idle for much of the time?

Given that there are league tables of performance of all NHS hospitals how does your hospital compare with others for all forms of treatment and surgery? Is your hospital free of the major virus problem, MRSA, and how effective is it at cleaning wards and treating infections? In the UK it has more recently been suggested, from inside the bureaucracy that runs the system, that private sector companies might run some NHS units more efficiently and effectively based on the premise that competition tends to improve management and organization. I guess what they really mean is that costs can be cut and therefore profits increased? Or, is this a way of encouraging NHS hospitals to take a closer look at the way they operate with a view to forcing efficiencies and greater efficiencies of scale?

Since the NHS is a monopoly or sorts how can the system be made to be more efficient or should hospitals operate independently or be privately run organizations? As Mario Puzo wrote on the subject of competition and monopoly, when referring to Don Vito Corleone in *The Godfather*,

“Like many businessmen of genius he learned that free competition was wasteful, monopoly efficient. And so he simply set about achieving that efficient monopoly.”

**(Mario Puzo (b.1920). US Novelist. *The Godfather* (1969) (referring to Don Vito Corleone)**

And, finally, take a look at high street banks. Over the last two decades banks have gone through all the management programmes dreamt up by management consultants, self-styled management gurus and academics to reduce overheads whilst reporting huge increases in annual profits. First, the introduction of automatic teller machines (ATMs) was used as a reason to reduce the number of counter staff. Then banks began to close smaller branches, especially those in rural areas, villages and smaller towns, which were deemed not to be cost effective.

Much greater use of information technology (IT) led to yet more losses in the number of employees and programmes of rationalization led to the closure of branches even within major towns and cities. And, a number of acquisitions and mergers reduced the number of competing high street banks and the introduction of on-line banking, albeit many of those IT systems are not secure, also led to a reduction in employees and further increases in profit levels enhanced by the fact that banks still take 5 days to clear cheques to personal accounts. Finally, call-centres associated with banking and financial institutions were close in UK and the jobs outsourced to countries with much lower operating costs such as India. All these programmes were introduced as a means of increasing efficiency but as you can see they are all about cost savings.

In America they have organizations that will advise on energy efficiency in the home; energy efficiency with gas boilers and oil-fired systems; energy efficiency with air-conditioning units; energy efficiency with air-to-air heat pumps; and, energy efficiency with washing machines and other household appliances like lamps, refrigerators, freezer cabinets and vacuum cleaners. All the advice has nothing really to do with how efficient or effective the machines are; it is geared to saving on costs.

So, I have no doubt that if you take a look at all your examples you will see that efficiency and effectiveness, perhaps even competitiveness, cannot be measured effectively and that what every area of industry and commerce is really measuring, in every aspect, is cost. Of course costs must be controlled and of course waste must be cut out of any system, but they have to be weighed against a set of priorities, that is, what would be the cost of not doing something or not purchasing a particular item of equipment to allow someone else to operate more efficiently?

Unfortunately, managers who spend their entire time measuring the cost of this and the cost of that are not actually being efficient or effective, they are merely acting as accountants, 'number-crunchers' or 'bean-counters', to the extent that eventually they really will know the cost of everything but the value of nothing. As Peter Drucker suggests,

"There is nothing so useless as doing efficiently that which should not be done at all."

and,

"So much of what we call management consists in making it difficult for people to work."

**(Peter F Drucker (b. 1909 in Austria). US Management Consultant and University professor)**

It has been suggested, recently, that having too many regulatory bodies, established to look after the interests of consumers by having the authority to enforce regulations, is counter-productive to the efficient operations of businesses in general. I find that attitude fascinating particularly since a lack of moral, social and ethical values in some companies, coupled, allegedly, with creative accounting and a lack of internal controls, are what led to a number of large-scale financial scandals in companies in the United States.

The US government introduced the Sarbanes-Oxley Act in order to improve corporate governance through introducing an internal control framework in order to reduce deficiencies and improve inefficient business practices. It suggests, perhaps, that a lack of openness, honesty and trust lies at the heart of some organizations and implies that maybe some non-executive directors are not effective enough in questioning the operational, financial and strategic decisions of senior executives in the boardroom.

So, without those regulatory bodies who will represent the interests of consumers and investors and who will ensure that 'white-collar' crimes will be detected and will be punished? Or is it the intention that if you do not have internal controls over financial dealings and do not comply with financial regulations it is acceptable just as long as you do not get caught with your fingers in the till?

Companies begin to talk about efficiency savings usually when they find themselves in a tight financial situation, or perhaps sales are sluggish and profits are falling, or the organization has lost direction and needs to reduce costs in order to remain in business. So, the next time your company or organization decides to address the matter of efficiency what they are really referring to is taking a much closer look at costs as a preliminary to reducing overheads.

The introduction of management consultants to an organization means they are likely to use any and all of the management fads of delayering and downsizing, re-engineering, outsourcing and resource re-alignment as the excuse for removing employees. The introduction of management accountants means they will look at the cost of employees versus the cost of production and selling products; the internal cost of providing items of equipment and desks and chairs; the cost of providing any other internal programmes such as training or advancement; the cost of marketing products and services; the cost of research and development; and, the cost of maintaining electrical and other services to support the buildings in which employees operate.

In addition, there are a number of programmes such as business process re-engineering (BPR), Six-Sigma guidelines to maximize customer satisfaction and reduce defects or Total Quality Management (TQM) programmes also about improving efficiency through assessing internal processes and identifying weaknesses. Of course, companies can always go down the path of outsourcing parts of their operation to other organizations or even moving more areas of business support to parts of the world where labour costs are cheaper.

All these programmes are pressure to reduce numbers but what many directors and managers fail to appreciate is that this also increases pressure on those left behind to pick-up the work of their former colleagues and that this leads to exhaustion, disenchantment and to 'burn-out' leading to even greater inefficiency and often to more employees leaving for more efficient companies with more staff.

It seems what I have always believed being efficient is, or what promoting efficiency means, that is a happy team supporting one another through commitment, positive attitude, effort, reliability, motivation and communication and ensuring that programmes of work or tasks are completed on time, is not really the case. Being efficient appears to have a quite different connotation; it is all about costs.

(2880 words including quotations)

**Kenneth Armitage**

30 May 2005