



In Pursuit of Efficiency: Centralism and Resultant Economies and Diseconomies

by Andrew Dowse

FOREWORD

Sound management demands that organisations be both effective and efficient. There is a precedent to these ends though. There is no value in delivering a function efficiently if it does not meet the criteria of effectiveness.

This short working paper explores a dimension of an organisational design conundrum; specifically, balancing the effectiveness of a process or function against its efficiency. GPCAPT Dowse examines when centralising or homogenising a support process or function to realise efficiency gains damages its effectiveness or, worse still, establishes arrangements that are neither effective nor efficient.

There are times when the 'one size fits all' approach is not the appropriate one. This paper is food for thought for those engaged in designing organisational process or function, or indeed organisations themselves, to ensure they are fit for purpose. That is, that they deliver their ends effectively and efficiently as well, and in that order.

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There is an inclination periodically within Defence to centralise and outsource functions that are not considered to be 'core business'. Seeking economies by centralising support services within functional departments has some grounding in organisational theory. However, care should be taken to ensure that the customer continues to obtain the value required from the services and that centralised arrangements are likely to achieve efficiencies.

BACKGROUND

Despite three generations of relative peace, Australia's defence challenge remains significant. Factors such as our geographic expanse, small population, natural resources, as well as modernisation of regional militaries, high operational tempo and the potential for regional instability, make developing and maintaining a credible defence capability a difficult proposition for Australia. This situation is not particularly new - to meet the challenge in the past, we have relied largely upon technological edges over potential adversaries, public diplomacy and the leverage of strategic relationships. We have invested a moderate proportion of GDP in our Defence capability, although increasing personnel and capital equipment costs are bringing more pressure on the budget.

While the new Government has committed to a real increase in Defence expenditure, the predicted costs of providing future capability to meet our strategic objectives still exceeds the future budget. Government has directed that Defence achieve savings to bridge the gap between what we need and what we can afford. The typical, and possibly only, way in which we deal with this situation without reducing capability is to attempt to reduce support costs (i.e. improving the teeth to tail ratio).

There is, therefore, a strong desire to make support capabilities in Defence more efficient. While there may be some ways of realising efficiencies through initiatives such as automation, outsourcing and process improvement, by far the greatest focus is on centralisation and standardisation. This involves moving to a more mechanistic and bureaucratic organisational form to achieve what Blau (1970) describes as economies of scale in administration. As put another way recently by a Defence senior executive in discussing the need for rationalising responsibilities in a new base management model, 'we need to bring it all together under one group'.

However, is this oversimplification? Are there other considerations and does adoption of a more mechanistic form come at a cost? A review of organisational literature might assist in answering these questions.

ORGANISATIONAL THEORY

Administrative management theory describes the development of structural concepts for organisations, specifically the use of departmentalisation in such a way to increase organisational efficiency (March and Simon, 1993). In the first half of the twentieth century, a number of researchers developed this theory, including Fayol, Gulick, Urwick, Mooney and Reiley. In particular, Gulick (1937) identified that there are a number of different ways in which organisations may departmentalise for best effect (by purpose, process, customer, place or time).

Weber (1946) expanded upon the departmentalisation approach by describing bureaucracy theory, in which organisations are structured based upon clearly defined rules of formalisation and specialisation, with decision-making legitimacy based upon defined authority. The bureaucratic structure is based upon a horizontal division of work and a vertical division of authority. Whilst the term bureaucracy now carries with it a negative connotation due to formal and inflexible management of work and decision-making, it remains the basis for most organisations, especially large organisations and most notably the public sector.

Subsequently, bureaucracy theory became more concerned with the provision of administration to the organisation (Donaldson, 2001). Blau (1970) pointed out that centralisation of administrative functions in large organisations could allow a larger span of provision of those functions (ratio of managers to workers), thus permitting the achievement of economies of scale in administration. Economies of scale arise from the ability to manage or perform activities more efficiently at larger volume (Porter, 2004).

The ability for such efficiencies to be realised is subject to a number of contingency factors that characterise the organisational context (Donaldson, 2001). Typically more economies of scale in administration can be realised in large organisations. Conversely, these efficiencies can be limited by factors such as complexity, task differentiation and task interdependence. Where there is interdependence between organisational elements and departmentalisation is based upon a mix of means and ends, there is a greater requirement for lateral coordination across the organisation, which limits spans of control and therefore limits the achievable economies.

Centralisation in Defence

In Defence, economies of scale have been achieved by the creation of Service Provider Groups, which created departmentalisation at the support level underneath the departmentalisation associated with military professional mastery and operational capabilities. These arrangements create reliance from the output groups upon the support groups, which Porter characterises as a value chain.

While the Defence Business Model (at Figure 1) gives the impression that no such value chain exists, this diagram is misleading. The Defence Management Review confirmed the requirement for internal relationships within Defence with suppliers providing value to the output groups, and even expressed a need for increased rigour in the contractual management of such relationships.

It should be noted that the inappropriate structuring of organisations in the pursuit of efficiency could have the opposite effect. The creation of separate organisational structures to provide support services that were done more efficiently or more competently by their customers may result in what Porter (2004) calls **diseconomies of scale**. These may be diseconomies of scale in administration, in which the new arrangement is less efficient, or diseconomies of scale in production, in which the new arrangement no longer provides the requisite value.

Centralisation for the sake of efficiency can significantly impact upon the value derived from centralised functions through a focus on inputs, a lack of appreciation for quality and poor accountability; it can be a fundamental obstacle to management excellence (Creech, 1994). Creech explains that increasing the organisational distance between an organisation's teeth and tail can impact upon effectiveness and efficiency. This belief is aligned with more recent concepts for business networking and the US military concept of pushing power to the edge (Alberts, 2005). It is therefore critical that initiatives aimed at achieving administrative efficiencies be analysed and subject to a business case.

The demarcation of capability versus support as a means of determining organisational structure, as is currently being considered by Defence, is in practical terms quite ambiguous. As discussed earlier, there are a number of contingent factors identified in the organisational literature as relevant to assessing the value of pursuing centralisation. In respect of the centralisation of support services, the primary contingency should be **task differentiation**. Task differentiation is a determinant of competencies, and it is reasonable to consider that greater variance of these competencies will lead to lesser economies of scale.

It might be noted that the task differentiation dimension does not adequately account for the need for expeditionary capability, MRU or legal considerations of C2, which are additional considerations.

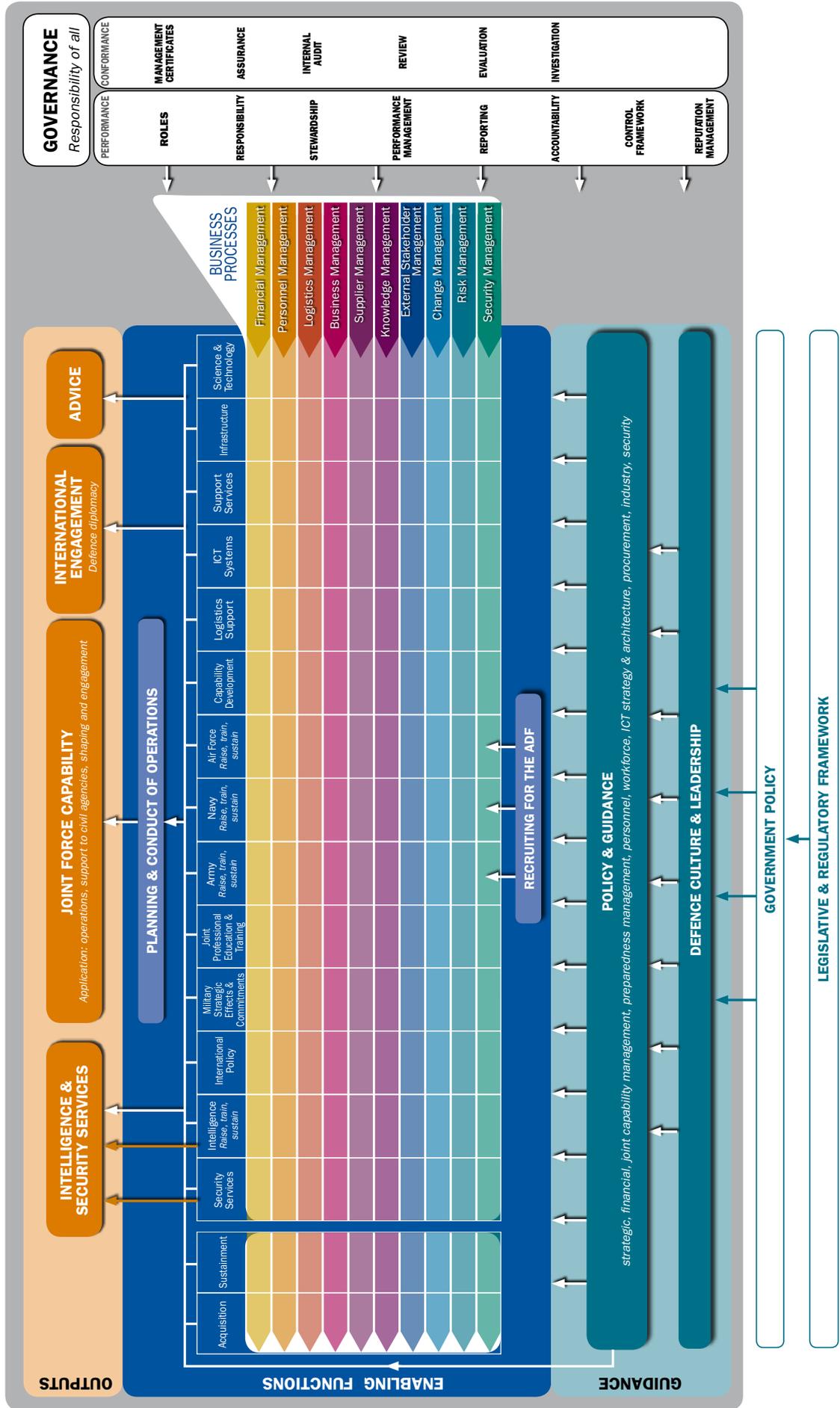
THREE SUPPORT ARRANGEMENT MODELS

This paper considers the simplified situation of a common support organisation (supplier) and multiple output organisations (customers) at a base. In reality, a single customer group may have primacy and there may be multiple service providers. However, the former situation is more appropriate in addressing the drive for administrative efficiency. Three models are considered here, with variations in the level of task differentiation. That is, situations:

- where the support functions are common to all customers;
- where there is a difference between the support requirements of the customers; and
- where the competencies of a support function are unique to a customer.



Defence Business Model



The first case is one in which there is clear potential for rationalisation. A consolidated approach to provision of common services can reduce duplication and achieve efficiencies. More importantly, such standard services can be provided as a utility and managed corporately. In Defence, most (if not all) such common services were rationalised under the Defence Reform Program. This transition is represented at Figure 2.

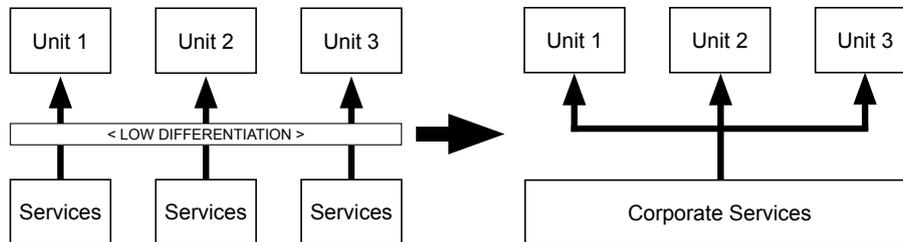


Figure 2

The second case is one in which the competencies required in the support function are similar but service levels and requirements vary across customers. This function can be departmentalised, and might obtain economies of scale. This is depicted at Figure 3, in which tailored services are provided by a common support organisation. There is a requirement in such arrangements for service level management to ensure requisite value is delivered to the customers. If these services are not articulated and subject to performance management, the customer may be left (as has often been the case in Defence) with less service and fewer resources. There is the potential for such variations in value to be scrutinised with a view to standardisation, with subsequent transition to a common service as described in case 1.

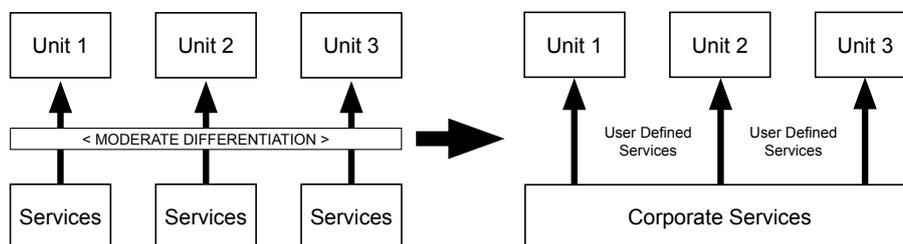


Figure 3

The third case is where there is no commonality of a support service across customers. In a centralised arrangement for such unique services, the service provider would need to maintain competencies and resources solely for each customer. As both the service provider and customer needs to maintain such competencies and there are overheads in managing the (potentially contractual) relationship, such a move does not offer economies. In fact, it is highly likely that pursuit of centralisation in such areas could only result in diseconomies of scale. In the worst case, it would create multiple layers of management between customer and supplier (as well as administrative overheads over each of those layers), which will make the support services less efficient and less responsive to the customer. An example of such a situation in Defence is airfield rescue and fire fighting. Figure 4 depicts the overlay of a corporate service provider in such a situation. If the service is outsourced, there may be benefits in the corporate service provider providing contract management support, but not managing the support function itself.

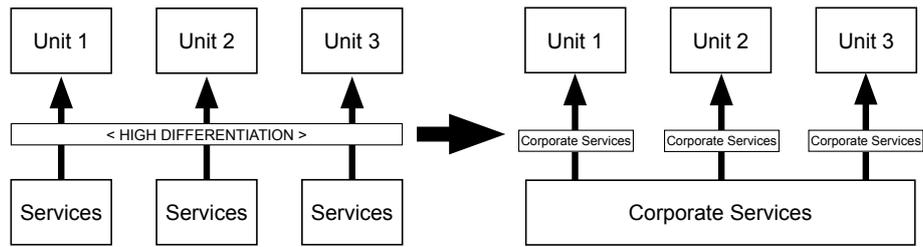


Figure 4

It is also likely that separation of wartime and peacetime (i.e. expeditionary and garrison functions) could also result in diseconomies of scale.

CONCLUSION

This paper has examined the theoretical basis for pursuit of organisational economies of scale through centralisation of support services. The key conclusion is that there needs to be cognisance of the level of task differentiation of the various functions that support capability, in order to determine whether centralisation is likely to result in economies or diseconomies of scale.

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