

The Big Read **Warren East**

Business: How to topple bureaucracy

It can be a short step from innovative start-up to a company overburdened by red tape



© Brian Saffer

Andrew Hill APRIL 14 2016

Funding Circle inhabits an outwardly traditional office in the staid heart of the City of London. But inside its headquarters — home since September — it boasts many of the trappings of ambitious young technology companies: an in-house café, a purple-baized pool table that matches the corporate colour scheme, a pitch-and-putt set and a variety of funky breakout areas for spontaneous meetings.

The [peer-to-peer lender](#), which is only six years old but now employs 570 staff, 280 outside the UK, has something else in common with all innovative, fast-growing enterprises: a preoccupation with bureaucracy.

“As you get bigger, you get all these critical matters,” says Andrew Mullinger, 33-year-old co-founder. “Disorder will exist at scale. How do you create order and be more effective as a group?”

It is not enough to “think smart” and “make it happen”, as the motivational messages on the office walls exhort. As [Funding Circle](#) grows, he admits, so does structure and hierarchy. With them comes the threat that, left unchecked, an overdose of bureaucracy could stifle innovation and silence initiative. Such a fate may seem far off for Funding Circle and other young organisations but the battle

against bureaucracy is a reality for almost every established company.

Faced with bloated costs and sluggish decision-making at [Rolls-Royce](#), [Warren East](#), the engineering group's chief executive, started a [cull of senior managers](#) in January, restructuring divisions and making operational units report directly to him. The former head of Arm Holdings, the chip designer, says he is reworking Rolls-Royce's "organisational software". [Volkswagen](#), hit by scandal, has [halved the number of senior managers](#) reporting directly to its chief executive, to speed up processes and streamline decisions.

To forestall bureaucracy, companies are developing models of "self-organisation" or "self-management" on a larger scale than previously attempted. Zappos, the shoe retailer owned by Amazon, [is converting to Holacracy](#), a flatter system that does away with titles — though staff departures and tension have generated much bad publicity during the painful transition. Haier, the Chinese white goods company, laid off 10,000 middle managers in 2013 and 2014. It is [transforming itself into an active shareholder](#) overseeing a network of micro-enterprises that compete with each other for central resources.

The \$3tn prize

Gary Hamel and Michele Zanini in [a study published last month](#) calculate that "busting bureaucracy" could deliver a valuable boost to US productivity. They suggest the ratio of employees to managers could be brought into line with more efficient "vanguard" companies, including Haier, Sweden's [Handelsbanken](#), which has only three tiers of management, and [General Electric's](#) aviation division, whose North Carolina plant employs one manager to supervise 300 technicians.





ESTIMATE BY GARY HAMEL
EXTRAPOLATING FROM BUREAU
OF LABOR STATISTICS

Extrapolating from US Bureau of Labor figures, they estimate there are 12.5m surplus “bureaucrats” — managers and administrators — clogging up the US economy, as well as the equivalent of 8.9m “paper-pushing subordinates”, a figure based on the number of hours spent by non-managers carrying out chores “of questionable value”.

Redeploying these 21.4m people into “wealth-creating” work could, the authors believe, add \$3tn to US annual gross domestic product. They estimate the size of the UK’s “bureaucratic class” at 19 per cent of the workforce, against 17.6 per cent in the US, in 2014.

“Bureaucracy won’t start to crumble until prominent public and private sector leaders acknowledge the fact that bureaucracy’s waste of human potential is morally indefensible,” wrote Prof Hamel and Mr Zanini.

The calculations are based on many assumptions and their rhetoric is, critics in academia say, overblown. But the paradox at the heart of the debate about the push to tear down hierarchies, abolish bureaucracy and dismiss middle managers is that all organisations need at least some of all three elements if they are to hold together at all — something even Prof Hamel acknowledges.



10,000
Middle managers
laid off by
Chinese white
goods company®
Haier in 2013-14

Guy Sochovsky, chief financial officer of NewVoiceMedia, a UK-based cloud

services company that has grown from 30 to 350 employees in four years, says: “Process and bureaucracy aren’t nice words and never desirable, but having processes and structures and clarity is an enabling tool rather than a tool of constraint.”

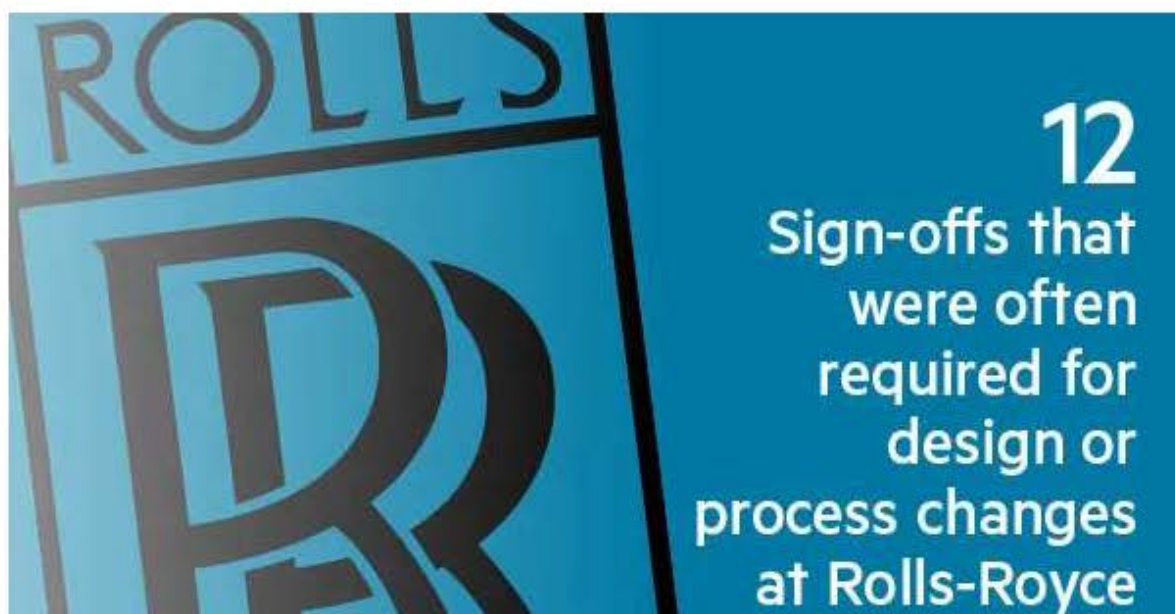
Even companies that start with freewheeling ambitions to be different need “guard rails”, which is how Kaiser Permanente, the US healthcare group, described the non-negotiable rules it used to manage its rollout of a new and complicated health record system between 2004 and 2010.

Chaos theory

Without such rails, companies can stray badly. Earlier this year, for example, Zenefits, a health insurance brokerage based in California, attracted adverse publicity and regulatory attention [for its lax culture](#). “The fact is that many of our internal processes, controls, and actions around compliance have been inadequate,” its chief executive said in a memo after his predecessor resigned.

Dominic Jacquesson, director of talent at Index Ventures, a venture capital group, says that in his experience of helping start-up companies scale up, “chaos is the main problem”, not an excess of bureaucracy.

As companies grow, however, the founders have to delegate duties to managers, from heads of product or marketing, to fully fledged chief operating officers. They also need traditional human resources policies — on maternity leave, for instance, or performance management — to recruit and retain staff. Mr Mullinger of Funding Circle, one of Index Ventures’ investments, says “as founders you are hugely empowered, but your whole journey is a de-powering experience”.



In the process of appointing managers, new hierarchies form. [Research by Lindred Greer](#) of Stanford Graduate School of Business, and others, found that, at best, when members of the team recognise each others' strengths, hierarchies can clarify roles and encourage better performance. At worst, though, a hierarchical structure can hinder a team by encouraging politicking and unproductive rivalry.

Another cause of administrative red tape is complexity. Bob Sutton, another Stanford professor and co-author of [Scaling Up Excellence](#), points out "how slow the best tech companies [such as Facebook] are to go to multiple locations". He says their early caution about geographical expansion may help explain their success.

Almost as soon as a company opens one or more satellite operations, it is on the road to "matrix" management, in which employees may have to respond to more than one boss — a regional president, say, and a divisional head. Such structures can usefully encourage communication between discrete divisions. But they can also multiply the number of fiefdoms and pockets of bureaucracy. Regulation — as banks in particular have discovered since the financial crisis — inevitably adds layers of new staff, charged with implementing rules, even as [revenue-producing jobs are cut](#).

Tradition can also reinforce administrative processes. At Rolls-Royce, strong pride in the group's engineering prowess, combined with the essential need to meet high safety standards, turned over time into [an excess of oversight](#). A dozen signatures were sometimes required for design or process changes that only needed four levels of certification, the company says, because "a mythology had grown that 12 was the number".



“What you get [with smaller project units] is agility, creativity, innovation, engagement and customer satisfaction”

ISAAC GETZ
CO-AUTHOR OF FREEDOM, INC

Finally, good fortune can blind chief executives to the build-up of inefficiency and process. John Kenneth Galbraith coined the term “[bezzle](#)” for the inventory of undiscovered embezzlement that accrues in good times when “people are relaxed, trusting and money is plentiful”. Similarly, companies often tolerate bureaucratic excess until markets turn down and the layers of unnecessary management become obvious, as in the case of some resource groups after the rout in commodities.

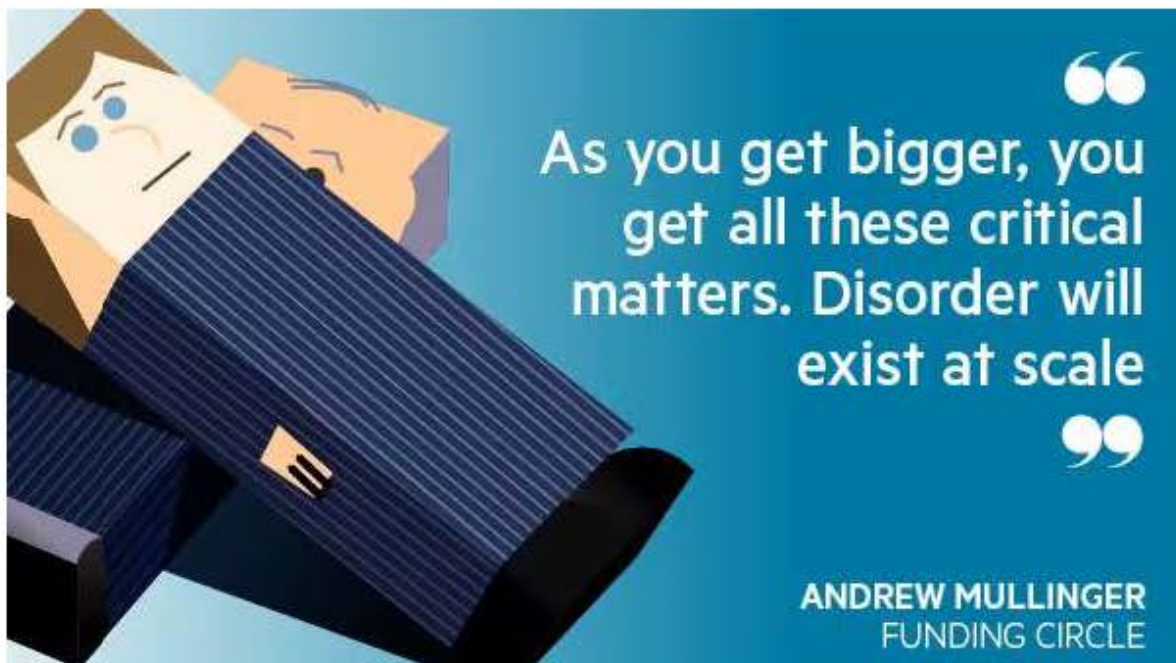
To avoid this fate, Prof Sutton suggests that as companies get larger they should divide into smaller units that are easier to manage and motivate.

Sprint finish

Running projects over shorter cycles also keeps the build-up of bureaucracy to a minimum. The approach is familiar to those who use [so-called Agile software development methods](#) and larger companies are experimenting with giving smaller teams more independence.

The Learning Consortium for the Creative Economy, which includes [Microsoft](#) and Riot Games, the online gaming group, was set up in 2015 to [share unconventional approaches](#) to reducing red tape and management friction. For instance, Ericsson has divided 2,300 enterprise software engineers, co-ordinated from Ireland, into more than 100 small autonomous teams, developing products in three-week “sprints”.

Isaac Getz, co-author of *Freedom, Inc.*, whose philosophy for “liberated” companies to grant more autonomy to workers is being adopted by groups such as France’s Decathlon and Michelin, says it may be more expensive to run smaller units. But, he adds: “What you get is agility, creativity, innovation, engagement and customer satisfaction.”



“As you get bigger, you get all these critical matters. Disorder will exist at scale”

ANDREW MULLINGER
FUNDING CIRCLE

In their paper, Prof Hamel and Mr Zanini say the usual easy victories over bureaucracy, such as reducing the size of head office or stripping out some managers as **Barrick Gold** and Rolls-Royce are doing, are usually “small and quickly reversed”. But while their aim of busting bureaucracy sounds radical, their solution is more gradual. They propose that companies should run “hackathons” — internal competitions — to find novel ways of solving operational problems. Fixes can then be rolled out more widely if they work.

“The question isn’t whether you need control or not, whether you need process or not, or discipline or not: the question is how do you get it?” Prof Hamel says.

As for more radical solutions such as Holacracy — which replaces managers with a carefully orchestrated system of meetings and discussions — he believes such top-down transformations are bound to fail. Holacracy’s fans say critics have misinterpreted the approach, which they describe as a framework for developing new ways of organising.

Prof Getz says that at “liberated” companies, “you need fewer managers, but these managers aren’t fired — why would you fire a guy who was good for 15 years? You offer them what’s called a bridge: ‘Come back to us and tell us what you would like to do to contribute to our vision?’ Not some kind of bureaucratic position but some kind of valid creative approach.” Haier’s chief executive Zhang Ruimin, for instance, says many of its redundant middle managers found more productive roles at the new micro-enterprises within the group.

Over corporate history, the pendulum has tended to swing between centralised bureaucracies and more loosely controlled networks. The challenge is preventing processes ossifying into bureaucracy over time. A leader who does not continually look at subtracting unnecessary rules and procedures is like a gardener saying, “I only have to mow my lawn once”, says Prof Sutton.

As Funding Circle grew, Mr Mullinger said one of the hardest things to explain to staff was that meetings were becoming unwieldy. Some employees would be better not taking part. But attendance, it turned out, was a sign of status that colleagues were reluctant to give up. He learnt a lesson: “One person’s bureaucracy is another’s empowerment.”