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**Overhead gewaardeerd. Verbetering van de balans tussen waarde en kosten van overhead bij organisaties in de publieke sector**

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## Summary

### *Introduction*

Overhead is often associated with the 'fat' of an organization. It does, however, have an important function: steering and supporting the organization. It is also an emotionally charged concept, which often evokes angry responses. At the present moment many organizations are making cuts in their overhead. The literature on this topic is, however, especially focussed on the assignment of the overhead costs and to a much lesser degree on managing these expenses.

### *Central research questions*

This research was aimed at two main questions: What types of explanations are there for the size of the overhead of public organizations? And how can these insights be used in improving the balance between the value and costs of overhead?

### *Method*

The research comprises a combination of statistical analyses and case studies conducted in three organizations. In 2001 the researcher started with a systematic comparison of the size of the overhead in a number of organizations. When commencing the research for this dissertation at the end of 2007, approximately 1,000 organizations were included in a benchmark study. There was, at that time, a large amount of statistical data available. This information revealed that among sectors, but also among organizations within the same sector, there were large differences in the size of the overhead. However, these differences could only be partly explained on the basis of the statistical material. Case research then offered the possibility to explore this variance in further detail by means of, among other approaches, document studies, and interviews.

In selecting the case organizations the first research question has been central. In other words: the aim was to make a selection of case organizations in which the differences in the size of overhead were as large as possible. In addition, the statistical data showed that the nature of the primary process (the sector) was of great importance for the size of the overhead. This is why three organizations from a completely different sector were selected: a supervisor (anonymous), a consultancy firm for education (the CED group), and an organization from the child welfare sector (the Dutch Child Welfare Council / CWC). The overhead size of two organizations was already known from the benchmark database. The overhead of the supervisor was very high, whereas that of the child welfare organization was very low. With respect to the overhead of the consultancy firm for education, no information was available prior to the research. In terms of employees, the organizations varied from 200 to 2,400 ftu.

The research was primarily aimed at the public sector in the Netherlands. In addition, a comparison was made with the Dutch service provision sector. As regards the primary process (labour intensity, service orientedness) the service sector can best be compared with the public sector.

### *Definition of overhead*

Since there are several definitions of overhead, a situation which has led to a confusion of tongues, an unambiguous definition of the concept of overhead was first developed (Huijben and Geurtsen, 2008). Overhead has been described as the whole of functions aimed at steering and supporting an organization's staff in the primary process. Overhead includes all functions serving this purpose. A distinction is made between *generic overhead* and *sector-specific overhead*. Generic overhead is common in every sector. Sector-specific overhead differs per sector. This distinction is important for making adequate comparisons among the overhead costs of organizations in the different sectors. What is characteristic of generic overhead is that it includes functions which can be found in all sectors. We consider generic overhead as consisting of all central and de-central business units engaged in the following functions:

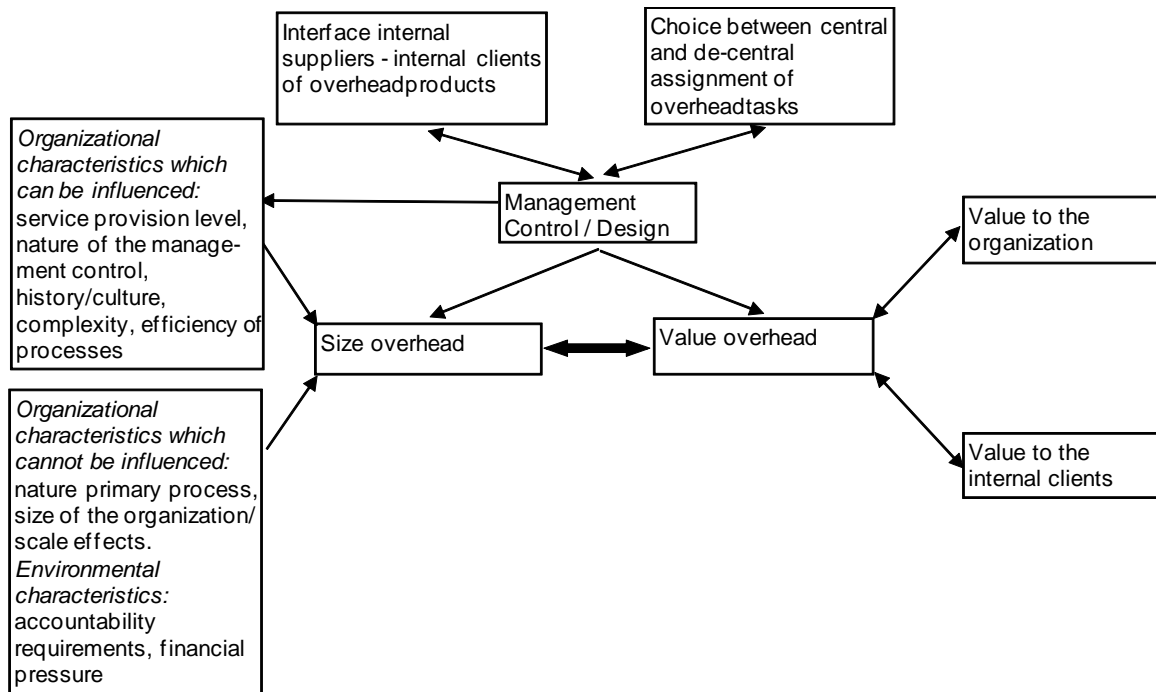
- Board, management, and secretarial support.
- Personnel department.
- ICT and automation.
- Finances and control.
- Communication.
- Legal affairs.
- Facilitating services.

Sector-specific overhead concerns specific functions which meet the basic definition, but which are exclusively related to one specific sector. For example, the function Education & Research support in universities and colleges or the transport of beds in hospitals.

### *Explanatory factors for the size of the overhead in public organizations*

On the basis of a literature study a theoretical model was developed for explaining the size of the overhead of public organizations. With the aid of the case research it was refined, resulting in the model depicted in figure 10.1.

**Figure 10.1. Adjusted theoretical model for explaining the size of the overhead of public organizations**



The basic idea of the model is that the size of an organization's overhead is determined by a combination of organizational characteristics which can and cannot be influenced, environmental characteristics, the value of the overhead, its management control, and its design. Here, the management control and design form an important point of departure for the alteration of factors which can be influenced. As regards the value of overhead a distinction can be made between the value to the organization as a whole (contribution to the organizational objectives) and the value to the internal users (tasks to support the staff members in the line). By means of an Overhead Value Analysis (OVA) an insight can be gained into the balance between the costs and the value of the overhead functions. This method was applied to the three case studies conducted in this research. On the one hand, the OVA showed the costs per subfunction, while on the other hand, the value of these subfunctions was indicated on the basis of the interviews with both the suppliers and the internal purchasers of the overhead services.

The predominant adjustments to the theoretical model resulting from the case study were the following:

1. In the management control and design of overhead two aspects appeared to be especially crucial: first, the choice of assigning the tasks either centrally or de-centrally, and second, the design of the user interface. The CWC case showed that a central control with carefully made agreements with the users could be efficient and effective, also for a larger organization.
2. The management control and design were important points of departure to influence the factors which could be changed. Here, also the distinction between the management (management control, regular intervention) and the design (re-design, just one fundamental intervention) was relevant.

3. Most of the potential factors explaining the size of overhead as mentioned in the literature actually appeared to be relevant in practice. The number of locations, however, was not unambiguous. Based on the case studies we explicitly added an element of the overhead's design, namely inefficiency in processes. This factor appeared to play a distinct role in the cases.
4. The factor 'turnover' was not explicitly but implicitly added under the heading 'financial pressure'. This factor played a role in the sense that organizations with a high turnover also have a higher overhead per direct staff member, because these companies have less financial pressure.

#### *The management control of overhead*

With respect to the management control of overhead, the theory roughly offers three models:

- *Central management control.* The purchase is obligatory for the users without them having any influence on its size and nature. The management control is based on input.
- *Central management control with interface.* The purchase is budgeted through consultation between the suppliers and the purchasers of these services. The supply and purchase are obligatory, but there are periodical negotiations about the size and quality of the services.
- *Internal market.* The supplier sets a tariff per unit. The internal users are free to choose between internal and external purchase. In addition, the supplier can offer services outside the organization. The management control is based on output. A more advanced form is *outsourcing*. In this case the overhead service is purchased on the external market.

What type of management control is the most suitable can differ per service, according to the transaction costs economics (TCE). TCE distinguishes three characteristics of transactions: uncertainty, asset specificity, and frequency. This distinction has resulted in a theoretical framework for determining the most desirable type of management control. On the basis of the case studies the framework has been adjusted to the model presented in table 10.1.

**Table 10.1: Adapted model for the proper management control of overhead functions**

<b>Asset specificity</b>	
<i>Low</i>	<i>High</i>
<p><b>Model 3: Internal market or outsourcing</b></p> <p>Applies to standard services.</p> <p>Prerequisites:</p> <ul style="list-style-type: none"> <li>- internal purchasers are actually held accountable for costs.</li> <li>- there are adequate administrative systems available for cost calculation.</li> </ul> <p>Example: cleaning, security, reception, catering/canteen, salary administration, internal post supply and delivery.</p>	<p><b>Model 2: Central management control with interface</b></p> <p>Applies to tailor-made services.</p> <p>Also applies to standard services, if the prerequisites mentioned in the left column have not been met.</p> <p>Example: financial planning and control, hrm-advice, ICT-policy, internal and external communication, various forms of secretarial work (in connection with organization-specific systems), documental information provision, quality care.</p>

The cases showed that the transaction costs theory lacks an important aspect, which in the management control of the overhead function in actual practice plays a significant role. TCE starts from 'limited rational action'. This means that actors make a choice without being able to oversee all alternatives. Within this context a rational decision is then made. In practice, however, people act less rational than suggested here. Apart from the limitation in the set of alternatives to oversee there is a second restriction: managers in public organizations are not always held responsible for costs. Often they are in the first place accountable for the realization of other organizational objectives. Consequently, the management control of many functions which are in theory associated with the internal market, are in practice more suitable for model 2 (central management control with interface). This is because the internal market often does not function to an optimum extent.

A second issue is that internal cost apportionment requires some degree of leeway on the part of the managers, which has been observed to cause risks, such as undesirable behaviour and differences among the organizational units. This situation undermines the uniformity.

With respect to the framework, it should be added that due to the long-term contracts (for example for housing) sometimes the management is of far lesser importance than the design. As regards these functions, the interface is therefore of great importance for the design, while the possibilities for management control during the execution of the contract are more limited.

### *Designing the overhead functions*

Furthermore, the research has led to the following insights with respect to the design of overhead functions:

- Scale increase does not lead to scale advantages in overhead, with the exception of that of small organizations. From this perspective, however, when the design of Shared Service Centres is based on the realization of scale advantages, some reservations are in place.
- There is no connection between the size of the overhead and the productivity in the primary process. In the service provision segment, however, the size of the overhead is connected with the turnover per direct staff member. This means that a certain degree of financial pressure leads to a lower overhead, which does not necessarily have to have negative consequences for the organization's productivity.
- Positioning the overhead departments centrally can also be effective in the case of a large organization.
- This approach does require, however, that the interface with the internal purchasers is well-organized and that the policy regarding the tasks and the level of service provision of the overhead departments is clearly formulated. An important advantage of central positioning is that the overhead is clearly visible, which also creates a counter-balance.
- The management and design of overhead functions should be realized in such a way that the tasks are not becoming too complex and that there is some financial pressure on the overhead departments.
- Benchmark research in combination with Overhead Value Analysis can help in mapping out over-capacity and, on the other hand, in taking measures to increase the value of the overhead services. Without these kinds of studies organizations apparently have insufficient knowledge of this issue. It is advisable to conduct the benchmark study prior to the OVA, so that the latter can specifically deal with the overhead services which have shown deviations in the benchmark. There can also be other reasons to perform an OVA, for example in the case of quality issues.