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Contribution of Adam Smith into management thought

Wkład Adama Smitha w rozwój myśli zarządzania

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Abstract. Adam Smith was the first person to identify specialization and the division of labour as the main drivers of productivity. He also conceptualized the “invisible hand principle” which explains how, under the proper set of incentives, self-interested individuals are directed to pursue activities that benefit the whole of society. Both ideas are of utmost importance in the field of management. Specifically, successful managers are those who are able to create good “rules of the game” which align the incentives of labour with the goals of the firm. Smith’s contributions provide a foundation for the division of labour and demonstrate the importance of establishing the right “institutions” within a firm, calling it a fair reward system. The paper arrives at practical implications for managers from the paper of an eighteenth-century economist. The major goal of the paper is to reflect over the decision-making process which requires vast time consumption.

Keywords: time, economy, labour market, management, society

Abstrakt. Adam Smith był pierwszą osobą, która zidentyfikowała specjalizację i podział pracy jako główne siły napędowe produktywności. Opracował koncepcję „niewidzialnej ręki”, która wyjaśnia, w jaki sposób, biorąc pod uwagę odpowiedni zestaw bodźców, pojedyncze jednostki nastawione na osiągnięcie własnych celów są kierowane do wykonywania działań przynoszących korzyści całemu społeczeństwu. Obie idee mają ogromne znaczenie w dziedzinie zarządzania. W szczególności odnoszący sukcesy menedżerowie to ci, którzy są w stanie stworzyć dobre „zasady gry”, dostosowując zachęty do pracy do celów firmy. Wkład Smitha stanowi podstawę podziału pracy i pokazuje znaczenie ustanowienia właściwych „instytucji” w firmie, nazywając to sprawiedliwym systemem wynagradzania. Artykuł traktuje o praktycznych implikacjach dla menedżerów, nawiązując do wkładu osiemnastowiecznego

ekonomisty. Głównym celem artykułu jest podjęcie próby zastosowania teorii z dziedziny ekonomii do dziedziny zarządzania.

Słowa kluczowe: czas, gospodarka, rynek pracy, zarządzanie, społeczeństwo

Introduction

Adam Smith's *Wealth of Nations* was published in 1776, coincidentally the same year as the Declaration of Independence is considered by many economic scholars to be the early framework of capitalism. Adam Smith's importance to the economics discipline is unquestionable. Indeed, he is commonly known as the "father of economics". His most influential paper, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776) remains the quintessential text in economic science even some 200 years after its publication. While at its core Smith's paper focused on answering the question "Why are some nations rich and others poor?" his ideas and conclusions have broad applicability and are especially relevant to contemporary management. One of his ideas can be applied to the value of time as a result of specialization.

People's choices are limited by the amount of time they may sacrifice for a certain activity. The more time from the total number of 24 hours a day a person may sacrifice the more complex and time-demanding actions they may complete. The paper aims to apply the ideas found in the paper of Adam Smith, the pre-eminent eighteenth-century economist, to the field of management. We are going to discuss the concept of the invisible hand and the value of time in relation to specialization.

The invisible hand

Without question, the most widely cited idea found in Adam Smith's *An Inquiry into the Nature and Causes of the Wealth of Nations* is the notion of the "invisible hand." Smith's invisible hand explains how a decentralized capitalist system, which lacks any central planner, can still manage to thrive and produce goods and services valued by consumers. The key insight at work in Smith's theory is that a free market aligns the incentives of a self-interested individual with the objectives of the society. Specifically, anyone who earns money from his or her labour can do so only by offering a good or service valued by someone else. To the extent the individual wishes to earn the highest possible wage, therefore increasing his or her standard of living, he or she will be motivated to pursue that activity most highly valued by those around him. It is the pursuit of these highly valued activities which create the most wealth for society. An oft-quoted passage in *Wealth of Nations* reads: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest (...) he intends only his own

gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention”.

In the context of management, the invisible hand principle has clear implications.

It is a request for decentralization rather than command and control (i.e. “central planning”) by firm managers. Decentralized decision-making can and will result in the best outcomes, as long as the proper “rules of the game” are in place. Looking back to Smith he advocates that managers need to introduce fare reward system. In particular, all that is required is that an incentive structure exists to align the individual self-interest of workers with the outcomes desired by the firm. For example, incentives such as stock options or profit-sharing can help to create this alignment of individuals. While it is important that employees face benefits that relate to the revenue of the firm, it is equally important that they understand (and bear some of) the costs their decisions have on the firm. A department within a firm would have, for example, little incentive to conserve the physical space it uses unless, like the firm as a whole, it bears a cost for the space it utilizes. In the presence of the right incentive structure, Smith’s invisible hand will do the rest.

Specialization as a time saving

The proverb practice makes a master is very often heard. Repeating the same sequence over and over again makes us remember the moves, it is called muscle memory (Johnson, 2007). Many people working at the factories experience a routine of their work, as every day they are repeating the same work. From the company’s point of view, it is an excellent outcome, as those people with specialized skills are more efficient as they need less time to complete certain activities.

The process of the division of labour was explained by one of the fathers of the modern economy Adam Smith in his greatest art *The Wealth of Nation*. In answering the main question of *Wealth of Nations*, “Why are some nations rich and others poor?” Smith identified specialization and the division of labour as the main driver of productivity and economic progress. He offered an example of the pin factory where there are ten people working on the production. If each worker has to carry out the whole operation from the very beginning till the very end, then according to Adam Smith the factory may not exceed ten pins daily twenty pins a day. However if an owner distributes tasks by workers, so each worker gets from two to three operations (repetitive operations) to complete then the production will be maximized (each worker will produce up to four hundred eighty pins daily) (Smith, 1872).

Specifically, Adam Smith was the first to realize that specialization and the division of labour were the primary sources of productivity, and he was the first to conceptualize the “invisible hand principle” demonstrating the tendency for

self-interested individuals to be guided towards undertaking activities valued by the whole of society in a free market system governed by the rule of law and market prices.

Division of labour is a great option from the company's point of view. However, from the perspective of the worker, it is nothing more than locking people in a frame of their responsibilities with no perspectives for promotion or changing the profession. Workers locked in their position create a very special and dangerous social group. A mass of uneducated, tired work routine people is a threat to the society and fragile economic balance in the world (Hanlon, 2015).

The division of labour allows individual workers to specialize in specific phases of the production process and collectively produce more than if each were to produce individually. Likewise, when individuals specialize across different industries similar gains are realized. This increase in labour productivity not only yields higher output but also leads to increases in wage rates.

Adam Smith's division of labour is still being practiced in the modern job market. It is estimated that only 29% of employees will completely change their profession, the majority of workers do not risk changing their profession due to various reasons (specialization is one of them) (Apollo Technical, 2022). It is really difficult to change the career path once you gained experience in the selected profession. Adam Smith has proved in the example of the pin factory that specialization is a key to achieving profitability, thus, it is in the interest of the company to promote specialization in the labour market.

The implications for managers of Smith's observation concerning the benefits of a division of labour and specialization are clear. Workers are more productive when the levels of production are divided between specialized workers. Specialization of production in certain cases may lead to sustainable wealth distribution. The blossom of e-commerce entrepreneurship in the Chinese province strongly contributed to the development of social innovations growth (Cui, Pan, Newell et al., 2017) and wealth distribution in the Chinese villages (Luo, Qiao, 2021). The phenomenon of e-commerce entrepreneurship is called the name of one of the Chinese online shopping platforms "Taobao villages". Taobao villages become a world-famous phenomenon proving the specialization in a labour market may successfully compete with mass production.

Specialisation can be also referred to the consulting business when these are being managed. One can find on the market consulting companies who offer a wide range of services other consulting businesses want to specialise on the niche market. It happens that firms who decide to specialise are usually, though not exclusively, small in size and highly focused on a particular market. They are known for their expertise and reputation. On the other side the challenge here is how to grow: like any nascent business, it's tempting to stray off your home territory, partly to have a more diversified portfolio so that as a company is less exposed to downturns, but partly because the growth figures in other sectors may be very attractive.

The phenomenon of specialisation is not new. There are countless examples of industries that, when in their nascent stages, spawned numerous competing startups that eventually congealed to become larger, more dominant players due to their specialisation. Examples include banks, software developers, car manufacturers and media companies. The advantages of scale are undeniable, but it is important not to lose the core competency that we understand as specialisation that makes firms valuable in the first place.

Psychological problems resulting of “selling the time”

Time is probably the most important resource people possess. In opposite to time, essential goods and services might be stored or purchased. Time is an un-replenishable commodity.

Still, some people decide to sacrifice their lives for a sake of more profit. Does it mean that those people are making the wrong choice? Absolutely not! Nevertheless choosing to work overtime means that people do not only make more profit, but it also may bear negative consequences. Working overtime is a choice people have made for the price of other activities. Many office workers are suffering due to a lack of physical activity. According to the study conducted by The University of Texas Health Science Centre people who spend too much time working without making themselves a break are at a high risk of having cardiovascular disorder (Dembe, 2005). Moreover, people who are overworked often suffer an overweight, it is due to a sitting workstyle at the office. Keeping a proper BMI ratio¹ is a serious problem for many people overworking people.

The high level of stress that individuals experience every day puts them on their edge. In order to relax, many people decide to start smoking cigarettes and drinking alcohol. Both smoking and drinking alcohol cause cancer (Kivimäki, Virtanen, Kawachi et al., 2015).

On top of physical problems lies mental health disabilities, which are very often underestimated by both sick people and their supervisors at the workplace. Employees who decide to spend time working extra hours have to face serious health and mental problems. Lack of time for yourself might be a trap, many young people tend to push themselves to achieve better results. The result of this rat race is a high number of mental illnesses and physical problems. According to the survey conducted by “Forbs Magazine” among 2000 employees, 46% of people had no time to take a rest at work while 36% of respondents had to stay overtime at work

¹ Body Mass Index (BMI) is a measure of body fat based on height and weight that applies to adult men and women.

(Karsten, 2016). Overworking leads to various mental diseases such as (Allison, Peter, LaMontagne, 2015):

- blue mind (mind fullness);
- stress;
- depression;
- mood swing;
- irritability;
- anxiety.

Those sicknesses are a huge problem not just for individuals but for society as a whole. People with those kinds of problems usually do not go to see a doctor. Many of them are not aware of the problem they have, thus only a small percentage of metal sick people are searching for professional help.

There is also another aspect of the overworking problem very randomly discussed in media. People who are working overtime have fewer or even no children in comparison to the ones who have more time for themselves. A low natality rate may lead to serious problems in the economy as a whole (Waterhouse, Folkard, Minors, 1978).

Japan is a country with a very long tradition of working long hours. Japanese people are famous for working for a number of hours with almost no breaks. The results of their hard work are both impressive and horrifying. Japan after World War II achieved phenomenal economic results. Economic indicators are outstanding, GDP per capita in Japan is one of the highest in the world (40 246 USD GDP per capita) (World Bank, 2020). However, the price of the progress was terrifying. The word Karoshi invented in the 1970s refers to workers' compensation related to death or permanent disability from cerebrovascular diseases and ischemic heart diseases caused by overwork (Iwasaki, Takahashi, Nakata, 2006).

Is it worth pushing yourself to the limits in order to prove your superiority over the others at work for a price of all your time? This is the question that has to be answered by everyone.

Conclusions

The modern economy makes people compete in every aspect of their professional and private life. Specialization helps people to become masters in their profession but locks them in frames of routine. Routine and monotony of daily activities may lead to frustration, various physical and mental diseases and consequently to lower productivity rate of the employees. This is just one price that individuals and society pay for cutting the time of production and maximizing profits.

No matter if people choose to work overtime and sell their time for a lower price or not, people should be aware of the cost that their decisions carry out. Each

time employees push overwork their bodies experience it and the consequences of overworking might be critical for the human body. So, should people push to lower the cost of time? Again, there is no exact answer. Cutting the time of production is very desirable as the production pushes the economy, thus people have a better life. However, companies have to understand that employees are not machines and should keep the work-life balance.

Therefore the paper of Adam Smith, the father of modern economics, has far-reaching implications that stretch beyond any one discipline. Of particular relevance to managers, Smith was the first to conceptualize the invisible hand and identify the benefits of specialization and a division of labour. The invisible hand describes the link between individual self-interest and the well-being of the group. The division of labour, which Smith identified as the main driver of economic progress, describes how decentralization and specialization lead to increases in output and wages. The invisible hand can be stifled by poor institutions or “rules of the game” which do not align worker interests with those of the firm. The gains from specialization and a division of labour are limited by the extent of the market. The role of a manager wishing to gain from Smith’s insight is then to minimize these limiting factors. A successful manager will not attempt to “top-down” plan but will instead establish an appropriate incentive structure that aligns worker and firm interests.

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