



Productivity and Management Practices: Why They Matter - Background

Stephen Dorgan, McKinsey & Company
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WHY CARE ABOUT PRODUCTIVITY?

Productivity is the key indicator of economic wellbeing.

If it grows faster:

- “speed limit” of the economy is raised: more room for cut in interest rates
- More tax cuts
- Or spending on social security, health, national security, etc.
- Otherwise someone has to take the pain

WHY CARE ABOUT PRODUCTIVITY?

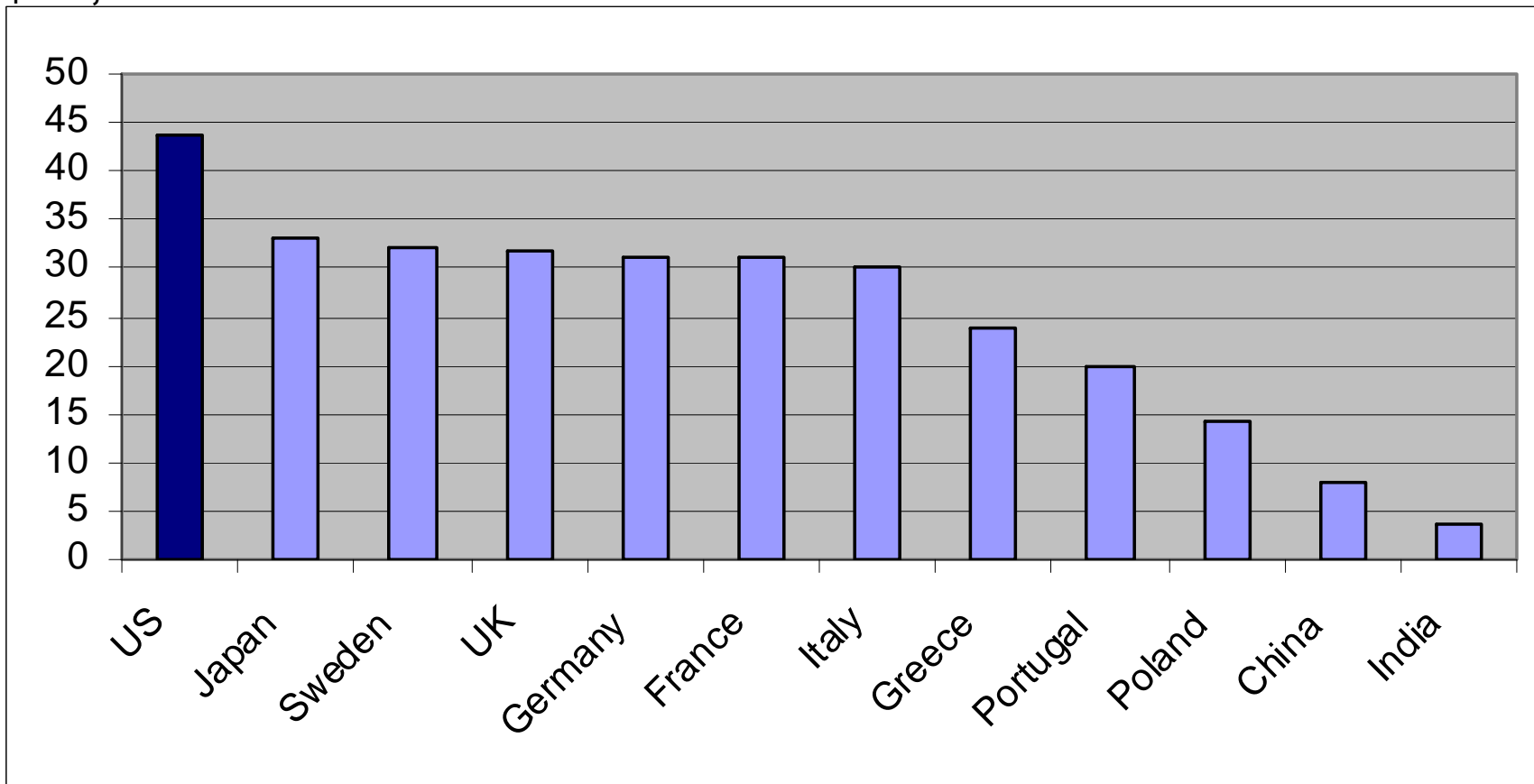
What are the key facts?

1. ***US position is strong, despite the recent gloom and turmoil***
2. Over the last decade or so US has experienced a “productivity miracle” that has not been replicated in Europe or other countries.
3. China is rising to be a global behemoth



THE US IS LEADER IN IN GDP PER CAPITA

\$000, 2006



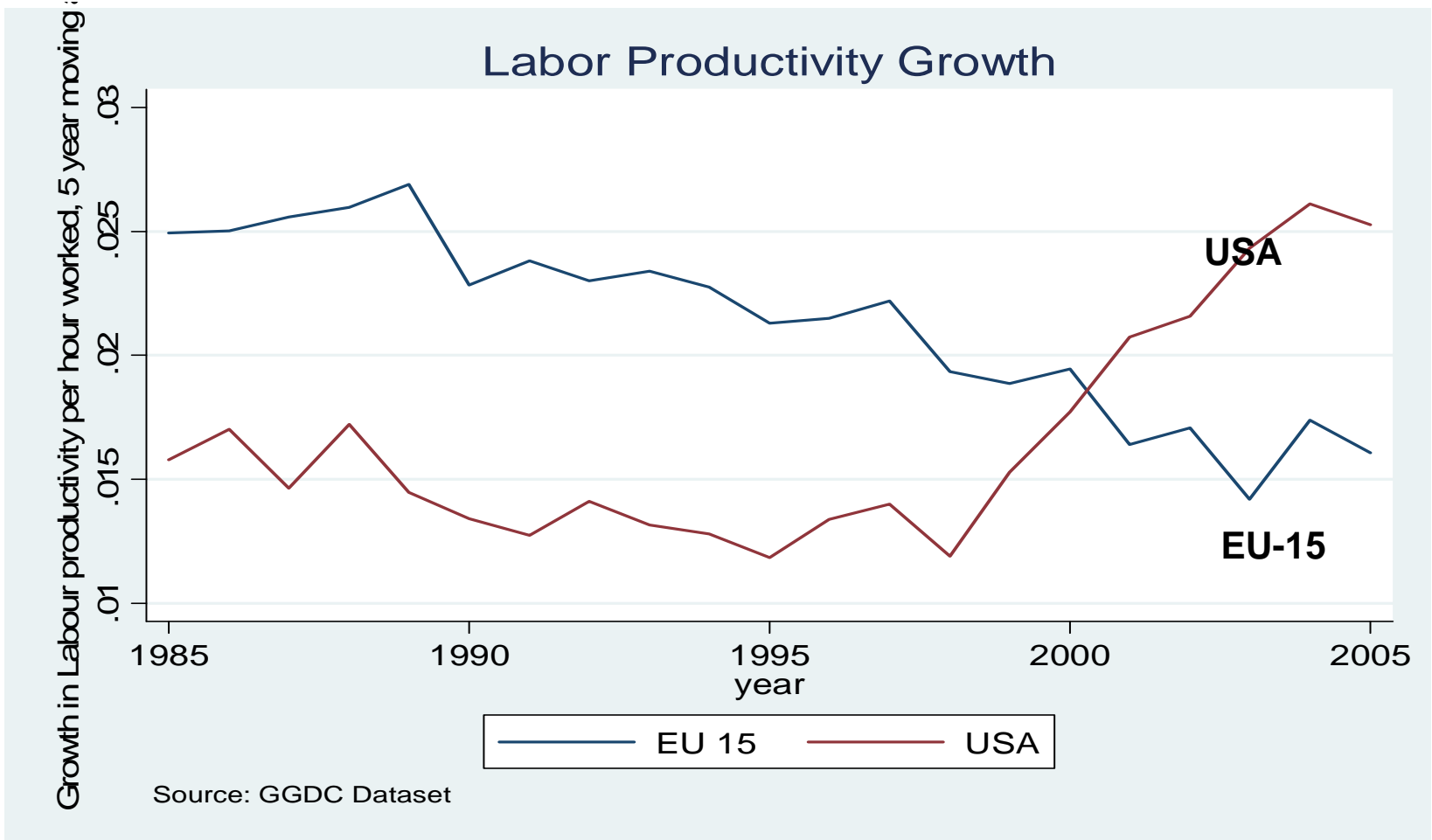
WHY CARE ABOUT PRODUCTIVITY AND MANAGEMENT?

What are the facts?

1. US productivity position is strong, despite the recent gloom and financial turmoil
2. ***Over the last decade or so US has experienced a “productivity miracle” that has not been replicated in Europe or other countries.***
3. China is rising to be a global behemoth



THE US MIRACLE - PRODUCTIVITY GROWTH (GDP PER HOUR) SURGES AHEAD SINCE 1996

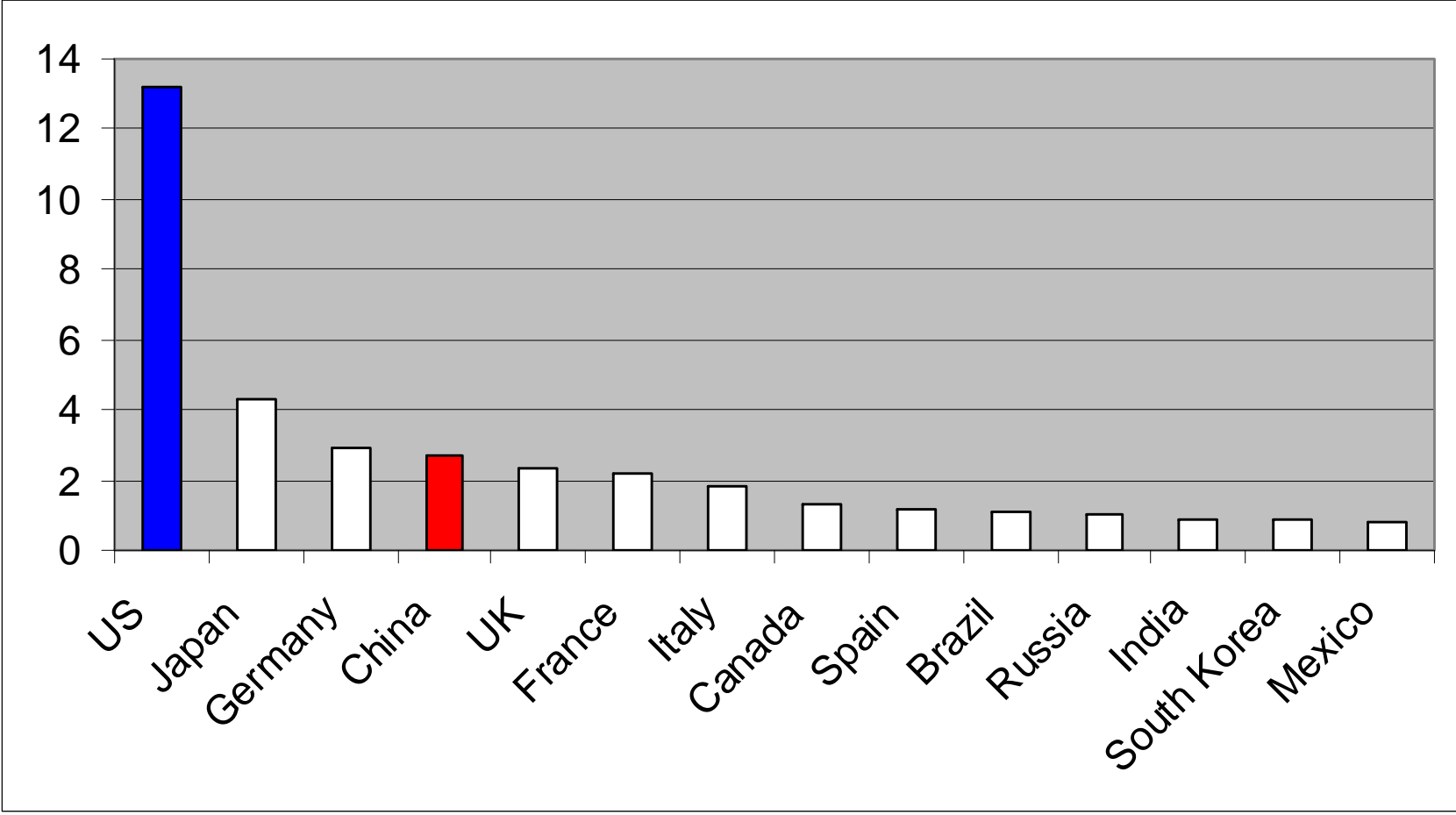


WHY CARE ABOUT PRODUCTIVITY AND MANAGEMENT?

What are the facts?

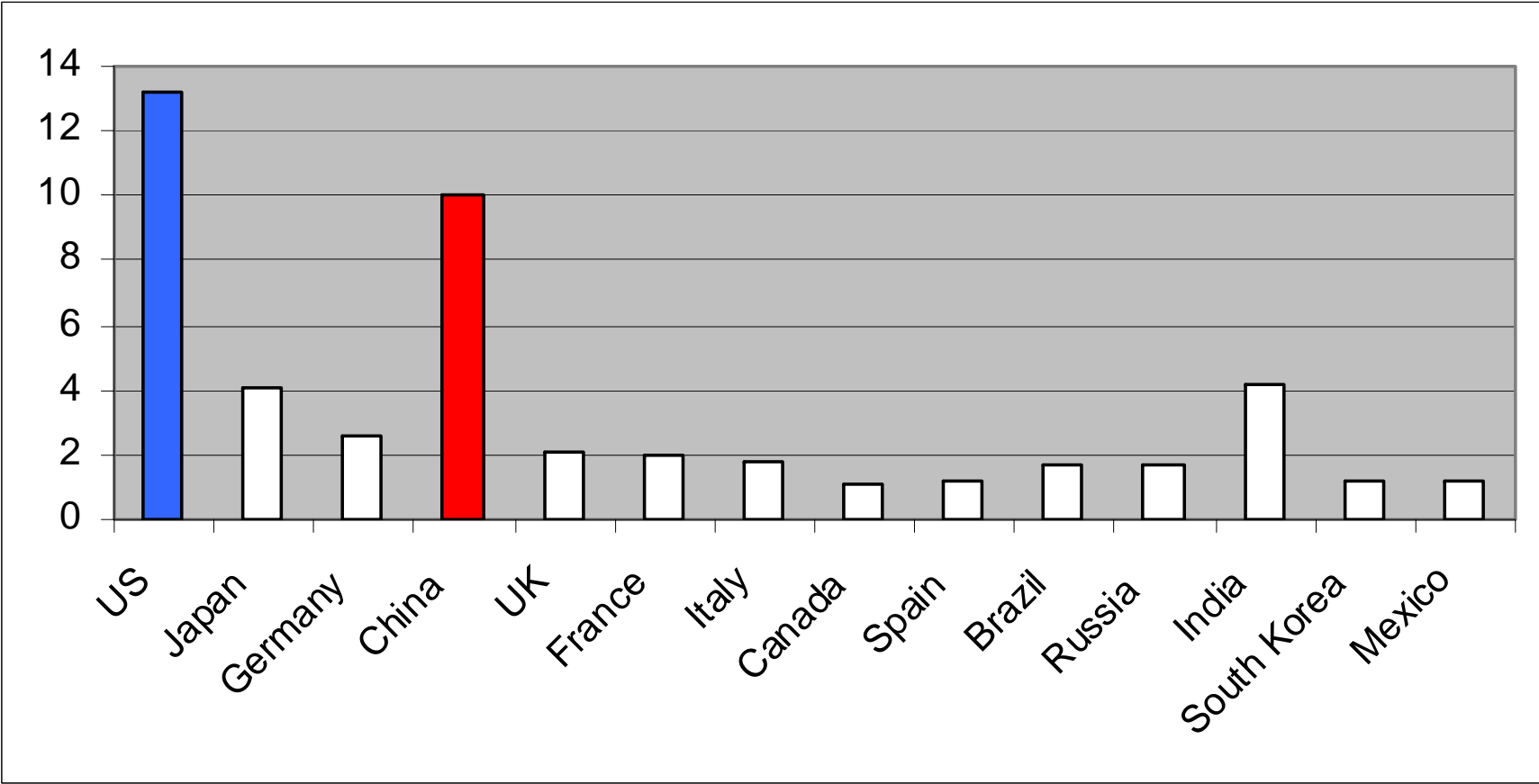
1. US productivity position is strong, despite the recent gloom and turmoil
2. Over the last decade or so US has experienced a “productivity miracle” that has not been replicated in Europe or other countries.
3. ***China is rising to be a global behemoth***
 - Real growth rates of 9-10% per annum since early 1980s
 - Fourth largest economy in the world using current exchange rates
 - Second largest economy in the world using Purchasing Power Parity

GDP AT MARKET EXCHANGE RATES, 2006, in US \$trillion



Source: World Bank, <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf>
Downloaded 2/11/07

GDP AT PURCHASING POWER PARITY, 2006, in US \$trillion



Source: World Bank, http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP_PPP.pdf
Downloaded 2/11/07

WHY CARE ABOUT PRODUCTIVITY AND MANAGEMENT?

- **Despite the importance of productivity our understanding of what causes productivity differences is poor**
 - Even after controlling for human and physical capital, there is a large “unexplained residual” in productivity both between countries and within countries
 - Is the US productivity miracle due to the information & communication technology revolution? But this is common across the world: why have Americans managed to “do I.T. better”?
 - **Our approach:** what is the role of management practices? Time to look into the black box.....



Management Practice and Productivity – Why They Matter

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John Van Reenen, Centre for Economic Performance, LSE

**WE ARE EXTREMELY GRATEFUL FOR THE SUPPORT
RECEIVED FROM OUR FUNDERS**



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Foundation





AGENDA

Measuring management practice

Evaluating the management measure

Describing management across Firms and countries

Explaining management across Firms and countries

Management practices in the U.S.



ASSESSING MANAGEMENT PRACTICE

Scoring management practice

- Created a robust assessment tool to score management of operations, people and performance

Setting the sampling frame

- 4,000 medium sized* manufacturers across U.S., Asia and Europe
 - Medium sized as intra-firm practices more homogeneous
 - Manufacturing as productivity easier to measure

Obtaining unbiased responses

- Conducted 'Double-blind' interviews
 - Managers unaware of the scoring methodology
 - Interviewers unaware of corporate performance
- Executed by 46 MBA-trained interviewers with business experience

Getting firms to participate

- Obtained Central Bank, Ministry and Employer Association endorsements

* Median ~250 employees



TO SCORE COMPANIES, WE USED DESCRIPTIONS OF POOR, AVERAGE AND GOOD PRACTICE FOR EACH DIMENSION

Management practices

Operations management

Performance management

People management

Example dimensions evaluated

Quality of targets

Interconnection of targets

Performance tracking

Time horizon of targets

Consequence management

Dimension scoring criteria

1	<i>Measures tracked do not directly indicate if overall business objectives are being met. Tracking is ad hoc</i>
3	<i>Most key performance indicators are tracked formally. Tracking is overseen by senior management</i>
5	<i>Performance is continuously tracked and communicated, formally and informally, to all staff, using a range of visual management tools</i>

Measuring management practice

Evaluating the management measure

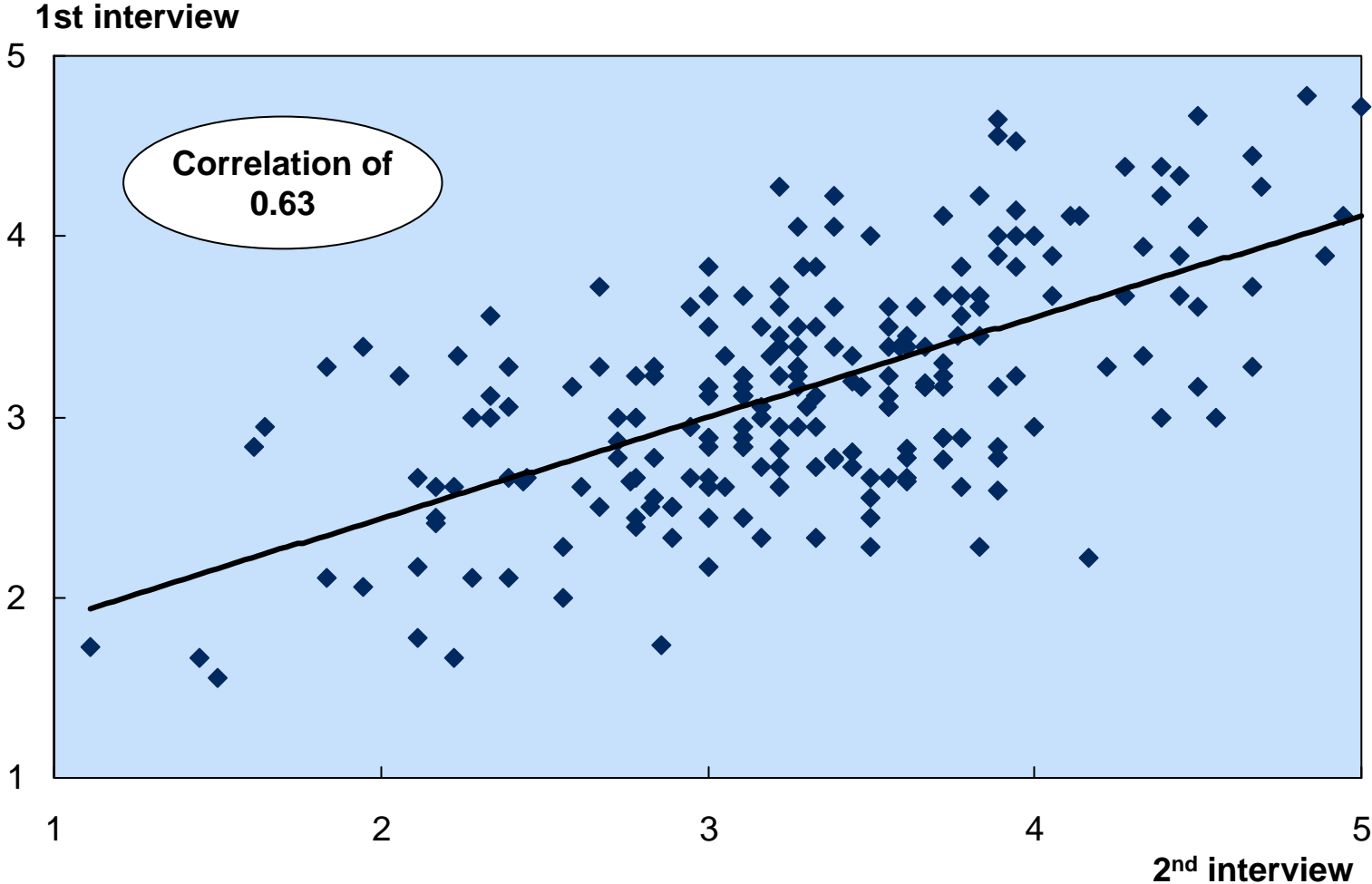
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INTERNAL VALIDATION SUGGESTS THAT OUR ASSESSED MANAGEMENT PRACTICE SCORE IS INFORMATIVE

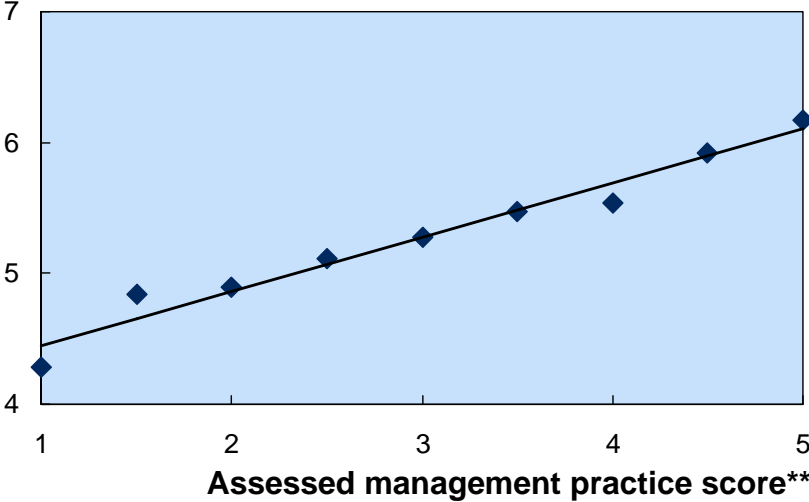
Assessed management practice score*



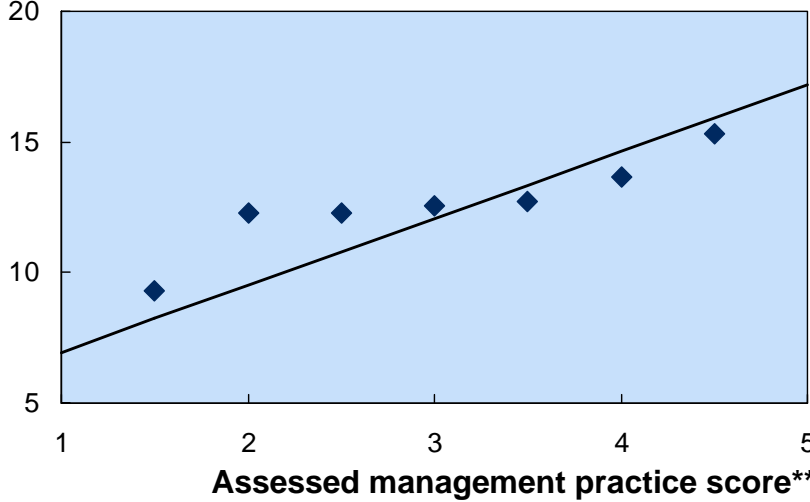
* 222 firms interviewed by 2 different interviews, interviewing 2 different managers

THE ASSESSED MANAGEMENT PRACTICE SCORE CORRELATES WELL WITH A NUMBER OF FINANCIAL PERFORMANCE METRICS

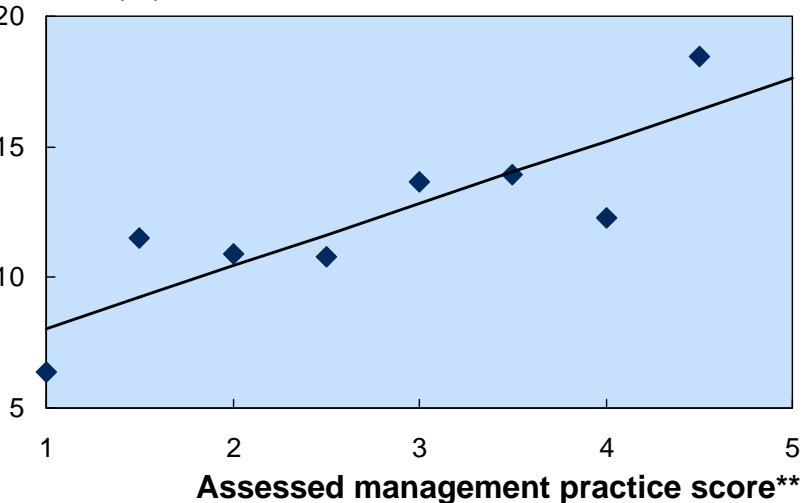
Labour productivity*



Sales growth (%)



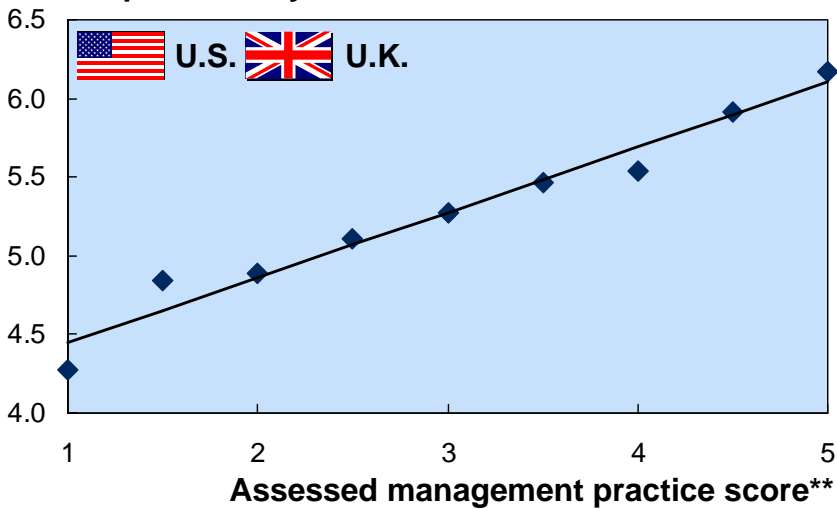
ROCE (%)



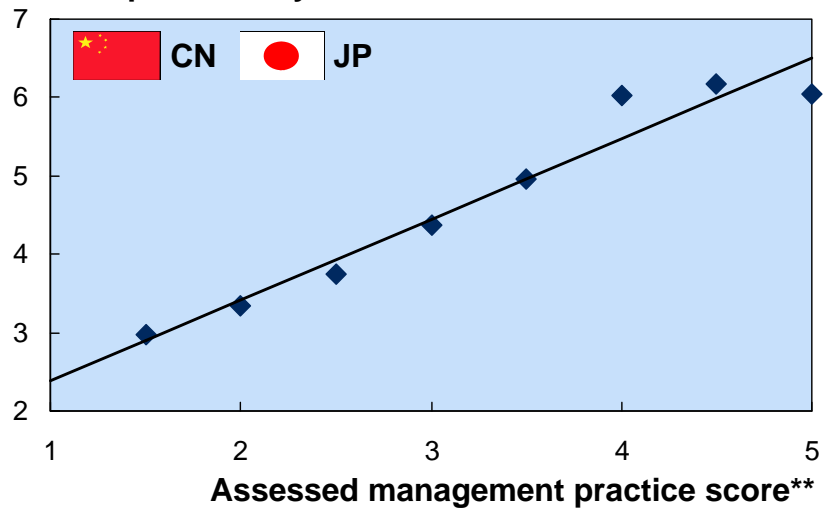
* Log scale
** Firms are grouped in 0.5 increments of assessed management score

THIS LINK HOLDS TRUE ACROSS DIFFERENT COUNTRIES AND CULTURES

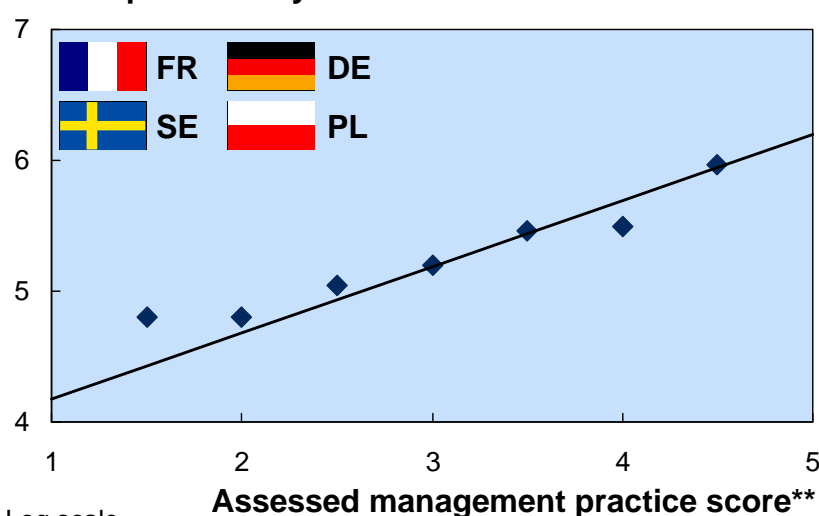
Labour productivity*



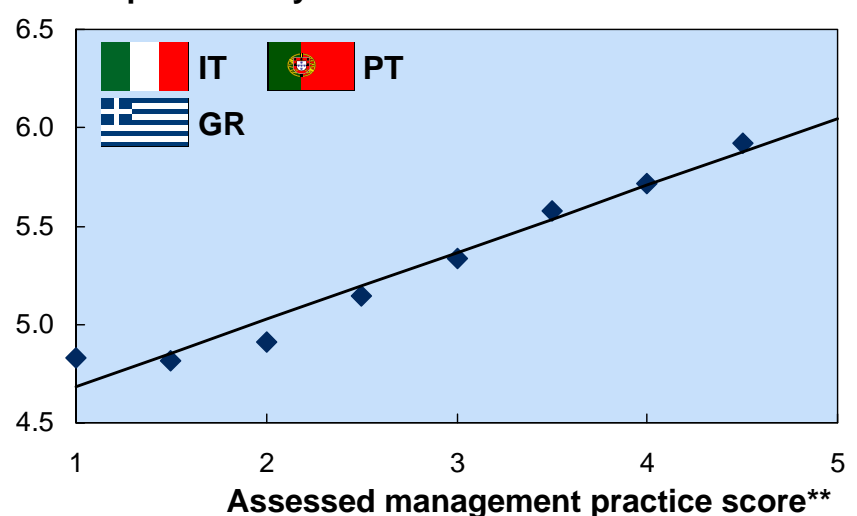
Labour productivity*



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Labour productivity*



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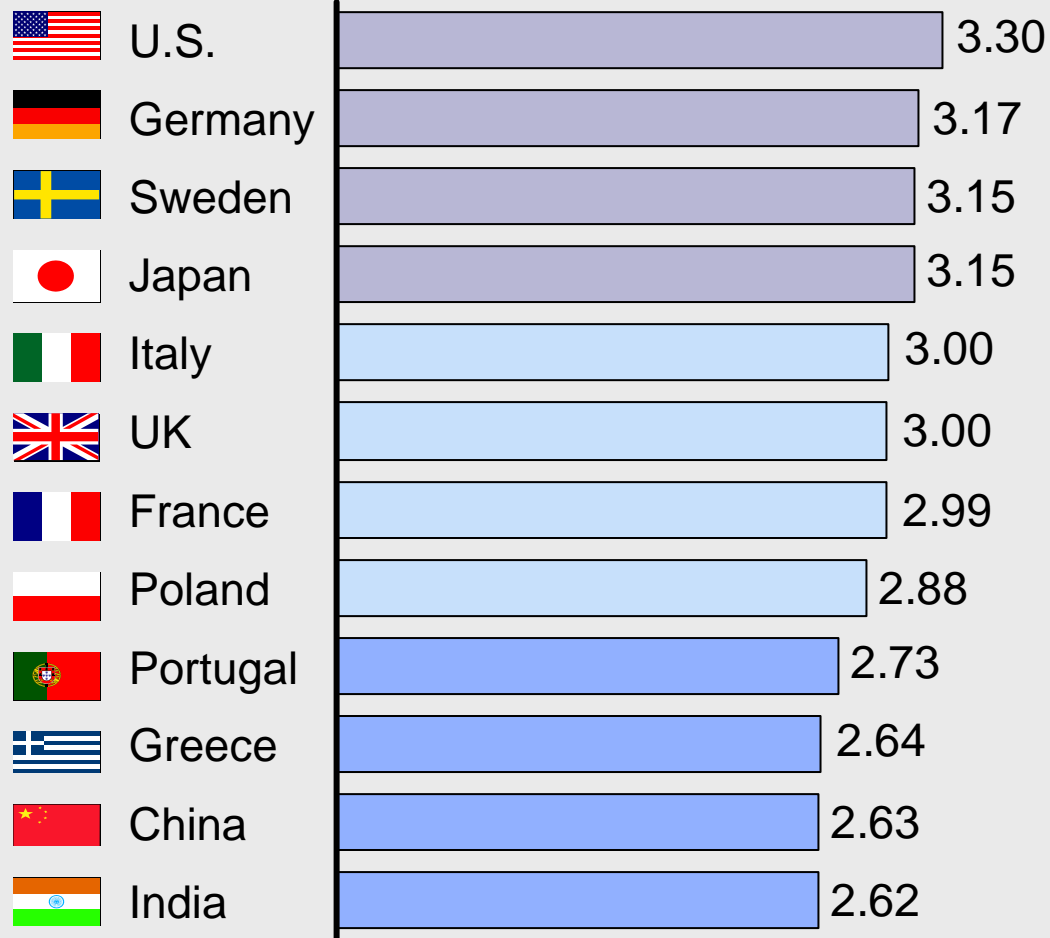
Explaining management across Firms and countries

Management practices in the U.S.



THERE IS SUBSTANTIAL INTER-COUNTRY MANAGEMENT PRACTICE VARIABILITY

Assessed Management Practice Score – by country

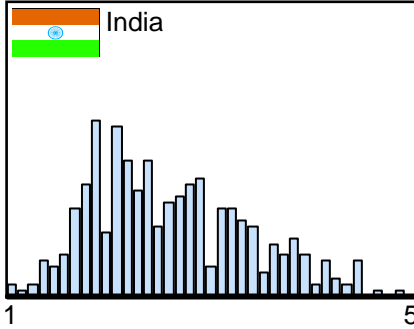
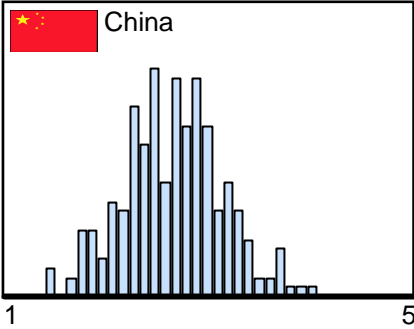
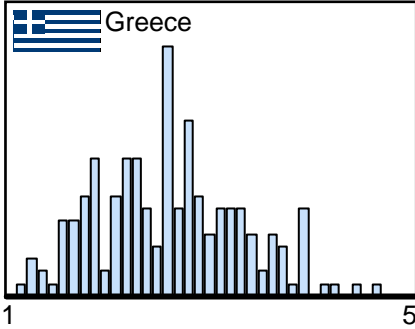
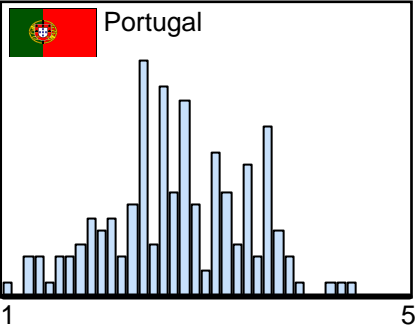
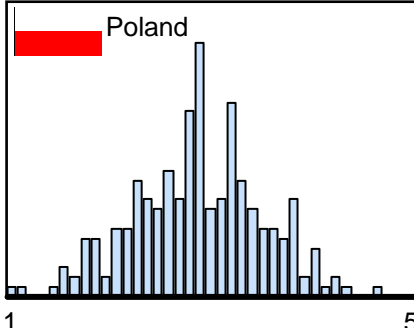
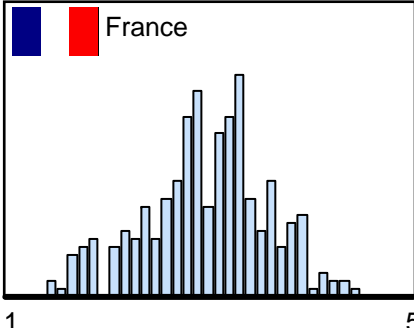
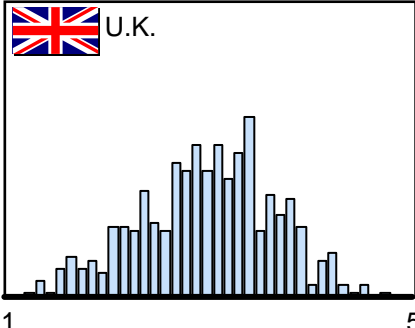
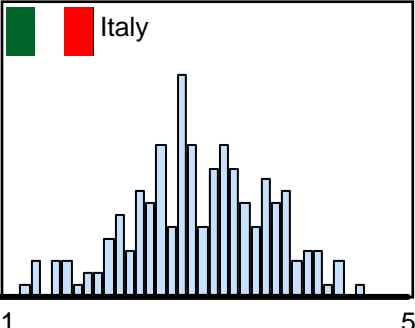
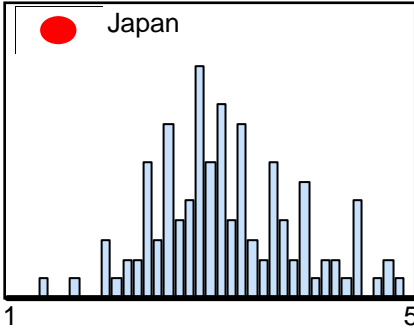
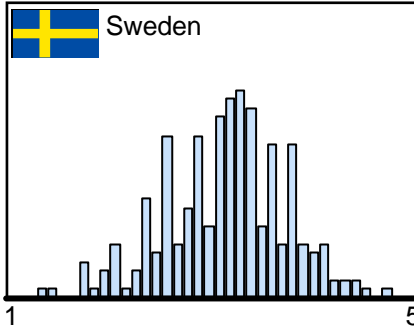
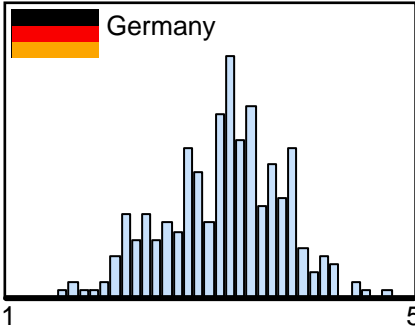
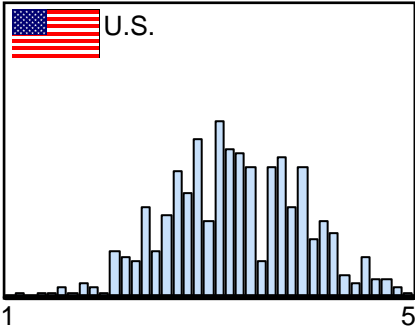


3 distinct groups appear

- U.S., Germany, Sweden and Japan
- Italy, U.K., France, and Poland
- Portugal, Greece, China and India

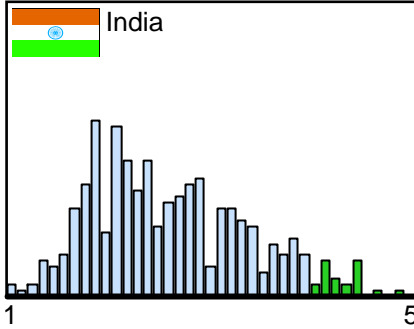
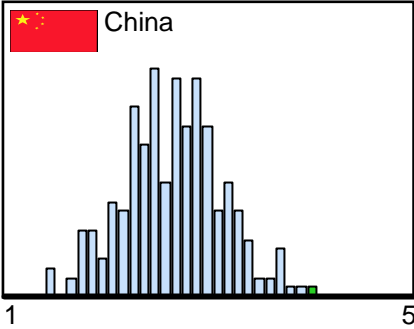
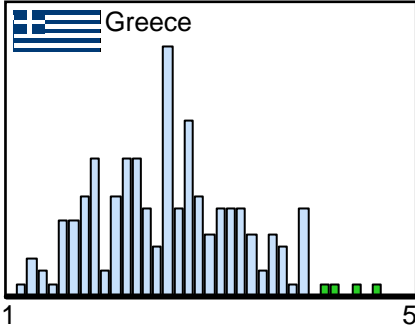
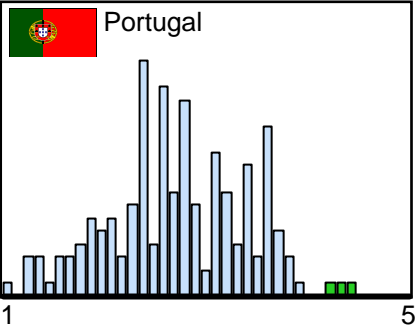
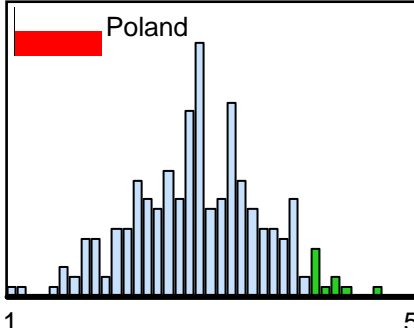
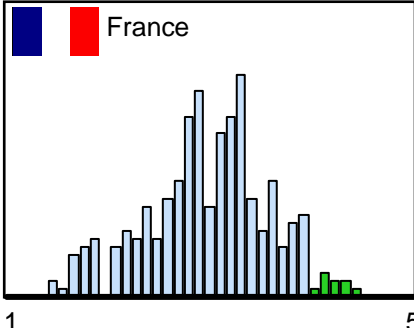
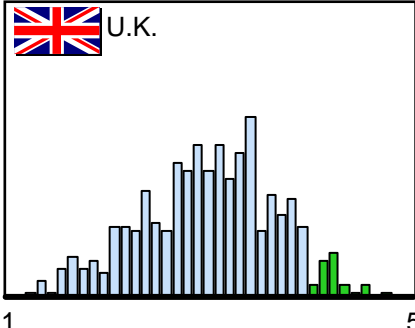
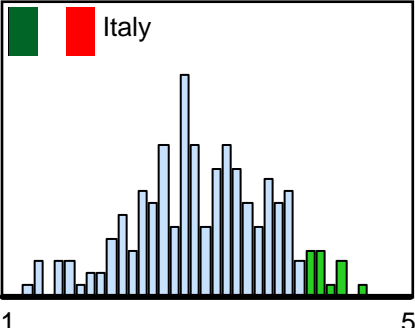
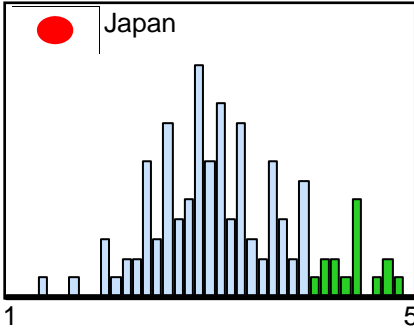
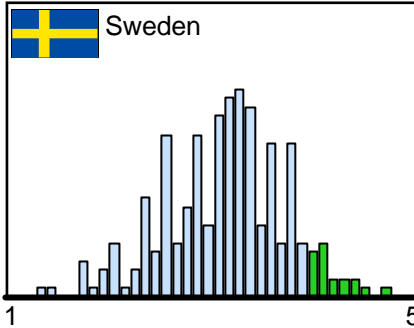
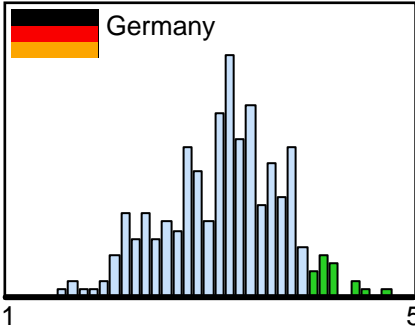
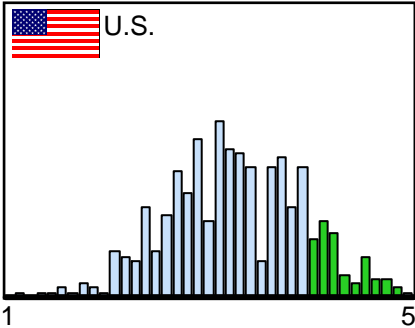
HOWEVER, MANAGEMENT PRACTICES VARY MUCH MORE WITHIN THAN ACROSS COUNTRIES

Distribution of firm level management practice scores – by country



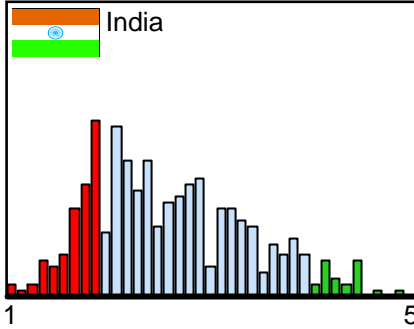
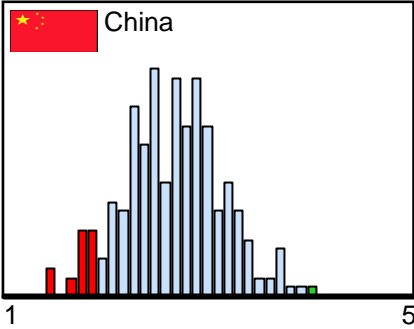
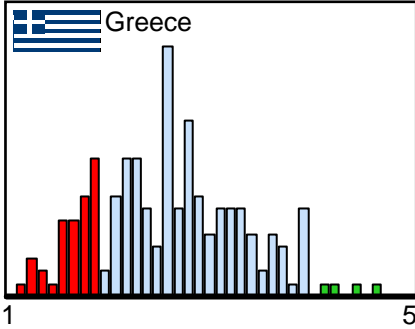
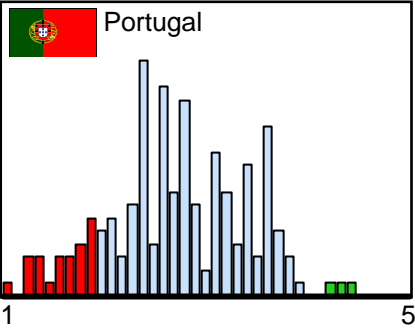
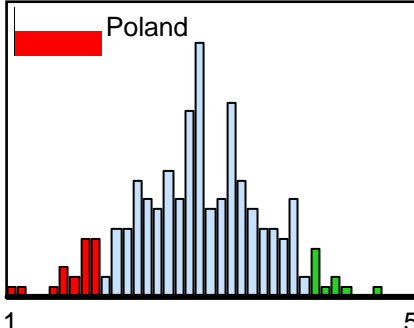
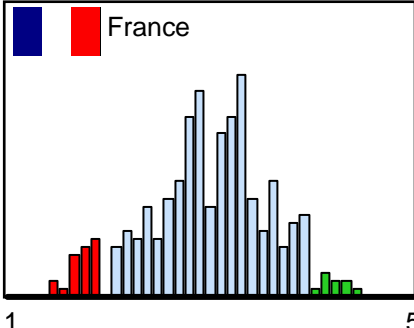
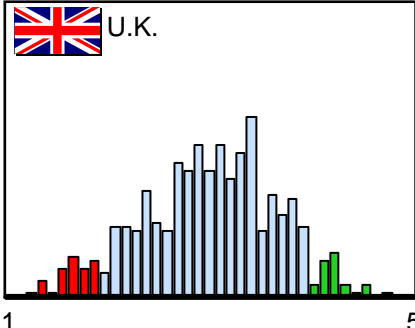
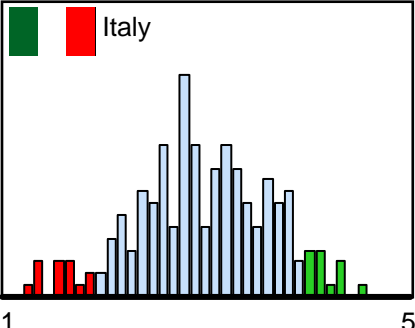
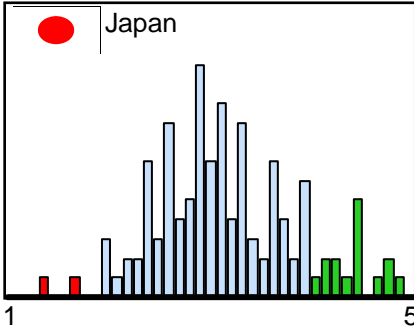
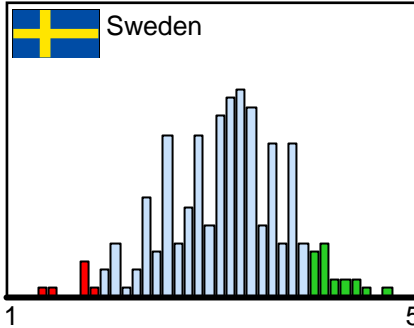
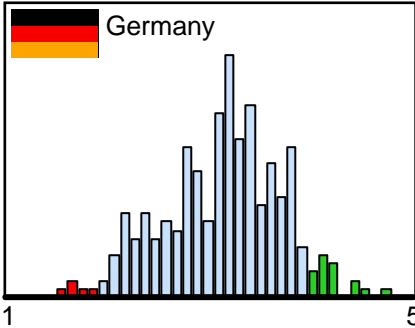
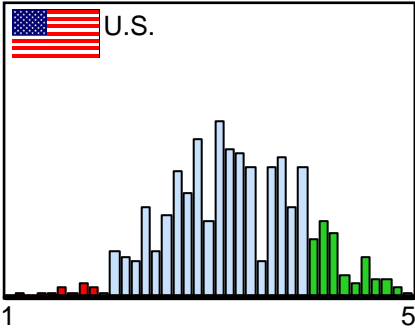
HOWEVER, MANAGEMENT PRACTICES VARY MUCH MORE WITHIN THAN ACROSS COUNTRIES

Distribution of firm level management practice scores – by country



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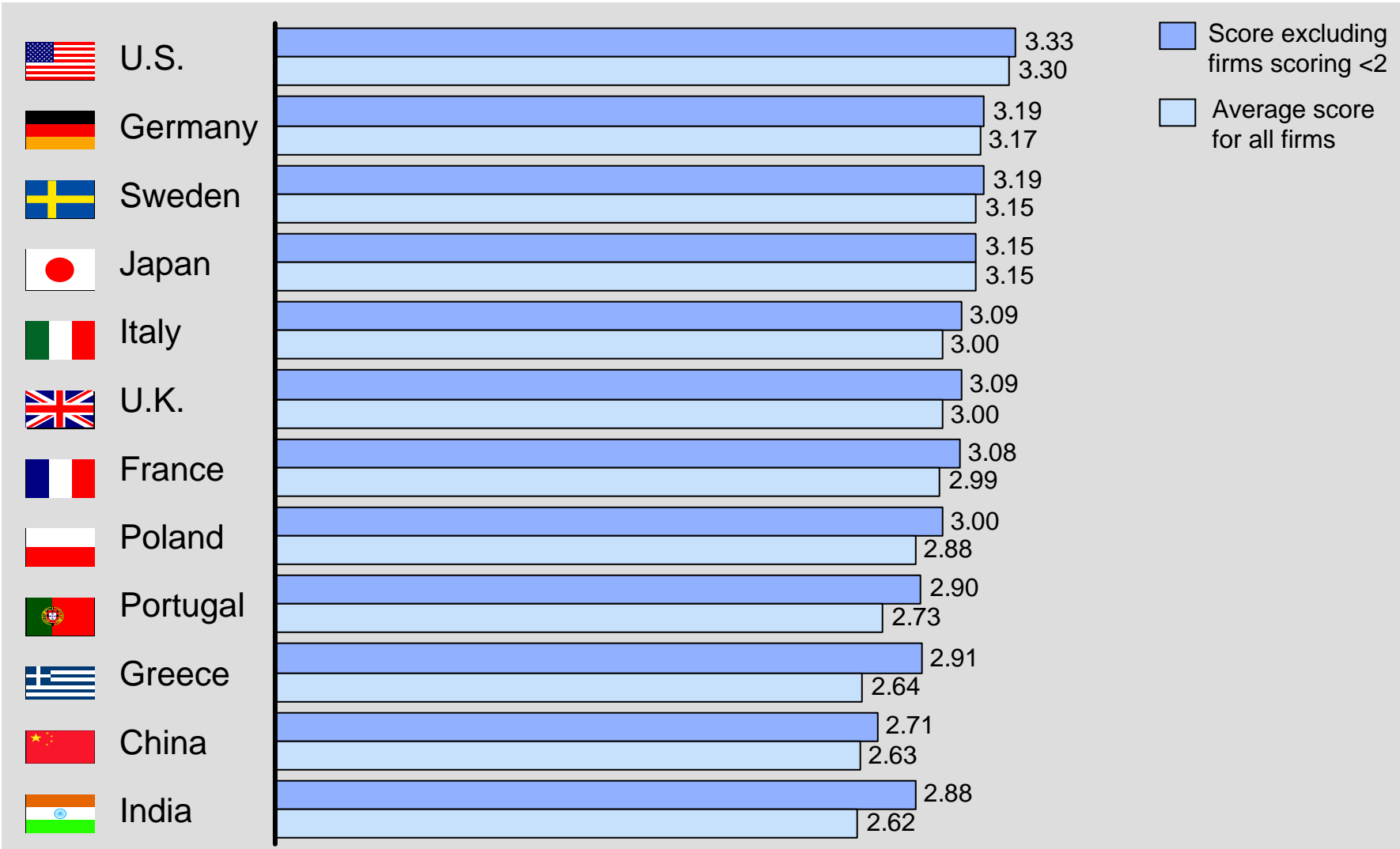
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THE LONG 'TAIL' OF POORLY MANAGED FIRMS PULLS DOWN THE AVERAGE MANAGEMENT SCORE OF LOW PERFORMING COUNTRIES

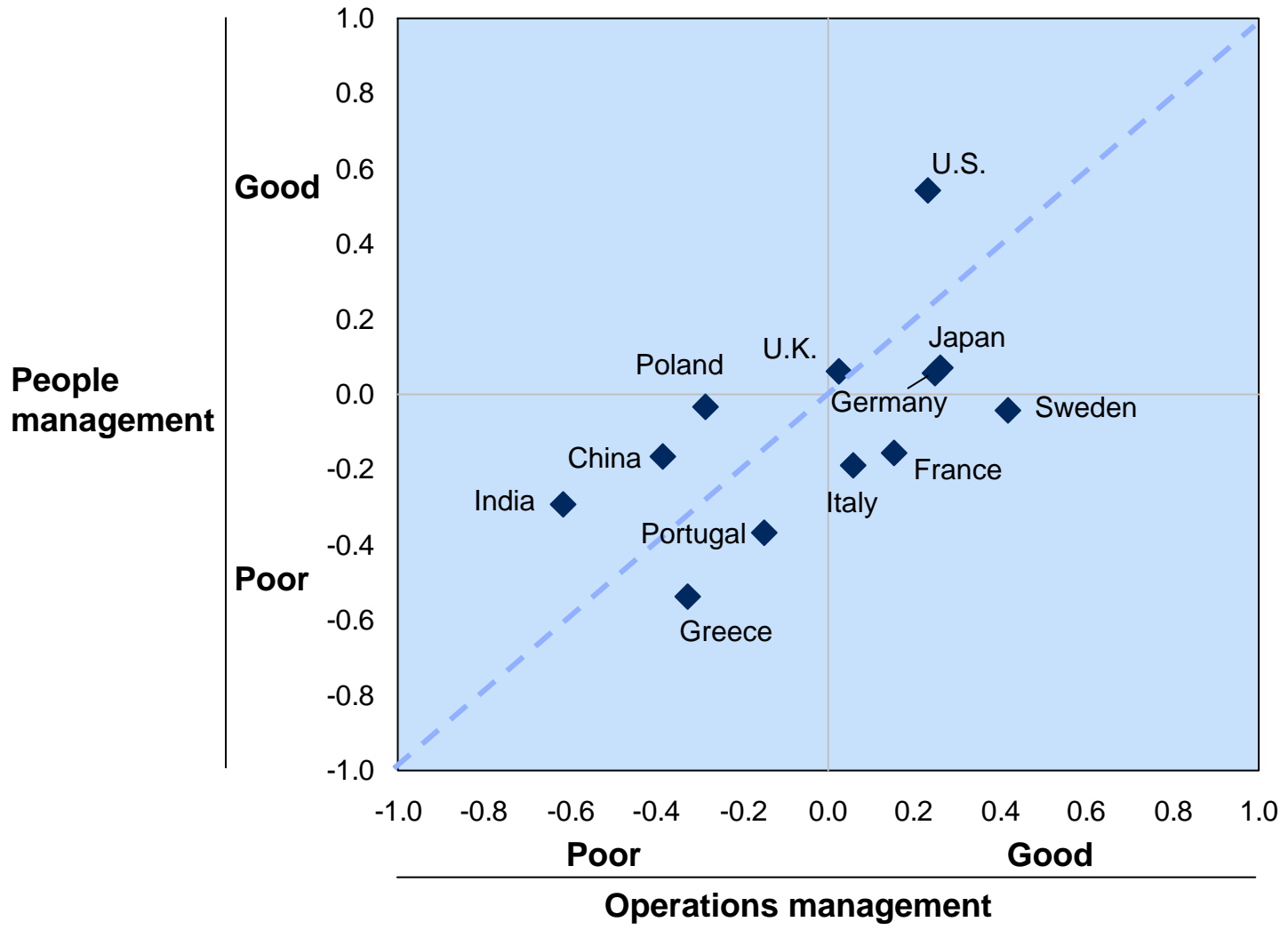
Assessed management practice score – by country



Source: Management Matters dataset; team analysis

THE U.S. IS NOT BEST AT EVERYTHING – THERE ARE NATIONAL STRENGTHS & WEAKNESSES

Average operations and people management practice scores* - by country



*Z-scores, i.e. normalized to zero mean and standard-deviation 1 by question

AGENDA

Measuring management practice

Evaluating the management measure

Describing management across Firms and countries

Explaining management across Firms and countries

Management practices in the U.S.

WHAT WE THINK WE ALREADY KNOW . . .

2005

- 2 factors associated with better management practice
 - Competition and free trade
 - Management selection/appointment based upon merit

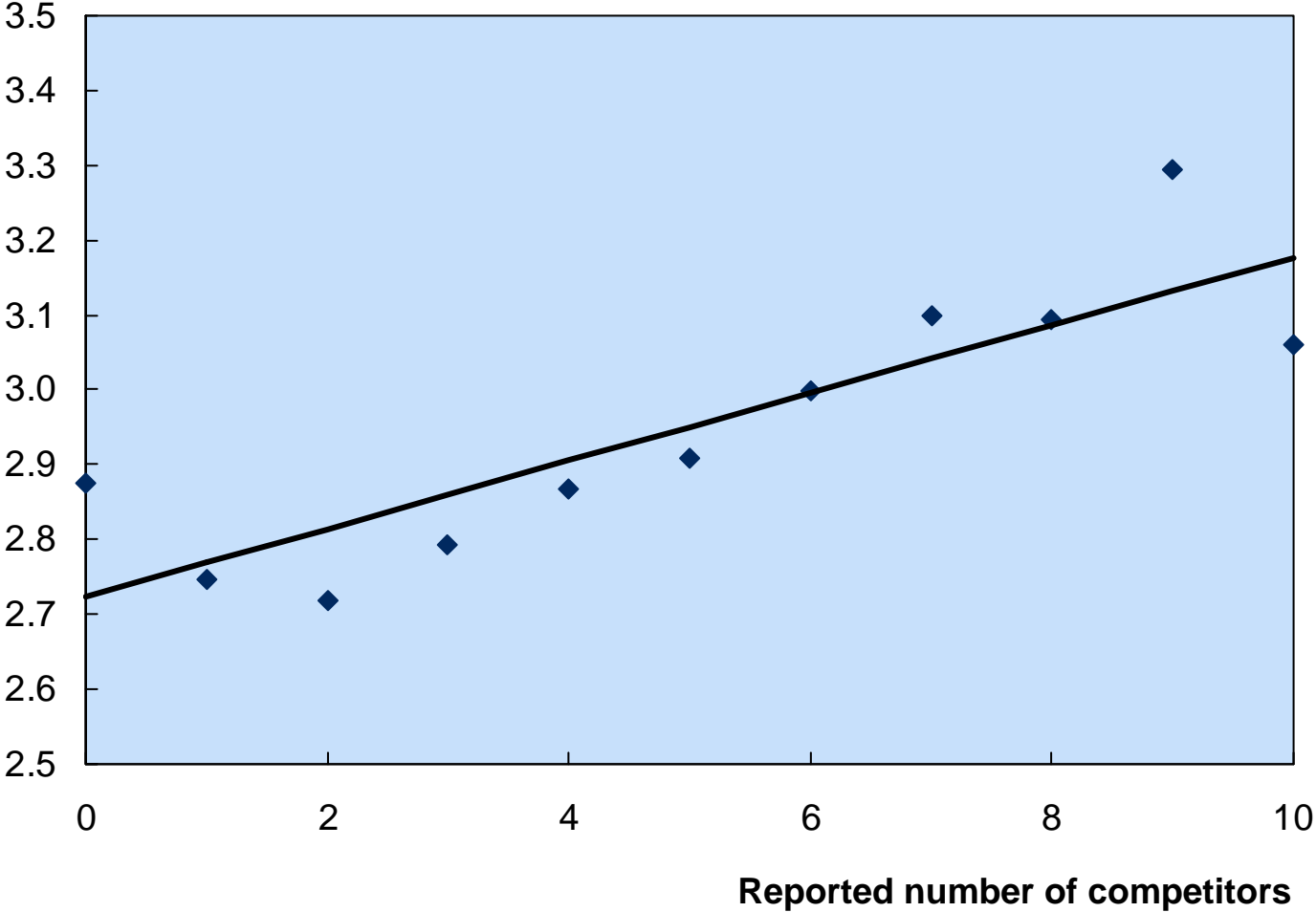
2007

- Confirm key role of
 - Competition and free trade
 - Management selection/appointment based upon merit
- Identify other key drivers
 - Labour market regulation
 - Ownership type
 - Skills
- Find managers are poor at assessing their own performance



MORE INTENSE COMPETITION IS CLEARLY ASSOCIATED WITH BETTER MANAGEMENT PRACTICES

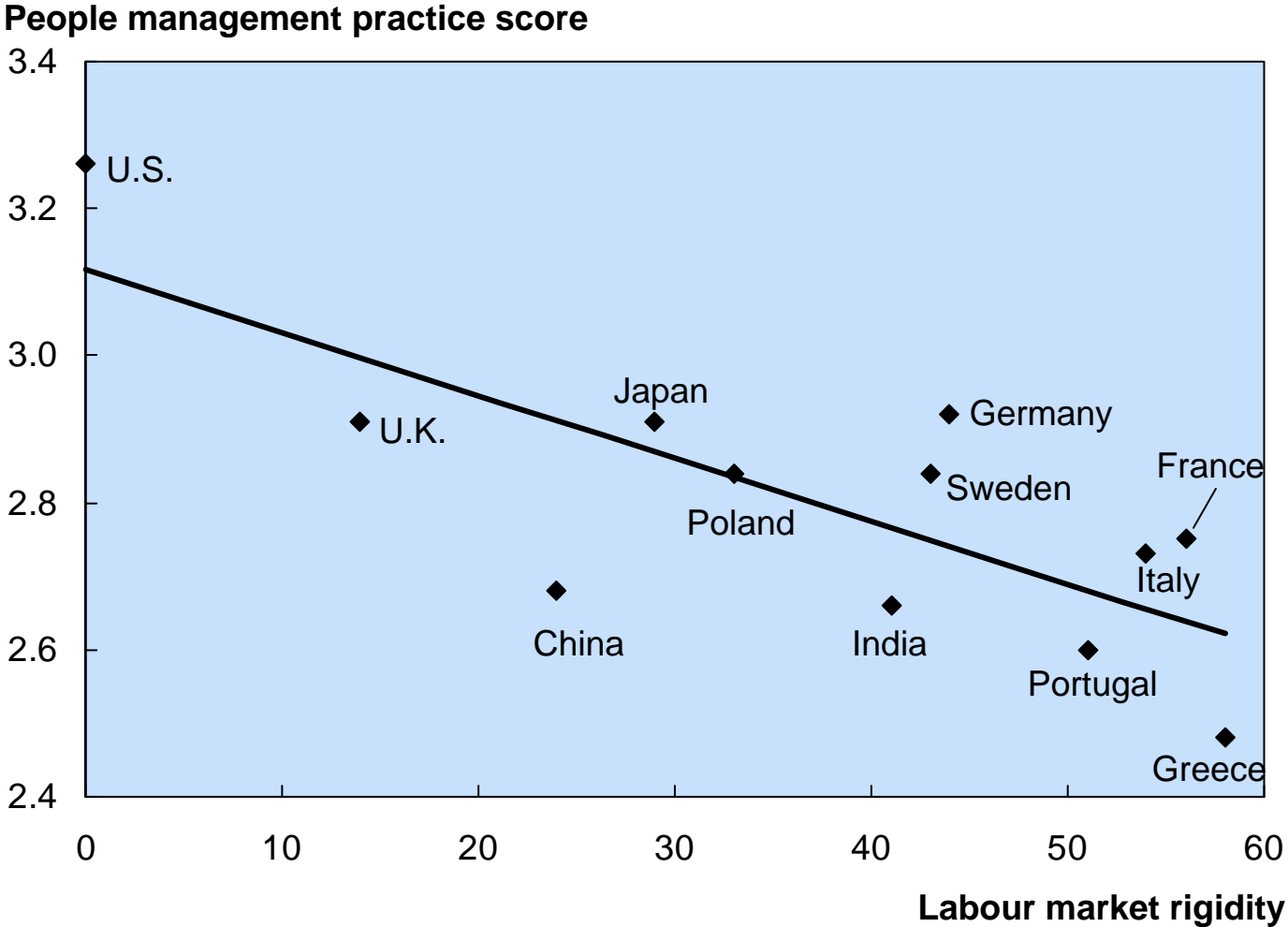
Assessed management practice score





COUNTRIES WITH MORE RIGID LABOUR MARKET REGULATIONS HAVE LOWER PEOPLE MANAGEMENT SCORES

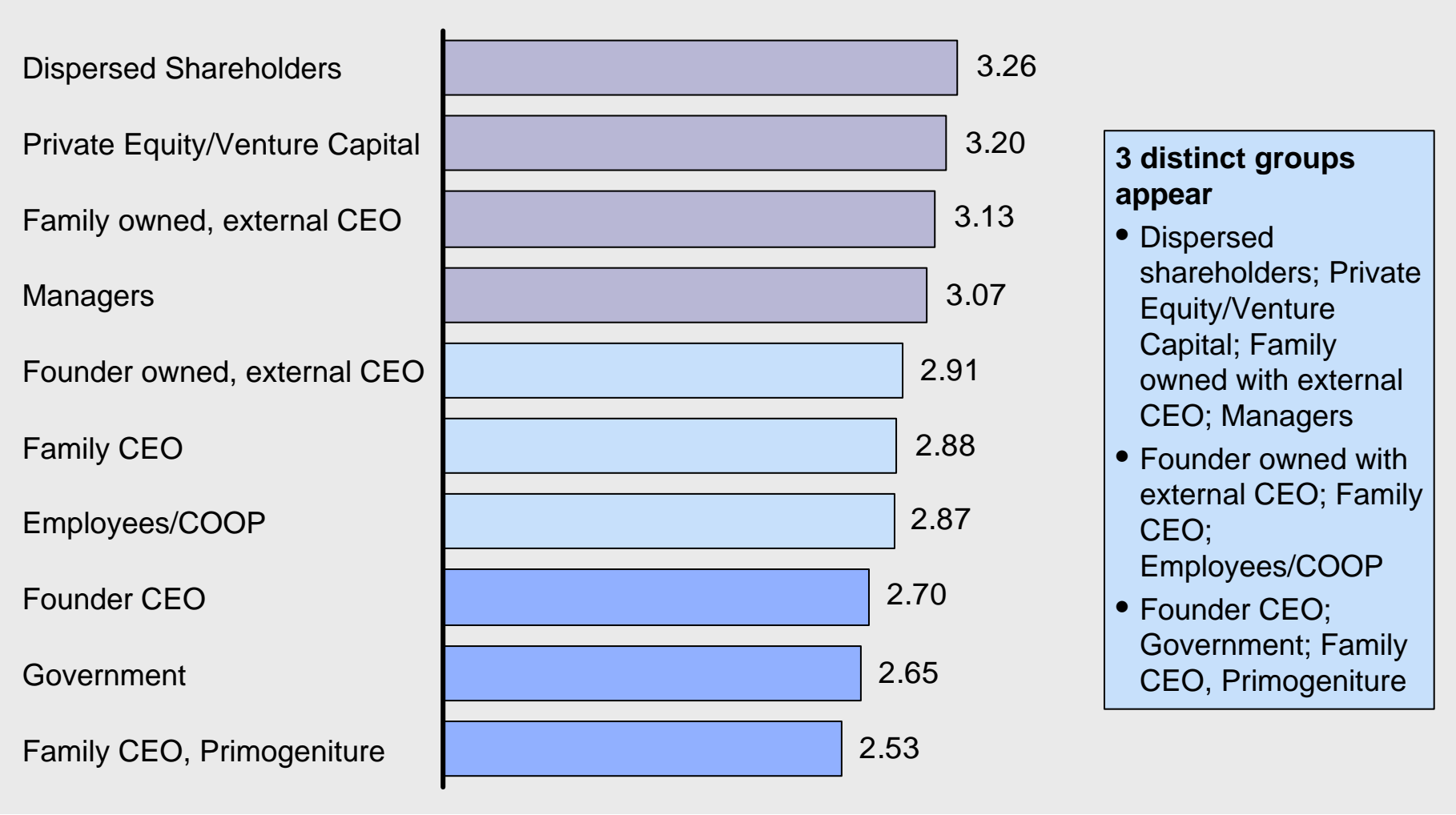
Labour market rigidity* vs. people management practice score – by country



* World Bank "Employee rigidity index"

WE FIND MANAGEMENT PRACTICES TO VARY SUBSTANTIALLY BY OWNERSHIP TYPE

Management practice score* – by ownership type

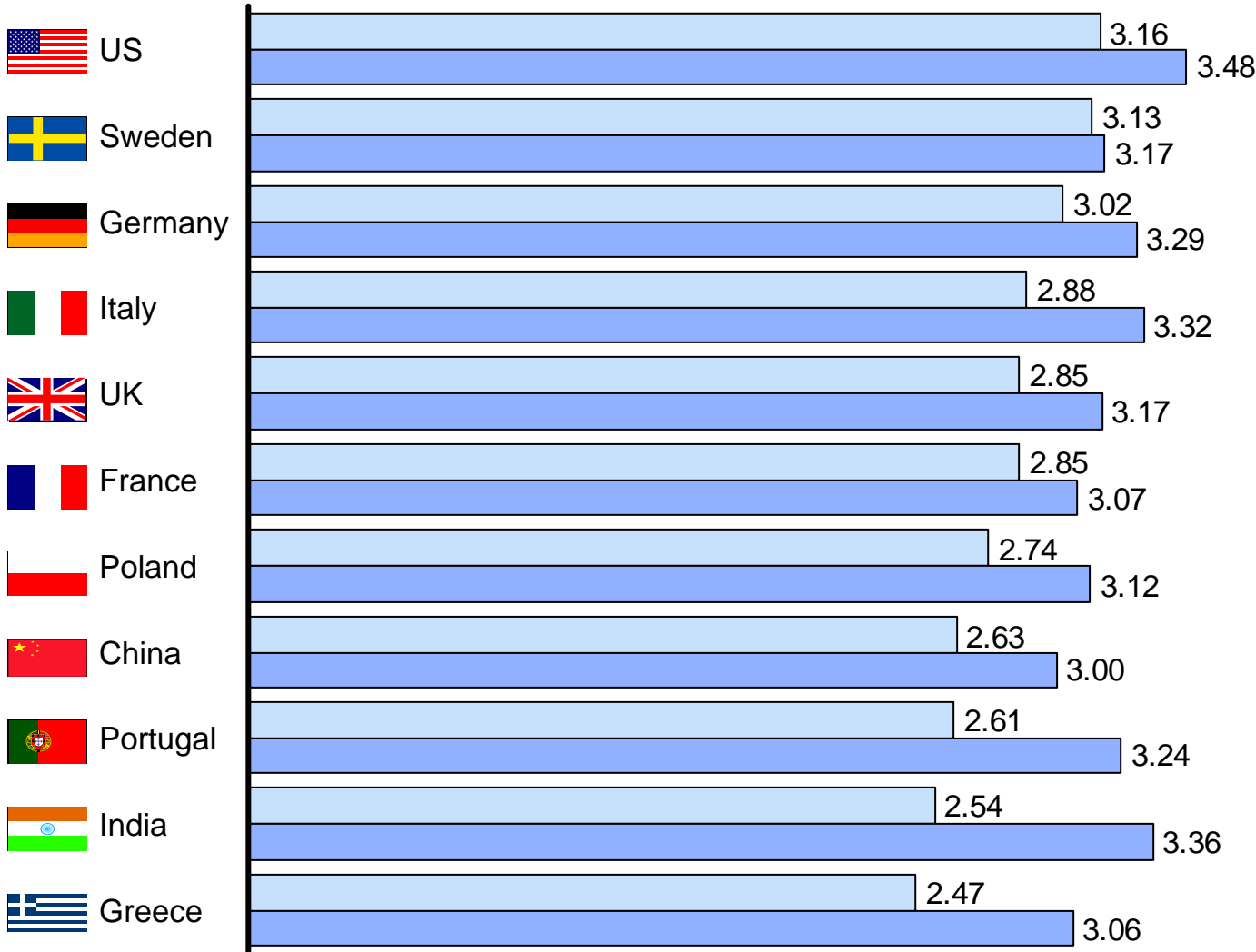


*All 12 countries

MULTINATIONALS ARE WELL RUN EVERYWHERE

Management practice score – by country*

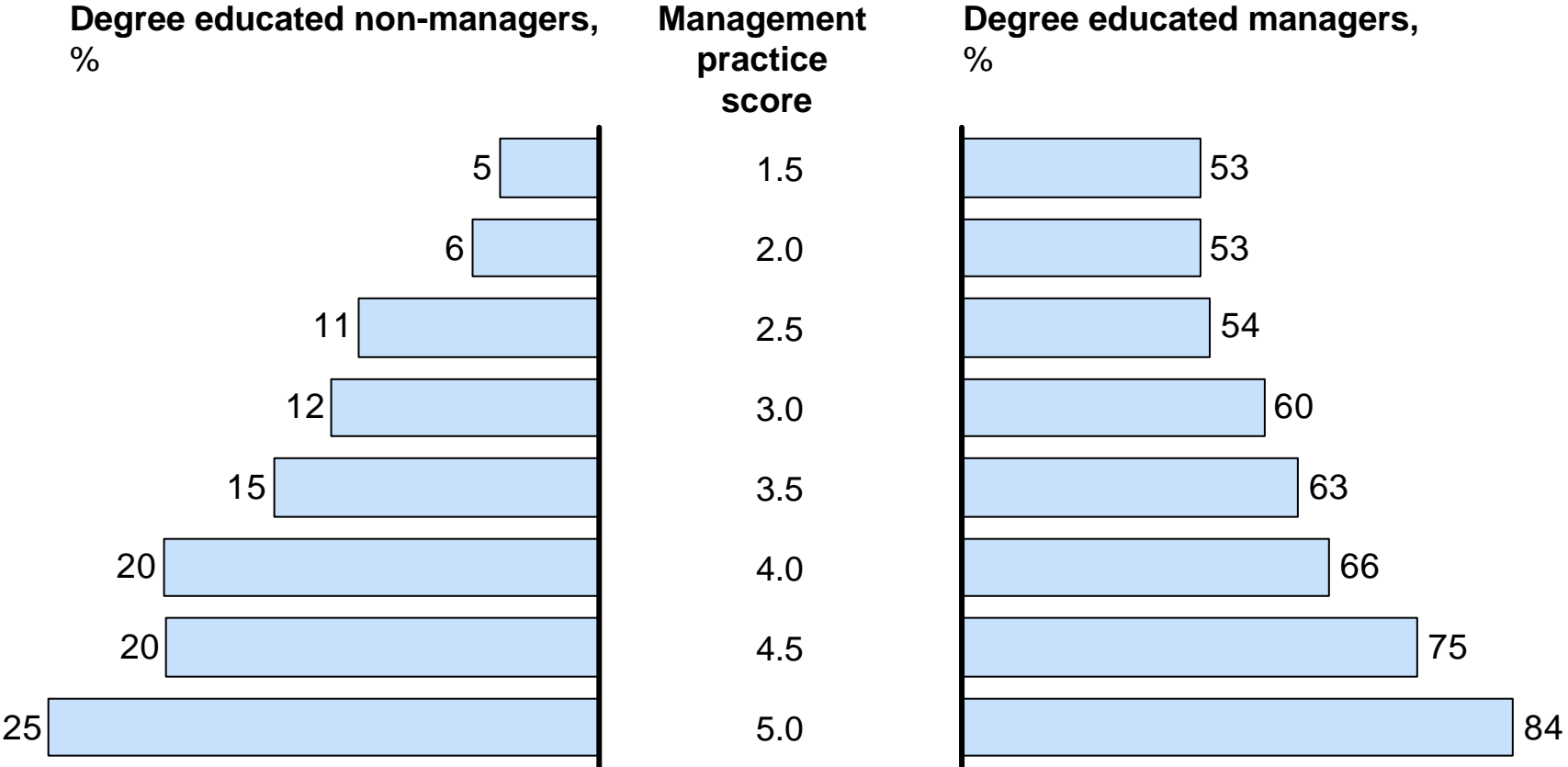
Domestic firms
Multinationals



* Japan excluded due to low multinational sample size

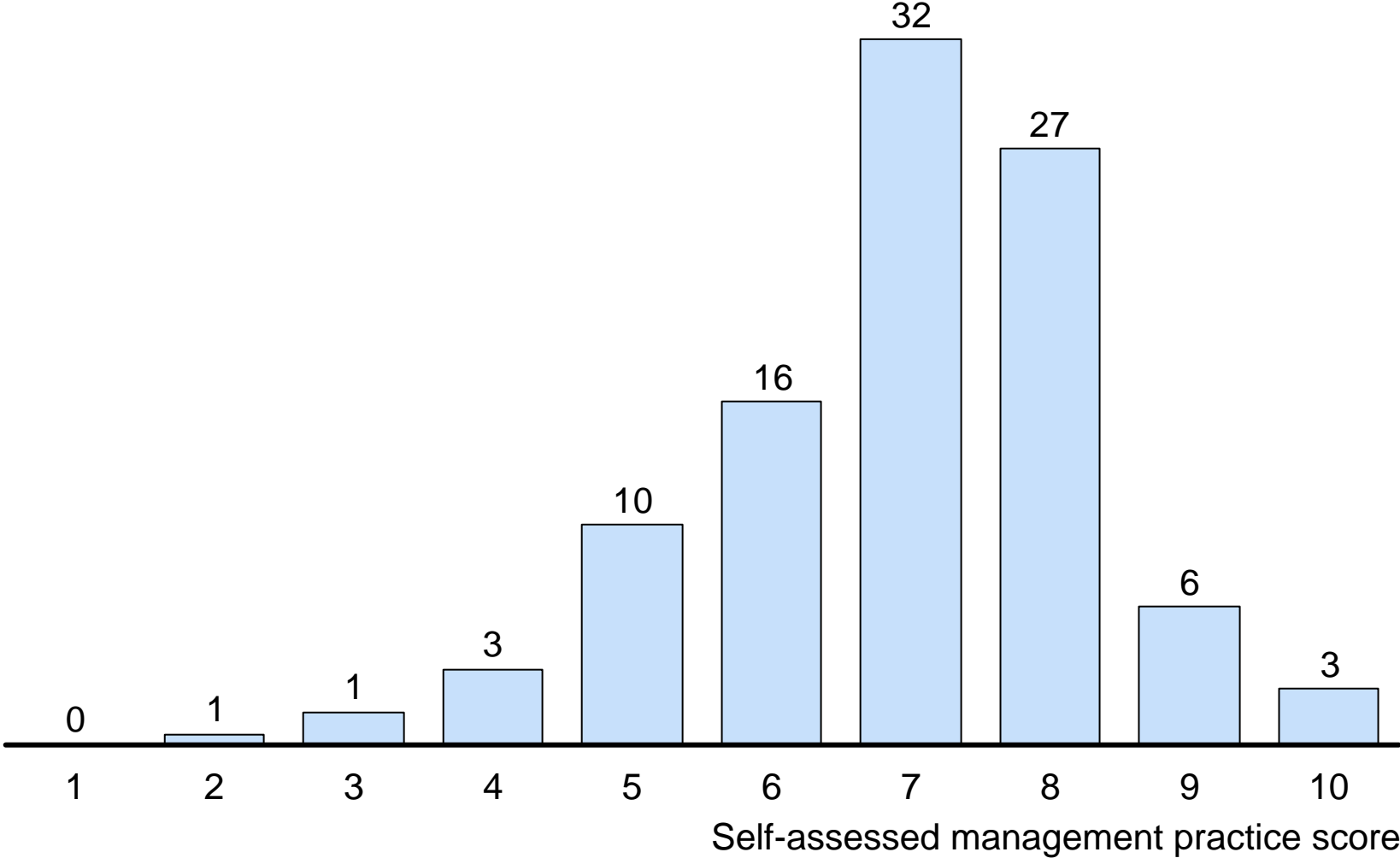


BETTER MANAGEMENT IS LINKED WITH HIGHER SKILL LEVELS OF BOTH MANAGERS AND NON-MANAGERS



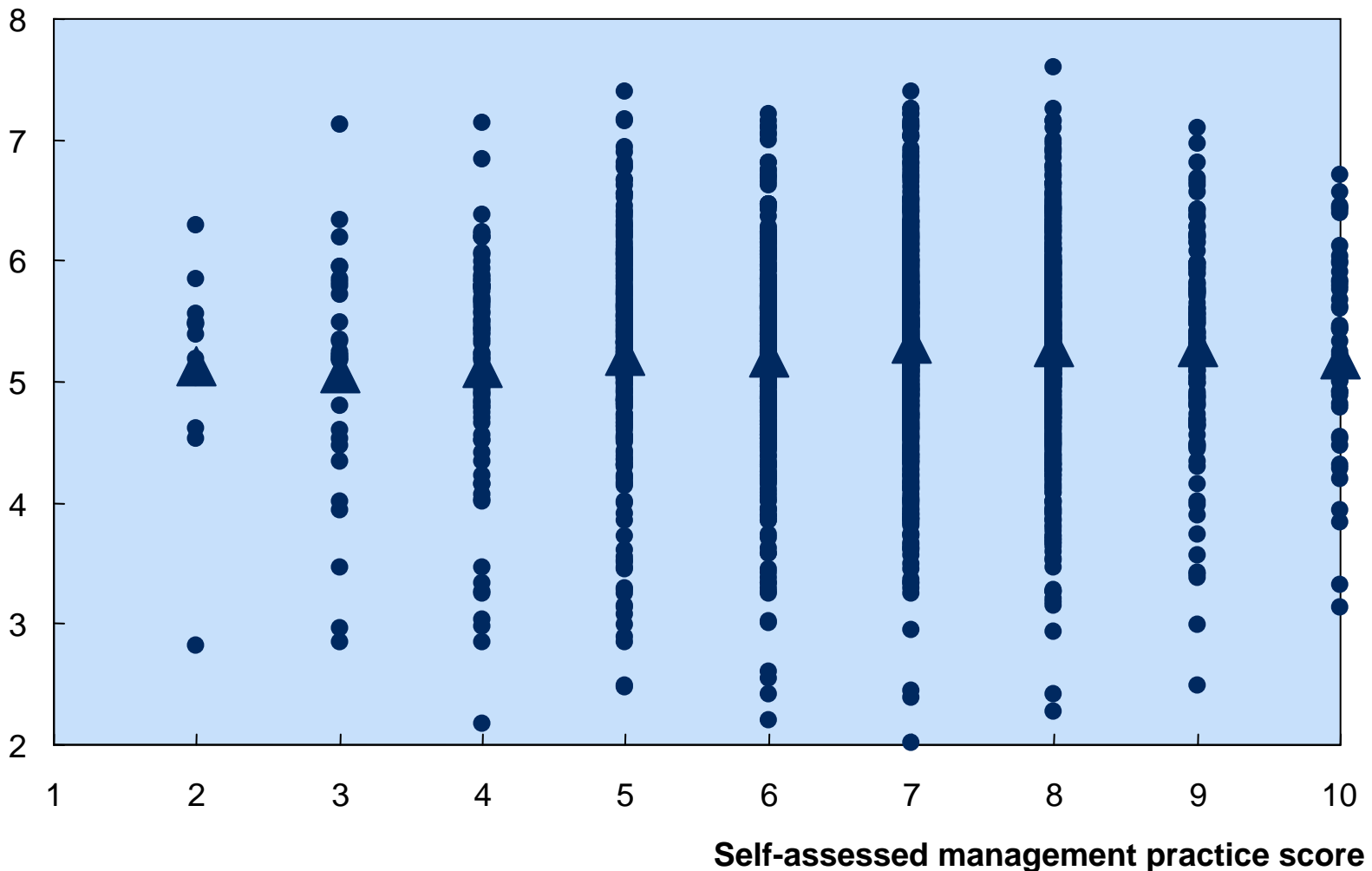
THE AVERAGE MANAGER BELIEVES THEIR COMPANY HAS ABOVE-AVERAGE MANAGEMENT PRACTICE

%



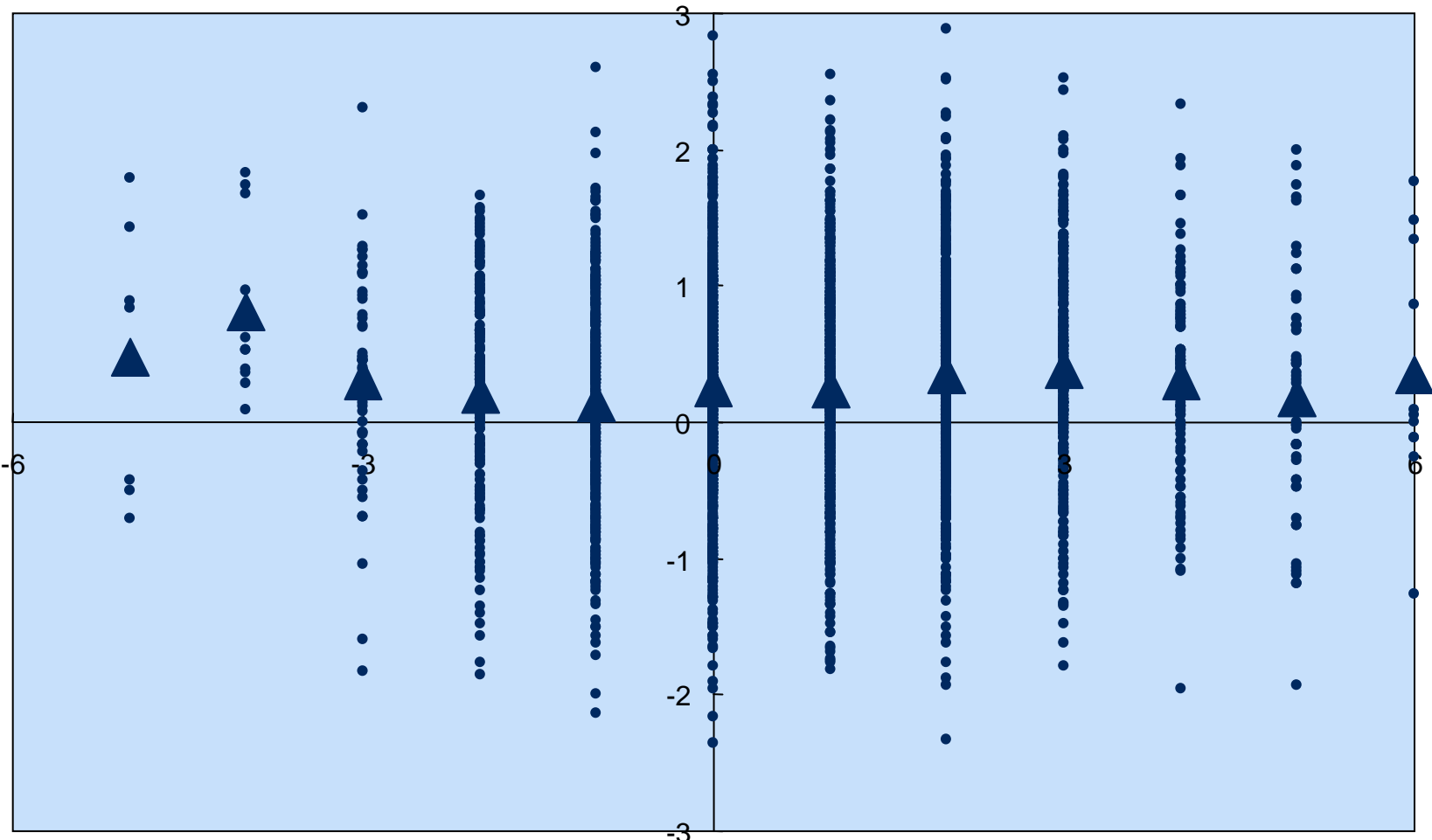
IT TURNS OUT MANAGERS APPEAR TO BE POOR AT SELF-ASSESSING THEIR FIRM'S MANAGEMENT PRACTICE

Labour productivity



MANAGERS EVEN APPEAR POOR AT ASSESSING THEIR RELATIVE STRENGTHS AND WEAKNESSES

Assessed gap operations vs. people management practice score



Self-assessed gap operations vs. people management practice score

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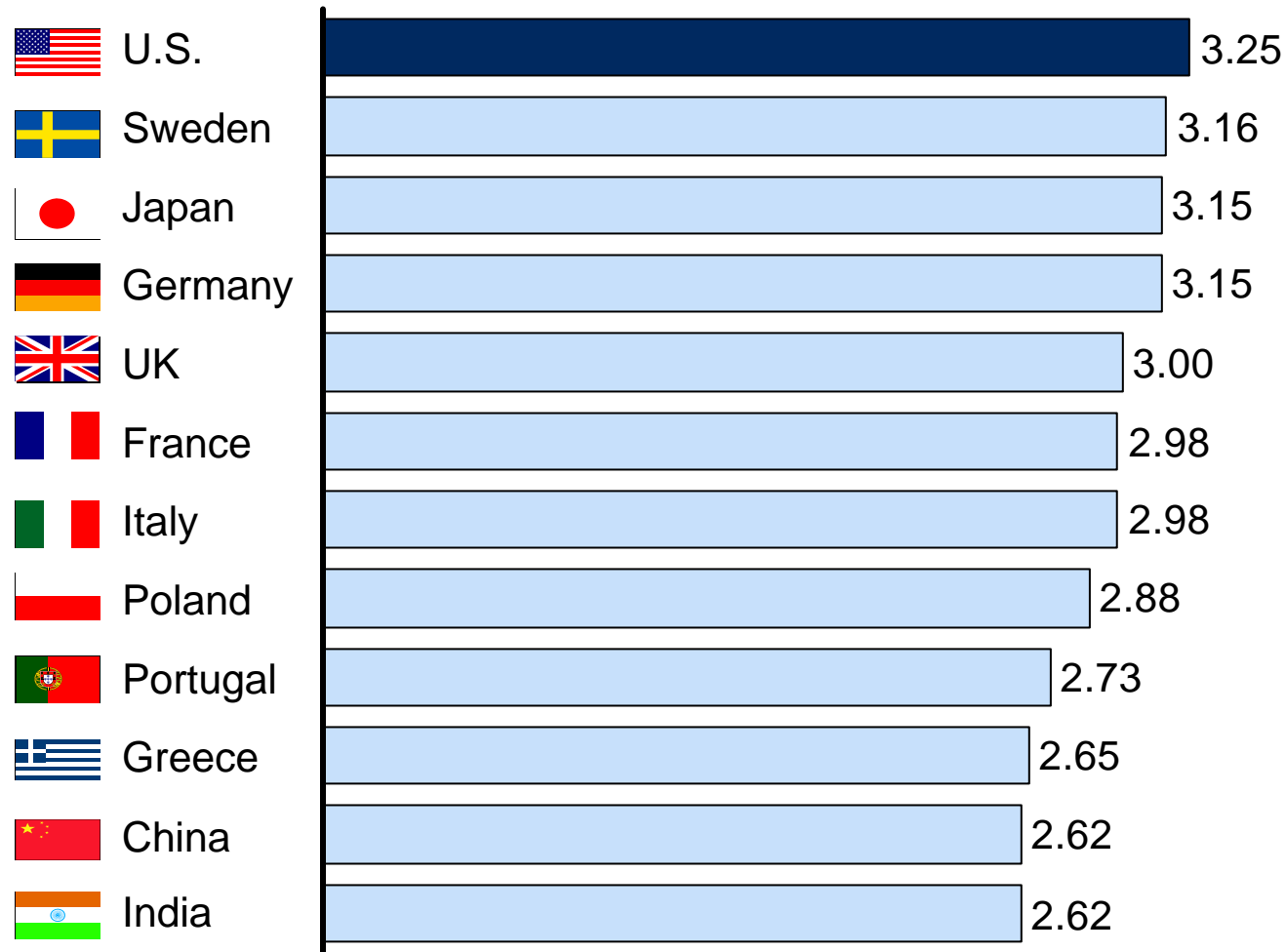
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Management practices in the U.S.



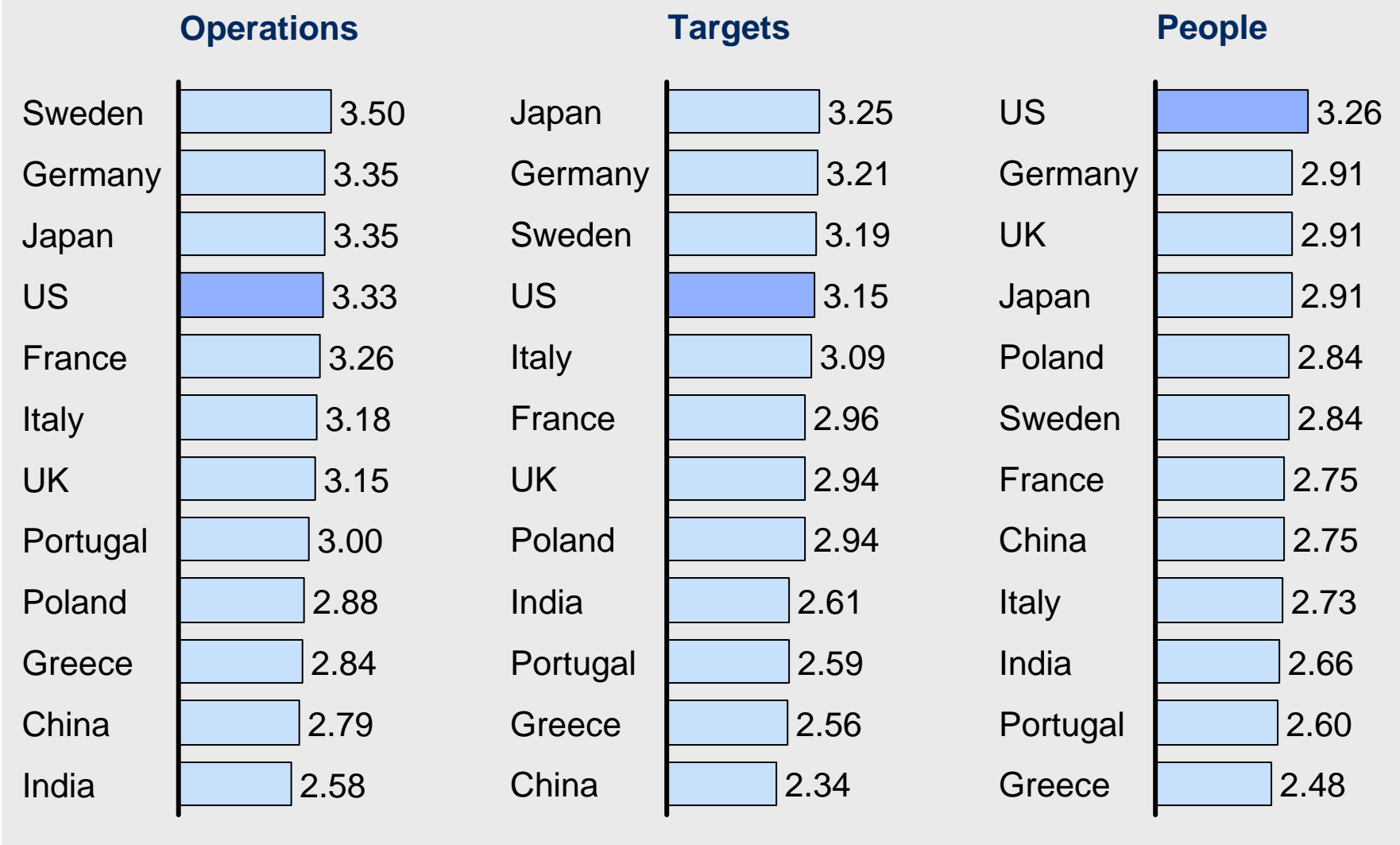
THE U.S. REMAINS AN INTERNATIONAL LEADER IN MANAGEMENT PRACTICE

Average management practice score – by country



THE US IS NOT THE BEST AT EVERYTHING, ALTHOUGH IT IS DISTINCTIVE IN PEOPLE MANAGEMENT

Assessed Scores across three dimensions – by country

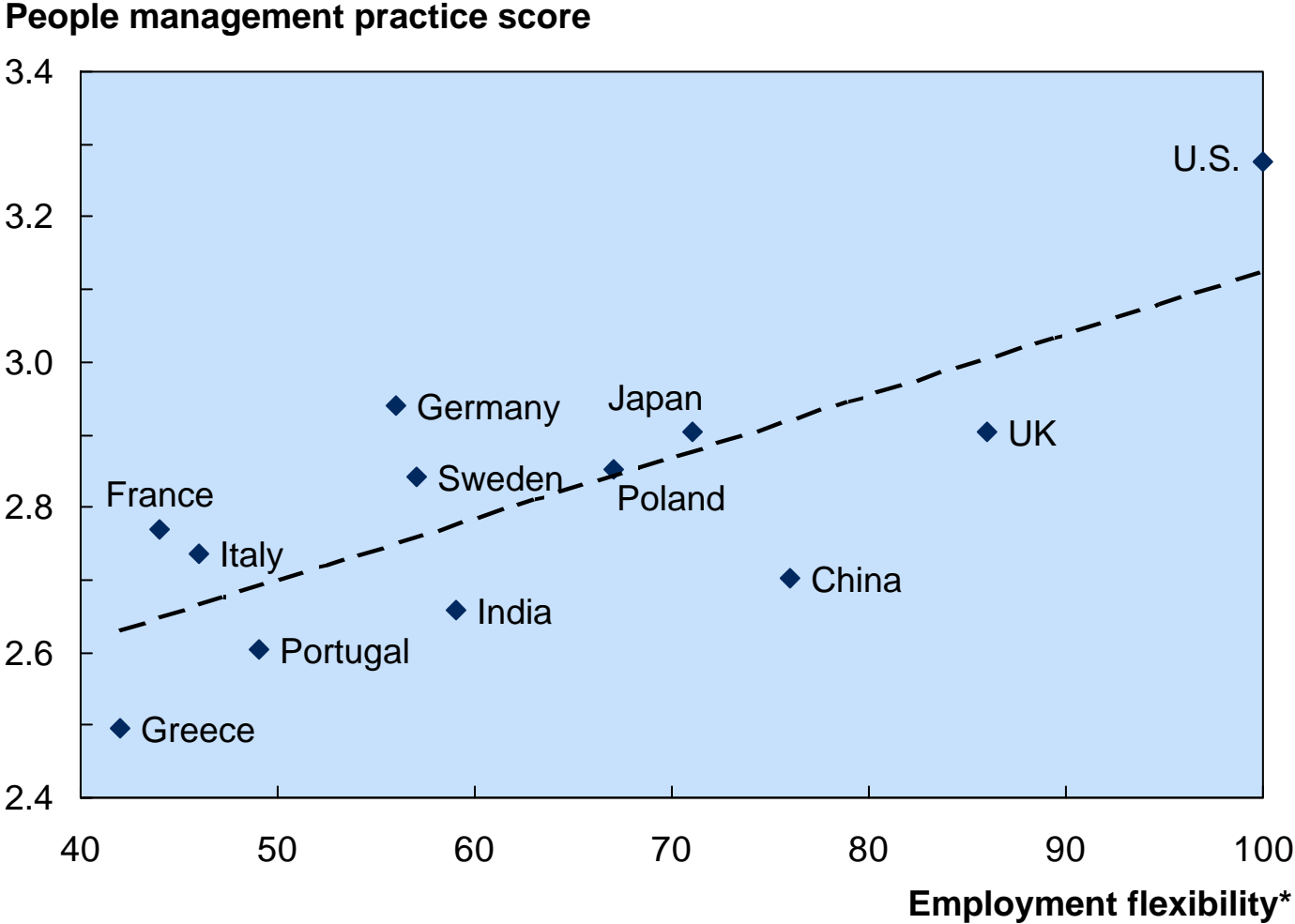


Source: Data collected from interviews as of Aug 01, 2007; team analysis



THE HIGH LABOUR MARKET FLEXIBILITY AND PEOPLE MANAGEMENT SETS THE U.S. APART FROM OTHER COUNTRIES

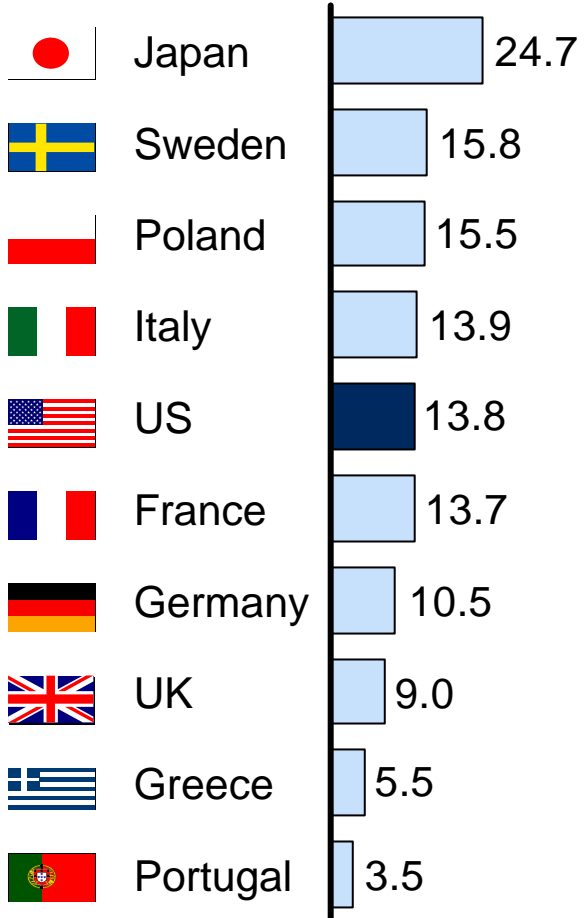
Labour market flexibility* vs. people management practice score – by country



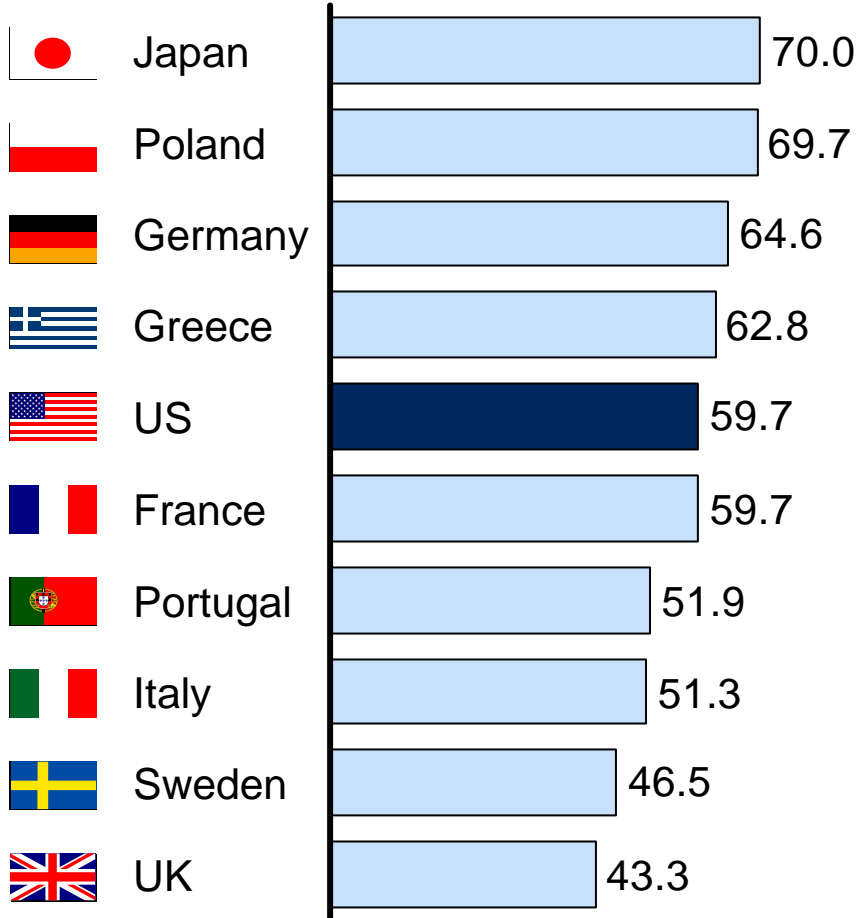
Source: World Bank; Management Matters dataset

THE U.S. HAS AVERAGE WORKFORCE EDUCATION LEVELS

Average share of non-managers with degree – by country



Average share of managers with degree – by country

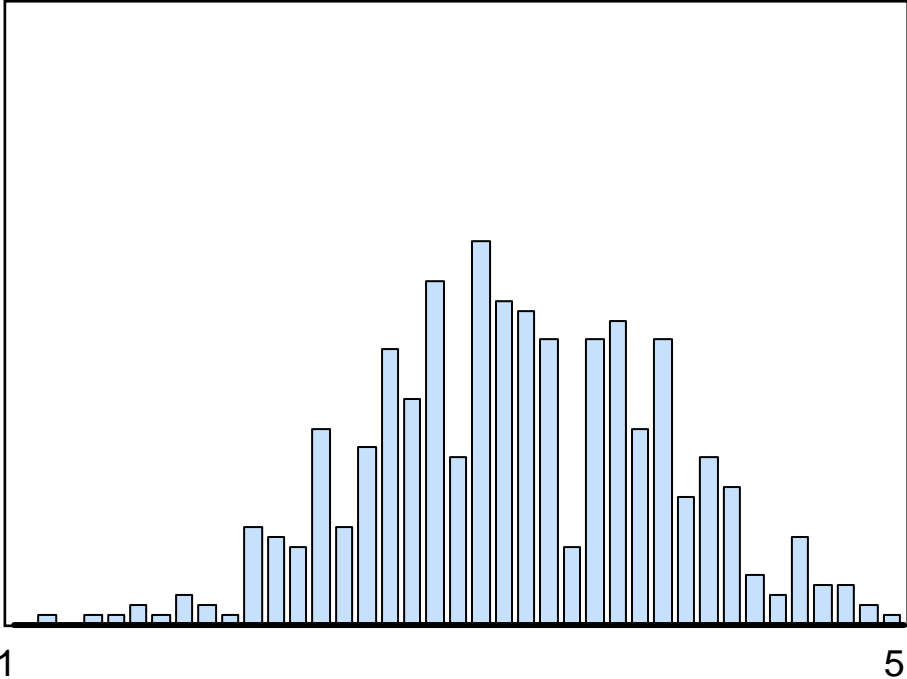
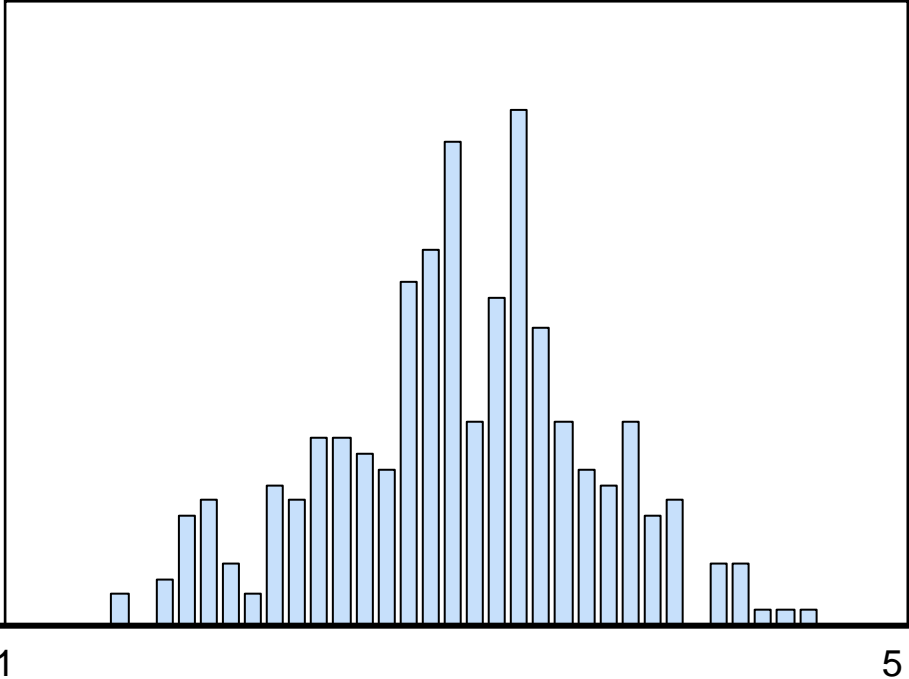


ONE REASON FOR U.S. SUCCESS IS THE REMOVAL OF UNDERPERFORMING COMPANIES IN THE ECONOMY

Distribution of firm level management practice scores

France

U.S.



Assessed management practice score

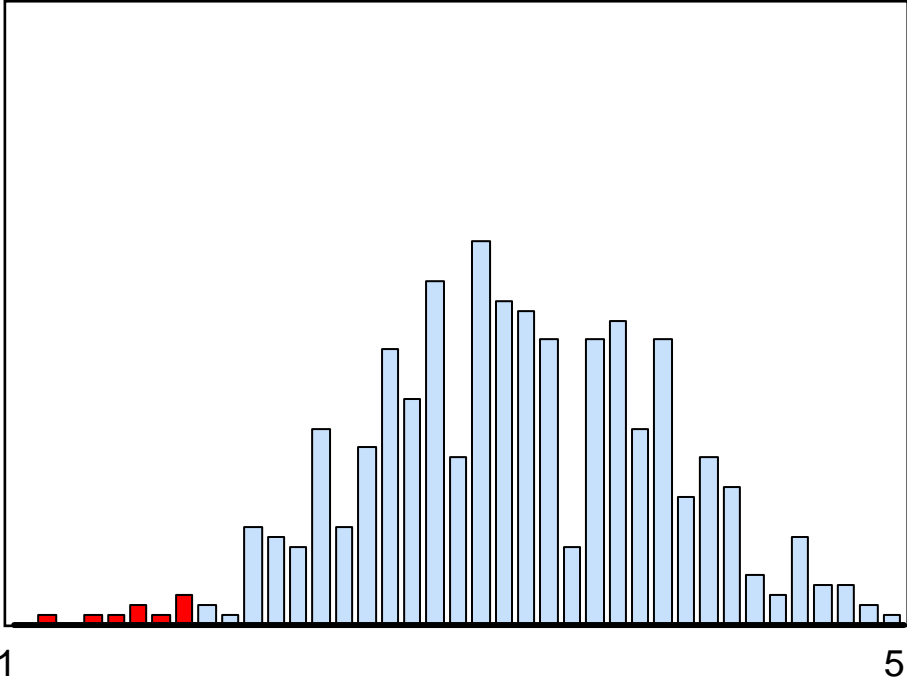
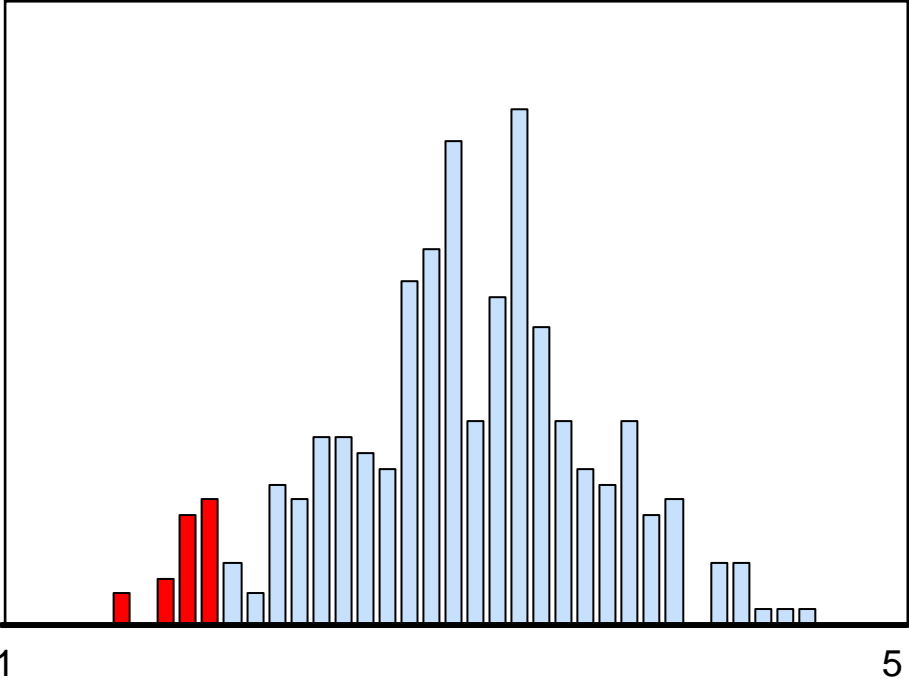
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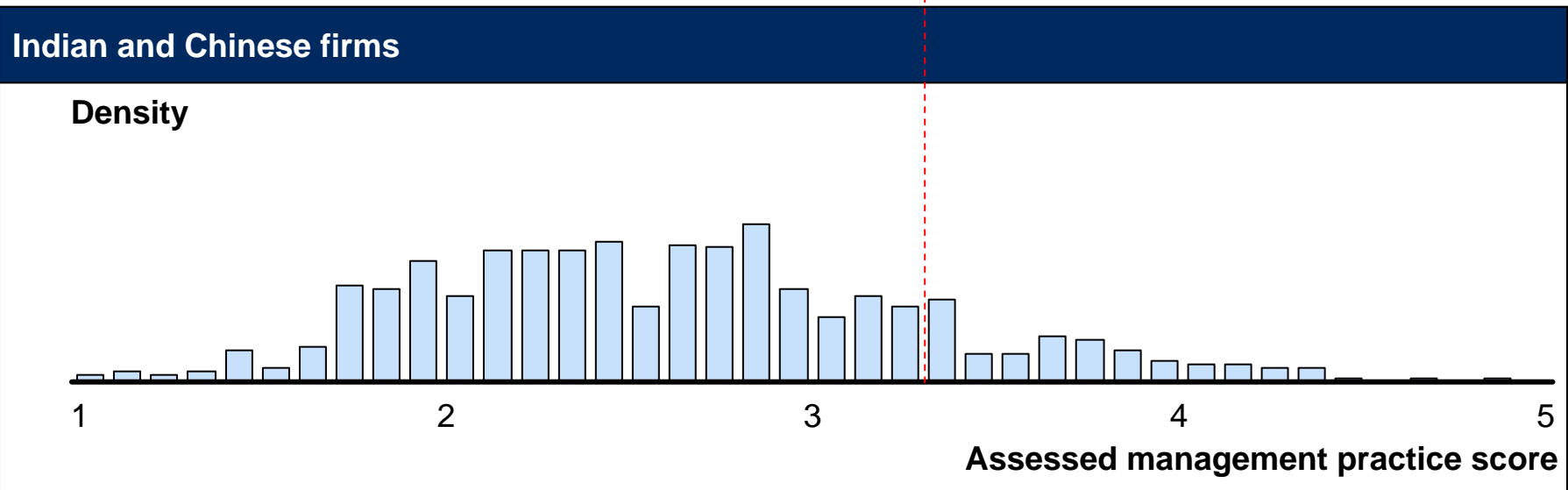
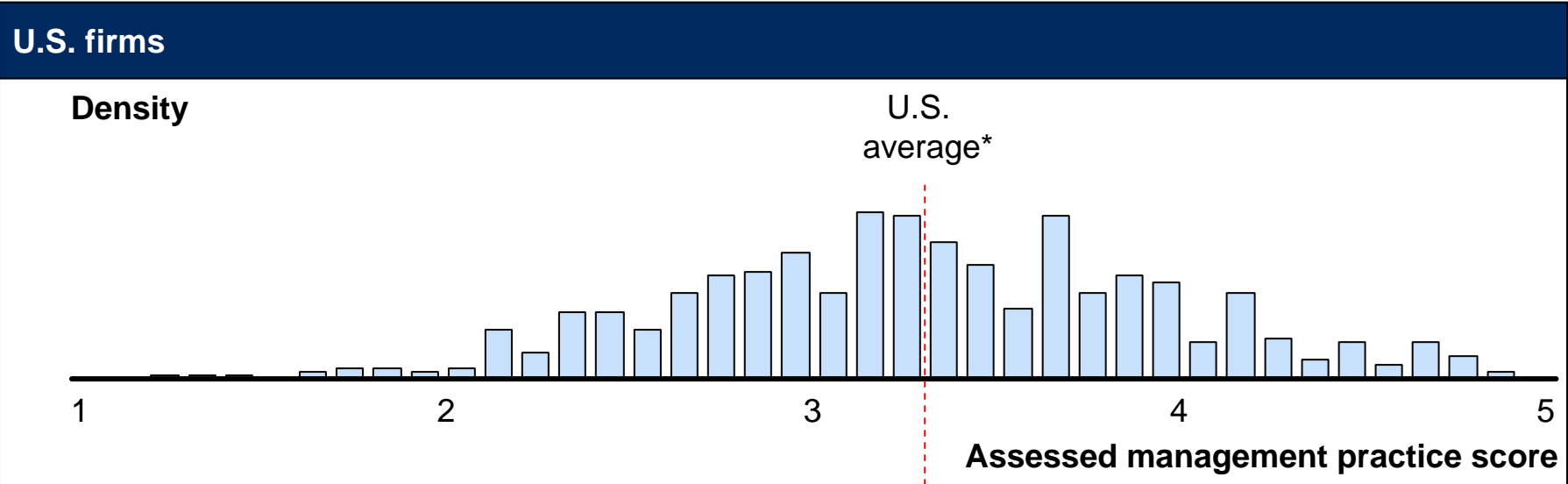


Assessed management practice score

Assessed management practice score



OVER 15% OF INDIAN AND CHINESE FIRMS ARE ALREADY BETTER MANAGED THAN THE AVERAGE U.S. FIRM



* 3.30

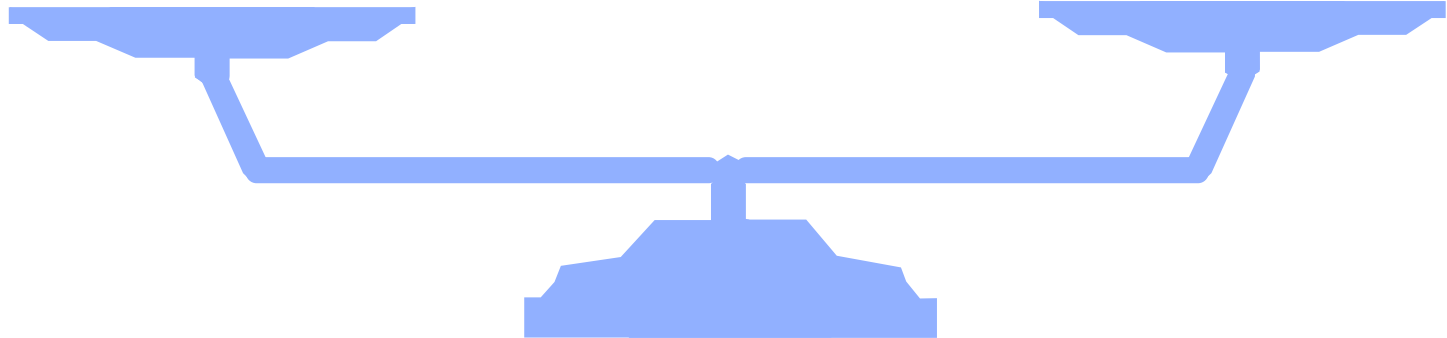
CONCLUSIONS

Positives

- Competitive intensity
- Labor market flexibility
- Meritocratic CEO selection

Cautions

- Protectionism could undermine competition
- Average skill base
- International competitors catching up fast



MY FAVOURITE QUOTES:

Staff retention the American way

Production Manager: “I spend most of my time walking around cuddling and encouraging people - my staff tell me that I give great hugs”

The difficulties of defining ownership in Europe

Production Manager: “We’re owned by the Mafia”

Interviewer: “I think that’s the “*Other*” category.....although I guess I could put you down as an “*Italian multinational*” ?”

MY FAVOURITE QUOTES:

Staff rewards the American way

Production Manager: “For example, if an employee suggests a company slogan, and his name is used, he gets a TV.
If he is employee of the month, he gets a parking space”

Staff retention the UK way

Interviewer: “How would you persuade your top performers to stay?”
UK Chairman: “Sex is a great thing! If the employee finds a new girlfriend somewhere else, I can't do anything!”



Management Practice and Productivity: Why They Matter

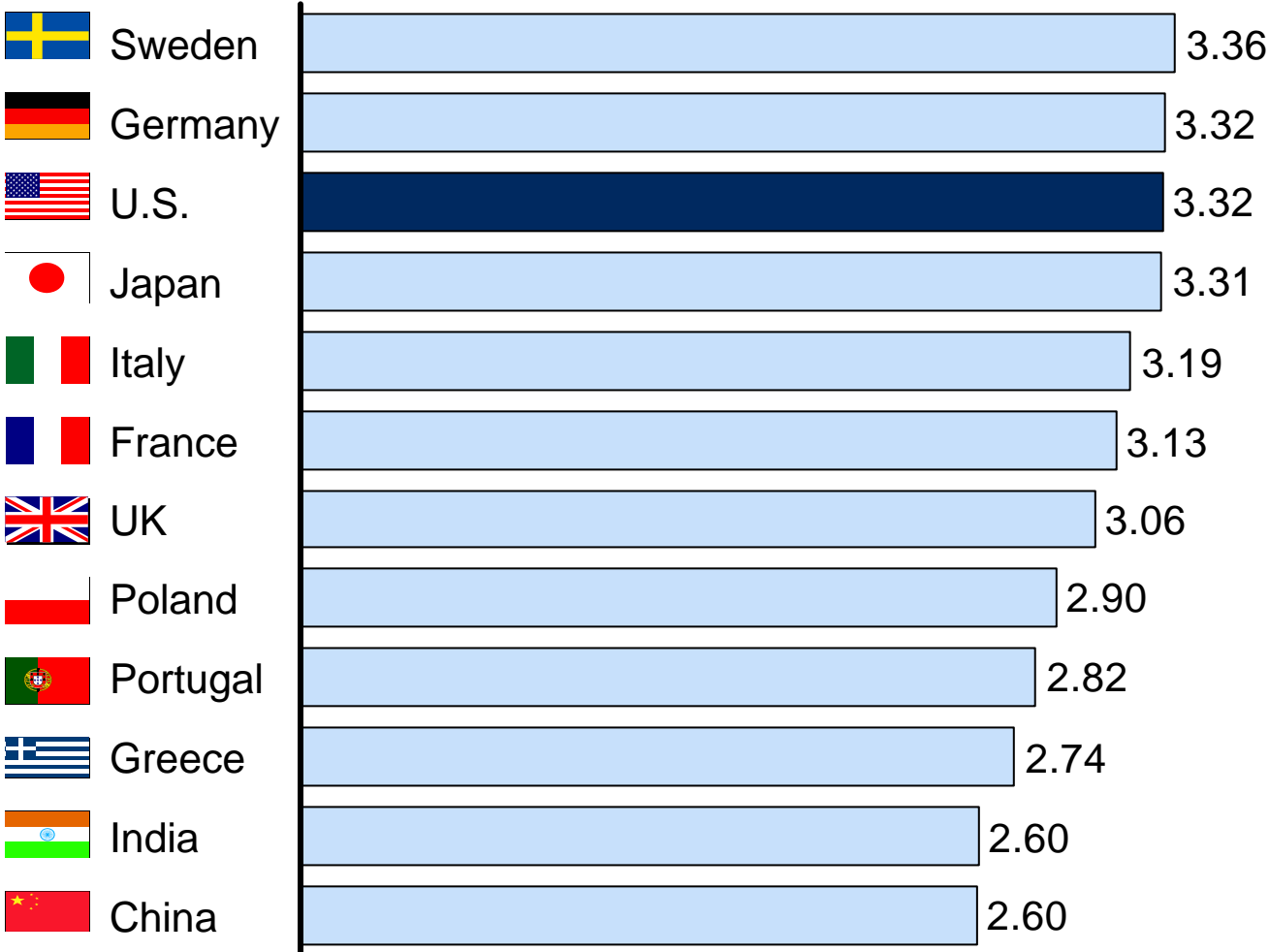
Stephen Dorgan, McKinsey & Company
Nick Bloom, Stanford University

John Van Reenen, Centre for Economic Performance, LSE

BACK UP SLIDES

SWEDISH AND GERMAN FIRMS ARE ON AVERAGE BETTER OPERATIONS MANAGERS

Average operations and targets score – by country

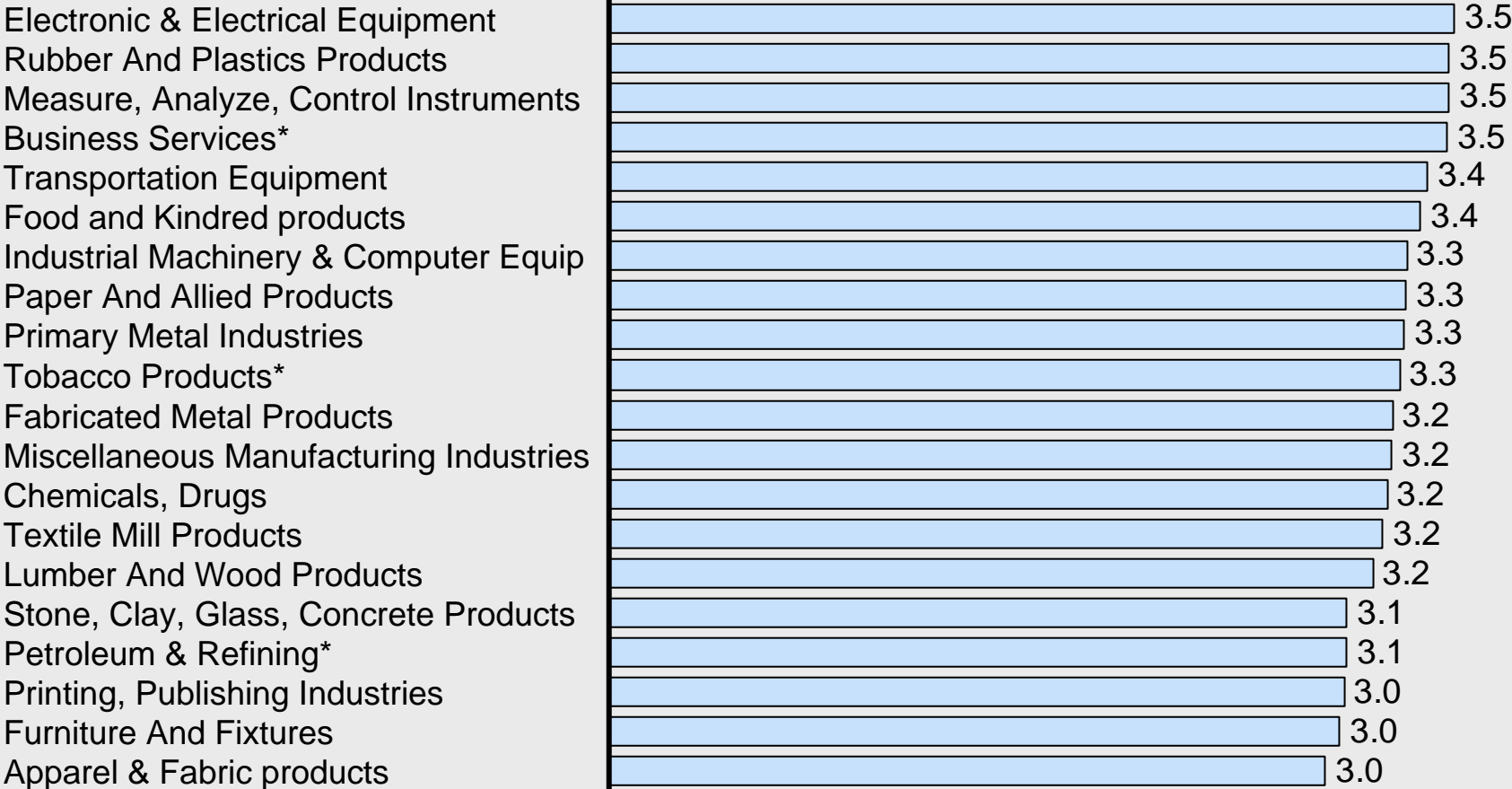


Source: China: Chinese interviews as of 11/10/2007; U.S. and India: Interviews as of 21/09/2007

MANAGEMENT PRACTICES ALSO VARY BY INDUSTRY

Management practice score by industry

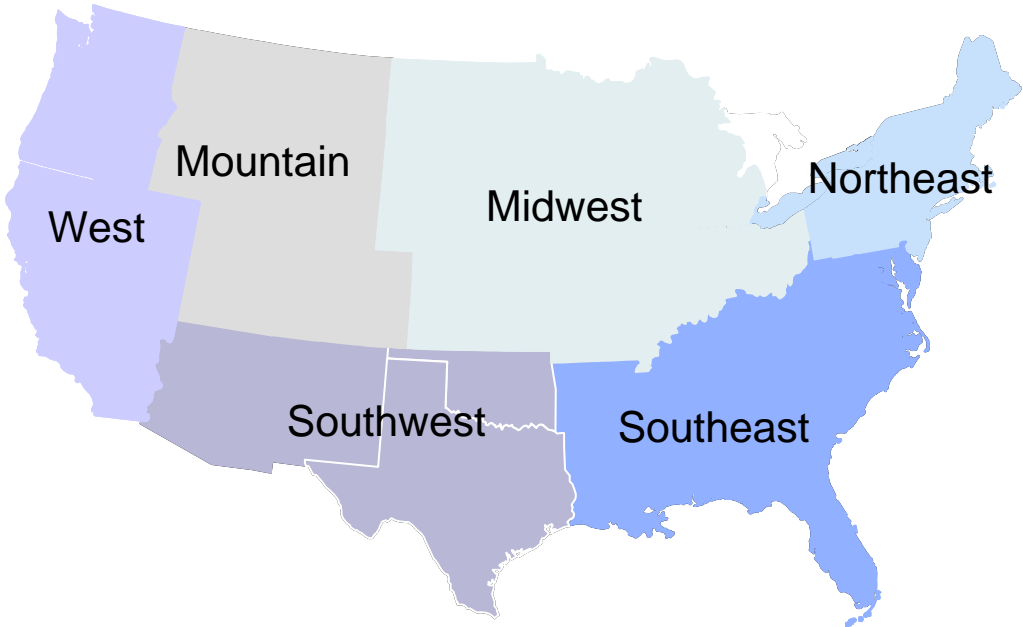
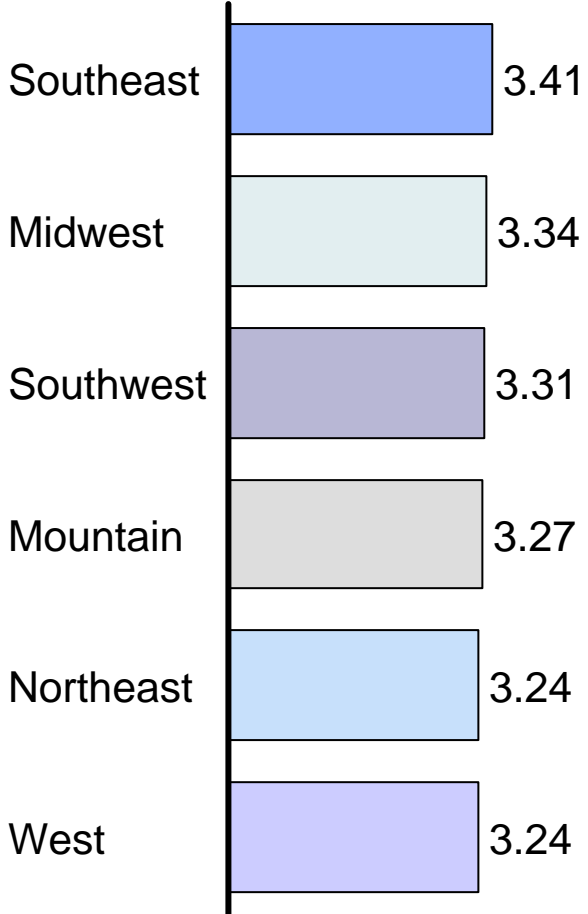
Overall



* Scores not reliable due to very small sample size

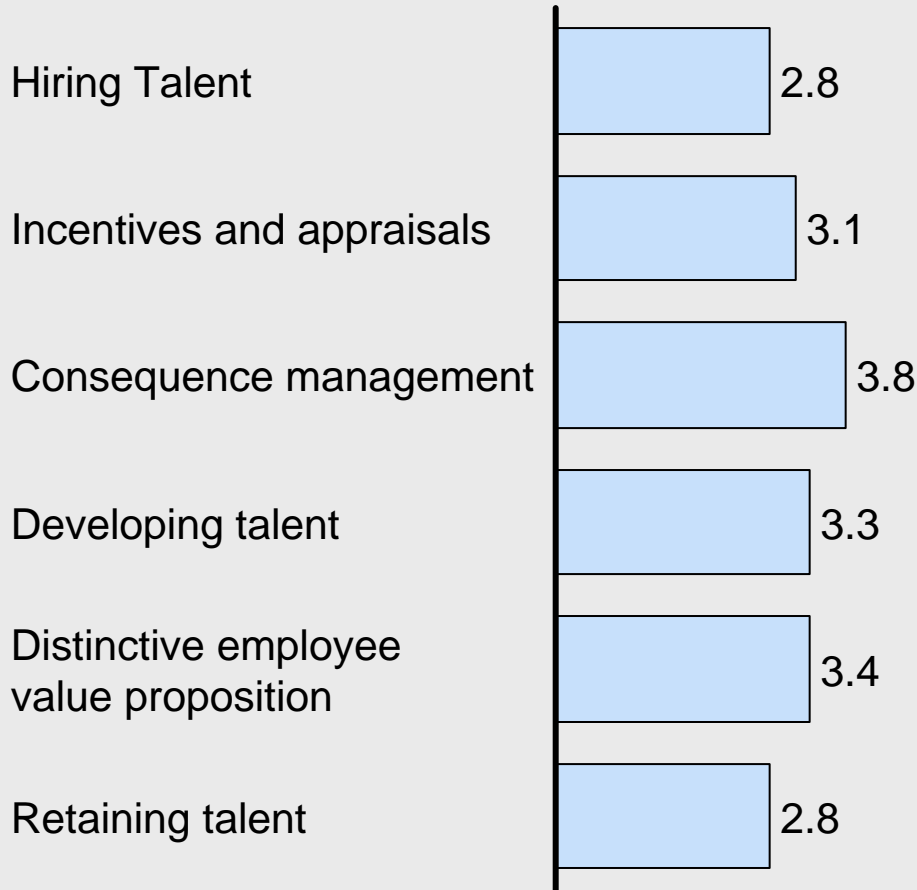
LITTLE VARIATION EXISTS ACROSS REGIONS

Management practice score



... BUT SCORES HIGH IN CONSEQUENCE MANAGEMENT, TALENT DEVELOPMENT AND EMPLOYEE VALUE PROPOSITION

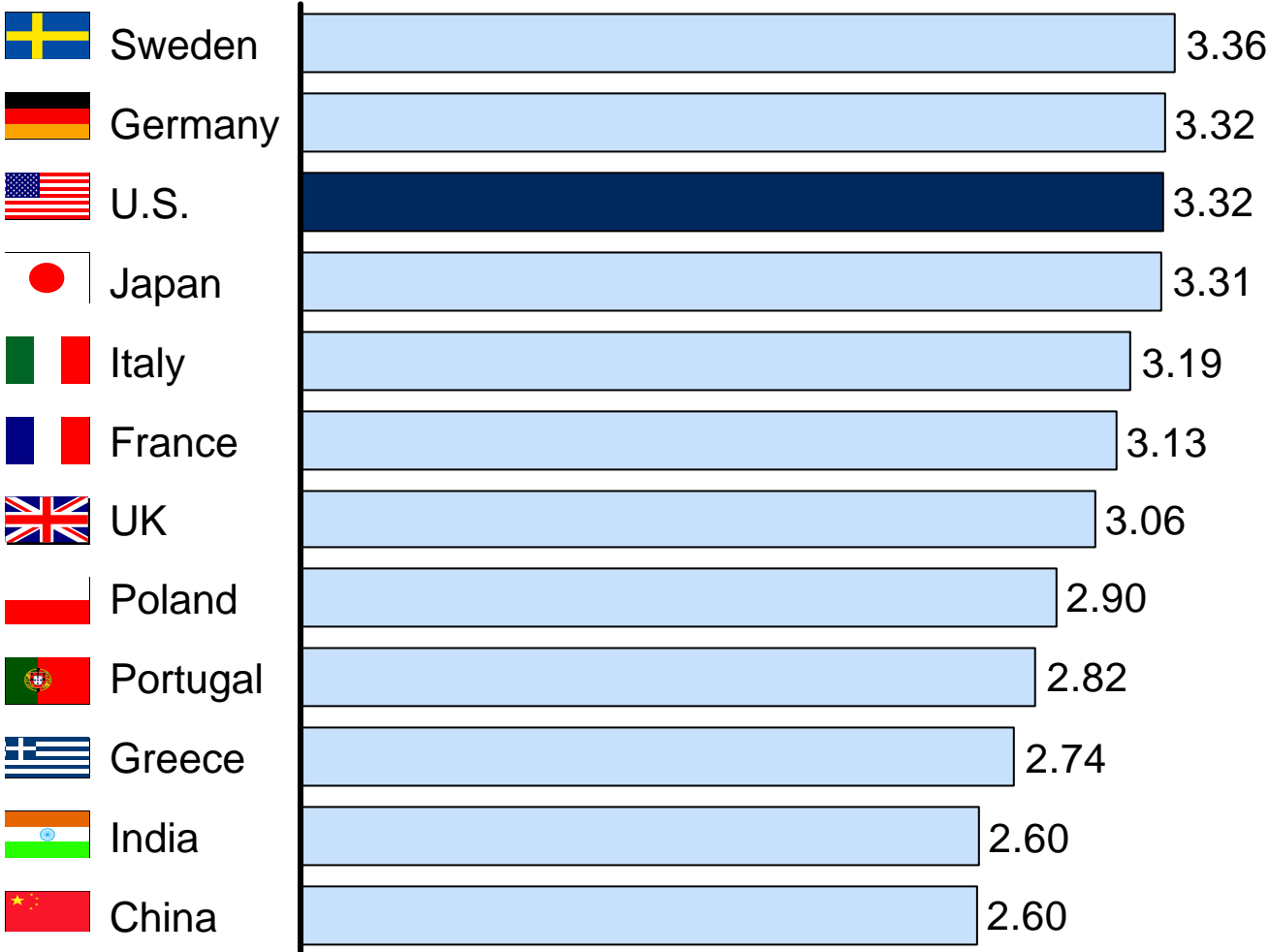
People Management Score



- U.S. companies have strong practices in consequence management, employee value proposition and developing talent
- ... However, there is still room for improvement in hiring talent as well as retaining them

SWEDISH AND GERMAN FIRMS ARE ON AVERAGE BETTER OPERATIONS MANAGERS

Average operations and targets score – by country

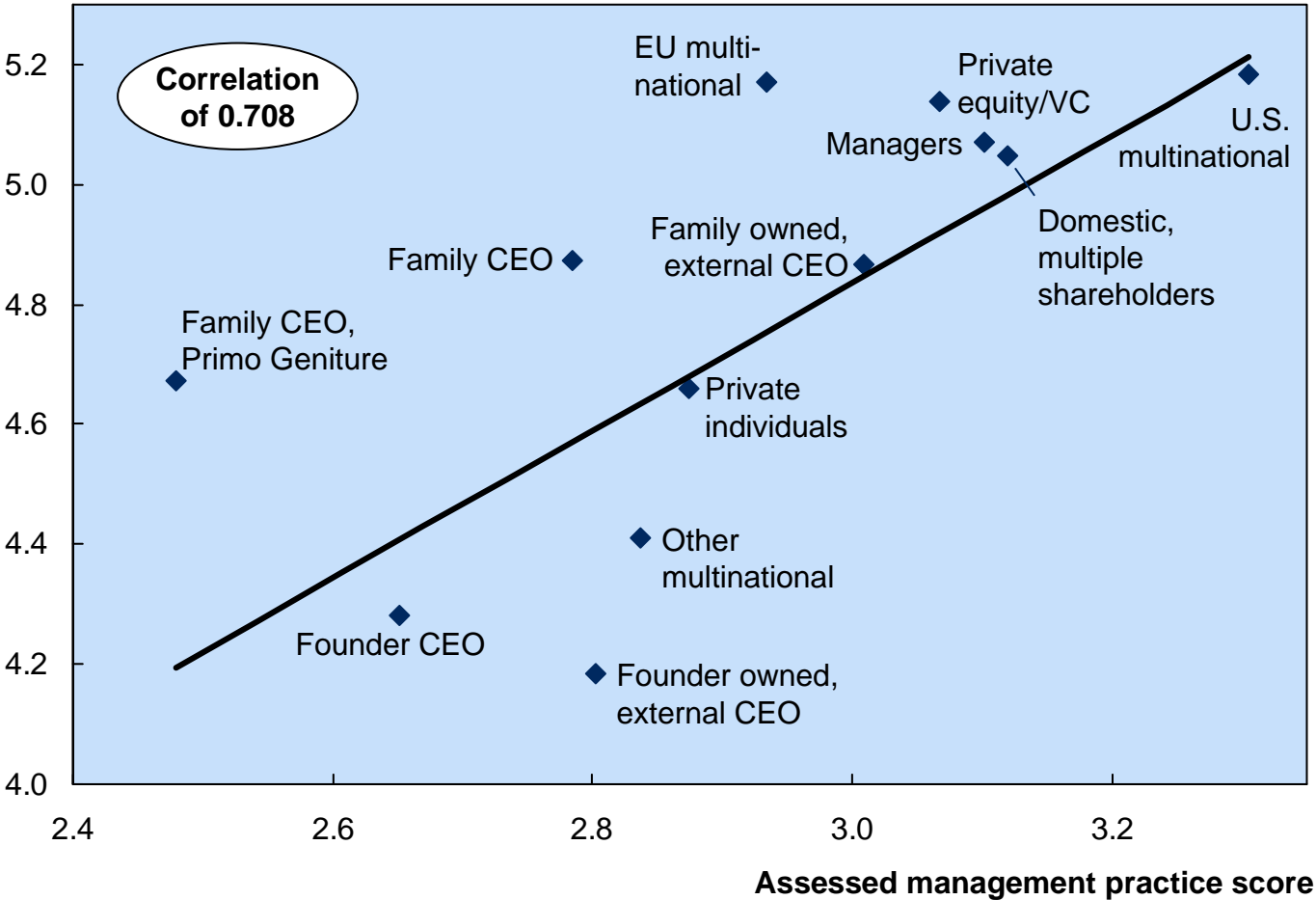


Source: China: Chinese interviews as of 11/10/2007; U.S. and India: Interviews as of 21/09/2007

PRODUCTIVITY BY OWNERSHIP TYPE ALSO VARIES SIGNIFICANTLY AND IS CORRELATED WITH MANAGEMENT PRACTICE

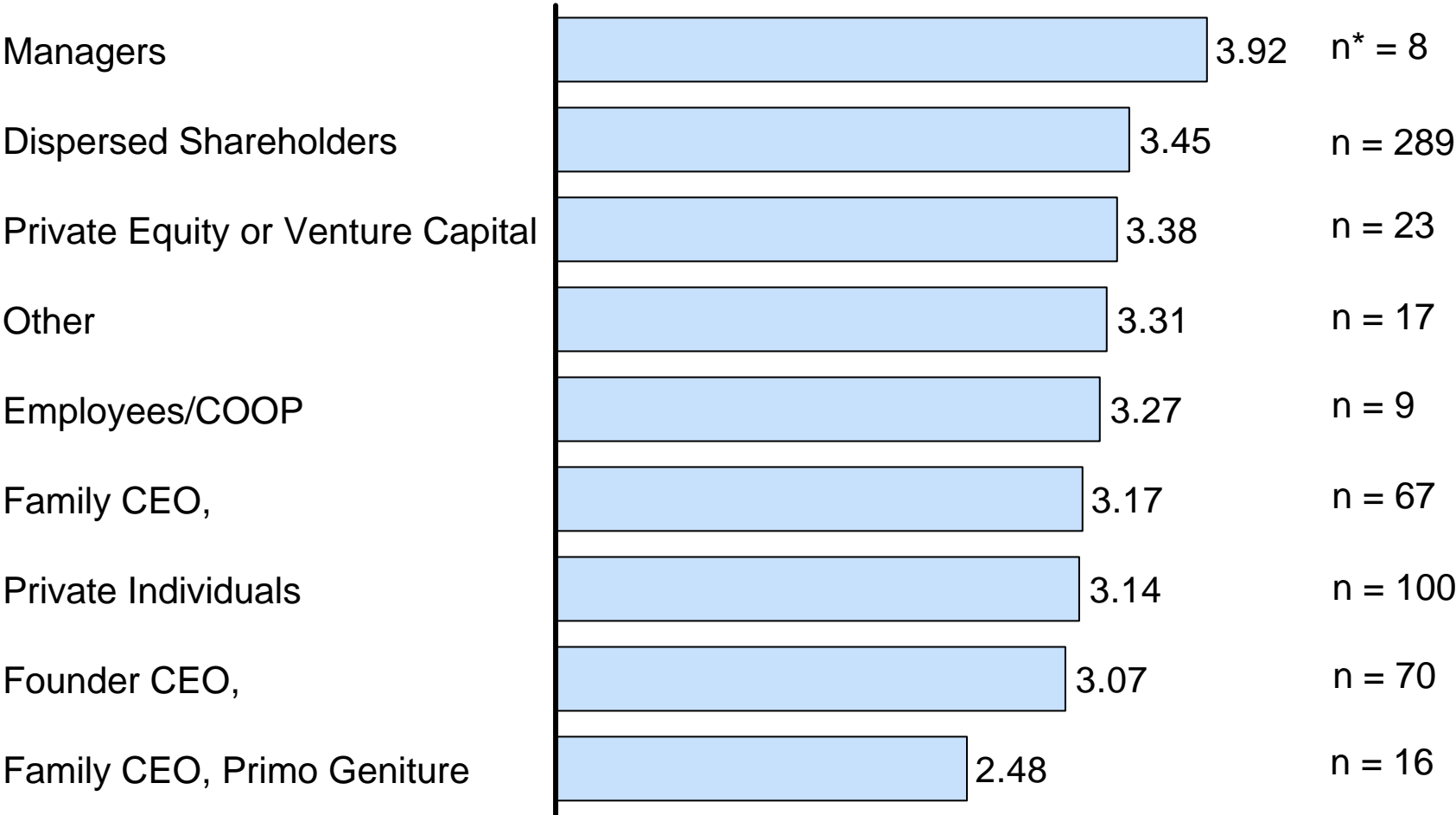
Productivity vs. management practice score – by ownership type

Labour productivity



MANAGEMENT PRACTICES VARY SUBSTANTIALLY BY OWNERSHIP TYPE FOR US COMPANIES

Management practice score – by ownership type



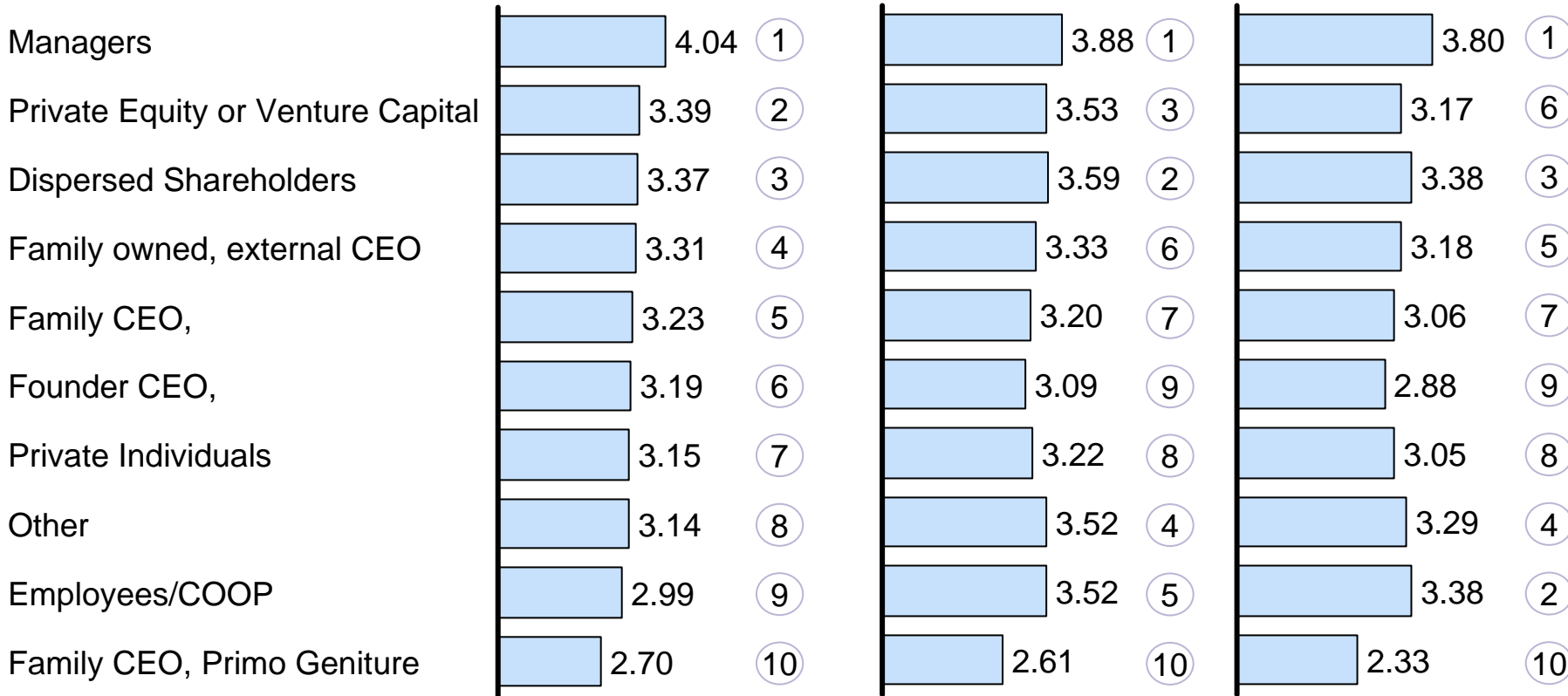
*n indicates the sample size for each ownership structure

ACROSS OWNERSHIP STRUCTURES, FEW EXCEPTIONS EXIST BETWEEN OVERALL PERFORMANCE AND PERFORMANCE IN SPECIFIC AREAS

People Management

Operations management

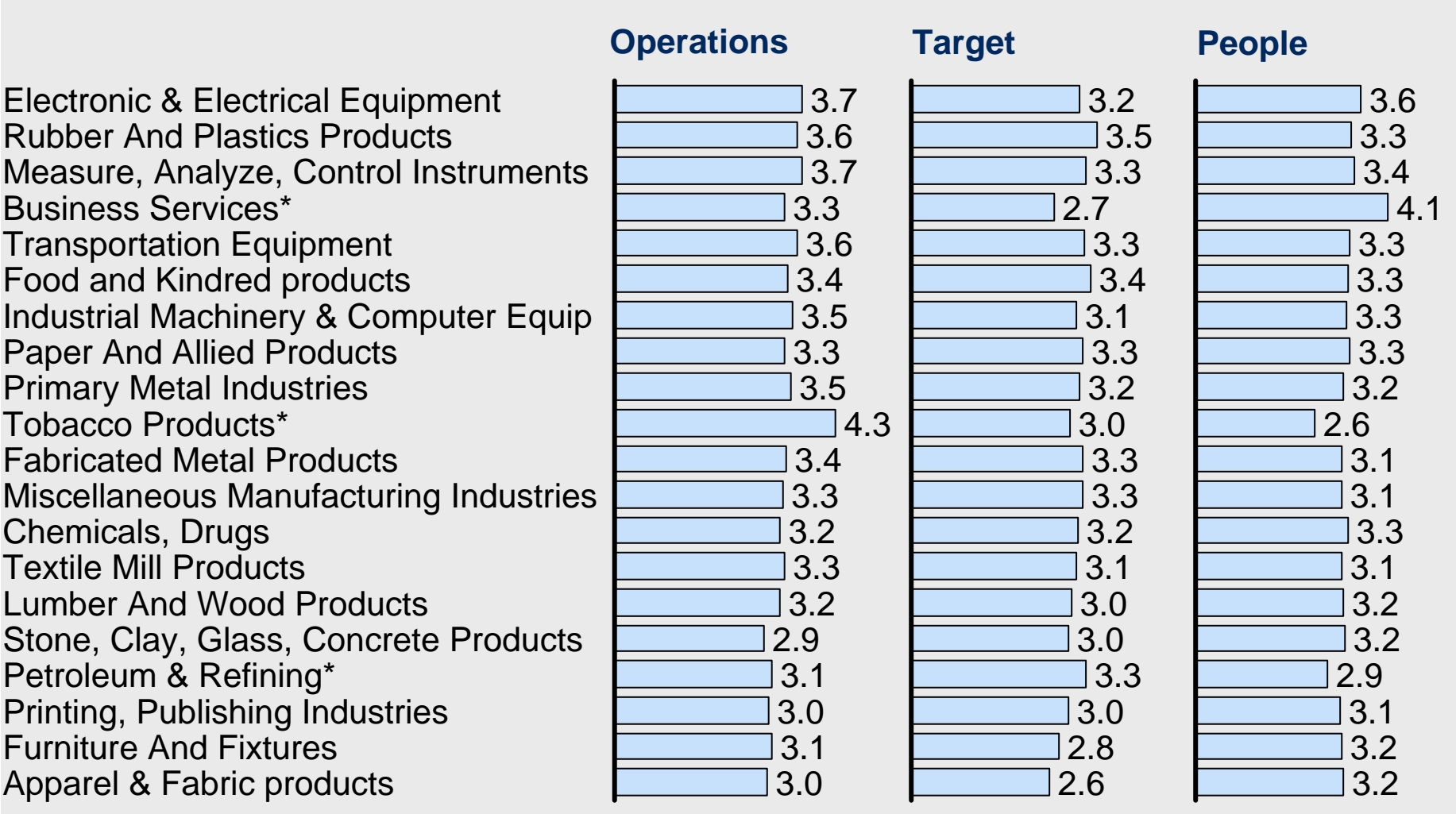
Target Management



* ownership only included if contain over 5 firms

HOWEVER, LARGER DIFFERENCES CAN BE SEEN IN INDIVIDUAL METRICS, PARTICULARLY IN PEOPLE MANAGEMENT

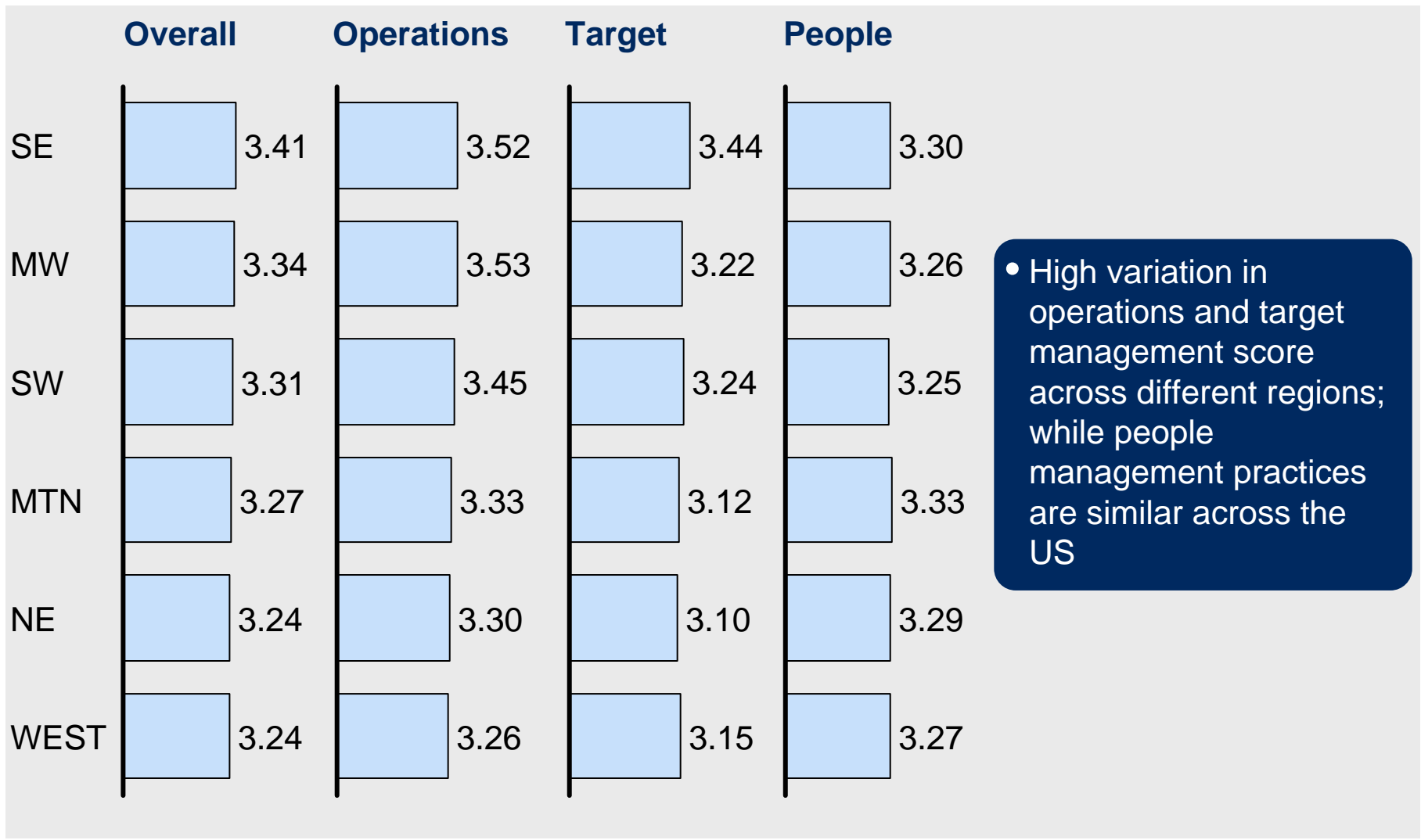
Assessment of practices by Industry



* Scores not reliable due to very small sample size

... HOWEVER THERE ARE SIGNIFICANT DIFFERENCES IN OPERATIONS AND TARGET MANAGEMENT PRACTICES ACROSS REGIONS

Assessment of practices by US regions



MY FAVOURITE QUOTES:

India is such an interesting place...

Plant Manager: “Modern manufacturing? Yes, I have heard about it, but it doesn’t make any sense at all, does it?”

Interviewer: “How do you identify your star performers?”

Manager: “This is India, everyone thinks he is a star performer!”

Interviewer: “How do you keep your top performers?”

Manager: “I am a star performer and I want to leave!”

MY FAVOURITE QUOTES:

The British way of (not) getting a date

[Male manager speaking to an Australian female interviewer]

Production Manager: “Your accent is really cute and I love the way you talk. Do you fancy meeting up near the factory?”

Interviewer “Sorry, but I’m washing my hair every night for the next month....”

MY FAVOURITE QUOTES:

The Indian alternative

Production Manager: “Are you a Brahmin?”

Interviewer “Yes, why do you ask?”

Production manager “And are you married?”

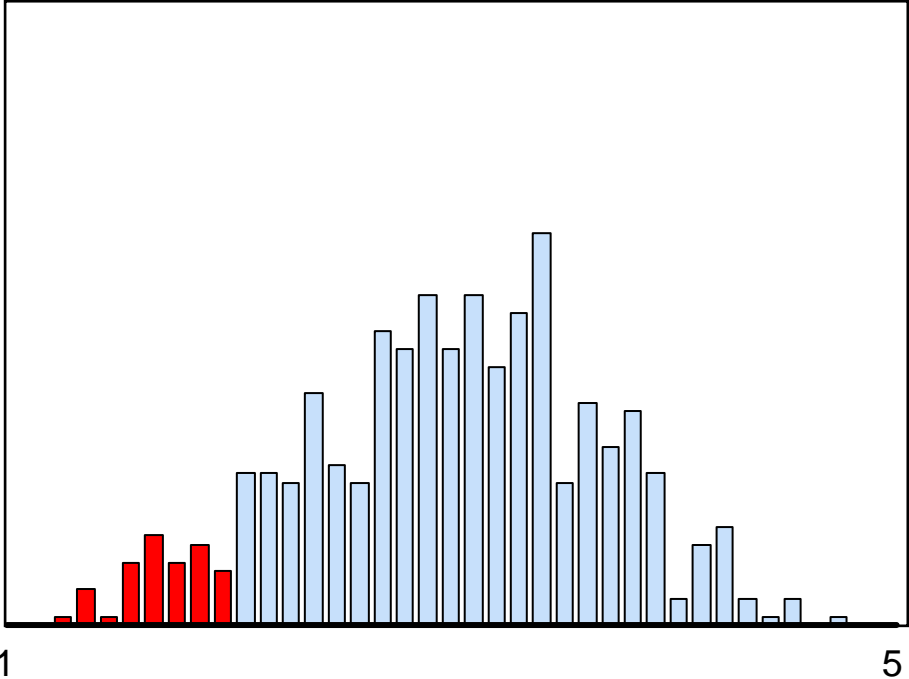
Interviewer “No?”

Production manager “Excellent, excellent, my son is looking for a bride and I think you could be perfect. I must contact your parents to discuss this”

ONE REASON IS THE PERSISTENT 'TAIL' OF UNDERPERFORMING COMPANIES IN THE ECONOMY

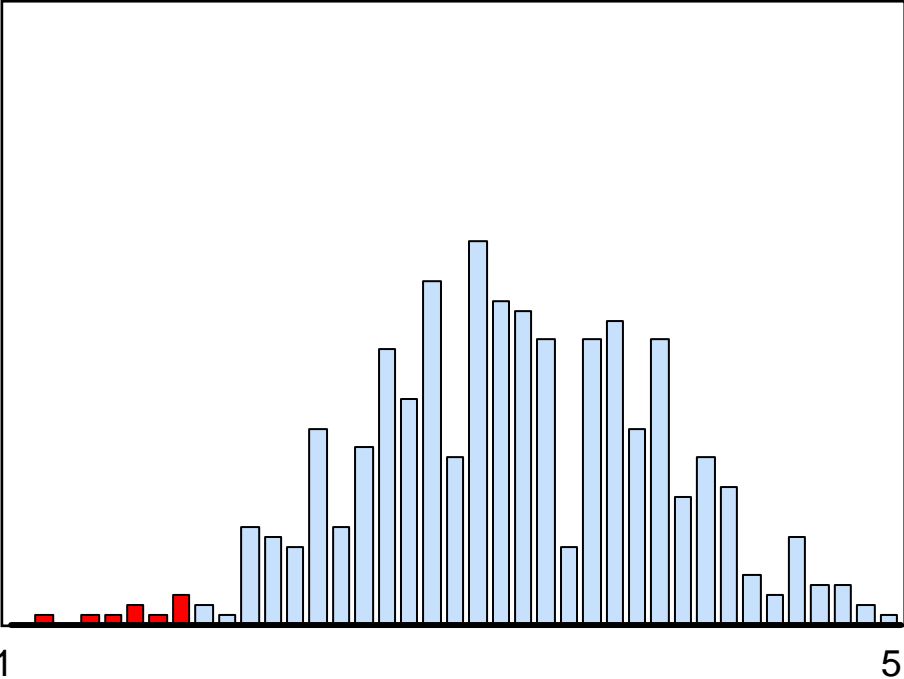
Distribution of firm level management practice scores

 U.K.



Assessed management practice score

 U.S.



Assessed management practice score