Management Practice and Productivity: Why They Matter

McKinsey & Company

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WE ARE EXTREMELY GRATEFUL FOR THE SUPPORT RECEIVED FROM OUR FUNDERS
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.K.
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.

Example dimensions evaluated:
- Quality of targets
- Interconnection of targets
- Time horizon of targets
- Consequence management

Dimension scoring criteria:

1. Measures tracked do not directly indicate if overall business objectives are being met. Tracking is ad hoc.

3. Most key performance indicators are tracked formally. Tracking is overseen by senior management.

5. Performance is continuously tracked and communicated, formally and informally, to all staff, using a range of visual management tools.
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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

ROCE (%)

Sales growth (%)

* Firms are grouped in 0.5 increments of assessed management score
**THIS LINK HOLDS TRUE ACROSS DIFFERENT COUNTRIES AND CULTURES**

- **Labour productivity**
  - US, UK
  - CN, JP
  - FR, DE, SE, PL
  - IT, PT, GR

* Firms are grouped in 0.5 increments of assessed management score
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Management practices in the U.K.
THERE IS SUBSTANTIAL INTER-COUNTRY MANAGEMENT PRACTICE VARIABILITY

Average management practice score - by country*

<table>
<thead>
<tr>
<th>Country</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>3.25</td>
</tr>
<tr>
<td>Sweden</td>
<td>3.16</td>
</tr>
<tr>
<td>Japan</td>
<td>3.15</td>
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<tr>
<td>Germany</td>
<td>3.15</td>
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<td>UK</td>
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<tr>
<td>France</td>
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<td>Italy</td>
<td>2.98</td>
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<tr>
<td>Poland</td>
<td>2.88</td>
</tr>
<tr>
<td>Portugal</td>
<td>2.73</td>
</tr>
<tr>
<td>Greece</td>
<td>2.65</td>
</tr>
<tr>
<td>China*</td>
<td>2.62</td>
</tr>
<tr>
<td>India</td>
<td>2.62</td>
</tr>
</tbody>
</table>

*China score not robust due to small sample size of 32 firms

3 statistically distinct groups emerge
• U.S., Sweden, Japan and Germany
• U.K., France and Italy 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
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Distribution of firm level management practice scores – by country
BUT 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
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Management practices in the U.K.
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

Reported number of competitors
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”
Source: World Bank; Management Matters dataset
WE FIND MANAGEMENT PRACTICES TO VARY SUBSTANTIALLY BY OWNERSHIP TYPE

Management practice score* – by ownership type

<table>
<thead>
<tr>
<th>Ownership Type</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Multinationals</td>
<td>3.41</td>
</tr>
<tr>
<td>Other Multinationals</td>
<td>3.21</td>
</tr>
<tr>
<td>Dispersed Shareholders</td>
<td>3.19</td>
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<tr>
<td>Private Equity/Venture Capital</td>
<td>3.18</td>
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<tr>
<td>EU Multinationals</td>
<td>3.14</td>
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<tr>
<td>Family owned, external CEO</td>
<td>3.05</td>
</tr>
<tr>
<td>Other Managers</td>
<td>3.04</td>
</tr>
<tr>
<td>Private Individuals</td>
<td>3.04</td>
</tr>
<tr>
<td>Employees/COOP</td>
<td>2.93</td>
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<tr>
<td>Family CEO</td>
<td>2.83</td>
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<tr>
<td>Founder owned, external CEO</td>
<td>2.81</td>
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<tr>
<td>Founder CEO</td>
<td>2.69</td>
</tr>
<tr>
<td>Family CEO, Primogeniture</td>
<td>2.54</td>
</tr>
<tr>
<td>Government</td>
<td>2.45</td>
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</tbody>
</table>

*All 12 countries
PRODUCTIVITY BY OWNERSHIP TYPE ALSO VARIES SIGNIFICANTLY AND IS CORRELATED WITH MANAGEMENT PRACTICE

Productivity Vs management practice score – by ownership type

Assessed management practice score

Labour productivity

Correlation of 0.708
### MULTINATIONALS ARE WELL RUN EVERYWHERE

Management practice score—by country

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<thead>
<tr>
<th>Country</th>
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<tbody>
<tr>
<td>Greece</td>
<td>2.47</td>
</tr>
<tr>
<td>India</td>
<td>2.54</td>
</tr>
<tr>
<td>Portugal</td>
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<tr>
<td>Poland</td>
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<tr>
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<tr>
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MULTINATIONALS ARE WELL RUN EVERYWHERE

Management practice score– by country

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<thead>
<tr>
<th>Country</th>
<th>Domestic Firms</th>
<th>Multinationals</th>
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</thead>
<tbody>
<tr>
<td>Greece</td>
<td>2.47</td>
<td>3.06</td>
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* China and 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

Percentage

Average

Self-assessed management practice score
IT TURNS OUT MANAGERS APPEAR TO BE POOR AT SELF-ASSESSING THEIR FIRM’S MANAGEMENT PRACTICE
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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Management practices in the U.K.
THE U.K. REMAINS IN THE MIDDLE OF THE PACK DESPITE HIGH LABOUR MARKET FLEXIBILITY AND STRONG COMPETITIVE PRESSURES

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ONE REASON IS THE PERSISTENT ‘TAIL’ OF UNDERPERFORMING COMPANIES IN THE ECONOMY

Distribution of firm level management practice scores

Assessed management practice score

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ONE KEY DRIVER OF THE U.K. AVERAGE MANAGEMENT SCORE IS ITS RELATIVELY LOW SKILL LEVELS

<table>
<thead>
<tr>
<th>Country</th>
<th>Average share of non-managers with degree – by country</th>
<th>Average share of managers with degree – by country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>24.7</td>
<td>70.0</td>
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<tr>
<td>Sweden</td>
<td>15.8</td>
<td>69.7</td>
</tr>
<tr>
<td>Poland</td>
<td>15.5</td>
<td>64.6</td>
</tr>
<tr>
<td>Italy</td>
<td>13.9</td>
<td>62.8</td>
</tr>
<tr>
<td>US</td>
<td>13.8</td>
<td>59.7</td>
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<tr>
<td>France</td>
<td>13.7</td>
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<td>Germany</td>
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<td>51.3</td>
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<tr>
<td>Greece</td>
<td>5.5</td>
<td>46.5</td>
</tr>
<tr>
<td>Portugal</td>
<td>3.5</td>
<td>43.3</td>
</tr>
</tbody>
</table>
PRIMOGENITURE FAMILY OWNERSHIP IN THE U.K. SAMPLE IS MORE THAN THREE TIMES THAT OF THE U.S. SAMPLE

Percentage of firms family-owned with a CEO selected by primogeniture

- Sweden: 0.8%
- Poland: 1.3%
- US: 2.6%
- China: 2.9%
- Germany: 5.7%
- Portugal: 7.3%
- France: 8.3%
- Italy: 8.9%
- UK: 9.1%
- Japan: 13.2%
- India: 14.3%
- Greece: 15.5%
LOW SKILLS AND PRIMOGENITURE FAMILY FIRMS EXPLAIN MORE THAN HALF OF THE UK ‘TAIL’ OF BADLY MANAGED FIRMS

* Firms in which less than 5% of non-managers have a degree, N = 241
** Firms in which more than 5% of non-managers have a degree, N = 398

* Firms in which less than 5% of non-managers have a degree, N = 241
** Firms in which more than 5% of non-managers have a degree, N = 398
CONCLUSIONS

Positive influences
- Labour market flexibility
- Openness
- Competitive intensity

Negative influences
- Poorer skills
  - Managers
  - Non managers
- Primogeniture firms
MY FAVOURITE QUOTES:

The Swedish manufacturing goals

*Production Manager:* “Workers individual goals? They just want to go home!”

Americans on geography

*Interviewer:* “How many production sites do you have abroad? Manager in Indiana, US: “Well…we have one in Texas…”

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”?”
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