

Management Practices in Europe, the US and Emerging Markets

Nick Bloom (Stanford Economics)
John Van Reenen (Stanford GSB)

Lecture 1: May 11th, 2009



Course Objectives

This course is built on 8 years of research by LSE, McKinsey & Stanford, with recent extensions with Accenture, the World Bank & European Bank for Reconstruction & Development

This course aims to provide to do three things:

- Provide a “management 101” overview of basic practices
- Explain how management practices vary around the world
- Introduce you to some management research techniques



Course Timing

We will have 5 classes as follows:

Core Management Practices:

May 11th: Research overview + performance management grid

May 14th: Management & performance + talent management grid

May 15th: Drivers of management, field experiments + target management grid

Extensions:

May 18th: Organization of firms across countries

May 21st: Management across industries + management in India



Course Organization

Nick Bloom (Stanford Economics) and John Van Reenen (Stanford GSB/LSE) will co-teach the whole course.

There will be no take home work or exams

Passing the class for credit simply requires:

1. Class attendance
2. Class participation – we'll be asking people for their own experiences and views

All slides will be put up within 24 hours of class on my website
<http://www.stanford.edu/~nbloom/>



Course Timing

Classes run from 1:15 to 3:05

We will take a 5 minute coffee and cookie break at about 2:15pm each day

John and I will also be around for about 20 minutes after class to answer questions, and are happy to meet up at other times as well

INTRODUCTIONS & QUESTIONS



Introduction

Why care about management and productivity?

Background to the management research

Performance management

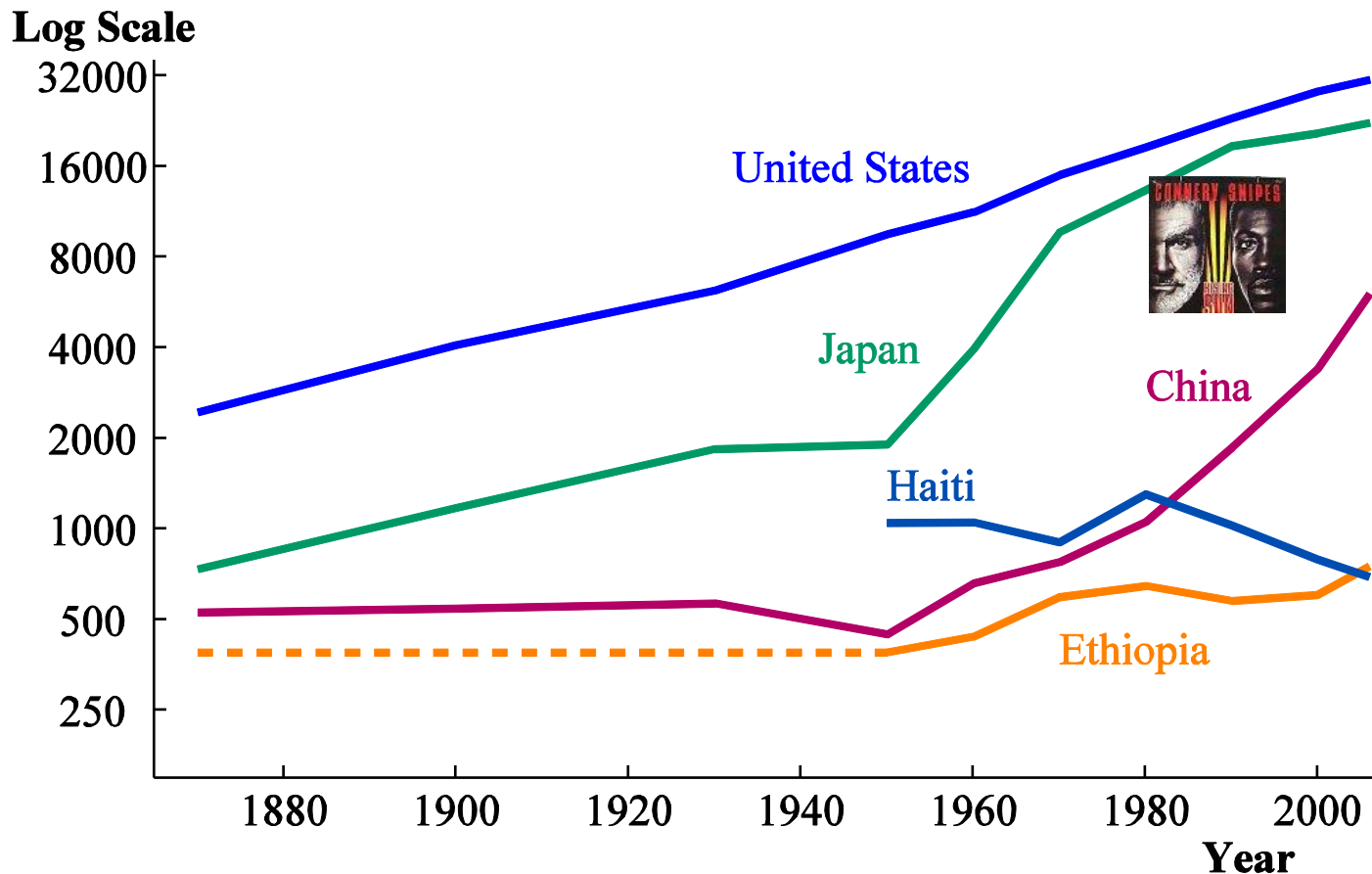


Productivity

- GDP per capita (Income per person) basic indicator of economic wellbeing
- GDP per capita increases by growth of inputs (e.g. more capital or labor) or higher Total Factor Productivity (TFP)
- **Macro:** This varies hugely across nations and time
 - Robert Solow: TFP growth at least as important as growth of inputs in explaining economic growth
 - GDP/capita largely due to TFP differences
- **Micro:** varies hugely within countries



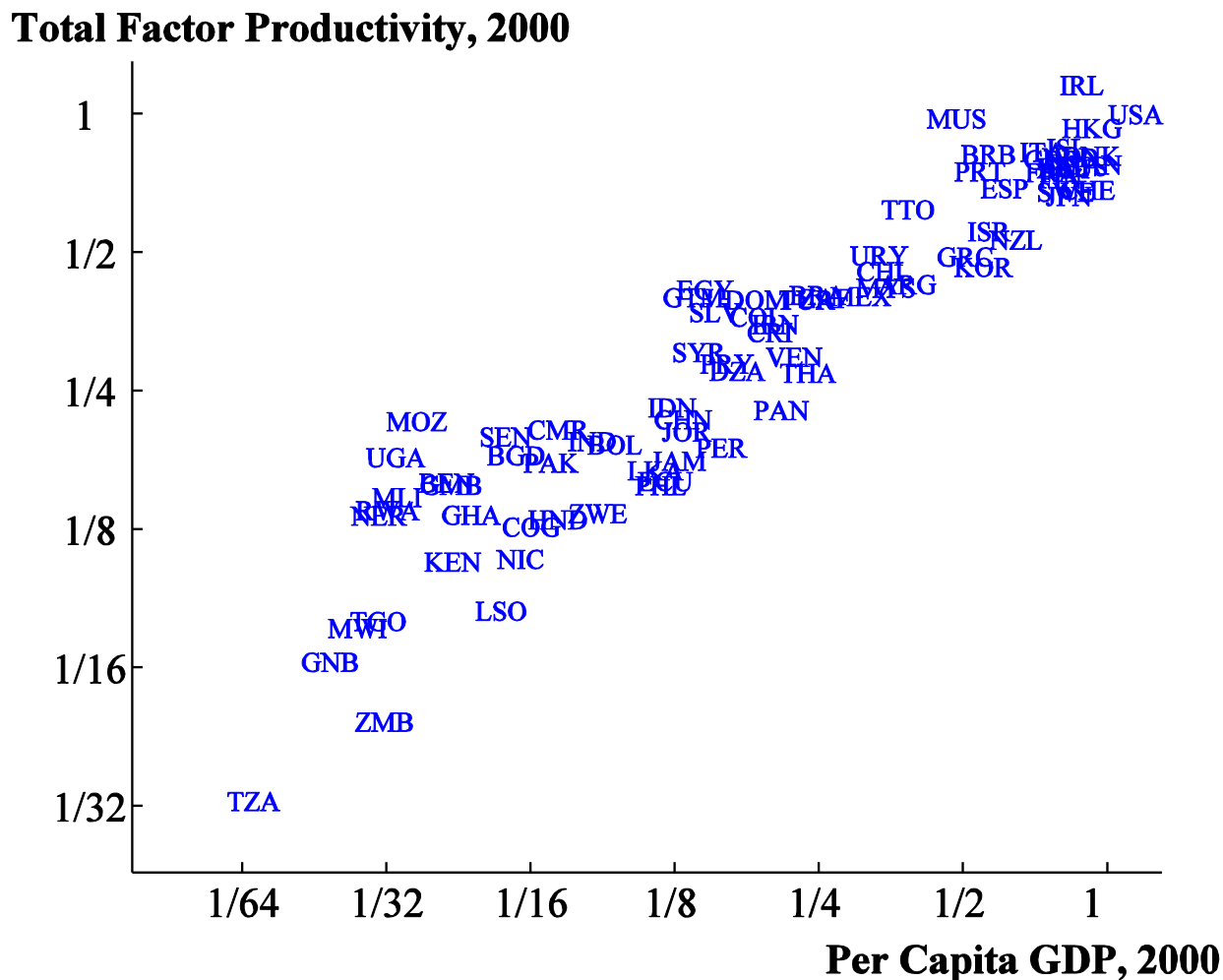
In long-run most countries have enjoyed catch up Growth with the GDP/head leader (US) but not all



Source: Maddison (2008) Data is smoothed by decade



Large Income & TFP Differences between countries



What it matters for policy

- Increasing TFP means that the economic pie is bigger so more room for
 - Consumption
 - Tax cuts
 - Increases in public goods (e.g. Environmental quality)
- Harder to achieve if productivity stagnant
- But what can be done to increase productivity?



Factors increasing productivity

- Proximate factors:
 - Technology (e.g. R&D)
 - Skills (e.g. Expansion of college education)
 - **Management** (a technology & a skill?).
- Some deeper factors “driving” the above
 - Competition
 - Globalization
 - Regulations
 - Culture

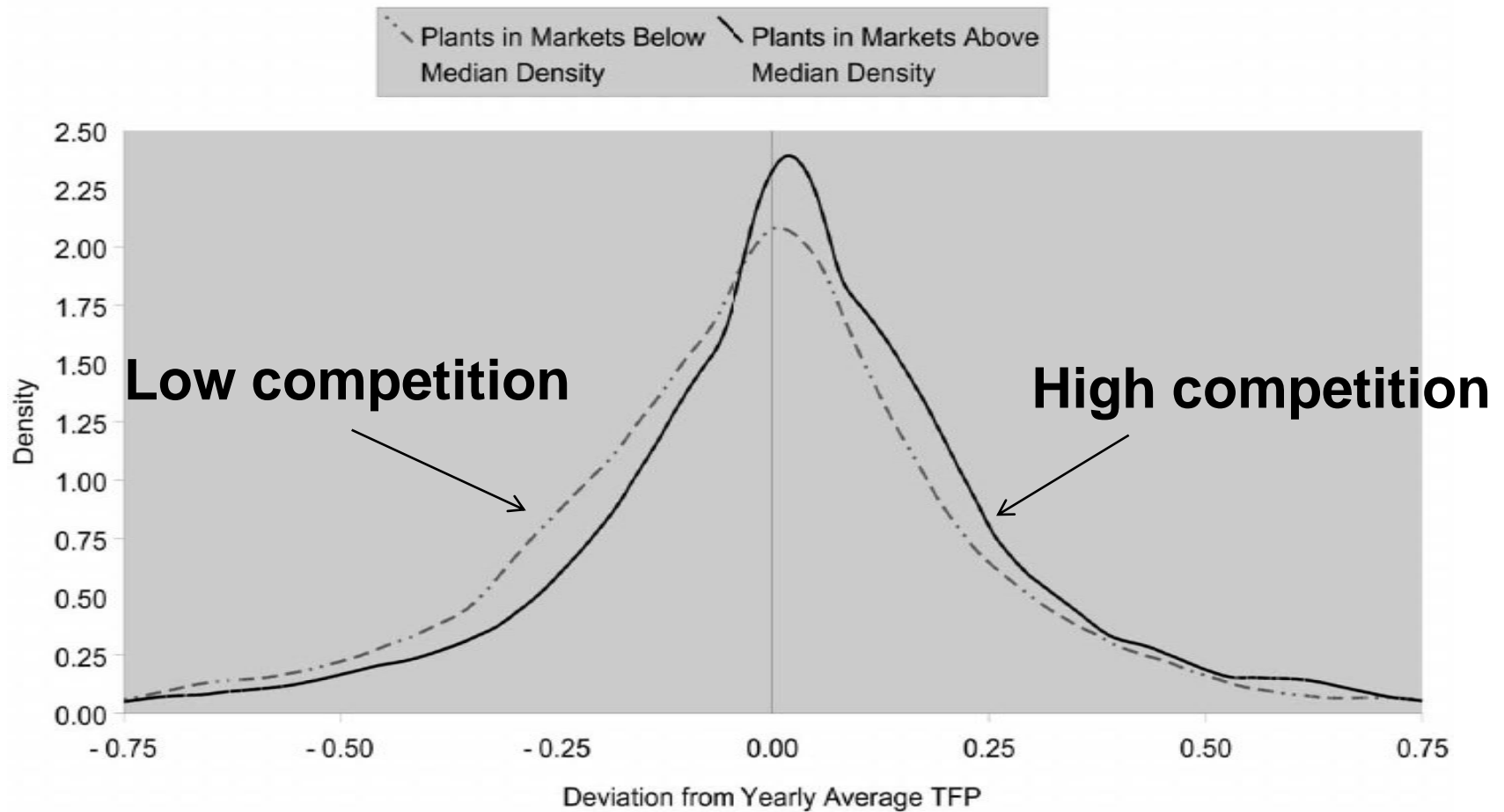


Productivity Differences across firms within countries is huge

- Census data on population of plants
 - US 1997: plant at the 90th percentile produced 4x higher labor productivity as plant at the 10th percentile (Syverson, 2004)
- Controlling for other inputs
 - TFP difference 1.9 in US
- Not just mismeasured prices: even in SIC 7 (e.g. Boxes, bread, carbon black, block ice, concrete, plywood, etc.) Differences get bigger (Foster et al, 2008)!
- Not just temporary
- Could account for large part of cross country diffs



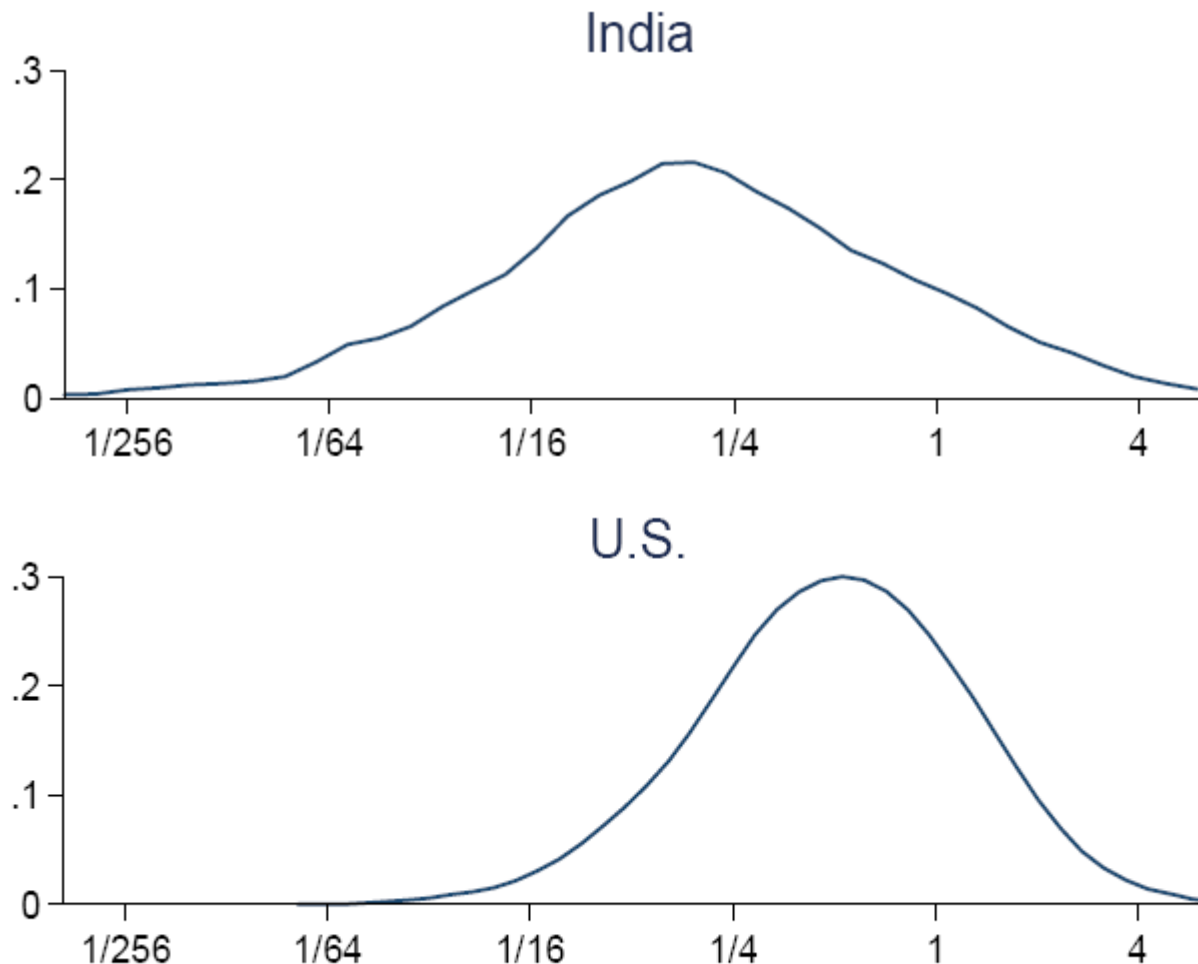
Big TFP dispersion among US ready mix concrete plants: More Competition means higher productivity (cut off lower tail)



Source: Syverson (2004)



Distribution of plant TFP differences: Higher average US productivity due to fewer less productive plants



Source: Hsieh and Klenow (2008)

Nick Bloom and John Van Reenen, Management Practices, Spring 2009



Management

- Case studies management in similar industries and positions respond differently
 - Toyota and General Motors
 - Goldman Sachs and Lehman Brothers
 - Valve Manufacturers
- Obviously management matters but (i) how to generalize, (ii) how much, (iii) what causes the differences?



What we need

- A way to quantitatively benchmark management practices
 - Firm-level
 - Across countries
 - Across sectors
 - Over time
 - That can be matched with productivity and performance data



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- **The basics**
- Some extensions

Performance management



THE SURVEY METHODOLOGY

1) Developing management questions

- Scorecard for 18 monitoring, targets and incentives practices
- ≈45 minute phone interview of manufacturing plant managers

2) Obtaining unbiased comparable responses (“Double-blind”)

- Interviewers do not know the company’s performance
- Managers are not informed (in advance) they are scored
- Run from London, with same training and country rotation

3) Getting firms to participate in the interview

- Introduced as “Lean-manufacturing” interview, no financials
- Official Endorsement: Bundesbank, PBC, CII & RBI, etc.
- Run by 78 MBAs types (assertive with business experience)



MONITORING - i.e. “*HOW IS PERFORMANCE TRACKED?*”

Score

(1): Measures tracked do not indicate directly if overall business objectives are being met. Certain processes aren't tracked at all

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

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



THIS SURVEY TECHNIQUE ALSO HAS A WIDER USE

- Collecting data from people in firms
 - In many situations people do not want to provide data
 - So as a consultant I had to use “blind-interview” techniques
- Interviewing candidates
 - Some consulting firms also use this “blind interviews” for recruitment
 - Reason is they want to get to the truth from candidates



MANAGEMENT SURVEY SAMPLE

- Interviewed about 6000 firms across Asia, Europe, US & South America
- Obtained 44% coverage rate from sampling frame (with response rates uncorrelated with performance measures)

Medium sized manufacturing firms:

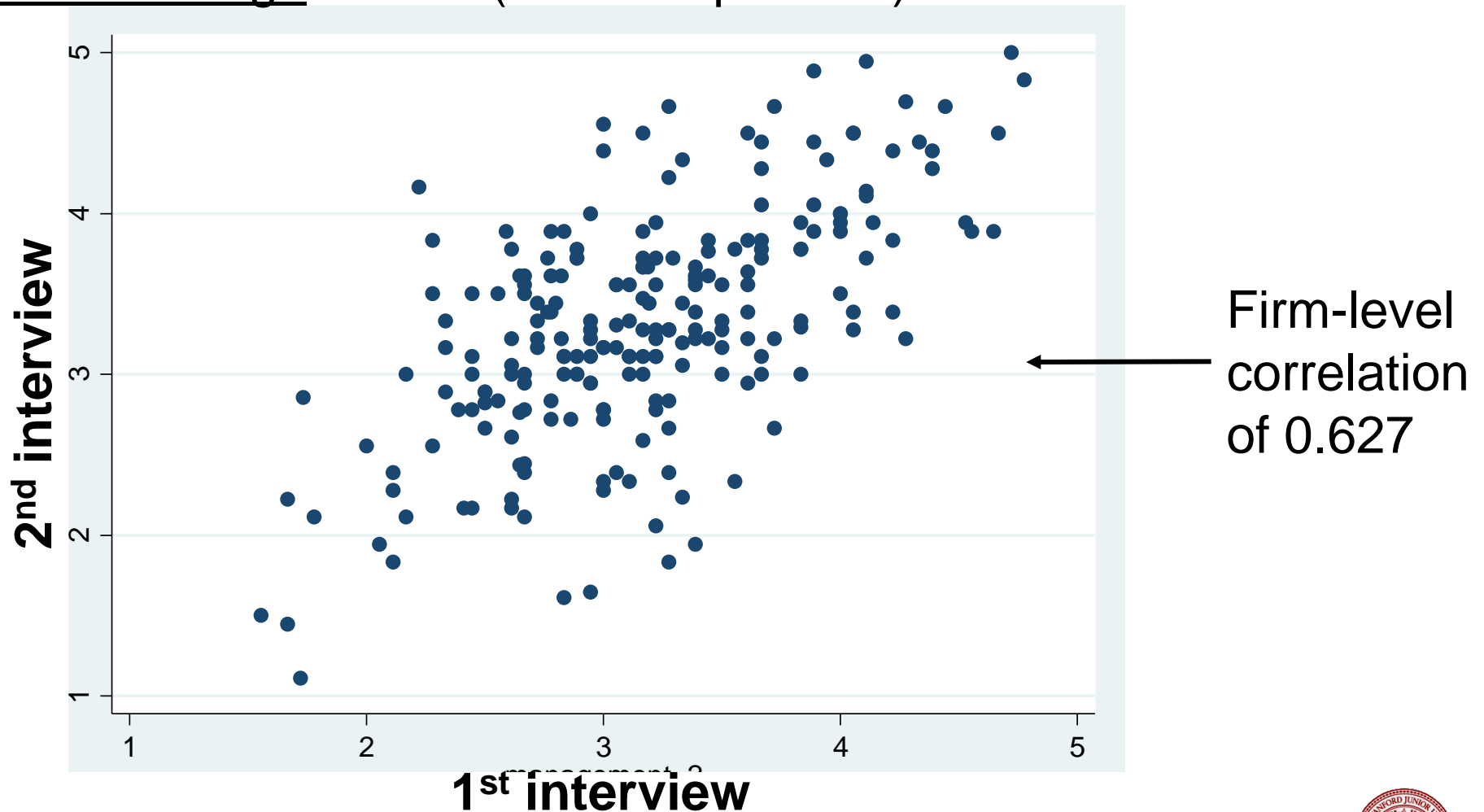
- Medium sized (100 - 5,000 employees, median \approx 250) because firm practices more homogeneous
- Manufacturing as easier to measure productivity (currently piloting in Schools, Hospitals, Retail and Law Firms)



INTERNAL VALIDATION: RE-RATER ANALYSIS

Re-interviewed 222 firms with different interviewers & managers

Firm average scores (over 18 question)



EXTERNAL VALIDATION: FIRM PERFORMANCE

Performance measure country c

$$y_i^c = \beta MNG_i^c + \alpha_l l_i^c + \alpha_k k_i^c + \alpha_m h_i^c + \gamma' x_i^c + u_i^c$$

management (average z-scores) ln(labor) ln(capital) ln(materials) other controls

- Use most recent cross-section of data (typically 2006)
- Note – not a causal estimation, only an association



EXTERNAL VALIDATION: BETTER PERFORMANCE IS CORRELATED WITH BETTER MANAGEMENT

Dependent variable	Productivity (% increase)	Profits (ROCE)	5yr Sales growth	Share Price (Tobin Q)	Exit
Estimation	OLS	OLS	OLS	OLS	Probit
Firm sample	All	All	All	Quoted	All
Management	28.7***	2.018***	0.047***	0.250***	-0.262**
Firms	3469	1994	1883	374	3161

Includes controls for country, with results robust to controls for industry, year, firm-size, firm-age, skills etc.

Significance levels: *** 1%, ** 5%, * 10%.

Sample of all firms where accounting data is available



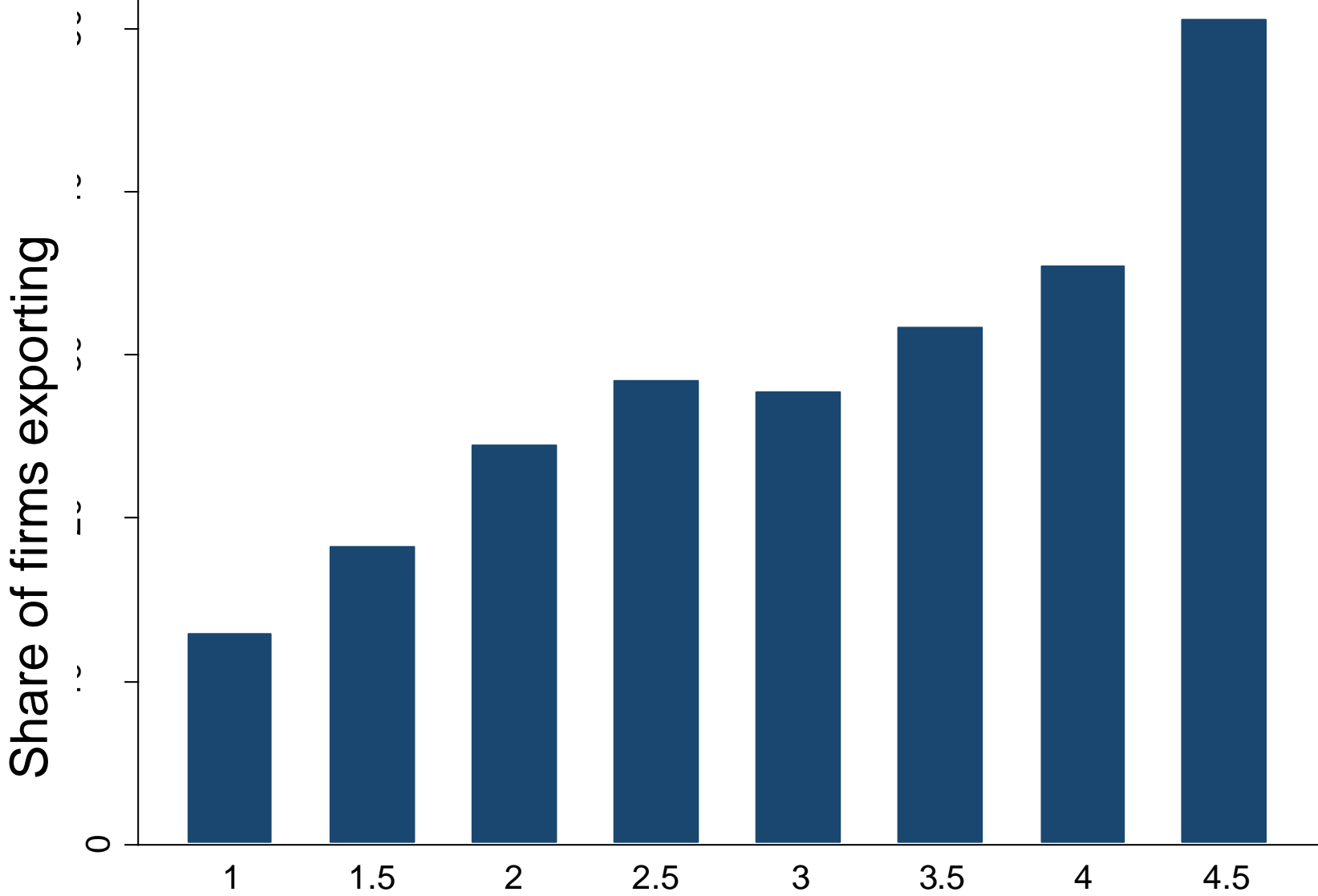
EXTERNAL VALIDATION: PERFORMANCE RESULTS ROBUSTNESS ACROSS COUNTRIES

Performance results robust in all main regions:

- Anglo-Saxon (US, UK, Ireland and Canada)
- Northern Europe (France, Germany, Sweden & Poland)
- Southern Europe (Portugal, Greece and Italy)
- East Asia (China and Japan)
- South America (Brazil)



EXTERNAL VALIDATION: WELL MANAGED FIRMS ARE ALSO MORE LIKELY TO EXPORT



Nick Bloom and ... on the relationship between management practices, firm size, and

Management score (rounded to nearest 0.5)



UNIVERSAL MANAGEMENT VS. CONTINGENT MANAGEMENT: A FALSE DICHOTOMY?

- The 18 Practices highly correlated with each other – some “universal” good management practices?
- But also find some specialization
 - We find also substantial variation in firms relative strengths in “operations” management versus “people” management
 - Firms in high-skilled industries are relatively better as people management
- Suggests some contingency



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EXTENSION 1: WELL MANAGED FIRMS ALSO APPEAR MORE INNOVATIVE

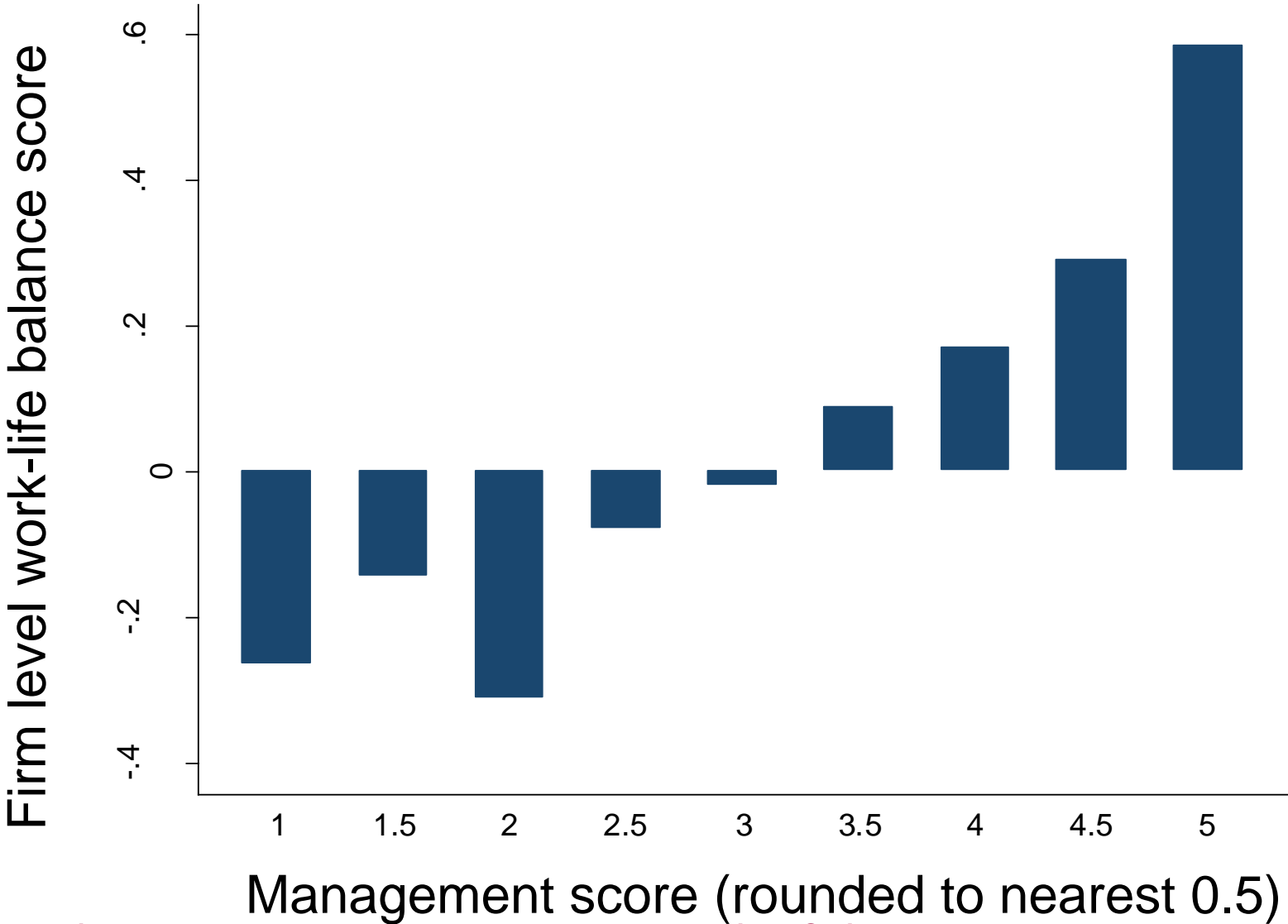


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Note: European firms only as uses the European Patent Office database

EXTENSION 2: WELL MANAGED FIRMS ALSO APPEAR TO TREAT WORKERS BETTER



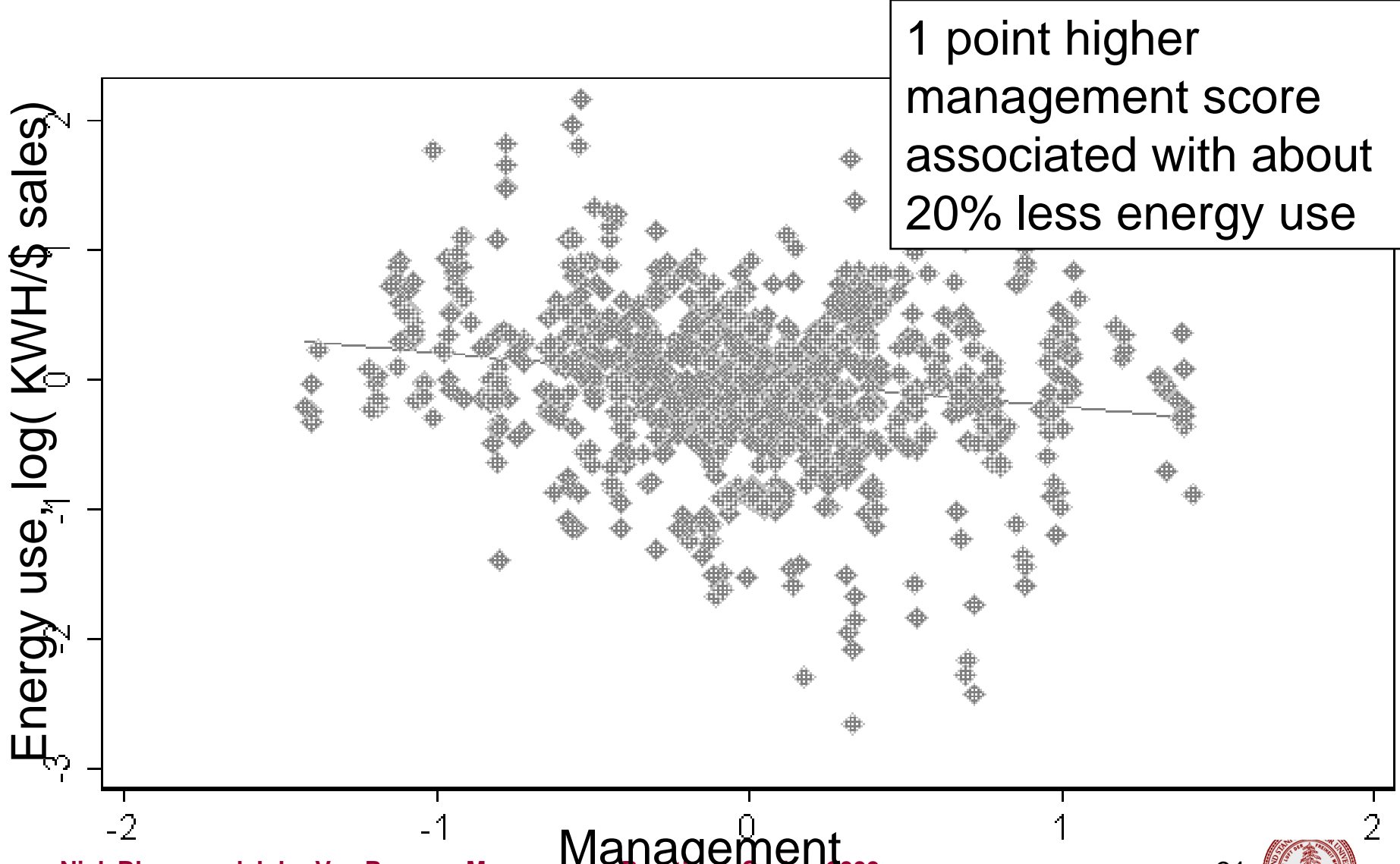
Nick Bloom and John Van Reenen, Management Practices, Spring 2009

Source: Bloom, Kretschmer and Van Reenen, "Work life balance, management practices and productivity", (2009, NBER).

Notes: Data for 468 firms from UK, US, Germany and France surveyed in 2004, when we included WLB questions.



EXTENSION 3: WELL MANAGED FIRMS ALSO APPEAR TO BE MORE ENERGY EFFICIENT

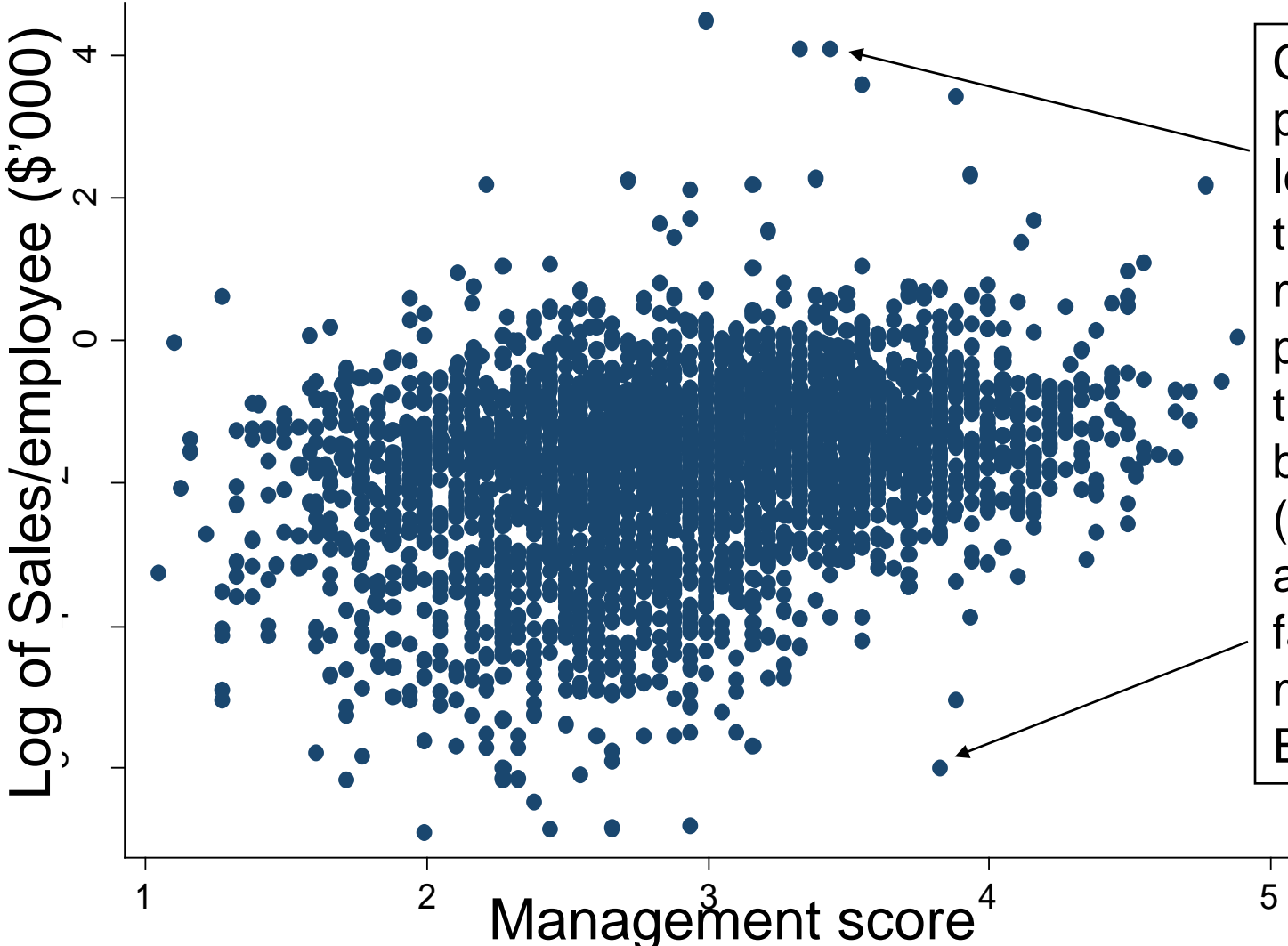


Nick Bloom and John Van Reenen, Management Practices, Spring 2009



Source: Bloom, Genakos, martin and Sadun, NBER WP14394. Analysis uses Census of production data for UK firms

FINALLY, OUR LARGE SAMPLE ILLUSTRATES THE RISKS OF RELYING ONLY ON CASE STUDIES



Case studies provide rich firm-level details, but the variation in management practices means these can easily be misleading (e.g. Enron, was a case-study favorite with many HBS Enron cases)



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Scoring grids

Between the next three classes we will run through the individual practice questions on the grid in detail.

This will be organized into three sections:

- Performance management
- Talent management
- Targets

These all from the management scoring grid out in your binder

In class I would like to discuss each question in detail and get examples from your own experiences



Performance management

Today we will run through 5 dimensions on performance management (questions 1, 3, 4, 5 and 6)

The basic concept is around the collection and use of information within firms.

While the data we have shown is for manufacturing, these questions have been used in retail, healthcare, education and law

In class it would be good to get a wide range of feedback across different industries to illustrate the concepts



(3) Process problem documentation

Score	(1): No, process improvements are made when problems occur.	(3): Improvements are made in one week workshops involving all staff, to improve performance in their area of the plant	(5): Exposing problems in a structured way is integral to individuals' responsibilities and resolution occurs as a part of normal business processes rather than by extraordinary effort/teams
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(4) Performance tracking

Score	(1): Measures tracked do not indicate directly if overall business objectives are being met. Tracking is an ad-hoc process (certain processes aren't tracked at all)	(3): Most key performance indicators are tracked formally. Tracking is overseen by senior management.	(5): Performance is continuously tracked and communicated, both formally and informally, to all staff using a range of visual management tools.
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(5) Performance review

Score	(1): Performance is reviewed infrequently or in an un-meaningful way e.g. only success or failure is noted.	(3): Performance is reviewed periodically with successes and failures identified. Results are communicated to senior management. No clear follow-up plan is adopted.	(5): Performance is continually reviewed, based on indicators tracked. All aspects are followed up ensure continuous improvement. Results are communicated to all staff
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(6) Performance dialogue

Score (1): The right data or information for a constructive discussion is often not present or conversations overly focus on data that is not meaningful. Clear agenda is not known and purpose is not stated explicitly	(3): Review conversations are held with the appropriate data and information present. Objectives of meetings are clear to all participating and a clear agenda is present. Conversations do not, as a matter of course, drive to the root causes of the problems.	(5): Regular review/performance conversations focus on problem solving and addressing root causes. Purpose, agenda and follow-up steps are clear to all. Meetings are an opportunity for constructive feedback and coaching.
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(1) Modern manufacturing, introduction

Score	(1): Other than JIT delivery from suppliers few modern manufacturing techniques have been introduced, (or have been introduced in an ad-hoc manner)	(3): Some aspects of modern manufacturing techniques have been introduced, through informal/isolated change programs	(5): All major aspects of modern manufacturing have been introduced (Just-in-time, automation, flexible manpower, support systems, attitudes and behaviour) in a formal way
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(2) Modern manufacturing, rationale

Score	(1): Modern manufacturing techniques were introduced because others were using them.	(3): Modern manufacturing techniques were introduced to reduce costs	(5): Modern manufacturing techniques were introduced to enable us to meet our business objectives (including costs)
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Summary

Today we covered:

- Measuring management practices
- The basics of performance management

On Thursday we will examine:

- How management practices vary across countries
- The links between management and performance
- The basics of talent management



Backup slides

