in brief...
The value of good management

To what extent does the quality of management matter for a business to be successful? In their latest examination of the relationship between management practices and firms' performance, **John Van Reenen** and colleagues analyse data collected from over 35,000 manufacturing plants in the United States.

Ask any sports fan about their favourite team and they will usually spend half the time either cursing or extolling the manager. The manager is apparently responsible for every loss, and perhaps even the occasional victory.

On the other hand, many people also have an ingrained cynicism about the fads and fashions of management thinking. For example, there's an old saying that 'management consultants borrow your watch to tell you the time', implying that good management is so obvious everyone knows what to do.

The public remains divided over the value of good management. But what do the data tell us? In our research, we've confirmed that management matters – a lot. In fact, it matters as much or more than a number of other factors associated with successful businesses, such as the adoption or generation of new technology.

Large-scale data on management has been virtually non-existent, at least until recently. As Chad Syverson at the University of Chicago wryly noted in his 2011 round-up of the evidence on what drives productivity: 'no potential driver of productivity differences has seen a higher ratio of speculation to actual empirical study' than management.

Of course, there are thousands of case studies and small samples, but it's hard to generalise from these, since the firms they focus on are seldom representative of the broader economy. How confident are we that any of the dozens of breathless articles about Apple, Facebook, General Electric and Google are telling us anything reliable about management in a typical firm?

To address this lack of data on management, we teamed up with colleagues at the US Census Bureau to collect data on a large number of establishments used in American national statistics. Our survey contained 16 management questions in three main areas: monitoring, targets and incentives. We believe these three functions are the core of what business schools and consultancies claim is the essence of good management.

Management quality varies widely, even within a single firm

Our survey was nationally representative but limited to manufacturing, covering small and large firms across every state in the country. With a response rate of almost 80%, it covered plants that account for more than half of all US manufacturing employment, so it is genuinely representative of US management practices. In total, we got data from over 35,000 manufacturing plants in a massive national survey.

So what does the first-ever management survey at this scale tell us?

We find that only one fifth of plants use three quarters or more of the performance-oriented management techniques that we asked about, but that these plants have dramatically better performance than their competitors. The plants that have adopted monitoring and incentives-based management practices are far more productive, innovative and profitable. Every 10% increase in a plant's management index is associated with an impressive 14% increase in labour productivity, meaning higher value added per worker.

It isn't just that already successful firms are more likely to be well run; plants that switch to more performance-oriented practices tend to become significantly more productive, suggesting that better management is driving better performance. Firms with higher management scores are also more likely to expand and less likely to go belly up.

We also compare the impact of management approaches with more traditional explanations of business performance, including research and development (R&D), information technology (IT) expenditures, and workers' skill levels.

We examine differences between plants in the top 10% and the bottom 10% in terms of performance, to see what explains the difference. Management techniques explain 18% of that difference. By contrast, R&D accounts for 17%; employee skills, 11%; and IT spending, 8%. In other words, management matters more than the most common explanations for performance.

Perhaps most surprisingly, we find that management quality varies not just between companies, but also within them. We find that over 40% of the variation in management quality between plants is because of differences across establishments within the very same firm.

In other words, in many large firms, we find some outstandingly managed plants alongside those with mediocre practices. This variation is greatest in the very largest firms, possibly because standardising practices across regions and divisions is particularly hard for the very biggest companies.

What could cause these huge differences in management practices across firms? We find several major factors:

Better management depends on competition, skills and learning from the leading firms

■ First, establishments in more competitive industries and in states where there is less business red tape tend to be better managed.

■ Second, establishments employing more skilled workers and firms located near universities tend to adopt better management practices.

■ Third, when a large new multinational plant is built, this boosts the management quality of firms that are geographically close to the 'million dollar plant'. This is because local companies are able to learn about best practices from these leading firms.

All these factors matter, but they explain less than half of the variation in management techniques, which means that many other factors matter too. Our guess is that individual managers and chief executives themselves are another critical driver – great managers make great management practices.

The bottom line of our research is that management matters a lot for company performance, and with the huge variation we see across firms, this suggests that there are many opportunities to make big performance improvements.

Improving management can be relatively cheap compared with investments in R&D or IT. While our study focuses on US manufacturing, this huge spread of management practices is just as true in other sectors such as retail, education and healthcare, and even more striking in firms in Europe, Asia, South America and Africa – as our previous work with the World Management Survey has shown (http://worldmanagementsurvey.org/).

It turns out that good management is not necessarily so obvious. It's relatively rare and incredibly valuable. It shapes fates of companies, their workers and entire economies – and we need more of it.

This article summarises 'What Drives Differences in Management?' by Nicholas Bloom, Erik Brynjolfsson, Lucia Foster, Ron Jarmin, Megha Patnaik, Itay Saporta-Eksten and John Van Reenen, CEP Discussion Paper No. 1470 (http://cep.lse.ac.uk/pubs/download/dp1470.pdf).

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