Management Practice & Productivity: **Why they matter**

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We have spent the last five years developing, testing and applying a new approach for the robust measurement of a company's management practices, allowing them to be compared directly with real business performance.

This project has examined practices and performance of more than 4,000 medium sized manufacturing operations in Europe, the US and Asia. The findings of the new study support our earlier research: firms across the globe that apply accepted management practices well perform significantly better than those that do not. This suggests that improved management practice is one of the most effective ways for a firm to outperform its peers.

The size and breadth of the latest study - where we increased the number of firms from 700 to over 4,000 - allowed us to gain a deeper understanding of a range of factors that affect a company's management performance. Multinational companies, wherever in the world they operate, tend to outperform local competitors. They are also likely to raise the average performance of domestic firms in the countries where they are most prevalent. In general, the less likely an organization is to make use of professional managers and to appoint its managers on merit, the poorer its performance – with government-owned and primogeniture family firms (those that are family-owned and run by the eldest son or grandson of the founder) bringing up the rear.

The spread of management performance between firms, even those of similar size operating in the same industry sectors in the same regions, is very broad, suggesting that management excellence is a matter of internal policy and not just the business environment. The techniques of good management are well known and in the public domain so the fact that they are so poorly disseminated suggests either that successful implementation is elusive or that it is not a priority for many firms. We also found the managers interviewed had little idea of the overall management performance of their own organizations.

The latest study confirms earlier findings that greater competitive intensity drives improved management practice, while labour market flexibility leads to particularly good people management habits. We have also found that better-managed firms also have a more highly educated workforce, among managers and non managers alike.

For companies, this research is good news, suggesting that they have access to dramatic improvements in performance simply by adopting good practices used elsewhere. For policy makers, it lays down a challenge. The overall performance of most countries is determined not by the performance of its leading companies, but by the size of its 'tail' of poor performers. By developing environments that promote good management practices across all firms and by devoting as much attention to the followers as to the leaders, governments can drive the competitiveness of their entire economies.

Quantifying management practice

When we began this research project in 2001 we believed that the way a firm is managed has a strong effect on its performance. We also believed that this effect might be stronger than many of the other factors that determine whether a business succeeds – national culture, market conditions and regulation for example.

To examine this hypothesis we developed a tool to assess overall management practice and compare it with company performance. Our earlier studies involved more than 700 medium sized manufacturing firms in the US, the UK, France and Germany. These earlier studies did indeed show a strong relationship between management practice and firm productivity and delivered some powerful insights for governments and corporations alike. But they also left many questions unanswered.

In the latest round of research, we have applied the same methodology to more than 4,000 companies in the US, Asia and Europe. We stuck with medium sized firms because it is much more straightforward to investigate the link between plant level management practice, and corporate productivity. We chose manufacturers because of the importance of operational management to overall performance.

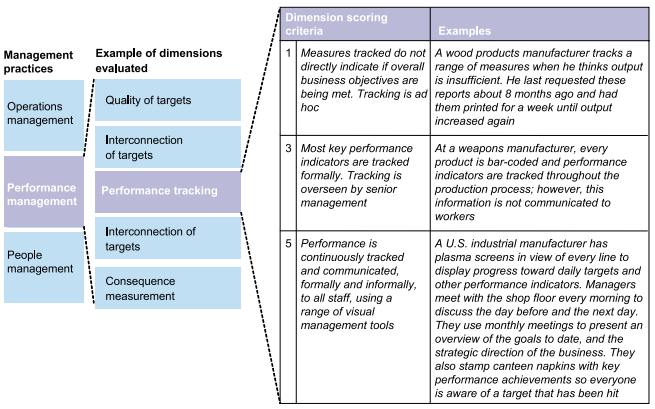
To assess management practice we conducted "double blind" interviews. The plant managers we interviewed did not know our scoring methodology and our interviewers knew nothing about the performance of the organizations they were interviewing.

Our interviews covered 18 topics in three broad areas: shop floor operations; performance management; and talent management. Interviewers gave the firms a score from one to five, depending on how well they performed according to pre-determined scoring criteria for each dimension (Exhibit 1).

After extensive testing this approach has been found to be robust. The results for an individual firm can be reproduced even when both interviewee and interviewer are changed (i.e. by interviewing multiple managers in the same firm using different interviewers). The answers to each question are strongly correlated with superior performance such as productivity, profitability and growth. The questions tend to be cross-correlated implying that, on average, if a firm is good in one dimension of management it tends to be good in all dimensions. The answers to each question give a deeper insight into a company's management performance and better-managed companies show more consistent management scores across all dimensions.

These findings confirm our belief that no single dimension provides the key to improved management performance: there is no magic lever for management excellence. Average score across all 18 dimensions provides the most accurate indicator.

Exhibit 1: To score companies, we used descriptions of poor, average and good practice for each dimension



	Dimension scoring criteria	Examples
1	*Measures tracked do not directly indicate if overall business objectives are being met. Tracking is ad hoc*	*A wood products manufacturer tracks a range of measures when he thinks output is insufficient. He last requested these reports about 8 months ago and had them printed for a week until output increased again*
3	*Most key performance indicators are tracked formally. Tracking is overseen by senior management*	*At a weapons manufacturer, every product is bar-coded and performance indicators are tracked throughout the production process; however, this information is not communicated to workers*
5	*Performance is continuously tracked and communicated, formally and informally, to all staff, using a range of visual management tools*	*A U.S. industrial manufacturer has plasma screens in view of every line to display progress toward daily targets and other performance indicators. Managers meet with the shop floor every morning to discuss the day before and the next day. They use monthly meetings to present an overview of the goals to date, and the strategic direction of the business. They also stamp canteen napkins with key performance achievements so everyone is aware of a target that has been hit*

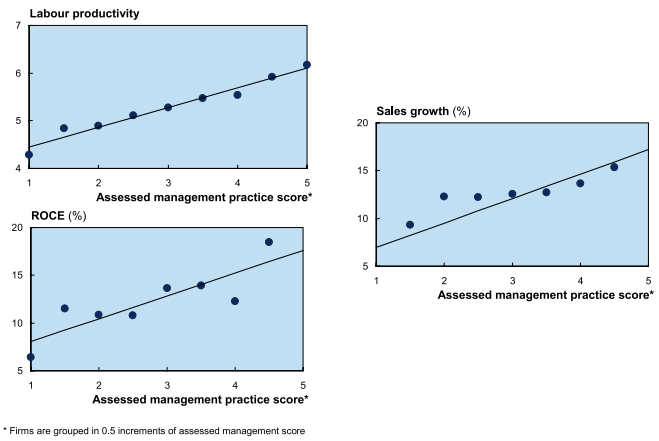
Management matters across the globe

The results of the latest study demonstrate once again that our management practice scoring methodology is a robust metric, closely correlated to a range of corporate performance metrics including labour productivity, sales growth and return on capital employed (Exhibit 2).

Importantly, the latest study represents the first time that the methodology has been applied to firms beyond the UK, US, France and Germany. We found the same strong relationships between management and performance hold true across the different countries and cultures we analyzed (Exhibit 3).

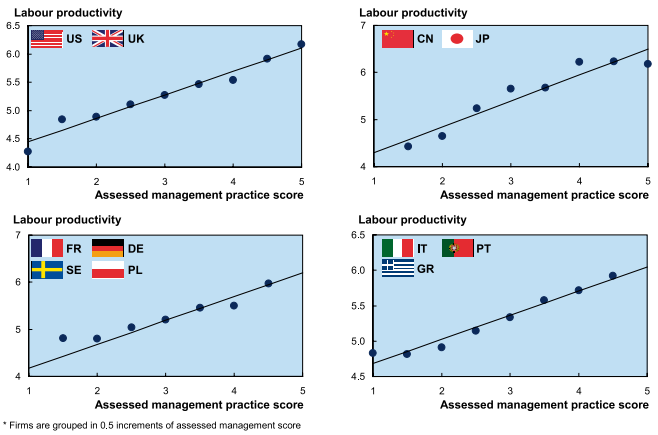
Improving management practice is also associated with large increases in productivity and output. Across all the firms in the research, a single point improvement in management practice score is associated with the same increase in output as a 25 percent increase in the labour force or a 65 percent increase in invested capital (Exhibit 4). We found this observation is true even after controlling for a host of factors like the firm's country, sector and skill level.

Exhibit 2: The assessed management practice score correlates well with a number of financial performance metrics



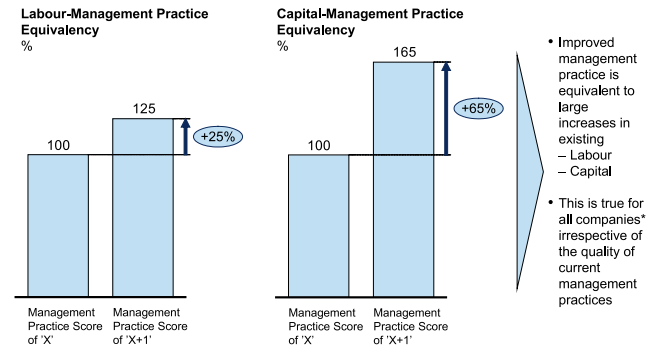
* Firms are grouped in 0.5 increments of assessed management score

Exhibit 3: The link holds true across different countries and cultures



* Firms are grouped in 0.5 increments of assessed management score

Exhibit 4: Output increases associated with improved management practice are large relative to labour and capital investment*



* Controls for country, sector, employees skill and hours worked. Specifications using less controls generate even larger labour and capital increases associated with a 1 point improvement in management

Exhibit 5: Management practices vary much more within than across countries

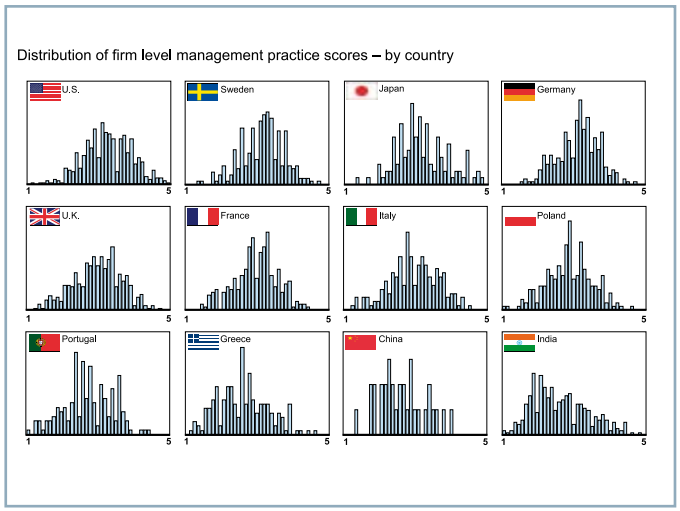
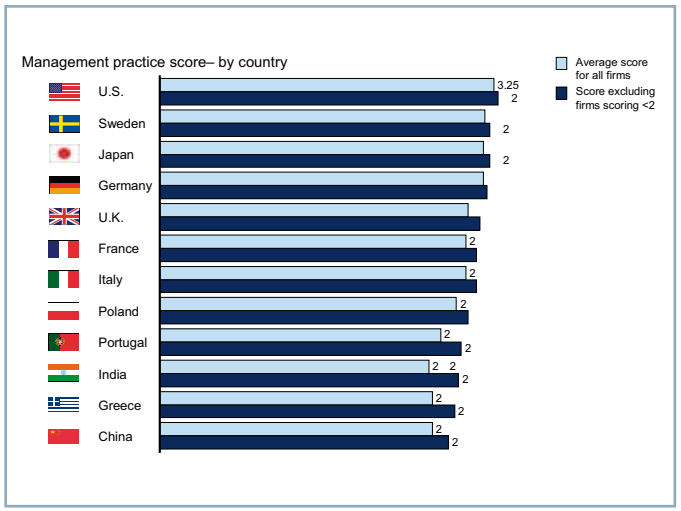


Exhibit 6: Poorly managed firms 'pull down' the average management scores of low performance countries



An issue for companies, not just countries

The latest study did reveal significant differences in management performance between countries. The US is at the top of the table with an average score 3.25, while India brings up the rear with average score 2.62. The US is not entirely dominant, however. US firms score particularly highly for people management (such as promoting and rewarding talented workers quickly), but in shop floor operations management Germany, Japan and Sweden do better, with the UK, Italy and France close behind.

Overall, regional differences accounted for only 9 percent of the difference in management practice. Performance differences between companies in the same country were far larger than any regional variations and there is substantial overlap between regions. The best 20 percent of firms in India, for example, performed better than the average US firm and 75 percent of US firms are worse managed than the top 10 percent of Indian firms.

Importantly, the largest difference between high performing nations and the rest is to be found in the tail of low performing companies. Eliminating the worst managed firms (those with an overall practice score of less than 2) from the sample has little effect on the average score of the leading countries, but it raises the score of low performing countries significantly (Exhibit 6).

Multinational corporations are the best-managed

When the firms in our survey were grouped according to ownership type we found pronounced differences in both management practice score and performance. Multinational companies, particularly US-based multinational companies, performed best, while organizations owned and run by their founders or members of the founder's family performed poorly (Exhibit 7). Worst performing of all were government-owned firms, with an average management score of 2.38.

Scale effects cannot fully account for the improved performance of multinational companies. Although larger firms did tend to perform better in the survey, this effect could account for only a quarter of the difference between multinationals and their domestic rivals.

The spread of performance according to ownership type suggests strongly that a propensity to employ professional managers and to promote them on the basis of merit delivers better managed, better performing firms.

Multinational companies perform well wherever they are in the world, even in areas where overall management practice scores were particularly low. In fact, multinational firms operating in India outperformed all other companies except US multinationals operating on their home turf.

It is not just the multinationals themselves who benefit from their better management practice. Within our sample, we find that the presence of multinationals within a region serves to assist in the transfer of best practice to local firms both, possibly through the migration of employees and knowledge and through commercial interactions between the two groups.

Exhibit 7: Ownership type plays a clear role

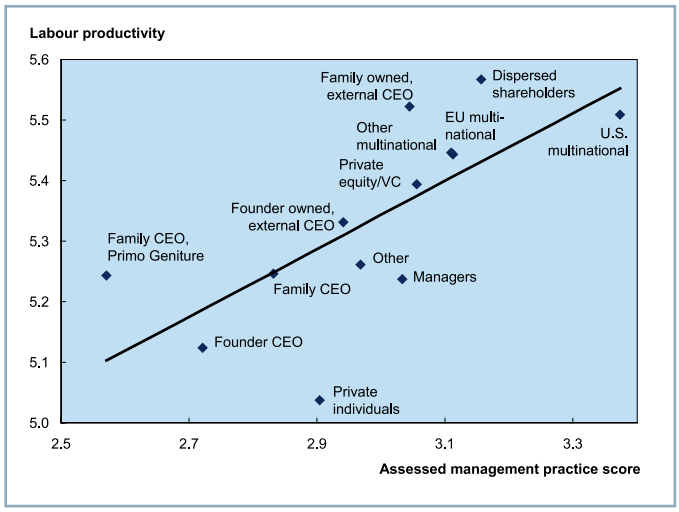
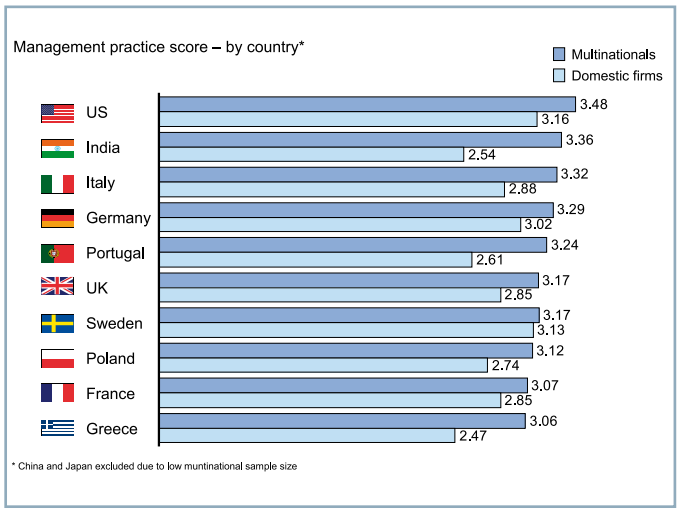


Exhibit 8: Multinationals are well run everywhere



Lack of insight, loss of opportunity

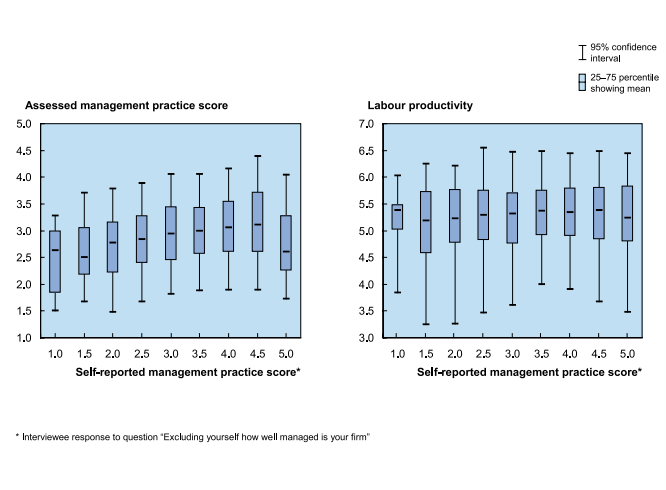
Good management appears to be so strongly linked with good performance that it might be reasonable to expect all firms to make better practices a priority. The techniques of good practice are, after all, available in the public domain in a wide range of easily accessible forms. Yet many firms are still poorly managed.

To examine possible causes of this disconnect, the latest round of research sought to evaluate companies' perception of their own performance. As the final question in the interview, subjects were asked to assess the overall management performance of their firm on a scale of one to five. To avoid false modesty they were asked to exclude their personal performance from the calculation.

Subjects' answers to this question were not well-correlated with either our management practice score, or their own business performance. This situation applied in all regions, and did not change in better or more poorly managed firms (Exhibit 9).

We found this lack of self-awareness striking. It suggests to us that the majority of firms are making no attempt to compare their own management behaviour with accepted practices or even with that of other firms in their sector. As a consequence, many organizations are probably missing out on an opportunity for significant improvement because they simply do not recognize that their own management practices are so poor.

Exhibit 9: Managers are poor at assessing their own performance



Government action could help

A variety of policy factors have an effect on companies' adoption of good management practices. Most significant among these were their competitive environment and the flexibility of the local labour market.

Companies in the survey were asked to estimate the number of competitors operating in their market. The more competitors a company reported, the higher its management practice scores (Exhibit 10). This could be as a result of two effects: 1) good practice spreads quickly in highly competitive environments, and 2) poor practice is eliminated by natural selection as poorer performing companies are removed from the marketplace.

Flexible labour markets should encourage companies to adopt better people management practices in order to attract and retain the best employees. The larger number of countries included in the latest research, with widely different labour market environments, allowed this hypothesis to be explored in depth.

The link proved to be a strong one. Companies operating in countries with more flexible labour polices (measured using the World Bank's measure of employment law rigidity index) scored markedly better in people management practices (Exhibit 11). The US, with its extremely flexible employment laws, had by far the best people management record, a factor which contributed strongly to its overall top position among surveyed companies.

The availability of skilled people, both in management and among the workforce in general, is another important difference between better managed firms and the rest. 84 percent of managers in the highest scoring firms were educated to degree level or higher, as were a quarter of the non-management work force. Among the lowest scoring firms, by contrast, only 54 percent of managers and only 5 percent of the wider workforce had degrees (Exhibit 12).

Exhibit 10: More intense competition is clearly associated with better management practices

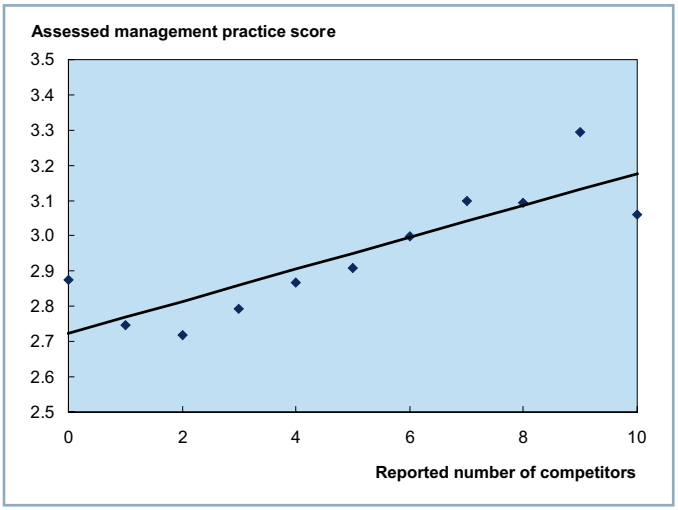


Exhibit 11: Countries with more flexible labour markets have better people management

Exhibit 12: Better management is linked with higher skills

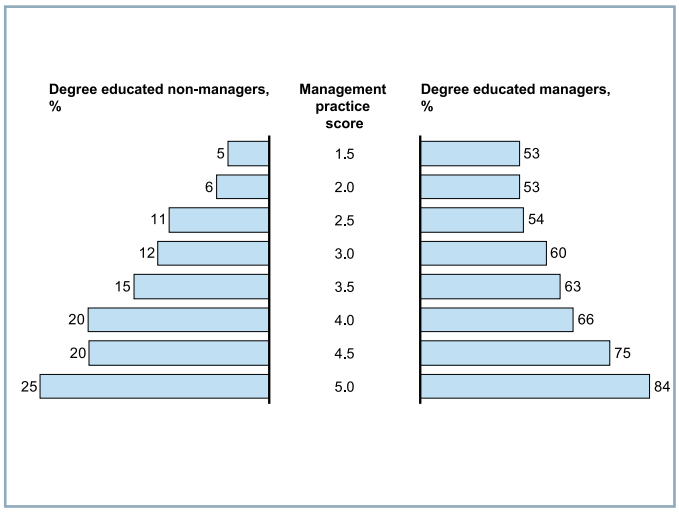
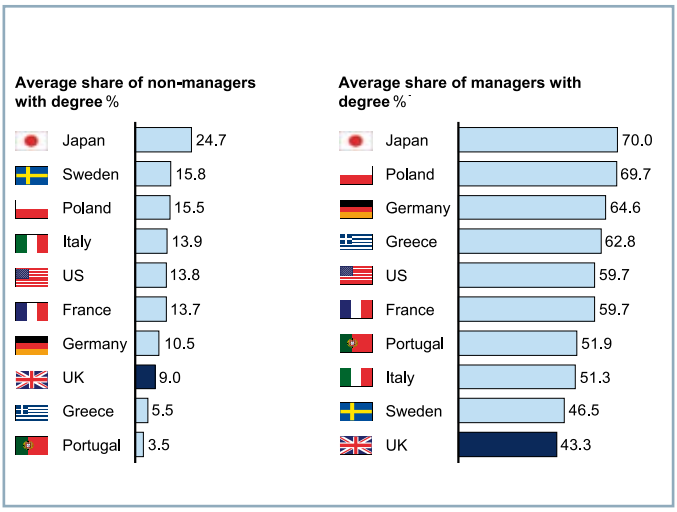


Exhibit 13: One key driver of the UK average management score is its relatively low skill levels



The UK: 2nd division, struggling for promotion

While the UK prides itself in its position as one the world's leading service economies, manufacturing still plays a highly significant role in the region's economy. Over one in ten UK jobs are still provided by the manufacturing sector and the sector accounts for more than half of export revenues.

Low standards of labour productivity remain a concern for UK manufacturers. The country lags behind many of its developed world competitors and, while productivity has improved significantly in recent years, the productivity gap between the UK and the US remains wide.

Can the UK's management practices help to explain its productivity issues? In overall performance, the UK sits in a second tier of companies, with a lower score than the US, Sweden Japan and Germany, but a (slightly) better one than France, Italy and Poland. As with many regions in the survey, it is a tail of low-performers that drives down the UK's overall score.

The UK has one of the most flexible labour markets in the world and its scores for people management practices reflect this, being among the highest of any region in the survey. Its scores for operations management were low, however, indicating that UK manufacturers have been slow to adopt many of the modern production techniques that have been applied with great success elsewhere.

Comparing UK performance in specific dimensions of management delivers other insights. While UK firms are among the best in their approaches to attracting and retaining talented people, they do not rank highly in aspects of individual performance management such as the establishment of effective, well structured targets.

The implication here is that while the UK's flexible labour market (and competition from a thriving service sector) forces firms to work hard to attract good people, they are far less effective at equipping their employees to deliver improved performance and at motivating them to do their best.

Worryingly for UK manufacturers, the strength and desirability of the UK's service sector economy mean that even their good talent retention practices may be failing to deliver the highly skilled workforce the sector needs. While the UK actually performs better in terms of management practice than the education of its manufacturing workforce might predict, the UK is close to the bottom of the league in terms of the educational level of its wider workforce too.

The Takeaway

For companies

Multinational companies have been forced to take a systematic approach to management. Only by having strong, effective management practices in place have they been able to replicate the same standards of performance across different regions, cultures and markets. Today, they are reaping the benefits of this effort in terms of higher productivity, better returns on capital and more robust growth.

The same benefits are easily accessible to other organizations, wherever they operate. Yet surprisingly few firms have made any attempt to gain an insight into the quality of their management behaviours. Those that do so give themselves the opportunity to access rapid, cost-effective and sustainable competitive advantage.

For policymakers

Governments can play their part in encouraging the take-up of good management behaviour. Doing so may be the single most cost-effective way of improving the performance of their economies. Strong competition and flexible labour markets both lead directly to improved management performance. Multinational companies have a strong positive effect too, and their influence is felt throughout the regions in which they operate.

Relentless improvement in educational standards is also essential. Better-managed firms need more highly skilled workers and they make better use of them, while better educated managers will be a key component of the performance transformation that both established and emerging economies must undertake if they are to maintain and improve their global competitive position.

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