

Does Management Really Work?

by Nicholas Bloom, Raffaella Sadun, and John Van Reenen

FROM THE NOVEMBER 2012 ISSUE

HBR's 90th anniversary seems like a good time to back up and ask a basic question: Are organizations more likely to succeed if they adopt good management practices? For a decade we've been conducting research to find out. That may seem like a foolish endeavor—isn't the obvious answer yes? But as classically trained economists, we believe in reexamining long-held assumptions to see whether they stand the test of time.

At least since Frederick Winslow Taylor published *The Principles of Scientific Management* in 1911, businesses have been trying to follow formalized sets of best practices. Academic disciplines such as complexity and contingency theory have sprung up, as have numerous practical innovations, from decentralized budgets to performance reviews to lean manufacturing. To formulate a testable hypothesis for our research effort, we asked whether or not the thousands of organizations we studied adhere to three practices that are generally considered to be the essential elements of good management:

- **Targets:** Does the organization support long-term goals with tough but achievable short-term performance benchmarks?
- **Incentives:** Does the organization reward high performers with promotions and bonuses while retraining or moving underperformers?
- **Monitoring:** Does the organization rigorously collect and analyze performance data to

identify opportunities for improvement?

Our teams of researchers asked managers a targeted list of open-ended questions, designed to ferret out details about how their companies were—or were not—implementing these practices. Overall, we learned three things. First, according to our criteria, many organizations throughout the world are very badly managed. Well-run companies set stretch targets on productivity and other parameters, base the compensation and promotions they offer on meeting those targets, and constantly measure results—but many firms do none of those things. Second, our indicators of better management and superior performance are strongly correlated with measures such as productivity, return on capital employed, and firm survival. Indeed, a one-point increment in a five-point management score that we created—the equivalent of going from the bottom third to the top third of the group—was associated with 23% greater productivity. (See the exhibit “The Return on Good Management.”) Third, management makes a difference in shaping national performance. Our analysis shows, for example, that variation in management accounts for nearly a quarter of the roughly 30% productivity gap between the U.S. and Europe.

The Return on Good Management

A one-point increment on a five-point management score correlated with better performance at manufacturers around the globe. The score was based on how well the firms adhered to three basic management practices: targets, incentives, and monitoring.

Having established that good management can yield practical improvements, we turned to a tougher question: Can these simple principles be applied to complex worldwide problems, including deficiencies in education and health care? A huge question, obviously. To approach it, we did what we had done with manufacturers: We looked at whether or not schools and hospitals showed a correlation between performance and implementation of the three basic management principles. On the basis of interviews conducted in local managers’ own languages, we found that effective management can indeed improve performance, even beyond the private sector.

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POINT INCREMENT ON A
MANAGEMENT SCORE
WAS ASSOCIATED WITH

+23%
PRODUCTIVITY

+14%
MARKET CAPITALIZATION

+1.4 PERCENTAGE
POINTS
ANNUAL SALES GROWTH

Transforming Manufacturers

When we began assessing management practices, we focused on medium-sized manufacturers, both independent and multinational-owned companies that had 50 to 5,000 workers. With more than 100 researchers accumulating data since 2004, our sample has come to include more than 8,000 firms in 20 countries in the developed and developing worlds.

Examples of bad management were all too easy to find. A manager at a privately held manufacturer in France, with about 500 workers, was hamstrung by his firm's inability to motivate apathetic employees. Union pressure and labor regulations meant that workers effectively had jobs for life. The

only way he could balance his production line was to team up poor employees with star performers, but this practice prevented stars from earning team bonuses and eventually drove them out of the company. He said his firm was turning into an asylum for the chronically lazy. At another company, the bonus scheme for managers was so complex that it was nearly useless. There were more than 20 targets—including profit margins, sales growth, inventory turns, and employee turnover—with many measured over different time periods and weighted inconsistently. Managers told us that they ignored the targets and felt unmotivated by “seemingly random” annual bonuses.

Using a business-assessment tool we developed with McKinsey partners John Dowdy and Stephen Dorgan, we looked closely at 18 practices that fall into the three broad categories: targets, incentives, and monitoring. (See the sidebar “What to Ask Your Managers.”) After interviewing managers by telephone, we rated each plant's implementation of each practice on our five-point scale and determined an average overall score for each organization. Low management scores abounded. Only 15% of U.S. companies—and fewer

than 5% outside the U.S.—scored above a four. More than 30% of U.S. firms and more than 70% in Brazil, China, and India scored a three or lower. These firms fail to collect even the most basic performance data and offer few employee incentives.

What to Ask Your Managers

Interviews with plant managers at more than 8,000 manufacturers in 20 countries revealed what management practices are actually being used on the front lines. Here is a small sampling of interview topics and related questions. For more detail, go to worldmanagementsurvey.org.

Interconnection of Targets

How are goals cascaded down to the individual workers?

Clarity and Comparability of Goals

Does anyone complain that the targets are too complex?

Consequence Management

How do you deal with repeated failures in a specific business segment?

Instilling a Talent Mind-Set

How do senior managers show that attracting and developing talent is a top priority?

Removing Poor Performers

How long is underperformance tolerated?

Unique Employee-Value Proposition

What makes it distinctive to work at your company?

In a related initiative, we partnered with the World Bank to offer 66 manufacturers in the textile-hub city of Tarapur, India, the opportunity to participate in an experiment involving management practices. Twenty-eight plants (at 17 firms) accepted the invitation, and we randomly assigned them to either an intervention group or a control group. The 14 plants in the intervention group got free, high-quality advice from a consultant who was on site half-time for five months to diagnose problems, teach managers, and implement practices. The advice focused on the basics of lean manufacturing—nothing cutting-edge or sophisticated. Essentially, the companies were taught the three aforementioned fundamentals: setting targets, establishing incentives, and monitoring performance. For follow-up, all 28 factories were visited one day each month for more than a year.

When we started, facilities were often dirty and unproductive. Many workers received \$5 a day for brutal 12-hour shifts, and accidents were common. At one textile plant, we heard that a worker had broken his leg when a faulty restraining strap allowed a beam to fall off a trolley. With no sick pay, he and his

Retaining Talent

What does the company do about a star performer who wants to leave?

Continuous Improvement

How do problems typically get exposed and fixed?

Performance Tracking

What key indicators do you use for performance tracking?

Performance Dialogue

For a given problem, how do you identify the root cause?

family experienced severe financial hardship. Even though wages were low, the company's profits were meager. It was common for companies in the area to default on their loans and go out of business.

The intervention transformed the plants that had received help. On average, they cut defects by more than 50%, reduced inventory by 20%, and raised output by 10%. They also became far easier for their CEOs to manage, which allowed for the addition of new facilities and the expansion of product lines. Productivity at the factory where the worker had broken his leg increased by

almost 20%, and average profits rose by what we estimate to be roughly 30% (profit is often a closely guarded secret at these companies). That company is opening a second factory and hiring 100 more weavers, after attracting them away from rival firms with the promise of 10% higher pay. Safety also improved: For example, daily monitoring of cleanliness at the factory avoided the buildup of oil and cotton waste around weaving machines, thereby preventing life-threatening fires.

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Beyond the Factory Floor

Having seen the effect on manufacturing operations, we expanded our research to other kinds of organizations. So far we have conducted interviews at 1,000 schools in the U.S., UK, Germany, Italy, Sweden, and India, and at 1,300 hospitals in those countries and in

France, ranking each of the organizations in much the same way as we ranked the manufacturers.

Our management scores showed that, overall, schools and hospitals are even more poorly managed than manufacturing companies. In one illustrative example, a nurse in the UK told us that her hospital didn't store bed linens on each floor, despite the obvious advantages of such a policy. One evening, when she was overseeing a ward, she went to a different floor to get new linens for a patient; upon returning, she found that another patient had died from a seizure. With no process for monitoring or correcting problems like this, the linens policy persisted two years later.

The public sector is also strikingly bad at rewarding good employees and dealing with underperformers. One U.S. high school principal confided to us about a teacher who spoke so quietly that her pupils struggled to hear her. According to the principal, grades were often poor, and parents complained if their kids were seated at the back of the class. The principal had repeatedly offered training to help the teacher, to no avail. Removing the individual was impossible under union rules, so the poor teaching continued year after year.

Of course, some educational organizations regularly evaluate pupils and teachers against clear goals and provide appropriate incentives. Similarly, many health care institutions establish targets for various kinds of processes, such as order entry and error reduction, and compensate employees on the basis of rigorous monitoring. Comparing management practices with outcomes, we found that high-scoring schools have better exam results: A one-point improvement in the management score is associated with about a 10% jump in student test performance. Similarly, at hospitals, a one-point management-score increase is associated with a 0.5% lower 30-day mortality rate for heart attack victims who are admitted to emergency rooms.

We didn't conduct interventions in the schools and hospitals we studied, but other researchers have. For example, Harvard's Roland Fryer ran management experiments in schools in Houston, Texas. In one study, nine schools in the city's worst-performing district adopted simple techniques such as collecting and analyzing weekly grading data—a

surprisingly uncommon practice—so that teachers could rapidly assist underperforming students. Target measures such as math grades, attendance, and graduation rates soared past those of a control group of schools that stuck to their old ways, and the percentage of failing students dropped by more than 70%. Monetary incentives for teachers have been successful at increasing achievement in developing countries such as India and Kenya (results in the U.S. have been more mixed).

The example of Virginia Mason Medical Center, in Seattle, illustrates what can happen when a health care organization makes a concerted effort to improve management practices. In 2002 it introduced procedures, such as extensive performance monitoring and weekly team meetings, inspired by the Toyota Production System. These changes dramatically improved patient care. In the breast clinic, for example, the average elapsed time between a patient's first call and a diagnosis dropped from three weeks to three days. The changes also bolstered employee morale and returned the hospital to profitability after years of losses.

Raising Consciousness

At the companies in Tarapur where we conducted interventions, we easily made a convincing case for the value of good management. But the need to spread the word to the thousands of other underperforming companies, schools, and hospitals worldwide is urgent. Awareness is very low: 79% of the organizations in our study claimed to have above-average management practices, yet no correlation existed between our scores and the institutions' self-scores, either in management practices or in overall performance.

Much of the opportunity for improvement is in the hands of local managers. To see how far behind their organizations are, they must rigorously evaluate their own practices and compare themselves with others'. Managers can quickly benchmark themselves by country and industry on our management scoring grid at worldmanagementsurvey.org.

Awareness is only the beginning, of course. Having seen where they need to improve, managers should begin working toward slow but steady progress. We've seen organizations make a good start by identifying which processes they need to change (for example, is product development too slow?) and then devising metrics for monitoring

progress over the short and long terms. Ideally, goals should be visible to everyone—one company we studied posted its goals on the CEO's door—and should be translated into companywide, group, and individual targets that are tracked frequently and meaningfully. That approach helps companies replace finger-pointing with timely, effective action plans across all organizational functions.

But you shouldn't expect immediate results. GE, McDonald's, Nike, and Toyota didn't become top performers overnight. They established well-focused targets and powerful incentives, and they continuously monitored performance for many years, always seeking to improve. Small changes can be very effective in driving larger shifts later. In the Indian textile factories we studied, for example, we typically overcame resistance to lean manufacturing by piloting changes on a few machines in one corner of the factory. The positive results then opened the way for overhauling the whole plant.

In many instances, poor management is reinforced by national policies such as production quotas and tariff barriers, which reduce competition. In India, for example, hefty tariffs keep low-cost Chinese textiles out of the market and shelter domestic firms from international competition. Governments can play a positive role by reducing subsidies for certain sectors, eliminating tax breaks for favored companies, and lowering barriers to trade.

In education and health care, better management practices usually take especially long to have transformational effects. After Mastery Charter Schools took over three middle schools in Philadelphia, for instance, test scores increased by 50% and violence declined by 80% over three years. And Virginia Mason's CEO Gary Kaplan and his management team spent several years turning around that health center's performance. Teams of managers and frontline workers traveled to Japan to study the Toyota Production System; when they returned, they worked with other staff people to transform patient care. Another question we addressed in our research is why some organizations are motivated to change and others aren't. We eventually found a pattern: Leaders often initiate transformations in response to extremely challenging conditions. For example, because of its location in a seismically active zone, Virginia Mason had to upgrade its outdated buildings to make them safe against earthquakes. Facing huge costs for this overhaul, the hospital's leaders

realized they needed to turn their losses into profits. That initiative, combined with managers' desire to improve the hospital's delivery of health care, led Virginia Mason to embark on the management initiatives that transformed the organization.

The recent global recession is just that kind of extreme challenge. It has generated tough conditions that will undoubtedly spur at least some companies, schools, and hospitals to examine and overhaul their management practices. A call for "better management" may sound prosaic, but given the potential effect on incomes, productivity, and delivery of critically needed services worldwide, it's actually quite radical.

A version of this article appeared in the November 2012 issue of *Harvard Business Review*.



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