

***Management matters: Skills,
management practices and firm
performance***

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Centre for Economic Performance
2012**

**Presentation for Skills mismatch and firm dynamics:
Integrating skills with the world of work
Expert Workshop
27 April 2012**

AGENDA

- **Context : Productivity and management**

- Measuring management practices
- Describing management and the UK position
- Explaining differences in management: Key drivers
- Key considerations and policy implications

WHAT COULD CAUSE OF THESE PRODUCTIVITY GAPS?

Despite the importance of productivity, our understanding of what causes productivity differences is poor:

- Even after controlling for human and physical capital, there is a large “unexplained residual” in productivity across firms, both between countries and within countries

WHAT DRIVES THESE GAPS?

TECHNOLOGICAL INNOVATION?

Partially correct

But problem is not just “hard” technologies: There are also problems with the way firms are managed

MANAGEMENT AS AN EXPLANATION FOR THESE PRODUCTIVITY GAPS

Technologies global - so why do some countries/firms not utilise these?

- Large variation in productivity between firms as well as countries
- Why do others lag?

Could this be in part because of differences in management?

- But how to quantify and compare across firms and countries?

Historically there has been no international management data

Our approach  **Role of management practices**

Almost a decade Centre for Economic Performance & McKinsey research agenda which measures and explain management practices across the globe

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ASSESSING MANAGEMENT PRACTICE

Scoring management practice

- Created a robust assessment tool to score management of operations, people and performance

Setting the sampling frame

- 9,000 + medium sized* manufacturers across the US, Asia, Europe Latin America and Australia
 - 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 >50 MBA/ PhD trained interviewers with business experience

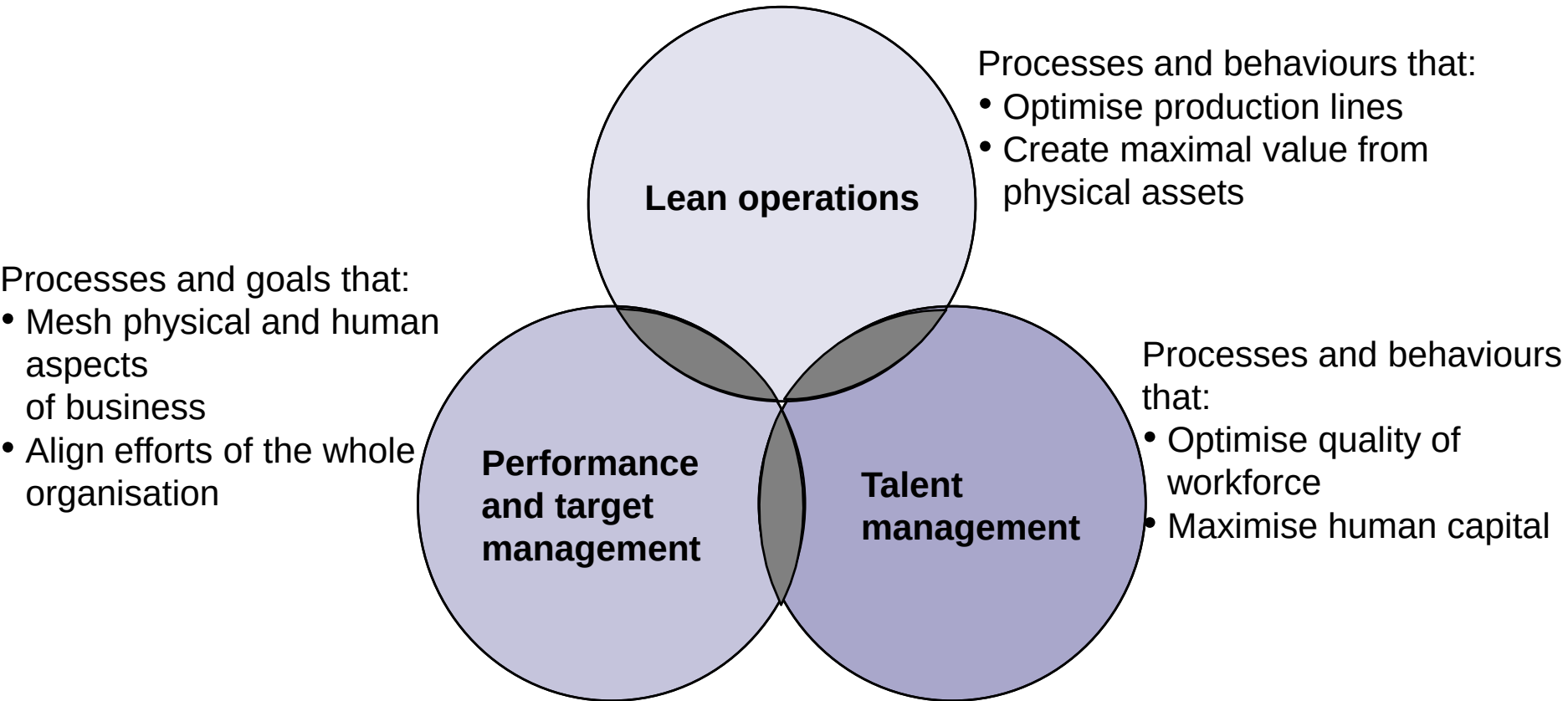
Getting firms to participate

- Obtained Central Bank, Ministry and Employer Association endorsements
- Managers ensured confidentiality

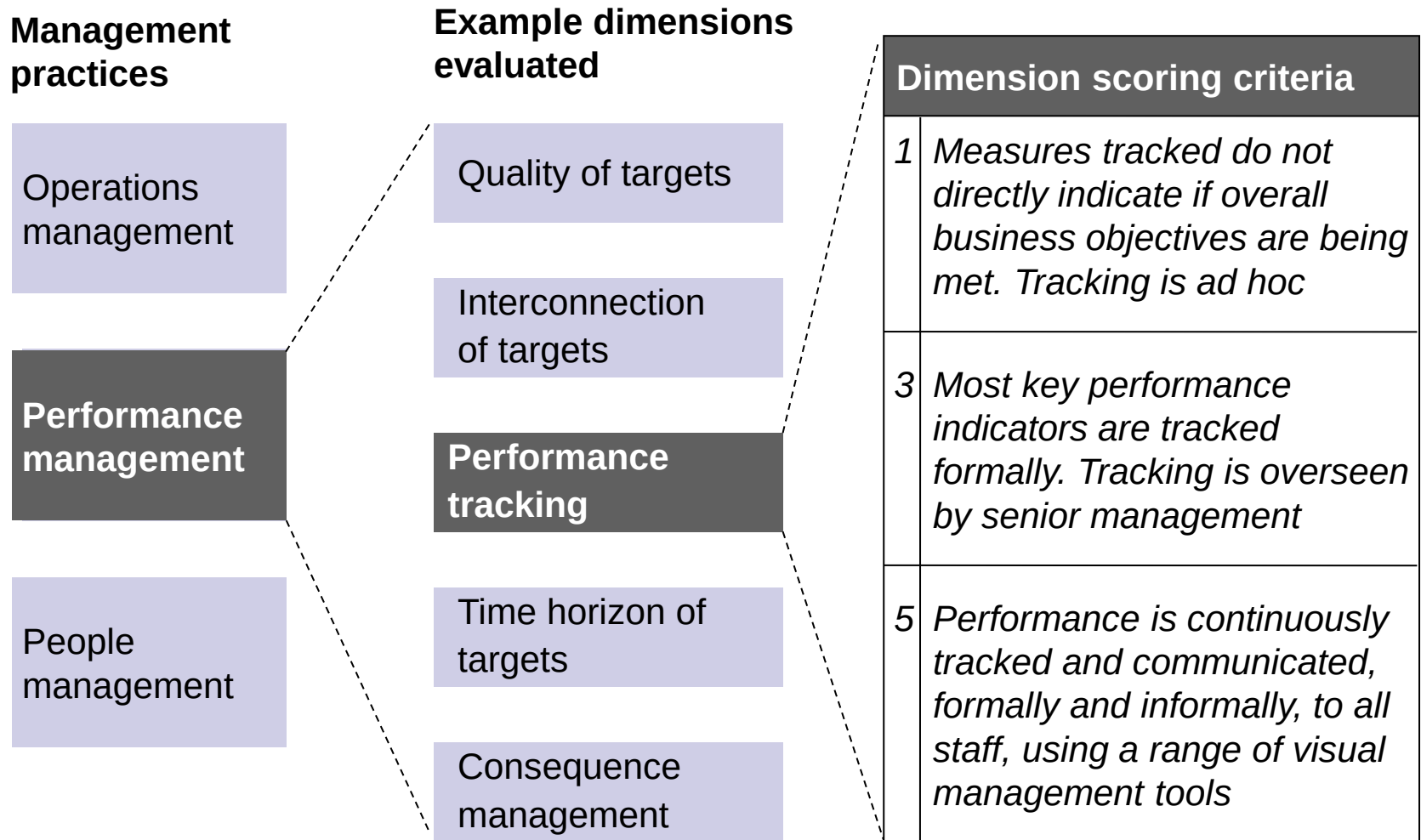
* Median ~250 employees

INTERVIEW METHOD FOCUSES ON MAIN AREAS OF MANAGEMENT

Interviews of about 45 minutes were conducted to examine managerial practices in three main areas of management



TO SCORE COMPANIES, WE USED DESCRIPTIONS OF POOR, AVERAGE AND BEST PRACTICE FOR EACH DIMENSION



TO GENERATE THE OVERALL MANAGEMENT SCORE, WE TOOK THE AVERAGE OF ALL 18 DIMENSIONS MEASURED

Lean shop-floor operations

Dimensions

1. Introduction of lean manufacturing
2. Degree of lean principles used
3. Documentation and improvement of processes
4. Performance tracking
5. ...

Score

- 2
- 3
- 2
- 3
- 4

Performance and target management

7. Consequence management
8. Quality of targets
9. Target stretch
10. Clarity of goals and measurement
11. ...

- 3
- 2
- 3
- 3

Talent management

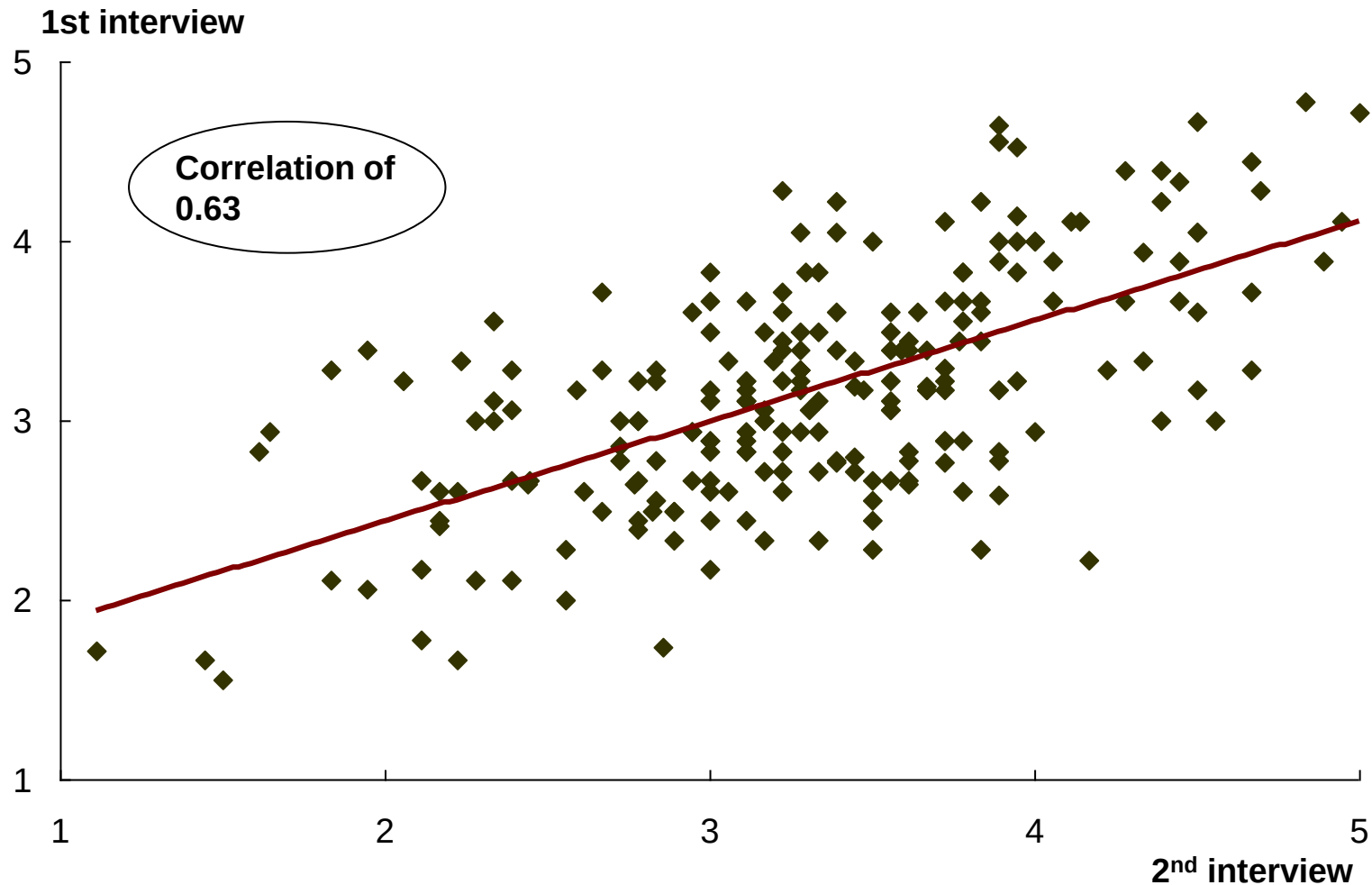
13. Importance of human capital
14. Reward of high performers
15. Rewarding poor performers
16. Promoting high performers
17. ...

- 3
- 4
- 3
- 4
- 5

Overall management score, on scale of 1–5, is calculated from average of all 18 dimensions

FURTHER INTERNAL VALIDATION SUGGESTS THAT OUR ASSESSED MANAGEMENT PRACTICE SCORE IS INFORMATIVE

Assessed management practice score*

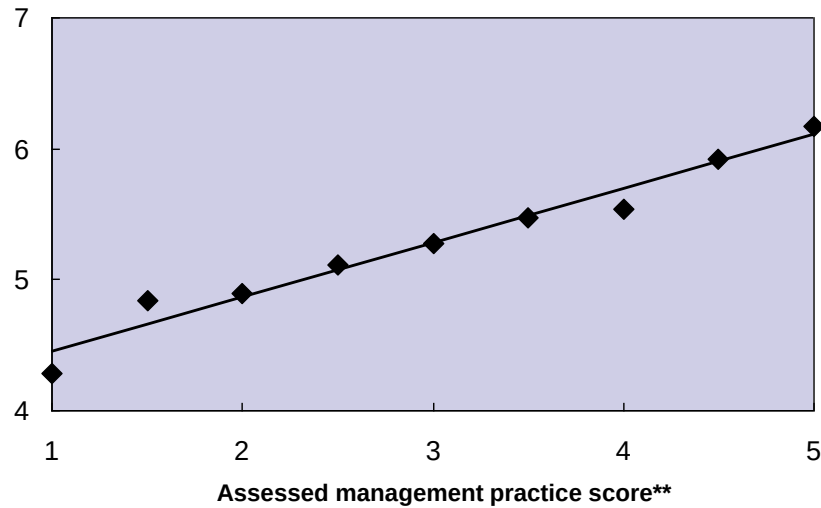


* 222 firms interviewed by 2 different interviewers, interviewing 2 different managers
Source: Data collected from interviews as of September 2008; team analysis

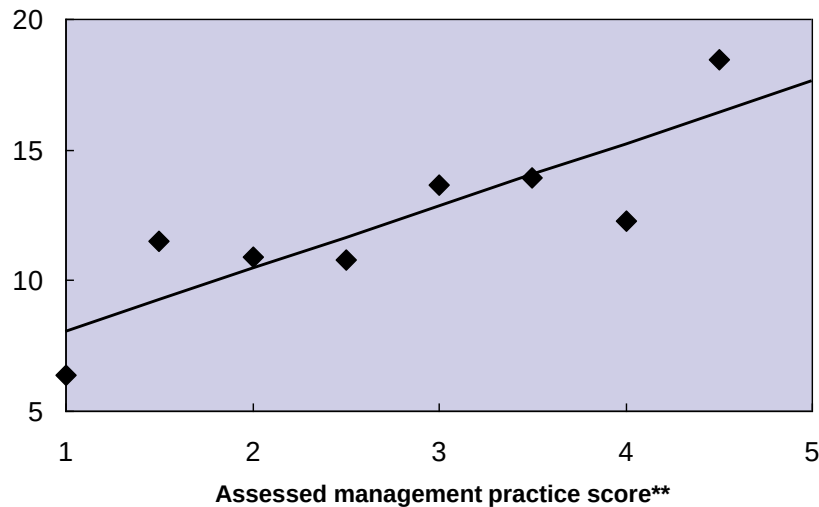
Homkes, Centre for Economic Performance 2011 9

THE ASSESSED MANAGEMENT PRACTICE SCORE CORRELATES WELL WITH A NUMBER OF FINANCIAL PERFORMANCE METRICS

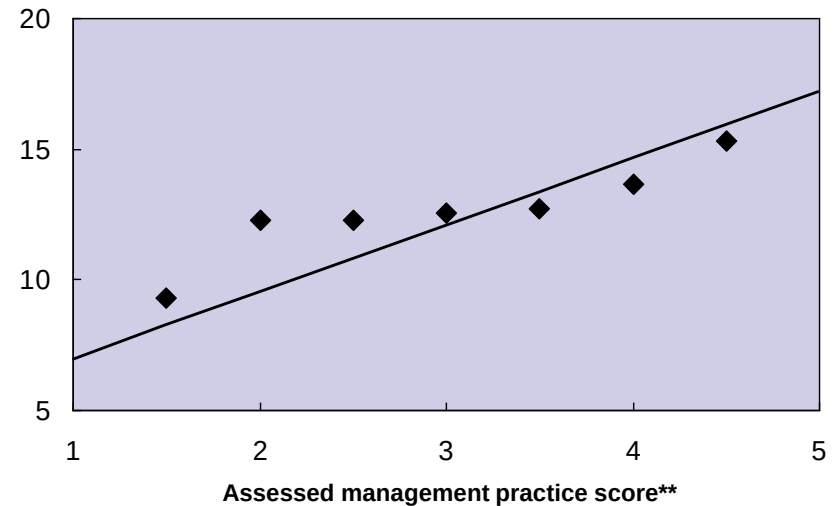
Labour productivity*



ROCE (%)



Sales growth (%)

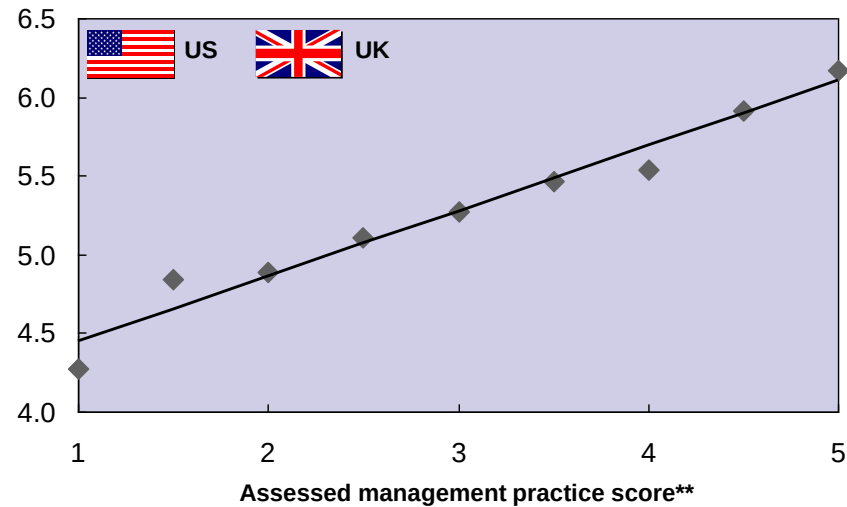


* Log scale

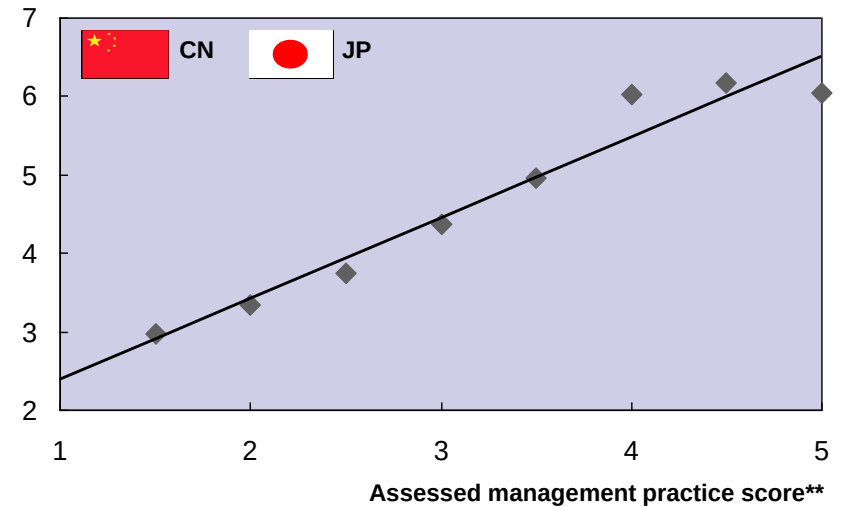
** Firms are grouped in 0.5 increments of assessed management score

THIS LINK HOLDS TRUE ACROSS DIFFERENT COUNTRIES AND CULTURES

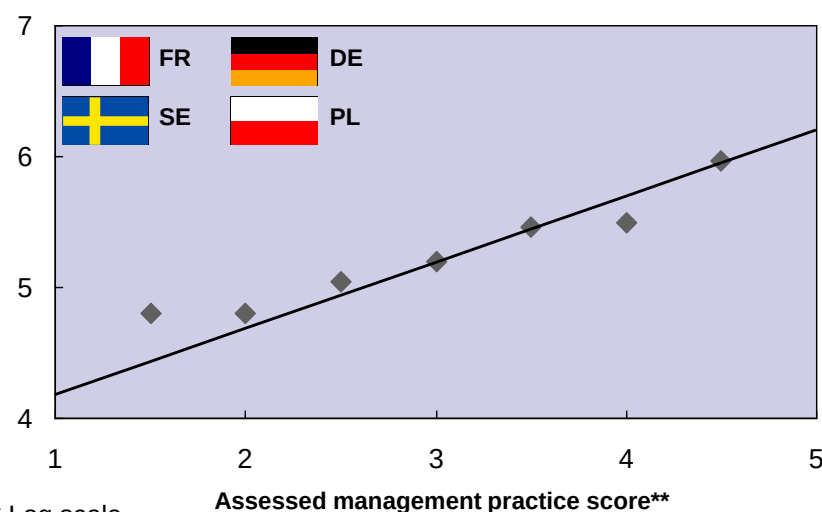
Labour productivity*



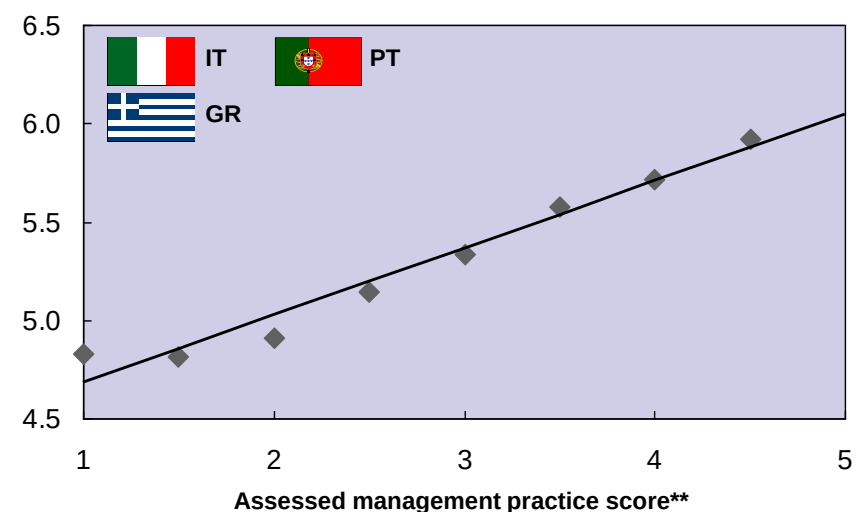
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Labour productivity*



Labour productivity*



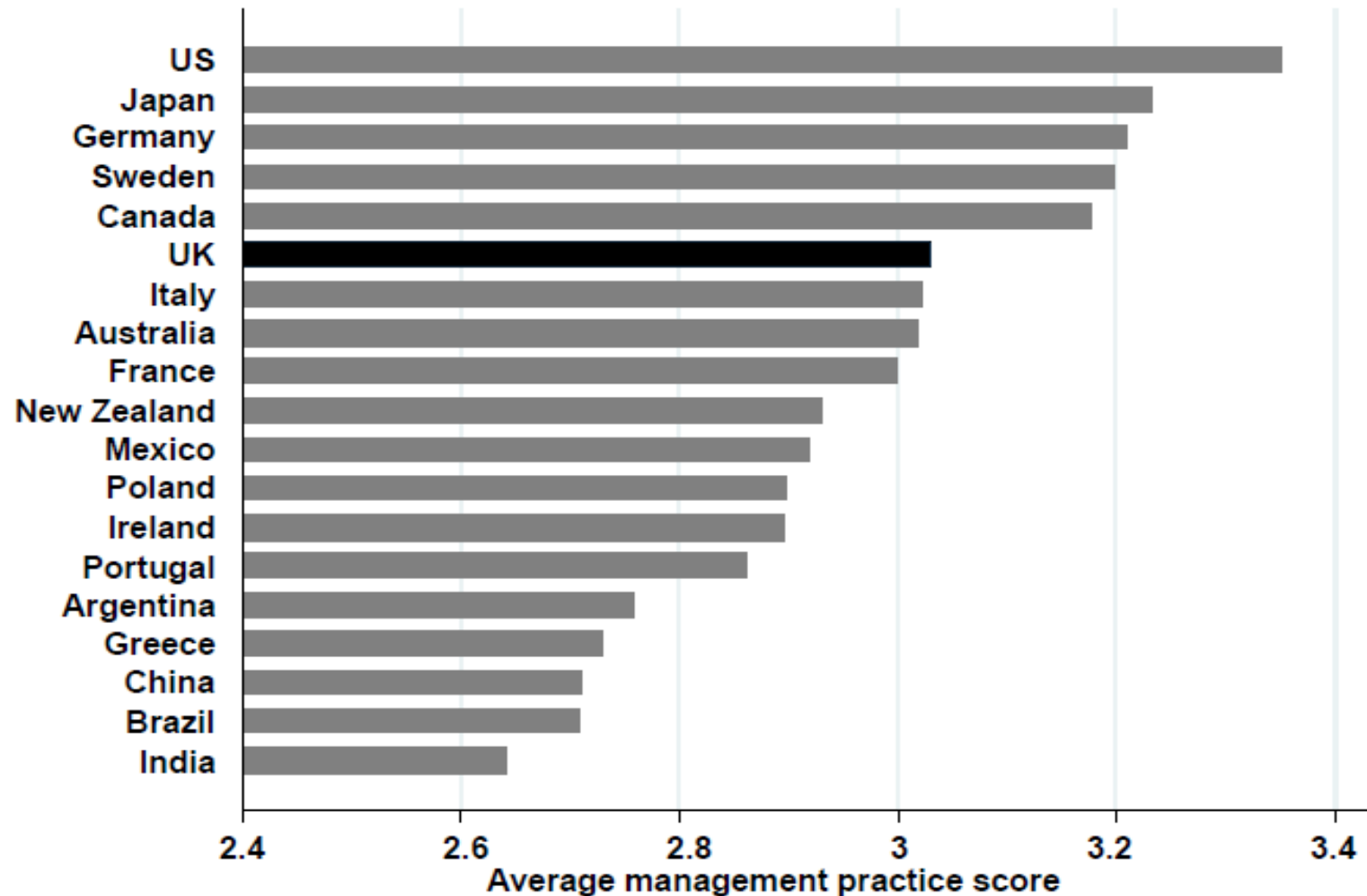
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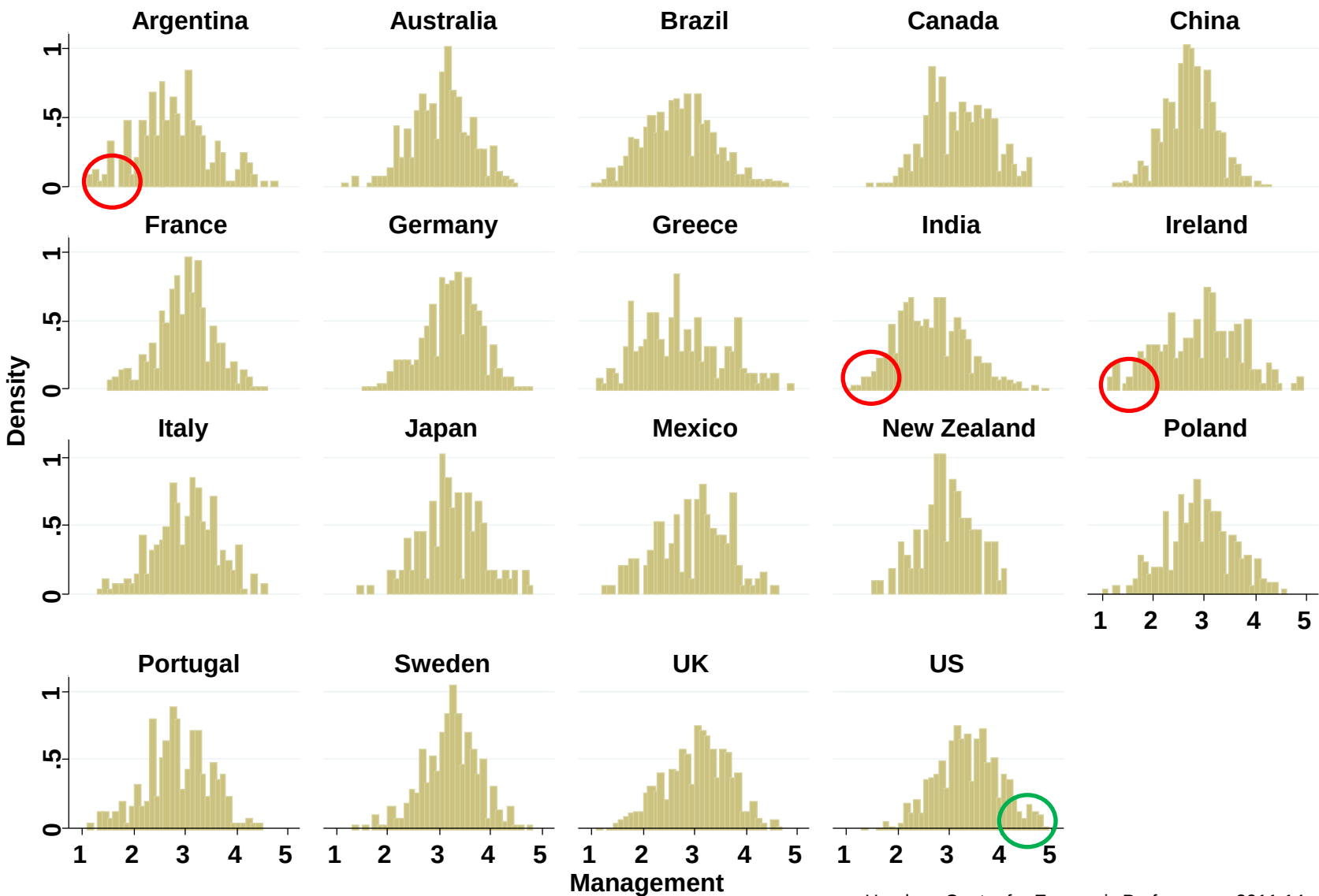
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- **Describing management and the UK position**
- Explaining differences in management: Key drivers
- Key considerations and policy implications

MANAGEMENT PRACTICES VARY ACROSS COUNTRIES, BUT STRONGLY LINKED TO DEVELOPMENT



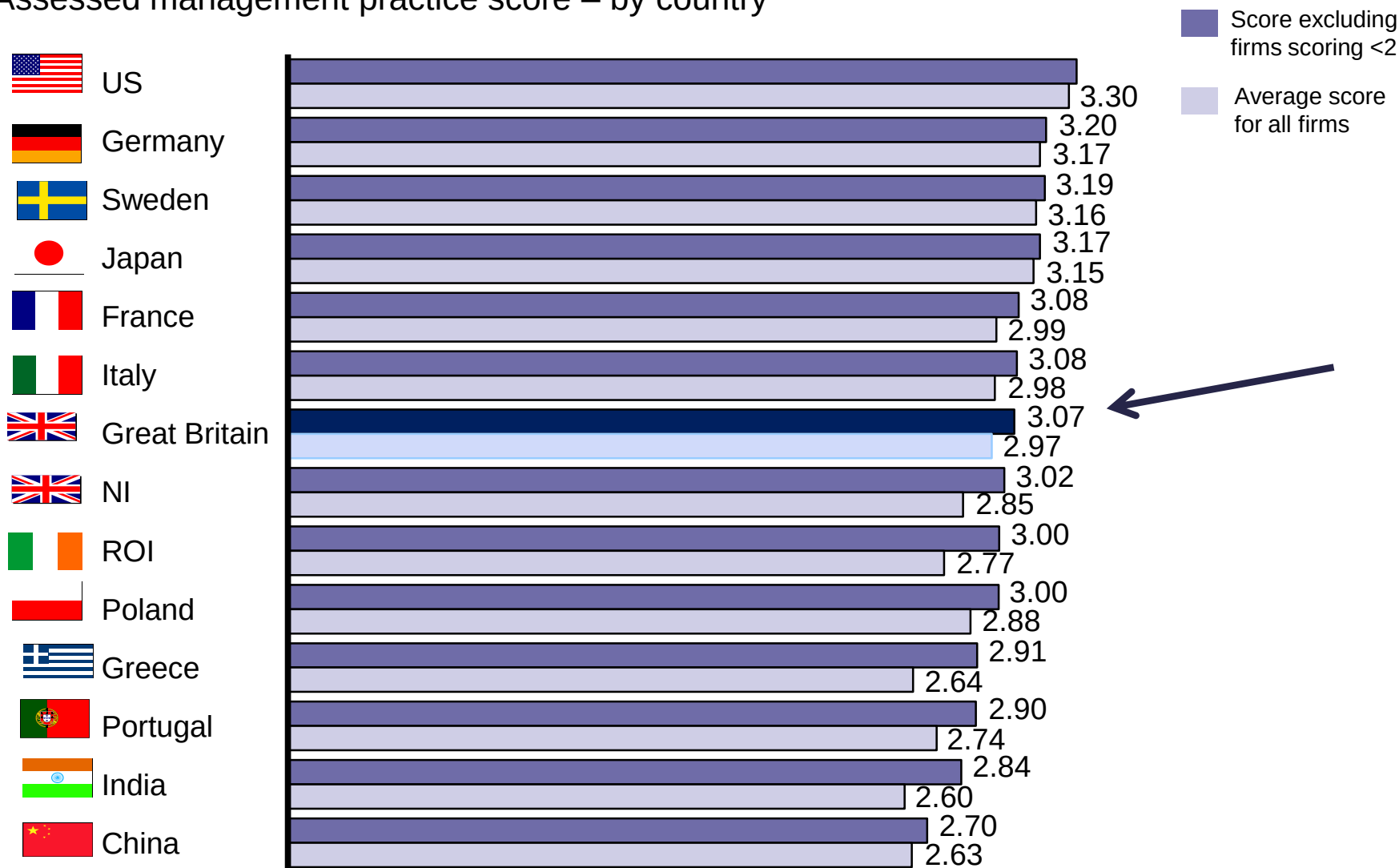
Note: Based on 8,261 management interviews between 2006 and 2010. We pool across multiple survey waves to maximize the extent of cross-country management comparison

BUT MANAGEMENT PRACTICES VARY MUCH MORE WITHIN THAN ACROSS COUNTRIES

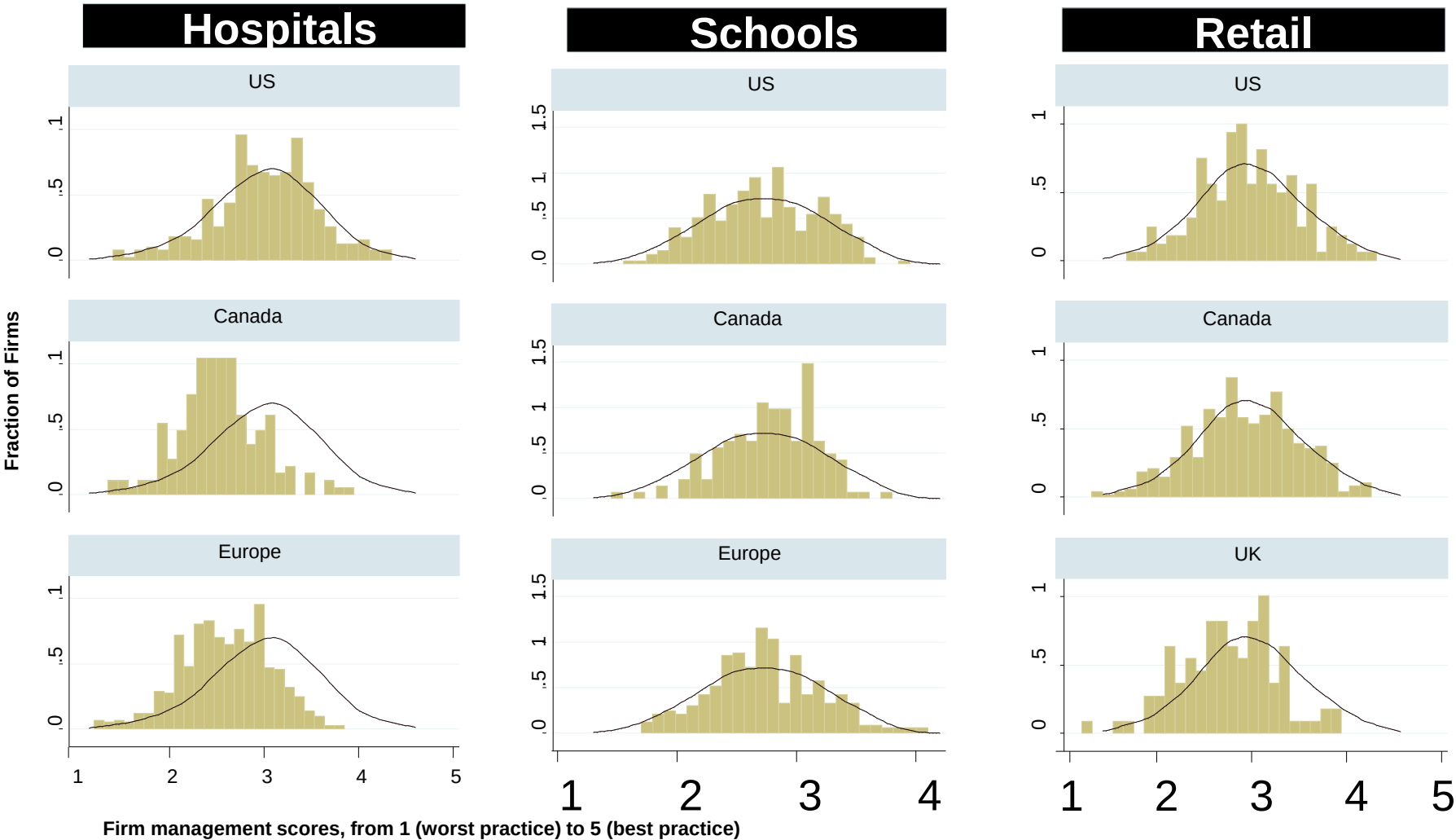


THIS 'LONG TAIL' OF POORLY MANAGED FIRMS PULLS DOWN THE AVERAGE MANAGEMENT SCORE OF LOW PERFORMING COUNTRIES

Assessed management practice score – by country



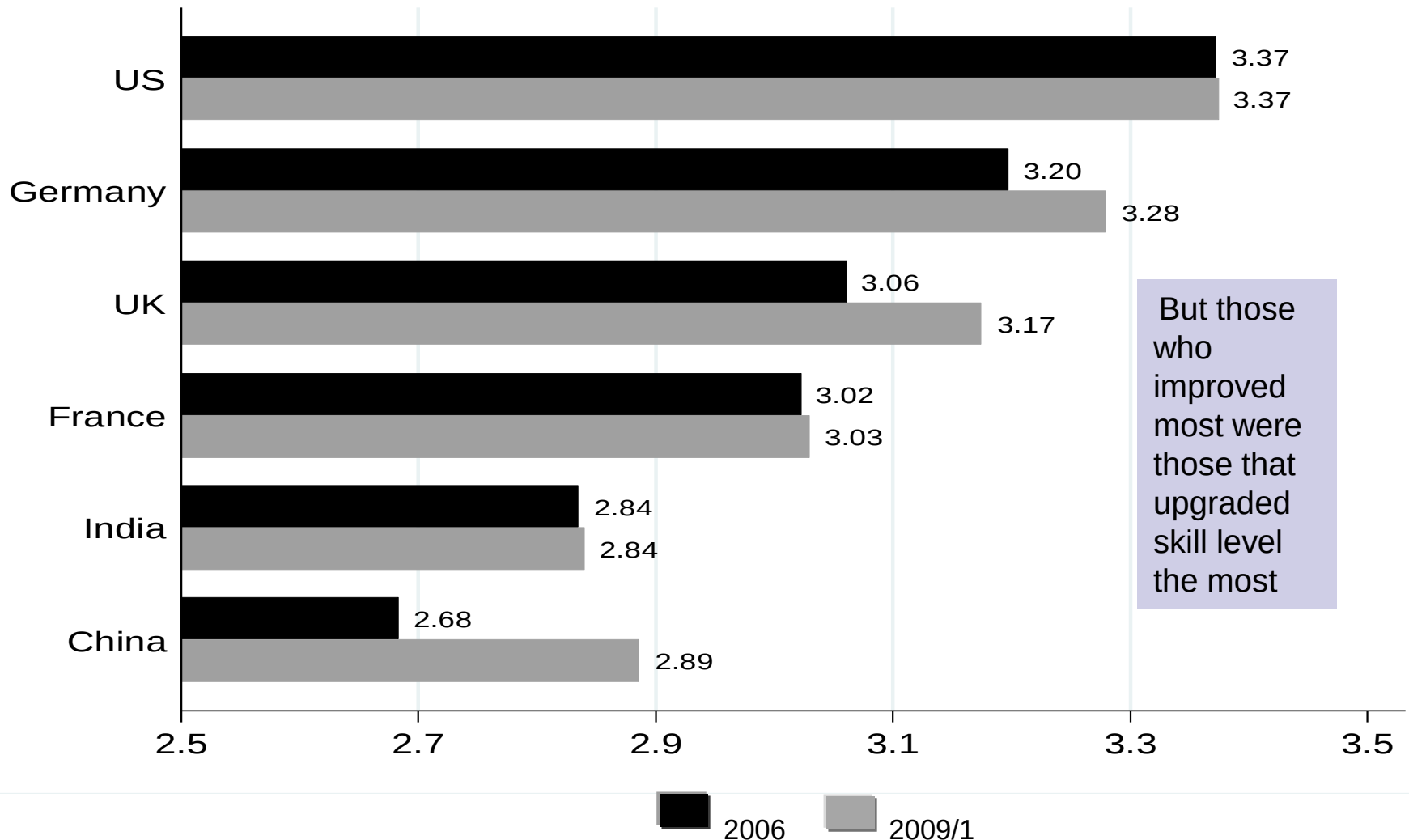
Hospitals, Schools and Retail Management Practices Also Show A Large Spread Across Organizations Within Each Country



Note: Bars are the histogram of the actual density. The line is the smoothed (kernel) of the US density for comparison.

Homkes, Centre for Economic Performance 2011 16

MANAGEMENT RELATIVELY STABLE ACROSS TIME (2006-2009) ACROSS COUNTRIES

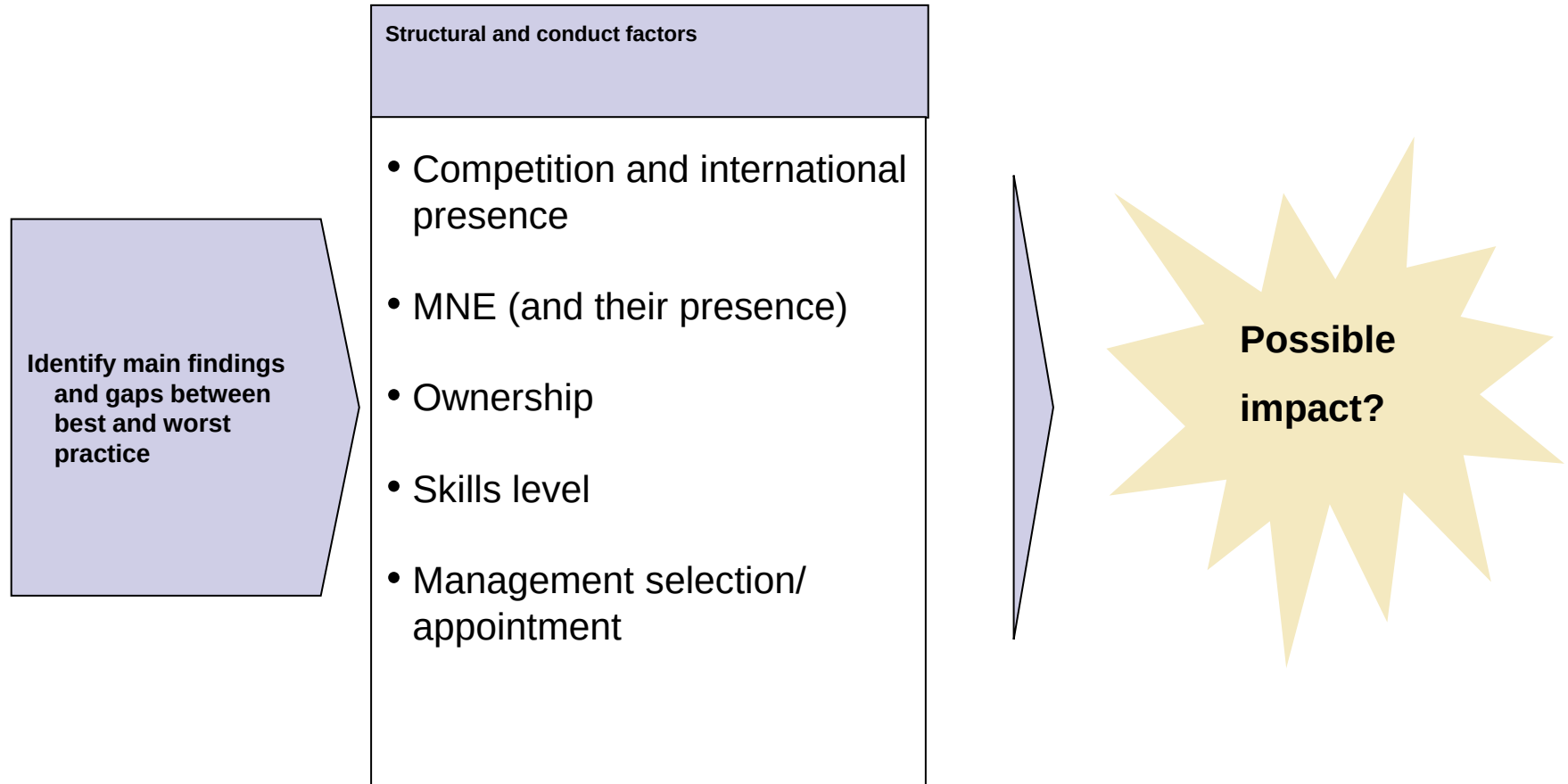


Note: Data from a total of 1,718 firms interviewed in 2006 and 2009/10 (263 US, 118 German, 253 UK, 157 French, 197 Chinese, 107 India firms).

AGENDA

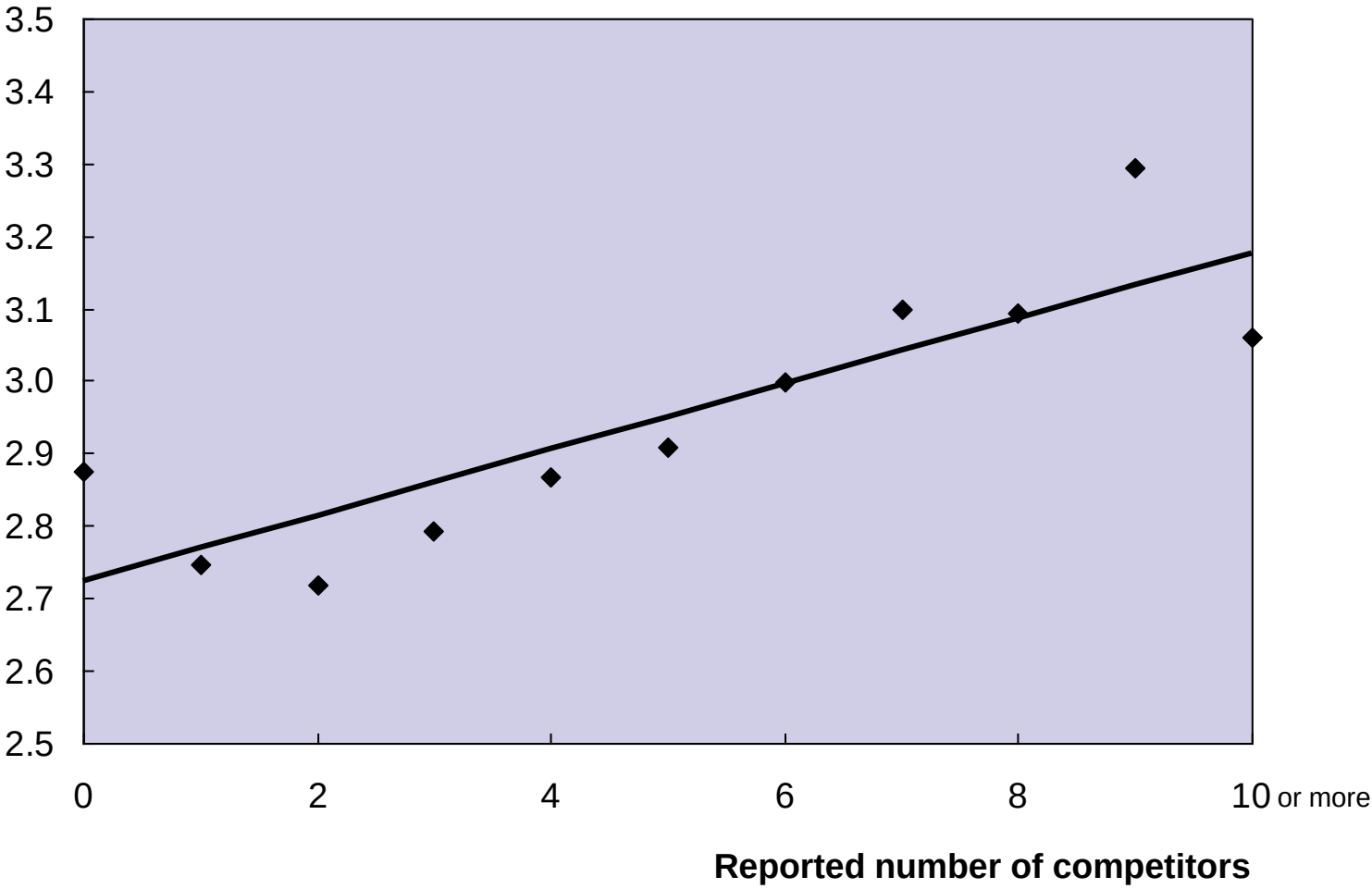
- Context : Productivity, management and skills
- Measuring management practices
- Describing management across countries
- **Explaining differences in management**
 - Drivers of management
 - Focus on skills gap
- Key considerations and policy implications

WE OBSERVE A SET OF STRUCTURE AND CONDUCT FACTORS THAT INFLUENCE THE IMPACT OF MANAGEMENT PRACTICES

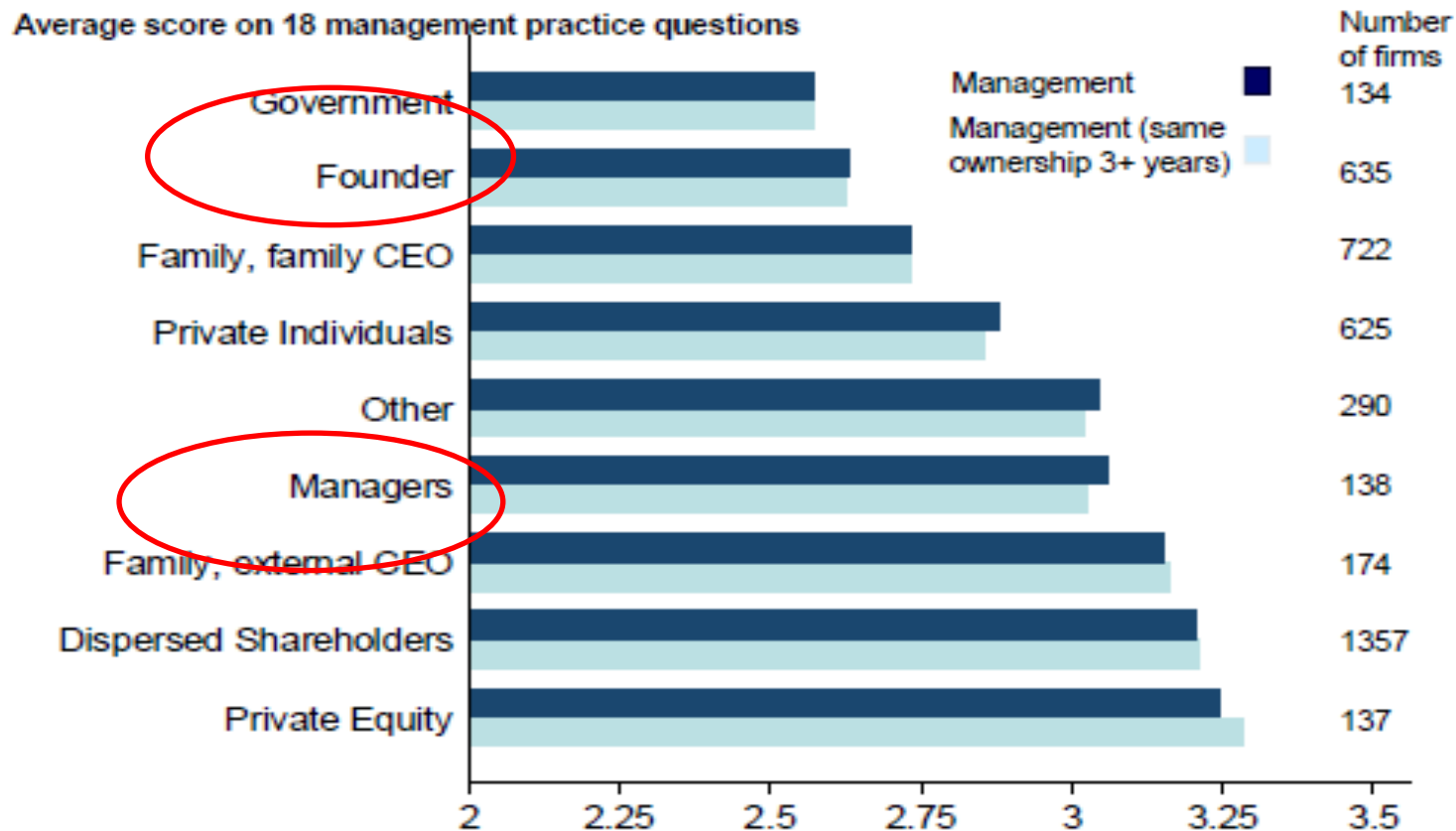


MORE COMPETITION IS ASSOCIATED WITH BETTER MANAGEMENT PRACTICES

Assessed management practice score

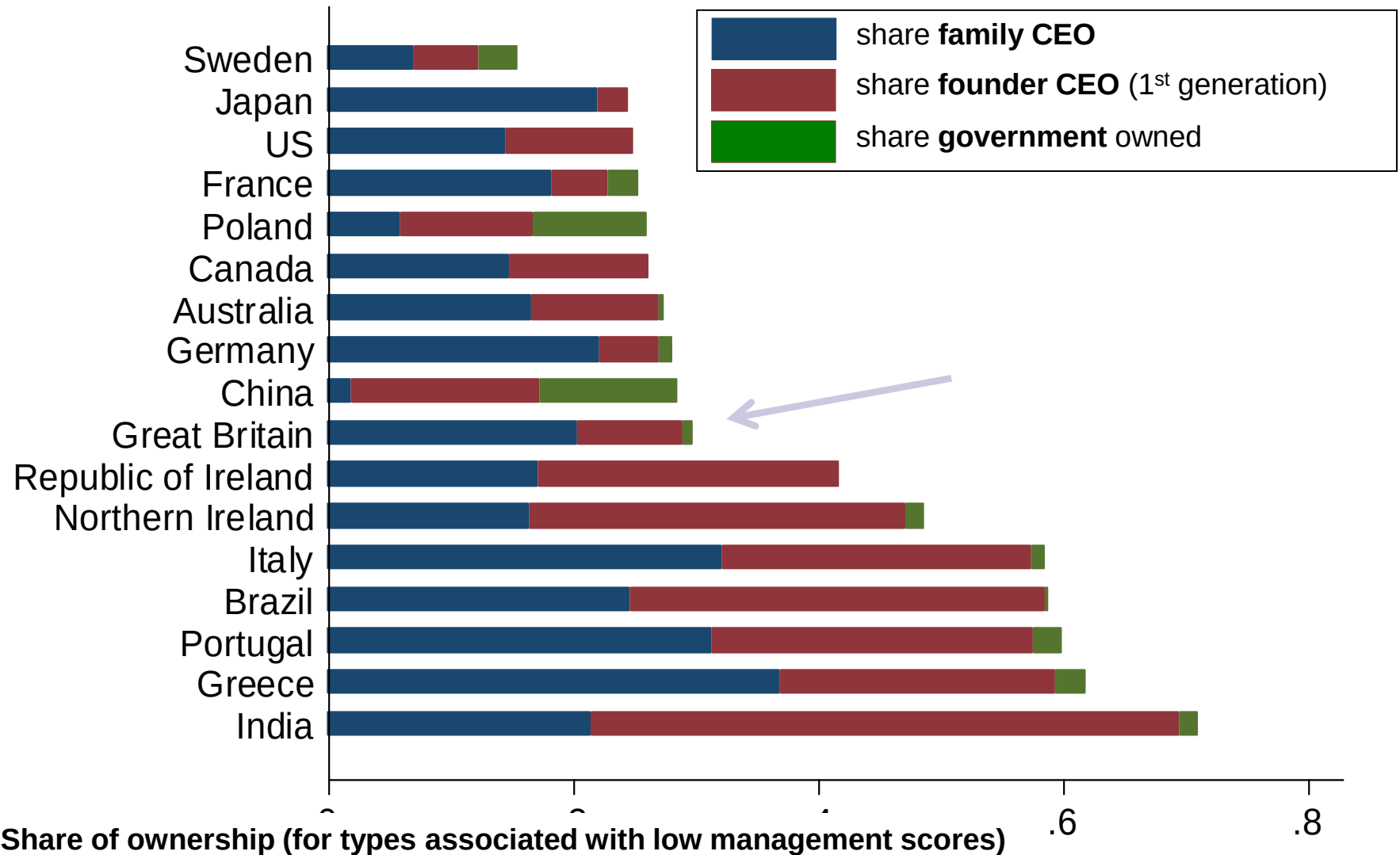


FAMILY FIRMS AND GOVERNMENT-OWNED FIRMS ARE THE WORST MANAGED ACROSS ALL COUNTRIES



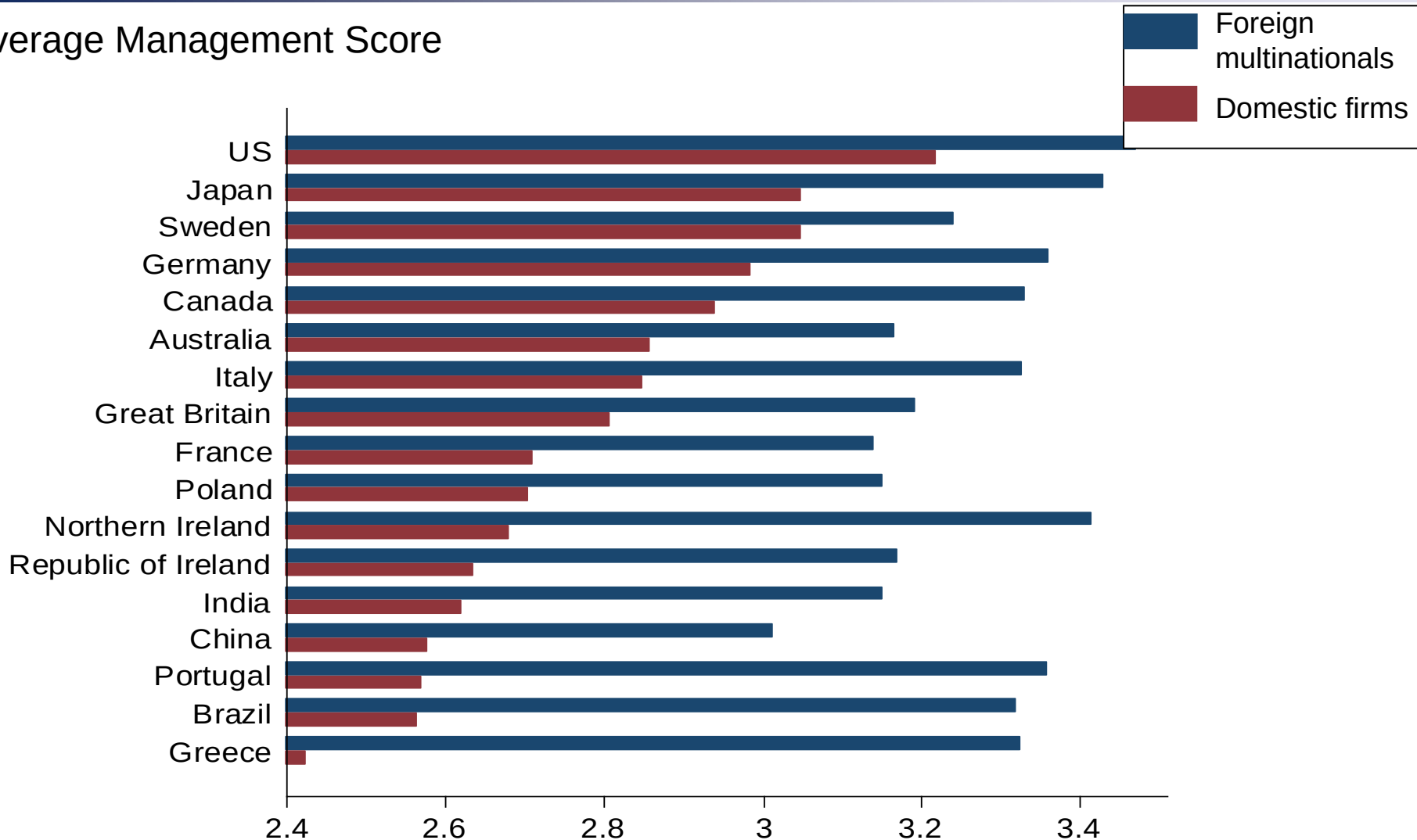
Note: Sample of 4,221 medium-sized manufacturing firms. The bottom bar-chart only covers the 3696 firms which have been in the same ownership for the last 3 years. The "Other" category includes venture capital, joint-ventures, charitable foundations and unknown ownership.

OWNERSHIP PATTERNS OF THESE “POOR MANAGEMENT” GROUPS VARY SUBSTANTIALLY ACROSS COUNTRIES



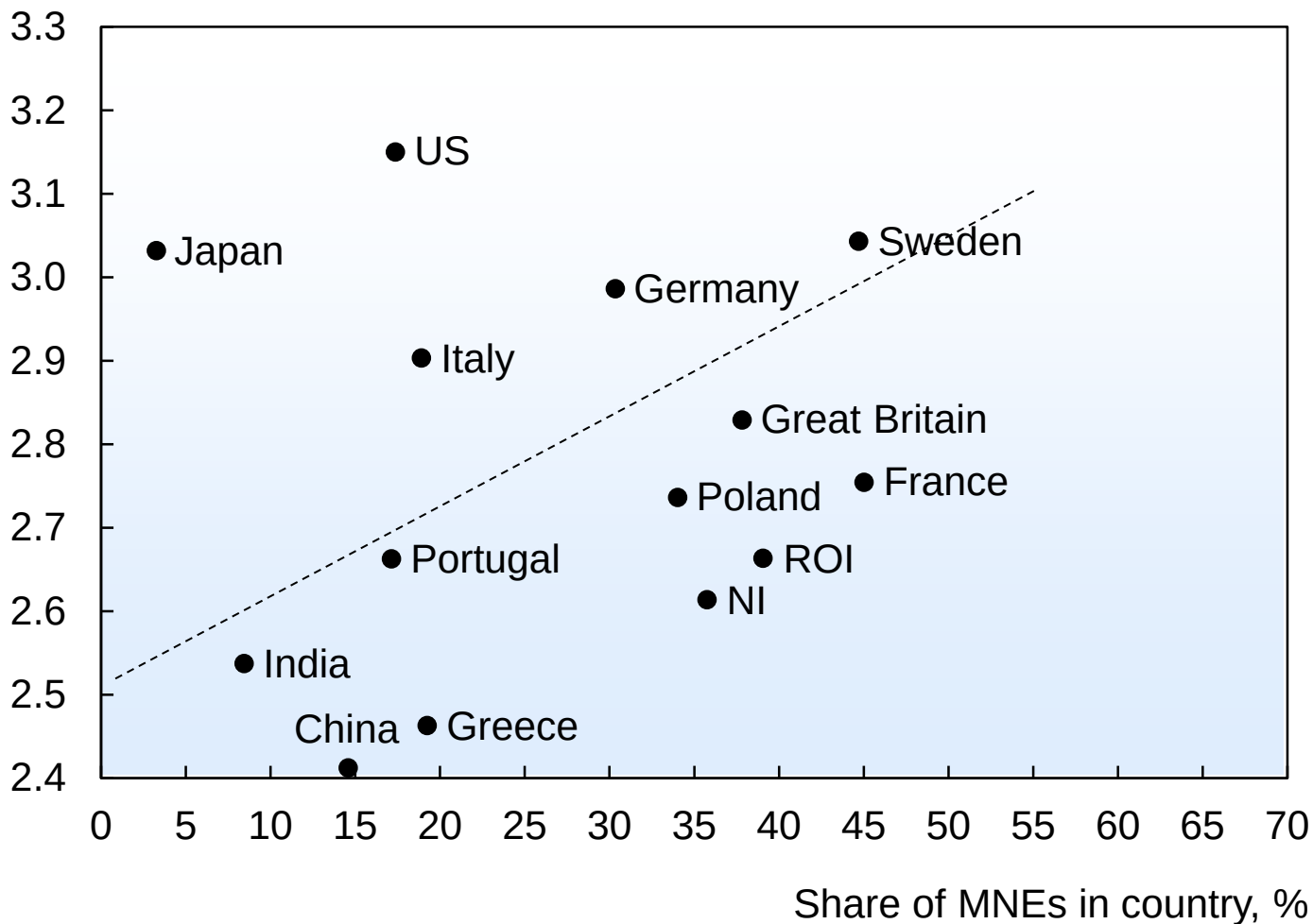
MULTINATIONALS ARE WELL RUN EVERYWHERE

Average Management Score



WE ALSO FIND A LINK BETWEEN MORE MNEs IN A COUNTRY AND IMPROVED MANAGEMENT PRACTICES AT DOMESTIC FIRMS

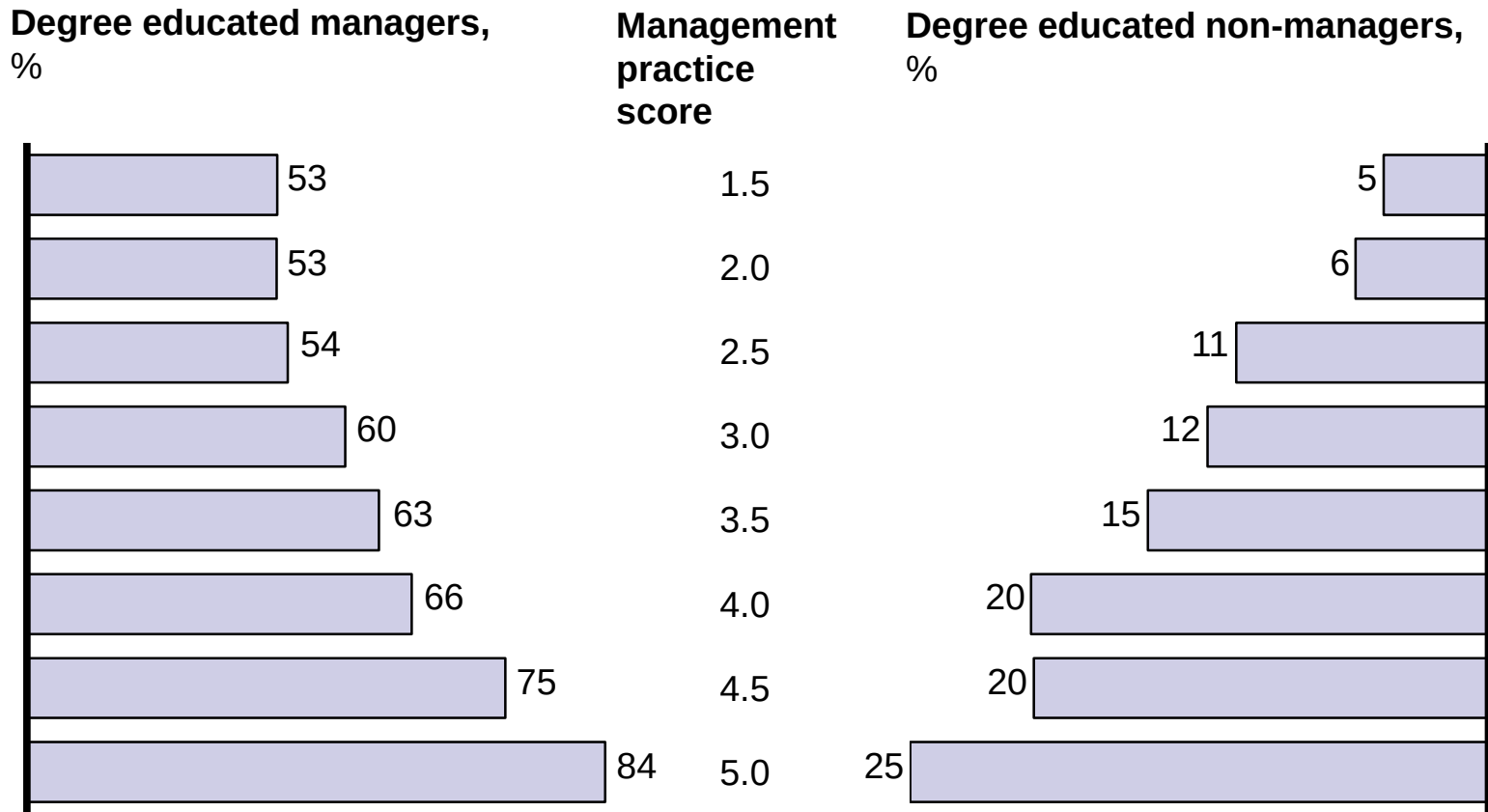
Mean management practice score – domestic firms, by country



AGENDA

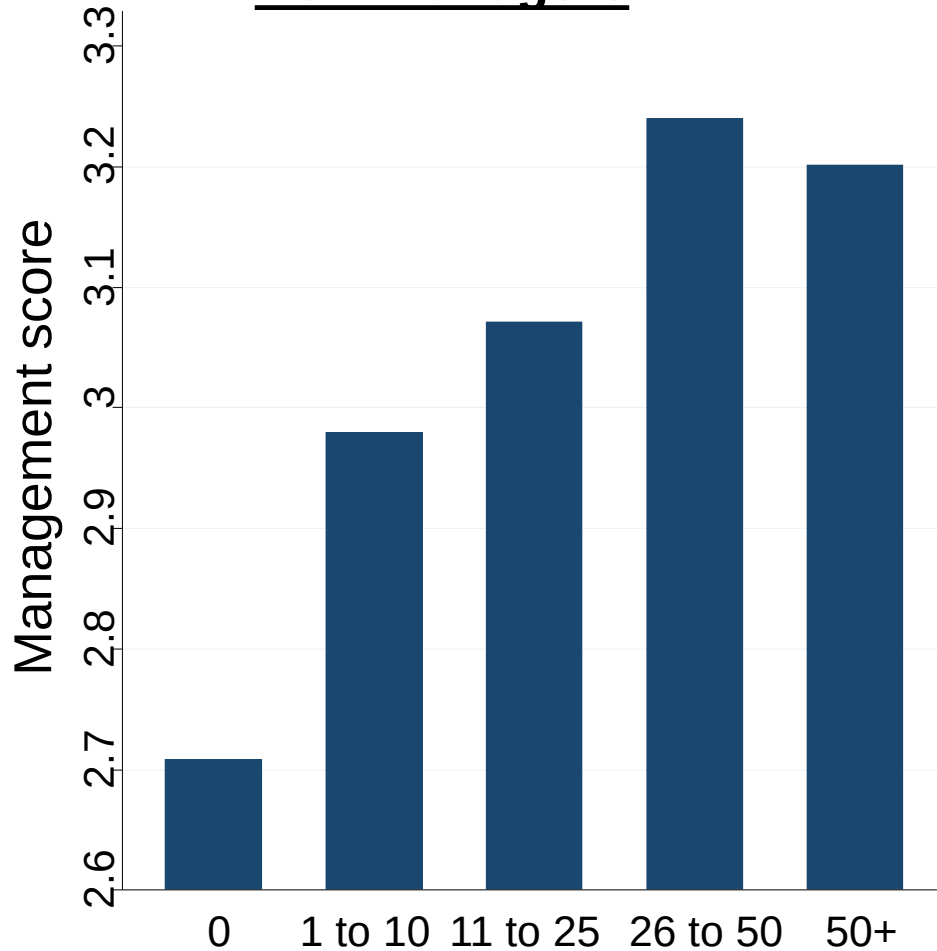
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BETTER MANAGEMENT IS ALSO LINKED WITH HIGHER SKILL LEVELS OF BOTH MANAGERS AND NON-MANAGERS

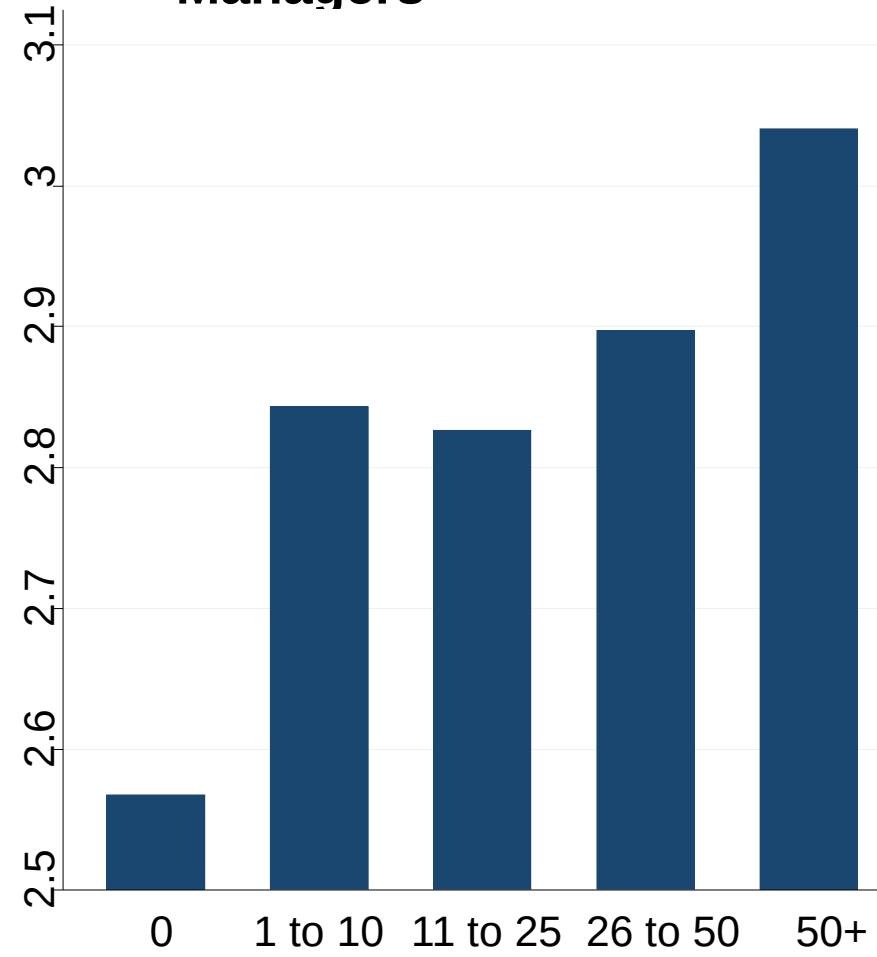


Education for Non-Managers and Managers Appear Linked to Better Management IN RETAIL FIRMS

Non-managers



Managers

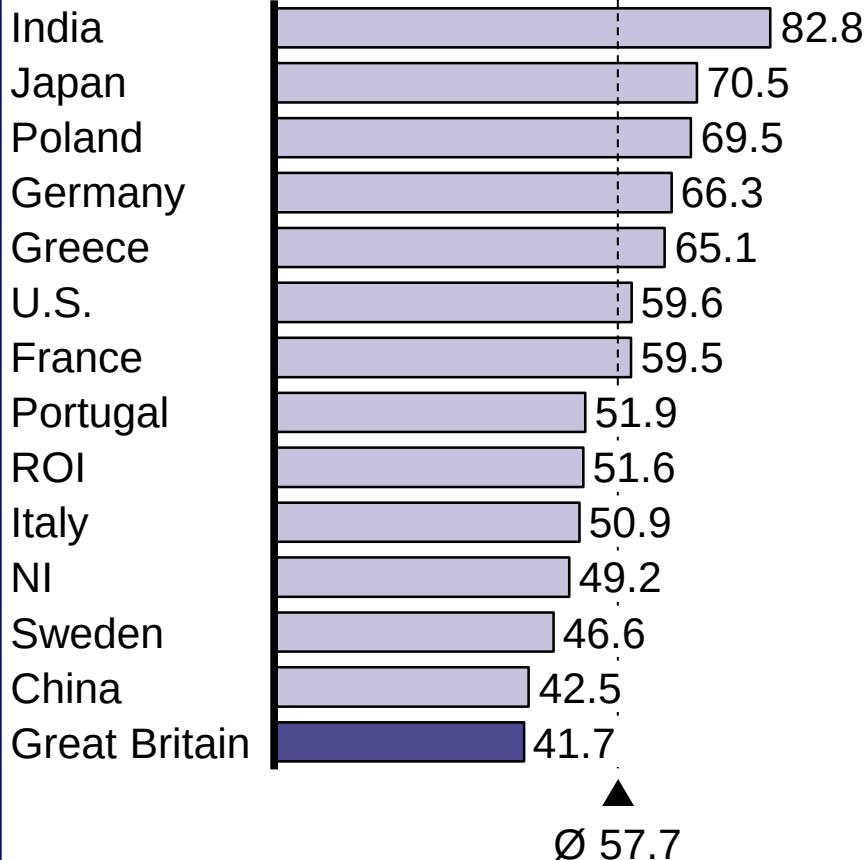


Percentage of employees with a college degree (%)

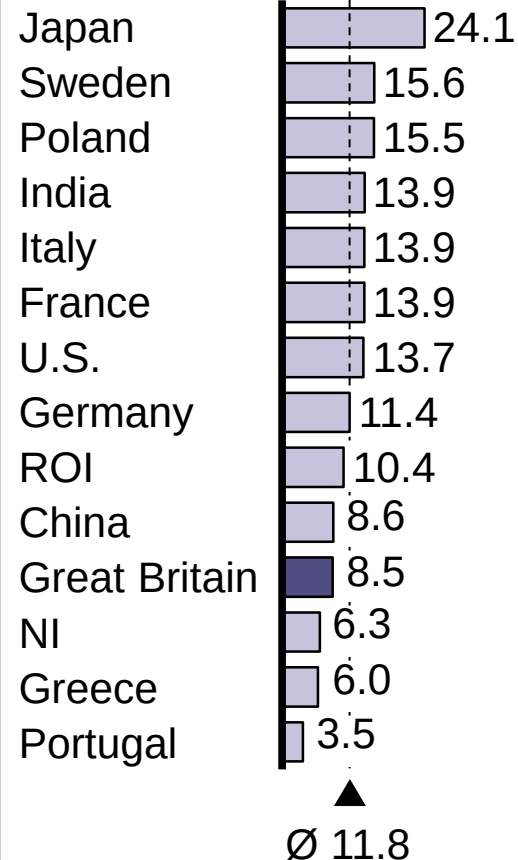
ONE KEY DRIVER OF THE U.K. AVERAGE MANAGEMENT SCORE IS ITS RELATIVELY LOW SKILL LEVELS

Share of employees with degrees – by country, %

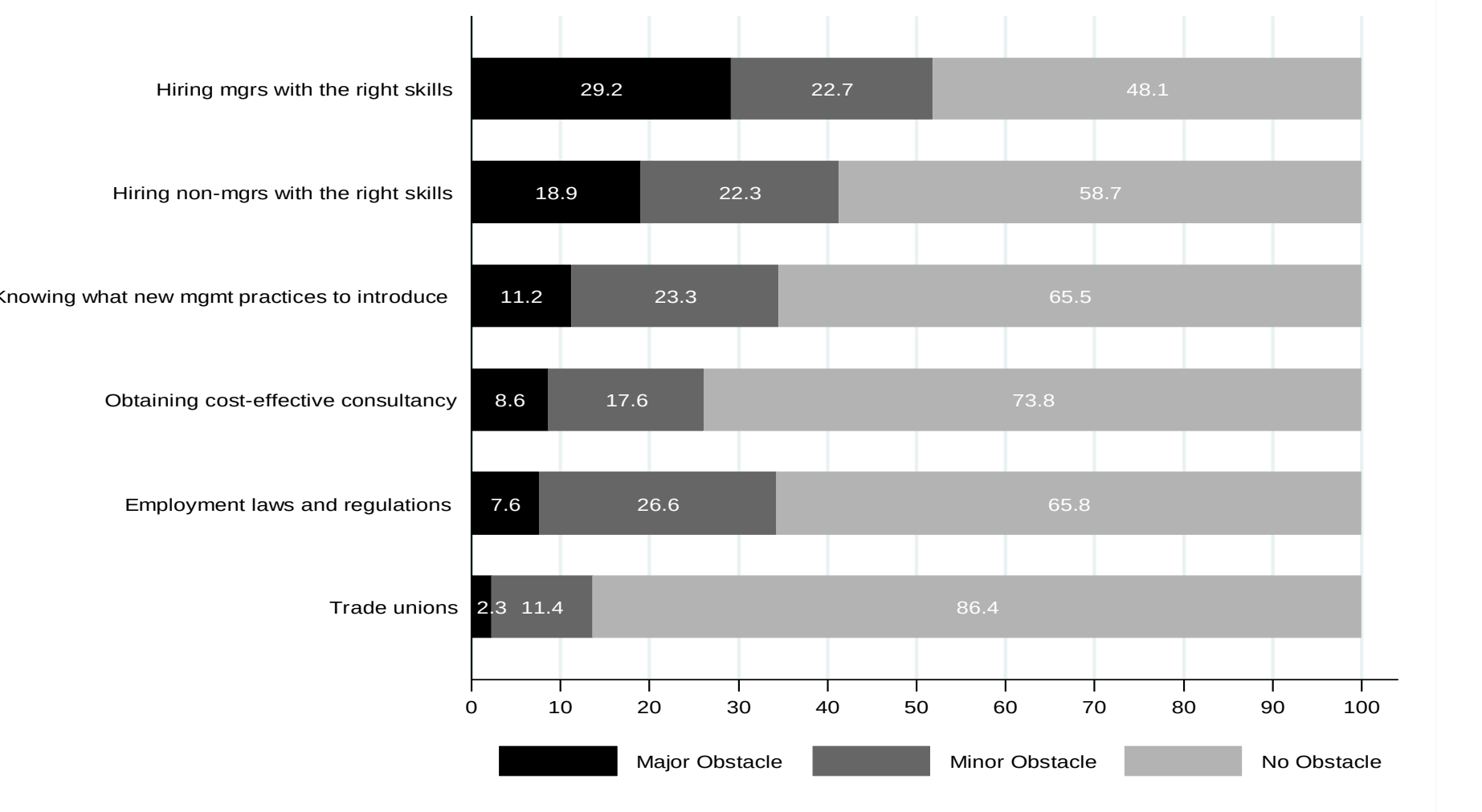
Managers



Non-managers



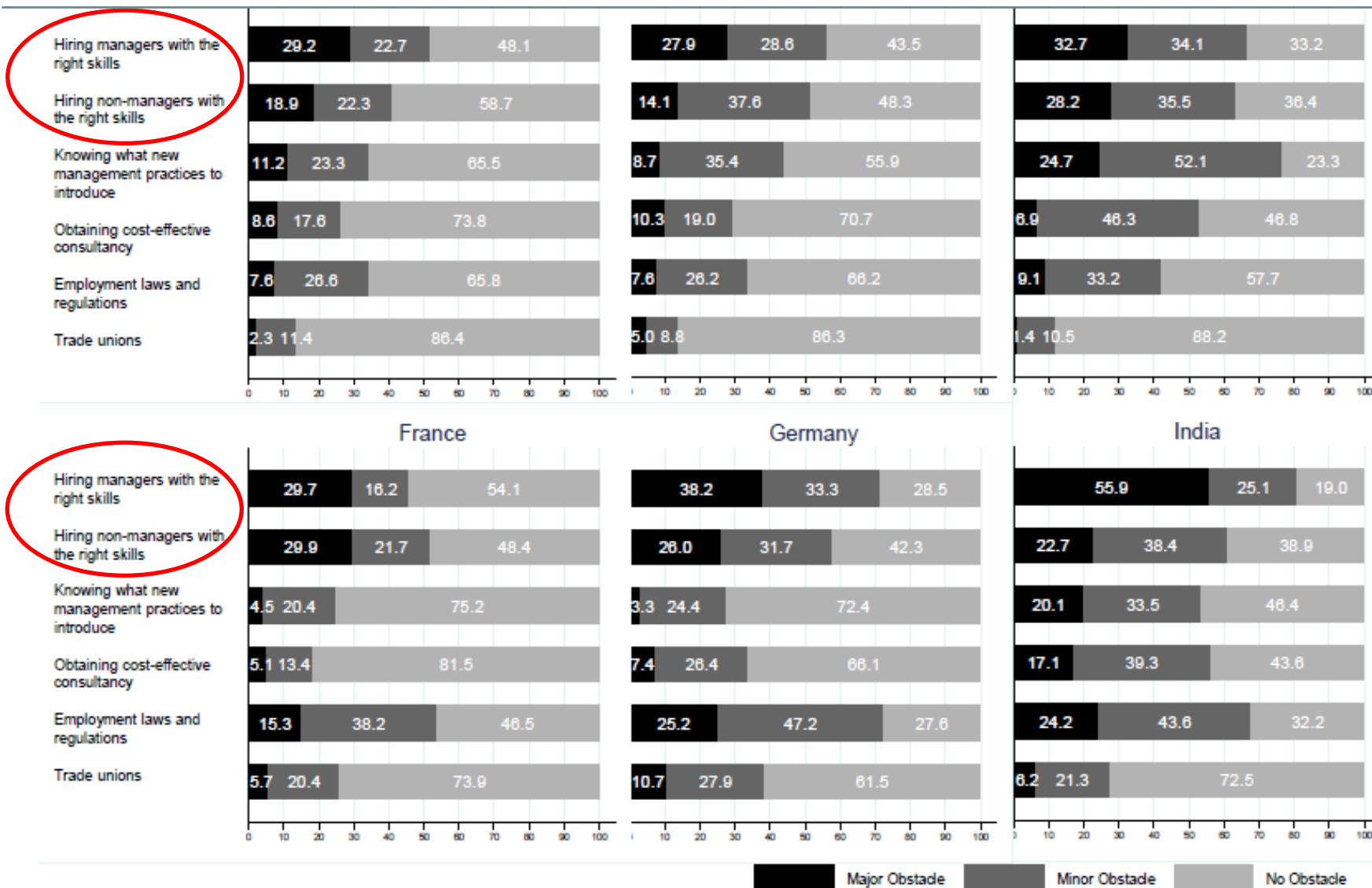
MANAGERS WITH RIGHT SKILLS BIGGEST CONSTRAINT ON IMPROVING MANAGEMENT IN THE UK



Note: After discussing different aspects of management we asked plant managers to reflect upon the constraints they might face while trying to improve their management practices such as , 1) Hiring managers with the right skills, 2) Hiring non-managers with the right skills, 3) Employment laws and regulations, 4) Trade Unions, 5) Knowing what new management practices to introduce, 6) Obtaining cost-effective management consultancy. Data from 265 companies interviewed in 2006 and 2009/10.

Homkes, Centre for Economic Performance 2011, 29

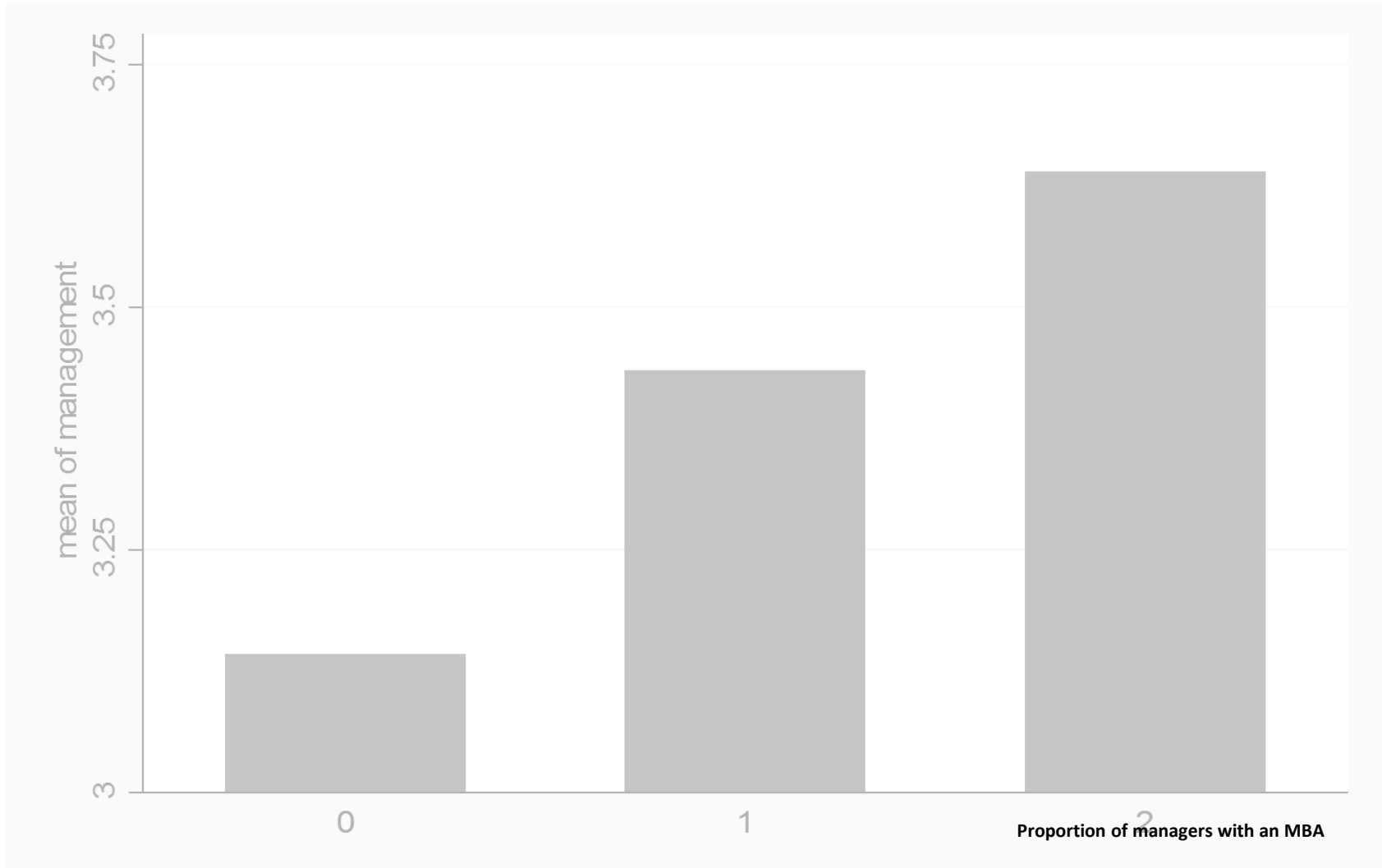
AND INTERNATIONALLY



Note: Data from 265 UK, 266 US, 123 German, 157 French, 211 Indian and 221 Chinese companies interviewed in 2009/10.

FIRMS WITH MORE MBA TRAINED MANAGERS ALSO ARE BETTER MANAGED

Average Management score relative to national mean

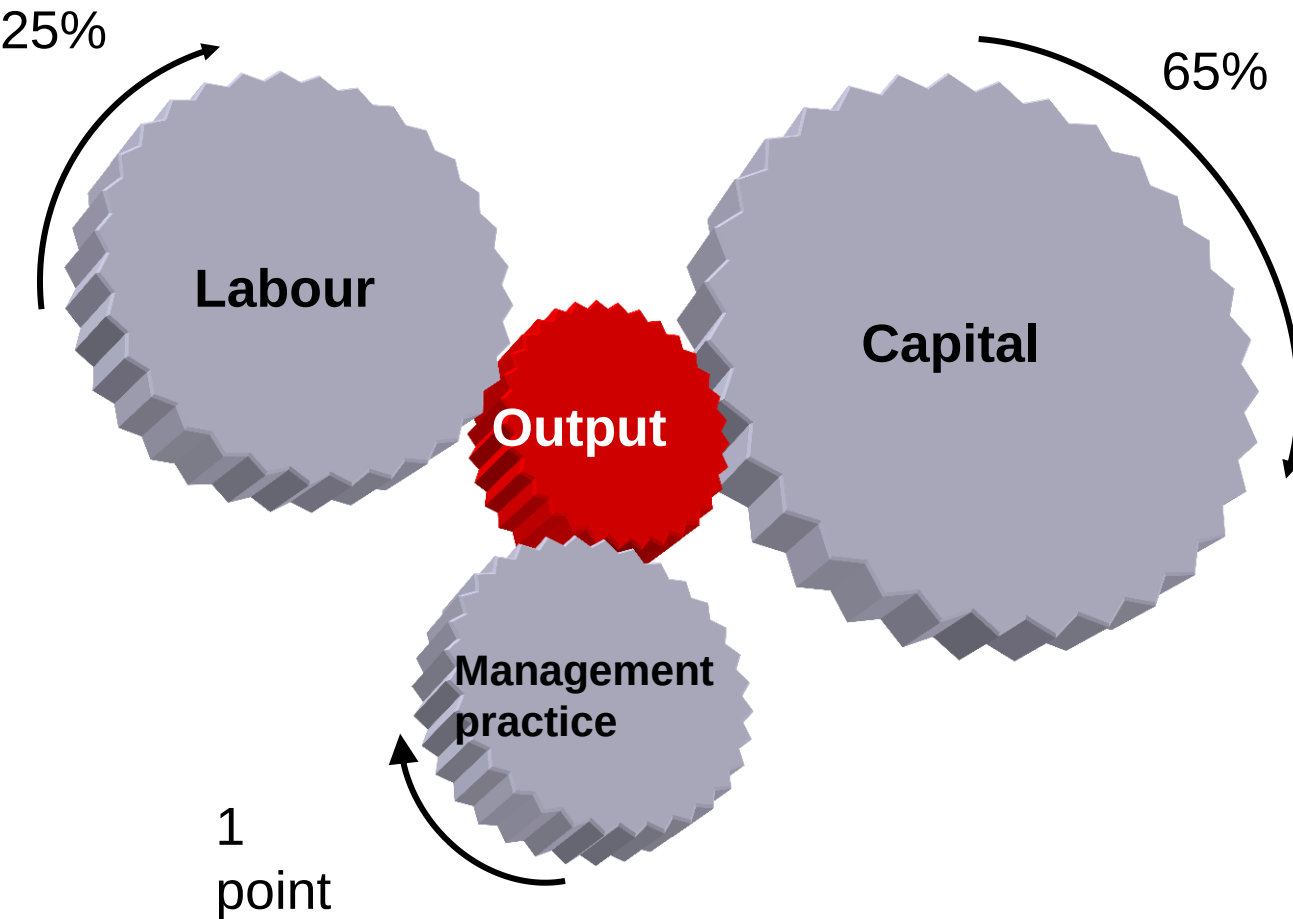


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Globally, the effect of improving management is large compared to investing in labour or capital

Effect* of increased factor inputs on output

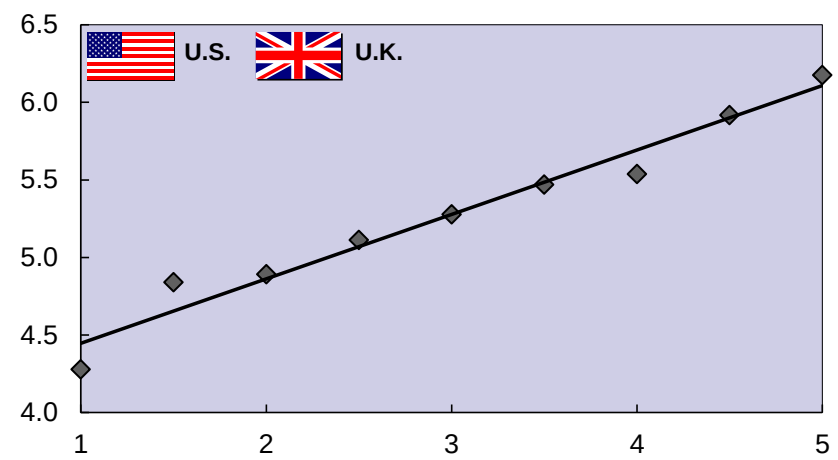


- Improving management practice is a highly leveraged means of getting more output from the firms existing
 - Labour
 - Capital
- This is true for all companies* irrespective of the quality of current management practices

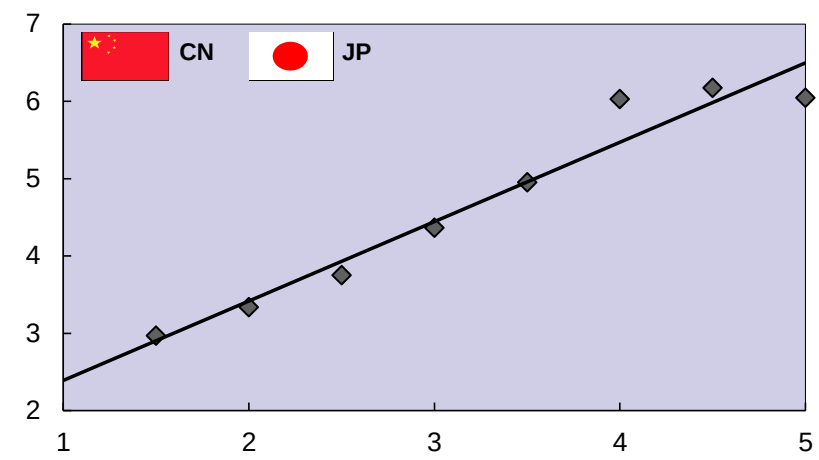
* Independent of sector, ownership type, profitability, past productivity growth, size Homkes, Centre for Economic Performance 2011 33

THE LINK BETWEEN PRODUCTIVITY AND MANAGEMENT HOLDS TRUE ACROSS DIFFERENT COUNTRIES

Labour productivity*

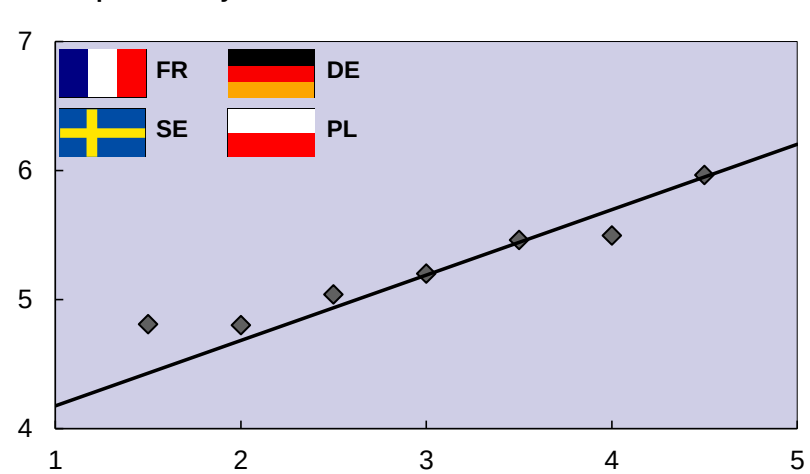


Labour productivity*

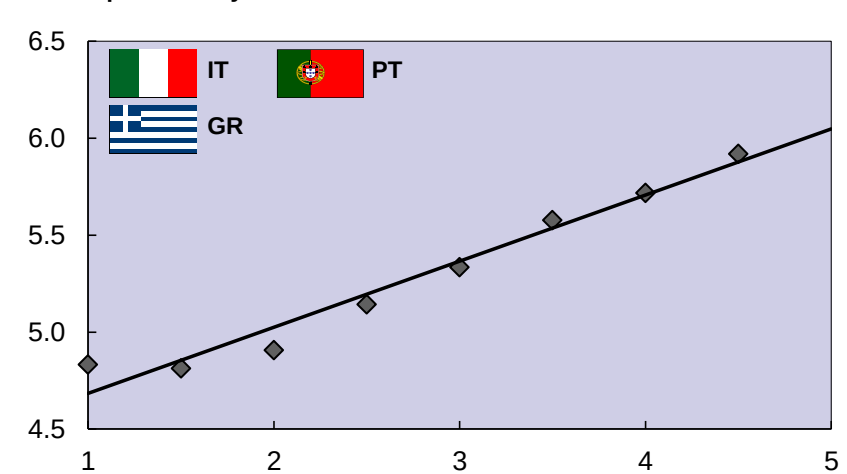


Labour productivity*

management practice score**



Labour productivity*

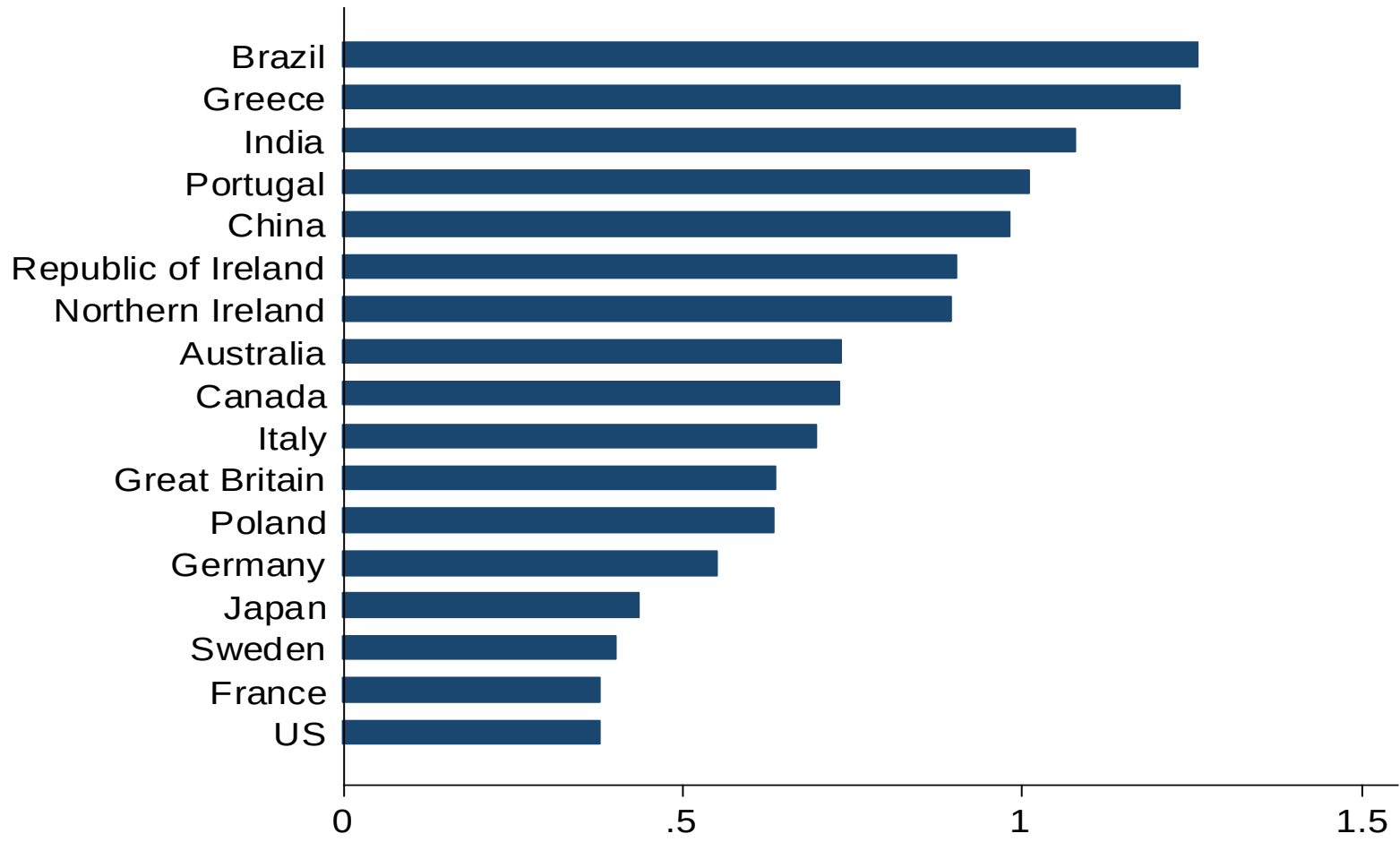


* Log scale (sales per worker)
** Firms are grouped in 0.5 increments of assessed management score

THE AVERAGE MANAGER THINKS THAT HIS OR HER FIRM'S MANAGEMENT IS WELL-ABOVE AVERAGE,



AND THIS OVER CONFIDENCE OCCURS IN EVERY COUNTRY OF OUR SAMPLE



Self score (normalized to 1 to 5 scale) less the assessed Management score

IN CONCLUSION, SEVERAL MAIN DRIVERS IDENTIFIED THAT ARE ASSOCIATED WITH MANAGEMENT PRACTICES

Positive influences

- Labor market flexibility
- Openness
- Competitive intensity

Negative influences

- Poorer skills
 - Managers
 - Non managers
- Primogeniture firms



SKILLS, MANAGEMENT AND FIRM PERFORMANCE

Skills and management

- Education of both managers strongly correlated with management scores
- Strong correlation with worker skill levels: suggests implementing practice easier with knowledgeable work force

Skills: Degrees

- MBA strongly correlated with management, but even business education could substantially improve firm management
- This is especially case for developing countries (India interventions)

Skills: constraints

- Greatest constraint for improving management is an inadequate supply of managerial human capital
- Second most is worker skills, then information barriers

Future research

- Type and level of skills
- Industry-specific market failures that lead to under-supply of managerial skills to smaller firms

MANAGEMENT AND SKILLS: IMPLICATIONS

KEY INSIGHTS:

Sources of productivity growth are innovation (well-studied) and management (less studied):



Our tool assess management across countries

- Substantial intra-country variation in management practice
 - UK lags, mainly due to the tail of lower performing firms
- Management and innovation can be improved via reforms to competition, tax reform, universities, R&D
- **Skills major driver of management, and constraint faced by managers:**
- possible policy responses:
 - Firm with ~100-300 workers face largest constraints for skills & information: Focus here on business support
 - Need to expand supply of human capital by allowing university expansion (e.g. by abolishing fee caps for home students as recommended by the Browne Report) and increasing the availability of travel/work visas for experienced managers from other well managed countries such as the US.
 - Facilitate the creation of management education courses and facilities as a measure for increasing the supply of capable managers for small firms

THESE MANAGERS SHARED SEVERAL MEMORABLE QUOTES

Americans on
Geography...

Interviewer: “How many production sites do you have abroad?”

Manager in Indiana, US:
“Well...we have one in Texas...”

French secretary: “You want to talk to the plant manager? There are legal proceedings against him, so hurry up!!”

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*” ?”

... AND DURING OUR IRISH INTERVIEWS, WE HEARD SOME OF MY PERSONAL FAVOURITES

Money's a sensitive topic to the Irish....

Interviewer: "Would you mind if I asked how much your bonus is as a manager?"

Irish manager: "I don't even tell my wife how much my bonus is!"

Interviewer: "Probably the right decision..."

No fault attrition...

Interviewer: "Have any managers left within the last 12 months?"

Irish manager: "One died..."

Interviewer: "I won't count that one."

Irish manager: "And one fell in love with a girl a long way away. So there was nothing I could do."

Position fatigue in Ireland....

Interviewer : How long have you been with the company for?

Irish manager: : 24 years

Interviewer : Brilliant!

Irish manager: : Brilliant? I'd be out of prison at this stage.

TALENT MANAGEMENT ACROSS COUNTRIES?

Staff rewards the American way

Production Manager: “For example, if an employee suggests a company slogan, and his name is used, he gets a TV.
If he is employee of the month, he gets a parking space”

Staff retention the UK way

Interviewer: “How would you persuade your top performers to stay?”
UK Chairman: “Sex is a great thing! If the employee finds a new girlfriend somewhere else, I can’t do anything!”

CONTACTS AND FURTHER READING

1. Enhancing management quality: the potential for productivity growth after the recession
Rebecca Homkes, March 2011 *Centrepiece Paper No' CEPCP328*
2. Nicholas Bloom and John Van Reenen (2010) 'Why do Management Practices Differ across Firms and Countries?', *Journal of Economic Perspectives* 24(1): 203-24
3. Bloom and Van Reenen (2007) "Measuring and Explaining Management practices across firms and nations" Forthcoming, *Quarterly Journal of Economics*, Centre for Economic Performance Discussion Paper No. 716 <http://cep.lse.ac.uk/pubs/download/dp0716.pdf>
4. Bloom, Sadun and Van Reenen (2007) "Americans do IT better" Centre for Economic Performance Discussion Paper No. 788 <http://cep.lse.ac.uk/pubs/download/dp0788.pdf>
5. UK productivity improvements : http://cep.lse.ac.uk/briefings/pa_uk_productivity.pdf

www.worldmanagementsurvey.com

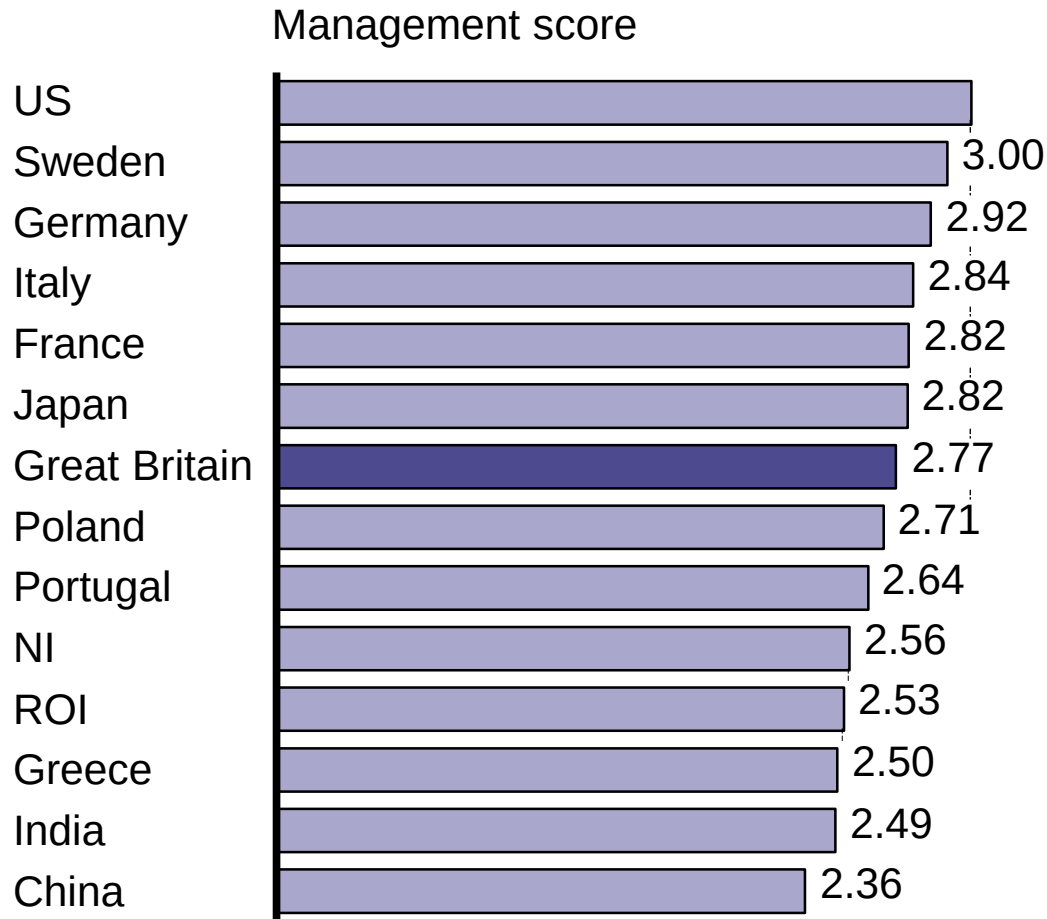
http://cep.lse.ac.uk/_new/research/productivity/management.asp

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MEAN MANAGEMENT SCORE OF SME SECTOR FIRMS BELOW GLOBAL AVERAGE

Mean management score by country for firms with <250 employees, adjusted for size* of firm
Based on a 1-5 scale



* Controlling country scores to use same average firm size (using log values to take into account effect of largest firms)

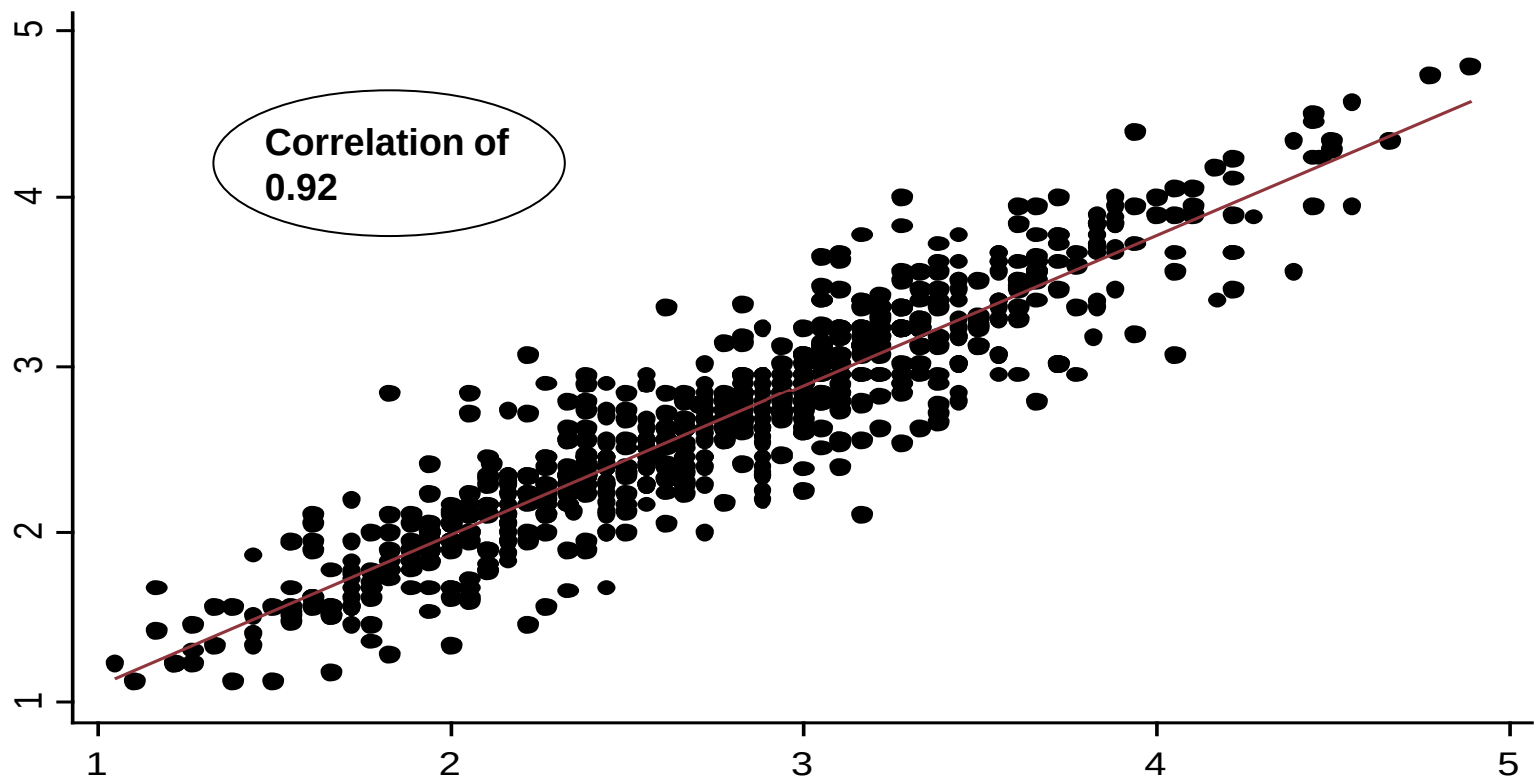
Homkes, Centre for Economic Performance 2011 45

Source: Data collected from interviews as of October 2008; team analysis

ASSESSMENT TOOL CONTINUES TO PROVE ROBUST

Assessed management practice score

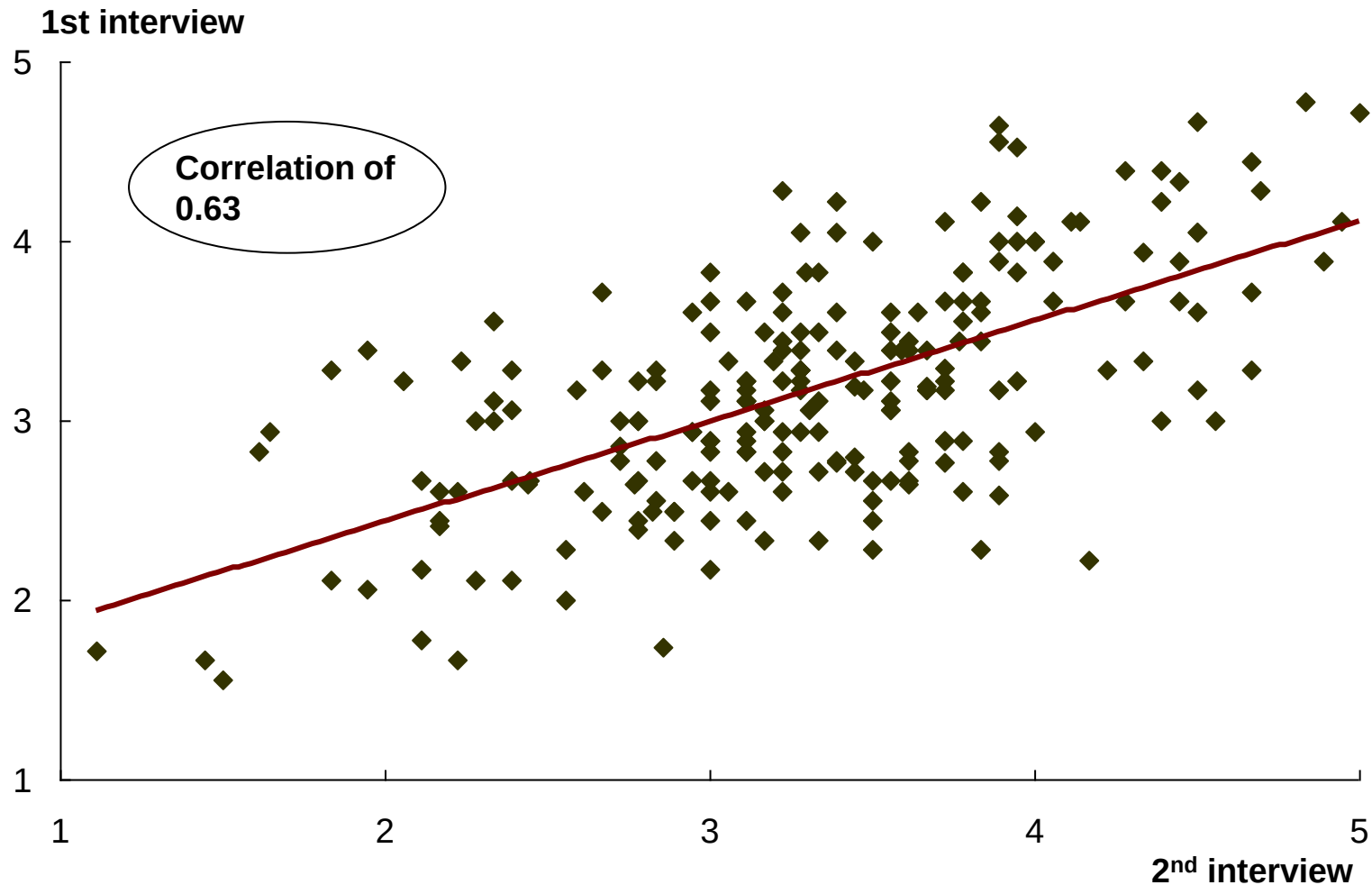
1st analyst (interviewer)



2nd analyst (silent listener)

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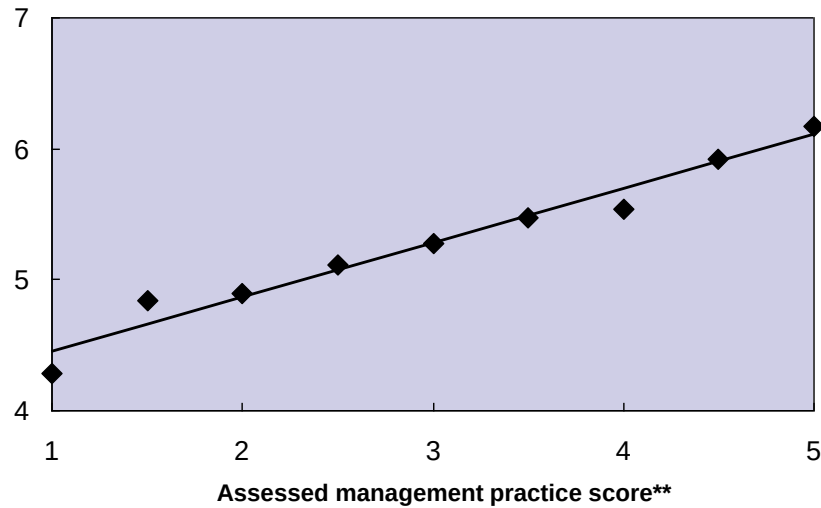
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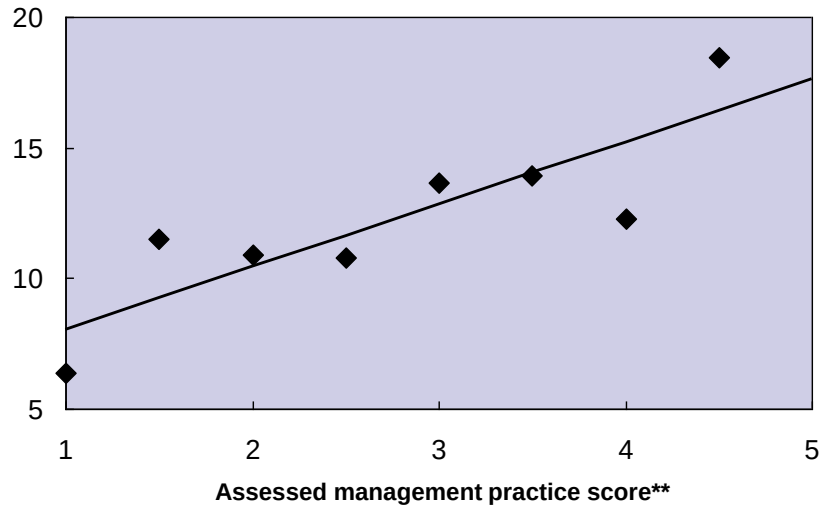
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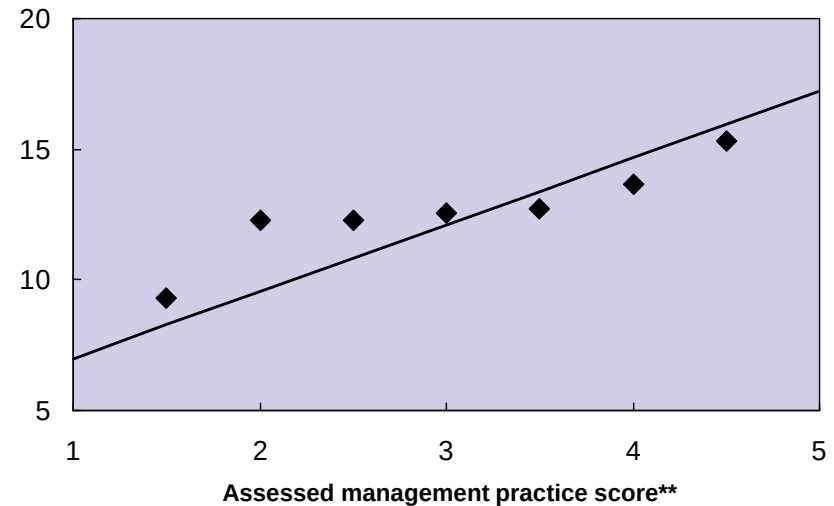
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ROCE (%)



Sales growth (%)

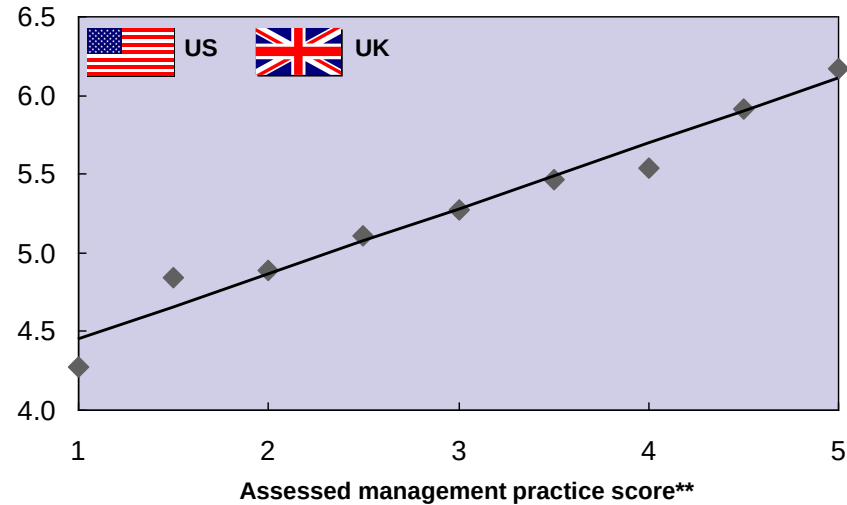


* Log scale

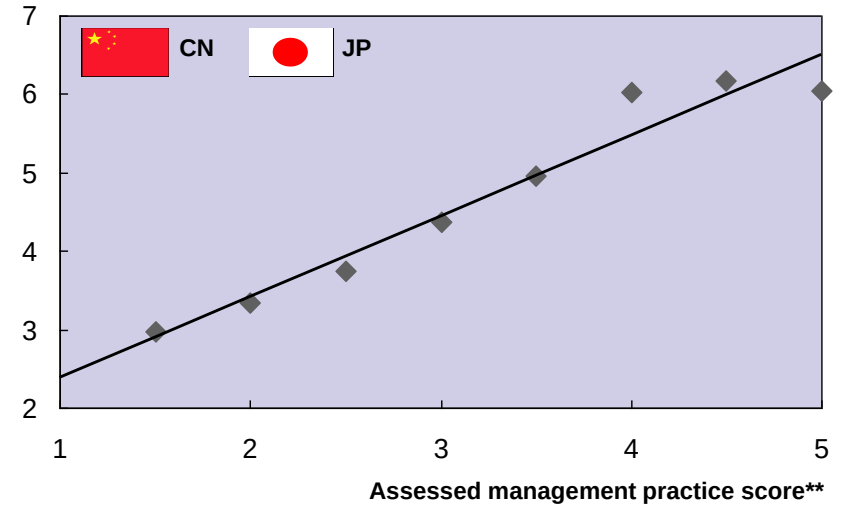
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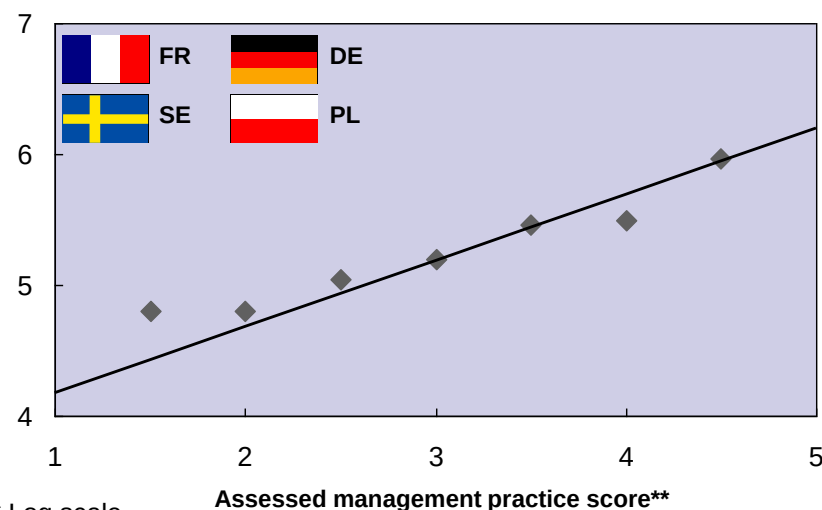
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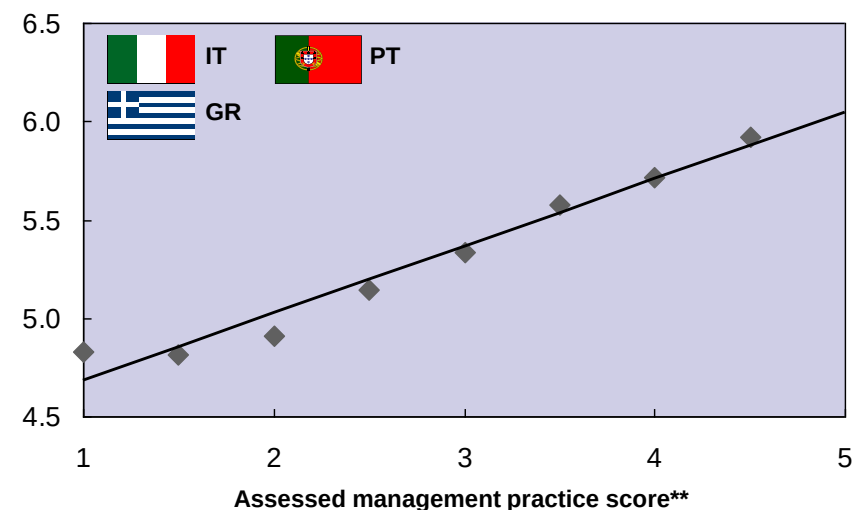
Labour productivity*



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* Log scale

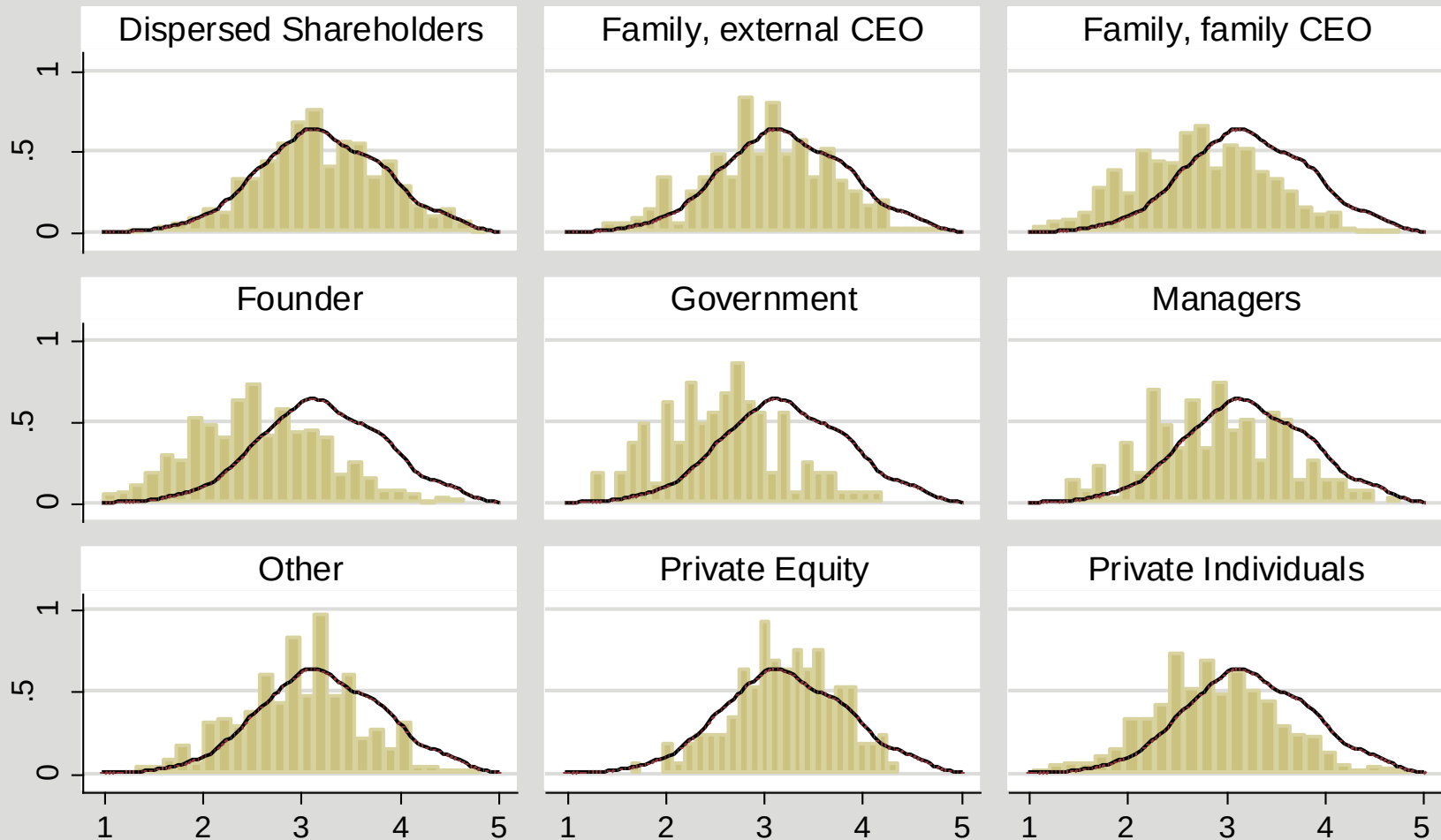
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SOME POLICY IMPLICATIONS

- Avoid accelerated budget reduction programme
- Family firms problem (remove inheritance tax break)
- Competition
- Services Directive, Doha round, public sector
- Constraints
- Firm with ~100-300 workers face largest constraints for skills & information. Focus here on business support
- UK response to recession
- Benefits of labour market flexibility
- Management quality aids *resilience*

FIRMS WITH PROFESSIONAL CEOS ARE TYPICALLY WELL RUN. GOVERNMENT, FOUNDER, FAMILY MANAGED FIRMS

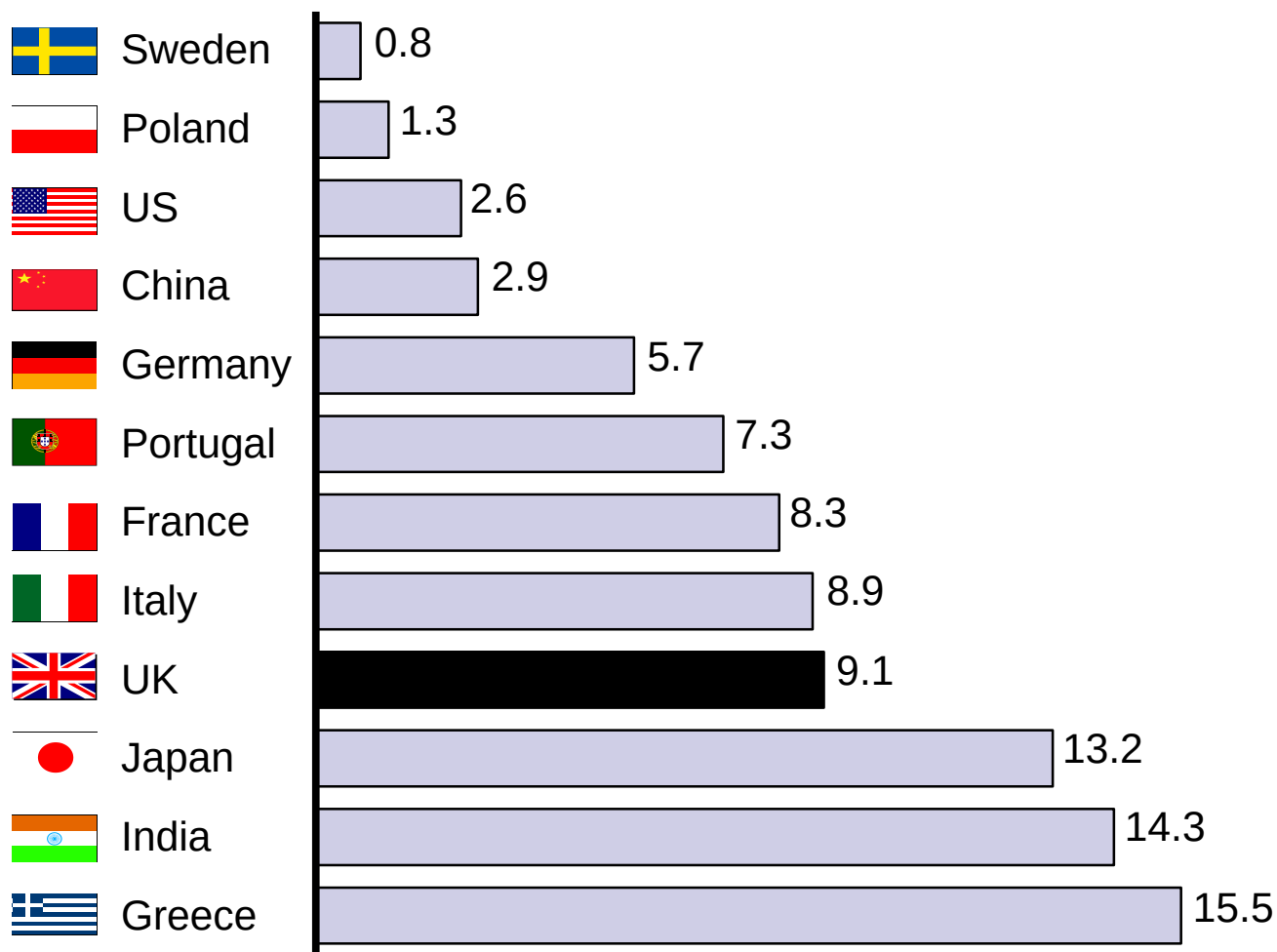
Distribution of firm management scores by ownership. Overlaid dashed line is approximate density for dispersed shareholders, the most common US and Canadian ownership type



Average Management Score

FAMILY OWNERSHIP IN THE U.K. SAMPLE IS MORE THAN THREE TIMES THAT OF THE U.S. SAMPLE

Percentage of firms family-owned



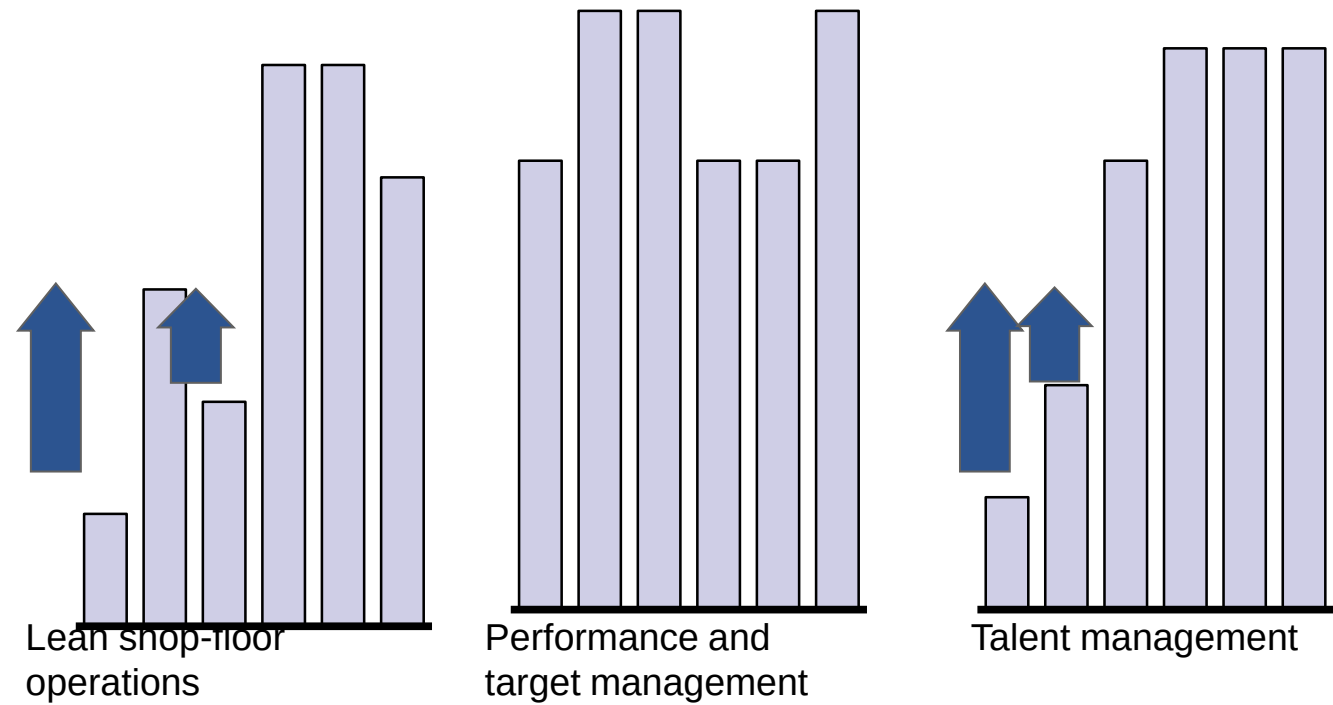
FOR FIRMS, OUR ASSESSMENT AND TOOLS CAN HIGHLIGHT THE AREAS FOR TARGETED IMPROVEMENTS TO INCREASE PERFORMANCE

Management score

ILLUSTRATIVE

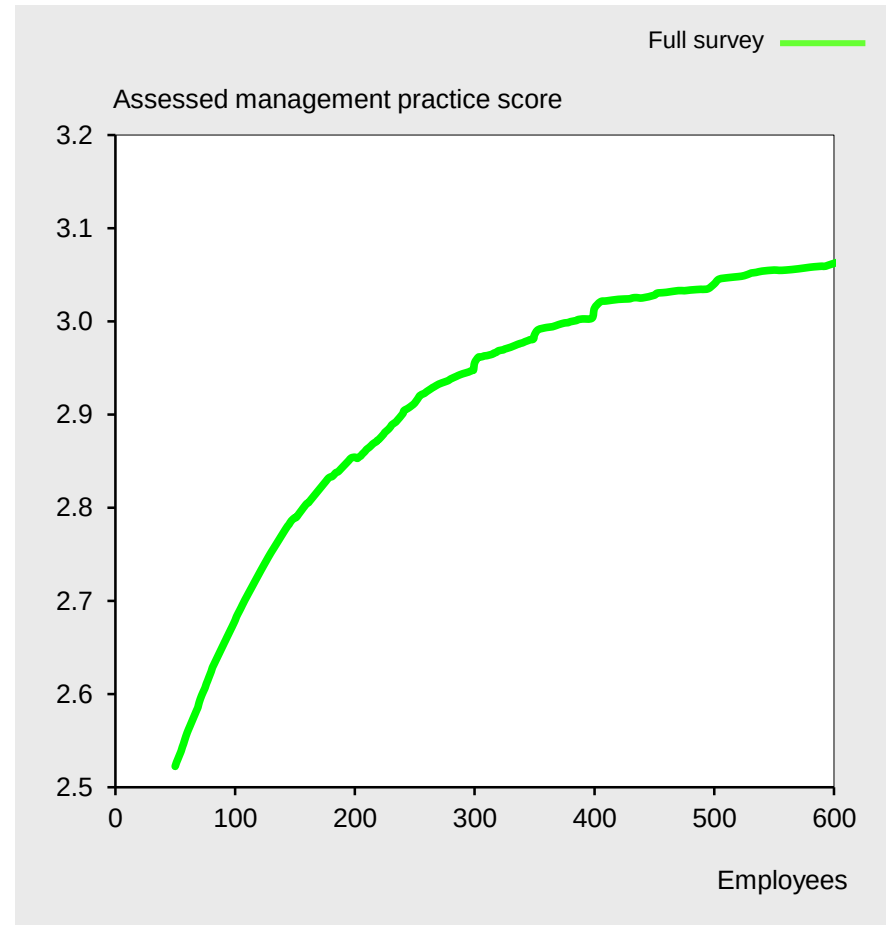
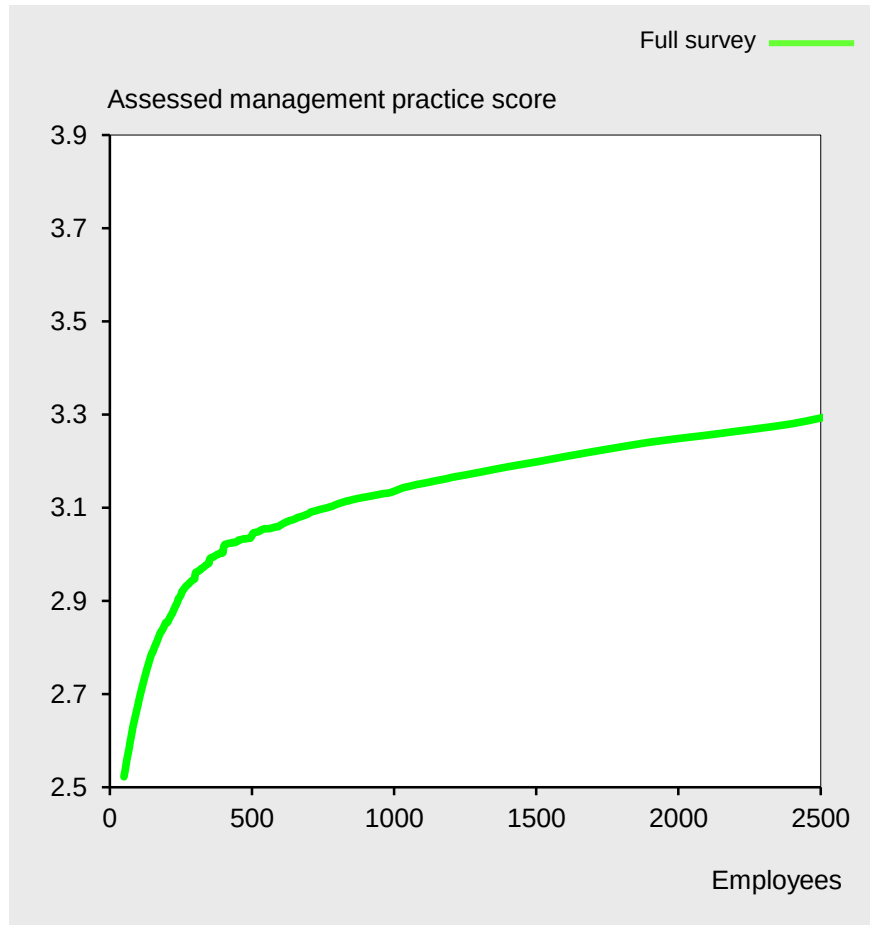
 Targeted interventions

 Management practice score



- Focus on key areas to improve
- Consistency of management practice
 - Average management score
 - Associated performance
 - ROCE
 - Productivity
 - Growth
 - Market capitalisation

Firm size vs. assessed management practice score*

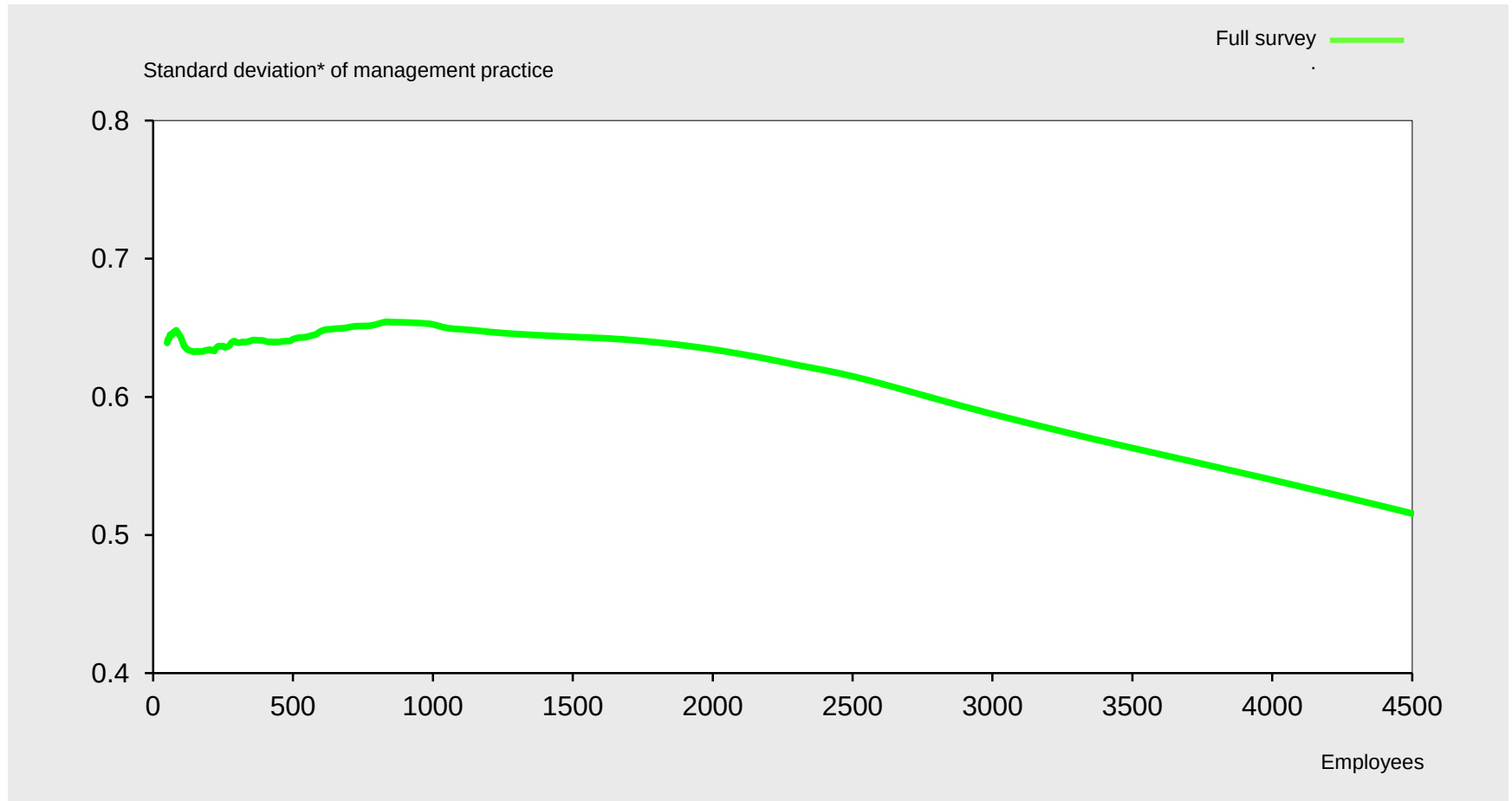


* Lowess regression fit; Size significant with step-wise linear regression, cut-off point 500 employees

Source: Data collected from interviews as of Jan 15, 2007; team analysis

Homkes, Centre for Economic Performance 2011 54

Variation in firms' management practice vs. assessed management practice score**



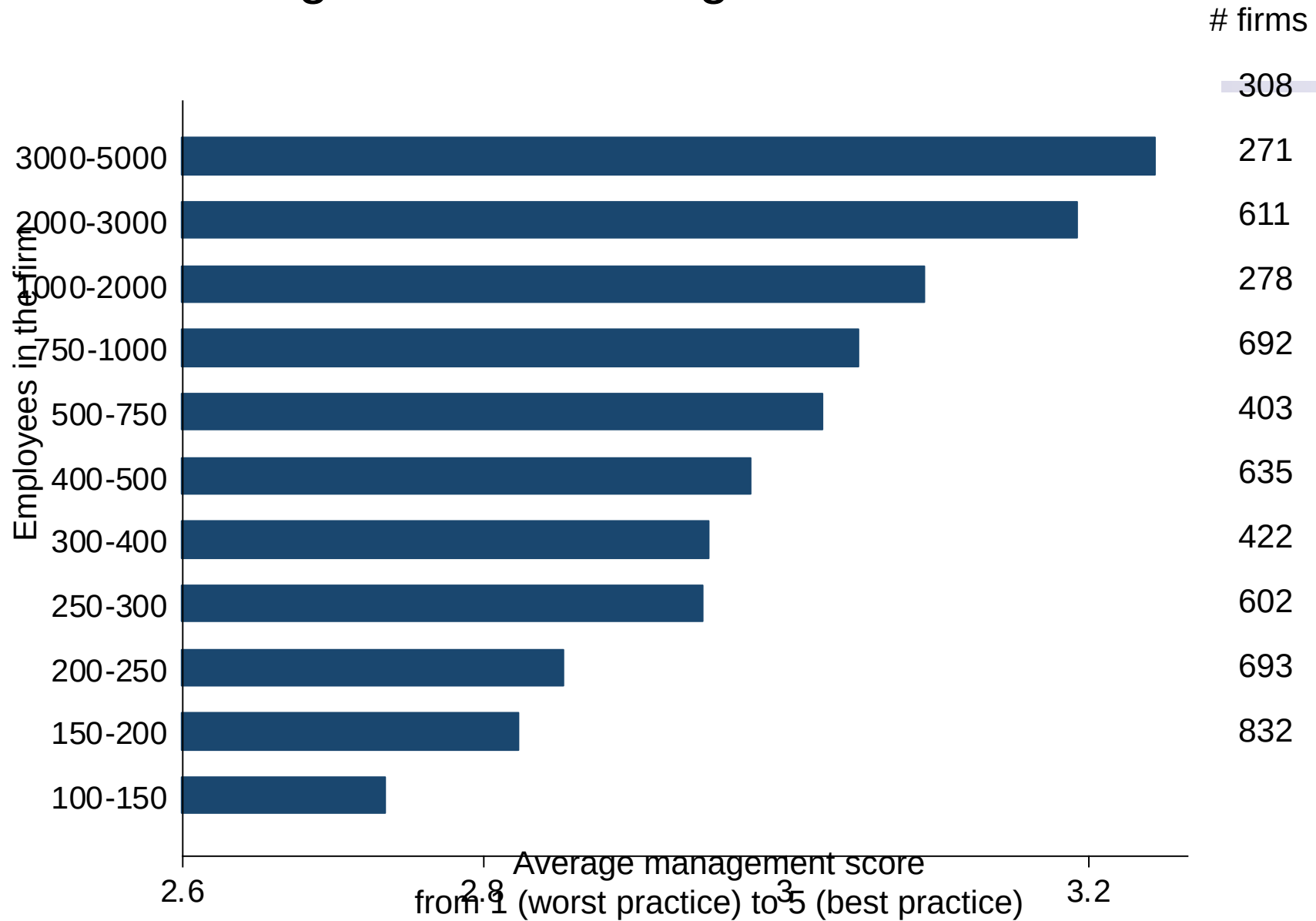
* Note that decreasing variance may well be a purely statistical effect ("fringe effect") due to limitation within 1-5 band

** Lowess fit

Homkes, Centre for Economic Performance 2011 55

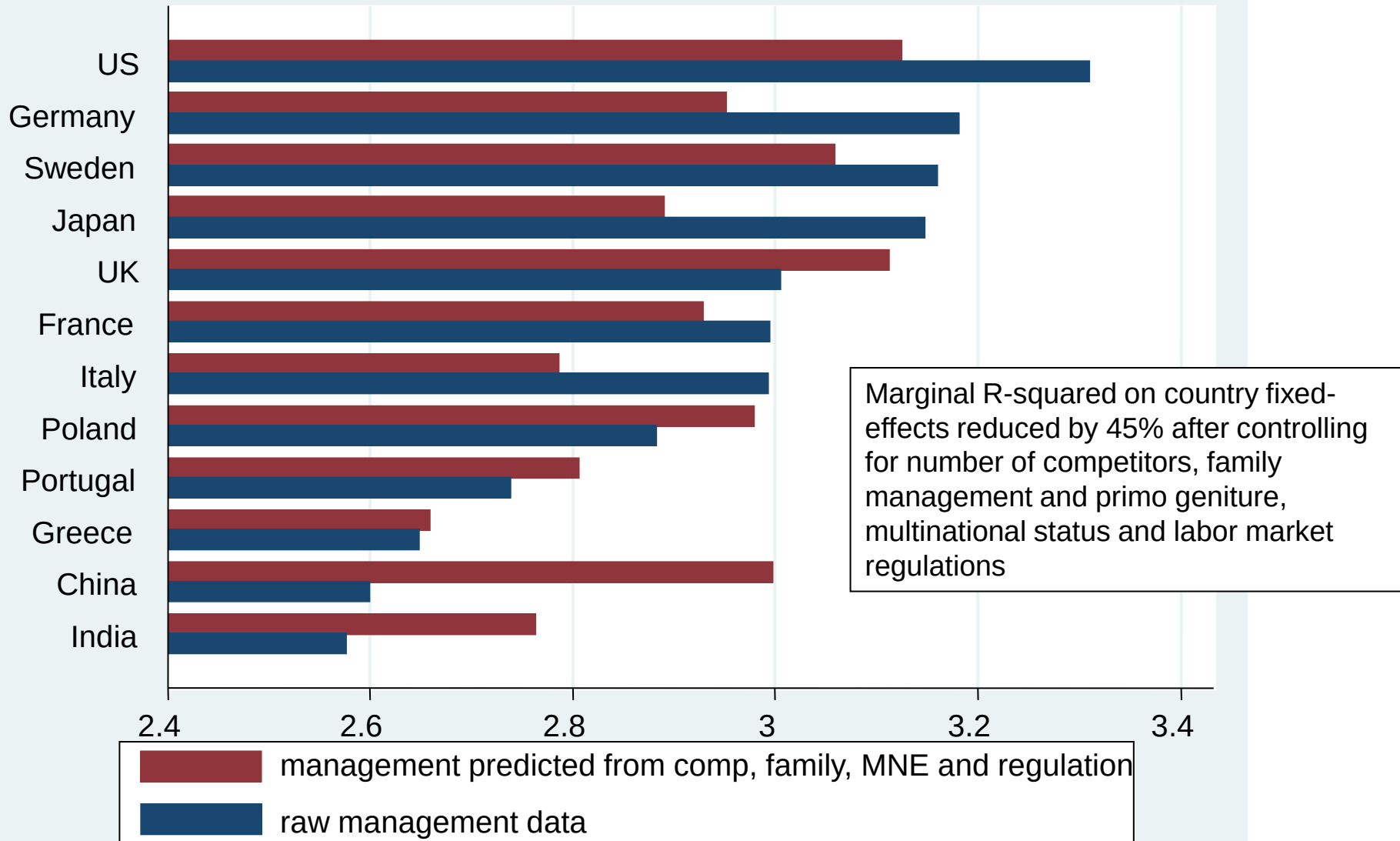
Source: Data collected from interviews as of January 15, 2007; team analysis

Better Managed firms are larger



Note: Averages taken across all firms within each country. 5,747 observations in total. Mean and median firm size is 701 and 320 employees respectively.

COMPETITION, FAMILY FIRMS, MULTINATIONALS & LABOR REGULATIONS ACCOUNT FOR $\approx \frac{1}{2}$ COUNTRY SPREAD



LIGHT LABOR MARKET REGULATIONS ALSO FACILITATE GOOD PEOPLE MANAGEMENT

