Response to the Business Productivity Review
What role can business play in driving firm-level productivity growth in the UK?

1. Introduction

Be the Business is a new business-led movement created to close the UK's productivity gap. Chaired by Sir Charlie Mayfield, Chairman of the John Lewis Partnership, Be the Business is spearheading a business-led drive to help companies across the UK improve their performance.

Like others, we have looked at the compelling body of evidence that has been developed on firm-level productivity. Our own genesis was based on key evidence:

- The significant volume of UK firms who underperform on productivity compared to their peers in other G7 nations – our 'long tail' of businesses. We also have a larger gap between 'the best' firms in the UK and 'the rest' compared to similar nations which indicates a lack of uptake of best practice.
- The importance of leadership and management practices in driving productivity. Bloom et al (2014), for example, estimate that about a quarter of the UK's productivity gap with the United States could be down to poor management.
- The distinct needs of SMEs where there is less time for management training and advisory support compared to large firms.

Since Be the Business formally began work six months ago we have been raising awareness of the productivity challenge and have provided a call to action for individual firms. At the same time, we are building a body of evidence about improving management and leadership capacity and driving firm-level change. We are engaging with hundreds of firms and working with them to unpick the core drivers that will deliver sustained change. This is not a short journey, but we are already learning a significant amount.

Given the central role of investment, technology and exports to the UK's productivity success, we must recognise the critical dependency of good management and leadership in driving business productivity.

This paper sets out Be the Business's insights about the productivity puzzle. We have leveraged our engagement with industry, including with some of the UK's leading businesses, as well as some of our own research.

We recognise that Government is keen to hear views on a range of questions and that there is already a degree of consensus on a number of the existing challenges. Instead of repeating these issues, we have instead focused on drawing together some of the key insights that Be the Business has gained since it became operational six months ago.

2. *What we have learned: UK productivity and firm-level practices*

In this section we have focused our insights around five key themes:

- The importance of management and leadership
- Measurement
- The diffusion of best practice
- The market for SME support
- Firm-level attitudes

Management is absolutely vital to productivity in the UK

The evidence that management is vital to productivity holds true not only in the UK but also around the world. But it's critical for the UK, where we lag behind international competitors. At the firm level, we believe great leadership is central to a firm's potential to strengthen other business practices - from employee engagement to digital adoption to exporting. At the national level, adoption of good practices is estimated to be the driver for more than half of the future growth in the UK, and good management and leadership will sit at the heart of that adoption.

- <u>The uptake of better management and leadership needs to drive our future growth.</u>

  McKinsey & Co conducted a macroeconomic analysis of future UK growth and found that 55% will have to come from firms adopting existing best practices with the rest coming from pushing the frontier.[1]

- <u>Good management practices are one of the biggest drivers of better productivity at the firm level around the world.</u>

  Robust research demonstrates the link between management practices and productivity not just in the UK. Bloom et al (2014) estimate that about a quarter of the UK's productivity gap with the United States could be down to poor management. The flip-side analysis supports the same conclusion. Studies have shown that deficiencies in UK management skills have also been shown to be a key driver of inter-firm productivity gaps. The international evidence reflects the realities of our experience of businesses on the ground. Firms we have worked with on management and leadership point to the specific take-aways this provided - such as regular performance reviews, target-setting, and engaging employees in identifying improvement opportunities - as having a transformative effect on their business and productivity. This also echoes the findings of David MacLeod and Nita Clarke's 'Engage for Success' report and the CBI's recently published 'Be More Magpie' report.

[1] McKinsey Global Institute, Global Growth: can productivity save the day in an ageing world?, January 2015

- Uptake of these leadership and management practices underpins the ability of firms to invest in their businesses, implement digital technology, and expand into exports.

  We have heard from business leaders, banks, accountants and other business support firms, alike, that they see a marked difference between the business leaders doing only the immediate work required to sustain the business on a day-to-day basis, and those also doing the longer-term work of improving their businesses for the future. Interestingly, we hear that firms who have more knowledgeable and confident leaders focus on the longer-term strength and sustainability of the business (whether through greater uptake of digital technology, stronger emphasis on human and physical capital, exporting or broader investments in their leadership development).

- The relevant management practices are well-understood.

  The management practices that make the biggest difference have been established as a result of extensive research from McKinsey Global Institute and a range of academics including Bloom, Van Reenen, and supported by many other leading practitioners. They have been endorsed by our advisory board, who recognise these practices as key to their own businesses and supply chains. We also know that all these practices are within reach of every firm though some, for example, digitisation, require some new capability building to ensure firms are able to embed this in their businesses.

Measurement

Many argue the national productivity numbers do not appropriately account for real productivity for a combination of data reasons. While this is not an invalid argument, we do not believe a different data cut would change the importance of supporting better management and leadership in UK firms

- Studies have shown that mismeasurement alone is unlikely to account for the majority of the productivity puzzle.

  Studies have found that mismeasurement alone is unlikely to account for the majority of the productivity puzzle, whether in the UK or internationally.[2] Some of the mismeasurement problems already existed before productivity started slowing. These measurement challenges would need to have increased dramatically – and probably unrealistically – to explain fully the productivity slowdown. Any measurement changes would also apply internationally, and we do not believe these would change Britain's competitive position.

[2] Syverson (2016) Byrne et al (2016) - Syverson, C (2016), 'Challenges to Mismeasurement Explanations for The U.S. Productivity Slowdown', NBER Working Paper No. 21974; Byrne, D, Fernald, J, Reinsdorf, M (2016), 'Does the United States have a productivity slowdown or a measurement problem?', Brooking Papers on Economic Activity, Spring.

Something is not working at the firm-level in uptake of good practices

While the UK boasts some of the most productive firms in the G7, firm-level uptake of leadership and other good business and technology practices across the majority of SMEs is not sufficient. At the leadership level, there is simply not enough training, and workforce training doesn't seem to focus enough on broader management practices. There are still additional barriers around particular areas, like technology adoption, where firms often lack the in-house skills to embed technology in their firms.

- The best in the UK are some of the best in the G7 but the gap between the best and the rest is also one of the largest.

  Our most innovative firms are some of the best in Europe at collaborating with others. But the productivity gap between the best and the rest in the UK is also one of the largest in the G7. It means that the for the rest, a range of issues seem to persist. On the demand side many firms simply do not seek advice, and most tend to overstate their productivity compared to others. On the supply side, challenges like the variability in the quality of advice have exacerbated the issue.

- The focus on leadership needs to be stronger and more effective across all firms

  39% of SMEs[3] invest in increasing the leadership capability of their managers. However, we suspect this is more densely concentrated in the top performing firms given what we are seeing elsewhere. Further evidence shows that 4 in 5 managers leading teams in the UK are 'accidental managers', that is those who have been given very little to no management training. These figures suggest as many as 2.4 million bosses across the UK are untrained to lead.[4]

- Workforce training is still the primary way to develop employees, but it's in decline.

  One of the top ways that SMEs are investing in improving their businesses is by increasing the skills of the workforce (training) (62%). Yet overall investment in off-job training has been in steady decline since before the crisis even began.[5] Further, the majority of workforce training is technical (e.g. taxation, regulation, cash flow), whereas we would argue that even at the workforce level it is vital to boost leadership and management capabilities particularly around employee engagement.

- Technology adoption is hampered by a lack of firm-level capability

  Evidence shows the link between the adoption of basic technology and productivity improvement, and the importance of good management and leadership in embedding technology in firms. However, firms often don't have the right skills to

[3] Employer Skills Survey
[4] CMI
[5] Ibid

successfully deploy new technologies in their own businesses. Alongside this, businesses are reluctant to experiment with new technology. Many of the businesses we speak to have made mistakes in sourcing and embedding technology into their businesses in the past, leaving them reluctant to experiment and invest further. Smaller firms don't have CTO capability and there's limited support to help firms understand the potential impact of technology and how to introduce it. The provision that does exist is solution and sales oriented, and is therefore often mistrusted.

The economics of the market for SME business support do not stack up, so the market doesn't function effectively.

While the UK boasts some highly productive firms of all sizes, there is less firm-level uptake of management and technology practices across the economy. On the supply side, the economics of supply for business advisors or business schools only stack up for a high level of steady demand, which is not forthcoming. On the demand side, a range of hurdles to seeking advice exist from costs and time demands, to unclear value to the bottom line.

- The economics of productivity improvement services (training or advisory work) don't always stack up.

  Many of the successful SME training programmes to date have been delivered through subsidy, either through business schools finding pots of funding – mostly European – to draw on, or through private subsidy as is the case for the Productivity through People programme and the Goldman Sachs 10,000 programme. Without these subsidies the market is uneconomical, primarily because the cost of service delivery outweighs what SMEs can or are willing to pay. While some business schools and third parties are keen to work with the SME market (most notably those accredited through the Small Business Charter), we know there is a lack of demand underpinning the challenge in the market. And without sufficient demand, there is little incentive for business schools and providers to create accessible, reasonably priced productivity improvement programmes. Thus supply and demand don't rise together.

- There are a mix of factors underpinning weak demand for support.

  Based on our extensive conversations with SMEs we believe there are six demand side issues for firms seeking advice:

  - Time: Most SMEs simply lack time to think about the kind of support they need. But even when they do, the work of engaging support or entering training can also require significant time away from the business that is a major deterrent.

  - Value: While firms will often advocate for training programmes after participating, many fail to see the value before participating, especially in line with price points. Further many firms feel they have unique needs not aligned to the kind of general support available.

- Cost: Firms often see the scale of the upfront costs for management and leadership training as prohibitive.

- Quality: A perceived (and real) lack of consistency across / between regions and for firms of different sizes / different industries within a region.

- Lack of awareness: Many firms have very little awareness of how they compare to their peers and, therefore, whether there's an opportunity for them to improve.

- Opacity: Some firms aren't aware of the support that's available to them.

- <u>There are some common triggers to exploit that drive firms to seek advice.</u>

  These triggers are varied, but some common ones include: new trends in a sector that demand a fresh response, a substantive disruption (e.g. loss of a major contract); or changes in firm leadership. We also see that many managers who are fighting-fires from month to month rather than managing for the long-run, are typically very aware but are caught in a cycle they find hard to break away from. Family-run firms in particular have specific points in their lifecycle, for example, bringing non-family members into management or succession, at which point market support is likely to be most effective.

- <u>The market for technology appears strong but is more supply than demand-oriented.</u>

  Despite the plethora of options, firms often cite a lack of awareness about a) what types of technology will make a difference to their firm, b) the best provider for firms like theirs, and c) how to successfully deploy the technology in their own businesses. The CBI 'Magpie to Ostrich' report was right to state both Government and business must lead a long-term change in the UK's adoption of technology and management best practice. There is no objective source of advice for firms on productivity-enhancing technology, and there's therefore a broader opportunity to improve the market for 'productivity tech'.

- <u>Demand may be linked to competitive intensity, where the UK is lower than many of our European peers.</u>

  The UK's competitive dynamism can be measured in a number of ways, and on a number of these measures we are behind. In competitive intensity and customer orientation the UK lags notably behind Germany and the US.[6] And while our business dynamism as defined by business churn (i.e. creation and folding of firms) has not

[6] WEF Survey

changed since before the recession, there are big regional differences in this kind of business dynamism.[7]

There are mixed firm-level attitudes to improvement

While UK firms are not explicitly focused on productivity in name (except in manufacturing) most firms do focus on issues that would be underpinned by strong leadership and management. But firms think more in terms of the symptoms of their issues, and less in terms of potential underlying causes. Firms also overestimate their productivity, but we don't believe this is over-confidence as there is evidence of the contrary. Rather, we see this as lack of awareness.

- Both British managers and employees have a tendency to overestimate their productivity. Many are simply not aware they are behind their peers.

  Four in five (79%) business owners or managers believed their business was as productive or more productive than their peers. [8] This shows a similar result to earlier research conducted by CIPD which shows 95% of UK employees believe they are as or more productive than their peers.[9]

- British firms are not explicitly worried about productivity in name, but business's concerns and priorities link directly to productivity practices and capabilities.

  Top of mind issues for UK firms are things like rising prices, the economic climate and competition, staff recruitment and skills, and Brexit.[10] While none of these stated concerns are explicitly 'firm-level productivity', issues like staff and rising prices are central to productivity. Further, many firms cite management practices as an explicit priority in tackling their major challenges, which we know is a key to better productivity when done well.

- When it comes to management and leadership issues, firms typically think in terms of the symptoms of their challenges, and far less often about the underlying causes.

  In firms we work with we often see immediate problems that are best solved by adopting long-term management changes. For example, the firms we work with in Cornwall talk about retaining skilled chefs and waiting staff and driving off-peak demand. Sustainable solutions to these problems – for example, new talent management and marketing practices – are the best way to respond.

There are a suite of improvement support initiatives that add value when delivered in the right format to the right audiences.

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[7] Hart et al
[8] Be the Business/ YouGov Omnibus
[9] CIPD
[10] BEIS Small Business Survey 2017

We have learnt a number of lessons about effective interventions from reviewing current provision and piloting new programmes:

- We know high contact programmes are highest impact.
- Tailored benchmarking can be a very effective first step in stimulating greater business interest in improvement, but it works best in context of advisor or peer-to-peer discussions.
- Leadership and mentoring programmes work. They are high impact but very hard to scale in light of the economics of the improvement market.
- Mentoring is particularly powerful when SMEs feel they are getting access to mentors they trust and would be hard to reach through their own networks.
- Firms are best engaged at specific points in the business lifecycle, when they are most receptive to change. Firms don't go from low performing to high-growth over their lifetime but rather tend to oscillate through these phases.

3. *What we have learned: productivity practices*

We have framed the core management and business practices that drive productivity under six levers. These practices were identified from extensive analysis of evidence around linkages to productivity or proxies thereof, and the evidence is compelling. Our sources for the analysis were broad including various BIS, CIPD, ERC, Sage, UKTI data and reports, academic literature including Bloom & Van Reenen (2006, 2007), Black & Lynch (1997) Goldman Sachs (2015) Unlocking UK productivity, Golvoko and Valentini (2011), and McKinsey analysis.

Below is a sample of the highlights from our analysis of the linkages between business practice levers and productivity.

Leadership: Displaying management behaviours, organisational vision and values

- Ineffective management costs UK businesses ~£19bn per year
- Meaningful values correlate with good employee motivation: 51% of organisations with top quartile meaningful values have top quartile motivation

Talent management: Utilising performance management and talent development processes

- Motivation increases employee engagement which improves business performance. For example, sickness absence rates are reduced amongst engaged employees: engaged employees take 2.7 days per year vs. 6.2 from disengaged employees

Planning for the future: Clearly setting targets and ambitions for the future, and communicating this with staff

- High ambition SMEs are 14% more likely to experience turnover growth

- Up to 70% of UK's long-term economic growth is driven by innovation at company, industry and national level

Digital: Adopting best in class commercial and operational practices

- Better adoption of existing technologies could help businesses streamline day-to-day functions – and help save many of the 120 days' worth of time each business spends on administration each year.

Operational efficiency (sector-specific): Embedding continuous improvement and cost management processes

- Best practice maintenance, planning and scheduling can increase productivity by up to 30% in three months

Commercial excellence (sector-specific): Maximising sales, exports and establishing a strong online presence

- 85% of UKTI clients felt exporting led them to achieve growth that would not otherwise have been possible

4. Areas for further consideration

Be the Business believes there are additional areas of focus, based on the evidence and our conversations to date, that need support to address market functionality in business support and to address some of the demand side barriers to the uptake of best practice.

SME leadership development

The problem: While large companies tend to have programmes of leadership training, SMEs do not benefit from the same, and the cost of third party management training can be prohibitive for smaller businesses. We've observed that high-quality and free / reasonably priced supply-side provision is often subsidised by European funding, or private-sector donations. This holds true for our Productivity through People programme and the Goldman Sachs 10,000 programme, to name two examples. As a result, the market provision of good leadership training is smaller than is economically optimal.

Possible approach: We believe there is an opportunity for Government to address the demand and supply deficiencies in this market. For example, on the demand side, Government could create an equivalent of the R&D tax credit for firms who invest in human capital, awarded on the basis of completion of a recognised / accredited management and leadership programme.

Independent champion for smarter technology adoption

The problem: There is a real gap in the market for objective advice for firms on productivity-enhancing technology. The market of providers is very crowded and SMEs are inundated with sales pitches, but they typically don't have the time nor expertise to navigate the choices, benefits and investment costs. As such most are left putting off the decisions or making choices which don't benefit their firms.

Possible solution: A product to help firms navigate this market could broadly be modelled on the 'Which?' approach to product reviews that currently exist in the consumer space. It would educate buyers of technology on what it takes to successfully embed technology; how to think about the right solutions; how to buy effectively; and allow firms to share experiences. This kind of approach is well-recognised for consumer technology but this has not been replicated in a B2B context. This suggested intervention builds on the Business Basics programme which BEIS have recently announced, and a similar intervention has also been championed by the CBI.

Activating intermediaries in the SME sector

The problem: Similar to above, but broader than just technology adoption, SMEs often don't have the bandwidth to take a step back and look at where they need to focus to improve the business overall, and they are also limited by resources. But even if they do decide it's time to focus on the business, they often don't have available trusted advisors. They may however have a series of trusted partners in accountants, bank managers, and others who they are already working with, and who have a vested interest in these firms doing better.

The solution: Develop the 'army of champions' for productivity tools. Explore which tools most align to the needs of both the SMEs and the service providers already working with them. They could be equipped with a core toolkit (including benchmarking, which we have seen work well elsewhere) or a wider toolkit (also incorporation direction to mentoring and training provision). We know that often these intermediaries are often the first source for firms accessing initial support and are therefore an obvious route by which to channel elements of SME support.

Further information

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