

## **ENABLERS OF PRODUCTIVITY – ARE THEY ALWAYS WHAT THEY SEEM?**

**Terry Pilcher, DMS MCFI**  
**Director**  
**BCS Management Services**  
**Cambridgeshire, England**  
**E. Mail: BCSMgt@aol.com**

### **Abstract**

The Department of Trade and Industry's benchmarking tool, the **Benchmark Index** has enabled small and medium-sized companies to enjoy the advantages of high-quality benchmarking that larger organisations with their greater resources have benefited from for some time. An extensive database of information has been built up since the Index came into operation in 1996. This now has a database of over 9,000 companies, including a significant international contribution. The aggregate data was used to produce a report 'Enablers of Productivity' which looks at the relationship between management policies and productivity levels.

### **Introduction**

Benchmarking is an invaluable management tool that enables all types of organisations to examine their performance critically, so that they may adopt the better practices of those that are considered market leaders. By appraising their performance and assessing their strengths and weaknesses through benchmarking, organisations gain the opportunity to develop the appropriate policies and implement the changes necessary to achieve competitive advantage. But best practice is not just the preserve of companies in a particular market. Whilst improving performance locally and being more competitive is very important, a given organisation could still be falling behind its global competitors.

### **Background**

The UK has been in the forefront of benchmarking activity for many years. This has been driven by the perceived need to improve productivity and thereby become more competitive. This is particularly important for Small to Medium Size Enterprises (SMEs) who are vital in the establishment of a dynamic economy. A flourishing SME sector leads to improved economic growth, higher employment levels and can be an important source of innovation. The increased range of products and services that can be supplied by this part of the economy also contributes towards the growth of large companies by the very nature of the greater diversity of goods and services that they provide. But in order to improve productivity and with it competitiveness contributing to the wider economy SMEs can benefit greatly from high performance measurement tools so that they may introduce appropriate policies and strategies to enable them to achieve their full potential.

The DTI's own benchmarking service, the Benchmark Index, is just such a tool. It enables organisations to measure their performance in 80 key aspects of performance

in Financial, Management and Business Excellence areas. Apart from these aspects of performance, the service also provides a suite of additional modules which enable SMEs in particular sectors or engaged in particular types of activities to benchmark themselves in very specific ways. For example over 2,000 SMEs have already benchmarked themselves using the service's manufacturing module, in addition to their using the core questionnaire. More than 1000 SMEs have also taken advantage of modules on Marketing and Quality Cost Delivery.

As the biggest service of its type in the world, with over 8,000 benchmarks having been carried out using its core questionnaire, the Benchmark Index has accumulated a wealth of performance comparison data in the six and a half years since its inception that is increasingly being used alongside other benchmarking and best practice activities. Its particular strength lies in the accumulated hard management data, which complement the softer, more qualitative, Business Excellence- based approach of many other prominent benchmarking services.

With such a wealth of information available on SME performance there is a growing emphasis on the analysis of aggregate data. At the outset the position regarding sector and country performance could be explored. Now after several years specific trends can also be examined. The data is unique in that it covers hard management questions and is available in large quantities. It was possible to analyse the data to see if identification of issues followed by remedial action over a number of year was having the desired effect in relation to productivity.

### **Enablers of Productivity Report**

It is interesting to consider the links between productivity and profitability. Clearly, profit is critical to business, whereas productivity is key to economic success and is, therefore, often the focus of economists and strategists. Can productivity and profitability exist as easy bedfellows or are the two mutually exclusive? Whilst the **Enablers of Productivity** report is intended to focus on productivity it is interesting to share some observations in this regard. In many cases, the enablers of productivity have a similar effect on profitability (i.e. both positive and negative) however, there are exceptions, which will become evident from the results of this analysis.

A number of recent studies have identified major weaknesses in UK productivity when compared to companies in the US and elsewhere in Europe. (The latest of these being the McKinsey report **Fostering Excellence: Challenges for productivity growth in Europe published in June 2004**). Productivity is a measure of how efficient we are at creating wealth, how prosperous the UK is as a nation and how likely it is that jobs created today will increase prosperity. It is, however, important when tackling the decline in traditional industries that we understand the impact of creating jobs in other sectors and industries. Replacing high value jobs in manufacturing with low value added jobs in service-related jobs, for example, is an unattractive long-term prospect. Similarly, we need to understand why many sectors of business in the UK are less productive than similar sectors elsewhere.

There has been much discussion about how this low productivity may be linked to problems with management and leadership or the slow adoption of ICT. Many of these expert views may well be correct but are often based on incomplete information

or matter of opinion. In this research exercise the Benchmark Index data covering 4000 UK companies was used and sought to link cause and effect. By studying 'enablers' and productivity, it has been possible to determine what really adds value to UK business.

The Benchmark Index core questionnaire collects 59 pieces of hard data. The analysis undertaken within this research considered the correlation between these data elements and productivity performance to establish what can be learned and therefore applied to improve business productivity. Within the Benchmark Index there are three main measures of productivity, which are pre-tax profit per employee, turnover per employee and value added per employee. The use of value added is particularly appropriate as it is consistent with other measures used by the DTI in considering productivity namely, P1 labour productivity which is value added per employee and P2 value added efficiency which relates value added (the output) to the main inputs and capital equipment. It is calculated by dividing value added by the sum of employee costs and depreciation. In the research undertaken P1 (labour productivity) is used although P2 (value added efficiency) has been used in the sectoral analysis.

The analysis was undertaken in two stages. The first was to determine potential enablers. An initial analysis was undertaken of the potential correlations between value added per employee and the data collected from the Benchmark Index core questionnaire. This identified factors that had a positive and negative effect on productivity. Having identified potential enablers their relevance was tested by comparing companies with low (bottom third), medium (middle third) and high (top third) performance in those areas to determine their impact on productivity. For example this research considers the impact of training on productivity. One measure of this is the amount of training expenditure per employee. The difference in productivity between those with a low, medium and high-level of training expenditure is compared.

## **Results**

### ***Customer Focus***

In both the manufacturing and service sector the figures show higher labour productivity is linked to higher complaints. There could be a number of potential reasons for this. Firstly, higher added value companies are better and more thorough at recording complaints and secondly customers of higher value added companies may have higher expectations and are more likely to complain.

It is a long-held belief that the customer is the final arbiter in product and service quality and that a high level of complaints is bad for business. What if high value added companies encouraged complaints and used the feedback to shape product and service offerings? This could explain why higher added value companies seem to have more complaints than their weaker performing counterparts.

The research also showed that companies with a 'medium' level of performance in terms of rejected orders seem to be most productive. Once again, this is perhaps counterintuitive. We need to bear in mind that higher productivity companies are, perhaps, working in bigger batch sizes, which could mean that they are working with

fewer orders and customers overall. This could lead to order rejection rates appearing higher. However, as order rejection rates increase even further, labour productivity sharply decreases, no doubt as a result of reworking required.

Another finding was that as the proportion of new customers grows productivity falls. This negative impact on productivity is almost twice as bad in service industries (27% reduction) as it is in manufacturing (14% reduction). There are two observations on this situation. Firstly, it is more labour intensive to recruit new customers, with more sales people required and possibly more technical development staff as well. Secondly, it could be argued that new customers are an investment in the future and this intuitively makes sense. However, the results seem to suggest at some point a business has to reap what it has sown and look to maximise the relationship that it has with its existing customers. Constantly pursuing new customers may not always be beneficial.

### ***People Satisfaction***

The proportion of graduates seems to be more important in the manufacturing sectors than in the service sectors, where companies with the highest proportion of graduates see a decreasing amount of labour productivity. More generally, there is a negative correlation with lower productivity being associated with a high incidence of early leavers (those leaving within 6 months). Also, the report shows that the higher the proportion of new employees to total employees the lower the rate of labour productivity. For manufacturing, productivity is similar for companies with a low or medium number of new employees, showing this issue is less sensitive in this area, possibly as a result of automation and clearly defined processes. However, as the rate of new starters continues to increase, manufacturing becomes more sensitive to it as even highly automated process driven activity begins to suffer. As would be expected similar results apply to staff retention.

Surprisingly, there is little impact on manufacturing productivity between companies with low and high levels of absenteeism. This could be as a result of automation, which minimises the impact of staff not turning up for work. Conversely, there is a positive correlation between absenteeism and productivity in the service sectors, where companies with high levels of absenteeism are much more productive than those with a low level. Again, we need to ask what is 'cause' and what is 'effect'? It might be that companies with higher levels of productivity suffer higher absenteeism rates. This could be as a result of extra pressure placed on people working to high unsustainable targets.

### ***Continuous Learning and Improvement***

It is a widely held belief that organisational performance is maximised when it is based on the management and sharing of knowledge, within a culture of learning and improvement. While the data supports this concept for the manufacturing sector it is not the case in the service industries.

Manufacturers that provide a high number of days for staff training enjoy productivity that is 24% better than manufacturers that provide very little time for staff training. The opposite is true in the service sector, where companies that provide significant

time for staff training have 18% worse productivity than those that provide little time for this activity.

There is a similar curious pattern in terms of training expenditure. Manufacturers that spend heavily on staff training enjoy 47% better productivity than those that spend little. The same is true in the service sectors. While those that spend heavily on staff training enjoy better productivity the difference is only 13%. It is worth noting that in the service sectors, productivity falls with training expenditure between those spending least and those spending at the medium.

What this potentially tells us is that in the service sectors, the matter of training and development is far from clear-cut. Days out of the office on training courses have a negative impact on productivity. However, companies spending the most on training see a worthwhile gain in productivity.

### ***Partnership with Suppliers***

Substandard supplies have a big impact in both manufacturing where the data showed an 8% reduction in productivity and service, where the productivity reduction was 28%. This shows the importance of supplier relationships. Old models of 'customer' and 'supplier' relationships need to be re-thought, with a partnership approach adopted. Companies involved in a supply chain should have mutually beneficial relationships that are built on trust and value to both parties.

### ***Investment for Innovation and Growth***

The research looked at the impact of investment in equipment, in products, in market development, in R&D and in marketing. As with any investment, the results may not be immediately seen and, therefore, it is not always easy to determine the effects of the investment. However, there are several areas of note. Firstly, innovative companies in the manufacturing sectors (those generating income from new products or markets) see an earlier benefit from investment than those in the service sectors, where innovation usually results in a drop in productivity. Secondly, marketing expenditure destroys value in the service sectors, at least in the short term. Thirdly, R&D expenditure in the manufacturing sectors has greater immediate benefits than it does in the service sectors where productivity falls, at least initially.

### ***Company Structure***

The research looked at the number of people directly involved with the production or provision of a product or service. It is not always easy to compare this between companies, as there is uncertainty as to whether things such as transport, or sales and marketing are direct or indirect. However, it is interesting to note that the fewer directs there are, the better the level of productivity.

The ratio of employees to managers was the final area that was studied. Conventional wisdom suggests that management structures should be flatter, with fewer managers and a greater number of people reporting directly to them. The evidence from the research suggests that this is not necessarily the case. The most productive companies

within the Benchmark Index database, both in manufacturing and service sectors actually have a lower ratio of employees to managers.

## **Conclusion**

It is important to outline the possible limitations of the analysis in order to present a balanced view. This analysis has considered the manufacturing and service sectors in a broader context. In reality each sector will have its own unique characteristics, which might show different responses to the various enablers. The analysis also looked at the dataset at a specific point in time, with no consideration to the time effects of strategy. Additional analysis of the productivity growth of companies investing in R&D, capital equipment or people development, for example, might well demonstrate the longer-term benefits of such strategies.

However, even though limited the research has provided some interesting areas for discussion based on good quality hard management data. Many of the topics covered in the report are of great importance to a company wishing to maximise both its productivity and bottom line. Further work in this area should be encouraged.

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