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OPERATIONS

Why Do We Undervalue Competent Management?

Neither great leadership nor brilliant strategy matters without operational excellence.

by Raffaella Sadun, Nicholas Bloom, and John Van Reenen

UNDERSTANDING MANAGEMENT'S VALUE

WHY DO WE UNDERVALUE COMPETENT MANAGEMENT?

NEITHER GREAT LEADERSHIP NOR BRILLIANT STRATEGY MATTERS WITHOUT OPERATIONAL EXCELLENCE.

BY RAFFAELLA SADUN, NICHOLAS BLOOM, AND JOHN VAN REENEN

EVERETT COLLECTION/SHUTTERSTOCK

IN MBA programs, students are taught that companies can't expect to compete on the basis of internal managerial competencies because they're just too easy to copy. Operational effectiveness—doing the same thing as other companies but doing it exceptionally well—is not a path to sustainable advantage in the competitive universe. To stay ahead, the thinking goes, a company must stake out a distinctive strategic position—doing something different than its rivals. This is what the C-suite should focus on, leaving middle and lower-level managers to handle the nuts and bolts of managing the organization and executing plans.

Michael Porter articulated the difference between strategy and operational effectiveness in his seminal 1996 HBR article, "What Is Strategy?" The article's analysis of strategy and the strategist's role is rightly influential, but our research shows that simple managerial competence is more important—and less imitable—than Porter argued.

If you look at the data, it becomes clear that core management practices can't be taken for granted. There are vast differences in how well companies execute basic tasks like setting targets and grooming talent, and those differences matter: Firms with strong managerial processes perform significantly better on high-level metrics such as productivity, profitability, growth, and longevity. In addition, the differences in the quality of those processes—and in performance—persist over time, suggesting that competent management is not easy to replicate.

Nobody has ever argued that operational excellence doesn't matter. But we contend that it should be treated as a crucial complement to strategy—and that this is true now more than ever. After all, if a firm can't get the operational basics right, it doesn't matter how brilliant its strategy is. On the other hand, if firms have sound fundamental management practices, they can build on them, developing more-sophisticated capabilities—such as data analytics, evidence-based decision making, and cross-functional communication—that are essential to success in uncertain, volatile industries.

Achieving managerial competence takes effort, though: It requires sizable investments in people and processes throughout good times and bad. These investments, we argue, represent a major barrier to imitation.

In this article we'll review our research findings and then discuss the obstacles that often prevent executives from devoting sufficient resources to improving management skills and practices. Throughout, we'll show that such investments are a powerful way to become more competitive. If the world has really entered a "new normal" of low productivity growth, as Robert Gordon and others have argued, pushing managerial capital up a level could be the best route out of the performance doldrums.

IN BRIEF

THE CONVENTIONAL WISDOM

It's a truism among strategists that you can't compete on the basis of better management processes because they're easily copied. Operational excellence is table stakes in the competitive marketplace.

WHAT THE DATA SHOWS

There are three problems with this thinking. First, effective management processes are highly correlated with measures of strategic success. Second, differences in process quality persist over time. Third, there's little evidence that best-in-class processes can be imitated. GM tried for years to adopt Toyota's superior production system and failed miserably.

IMPLICATIONS

Organizations need competent management just as much as they need analytical brilliance. We should stop teaching business school students that operational issues are beneath the CEO—and should encourage firms to invest in strengthening management throughout the organization.

CORE MANAGERIAL PRACTICES

In our research, we assess the sophistication with which organizations manage the four broad dimensions—and the 18 specific aspects—of management shown below. The list varies slightly depending on sector (this one is for manufacturers). It's not exhaustive, but companies that manage these fundamentals well tend to have high levels of overall operational excellence.

OPERATIONS MANAGEMENT

USE OF LEAN TECHNIQUES

REASONS FOR ADOPTING LEAN PROCESSES

PERFORMANCE MONITORING

PROCESS DOCUMENTATION

USE OF KEY PERFORMANCE INDICATORS

KPI REVIEWS

DISCUSSION OF RESULTS

CONSEQUENCES FOR MISSING TARGETS

TARGET SETTING

CHOICE OF TARGETS

CONNECTION TO STRATEGY, EXTENT TO WHICH TARGETS CASCADE DOWN TO INDIVIDUAL WORKERS

TIME HORIZON

LEVEL OF CHALLENGE

CLARITY OF GOALS AND MEASUREMENT

TALENT MANAGEMENT

TALENT MINDSET AT THE HIGHEST LEVELS

STRETCH GOALS

MANAGEMENT OF LOW PERFORMANCE

TALENT DEVELOPMENT

EMPLOYEE VALUE PROPOSITION

TALENT RETENTION

THE RESEARCH

Over the past century, scholars have learned a great deal about how core management processes affect a company's performance. For example, researchers such as Kim Clark, Bob Hayes, and David Garvin documented differences within factories, industries, and companies. But a lack of big data encompassing many firms, industries, and countries inhibited the statistical study of management practices. In the past decade, however, we have developed ways to robustly measure core management practices, and we can now show that their adoption accounts for a large fraction of performance differences across firms and countries.

As we've described in earlier articles in HBR, in 2002 we began an in-depth study of how organizations in 34 countries use (or don't use) core management practices. Building on a survey instrument that was initially developed by John Dowdy and Stephen Dorgan at McKinsey, we set out to rate companies on their use of 18 practices in four areas: operations management, performance monitoring, target setting, and talent management. (See the sidebar "Core Managerial Practices" for a detailed list. Though these don't represent the full set of important managerial practices, we have found that they're good proxies for general operational excellence.) The ratings ranged from poor to nonexistent at the low end (say, for performance monitoring using metrics that did not indicate directly whether overall business objectives were being met) to very sophisticated at the high end (for performance monitoring that continuously tracked and communicated metrics, both formally and informally, to all staff with an array of visual tools).

Our aim was to gather reliable data that was fully comparable across firms and covered a large, representative sample of enterprises around the world. We realized that to do that, we needed to manage the data collection ourselves, which we did with the help of a large team of people from the Centre for Economic Performance at the London School of Economics. To date the team has interviewed managers from more than 12,000 companies about their practices. On the basis of the information gathered, we rate every organization on each management practice, using a 1 to 5 scale in which higher scores indicate greater adoption. Those ratings are then averaged to produce an overall management score for each company. (For more details, see the sidebar "About the Research.")

That data has led us to two main findings: First, achieving operational excellence is still a massive challenge for many organizations. Even well-informed and well-structured companies often struggle with it. This is true across countries and industries—and in spite of the fact that many of the managerial processes we studied are well known.

The dispersion of management scores across firms was wide. Big differences across countries were evident, but a major fraction of the variation (approximately 60%) was actually within countries. (See the exhibit "Management Quality Varies Across—and Within—Countries.") The discrepancies were substantial even within rich countries like the United States.

In our entire sample we found that 11% of firms had an average score of 2 or less, which corresponds to very weak monitoring, little effort to identify and fix problems within the organization, almost no targets for employees, and promotions and rewards based on tenure or family connections. At the other end of the spectrum we identified clear management superstars across all the countries surveyed: Six percent of the firms in our sample had an average score of 4 or greater. In other words they had rigorous performance monitoring, systems geared to optimize the flow of information across and within functions, continuous improvement programs that supported short- and long-term targets, and performance systems that rewarded and advanced great employees and helped underperformers turn around or move on.

By interviewing several companies multiple times throughout the past decade, we were able to observe that these large differences in the adoption of core management practices were long-lasting. This isn't really surprising: According to our estimates, the costs involved in improving management practices are as high as those associated with capital investments such as buildings and equipment.

One of our findings may surprise readers: These differences show up within companies, too. A project conducted with the U.S. Census revealed that variations in management practices inside firms across their plants accounted for about one-third of total variations across all plant locations. This was particularly true in large firms, where practices can differ a great deal across plants, divisions, and regions. Even the biggest and most successful firms typically fail to implement best practices throughout the whole organization. Some parts of it are effectively managed, but other parts struggle.

Our second major finding was that the large, persistent gaps in basic managerial practices we documented were associated with large, persistent differences in firm performance. As we've noted, our data shows that better-managed firms are more profitable, grow faster, and are less likely to die. Indeed, moving a firm from the worst 10% to the best 10% of management practices is associated with a $15 million increase in profits, 25% faster annual growth, and 75% higher

ABOUT THE RESEARCH

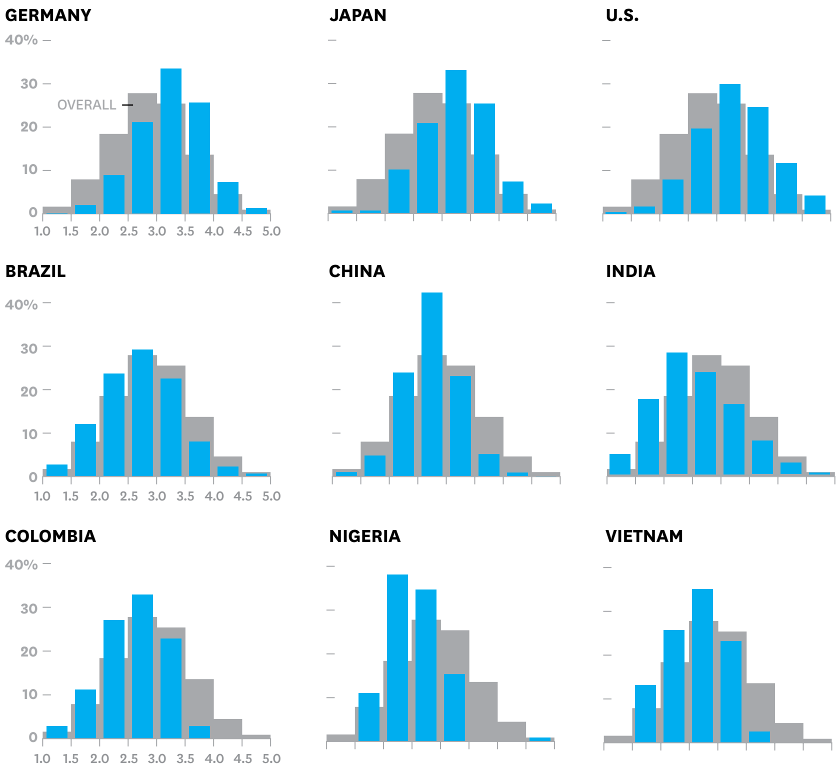
Our research project, World Management Survey, has examined the adoption and use of management practices across more than 12,000 firms and 34 countries. We measure each organization's performance on 18 specific practices in four areas: operations management, performance monitoring, target setting, and talent management. To do that, we have experienced interviewers speak by phone with a firm's plant managers, asking everyone the same 18 open-ended questions and following up with more questions until they have a good sense of the firm's habits. A listener, who doesn't have information about the organization's financial performance, independently scores the organization on each question and each practice.

So far we've conducted more than 20,000 interviews and surveyed companies in four sectors: manufacturing, health care, retail, and higher education. More information about our methodology is available on our website, worldmanagementsurvey.com, where readers can also download the survey, fill in their own responses, and compare their organizations against the benchmarks in our data set. Obviously, the results won't be as complete, or as trustworthy, as they'd be if the organization were being independently assessed, but the process can provide a useful broad-strokes view.

ACHIEVING OPERATIONAL EXCELLENCE IS STILL A MASSIVE CHALLENGE FOR MANY FIRMS.

MANAGEMENT QUALITY VARIES ACROSS—AND WITHIN—COUNTRIES

Some countries get higher average ratings than others on the use of management processes. But as data from this sample of countries shows, in-country variation is even more striking. The blue bars indicate what percentage of firms in each country fell into each scoring range (1 equaled the worst and 5 the best performance). The gray bars show total global percentages.



productivity. Better-managed firms also spend 10 times as much on R&D and increase their patenting by a factor of 10 as well—which suggests that they're not sacrificing innovation to efficiency. They also attract more talented employees and foster better worker well-being. These patterns were evident in all countries and industries. (For a sample of metrics, see the exhibit "Good Management Correlates with Strong Performance.")

But these empirical findings raise a major question: If the benefits of core managerial practices are really so large and extensive, why doesn't every company focus on strengthening them? Also, a more existential issue (which we'll address toward the end of the article) is, What should executives, business schools, and policy makers take away from this body of research?

WHAT CAUSES THE DIFFERENCES?

Some of the variation in management practice is driven by external factors. The intensity of competition is one; competition creates a strong incentive to reduce inefficiencies and kills off badly managed firms. Labor regulations play a role as well; they can make it difficult to give opportunities to employees on the basis of merit or to adopt performance-related compensation. On the flip side, regulators may be in a position to create incentives for employee training or support firms that prioritize managerial competence.

We've also observed that inconsistencies often result from stubborn blind spots and deficiencies within companies. Here are the things that typically hinder the adoption of essential management practices:

False perceptions. Our research indicates that a surprisingly large number of managers are unable to objectively judge how badly (or well) their firms are run. (Similar biases show up in other settings. For example, 70% of students, 80% of drivers, and 90% of university teachers rate themselves as "above average.")

Consider the average response we got to the question "On a scale from 1 to 10, how well managed is your firm?," which we posed to each manager at the end of the survey interview. (See the exhibit "Overconfidence Is a Problem for Managers.") Most managers have a very optimistic assessment of the quality of their companies' practices. Indeed, the median answer was a 7. Furthermore, we found zero correlation between perceived management quality and actual quality (as indicated by both their firms' management scores and their firms' performance), suggesting that self-assessments are a long way from reality.

This large gap is problematic, because it implies that even managers who really need to improve their practices often don't take the initiative, in the false belief that they're doing just fine.

In a variant of this problem, managers may overestimate the costs of introducing new practices or underestimate how much difference they could make. This was a situation we encountered in a field experiment that one of us conducted with 28 Indian textile manufacturers. Accenture had been hired by a Stanford–World Bank project to improve their management practices, but many proposed enhancements—such as quality control systems, employee rewards, and production planning—were not implemented because of skepticism about their benefits. Consultants trying to introduce methods that are standard in most U.S. or Japanese factories were met with claims that "it will never work here" or "we do things our way." Yet the firms that adopted the methods boosted their performance.

Perception problems are hard but not impossible to eradicate. The key is to improve the quality of information available to managers so that they have an objective way to evaluate their relative performance.

As our survey shows, self-reported metrics are likely to be at best very noisy—they're imperfect indicators of what really happens on the ground. There are various reasons why. A common issue is that employees don't raise problems for fear of being blamed for those they identify. That dynamic deprives managers of critical knowledge needed to understand a firm's gaps.

In our experience, managers can address this issue by proactively creating opportunities for candid—and blame-free—discussions with their employees. That's the approach followed by Danaher, a large U.S. conglomerate known for its relentless (and effective) adoption of the Danaher Business System (DBS)—a tool kit of managerial processes modeled on the Toyota Production System—across its many subsidiaries. Danaher typically initiates the relationship with a newly acquired subsidiary through a series of hands-on, structured interactions between senior Danaher managers and the acquisition's top executives, which challenge the latter to identify managerial gaps that may be preventing the business from fulfilling its potential. People taking part in these open conversations—especially those with longer tenure—describe them as eye-opening experiences that significantly change attitudes toward core management processes.

Governance structure. In other cases, managers may be fully aware of the need to improve their practices but pass on this opportunity for fear that change may jeopardize private objectives. This problem is particularly common in firms that are owned and run by families, as you can see in the exhibit "Family-Run Firms Tend to Have Weaker Management." Even when we cut the data by firm size, sector of activity, and country, family-run enterprises still had the lowest average management scores.

Why are family firms so reluctant to embrace strong management processes? One explanation—which finds support in our research—is that their adoption may have significant personal costs to family members. New practices may require hiring or delegating authority to talent outside the family circle. (Indeed, we've seen that higher management scores tend to go hand-in-hand with more-decentralized decision making.)

An example of this is Gokaldas Exports, a family-owned business founded in 1979 that had grown into India's largest apparel exporter by 2004. Gokaldas was a highly successful firm with 30,000 workers, was valued at approximately $215 million, and exported nearly 90% of its production. Its founder, Jhamandas Hinduja, had bequeathed control of the company to three sons, each of whom brought his own son into the business. Nike, a major customer, wanted Gokaldas to introduce lean management practices; it put the company in touch with consultants who could help make that happen. Yet the CEO was resistant. It took rising competition from Bangladesh, multiple visits to see lean manufacturing in action at firms across Asia and the United States, and finally the intervention of other family members (one of whom we taught in business school) to overcome his reluctance.

Self-reflection exercises can help family CEOs clarify whether they value their firms' long-term success more than "being the boss"—even if success means sharing the glory with other managers. In our experience a candid evaluation of one's priorities is crucial—managers are often oblivious to the fact that their own desire for control may be inhibiting the growth and success of their organizations.

In addition, family executives—and especially owners—should understand that introducing new managerial capabilities within the firm does not necessarily entail a loss of control. It is more likely to create a different role for them—but not necessarily fewer responsibilities.

That is what happened at Moleskine, based in Milan, Italy. Launched in 1997 by three friends, Moleskine went from being a niche notebook producer to a market leader in the space of a few years.

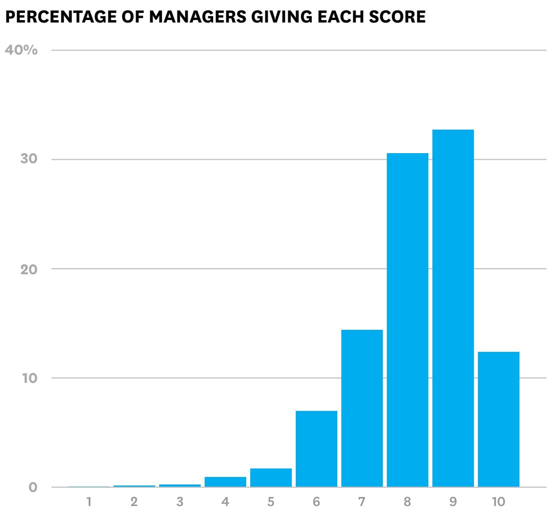
GOOD MANAGEMENT CORRELATES WITH STRONG PERFORMANCE

The companies scoring in the top decile on management outperformed on a variety of strategic measures. Performance by decile:

A LARGE NUMBER OF MANAGERS CAN'T OBJECTIVELY JUDGE HOW WELL THEIR FIRMS ARE RUN.

OVERCONFIDENCE IS A PROBLEM FOR MANAGERS

At the end of every interview, we ask managers to say how well they think their organizations are run and to score them on a scale from 1 (worst) to 10 (best). Overall, their responses are far more positive than warranted.



IT'S UNWISE TO TEACH LEADERS THAT STRATEGY AND BASIC MANAGEMENT ARE UNRELATED.

Its success created a dilemma for its founders: While it was clear that the company had tremendous potential to grow further, they also recognized the pressing need to professionalize its operations. The founders searched for a private equity firm that could provide the necessary capital and expertise and help them find a new CEO. Eventually, they chose Syntegra Capital and Arrigo Berni, an experienced chief executive who had held leadership roles at family-owned producers of luxury products. Berni brought new rigor to strategy development and operations and at the same time crafted a role for the founders that made the most of their commercial and design expertise. Thanks to this successful partnership—and an IPO in 2013—Moleskine was able to deepen its competitive advantage and develop new growth opportunities globally.

Skill deficits. Good management practices require capabilities (such as numeracy and analytical skills) that may be lacking in a firm's workforce, especially in emerging economies. Indeed, our data shows that the average management score is significantly higher at firms with better-educated employees. Being located near a leading university or business school is also strongly associated with better management scores. Superior performance is likelier when executive education can be had nearby, it seems. While to some extent the availability of skills is shaped by a firm's specific context, managers can play a critical role by recognizing the importance of employees' basic skills and providing internal training programs.

Organizational politics and culture. Even when top managers correctly perceive what needs to be done, are motivated to make changes, and have the right skills, the adoption of core management processes can be a challenge. Videojet, a subsidiary acquired by Danaher, provides a case in point. In 2005, Videojet launched a new internal initiative that required the engineering and sales teams to collaborate on developing an innovative printer. The Videojet executives decided to use core DBS managerial processes—which up to that point had been used almost exclusively within manufacturing—to structure regular debriefing and problem-solving sessions between the two teams.

Unfortunately, preexisting divides between engineers and salespeople meant that the structured interactions, which had been effective in driving continuous improvement in manufacturing, became perfunctory meetings. For example, just before the product launch, a member of the sales team raised concerns about some technical aspects of the new printer, which in his eyes could seriously compromise its success. The core DBS processes had been introduced to help teams identify and address precisely this type of concern. Whereas in manufacturing, employees were encouraged to stop the production line to flag quality problems in real time so that they could be isolated and fixed, in this instance the feedback was ignored and interpreted by the rest of the team as a boycotting attempt rather than a constructive suggestion. Shortly after this episode, the printer was launched to a poor market reception, which confirmed the gravity of the issues the salesperson had raised. Thanks to this experience, Videojet executives understood that they would need to work more consciously to foster interactions between diverse pockets of expertise within the firm. They continued to use the DBS tools but also committed to frequent, longer structured interactions and collective sign-offs between engineers and salespeople during the various product development stages. Videojet launched a very successful printer just a couple of years after the initial failed product launch and has since become an exemplar in the use of DBS tools for product development.

Sometimes the organization at large resists change. Susan Helper and Rebecca Henderson provide a fascinating account of the difficulties GM encountered in implementing the Toyota Production System during the 1980s and 1990s. Even in the face of mounting competition, GM found it hard to adopt Toyota's superior management methods, mainly because of adversarial relationships with suppliers and blue-collar workers. Employees, for example, thought that any productivity enhancement from the new practices would just lead to head-count reductions and would more generally put employees under greater pressure. This distrust inhibited GM's ability to negotiate for the working arrangements needed to introduce the new practices (such as teams and joint problem solving).

Videojet's and GM's experiences illustrate a fundamental issue: Management practices often rely on a complicated shared understanding among people within the firm. The inability to foster it can easily kill the efforts of the most able and well-intentioned managers. On the other hand, once such an understanding is in place, it's very difficult for competitors to replicate.

A question that managers face is how to create this common understanding. Changing individual incentives is unlikely to work, since the adoption of new processes usually requires the cooperation of teams of people; it's difficult to disentangle the rewards to be assigned to a single employee. And adoption is hard to measure, so it would be challenging to tie an individual bonus to the implementation of a certain practice. As organizational economists know, simple contractual solutions are hardly effective in these situations.

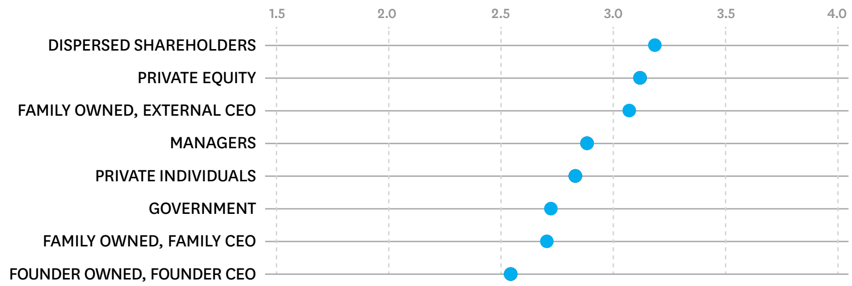
But managers have a different weapon at their disposal, which in our experience can potentially be more effective. It's their presence. The successful adoption stories that we've encountered in our research often took place in organizations where someone very high up signaled the importance of change through personal involvement, constant communication, message reinforcement, and visibility. "Walking the talk" matters enormously and can drastically affect the odds of success for change initiatives.

This idea is supported by a large-scale research project on the relationship between management and CEO behavior that Raffaella conducted with a different team of researchers at the London School of Economics and Columbia University. After a painstaking exercise in which they codified the agendas of more than 1,200 CEOs of manufacturing firms in six countries, they found that management quality was significantly higher in organizations in which CEOs dedicated a larger portion of their time to employees than to outside stakeholders.

Though core management practices may appear to be relatively simple—in that they often rely on nontechnological investments—they are not light switches that can be flipped on and off at will. They require a profound commitment from the top, an understanding of the types of skills required for adoption, and—ultimately—a fundamental shift in mentality at all levels of the organization.

FAMILY-RUN FIRMS TEND TO HAVE WEAKER MANAGEMENT

AVERAGE SCORE BY TYPE OF OWNERSHIP (1 = WORST; 5 = BEST)



NEXT STEPS

Our findings have implications for how managers are trained. Today business students are encouraged to judge case studies about operational effectiveness as "nonstrategic" and to see these issues as not pertinent to the role of the CEO. But it's unwise to teach future leaders that strategic decision making and basic management processes are unrelated, and that the first is far more important to competitive success than the second.

Indeed, our work suggests that the management community may have badly underestimated the benefits of core management practices—as well as the investment needed to strengthen them—by relegating them to the domain of "easy to replicate." Managers should certainly dedicate their time to fundamental strategic choices, but they should not suppose that fostering strong managerial practices is below their pay grade. Just as the ability to discern competitive shifts is important to firm performance, so too is the ability to make sure that operational effectiveness is truly part of the organization's DNA.

One frequent suggestion in this era of flattened organizations is that everyone has to be a strategist. But we'd suggest that everyone also needs to be a manager. Core management practices, established thoughtfully, can go a long way toward plugging the execution gap and ensuring that strategy gets the best possible chance to succeed.

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