



## The Relationship between Efficient Management and Productivity in Global Proportions: A Review of Successful Companies Experience

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**Abstract:** Good management is the most important driver of productivity, new research suggests. And a firm's management performance is driven by ownership type, competition, labor market regulation and skills. The techniques of good management are well known and in the public domain so the fact that they are so poorly disseminated suggests either that successful implementation is elusive or that it is not a priority for many firms. The team also found that managers interviewed had little idea of the overall management performance of their own organizations. Improving management practice is also associated with large increases in productivity and product.

[Kamyar Kameli, Farhad Almasi. **The Relationship between Efficient Management and Productivity in Global Proportions: A Review of Successful Companies Experience.** *N Y Sci J* 2020;13(9):16-20]. ISSN 1554-0200 (print); ISSN 2375-723X (online). <http://www.sciencepub.net/newyork>. 4. doi:[10.7537/marsnys130920.04](https://doi.org/10.7537/marsnys130920.04).

**Keywords:** Management, Productivity, Organization, Successful Companies

### 1. Introduction

In today's political environment, the push for increased productivity, responsiveness, and accountability affects an organization's ability to effectively achieve its objectives. Different issues will emerge over time, and they must be addressed (Colombo and Delmastro, 2004). Because perhaps no areas of management are changing more rapidly than in public and service sector productivity, flexibility in addressing new issues as they arise is critical to providing transportation organizations with the most current approaches (Bryson and Freeman, 2009). A joint research team from the Centre for Economic Performance and McKinsey & Firm has spent the past five years developing, testing and applying a new approach for the robust measurement of a firm's management practices, allowing them to be compared directly with real business performance. This project has examined practices and performance of more than 4,000 medium sized manufacturing operations in Europe, the US and Asia. The findings of the new survey support the project's earlier research: firms across the globe that apply accepted management practices well perform significantly better than those that do not. This suggests that improved management practice is one of the most effective ways for a firm to outperform its peers. The size and breadth of the latest survey – which increased the number of firms examined from 700 to over 4,000 – allowed the research team to gain a deeper understanding of a range of factors that affect a firm's management performance (Gant et al., 2002). Multinational

companies, wherever in the world they operate, tend to outperform local competitors. They are also likely to raise the mean performance of domestic firms in the countries where they are most prevalent. In general, the less likely and organization is to make use of professional managers and to appoint its managers on merit, the poorer its performance – with government-owned and primogeniture family firms (those that are family-owned and run by the eldest son or grandson of the founder) bringing up the rear (Lazear, 2000).

It has identified four key areas that will define the ability of transportation organizations to meet future challenges:

- Management techniques and practices,
  - Human resource issues,
  - Performance assessment and analysis tools,
- and
- Customer focus (Zabojnik, 2002).

The spread of management performance between firms, even those of similar size operating in the same industry sectors in the same regions, is very broad, suggesting that management excellence is a matter of internal policy and not just the business environment. The techniques of good management are well known and in the public domain so the fact that they are so poorly disseminated suggests either that successful implementation is elusive or that it is not a priority for many firms. The team also found that managers interviewed had little idea of the overall management

performance of their own organizations (Olson and Torsvik, 2000).

Never before have transportation agencies and other public entities operated in such a changing climate. Rapid, accelerating change has departments responding to internal and external pressures, technological innovations, and political and institutional concerns in unique and creative ways. Historically, the institutional context for implementing departments' programs was relatively standardized. Today, these organizations find that traditional management techniques no longer lead to effective, efficient delivery of services, nor do they promote the public accountability necessary in today's political environment. The latest survey confirms earlier findings that greater competitive intensity drives improved management practice, while labor market flexibility leads to particularly good people management habits (Huselid, 1995). The research also indicates that better-managed firms also have a more highly educated workforce, among managers and non-managers alike. For companies, this research is good news, suggesting that they have access to dramatic improvements in performance simply by adopting good practices used elsewhere. For policy makers, it lays down a challenge. The overall performance of most countries is determined not by the performance of its leading companies, but by the size of its 'tail' of poor performers. Developing environments that promote good management practices across all firms devoting as much attention to the followers as to the leaders, governments can drive the competitiveness of their entire economies (Heckman and Smith, 2004).

## 2. Material and Methods

The results of the latest survey demonstrate that the management practice scoring methodology developed by the team is a robust metric, closely correlated to a range of corporate performance metrics including labor productivity, sales growth and return on capital employed (Caselli, 2005).

Importantly, the latest survey represents the first time that the methodology has been applied to firms beyond the UK, US, France and Germany. The same strong relationships between management and performance hold true across the different countries and cultures analyzed.

Many organizations, particularly in the public sector, are embracing these philosophies. The benefits of changing how transportation agencies do business and relate to the public (that is, to their customers) have not yet become apparent to many. Traditionally, the primary emphases of transportation agencies are:

- Getting projects out the door;

- Seeking to boost revenue through traditional financing mechanisms;
- Modifying internal processes to increase efficiency and effectiveness;
- Competing rather than cooperating;
- Hiring new employees rather than retaining current ones;
- Focusing on discrete modal projects and needs rather than intermodal solutions;
- Assuming what the customer wants and reluctantly (Edmans et al., 2008)

Improving management practice is also associated with large increases in productivity and product. Across all the firms in the research, a single point improvement in management practice score is associated with the same increase in product as a 25% increase in the labor force or a 65% increase in invested capital. This observation is true even after controlling for a host of factors like the firm's country, sector and skill level.

## 3. Results

The latest survey did reveal significant differences in management performance between countries. The US is at the top of the table with an mean score 3.25, while India brings up the rear with mean score 2.62. The US is not entirely dominant, however. US firms score particularly highly for people management (such as promoting and rewarding talented workers quickly), but in shop floor operations management Germany, Japan and Sweden do better, with the UK, Italy and France close behind. Overall, regional differences accounted for only 9% of the difference in management practice. Performance differences between companies in the same country were far larger than any regional variations and there is substantial overlap between regions. The best 20% of firms in India, for example, performed better than the mean US firm and 75% of US firms are worse managed than the top 10% of Indian firms. Importantly, the largest difference between high performing nations and the rest is to be found in the tail of low performing companies (Jorgenson et al., 2008). Eliminating the worst managed firms (those with an overall practice score of less than 2) from the sample has little effect on the mean score of the leading countries, but it raises the score of low performing countries significantly (Thesmar and Thoenig, 2000).

The process perspective looks at how the organization goes about getting things done. Organizations are institutionalizing their costing systems based on performance measurements and activities. This can improve their understanding of

how managers balance demands to lower unit costs, improve process efficiency, and reduce support costs with the competing demands to maintain and improve the transportation infrastructure, public satisfaction with services, and organizational learning and growth. In conjunction with best-practices programs, these measurement systems are being used for internal benchmarking. Some organizations are taking initial steps toward tracking the costs of infrastructure assets and relating them to specific conditions. The goal is to set up a holistic system for managing infrastructure assets—that is, a system that looks at the “big picture” and treats the infrastructure as a whole and not as individual parts. Organizational self assessment tools, such as the Malcolm Baldrige Quality Award and criteria established at the state level, are being used to identify the most significant performance gaps (Garen, 2012).

When the firms in the survey are grouped according to ownership type there are pronounced differences in both management practice score and performance. Multinational companies, particularly US-based multinational companies, performed best, while organizations owned and run by their founders or members of the founder’s family performed poorly. Worst performing of all were government-owned firms, with an mean management score of 2.38. Scale effects cannot fully account for the improved performance of multinational companies (Bresnahan et al., 2002). Although larger firms did tend to perform better in the survey, this effect could account for only a quarter of the difference between multinationals and their domestic rivals. The spread of performance according to ownership type suggests strongly that a propensity to employ professional managers and to promote them on the basis of merit delivers better managed, better performing firms. Multinational companies perform well wherever they are in the world, even in areas where overall management practice scores were particularly low. Within the sample, the presence of multinationals within a region appears to assist in the transfer of best practice to local firms, possibly through the migration of employees and knowledge and through commercial interactions between the two groups. In fact, multinational firms operating in India outperformed all other companies except US multinationals operating on their home turf. It is not just the multinationals themselves who benefit from their better management practice. Good management appears to be so strongly linked with good performance that it might be reasonable to expect all firms to make better practices a priority. The techniques of good practice are, after all, available in the public domain in a wide range of easily accessible forms. Yet many firms are still poorly managed. To

examine possible causes of this disconnect, the latest round of research sought to evaluate companies’ perception of their own performance (Bull, 1987). As the final question in the interview, subjects were asked to assess the overall management performance of their firm on a scale of one to five. To avoid false modesty they were asked to exclude their personal performance from the calculation. Generally, subjects did not know how their management behavior compared against accepted practices or even with that of other firms in their sector, and answers to this question were not well correlated with either management practice score, or their own business performance. This situation applied in all regions, and did not change in better or more poorly managed firms.

As a consequence, many organizations are probably missing out on an opportunity for significant improvement because they simply do not recognize that their own management practices are so poor. Government action could help a variety of policy factors have an effect on companies’ adoption of good management practices (Cahuc et al., 2006). Most significant among these were their competitive environment and the flexibility of the local labor market. Companies in the survey were asked to estimate the number of competitors operating in their market. The more competitors a firm reported, the higher its management practice scores. This could be as a result of two effects: 1) good practice spreads quickly in highly competitive environments, and 2) poor practice is eliminated by natural selection as poorer performing companies are removed from the marketplace. Flexible labor markets should encourage companies to adopt better people management practices in order to attract and retain the best employees (Griffith and Neely, 2009). The larger number of countries included in the latest research, with widely different labor market environments, allowed this hypothesis to be explored in depth. The link proved to be a strong one. Companies operating in countries with more flexible labor polices (measured using the World Bank’s measure of employment law rigidity index) scored markedly better in people management practices. The US, with its extremely flexible employment laws, had by far the best people management record, a factor that contributed strongly to its overall top position among surveyed companies.

The availability of skilled people, both in management and among the workforce in general, is another important difference between better managed firms and the rest. 84% of managers in the highest scoring firms were educated to degree level or higher, as were a quarter of the non-management work force. Among the lowest scoring firms, by contrast, only

54% of managers and only 5% of the wider workforce had degrees.

#### 4. Discussions

For companies Multinational companies have been forced to take a systematic approach to management. Only by having strong, effective management practices in place have they been able to replicate the same standards of performance across different regions, cultures and markets. Today, they are reaping the benefits of this effort in terms of higher productivity, better returns on capital and more robust growth. The same benefits are easily accessible to other organizations, wherever they operate. Yet surprisingly few firms have made any attempt to gain an insight into the quality of their management behaviors. Those that do so give themselves the opportunity to access rapid, cost-effective and sustainable competitive advantage. Governments can play their part in encouraging the take-up of good management behavior. Doing so may be the single most cost-effective way of improving the performance of their economies. Strong competition and flexible labor markets both lead directly to improved management performance Multinational companies have a strong positive effect too, and their influence is felt throughout the regions in which they operate. Relentless improvement in educational standards is also essential. Better-managed firms need more highly skilled workers and they make better use of them, while better-educated managers will be a key component of the performance transformation that both established and emerging economies must undertake if they are to maintain and improve their global competitive position.

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9/24/2020