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Are Poor Management Practices Holding Back Middle-Income Countries

New Evidence from the Private and Public Sector in India



In brief

- Widespread differences in the productivity performance between firms within countries, even within the same narrow sector, have been documented over the past few decades.
- This study examines the quality of management practices at these firms using an interview-based evaluation tool that defines and scores basic management practices.
- Management practices are found to be robustly linked to firm and national performance, and competition, ownership structure, skills and labour market regulations play a major role in explaining management practice variation.
- Middle-income countries have much worse management practices than firms in high-income countries, which appears to be due to a large tail of badly managed firms coexisting with firms with world-class management practices.
- India's average management quality is lowest of all countries surveyed. This low average score is due to a large tail of badly managed firms, even though there are several firms in India with top-notch management practices. In the US, 2% of firms have little or no modern practices implemented, however in India this percentage is 25%.
- In terms of short term action points, human capital and diffusion of information need to be improved. Training programs across all sectors and support from government in human capital, and better information diffusion of management best practices may help.
- In terms of long-term action points, policies that enhance competition in both the public and private sector, as well as relieving some labour market regulation may help.

Policy Motivation

“We have collected management data for over 7,000 manufacturing firms, nearly 900 retail firms, 1,700 hospitals and 1,300 schools across middle and high-income countries”

For the past few decades, economists have documented wide differences in the productivity performance between firms within countries, even within the same narrow sector. The speculation as to why this difference exists and where it stems from has populated economics journals ever since. One likely factor is the quality of management practices at these firms, but, because of dearth of good data, it is only recently that empirical economists have started giving this topic any attention.

To address this absence of management data, the research team of the World Management Survey (WMS), at the London School of Economics’ Centre for Economic Performance, has been refining and implementing a methodology that systematically and consistently measures the quality management practices at the establishment level.¹ We use an interview-based evaluation tool that defines and scores a set of 18 to 23 basic management practices from one (‘worst practice’) to five (‘best practice’), depending on the sector.

Since the WMS project’s inception in 2001, we have collected management data for over 7,000 manufacturing firms, nearly 900 retail firms, 1,700 hospitals and 1,300 schools across middle and high-income countries. We found that management practices – defined in terms of more effective monitoring, targets and incentives – are robustly linked to firm and national performance. Furthermore, competition, ownership structure, skills, and labour market regulations play a major role in explaining variations in management practices across firms and countries.

“Middle-income countries have, on average, much worse management practices than firms in high-income countries”

This work finds that firms in middle-income countries have, on average, much worse management practices than firms in high-income countries. The low average management quality in middle-income countries appears to be due to a large tail of badly managed firms coexisting with firms with world-class management practices. In fact, 63% of the variation in management practices within the manufacturing management dataset is attributed to the variation within countries while only 21% to between countries.

Policy Impact

If we accept the link between management and productivity, understanding the drivers of better management is crucial to create policies that can improve the quality of management practices in a country or region and, in turn, potentially raise the region/country’s productivity. Decisions regarding competition policy (allowing for greater competition), labour market regulation, human capital development and information diffusion are all affected by this work.

1. For more information, see Bloom and Van Reenen (2007) and www.worldmanagementsurvey.org

Audience

Policy-makers and government stakeholders

Policy Implications

“If it is clear that better management practices can be adopted in Indian firms...the question becomes: why don't they all adopt good management?”

In manufacturing, we find India's average management quality to be the lowest of all the countries we surveyed. As Bloom, Sadun and Van Reenen (2010) note, however, this low average score is due to a large tail of badly managed firms, which is thin or non-existent in the countries with the highest average management scores. That is, there are several firms in India which have implemented top-notch management practices (the average score for the top quartile of firms in India is 3.5), but comparing the distribution of management scores for firms in the US, the country with the highest average, and India, we see that a tail of badly managed firms is simply not there in the US sample. In fact, the percentage of firms which have very little or no modern practices implemented (below 2 in our management measure) in the US is 2%, while this left tail includes 25% of Indian firms. If it is clear that better management practices can be adopted in Indian firms, and can lead to significant improvements in performance, the question becomes: why don't they all adopt good management? It seems that, among other factors, “informational barriers” as well as constraints affecting the efficient reallocation of resources are the most likely culprits.²

Although this latest work cannot yet establish causality, a few initial policy implications arise:

Product market competition

Much of the cross country variation is due to the tail of badly managed establishments. In the retail and hospital sectors, competition continues to matter.

Labour market regulation

Countries which have higher labour regulation tend to have lower management scores.

Human capital

Firms with better educated managers tend to be better managed. Creating incentives for continuing education of managers as well as employees is a policy action point.

Information diffusion

Our research indicates that managers are often unaware that they are not following best practices (see information gap figures).

2. Bloom and Van Reenen (2006), Bloom et al. (2012)

Implementation

In terms of implementation there are long-term and short-term action points within each of the 4 main policy implications we have mentioned in section IV. The first two policy implications we mentioned have a set of “longer-term action points”

“In our research, we find that manufacturing plants, hospitals and retail stores in India that face higher competition tend to be better managed”

Competition

Competition is one of the long-term action points. In our research, we find that manufacturing plants, hospitals and retail stores in India that face higher competition tend to be better managed, suggesting that policies fostering greater competition should be encouraged. For instance, in the private sector: lifting restrictions for foreign ownership of private enterprises (in sectors like manufacturing and retail) or devising a small and medium firm grant/loan scheme to encourage entrepreneurship. In the public sector, policies which increase patient choice and parental choice in services provided would be welcome, for example: implementing a voucher program for children of poorer families to attend private schools at a subsidized rate, or, similar to what was done in the UK, coordinate and fund the development of health centres where non-emergency surgery can be carried out. These centres should be in direct competition with normal public and private services, which would help drive cost efficiency and overall quality of the service.

Labour market regulation

Labour market regulation is also a long-term action point. In general, less labour regulation from the government gives more room for establishments to implement optimal incentive structures for employees in terms of merit-based promotions as well as disciplining poor performers. For example, changing regulation to expand the ability of establishments to fire their low performing employees without walking through long and expensive bureaucratic pathways.

The last two policy implication points have “shorter-term action points” associated with them.

Human Capital

“Training programs for basic operations across all sectors... could be a good place to start”

While human capital can be seen as a longer-term policy strategy in the general sense of the invariable benefits accrued from a more educated populace. However, there are a few short-term action points as well, such as identifying the types skills most needed in each sector and offering training and workshops to current managers and employees. Training programs for basic operations across all sectors, such as inventory and quality control for manufacturing, inventory and personnel scheduling for retail, patient flow layouts for hospitals and lesson plan standardization for schools could be a good place to start. Governments can also advise on the implementation of clear and transparent selection process of managers focusing on qualifications needed for the job, rather than relying on tenure or nepotism.

Diffusion of Information

Policies aimed at the diffusion of information regarding best practices in management across sectors can be the first step towards improving management practices. Holding workshops about best practices and helping managers critically

“Holding workshops about best practices and helping managers critically evaluate their own practices in a non-threatening way would be particularly beneficial.”

evaluate their own practices in a non-threatening way would be particularly beneficial. Officials could provide opportunities and promote events to collaborate and share best practices techniques and learnings with multiple methods to support the implementation of such practices in the establishments involved. Other points include creating easy-to-read and multi-lingual publications to disseminate latest best practice developments and giving managers a “basic tool pack” to help them get started (for instance, include an example of a basic profit and loss statement, or inventory checklist, surgical checklist, lesson plan example). The score for many establishments in India is so low that even these basic and non-capital-intensive changes are likely to make a difference.

Further Readings

All are available at www.worldmanagementsurvey.org

Working papers/reports:

Does management matter? Evidence from India

Nicholas Bloom, Benn Eifert, Aprajit Mahajan, David McKenzie and John Roberts, 2012

Management practices, firm ownership, and productivity in Latin America

Latin America Development Bank (CAF) Working Paper #2012/07, Renata Lemos and Daniela Scur, 2012

Management Matters

Institute for Competitiveness & Prosperity Working Paper 12, 2008

Americans do I.T. Better: US Multinationals and the Productivity Miracle

Nicholas Bloom, Raffaella Sadun and John Van Reenen, 2009

Management in Healthcare: why good practice really matters

McKinsey & Co. and Centre for Economic Performance, 2010

The Impact of Competition on Management Quality: Evidence from Public Hospitals

Nicholas Bloom, Carol Propper, Stephan Seiler and John Van Reenen, 2010

Management Matters in Retail

Institute for Competitiveness & Prosperity Working Paper 13, 2009

Peer-reviewed articles

Measuring and Explaining Management Practices Across Firms and Countries

The Quarterly Journal of Economics, Nicholas Bloom and John Van Reenen, 2007

Management practices across firms and countries

Academy of Management Practices, Nicholas Bloom, Christos Genakos, Raffaella Sadun and John Van Reenen, 2012

Does product market competition lead firms to decentralize?

American Economic Review, Nicholas Bloom, Raffaella Sadun and John Van Reenen, 2010

New approaches to measuring management and firm organization
American Economic Review, Nicholas Bloom and John Van Reenen, 2010

About the authors

Nicholas Bloom is a Professor in the Department of Economics and Professor, by courtesy, at the Graduate School of Business. He is also Co-Director of the Productivity, Innovation and Entrepreneurship program at the NBER. Professor Bloom's research focuses on measuring and explaining management practices. He has been working with McKinsey as part of an effort to collect management data from over 10,000 firms across industries and countries.

Renata Lemos joined the Centre for Economic Performance in 2008. She has directed several waves of data collection with World Management Survey (WMS) in manufacturing, retail, education, and healthcare sectors. She has a double Bachelor's Degree (High Honours) in Business (Finance) and International Studies from the University of Washington and a Master's degree in International Development from the University of Cambridge. She is currently pursuing a PhD in the field of applied microeconomics at the University of Cambridge.

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