

Business Productivity Review team
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Call for evidence: Business Productivity Review

About the IoD

The IoD was founded in 1903 and obtained a Royal Charter in 1906. It is an independent, non-party political organisation of approximately 32,000 individual members. Its aim is to serve, support, represent and set standards for directors to enable them to fulfil their leadership responsibilities in creating wealth for the benefit of business and society as a whole. The membership is drawn from right across the business spectrum. 49% of FTSE 100 companies and 45% of FTSE 350 companies have IoD members on their boards, but the majority of members, some 70%, comprise directors of small and medium-sized enterprises (SMEs), ranging from long-established businesses to start-up companies. IoD members' organisations are entrepreneurial and growth-orientated, and more than half (61%) export goods and services internationally.

Business Productivity Review

We appreciate the opportunity to participate in this call for evidence. Small and medium-sized enterprises form a major, and growing, part of our membership and assisting these organisations in raising their performance is a key priority.

As such, the Institute of Directors has conducted a comprehensive microanalysis of the productivity challenge facing UK firms. This includes a survey of around 700 business leaders, 25 structured interviews with start-ups, small enterprises and specialists, and consultations with accredited IoD professional development course leads. The study assesses the firm-level factors that influence the diffusion and adoption of management and technological best practice in small businesses, and evaluates related policy considerations for the public and private sector – mirroring the Department for Business, Energy & Industrial Strategy's Business productivity Review. The results will be published later this year.

With that in mind, our response below focuses on defining and framing the productivity challenge based on the themes outlined in the call for evidence, drawing upon evidence from previous IoD member surveys (**see Appendix**), interviews, and roundtables. An in-depth analysis of the questions, with fresh evidence, will follow in our forthcoming paper.

The Productivity Challenge (Qus 1-4), Summary (Qus 24-26)

Economic growth since the 2008/9 financial crisis has been driven by growth in employment, yet has been largely absent any pick-up in workers' output per hour¹ (**Figure 1**) – reiterating the importance of productivity policy and understanding what drives its weakness at the firm-level.

That said, when the focus shifts from the economy to the business, the lexicon around what productivity means also need to be adjusted. The bulk of micro and small-business owners do not recognise, formally measure, or prioritise 'output produced per input'. As such, creating an outright focus on targeting or measuring productivity, as defined, can be counterproductive. For example, it can divert attention from more immediate firm-size specific challenges (e.g. start-up pressures), and longer-term strategic thinking (e.g. future proofing) which contribute to overall business performance, and hence productivity, in a broader sense. For this reason, many of our members prefer simply to frame productivity as 'working smarter'.

Relatedly, whilst the focus on below median-productivity firms is sensible, it's important to note that the UK's relatively high start-up rate is likely to contribute to the larger population of low, and even negative, productivity firms when compared to peer nations. Secondly, although larger firms are generally more productive than smaller firms, many still face challenges and some of the most productive firms are yet to recoup efficiency losses from the financial crisis fallout². Gains among large business and this 'top-tail' can therefore deliver substantial aggregate productivity gains for the economy. On a similar point, it's important to consider how productivity challenges in large firms impact smaller businesses through the supply-chain and wider macroeconomic transmission channels³.

In sum, the focus on productivity in small firms should not detract from the broader challenges start-ups face in survival and scaling, the wider business environment, or productivity issues facing larger organisations. Indeed, the interest in the UK's relatively longer tail of low productivity firms should be to alleviate the unique, and evident, barriers that small and medium-sized corporates face in raising their performance – given that they comprise 99% of the business community – and should not be considered a panacea to the UK's wider productivity challenge.

Finally, while there is no clear evidence linking the level of domestic competition to the performance of the long tail, it's important to note that exposure to external competition in non-domestic markets also helps to drive productivity. The UK, however, lags its peers in SME's propensity to export⁴. Moreover, competition dynamics in labour markets are just as integral as competition in product markets; this is reflected in the difficulty low productivity firms have in attracting workers from high productivity firms⁵.

Understanding High and Low Productivity Businesses (Qus 5-7)

Adopting new technology and making organisational, or management style, changes are the main paths for boosting productivity at the firm-level according to our members (**Figure 2**). This makes businesses' relative ability to overcome the barriers to improving efficiency through these means –

¹ OECD Compendium of Productivity Indicators 2018

² 'The UK's productivity puzzle is in the top tail of the distribution', Bank of England, Bank Underground, Schneider (2018)

³ Large Businesses and SMEs, Jamieson et al, 2012

⁴ Unlocking UK Productivity, Enterprise Research Centre, Goldman Sachs, British Business Bank (2015)

⁵ 'The UK's Productivity Problem: Hub No Spokes', Bank of England, Andrew Haldane

primarily skills, time, and financial constraints (**Figure 3**) – key determinants of the overall distribution of business productivity.

In turn, firm-size, age, sector and location are closely linked to these barriers. For example business leaders in small firms typically; find it harder to attract and retain workers with the right skills⁶, spend disproportionately more time working ‘in’ their organisation versus ‘on’ their organisation, and have less financial leeway to make investments, relative to larger firms. So, while Office for National Statistics research shows greater variation *within*, rather than between, regions, sectors and sizes for business productivity⁷, it is insufficient to ignore their interacting influence on firm performance and behaviour.

Furthermore, the variation that does exist *within* these characteristics can partly be explained by ‘cultural factors’—or internal enablers – which raise efforts to boost productivity. This includes the growth ambition and networks of directors, founders and investors, which can be influenced by demographics, life trajectory, familial factors⁸, and foreign ownership— which, *ceteris paribus*, leads to around 50% higher productivity (measured as gross value added per worker) than domestic ownership⁹.

Beyond these exogenous impetuses, however, we do recognise management and the adoption of technology (**Figure 2**) as the most important factors driving subsequent productivity differences between businesses. And the characteristics set out in **Paragraph 3.9** largely echo what we hear from our members and director training course leaders as productivity best practices.

Leadership and Management (Qus 8-11)

Around 1 in 2 of our SME members believe organisational changes, and improvements to skills and training – which includes leadership and management competencies -- would be the best way to improve their productivity.

Management ‘best practice’ is, however, a bespoke and multifaceted concept, as such we would caution against trying to uncover any prescriptive silver bullets. The IoD’s own competency framework, albeit for training directors, considers best practice as a structure comprising of an interconnected skills, mind-set, and knowledge base¹⁰. The matrix of leadership tools need to be utilised and flexed as fits with a firm’s characteristics and circumstance. Indeed, the key determinants of a whether improvements are made are awareness of appropriate management practices (including assessing their benefits), the ability to implement change, and the will to do so.

[Our forthcoming research will elaborate on these barriers and the considerations needed to facilitate the effective adoption and embedding of new management practices in SMEs.]

Technology and Innovation: Adoption and Diffusion (Qus 12-16)

Over 50% of our SME members believe investing in new technology would be the best way to improve their productivity (**Figure 2**).

⁶ Future Attitudes, Aldermore (2018)

⁷ ONS (2017) Understanding firms in the bottom 10% of the labour productivity distribution in Great Britain: “the laggards”

⁸ Unlocking UK Productivity, Enterprise Research Centre, Goldman Sachs, British Business Bank (2015)

⁹ Foreign-owned firms and productivity, Bank of England, Bank Underground, Batten and Jacobs (2017)

¹⁰ IoD Academy Director Competency Framework,

<https://www.iod.com/Portals/0/PDFs/IoD%20Competency%20framework.pdf?ver=2017-10-06-135816-827>

The seven technologies identified in **Paragraph 5.14** are widely considered to be the base-level tools available for improving and monitoring business productivity, regardless of sector (automated machinery and RFID are relatively more prominent in retail, transport, and manufacturing). That said, it's important to balance improving the adoption of these established technologies with the suitability of their usage, as this will determine the potential productivity gains.

Firstly, the extent to which any particular technology is adopted, or embedded, into an organisation depends on its industry and particular business strategy – as output per hour improvements can be reaped from process improvements (e.g. automation), value added to outputs (e.g. customisation), and new platforms (e.g. e-commerce)¹¹. And secondly, there is a high variation *within* each type of technology, including several different suppliers and versions of the same base software, tweaked for various functionalities and interoperability. Relatedly, the key determinants of a whether technological improvements are made are awareness of appropriate technologies (including assessing their benefits), up-front costs, the ability to implement change, and the will to do so.

[Our forthcoming research will elaborate on these barriers and the considerations needed to facilitate the effective adoption and embedding of new to firm technologies in SMEs.]

The UK Market for Business Support and Advice Services (Qus 17-23)

The existing business support and advice landscape is both patchy and difficult to navigate according to initial feedback from our members¹². This reflects the regular chopping and changing of public policies, their suitability, and weaknesses in the private provision of advisory services to SMEs. As a result, a significant number of SMEs tend to leverage their personal and business networks to gain access to trusted consultants – particularly for back-office functions such as accounting – while relying on generic open-source advice and often missing out on crucial bespoke support for growth and performance enhancement.

[Our forthcoming research will assess the existing business advisory infrastructure, and will make recommendations for improving the diffusion of new management practices and technology in the long-tail through support and incentives]

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¹¹ The Role of Demand and the Promise of Digitization, Mckinsey Global Institute, 2018

¹² IoD Call for evidence: Small businesses and productivity,
<https://www.iod.com/Portals/0/PDFs/IoD%20response%20-%20Small%20businesses%20and%20productivity.pdf?ver=2018-03-19-100733-213>

Appendix

Figure 1: UK GDP growth rate by component

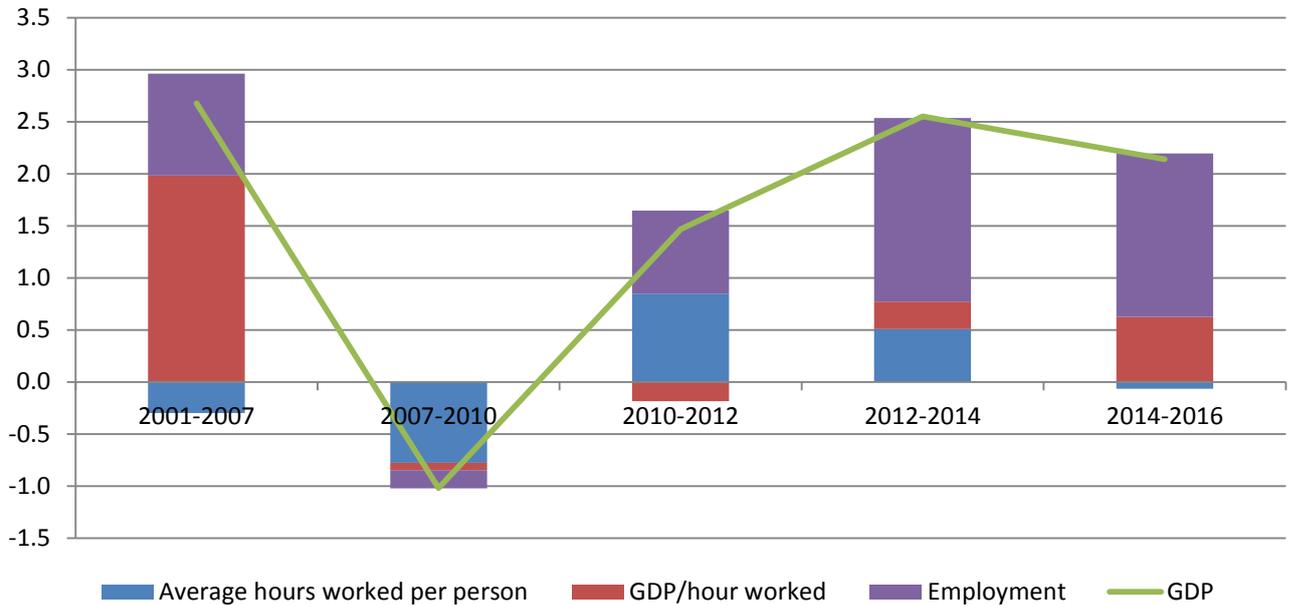
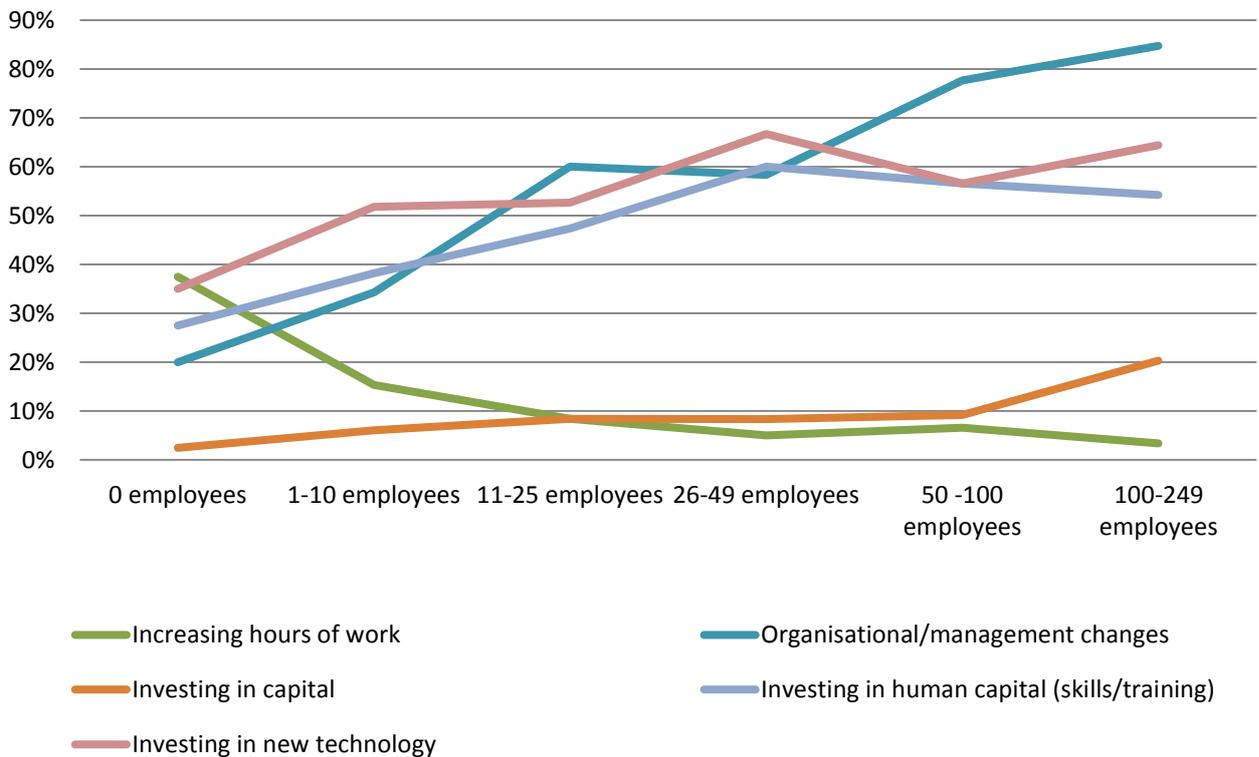


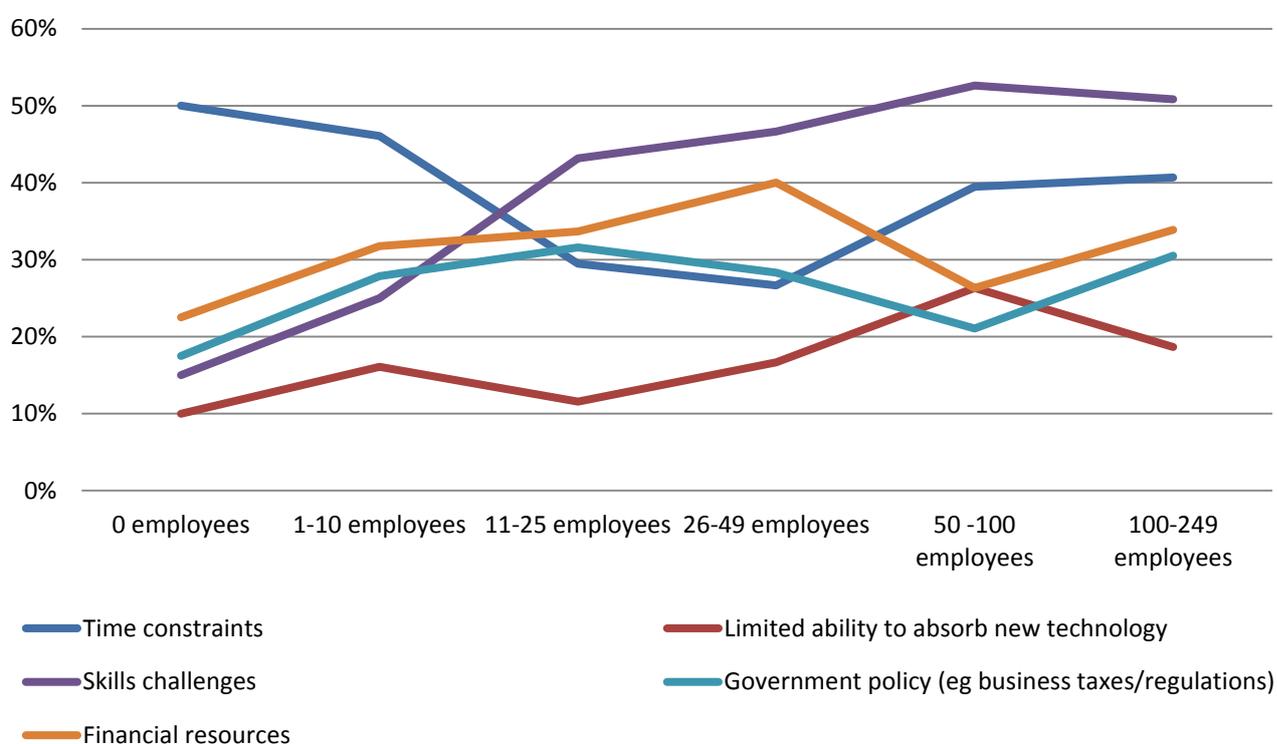
Figure 2: What would be the best way to increase productivity in your organisation?¹³



¹³ IoD Policy Voice survey conducted between 9-23 November 2017, with 687 respondents from across our membership, of which around 70%, shown here, are SMEs

Methods/Employees	0	1-10	11-25	26-49	50 -100	100-249
Hire more permanent workers	5%	9%	14%	17%	7%	5%
Hire more temporary workers	8%	7%	3%	7%	1%	0%
Increasing hours of work	38%	15%	8%	5%	7%	3%
Organisational/management changes	20%	34%	60%	58%	78%	85%
Investing in capital	3%	6%	8%	8%	9%	20%
Investing in human capital (skills/training)	28%	38%	47%	60%	57%	54%
Investing in new technology	35%	52%	53%	67%	57%	64%

Figure 3: What is the biggest limitation or barrier to increasing productivity in your organisation?¹⁴



Barriers/Employees	0	1-10	11-25	26-49	50 -100	100-249
Time constraints	50%	46%	29%	27%	39%	41%
Absorbing new technology	10%	16%	12%	17%	26%	19%
Broadband speeds	20%	22%	11%	13%	9%	5%
Skills challenges	15%	25%	43%	47%	53%	51%
Government policy	18%	28%	32%	28%	21%	31%
Financial resources	23%	32%	34%	40%	26%	34%
Recruitment processes	3%	6%	16%	25%	13%	22%
Office space	10%	4%	2%	8%	3%	5%

¹⁴ Ibid