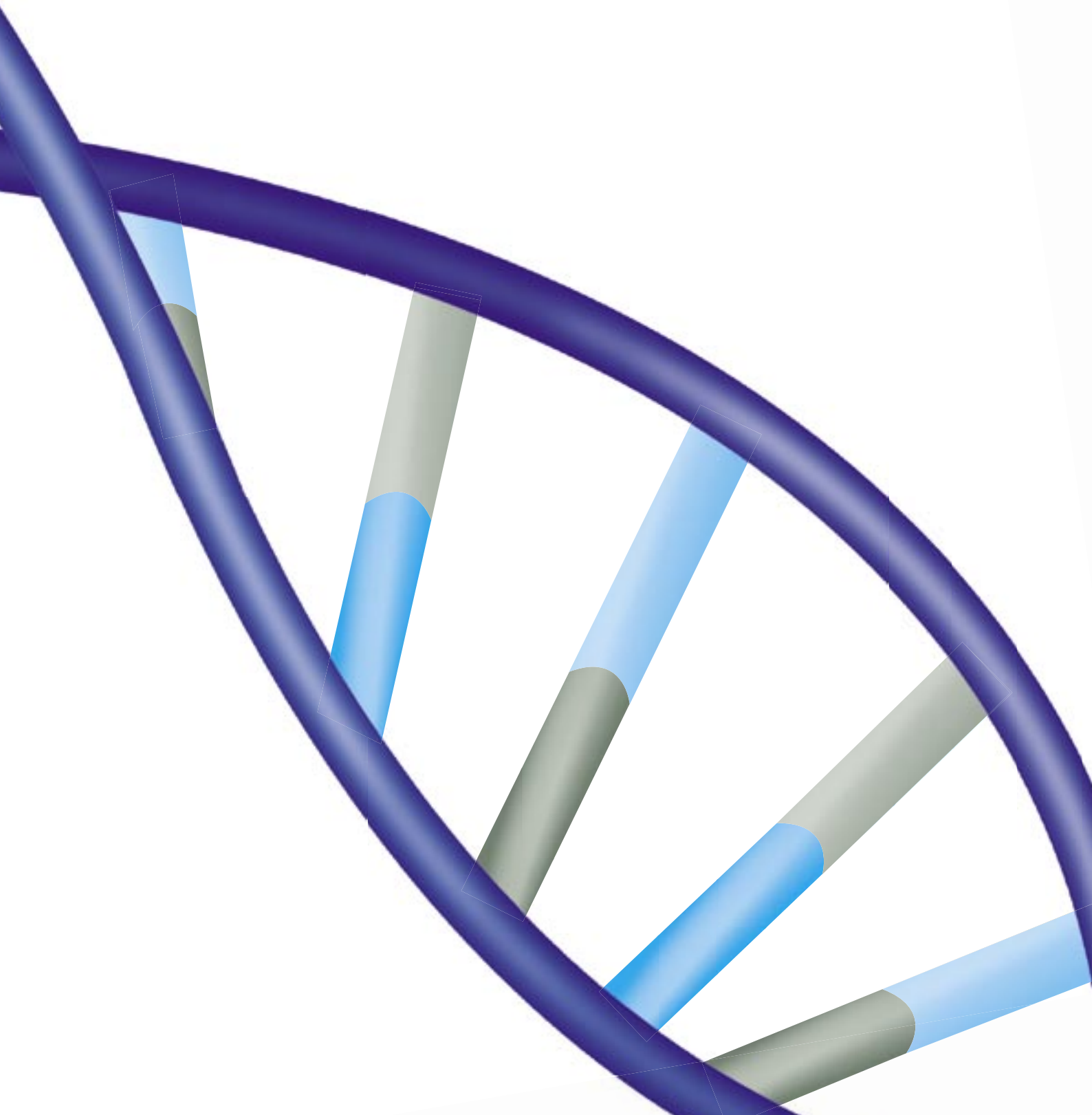




the work foundation

Cracking the Performance Code How Firms Succeed



In association with



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Section 1: **Cracking the Performance Code**

Outlines the key findings from the research programme and explains why the Company Performance Index (CPI) can help measure firm performance. It goes on to explain how successful companies work and the contingencies that can separate success from failure.

Section 2: **What Should Under-achieving Firms do?**

Offers a blueprint for the sustainable high success company. Drawing on extensive case study data it illustrates the 'how' of high performance as well as the 'what'. The section develops arguments for how low performing companies can overhaul their thinking to become high performing organisations.

Section 3: **Competition in an Inter-dependent World**

Explains how competitive pressures develop in today's economy and how globalisation, new technology and European integration affect UK business. The section explores what this means for companies and what it means for policymakers.

Section 4: **What Should Government do?**

Offers a set of broad policy prescriptions under four headings. Together the policy programme outlined should help support more successful companies and grow those firms with the potential to become sustainable high success organisations. Government to develop policies that will help more companies blend together strategies in the five areas of the Company Performance Index (CPI).



Executive Summary

1. Core Findings

Nearly 3,000 UK firms of all sizes and from all sectors were surveyed and ranked in a Company Performance Index (CPI). The results show that in terms of added value the top third of firms out-perform the bottom two-thirds by £1,600 per worker per annum.

This means that if just 10 per cent of the UK's lower performing firms moved to the performance levels of the top third of UK firms by acting on the recommendations in this report, the UK's productivity growth rate would increase by 0.25 per cent per annum.

The year-long research project into performance and productivity has confirmed that the Company Performance Index (CPI) accurately measures firm performance. It breaks the 'code' of company performance by measuring strategic drivers and their implementation across five core areas. The research also delved into the black box of the firm conducting over 20 case studies to understand the 'how' of high performance as well as the 'what'.

The research project was supported by Astra Zeneca, EDF Energy, Hermes Pensions Management Limited, Manpower/Working Links, Microsoft, PricewaterhouseCoopers, Rolls-Royce, The Royal Bank of Scotland and Standard Chartered.

The Company Performance Index (CPI) measures strategic effectiveness in the following areas:

- Customers and markets
- Shareholders and governance systems
- Stakeholder relationships
- Human resource practices
- Creativity and innovation management.

The share price performance of the listed firms at the top of the CPI index outperformed those at the bottom by 20 per cent over the last year. This strong correlation is evidence of the way in which high performing firms can deliver shareholder value along with high levels of performance in other areas of the CPI.

Furthermore, the CPI is a powerful reader of any company's performance 'code'. The survey evidence shows that over 25 per cent of the added value per employee is explained by the way the elements of the CPI plus basic factor inputs are combined and delivered.

The impact of the CPI on basic factor inputs explains 3 per cent of the difference in revenue growth across firms and 6 per cent of the difference in gross profit.

The five core clusters of the CPI have a powerful impact both on firm-level performance and on total factor productivity (TFP¹). Acting on basic factor inputs they explain 76 per cent of the difference in productivity across firms.

The five core areas of strategic inter-dependency captured by the CPI are translated into productive action through five 'intangible' factors of production.



The 'intangible' factors of production are:

- Structure
- Process
- Leadership
- Communication
- Culture and Employee Relations.

2. Sector Analysis

The most competitive sectors were retail, hotels, catering, utilities, personal household and mining, with 10 per cent new entrants per annum. By comparison, agriculture, construction and manufacturing have 6 per cent new entrants per annum.

Some 60 per cent of firms are actively investing in R&D but, of those that are, expenditure amounts to only 1 per cent of total sales. Moreover, average training spend per employee is only £874 per annum with a median of £167 per employee. Training spend is particularly low in agriculture, transport and other community sectors. Those businesses investing most in training are also the most innovative.

Only three sectors – transport and communications, manufacturing and utilities – have particularly well-developed industry networks. Health, mining, manufacturing and utilities show up as the sectors with the highest levels of innovation, but even here, in the case of manufacturing and mining, nearly 20 per cent of firms are well below the industry benchmark.

3. What Firms Should do

High performing firms have unique organisational structures resulting from geography, size and history, that enables continued success. They have a higher degree of informality and continued dialogue supported by simple – though not simplistic – processes that allow faster decision-making. They openly share information between peers and networks of managers that need timely and accurate information in order to get the best job done. They have visible and accessible leadership and management, combined with high expectations from those in decision-making roles. They distrust the status quo, valuing quality rather than

quantity, and have a focus on the long-term and on outcomes. The culture and employee relations are characterised – not codified – by pride, innovation and strong interpersonal relations.

Low performing firms had a focus on a narrower range of financially driven output metrics. Discussions about culture and performance were dominated by bureaucratic process and internal structure rather than customer satisfaction or end product. These companies did not have real energy or passion about the business or any restlessness with the status quo. Leadership in the lower-ranking organisations focused more on 'what the numbers say' rather than how top managers behave and interact with others. Interactions were more formal, structured and 'set-piece' in format.

High performing companies offer clear lessons in what to do in each of the five 'intangible' factors of production:



“This means that if just 10 per cent of the UK’s lower performing firms moved to the performance levels of the top third of UK firms by acting on the recommendations in this report, the UK’s productivity growth rate would increase by 0.25 per cent per annum”

On Structure: *Do not get hung up on structure. It is more a function of size, where the business is located, its history and its traditions. Structure does not drive performance but enables it. It is a means to an end rather than an end in itself.*

For example, ECS Metering was brought back ‘in house’ to provide metering services to EDF Energy retail customers only. ECS was subsequently re-branded as EDF Energy Customer Field Services and is now structured to allow meter readers to cross sell other EDF Energy products. The re-branding and restructuring helped signal to the workforce that they were truly part of a new organisation – EDF Energy. This helped with the psychology behind persuading the workforce to sell other products and increase their range of skills and overall adaptability.

On Process: *Keep processes simple and allow a higher degree of informality. Combined with continued dialogue, these will allow faster decision-making.*

At Working Links, for example, detailed procedures for capturing data required for compliance with contracts are supported by the new team structure that separates out the contract management role from the team performance role. This means that the distinct functions

of detailed compliance with public service contracts and delivery of those contracts are handled separately. Each part of the operation thus develops more expertise and skills in delivering their part of the deal. The result is happier clients and better outcomes.

On Communication: *Encourage open sharing of information between peers and networks of managers so that timely and accurate information is given and received.*

For example at Rolls-Royce, a large multinational, multi-site organisation, much of its communication has been conducted through collective mechanisms. Recently, the company has shifted emphasis to more direct communication between individuals. This is particularly important as the company develops a more agile workforce with engineers and other technical staff being required to take on and develop soft skills such as cross-team working. Both unitarist and collective mechanisms complement each other in communicating, negotiating, motivating and engaging with a skilled and very diverse workforce. This helps with staff motivation and retention among other things and so drives up performance.

On Leadership: *Make sure your leadership and management are visible*

and accessible and set high expectations from those in decision-making roles.

The strong values culture exemplified at Standard Chartered is led by the Group Chief Executive – he personally endorses the ‘Seeing is Believing’ campaign, encouraging staff to live the Standard Chartered values. In any organisation – and all organisations have hierarchy – what the leaders of the hierarchy do sends out strong signals about the relative importance of different types of behaviour and the values that support that behaviour. In this case the Group Chief Executive’s endorsement of this particular campaign tells all the staff that values are very important to the way business is and must be done. This in turn gives confidence to customers that a deal will be more than a set of transactions but a relationship underpinned by a set of principles.

On Culture and Employee Relations: *Keep asking questions about the status quo. Value quality rather than quantity, and keep the focus on the long-term and on outcomes. Establish a climate of employee relations that is characterised but not codified by pride, innovation and strong interpersonal relations. Understand that collective mechanisms support this.*

At Plasmor Ltd all staff are salaried, on harmonised terms and conditions, and



participate in profit-sharing schemes and productivity bonuses. The company has successfully got away from a traditional foreman, plant operatives and overtime culture, replacing it with a culture that has a high degree of commitment, pride and loyalty. Only three people have left in three years and one of those was through retirement. Costs have fallen as a result while performance has increased.

Employee relations are also important at Hermes Pensions Management Limited. The company does not build up large teams when the market is buoyant, only to cut them in harder times. This policy engenders a culture of relative security and sensible working hours – unique in the area of financial services. And much research has shown that security and control are the two factors that enable nearly all workers to deliver higher performance. Longer hours will arguably increase output but usually at the cost of performance and quality.

4. What Government Should do

The Government is urged to focus on improving policy in ways that will sustain the 21st Century high success company. In total there are four broad areas for policy development that the findings suggest:

1. Entrenching the conditions for more sustainable high success companies

2. Encouraging investment in innovation, R&D and knowledge
3. Encouraging investment in people
4. Encouraging the development of high trust relationships between businesses and between employers and employees.

In particular, the findings show that the Operating and Financial Review (OFR) can act as a vehicle to provide greater transparency on critical intangible aspects of business performance. The OFR should thus draw on metrics that cover the five areas of the CPI and the five 'intangible' factors of production. Once revealed, market mechanisms will take over and drive corporate behaviour in the right direction. It can also bring together pension fund trustees, the investment community and the boards of listed companies to agree what are the core things – over and above financial data – that should be measured and reported. The Government should also implement the recommendations of the Company Law Review and invest in the business advice services that businesses actually use. It must also develop a sophisticated way of evaluating 'good' regulation from bad and then apply it.

The Government should commit to hitting the Lisbon target of 3 per cent

of GDP to be invested in R&D by 2010 and review the operation of the R&D tax credit to evaluate whether it is having the anticipated effect on the level of innovation in the UK. It should implement the recommendations of the Lambert Report into science and innovation as soon as practicable while creating fast-track visa processes for scientists and researchers.

The Government should fund up to level 3 skills development through an extension of the National Employer Training Programme and through the Foster and Leitch reviews free-up the 'demand' side, notably sector skills councils, from unnecessary bureaucracy. Resources allocated to the ESRC's management research programme should be redirected to develop a better understanding of a 'pluralist' model of leadership. The DTI should consider establishing a 'Business Leadership' award scheme, which will benchmark performance against the indicators of success drawn from the CPI and other sources.

Resources should be increased to train employer and union representatives participating in Information and Consultation style bodies, perhaps managed by an arms-length public institution with a tripartite management structure.





Introduction

In 2003, six of the UK's leading firms and The Work Foundation launched a programme of investigation into how UK businesses could become more productive and thereby boost the UK economy's overall productivity rate². There is a significant gap between the highest and the lowest performing organisations in the UK. Reducing this gap would help to improve the UK's overall productivity – and this improvement can only happen at the level of the firms. Raising productivity levels ensures that firms enjoy a lower cost base and that scarce resources are more efficiently used.

The UK needs to raise its productivity growth rate in order to sustain its position as one of the world's leading

economies. This shift has been driven by three major factors: globalisation, particularly between OECD countries; the roll out of Information and Communications technologies that speed up flows of knowledge, intellectual capital, innovation cycles, sales and marketing between competing firms and between firms and consumers; and finally the drive towards completion of a single market in goods and services in the European Union (slow though that may appear to many observers). These three factors are all evident as drivers of change in one way or another, although there is considerable academic debate about their relative impact, pace and sustainability.

We already lag behind many other leading European countries such as France, Germany, the Nordic countries and others by up to 20 per cent

economies. We already lag behind many other leading European countries such as France, Germany, the Nordic countries and others by up to 20 per cent despite better overall GDP growth, more-or-less full employment and low inflation. Achieving the Treasury target of increasing productivity growth rate from around 2-2.25 per cent³ per worker per hour each year by a quarter of a percentage point is no easy task.

And the task has become harder, not easier, in recent years as our economy has tried to respond to an arguably

fundamental shift in what we produce and how we produce it. This context is of critical importance to our understanding of why more firms need to move up the 'food chain' of performance. It affects even those organisations in the non-traded sectors of the economy since they are being subjected to the ideas, influences and drivers that affect the traded sector.

However, as the 2003 research progressed it rapidly became clear that firms focus not on productivity per se but on improving levels of performance. The first tranche of research concluded that highly successful companies do

² When discussing the economists' concept of Total Factor Productivity (TFP) the Work and Enterprise Panel of Inquiry adopted the DTI's definition of TFP as described in Prosperity for All – The Strategy: Analysis Crown Copyright, DTI/Pub 6895/12k/02/02/03/NP. URN 03/1273

³ DTI PSA productivity target with HM Treasury

this by managing equally well the strategic business drivers and their implementation across five core areas. These areas, with overlap and mutual reinforcement between each and every one, were broadly defined as:

- Customers and markets
- Shareholders and governance systems (including finance and investment)
- Stakeholders (suppliers, customers and people but also community and CSR objectives)
- Human resource practices
- Creativity and innovation management.

A predictive Company Performance Index (CPI) was developed that was capable of reading any organisation's performance code, ie the way strategies were blended and applied across the five areas identified. By surveying over 1,000 companies in this first study, matched broadly to the profile of UK businesses, we were able to measure by how much the top companies outperformed the average.

We found that companies at the top of our index were generating 2.5 per cent extra growth, 2.5 per cent more sales per employee, 1 per cent more profitability and 17.5 per cent more growth in terms of exports as a percentage of sales than those at the bottom of the CPI ranking. Further, top ranking companies had, on average, a 6 per cent lead over lower ranking ones in terms of their ability to perform at the technological frontier of their industry. In short, the findings showed that the average UK firm was 25 per cent less productive than it arguably could and should be were it to be better managed and followed the measures of success predicted by the Company Performance Index (CPI).

But this evidence left gaps in our understanding of exactly how successful firms operated. If there was no single thing that a firm could do to become very successful, as our findings suggested, what exactly were the range of things high-achieving firms were doing? And what more could firms and Government do to help shape the external and internal environments in which all companies operate? To help answer these questions, a new nine-strong private sector panel was established to lead a second wave of research – probably the most comprehensive of its kind ever conducted.

During 2004-2005, Astra Zeneca, EDF Energy, Hermes Pensions Management Limited, Manpower/Working Links, Microsoft, PricewaterhouseCoopers, Rolls-Royce, The Royal Bank of Scotland and Standard Chartered led a research project that included a survey of 3,000 UK firms, a comprehensive literature review and over 20 case studies. What follows is our findings on how to unlock the performance code – the black box of the organisation.

And this is of vital importance to each and every one of us. Companies do not operate in a vacuum, isolated from the rest of society. They are part and parcel of the common weal. As the world grows more inter-dependent, understanding the increasing complexity around how firms succeed is not a nice-to-have optional extra as firms go about their business. It is the business of all of us. If we can move more of our low to medium performing firms up the performance ladder, the UK can achieve the improved productivity growth rate that is an explicit goal of UK Government policy, more companies will be more profitable and sustainable, and workers and their families will enjoy higher incomes, improved quality of life and better public services.



Section 1: Cracking the Performance Code

The performance code explains why the UK has simultaneously spawned some of the most innovative and successful companies in the world, and some of its least inspiring and unambitious. Until now, there has been no comprehensive or compelling evidence that might guide UK businesses in their search for answers to the following questions:

1. What unique blend of business strategies are most likely to drive the competitiveness of UK firms?
2. How should businesses transform what have traditionally been seen as 'soft' or intangible assets such as leadership style and organisational culture into 'hard' business drivers that deliver tangible economic value?
3. How do some firms produce levels of gross profit, revenue growth and added-value per head that outstrip those achieved by companies with apparently similar resources?
4. Do these high performance metrics translate into improved share-price performance?
5. How can high levels of company performance be translated into productivity growth at firm, sector and national level?

The results of the research programme provide some robust answers to these questions. From these, conclusions can and have been drawn to suggest ways that UK businesses and the UK Government can increase the number of firms that understand better the performance code of the most successful companies.

The Evidence

We draw our evidence from four main sources:

- A large survey of nearly 3,000 UK businesses which identifies the drivers of business success among high-flying firms based on the Company Performance Index (CPI)
- Share price data based on predictions made by our CPI
- Case study evidence of high performance strategy and practice from some of the UK's top firms and evidence from the top ten and bottom ten firms as determined by our CPI
- An extensive review of previous research.

Let us look at the core findings from this array of evidence and analysis:

Finding 1 – The Work Foundation's Company Performance Index (CPI) is a powerful predictor of several major measures of business performance

We conducted a business survey with nearly 3,000 UK-based firms participating. This ensures that the results are representative by size, sector and region and that our analysis can draw out, with confidence, findings which are underpinned by high levels of statistical significance, ie we can be confident that they are not happening by chance⁴. Essentially, our survey questionnaire was designed to collect data from CEOs, MDs, CFOs and HR Directors about:

⁴ A detailed technical report of the survey findings and associated statistical analysis appears at www.theworkfoundation.com/research/workandenterprise

- Their ownership and governance structures, business dynamics and internal demographics
- The strategic priorities underpinning their quest for competitive advantage in their key markets and how these are translated into practice and results
- The extent to which they made use of an array of management tools to drive and sustain business performance, often against a backcloth of rapid change.

We were especially interested in the ways that businesses translated their strategic 'intent' into practices and results, particularly when they were seeking to achieve an appropriate 'blend' between the primary performance 'levers' within their control.

competitiveness; their levels of investment in skills training; Trades Union recognition; proactive employee relations strategy; the percentage of workforce with access to performance pay.

Customers & Markets: The priority given to customer needs; the collection of systematic market intelligence; a focus on product/service quality versus cost and speed.

Innovation: Proximity to technology 'benchmark' for their sector; employees rewarded for creativity; employee autonomy to innovate; the extent to which competitiveness is 'technology-led'.

Stakeholder focus: How active firms are in their local community; how active among local business networks;

The CPI is the first truly comprehensive explanation of 'blended' business strategy

For example, we were interested in whether the *combined effect* of giving R&D strategic priority and engendering a climate where employees were empowered to be creative and innovative was stronger than the effect of R&D on its own.

We asked firms to describe the importance they attached to a range of policies and practices when seeking to drive their business performance and competitiveness. These included:


People: Their capacity to attract high quality workers; how skill-intensive their workforce needed to be to drive

how stakeholder-driven; how active their supply chain management was; how active was their pursuit of 'socially responsible' policies & practices.

Shareholders: Prominence of shareholder considerations in business decisions; adequacy of access to investment funds; how well-regarded by investment community.

In combination, these five areas of strategy form The Work Foundation's Company Performance Index (CPI) – our code breaking machine. It is a measure of the aggregate impact of adopting a blend of strategies





to drive performance. The importance of the CPI in research terms is its comprehensive nature. It is the first truly comprehensive tool that explains 'blended' business strategy. Previous research on high performing companies is simultaneously illuminating and disappointing⁵. For example, much of the more recent work has established a number of helpful principles. These include the findings that:

- So-called high performance work practices seem to have more impact when implemented in 'bundles' rather than in isolation
- That establishment-level analysis of firm performance is more reliable than studies which look at policy set by head offices or by remote holding companies
- That 'contingency' approaches to high performance – where firms seek the 'best fit' between their strategic choices over business goals and the practices they choose to achieve them – are more effective than following prescriptive templates or 'scorecards'.

The majority of previous research has failed to come up with evidence which goes beyond a narrow disciplinary focus (ie HR research only looks for people-focused impact on business performance). Our extensive review of previous literature⁶ looked hard for empirical studies which ranged across more than two domains of business strategy and found virtually none which examine how the balancing of strategic business priorities or the 'bundling' of practices works in real firms.

It is still the case, therefore, that no single previous research programme has attempted to measure as many variables, their inter-dependencies and their impact on performance as this research programme has tried to do.

We used a variety of statistical techniques to examine the extent to which firms that perform best (in terms of added-value per employee, revenue growth and gross profit) also adopt strategies and practices in the five areas of the CPI. The overall results of this analysis are shown in the following figures.

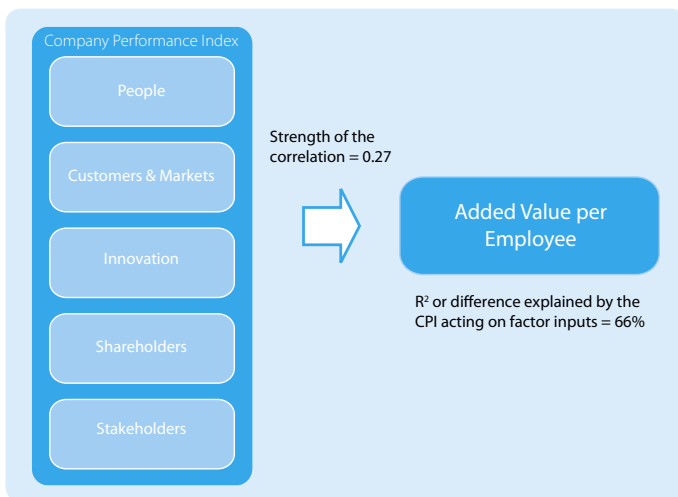
Added-value per Employee

We looked at the relationship between the CPI and added-value per employee (Figure 1.1). Here we can see that there is a positive correlation between the two and that 66 per cent of the difference in added-value per employee between companies is explained by the impact of the CPI on factor inputs. Indeed, the added-value per employee generated by firms at the top of the CPI is £1,600 more per year than those at the bottom.

⁵ See Full Literature Review for details: www.theworkfoundation.com/research/workandenterprise

⁶ Ibid

Figure 1.1 The CPI and Added-Value per Employee

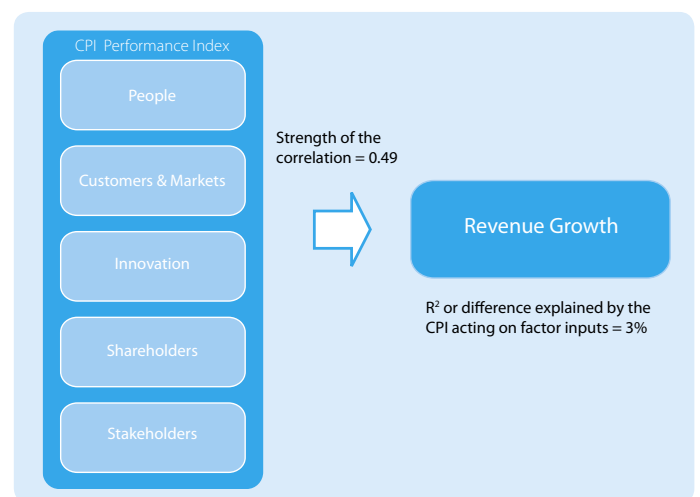


Source: The Work Foundation, 2005

Revenue Growth

We see a similar but weaker relationship between the CPI and revenue growth in Figure 1.2. We asked firms for a three year revenue growth figure and, on feeding this data into our model, a strong positive correlation with the CPI is again apparent. We calculate that the CPI acting on the basic factor inputs explains 3 per cent of the difference in revenue growth across firms.

Figure 1.2 The CPI and Revenue Growth



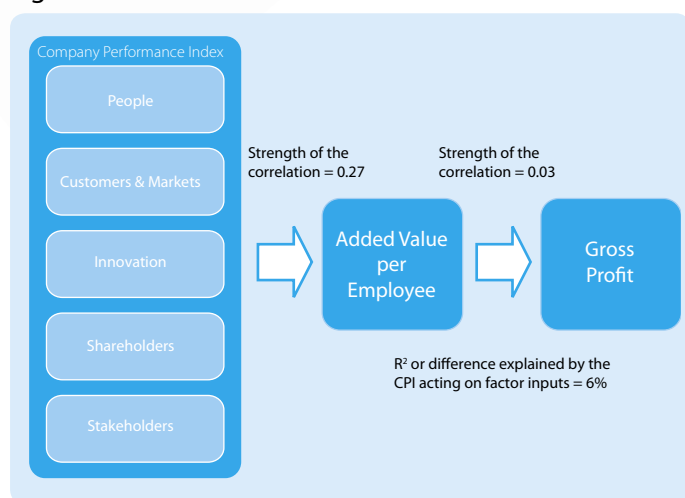
Source: The Work Foundation, 2005

Gross Profit

Figure 1.3 shows the relationship between the CPI, added-value per employee and ultimately Gross Profit across our 3,000 firms. It illustrates that the CPI acting on basic factor inputs explains 6 per cent of any difference in gross profits.



Figure 1.3 The CPI and Gross Profit



Source: The Work Foundation, 2005

A further test of the predictive power of the CPI is the extent to which it discriminates effectively between high and poor performing firms. Of course, one risk of using survey data based on self-reports from CEOs and MDs is that their responses will tend to paint a rosy picture of their businesses and that none will wish to admit to poor practice or incoherent strategy. If this were the case, it would be expected that many of the responses would be positively skewed and that the gap in CPI scores would be quite narrow. When we test for this so-called 'response bias', however, we find that the scores on the CPI are quite widely spread. From our baseline index, the lowest score (out of a possible 100) is 24.1 and the highest is 82.5. Thus there is substantial variation across firms, reinforcing the validity of the Index and supporting the view that it has the capacity to differentiate well between high and low performing firms.

When we look at the characteristics of firms scoring high on the index, it is clear that:

1. Medium-sized firms score consistently higher than other size categories. It is probable that one major factor related to size is that these firms do not have the same coordination difficulties of larger firms but have achieved more optimal economies of scale than small firms
2. Regional differences: as with the 2003 study, we note that there are relatively few regional differences in CPI scores. Perhaps the most striking comparison is between London and the North East. Firms in London are more likely to be operating close to the technological benchmark or average for their sector and to report an above average export ratio. Those in the North East are most likely to be characterised by a low technology benchmark and a low technology sales intensity, despite the fact that staff absence rates are the lowest in the UK. The key message is that the differences are largely structural and relate to the quantity and quality of key factor inputs (labour and capital) that drive many of the observable differences in regional economic performance. Investment of both capital and training in upskilling people are thus the key needs for these firms rather than anything else
3. Sectoral differences: the two sectors that stand out are retail/hotels/catering and mining. The former, despite being characterised as a low-tech sector has a surprisingly high technology-related sales intensity and a high exporting propensity. This suggests that this sector is punching well above its weight among UK businesses. As we argue below, this seems to be because the retail and wholesale sector utilise technology to a high degree

in parts of their operations (in distribution and customer tracking for example) which they are beginning to utilise more effectively. Mining has outperformed the rest of UK business sectors in terms of revenue growth and new technology sales intensity suggesting that this sector of the UK economy is strong and has a competitive edge that will enable it to remain competitive in the future.

what is happening in real firms. So, for the purposes of this research, we have adopted a total factor productivity (TFP) approach to analysing productivity at the company level⁷. Its advantage is that it allows us to build in the effects of the way firms exploit intangible assets such as human capital, leadership, strategy and corporate objectives. The approach we have taken integrates a standard analysis of productivity

Productivity is positively correlated with the CPI which, acting on factor inputs, explains 76 per cent of its difference

As mining has shrunk in size it has become more and more high tech. The key message is that sectors that are not particularly technology intensive or perceived to be at the cutting edge of knowledge can, with appropriate managerial vision, make a large contribution to overall UK performance.

Finding 2 – The Company Performance Index (CPI) predicts productivity at the level of the firm

So what, if any, is the relationship between the Company Performance Index (CPI) and productivity? After all, the wealth of the UK as a whole is driven substantially by real businesses improving the ratio between their inputs and outputs. Conventional productivity measures, especially those used by the Treasury to describe the UK's macroeconomic performance, are widely regarded as being 'blunt instruments' when they are used to understand

with survey-based information on governance, strategy and market positioning to add to our understanding of the impact of intangibles on business performance.

One specific innovation in our work is that we construct a series of strategic indices for five functional areas of strategic management, and an index combining strategies across these five core business areas and test whether performing across all five areas simultaneously enhances productivity to a greater extent than pursuing individual strategies in isolation⁸.

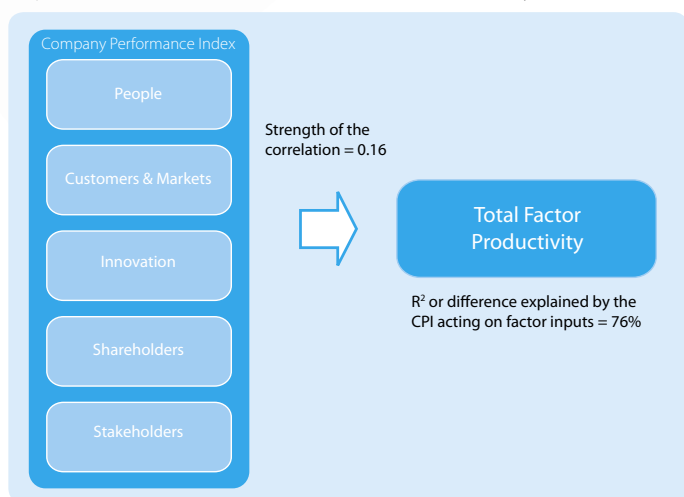
Overall, as we can see in Figure 1.4, the five core clusters of the CPI have a powerful impact both on firm-level performance and on total factor productivity (TFP). It can be seen that there is a strong statistical relationship, and that productivity is positively correlated with the CPI which, acting on factor inputs, explains 76 per cent of its difference.

⁷ The concept of Total Factor Productivity (TFP) the report uses is the DTI's definition of TFP as described in Prosperity for All – The Strategy: Analysis Crown Copyright, DTI/Pub 6895/12k/02/02/03/NP. URN 03/1273

⁸ For a technical description of the way this analysis was conducted, please refer to www.theworkfoundation.com/research/workandenterprise



Figure 1.4 Performance & Productivity



Source: The Work Foundation, 2005

success, it supports our contention that there is a set of organisational competences which support the choice, 'blending' and deployment of the five strategic clusters of the CPI into concrete and deliverable actions. The case study data shows that these 'intangible' factors of production focus on aspects of leadership behaviour, organisational climate and culture.

This finding may have far-reaching consequences. Our calculations suggest that, if we can increase the performance of just 10 per cent of the bottom two thirds of UK firms to the average performance of the top third, this would add around £1,600 added value per worker per annum – contributing £2.5 billion to the UK's total GDP, raising the trend rate of growth of the UK economy by around 0.25 per cent each year.

Finding 3 – The CPI appears to predict share price performance

Raising the trend rate of growth of the economy by around 0.25 per cent each year

This finding has several important implications.

1. First, is that the CPI is a strong predictor of TFP. This implies that a considerable part of the answer to the problem of UK productivity lies in closing the gap between the high and low performing businesses – by cracking the performance code
2. Second, as TFP explicitly allows for the fact that a series of intangibles will inevitably play a part in driving business

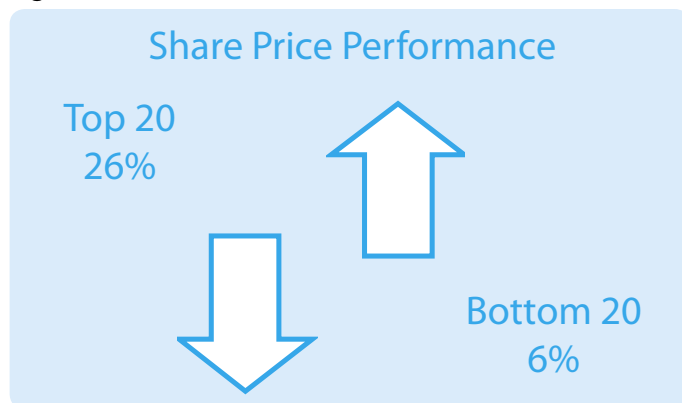
If all of our data and case study material are, in any significant way, allowing us to draw a robust and reliable series of conclusions about a performance code, then it might be expected that the market value of our top-performing companies (as measured by the CPI) should be higher than the average.

To test this we assessed whether the share-price performance of a group of our high performing firms outstripped that of those at the bottom-end of the CPI.

To do this, we took 20 listed firms at the top of the Index and 20 from the bottom. Using data in the public domain, we ‘bought’ 1,000 shares in each at March 2004 prices and computed their aggregate returns.

Figure 1.5 shows that, on an admittedly preliminary analysis, share price performance provides corroboratory evidence of the predictive ability of the CPI. The yield from the top twenty firms over 13 months was 26 per cent, and that from the bottom twenty was 6 per cent. For reference, average yield for the stock market as a whole was 14 per cent.

Figure 1.5 CPI & Share Price Performance



Source: The Work Foundation, 2005

These are, of course, only tentative findings – we are looking to develop our understanding with the help of the investment community. Nonetheless, the early signs are positive that the CPI can help explain why some firms’ market value is higher than others.


Finding 4 – Some of the UK’s top companies have already cracked the performance code

It is clear that the ‘how’ of high business performance is as important as the ‘what’. If business leaders are to derive meaningful benefits from research of this kind, they need more than statistical evidence. They need the practical stories of real businesses that have, themselves, built and sustained competitive advantage.

We have conducted case studies with some of the companies who supported this research many of them large, household names who have been at the vanguard of high performance for some years. We also drew up a list of twenty case study businesses drawn from our survey sample. We produced a ranking of the 3,000 surveyed firms using the CPI and selected ten firms from the top of the ranking and ten from the bottom. We then conducted interviews with senior managers in all those companies who agreed to co-operate, and then examined the critical factors between them. They illustrate the ways in which competitive advantage can be achieved and sustained by balancing the five components of the CPI.

Although the areas of the CPI (see above) describe the strategies being used and developed, the way they are blended and deployed is best captured through studying individual companies and what they do. What then becomes clear is that strategic intent is translated into practical action primarily through the way five similarly inter-dependent ‘intangible’ factors of production are used and applied. The five areas of the index combine with the five ‘intangible’ factors of production in a way that allows successive iterations and reiterations of strategy and practice to flow down, up





and across the organisation as it seeks to pursue its purpose over time. And high performing firms do this in particularly agile and adaptable ways that are explained below.

All of the companies that we looked at in more detail had their own unique story to tell about how they sought to be high performing. What follows are some of these stories highlighting the connectivity between the different areas

Strategic intent is translated into practical action primarily through the way five similarly inter-dependent 'intangible' factors of production are used and applied

These five 'intangible' factors of production are:

- 1. Structure:** unique organisational structure resulting from geography, size and history, that enables continued success rather than being a specific driver of that success
- 2. Process:** a higher degree of informality and continued dialogue supported by simple – though not simplistic – processes that allow faster decision-making
- 3. Communication:** openly sharing information between peers and networks of managers that need timely and accurate information in order to get the best job done
- 4. Leadership:** visible and accessible leadership and management, combined with high expectations from those in decision-making roles
- 5. Culture and employee relations:** a distrust of the status quo, valuing quality rather than quantity, a focus on the long-term and on outcomes; a positive climate characterised – not codified – by pride, innovation and strong interpersonal relations.

of the index, the 'intangible' factors of production and the virtuous helix they seek to create in order to improve or maintain performance. The five 'intangible' factors of production are common to all the successful companies we studied, from large multinationals working across time zones in many different cultures, to SMEs doing business in a particular part of the UK. They are not a function of size, geography or history but the fundamental ways organisations translate strategic intent into practical action. The question that an organisation therefore needs to ask itself if it is to become high performing is not the crude quest for a USP, but something more subtle that combines the external environment with the internal, hard with soft measures, contemporary culture with historical legacy: 'why is it that we continue to be uniquely placed to provide this good or service to our customers'. The abridged case studies below⁹ provide their own answers to this fundamental question.

Finding 5 – Firms with the best CPI scores are qualitatively different in the way they are led from those with the lowest CPI scores

⁹ When discussing the economists' concept of Total Factor Productivity (TFP), the Work and Enterprise Panel of Inquiry adopted the DTI's definition of TFP as described in Prosperity for All – The Strategy: Analysis, Crown Copyright, DTI/Pub 6895/12k/02/02/03/NP. URN 03/1273

On Structure

The exact structure and shape deployed seems to make little difference to high performing organisations. Though a topic beloved by CEOs and HR teams in slow-moving bureaucracies, the exact organisational shape seemed to matter little to the more successful firms. Whilst there were some general themes about how high performing companies organise themselves to manufacture their product or deliver their services, it was significant that no single organisational design seemed to emerge. This aspect of organisational life did not seem to be that important. Interviewees often had to think hard about how their business was structured and how this had an impact on their business performance.

Some of the consistent features tended to be aspects like flatter structures and some form of matrix working but beyond this, organisation design appeared to be more a function of size, geography and history.

It seems fair to conclude that, for high performing companies, structure is more likely to be an enabler than a driver of success and that 'form' is more likely to follow 'function'.

Case Study – Hermes Pensions Management Limited Structure helps drive performance

The Hermes Pensions Management Limited group was formed in 1983 from the Post Office Staff Superannuation Fund, when the fund split to become the Post Office and British Telecommunication Staff Superannuation Schemes. In 1995, the Trustees of the BT Pension Scheme bought the 50 per cent holding in PosTel owned by the Post Office scheme, and PosTel's name was changed to Hermes Pensions Management Limited. Hermes Pensions


Management Limited was created in 1995, when it became wholly owned by the BT Pension Scheme (BTPS). As a private company it does not have shareholders. In 1997, the Trustees of the scheme agreed that Hermes Pensions Management Limited should begin to offer its services to third parties in both the private and public sector, as long as it: improved the overall performance of BTPS; brought enhanced scale and reduced costs; enhanced recruitment, retention and motivation of staff; and increased the value of Hermes Pensions Management Limited.

Hermes Pensions Management Limited's largest client remains the BTPS – worth £40bn. As owner of Hermes Pensions Management Limited, this gives Hermes Pensions Management Limited's investment management an insight into the needs of other long-term investors, especially pension funds. There is a premium on keeping costs low.

Hermes Pensions Management Limited has managed to weather the downturn in the market since 2000, in part, it believes, due to its corporate governance programme. This incorporates the belief that companies with interested and involved shareholders are more likely to achieve superior long-term financial performance than those without. By always voting at company meetings, Hermes Pensions Management Limited aims to ensure that companies it invests in are run by managers and directors in the best long-term interests of their long-term investors'. It enables them to look at how companies operate, and to build consensus with other investors to put pressure on companies to 'do something different'.

Unlike other financial institutions, Hermes Pensions Management Limited does not have potential conflicts of





interest, and so can ‘punch above its weight’ and speak out. Though it may compete on index matching with BGI and on corporate governance with companies such as Standard Life, the organisation is unique with unique offerings such as its Focus Funds. Hermes Pensions Management Limited has thus taken its corporate governance programme to the next level by being the first major investment institution in the world to establish shareholder engagement funds. The Focus Funds invest in underperforming companies which are fundamentally sound but are undervalued due to a variety of strategic, financial or governance issues.

The success of Hermes Pensions Management Limited depends on the astute investment of the pension contributions it manages on behalf of the employees of 200 or so client companies. The focus of HR at Hermes Pensions Management Limited is on improving the quality of current and future employees, particularly, though not exclusively, the quality of the fund managers. Hermes Pensions Management Limited seeks those with extensive knowledge of markets – for example expertise in retail or utilities. Performance track record, compliance and the ability to take risks, are skills desired in equal measures, as many of the portfolios have a risk limit set by clients’ pensions trustees and pensions advisors that require the fund managers to adhere to specific rules. For those that are not fund managers, the trade off for lower risk jobs is a degree of job security not enjoyed by their counterparts working for Hermes Pensions Management Limited’s competitors. Hermes Pensions Management Limited does not build up large teams when the market is buoyant, only to cut them in harder times, as Hermes Pensions Management Limited has relatively few external clients. This engenders a culture of relative security and sensible working hours. Combined

with a feeling that management is visible, accessible and tries to promote on merit, employees broadly feel they get a ‘good deal’.

Processes

The top firms were also characterised by the apparent simplicity of their processes (although ‘simple’ should not be confused with ‘simplistic’). Such minimalist organisational processes are driven by a general philosophy that ‘less is more’ and by strong communications up, down and across the organisation (see below).

‘Meetings’ were often referred to as an unnecessary hindrance and talk of steering committees and work groups was conspicuous by its absence. Whilst some talked of the downsides of this ‘ready, aim, fire’ tendency, there seemed a general preference in the top-performing companies for this philosophy, above a more cautious and risk-averse approach to decision-making. The outcome, universally, was that decisions happen faster this way and that, even if they turn out not to be the right ones, adjusting course and actions afterwards can happen just as quickly too. Similarly, performance management was kept simple.

Case Study – Standard Chartered

Values help drive simple processes of engagement

Standard Chartered is one of the world’s leading international banks. Founded in 1853, the Bank is headquartered in London and is listed on both the London and Hong Kong stock exchanges. The Bank serves both Consumer and Wholesale Banking customers and aims to be the ‘Right Partner’ for its customers across 56 countries. Standard Chartered employs over 1,250 people in the UK and Europe, providing products and services for multinational

corporations and international banks in Europe, trading and investing across Asia, Africa, and the Middle East.

Standard Chartered occupies a distinctive global footprint. Having been present in its core markets in Asia, Africa and the Middle East for more than 150 years, the Bank

Standard Chartered also communicates proactively with its customers using creative means to demonstrate strength in key markets. For example, Standard Chartered worked with Tomkins, the engineering company, on a leadership development consortium. The relationships formed during this programme, helped Standard Chartered to develop a

The top firms were also characterised by the apparent simplicity of their processes

has established strong relationships and extensive local knowledge of the markets in which it operates. The Bank focuses on creating bespoke international solutions by balancing internal structures with external geographies to try and meet and exceed customers' needs.

Increasing growth in China and India present great long-term opportunities for Standard Chartered. The Bank is leveraging its global footprint to provide effective financial solutions for its customers by providing a gateway to diverse markets. For example, 90 per cent of the copper ore mined in Zambia is exported to China and there is a growing interface between the Middle East and China. The differentiation within such markets allows for diversification and organic growth in mature markets such as Hong Kong.


A deep understanding of markets, institutions and clients allows Standard Chartered to be the preferred financial services partner for its customers. This combination of local knowledge and technical expertise provides the ability to utilise the Bank's extensive networks. The ability to pull together the right team to create a solution tailored to meet customers' needs Standard Chartered believe is a key competitive advantage.

business relationship with Tomkins. When Tomkins decided to develop their Chinese operations, Standard Chartered was able to fast-track a cross geography credit approval across China, Hong Kong and UK offices to offer Tomkins a credit facility. This required fast communications lines, individual and team knowledge of products and external awareness of the market.

Five core values are the glue to benchmarking behaviour internally. The values – responsive, trustworthy, creative, international and courageous – are clearly espoused and lived, forming part of the overall strategy, 'Leading the Way'. The Bank believes that living the values is critical to the Bank's business performance and, as part of performance management, all employees are assessed on how well they live the values.

The Bank is rigorous about data putting a lot of effort into measuring employee engagement and productivity. The Bank's annual tool used to measure employee and team engagement has achieved a 97 per cent voluntary participation rate. Detailed business outcomes modelling has demonstrated that highly-engaged teams deliver





superior business performance. This includes higher revenue, profit margin, customer satisfaction as well as greater productivity. Indeed, productivity in the Bank has seen rapid growth in the last four years, in part due to a benign risk and credit environment, but also because of the performance-orientated culture.

A robust performance management system differentiates and recognises high performance in the Bank. For example, exceptional performers receive individual recognition from the Chairman and Group Chief Executive. Individual performance ratings, coupled with Group and business unit performance, form the basis of reward decisions. There is a strong focus on differentiating reward according to individual performance contribution.

Finally, Standard Chartered believes good governance goes hand-in-hand with financial success. The Bank's Corporate Responsibility aspiration and dedication to making a difference, ensures participation in the local communities in which and with which they do business. This strong tradition of supporting local communities ensures business is strongly linked to the needs of the communities. This allows the Bank to better understand how their skills, products and services can be used in the course of normal business. This commitment to Corporate Responsibility brings together the dynamism and focus of the whole organisation. The Corporate Responsibility Board Committee works to align business strategy with the Bank's Corporate Responsibility aspirations. The global 'Seeing is Believing' campaign aims to restore the sight of one million people and is personally supported by the Group Chief Executive.

Case Study – MBDA

The distinctive features of MBDA that appear to drive their superior position in the Company Performance Index (CPI) can be identified as follows:

- A market-leading position in a consolidated European market-place where there are significant barriers to entry
- A relatively stable (but increasingly competitive) marketplace, ownership structure and financial base
- Technological excellence; the organisation employs some of the world's leading engineers and is a contractor over some of the most innovative future missile system capabilities
- A contented, stable and experienced workforce where there is a premium on technical expertise in the market-place
- An integrated, systematic and rigorous approach to managing and developing individual performance MBDA is a world-leading missile systems company with an annual turnover of over €2 billion, an order book of €14 billion and over 70 customers around the world. It is the first fully-integrated, pan European defence company with a single, unified management and operating structure. To manage national customer interfaces, it maintains strong national 'footprints' in France, Italy and the UK. The organisation's strategy is to be the centre of European consolidation of the missile systems manufacturing market-place. It was formerly a wholly-owned subsidiary of BAE Systems. As MBDA, therefore, the organisation is quite young (2001) but is now the largest missile systems

manufacturer in Europe and the second largest in the World. The company employs some 10,000 people with 3,000 spread across three UK sites. Turnover in 2004 was €3.1 billion with new orders of €1.9 billion.

The operating model revolves around the delivery of key projects which pull in all the necessary technical, operational and logistical support from other functions. There are nine key projects currently in delivery, which can take anything up to 10 years depending upon technical complexity.

The organisation has a comprehensive strategic HR programme across areas such as reward and recognition; learning and personal development; communications and involvement; organisational development and resource and career management.

There is a common and well-embedded performance management system across the UK company. The corporate intranet is used to create a paperless approach and the company assesses individuals by *how* they achieve their targets and goals as well as whether they've achieved those targets and goals. Objectives are cascaded throughout the workforce during January-March in a well-rehearsed, automated process that coincides with a communication programme of events/roadshows that explain the organisation's current performance and future priorities. The outcome is a clear 'line of sight' between individual objectives and the priorities of the organisation as a whole. Another view of this quite rigorous approach is the measurement that goes around the process. Compliance with the objective-setting process is systematically checked (currently at 98 per cent) and managers are targeted accordingly.

The performance management system is also used to systematically identify learning and development needs which are then prioritised against corporate priorities and available investment. The company has a strong development ethos and whilst technical training naturally takes the biggest 'slice', management and leadership development investment is growing, even throughout some increasingly tough spending reviews.

Some key positions are restricted when advertised to certain cadres of management category and top management individuals regularly move into different functional disciplines.


The company used to be very hierarchical and bureaucratic – the thickness of office carpet pile, for example, depended upon seniority. All the UK workforce are now on single status, harmonised terms and conditions, which has created a more egalitarian environment in which non-performance entitlements have been eradicated.

The workforce is generally very stable. Attrition is less than 4 per cent per annum and average age is about 45 with average length of service 15-25 years. Regular attitude surveys show a generally contented workforce.

Communication

High performance means good communication between peers and an apparent willingness for managers to share openly all relevant information both to individuals and representative staff bodies such as Trades Unions and Works Councils. Communication and the steady flow of information not only up and down, but also across the organisation was typically seen as a strength by all levels of staff.





'Knowledge is power' was not in evidence but 'knowledge sharing' was very much seen as a core organisational objective especially to those acting at the customer interface or on the factory floor.

Operations then produces the core technology in the factories for each of the four key markets, playing an internal rather than a market-facing role. Advanced design groups produce a system of technology, based on operating systems and sub-systems. A competitive analysis

'Knowledge sharing' was very much seen as a core organisational objective

Case Study – Rolls-Royce

Combining both collective and unitarist communication mechanisms

Rolls-Royce plc continues to operate as a world leader in four global markets – civil aerospace, defense aerospace, marine and energy. Rolls-Royce also invests to create a competitive range of products. The success of these products is demonstrated by the company's rapid and substantial gains in market share over recent years. As a result, engine deliveries have grown and the company now has a total of 54,000 gas turbines in service worldwide. Investment costs in product, capability and infrastructure to gain this market position create high barriers to entry; in many cases, the market is a duopoly.

Following the September 11 attacks, and the downturn that followed, Rolls-Royce now has a clear business strategy focused on financial targets, a smaller core of employees and is working towards having a more trusted group of suppliers. Exploiting new technology is critical to Rolls-Royce's market share, brand and longevity. The Engineering and Technology function develops the technology strategy for each product. Gas Turbines

of the product is then drawn up, from which Rolls-Royce can determine the skills and people required to make and build the system or the product. The central division have patent targets as one measure of performance.

Products, such as engines, are designed by engineering in the customer-facing business units, such as civil aerospace, which adapt them to their market and decide the product strategy. An engine in civil engineering shares 80 per cent commonality with an engine in marine. If they need a bigger engine, for example in aerospace, the central division designs and produces it on their behalf. Innovation to product, service as well as process, is driven at the level of component parts and sub-systems, but also at the level of system design (eg of a whole engine). Reducing the time it takes to turn an innovation into a product and bring it to market remains a huge competitive pressure.

Illustrative of this virtuous circle of technological innovation, workforce development and meeting customer demand across a matrix structure, is the Trent Engine Programme – a flagship programme that

exemplifies the company's ability to exploit technology and learning gained in the Civil aerospace sector, in the Defence, Marine and Energy sectors. This cross-transferral of technology has extended to aftermarket services, where the company has introduced capabilities such as predictive data management, which can be applied across the group.

There are several implications of this multi-stranded approach to innovation for the workforce. Manufacturing engineers have been upgraded alongside the design engineers, requiring a growth in the skills sets of the former. The designers are having to become accustomed to working in project teams with people other than designers. The development of new ICT and information systems can accelerate the product life maintenance cycle of this latter procedure. For example, designers put in information required about a component, the engineers use and then give feedback on how this operates. Machine operators have now become multi-skilled, working within self-directed teams.

Health and safety is well managed. An announced commitment leads to a clear strategy, reinforced by regular reporting on performance and targets for improvement. Behind this is a strong recognition that this area is a critical business issue. This recognition was reinforced by the downsizing that followed the post September 11 downturn: the remaining working population had to be fit and healthy if the company was to meet its targets. It was also recognised that this was an issue of interest to the company's customers. Rolls-Royce has learned that management systems and process compliance are essential building blocks for an effective approach to

health and safety. World-class performance, however, requires a culture and behaviours that embed excellence, especially in the context of reduced resources and more delegation of responsibility. This aspect is reinforced by senior managers who use site visits to ask questions on these 'soft' aspects as well as 'hard' performance, and by non-executive directors, whose role in 'asking the awkward questions' is fully recognised.

Leadership

Openness, visibility and accessibility were characteristics of the prevailing leadership and management style in high performing businesses. There did not appear to be much evidence of so-called 'transactional' or 'transformational' behavioural styles. More apparent was a general lack of hierarchy accompanied by a strong focus to give people access to the resources, information and technology they needed to get the job done effectively. As reflected in culture (see below), these organisations had equal measures of task and people-orientation but this did not mean they were necessarily comfortable or affiliative given the competitive pressures they faced.

Leaders in these firms appear to set high standards and expectations of everyone around them but, at the same time, are aware of their position as role models. However the stewardship model of leadership emerging is light years away from the visionary leadership model beloved of the business press and business leaders themselves and confirms other's findings that it is better to be a clock maker than a time teller¹⁰.

¹⁰ James C Collins and Jerry I Porras, *Built to Last*, Random House, 1994



Case Study – ECS Metering/EDF Energy Customer Field Services

Restructuring has helped align the workforce with organisational goals

ECS Metering and Data Services was formed in 1996 when it was decided to bring all metering activities together under one brand and one structure. Two companies were created – ECS Data Services Ltd and ECS Metering Services Ltd. This was perceived as necessary to meet the regulatory requirements at that time. Subsequently, and as part of the newly-formed EDF Energy, ECS now re-branded EDF Energy Customer Field Services, no longer operates as a contractor to EDF Energy but a direct labour force and intrinsic part of the business. This has removed the tensions within the organisation, who now see EDF Energy Customer Field Services as part of an end-to-end process delivering a range of products to ever more demanding customers.

How have they achieved this? Previously, the strategy was to offer metering services to other energy companies.

issues. Frontline operatives have extensive local knowledge of the socio-demographics of an area which helps them to deliver high levels of customer service. This level of local knowledge is critical in delivering service extensions and further products and services. The workforce is in the process of undergoing considerable training to enable them to offer service extensions to customers. With 7 million customer visits per year, the opportunity to do this presents a considerable business opportunity. Shifts in how they reach customers has also led to improved performance, for example cold calling used to secure only a 30 access rate, but now with an appointments system, the rate has risen to 90 per cent.

The company has invested in new hand-held technology for its field staff that will support their drive towards service-extension. They do not anticipate concern over monitoring or the date-stamping of jobs, as these issues were successfully dealt with during the introduction of the previous generation of technology. In addition, the planned

Openness, visibility and accessibility

They now offer a broader range of services under the EDF Energy retail brand. Known as the 'metering strategy', it aims to provide a one-stop shop for customers buying gas and electricity. Rather than just reading and maintaining meters, they now offer a range of services, including win backs, dual fuel, direct debits and other service extensions, such as boiler servicing.

Customers are now able to ask operatives who come to their homes or business about a range of energy supply

upskilling initiative will reinforce the view that technology represents a tool to deliver improved service and business development opportunities.

Culturally, EDF Energy Customer Field Services retains elements of a public service ethos, which the company believe bring with it the advantage of employee commitment and the sense of 'having a wider social purpose' in providing electricity and gas for the least advantaged. However, incorporating a tougher

performance management regime, driven by the need to operate in a commercial environment, has led to a sharper focus on getting the industrial relations climate on an

There was a distrust of the status quo

even keel. But the company is aware that if customers lose their gas or electricity supply, then getting their supply re-connected should be done at all costs since very few people question that this is the right thing to do given the social ramifications of not having heat or light.

Culture and Employee Relations

Of course all the above are in some senses components of what might be described as 'culture'. But 'culture' in itself can be a conduit, enabler and driver of success.

In the high performing firms there were some clear cultural norms. First there was a distrust of the status quo (which extended in more than one firm to an almost paranoiac fear of standing still). These organisations also valued quality over quantity, an external as well as internal focus and had a sense of pride about their 'reason to be'. Managers seemed to have a positive self-image, be concerned about their own development and expect others to think the same way too. These behavioural norms clearly underpin cultural manifestations of leadership style and internal communication.

A long-term orientation around the needs of the customer was similarly evident. Elsewhere, knowing the business, pursuing excellence and subordinating processes and structure to outcomes and delivery were evidence of a strong achievement orientation. People had some real influence over what goes on in their work unit. Allowing workers as much

control as possible over when, where and how the job is done is a key feature of the high performing firms we studied.


This restless curiosity and achievement focus seems to show through also in the employee relations philosophy of many of the top firms. Support, loyalty and long service aligned to the broader organisational strategies were much in evidence. A set of positive employee outcomes around pride, engagement and motivation seemed more associated with a challenging, open and dynamic working environment than merely with a culture of friendliness and strong interpersonal relationships. Trust and respect were products of solidarity rather than simple sociability.

Case Study – Working Links

Demonstrating blending the positives from different cultural norms

A public/private partnership between Jobcentre Plus, Manpower and Capgemini, Working Links was set up in 2000 to deliver the Government's Employment Zones in some of Britain's most disadvantaged communities. Over the last five years, Working Links have placed over 50,000 long-term unemployed and disadvantaged people into jobs, helping them to overcome the practical barriers to finding work in a variety of ways, from arranging training or driving lessons, to paying for transport, childcare, or even new clothes for an interview. Job consultants provide ongoing support to both the jobseeker and employer. Almost every consultant joined Working Links because they wanted to make a difference for disadvantaged people and their local community, a strong public service ethos within an essentially private sector business structure.





Social and economic objectives are indeed a strong feature of Working Links, indicative of its status as a joint venture between the public and private sector. Its commercial focus is not, however, a secondary concern. Working Links uses its public/private status to develop its competitive advantage. Working with the most disadvantaged in society, Working Links aims to move people into sustainable work. It is strongly focused on partnership with employers in order to help ensure that work placements are right for both parties.

Job consultants at Working Links enjoy ready access to information as they need it. Mobile ICT such as laptops and mobile phones help them to answer any questions that candidates may have about work whenever and wherever they ask. Management information has also improved. Previously, performance information was 4 weeks old by the time it reached individuals; now data is available within a few days. This is a consequence of more emphasis on performance management and contracts having specific targets on the accuracy and timeliness of data. Getting people into sustainable work, rather than 'any old job', can make the achievement of work placement targets more difficult. Working Links seeks to manage the tension between short-term financial concerns – getting people off benefit – and longer-term social value – ensuring that job seekers and employers match, the right person in the right job.

Working Links has recently undertaken a business transformation programme, including job restructuring, in order to instil greater management discipline to allow the company to deliver increasingly complex contractual requirements. But becoming more business focused

has been a major cultural challenge. Many employees lacked commercial awareness. Contracts have increasingly strict criteria for success. So Working Links has had to improve performance, whilst not allowing contract terms to dictate behaviours or undermine their core values. The tension between business goals and social purpose has been managed by Working Links' belief that 'its not simply about profits, it's about saving taxpayer's money and changing people's lives'.

At a national level, other social issues that have emerged in recent years are widening the range of contracts Working Links deliver, they include the rise in gun crime (a new contract in partnership with the LDA, the Metropolitan Police and the charity 'Boyhood into Manhood') and drug addiction. These deal with people living in some of the most deprived areas of the country, facing seemingly intractable social and economic problems. Working Links is responding by working with expert partners and smaller voluntary sector organisations with experience of these problems who, while able to deliver vital support, may not have the infrastructure to deliver a full programme of work or to navigate the demanding requirements of the contract with their associated commercial risks.

Their HR strategy has had to respond to the external business drivers of increasing competition, diversity of services and level of contract complexity. HR has thus initiated a major organisational restructuring. For example, contract compliance (Performance Managers) is now separated from the task of working with the job consultants (Delivery Managers) to reflect the increasingly challenging task of meeting complex contract requirements. Team structures have also been relaxed to create space and stretch for ambitious individuals. This involved rethinking job descriptions, for example, around

the different approaches required to deliver to both those who come to Working Links on a voluntary basis and those who are referred on a mandatory basis, as a condition of continuing to receive benefits, at the same time the changes reflected 'raising the bar for the skills required to be a Performance or Delivery Manager'. Leadership development and individual coaching is provided to support managers in these changed roles.

Business conditions meant that the restructuring coincided with some redundancies. Clarity of individual accountability and improving the performance of the new teams were the next cultural issues to be addressed. Managers now have access to financial and business planning information which has allowed Working Links to be open about what is happening in the business and to encourage the development of greater business acumen amongst its managers. Though managers are in tune with the overall business, they very much own their local business plans, as they are responsible for delivering contract outcomes, contract compliance and managing the job consultants.

Communication between managers and staff has been strengthened with weekly team meetings for managers to discuss with their teams financial issues, quality and competency frameworks and 'roles and goals' as they arise. Improving knowledge of financial matters is further supported by the Finance Director travelling round the country to personally brief managers. Other directors, including the MD, undertake similar briefing tours, listening as well as telling.

Managers are now having to accept that Working Links must be run as a commercial business in order to be able to deliver the social outcomes that are its core purpose.

Case Study – Plasmor Ltd

The distinctive features of Plasmor Ltd that appear to drive their superior position in the Company Performance Index (CPI) are as follows:

- An independent, family-owned concern with a management team that care passionately for the quality of the product and the satisfaction of the customer
- A long-term and significant programme of capital investment all funded by cash from operations
- An ability to make the right judgements, strategically based on deep experience and knowledge of the market-place
- An extremely efficient and productive manufacturing process which enables them to deliver a consistently superior product to the customer faster than their competitors
- A track record of managing complex capital projects on time and within budget
- Progressive people management practices that maximise job rotation, enrichment and satisfaction. The outcome is a highly experienced and flexible manufacturing team who care as much about product quality as the directors
- An open, participative and customer-oriented culture in which site managers have the skills, experience and space to get on and run their operation.

Plasmor Ltd is a privately-owned concrete block manufacturer supplying a wide range of concrete products





to the building industry throughout the UK. Established in 1959, it has grown to be Britain's largest independent building block manufacturer. The company has two main product lines – walling blocks used in building construction and decorative paving products. The business employs some 400 people and has a turnover of £43 million owning five production sites and two distribution centres. These centres receive daily stock deliveries by a unique railfreight system which utilises the company's own specially converted railway wagons.

The directors see the business as an engineering company that just happens to service the construction industry, unlike their principal competitors who are primarily quarrying/building concerns. They believe this engineering culture to be a critical factor in their success, creating an efficiency of process and a focus on the end customer. All of the works managers have strong engineering backgrounds.

The company has four different customer groups: architects/building designers where the company is attempting to get their block or paving products written into the design specification process; building contractors where products are delivered direct to site; building merchants supplying the construction industry and finally smaller, individual paving/building contractors who buy direct.

The Managing Director regards managing this quite complex web of different customer relationships as a core skill area. The dynamics of the paver market are changing and such change will have implications for how Plasmor Ltd positions itself.

The company has a highly efficient and productive manufacturing process. Order-delivery lead time is anywhere between 3-5 days. The company's ability to get its product to its customers quickly is a core source of competitive advantage.

Owing to the ability to manufacture its own raw aggregate material needed for block production, the company has a cost advantage over competitors who have to import it from abroad. The company has recently opened a new manufacturing site at Boughton, Nottinghamshire. The site was acquired in May 2001, plant installation began in December and fully automated commercial production started in December 2002. The Boughton site has also enabled the company to do some very innovative things around people management which are now being 'exported' to other sites around the UK.

The business has introduced multi-skilling teamwork practices amongst the 25-strong production team. Everyone is able to perform each different role, ranging from maintenance to quality control to health & safety, etc. Many of the production staff were recruited prior to the new site opening and were heavily involved in the installation process. All staff are salaried, on harmonised terms and conditions and participate in profit-sharing schemes and productivity bonuses. The company has successfully got away from a traditional foreman, plant operatives, overtime culture and replaced it with one notable for the high degree of commitment, pride and loyalty. Only three people have left in three years and one of those was through retirement.

With such a high volume business (3,000 pallets per day) quality control is vital. All product is checked by the production staff who tend to set higher standards than the management. As a consequence, complaints about product quality are almost non-existent (target is zero tolerance).

The prevailing management style is collaborative and open. The Managing Director sees himself often as 'just the referee' and there is a high degree of involvement of the functional directors across the general manufacturing sites. Most senior managers have been with the company at least 10 years. The business tends to 'grow its own' leaders as parachuting in outsiders makes it difficult to command the necessary respect. The managers are well paid but the company believes that the key to retention is also through the autonomous and involving environment. The business does not have a 'meetings culture', problems are solved through having managers empowered and skilled to deal with issues. There are no internal HR managers or HR function, as this does not fit with the culture where managers are accountable and skilled in dealing with people management issues personally. Operational HR is provided by an arms-length provider which also saves money.

Under-achieving Firms

By contrast, the firms which occupied the lower reaches of the CPI ranking had a notably different 'feel' to them. From this and other research it is clear that lower performing firms often remain lower performing for one or more of the following three reasons. First many, particularly smaller firms, lack aspiration. The small firm sector is dominated by lifestyle or family businesses for whom growth is not an


objective. This sector has high birth and death rates with each firm employing few people. The proprietors of such firms do not want to grow their businesses seeing them as sources of income and no more.

Second, other types of low performing businesses that have the potential and desire to grow and become more productive are 'path dependent' stuck in a rut developed from their unique history, geography and experience. Finally, other companies are the victims of poor leadership and management or a combination of all these factors.

From the case studies of low performing firms it is clear that each of them was distinctive in their own way, and most – ostensibly – shared some of the same practices as the high performing companies. However, the following was distilled from the studies that explain their under-achievement:

- **Communication and Measurement.** In the poor-performing firms there seemed more of a focus on a narrower range of financially driven output metrics. This contrasted with the high-ranking organisations which had a more balanced approach that treated inputs as being as important as outputs
- **Structure and Process.** Discussions about culture and performance were more likely to be characterised by comments about process and internal structure than they were about customer or end product. While this may have been a function of size, we got the distinct impression that a more bureaucratic mindset prevailed in the under-achieving firms



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- **Culture.** Compared with the companies at the top end of the CPI ranking, the poorer-performing firms did not have the same energy or passion about the business. The 'top ten' companies had more of a 'buzz' about them. The uneasy fear that 'it may all go pear-shaped tomorrow' did not seem so close to the surface as with the high performing firms and, as a consequence, we were not left with the same sense of restlessness with the status quo
 - **Leadership.** Discussions about leadership in the lower-ranking organisations focused more on 'what the numbers say' – for example, employee survey results, rather than how top managers behave and interact with others. Again, size may be playing a part but leadership seemed more defined by the survey process than personal style and impact. Interactions generally seemed more formal, structured and 'set-piece' in format than the spontaneity and informality that was characterised by the higher-performing approaches.

In more than one sense, these reflections reinforce our central message that the 'intangible' factors of production can be decisive in helping firms to build and sustain high levels of business performance.

Section 2: What Should Under-achieving Firms do?

So what should under-achieving firms do to improve their performance? It is clear from the evidence outlined in section 1 that the five areas of the Company Performance Index (CPI) combined with the five 'intangible' factors of production need to be applied thoughtfully and with purpose. Successful companies have in-built flexibility and balance that allows them to absorb external and internal shocks to their equilibrium and move forward. For unlike low performing firms, such companies do not have a series of one-way catflaps installed that allow external shocks in without the mechanisms for allowing the effects out¹¹.

But the 'how' of successful company practice is notoriously difficult to replicate because it is by definition contingent. It is dependent on a broad range of cultural factors and

The Sustainable High-Success Company

The great companies of the past understood that, to be competitive over time, they needed to understand and communicate through a set of values their 'reason to be' or vocation as a first principle of their license to trade and then continually ask themselves the question 'why is it that we continue to be uniquely placed to provide this good or service to our customers?' Today's Corporate Social Responsibility industry has attempted to claim ownership of many of the ideas that are in fact embedded in sustainable high-success companies as core elements of how they think, act and deliver value.

In practice, these companies communicate well to all stakeholders using both unitarist and collective mechanisms;

Reading the performance code allows us to more accurately predict future performance

the positioning of that company within its own unique sectoral setting and in its relationship with the external environment. However, understanding the areas of the CPI and the 'intangible' factors of production by which they are applied, as we have tried to explain above, should – in each and every case – guarantee improved performance. This unique matrix of activity when blended together forms the performance code of each company – and the principles on which it is based describe the 21st Century version of the sustainable, high-success company. Reading the performance code allows us to more accurately predict future performance rather than, as with other tools and mechanisms, merely judge the past.

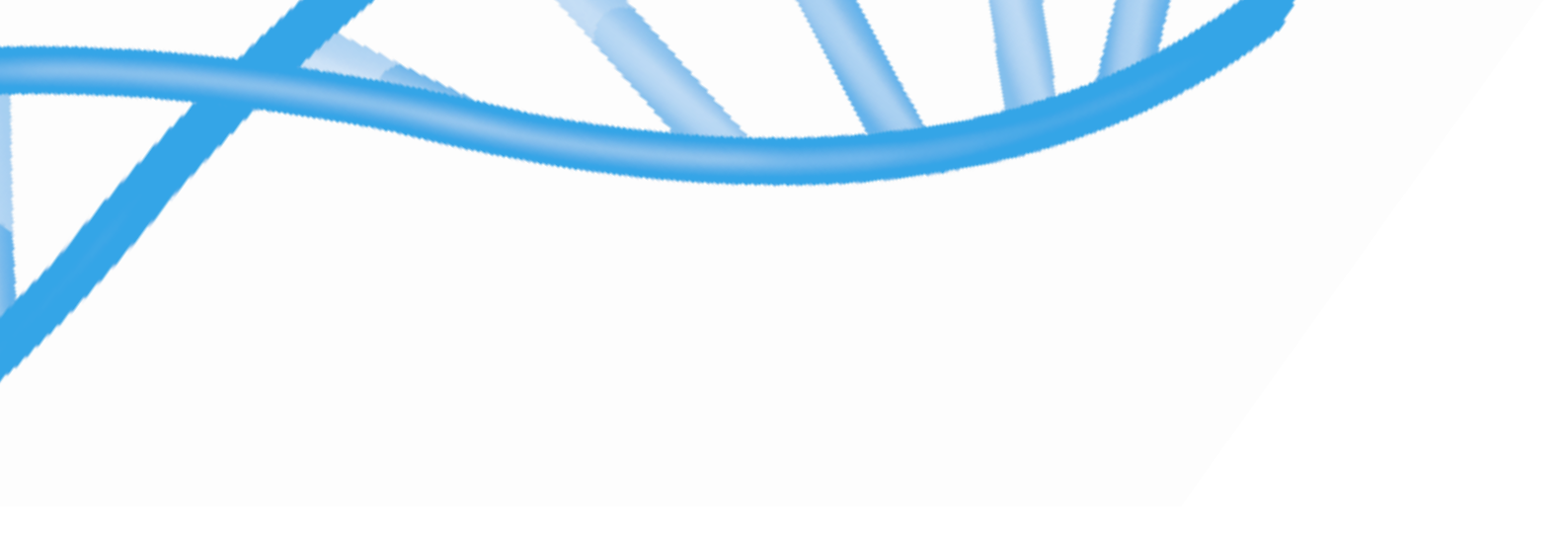
have processes that are simple, clear and well understood by all; are led by able stewards – not necessarily great visionaries – and have a culture that is edgy but supportive, challenging but rewarding¹².

However one labels it, at the heart of the CPI is the notion of the sustainable high-success company that understands its 'reason to be' and then pursues it wholeheartedly, supported by a set of values that are mutually reinforcing. This vision is not one that is very compatible with the 'shareholder value' revolution of the 1980s, but is one that is recognisable to people running (or working in) the UK's most successful firms.

¹¹ Davies, S in conversation

¹² See Literature Review at www.theworkfoundation.com/research and James C Collins and Jerry I Porras, *Built to Last*, Random House, 1994 and Kay, John, *The Truth about Markets*





This means the pursuit of deal-making over business building will ultimately reduce value, productivity and profitability. Of course, companies need to make profits and they need to create shareholder value but they do this over time not by focusing on making profits per se, but by blending the areas of the CPI and 'doing' something very well, whatever that something might be. This is why too much focus on 'shareholder value' upsets the blendedness of strategy and so leads to sub-optimal outcomes. Indeed, the evidence from this research suggests that there is a lack of shareholder engagement in strategic decision-making which reinforces the conclusion that in many cases there is too distant a relationship between owners (shareholders) and managers.

In the UK, it is arguable that the boards of companies are so incentivised to increasing short-term shareholder value above all else that it is more difficult than it should be for them to focus on what the company does really well – which is make, service, broker or provide something tangible. Instead, the people who run UK companies are arguably being required to focus on deal-making over business building. Thus it should come as no surprise to find that it is medium-sized firms that are disproportionately represented in the upper reaches of the CPI.

Though these firms, in many cases, suffer from a lack of access to affordable capital; a lack of knowledge about how to grow successfully, or access to the skills that can help recruit and retain people they are not constrained by rules of engagement that require them to focus on one area (owners or shareholders in the CPI) over all others.

It is also the case that the UK has a uniquely long tail of low performing smaller firms that lack aspiration. The survey data confirms the view of other research that many UK firms are very ambivalent about growth. They are lifestyle or family businesses who are very happy where they are. For these firms, growing is what other firms do. The conclusion to be drawn is that UK productivity growth is likely to come by growing our own 'mittelstand'.

However, for lower-performing firms that want to be higher-performing the first lesson is to go back to first principles and understand what the firm is there for and then ask themselves 'how' they want to proceed. What are the values that will effectively encapsulate their 'reason to be' and run through all that they do? Then they will be in a position to put into practice the lessons of the CPI analysis.

Towards Higher Performance

Table 1 highlights some more of the qualitative findings across the CPI arising from the comparison of high and low performing companies and illustrates what sort of things high performers do that low performers fail to do when they apply blended strategies captured by the CPI.

Table 1
Examples of typical good and low performance in the five areas of the Company Performance Index (CPI)

Good performance	Low performance
<p><i>Customers and markets</i></p> <ul style="list-style-type: none"> • People know who their customers are and understand their role in serving customer needs. Feedback loops are well established and feed into performance improvement and innovation. 	<ul style="list-style-type: none"> • People work for others, but have little concept or interest in where their work fits into the business as a whole.
<p><i>Shareholders and governance</i></p> <ul style="list-style-type: none"> • Investment analysts are a 'strategy soundboard' and understand the value in the business beyond returns on investment. Investors see their role in business as part of the building function – not just as compensation for risk. 	<ul style="list-style-type: none"> • Where companies are listed The City drives the business and its long-term investment plans. For unlisted companies lifestyle can be more important than growth – so keep the bank manager happy and all will be well.
<p><i>Stakeholders</i></p> <ul style="list-style-type: none"> • Understand their 'reason to be' and clearly communicate that through values, sense of shared purpose and way supply chain is dealt with. All connected with the business, including the supply chain, are pointing in the same direction. 	<ul style="list-style-type: none"> • Little or no stakeholder engagement beyond requirements of supplying the market with a good or service. Relationships all transactional. Workers do a 'job' no more.
<p><i>People</i></p> <ul style="list-style-type: none"> • People are rewarded for service to customers, innovative ideas, service to their communities and citizenship, as well as for the overall performance of the business • Measurement of management practice (for example employee satisfaction surveys, balance scorecard) is a diagnostic tool for improving management and plugging gaps • Company attracts and retains high skilled workforce • HR is strategic. 	<ul style="list-style-type: none"> • People's reward and recognition is not matched with the targets they are set in their personal reviews • Achievement of targets is both a measure of performance and a motivator for performance. Performance targets conflict with vision of company (eg they are sales driven rather than customer driven) • Company complains of skills shortages • HR is irrelevant.
<p><i>Creativity and innovation</i></p> <ul style="list-style-type: none"> • The culture of the organisation encourages creativity and innovation as a matter of course. People are encouraged to innovate, to attend conferences, seminars and classes and to network with other people outside the organisation with similar tasks or interests as a means of adding value to their work. The business has a pro-risk management style that can encourage and engage the networked, autonomous and flexible employee. 	<ul style="list-style-type: none"> • People may be encouraged to train and develop their skills but have to do this in their own time. Ideas and suggestions for change or improvements don't go anywhere. Training is limited to basic firm specific training or health and safety briefings. The odd senior manager gets major time and money invested.



But once the above is all understood what else should happen?

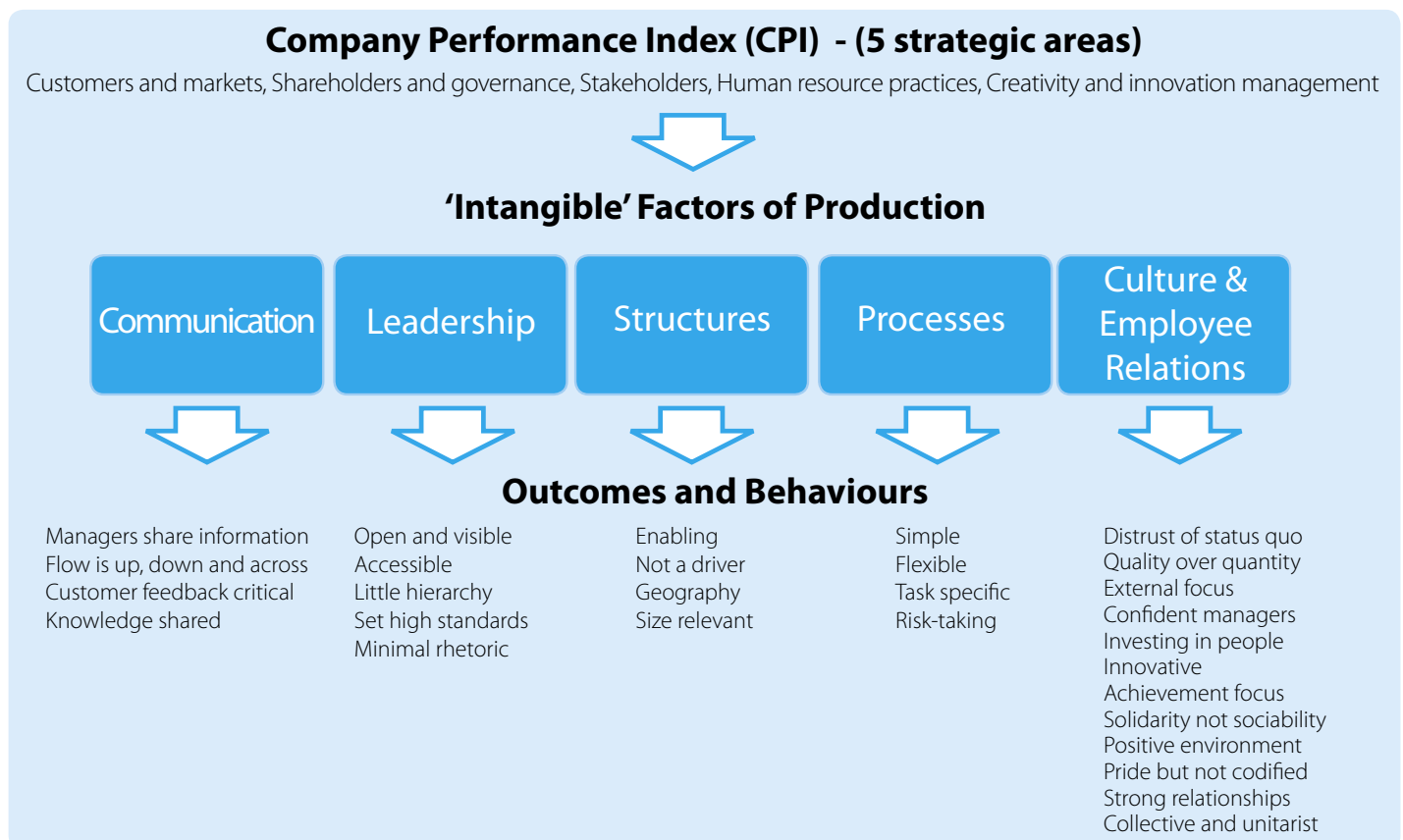
Code Breaking

As Figure 2.1 shows, the strategy into practice matrix attempts to explain in diagrammatic form how successful companies sustain their success in translating the strategic inter-dependencies captured by the CPI through the 'intangible' factors of production. In many ways, as argued above, the specifics described in the matrix are the core means by which organisations create value be it economic, social or public or a combination of all three.

Achieving High Performance

For firms to improve their performance they need to balance and understand the inter-dependencies across the CPI, then translate those strategies using the intangible factors of production mediated by certain behaviours rather than others. The exact 'fit' will depend on a myriad of external and internal factors such as history of the organisation, its geography, its sector and its position within that sector but the advice below is common to all.

Figure 2.1 Strategy into Practice



Source: The Work Foundation, 2005

Structure:

- ECS Metering was brought back 'in house' to provide metering services to EDF Energy retail customers only. ECS was subsequently re-branded to EDF Energy Customer Field Services and is now structured to allow meter readers to cross sell other EDF Energy products. The re-branding and restructuring helped signal to the workforce that they were truly part of a new organisation – EDF Energy. This helped with the psychology behind persuading the workforce to sell other products and increase their range of skills and overall adaptability

local markets. Knowledge that helps it gain first mover advantage when market opportunities arise.

Process:

Keep processes simple and allow a higher degree of informality. This combined with continued dialogue will allow faster decision-making.

- At MBDA there is a common and well-embedded performance management system across the UK company. The corporate intranet enables paperless communication.

Keep processes simple and allow a higher degree of informality. This combined with continued dialogue will allow faster decision-making

- Hermes Pensions Management Limited is particularly unique, as it is owned by a pension fund, enabling it to understand the demands of pensions trustees. Here its ownership structure is itself a reinforcer of a key business driver since Hermes Pensions Management Limited' owners are able to identify closely with the demands of its customers since they themselves are under the exact same pressures. This better understanding then leads to closer collaboration and usually better performance outcomes
- The geographical position of Standard Chartered's 'franchises' allows it to build up detailed knowledge of

The company assesses individuals by how they achieve their targets and goals as well as whether they've achieved those targets and goals. Objectives are cascaded throughout the workforce during January-March in a well-rehearsed, automated process that coincides with a communication programme of events/roadshows that explain the organisation's current performance and future priorities. The outcome is a clear 'line of sight' between individual objectives and the priorities of the organisation as a whole.



- Standard Chartered have a process by which teams are put together based on external knowledge of the client and market with internal technical abilities in a very short period of time in order to meet customer needs. In a fast-moving market such as finance with several larger competitors often dominant, such agility helps win contracts. The combination of closeness to the client and technical ability reassures the client that the Bank is working for their best long-term interests
- At Working Links, detailed procedures for capturing data required for compliance with contracts is supported by the new team structure that separate out the contract management role from the team performance role. Detailed compliance with public service contracts and delivery of those contracts are handled separately, so each part of the operation develops more expertise and skills in delivering their part of the deal. The result is happier clients and better outcomes.

Communication:

Openly share information between peers and networks of managers so that timely and accurate information is given and received.

- Working Links have also instituted weekly team meetings to discuss issues of contract compliance, quality and role definition as they arise rather than leaving them to become entrenched. These meetings help drive performance upward by dealing with issues and problems as they arise before they get in the way of smooth contract delivery. This is particularly important as the nature of the client group Working Links serves changes and as the demands of the contractor become more challenging

- At Rolls-Royce, a large multinational multi-site organisation, much communication has been conducted through collective mechanisms. Recently they have shifted to more emphasis on direct communication between individuals. This is particularly important as the company develops a more agile workforce with engineers and other technical staff being required to take on and develop soft skills such as cross team-working. Both unitarist and collective mechanisms complement each other in communicating, negotiating, motivating and engaging with a skilled and very diverse workforce
- Standard Chartered have created technology networks to facilitate the sharing of ideas and knowledge such as chatlines in the wholesale bank. Such ICT-enabled knowledge management in such a diverse global business is a good way to help with speedy deal-making and delivery of value to clients as well as helping with innovation and new product development.

Leadership:

Make sure your leadership and management are visible and accessible and set high expectations from those in decision-making roles.

- The strong values culture exemplified at Standard Chartered is led by the Group Chief Executive – he personally endorses the ‘Seeing is Believing’ campaign, encouraging staff to live the Standard Chartered values. In any organisation – and all organisations have hierarchy – what the head of the hierarchy does sends out strong signals about the relative importance of different types of behaviour and the values that support that behaviour. In this case, the Group Chief Executive’s endorsement of

this particular campaign tells all the staff that values are very important to the way business is and must be done. This in turn gives confidence to customers that a deal will be more than a set of transactions but a relationship under-pinned by a set of principles

- At Rolls-Royce, the senior management team try to embed excellence, especially in the context of reduced resources and more delegation of responsibility. Senior managers use site visits to ask questions on these 'soft' aspects as well as on 'hard' performance. This approach means that line managers with delegated responsibility for getting more from the people they manage know that their managers understand the issues they face. This helps breed confidence and higher trust relationships.

Culture and Employee Relations:

Keep asking questions about the status quo. Value quality rather than quantity, and keep the focus on the long-term and on outcomes. Establish a climate of employee relations which is characterised but not codified by pride, innovation and strong interpersonal relations. Understand that collective mechanisms support this.

- At Plasmor Ltd, all staff are salaried, on harmonised terms and conditions and participate in profit-sharing schemes and productivity bonuses. The company has successfully got away from a traditional foreman, plant operatives, overtime culture and replaced it with one notable for a high degree of commitment, pride and loyalty. Only three people have left in three years and one of those was through retirement

- Employees at EDF Energy Customer Field Services have a strong 'public service ethic' and is evidenced by their approach to service delivery and its completion. Staff are trained and motivated to ensure customers are very satisfied with very clear processes to follow to meet that objective. Staff will always go that 'extra mile' in pursuit of satisfaction particularly for customers who have special needs. This approach aims to embed the company in the communities it serves. It makes it less of a faceless corporation and more a company people can trust due to its flexibility and willingness to help. This can help capture loyalty and drive up customer retention – essential in an increasingly competitive energy supply market
- Hermes Pensions Management Limited does not build up large teams when the market is buoyant, only to cut them in harder times. This engenders an employee culture of relative security and sensible working hours – unique in the area of financial services. And much research has shown that security and control are the two factors that enable nearly all workers to deliver higher performance. Longer hours will arguably increase output but usually at the cost of performance and quality.





Section 3:

Competition in an Inter-dependent World

Creating more success at firm level is clearly important for those firms who would like more profitability and productivity. For it is not countries but firms that actually do the competing and help drive up overall productivity rates¹³. A higher productivity rate creates more wealth and from this everyone should benefit. This is why it is so important that the UK gains a better understanding of the mechanics of good and bad performance at firm level. Being more productive is the only way to ensure

As we argued earlier, there has been a fundamental shift in what we produce and how we produce it. This shift has been driven by three major factors: globalisation, particularly as it affects trade between OECD countries; ICT production and use; and the drive for single market completion in the European Union. In the majority of OECD countries, this shift is further complicated by the demographic changes that are altering the profile of the working age population.

It is not countries but firms that actually do the competing

long-term value creation and profitability. In the UK, for example, our results show that hotels, retail, catering and personal household sectors had 10 per cent new entrants into their marketplaces – increasing pressures to be more productive – compared, for example, with only 6 per cent for construction or manufacturing.

If it is the responsibility of firms to get their internal machinery well-oiled and working, then Government is responsible for setting the terms and conditions of much of the external environment. Government in turn is affected by broader and deeper changes from outside its direct domain that impact its choices and decisions. Understanding these broader, deeper and longer term pressures and changes is thus vital to understanding how high performance firms will be sustained and delivered now and in the future. And it is to a brief discussion of this external environment that we now turn.

Globalisation

Since 1980 global trade flows have increased dramatically. At first they were driven by the liberalising of international capital. This has now combined with the emergence of three vast trading blocs. One in North America, the North American Free Trade Agreement area (NAFTA) that includes the US, Mexico and Canada and satellite countries in central and South America; the second in Europe, the 25 countries of the European Union plus the countries that neighbour them; and the third in Asia, centered on the new tiger economies of China and India as well as the slightly older tiger economies of South Korea, Singapore, Indonesia and Japan.

To illustrate the scale of the increases in the growth of global trade as a proportion of global GDP, world trade in goods and services has risen from 20 per cent in 1990 to 30 per cent by 2003 – a 50 per cent increase in just 13 years¹⁴. Merchandise exports between 1990 and 2000

¹³ For a simple but clear discussion see John Kay's column in the Financial Times 17 May 2005. Also Krugman, Paul, *Pop Internationalism* 1994

¹⁴ World Trade Report 2004, WTO 2005

grew by an average 6.4 per cent per annum compared with merchandise production at 2.5 per cent and GDP at Purchasing Power Parity (PPP) at 3.4 per cent¹⁵. In fact, over the last 10 years, exports of commercial services have doubled to US\$2 trillion¹⁶ with developing economies contributing around 20 per cent of the total.

Contrast that to the previous period of international trade liberalisation at the turn of the 20th Century when global trade flows amounted to 8.7 per cent of world GDP at their peak in 1913¹⁷. It is clear that we are experiencing an unprecedented period of growth in international openness which is helping drive up competitive pressures across the world.

In among the global statistics, the story of the rise of the Chinese economy continues to dominate. For Chinese growth alone is a major driver in sustaining overall levels of global demand. The Chinese economy (now the world's fourth largest at 13 per cent of global GDP) continues to grow at between 8-9 per cent a year. Export growth is around 35 per cent. In 2003, more Chinese subscribed to new phone lines (112 million) than the populations of Britain and France combined¹⁸. China produces 90 per cent of the world's toys, but now a third of its exports are electronics as it moves aggressively into the production of higher value-added goods. It also accounts for about one-third of the growth in global oil

demand importing around \$26 billion of oil in 2004 and taking up 90 per cent of the increased demand for steel¹⁹.

Like China, India has focused on liberalising its economy, adding impetus to the Asian-led sustaining of global demand. In India, GDP growth since 1990 has averaged 6.2 per cent per annum²⁰.

However, as many commentators have noted, a dose of realism needs to be added to this analysis. Trade flows may have grown but the bulk of international trade is still between OECD countries and within trading 'blocs'²¹. So though China and India are rightly perceived to threaten some UK industries through their far cheaper cost base they also offer many opportunities for investment, exports and growth to others. And this is not incongruent with saying that, at the moment and for the medium term, what happens in Europe has more relative impact than what happens in China and India and elsewhere in the world.

¹⁵ Ditto

¹⁶ Karsenty, Guy Presentation to WTO Symposium April 28 – 29, 2005 on Cross Border Supply of Services

¹⁷ Beal, Tim, Liberalisation of Indian Foreign Trade: following China through an open door into global markets?, Centre for Asia/Pacific Law and Business, Victoria University of Wellington

¹⁸ Chinese National Bureau of Statistics

¹⁹ JPMorganChase Treasury Services

²⁰ Bradford DeLong, J. India Since Independence: An Analytic Growth Narrative, University of Berkeley, California 2001

²¹ See, Wolf, Martin, Why Globalization Works, 2004 Yale University Press



ICT

Similarly, despite the dot com crash of the early 2000's, Information and Communication Technologies (ICT) are increasing competitive pressures by shortening the life cycles of new products making it more imperative for firms to operate at the technological frontier. It has also speeded up transactions and thereby lowered costs particularly in some sectors such as the US retail sector; and it is arguably reducing information asymmetries which allow consumers to create more informed and faster demand. This

And it is faster productivity growth in ICT intensive services that accounts for the largest element of the productivity growth differential between the US and Europe²³.

Six out of 56 sectors common to both the EU and US – office equipment, semiconductors, communication services, wholesale, retail and financial services – dominate the growth story in both Europe and the US over the last 10 years and all are heavy users or producers of ICT. Despite the importance of these sectors in both the UK and the US,

The UK needs to capitalise more on the opportunities that ICT offers

is in turn creating more intense competitive pressure on firms to produce more individualised products. It means consumers are more fickle and the speed of change, innovation and marketing has all increased.

The UK needs to capitalise more on the opportunities that ICT offers. For example, there is growing agreement that the improvements in US whole economy productivity growth over the last 10 years when compared with Europe's is due in large part to its greater exposure to, and application of, ICT. The United States ICT advantage is closely related to spatial issues and focused particularly on ICT use in the retail and wholesale sectors where spatial factors have greater purchase than in other sectors. Europe, with its denser populations and older cities cannot compete in this regard²².

the US seems to apply ICT better and it also invests more, outscoring all EU economies and investing at nearly three times the rate of the UK²⁴.

Nevertheless, the faster application of knowledge is apparently revolutionising what we can do and how it is done. It is ratcheting-up competitive pressures but also enabling so called 'network structures'²⁵ to thrive.

In some senses new technologies have always enabled 'creative destruction' to speed up, with both winners and losers emerging. But ICT combined with globalisation is arguably creating a new tipping point where the network will become the new organising principle for economic and social life²⁶. Certainly, the evidence from this research

²² For a full argument see Turner, Adair, Just Capital, Pan 2001

²³ Van Ark, Inklaar and McGuckin, ICT Productivity in Europe and the United States: Where do the differences come from? The Conference Board 2005

²⁴ Veugelers, Reinhilde, ICT and Productivity Growth in Europe, DG Economic and Financial Affairs, European Commission

²⁵ Network structures refers to those formal and informal channels through which decisions, ideas and opinions flow freely – all of which is vastly enabled by ICT. In such organisations hierarchy is less obvious, structures are flatter and there is usually a stronger internal and external flow of communication and ideas

²⁶ Hutton, Will et al forthcoming scoping paper on the Knowledge Economy, The Work Foundation 2005

project suggests that successful organisations are demonstrating strong 'network' effects which help them become more innovative companies. In the UK today, our results show that manufacturing, mining, utilities and the health sectors show high levels of innovation; and, of these, manufacturing and utilities (joined by transport and communications) have well developed industry-wide networks. Finally, only a fifth of UK firms surveyed were developing their own technologies with manufacturing at 34 per cent the highest performing sector.

Europe

European economic integration is a major driver of performance and competitiveness among UK businesses. Nearly 60 per cent of Britain's trade is with other parts of the European Union (EU)²⁷. Common rules concerning employment rights and standards, environmental protection and competitiveness help create a level playing field on which all companies compete equally. Moreover, the EU negotiates trade terms as a bloc which helps UK firms competing in global marketplaces acquire better market access.

That is not to say Europe is one homogenous whole. Performance varies widely as it does between states in the USA. However joining those European economies that are at the top end of the performance world leagues is the goal for the UK. As last year's report of the High Level Group on the Lisbon Strategy said: 'Europe needs to innovate on its own behalf. The strength of its knowledge industries and Europe's capacity to diffuse knowledge across the totality of the economy are key to lifting the growth of its productivity to compensate for falling population growth

and pay for its social model. Lisbon should be understood as a means of transitioning the European economy, from structures where it essentially caught up with the world's best, to establishing economic structures that will allow it to exercise economic leadership²⁸.

This means over the next five to ten years, the newly enlarged European Union will be maintaining a sustained drive to create the world's leading knowledge economy. For more UK firms to compete effectively in such a marketplace they need to become ever more high performing, applying the lessons described above in sections 1 and 2.

Towards a Knowledge Economy

The knowledge economy story is not mere rhetoric. As outlined above, there seems to be a fundamental shift occurring in the international division of labour and production. Developing and transition economies alike are competing on cost, and taking an increasing share of the world's production of finished goods. They are also producing a greater share of higher value-added goods (see Chinese example quoted above). For the UK, with its existing productivity problem, the need to prioritise the development of its own knowledge economy is crucial. And this is not only true of ICT and biotechnology, but also of the creative industries (currently growing at 8 per cent a year), high tech manufacturing, and parts of the public sector, such as health care. Even some seemingly low-tech sectors such as retail have knowledge-diffusing centres that cut distribution and marketing costs²⁹.

²⁷ ONS data

²⁸ High Level Group on the Lisbon Strategy, Facing the Challenge: The Lisbon Strategy for Growth and Employment. European Commission 2004

²⁹ Van Ark, Inklaar and McGuckin, ICT Productivity in Europe and the United States: Where do the differences come from? The Conference Board 2005





To achieve all this requires the right environment – what the Treasury describes as ‘a flexible and enterprising economy’³⁰. For its part, the Government is committed to maintaining a stable macroeconomic environment; promoting enterprise and competition; sustaining employment opportunity for all, increasing public investment in science and technology to 2.5 per cent of GDP over the next 10 years³¹, and, crucially, raising overall skills levels of the UK workforce.

Skills is a sine qua non for the knowledge economy. As The Work Foundation argued in its analysis of UK adult skills compared with the rest of Europe, *Where are the Gaps?*, UK firms should be shooting for average minimum workforce skills at level 3 (A level or equivalent) rather than the Level 2 (GCSE A* - C or equivalent) floor we are aiming to establish now³². Without a higher overall level of skills in the UK economy firms will experience skills shortages that in turn will hamper attempts to improve performance.

In short, as a soon-to-be-published Work Foundation working paper argues: ‘the necessary ingredients of an ideal knowledge economy might be described as follows:

- Innovation and investment in R&D as the drivers of economic growth
- Effective competition policies to stimulate the demand for and supply of innovation
- An infrastructure of world-class research universities with strong linkages to the business community

- Access to a ready supply of venture capital for business (and universities) to ensure that ‘blue skies’ research can be transformed into real products, services and processes and an aptitude to manage innovation
- A high skilled workforce – where the majority of employees have level 3 qualifications, since it is only at this level that investment in skills delivers real improvements in productivity and performance
- Employers with the capacity to fully utilise the skills of a more highly qualified workforce – evidence suggests that at present around 25 per cent of the UK workforce are employed in jobs below their skill level
- Efficient transport infrastructure to facilitate access to markets
- Efficient ICT infrastructure where access to broadband is ubiquitous and businesses make the most effective use of ICT to streamline processes and boost productivity. This includes the need for software and hardware producers to ensure integration
- The promotion of more effective collaboration across industries, whether through business clusters or formal and informal business networks
- High levels of social capital to promote trust between businesses and between employers and employees³³.

³⁰ Budget Report 2005. HM Treasury

³¹ Budget 2005, HM Treasury

³² Hutton et al, *Where are the Gaps?* The Work Foundation for the DfES 2005 for a good discussion of the current state of the UK’s emergent comprehensive lifelong learning system.

³³ Coats, D et al, *Working Paper: What is the Knowledge Economy?* The Work Foundation Forthcoming

Productivity – a growth story?

If we can increase the performance of just 10 per cent of the bottom two thirds of UK firms, in whatever sectors they operate in, to the average performance of the top third this would add value by around £1,600 per worker per annum, adding £2.5 billion to the UK's total GDP and raising the trend rate of growth of the UK economy by around 0.25 per cent. However it is clear that there are a range of options and choosing the best ones between them by decision-makers in UK firms, business organisations and parts of Government will be fiendishly difficult. The debate over regulation is a case in point. It is obvious in some areas that regulation has reached a tipping point and is providing diminishing returns. Many (often smaller) companies argue that regulation is strangling their businesses. This may be in part due to a lack of knowledge and management time for compliance, but it is not the whole story. Much regulation stops harm being done to people or planet. And some regulation drives up, rather than harms, performance.

However, it does appear that the UK is ready for an economic gear shift – that we seem to have reached the end of the low road where 'pile them high and sell them cheap' is a viable strategy. For we simply cannot compete with the much lower labour costs of Eastern Europe and, further afield, China and India.

The challenge of raising UK firm level performance has been a 'holy grail' of policy-makers, academics, company leaders and Government for more than a hundred years. What we argue from our findings is that there is now a body of evidence from this and many other projects that enables us better to understand the contingencies of success. From this understanding it is possible for us to create the

conditions and overcome the challenges that will ensure more UK firms are successful leaders in their field and not poor imitators of others' success. We have described above what we believe lower performing firms should do. But what more should Government do?





Section 4: What Should Government do?

The findings contained in this report point to four areas in which to develop fresh responses to the challenges of the external environment and for Government to develop policies that will help more companies blend together strategies in the five areas of the CPI. Progress depends on the government maintaining macro-economic stability, low inflation and a responsible fiscal policy. There is every reason to believe that this can be delivered as long as the fiscal rules are observed and the Bank of England's symmetrical inflation target is met.

Stability enables businesses to plan investment and make investment decisions in as certain an environment as possible. Obviously the economy may experience external shocks and not every eventuality can be foreseen, but British business now has the best opportunity for a generation to tackle some of the nation's most persistent problems with productivity and performance.

But is there a role for government beyond the maintenance of macro-economic stability and the operation of an effective competition policy? Some would say no, and argue that government is most effective when it does the least. Business should be left to get on with the job without being second-guessed by politicians who understand little about the process of running a company.

This is a widespread view. Nevertheless, it is only a partial view, which takes no account of the notion of market failure, or the essential contribution the state can make to the supply of public goods like education and training.

Of course, nobody believes today that the government can create effective private sector businesses through

legislative fiat. Similarly, few believe that under performance or under investment in the private sector is best dealt with through public ownership. Nor are governments in the business today of picking winners or identifying national champions and giving them the support they need to succeed in international markets – not least because previous governments proved rather poor in making these judgments and wasted a lot of public money as a result.

The appropriate role for government today is to help entrench a business-building culture and establish an effective skills infrastructure that engages employers, ensures that there is an adequate supply of highly-skilled employees and creates sufficient leverage to raise employer demand for skills. Furthermore, by establishing an appropriate level of regulation, government can outlaw unacceptable business practices, apply pressure to 'low road' organisations and encourage innovation.

This suggests that there are four additional areas for government intervention, which can shape the overall business environment and create the conditions for high performance to flourish:

1. Policies to entrench more sustainable high success companies
2. Policies to encourage investment in innovation, R&D and knowledge
3. Policies to encourage investment in people

4. Policies that encourage the development of high trust relationships between businesses and between employers and employees.

In all these areas there have been considerable policy advances and it would be foolish to pretend otherwise. As The Work Foundation has described elsewhere: we have an emergent comprehensive lifelong learning system and strategy taking shape; attempts have been made

where there is strong competition, a level playing field for all, a stable macroeconomic environment, incentives to innovate, adaptable labour markets and workforces and a stable regulatory environment. On each of these areas there has been some progress but there is much more to be done. The government has taken legislative steps to enshrine the sustainable high success company model in law. Effective implementation of the requirement on all listed companies to prepare an Operating and Financial

Effective implementation of the requirement on all listed companies to prepare an Operating and Financial Review (OFR) is absolutely essential for a change in the culture

to reform corporate governance; there is ongoing higher levels of investment in people and firms; and some steps have been taken, however tentative, to close the trust deficit that exists in too many British workplaces.

Government has well-established policies addressing each of the five drivers of productivity as they see them – investment, innovation, skills, enterprise and competition. These interventions are all designed to reinforce the behaviours that drive the UK's highest performing companies³⁴.

1. Entrenching more sustainable high success companies

High performance companies are sustainable high success companies as we describe above. Such companies thrive best

Review (OFR) is absolutely essential for a change in the culture. In principle, the OFR should give an investor or any other stakeholder a 'fair view of the business'. We are collaborating with PricewaterhouseCoopers on a model that plcs might use to link their OFR to the CPI. We want the metrics that drive what is included in the OFR to cover the areas of the CPI and the intangible factors of production.

Government has a role to play too in working with others to give clear guidance to companies and consult with investors on the operation of the new arrangements. Through this mechanism it becomes possible to see how pension fund trustees, the investment community and the Boards of listed companies can collaborate better in agreeing what should be the core things – over and

³⁴TSO (2003)





above financial data – measured and reported on that then drive up future performance.

One critical element of the OFR must therefore be the comprehensive reporting of a company's people strategy, combined with outcomes around recruitment, retention and employee satisfaction. Investors need to know whether an organisation has a motivated or committed workforce and whether performance is improving. Implementation of the recommendations of the Kingsmill review of human capital reporting is of great importance in this context.

Reputable employers can be confident that regulation insulates them against unfair competition from the unscrupulous

Government must seek to broaden and strengthen the impact and reach of the OFR as an instrument to sustain high success companies. Adopting a 'minimalist' approach will have the effect of taking the pistons out of the engine.

We also believe that the time is now right for progress to be made on the implementation of the recommendations of the Company Law Review. This was initiated in 1997 and the work was completed three years ago. In particular, we believe that it is important for the government to implement the new statement of directors' duties despite the caveats about some ambiguity in their wording. This will give a clear indication that directors have responsibilities to a wider group of stakeholders than shareholders. In that sense it is a practical demonstration of the value that sustainable

high success companies place on effective management across the five areas of the CPI.

Regulation has attracted considerable attention as a barrier to 'competitiveness' and there is no doubt that a tipping point has been reached where some badly-designed or disproportionate regulation is having an adverse impact on business. This has meant that for many employers all regulation is simply a 'burden on business'. Yet there is also evidence that some regulation has a positive rather than negative effect. Over the last eight years there has

been a substantial re-regulation of the UK labour market – through the minimum wage, tighter dismissal rules, the social chapter measures and new rights for working parents – with no discernible adverse effects on the economy.

Indeed, a more positive case can be made. Those firms that are operating at the margins of the law will have little choice but to improve their performance or run the risk of failure. Having to pay the minimum wage has been accommodated by many employers so far through reductions in profits or increases in prices – there is no evidence of any job loss effect – but eventually these strategies will run their course and these businesses will have little alternative but to look for performance and productivity improvements to manage the increased wage costs³⁵.

³⁵ Coats, op cit

A very similar point might be made about health and safety regulation, where the need to comply has led organisations to rethink their processes, reorganise work or redesign jobs. Contrary to many employers' expectations, the effect has been an improvement in productivity.

Furthermore, reputable employers can be confident that regulation insulates them against unfair competition from the unscrupulous. As Winston Churchill said when introducing the wages boards legislation in 1909, in the absence of minimum wages, the good employer will be undercut by the bad, and the bad employer will be undercut by the worst. In essence, regulations are a response to what people think is needed to produce 'good' economic and social outcomes. In democratic economies, Governments respond to these impulses – no more or less.

Few employers have been willing to embrace such a pro-regulation argument with enthusiasm – but this is precisely the argument that needs to be made to establish a clear link between state intervention and improved productivity and performance. Otherwise, advocates of proportionate regulation will always be on the defensive, constantly fending off attacks from those who believe that any regulation is a brake on entrepreneurial dynamism.

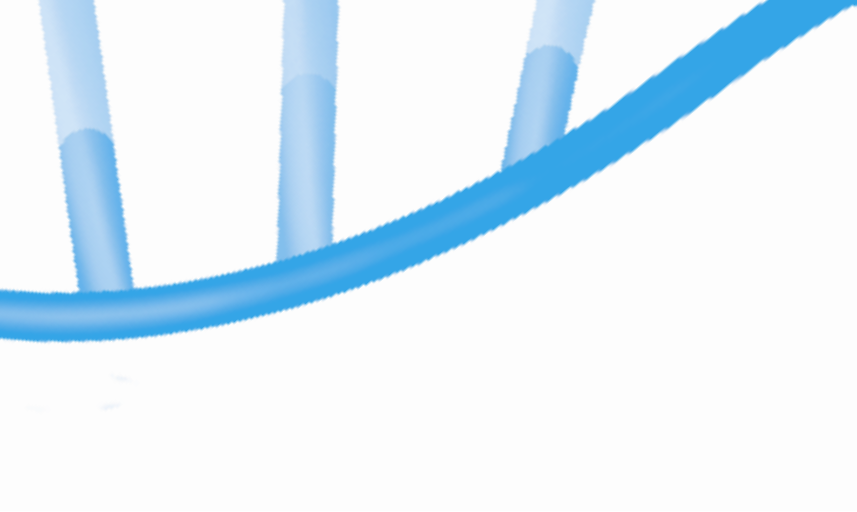
Government has a responsibility to ensure that businesses can easily comply with regulation and should offer support to SMEs in particular to enable them to respond innovatively. Otherwise, SMEs are likely to complain quite legitimately that they lack the capacity to comply or rethink their business processes to improve performance.

This means that high priority must be given to the range of services offered by Business Links and the Small Business Service. There should also be investment in other services that small businesses access voluntarily – such as ACAS – to ensure that they are in a position either to give advice or to ensure businesses are put in touch with someone who can.

The Competition Commission and bodies designed to act as a strong conduit for consumer voice also need to be strengthened. Competitive product markets are a necessary pre-condition for higher performing companies and mechanisms which drive up the power of consumers to demand better quality goods and not accept poor service help entrench such markets.

At regional level, the coordination of policy, advice, avenues to cheaper finance for growth, innovation, skills development and R&D should increasingly fall to the Regional Development Agencies. At present the articulation of responsibilities between national policy and regional delivery is not always clear, and a plethora of institutions with overlapping responsibilities often find it difficult to collaborate on areas of common interest. RDAs should be given greater opportunities to break their own path, should also be held to account for their delivery of national policy objectives and must be clearly identified as the lead agencies in the regions with responsibilities for economic development.





2. Innovation, R&D and Knowledge

As the High Level Group on the Lisbon Strategy argued last year, one of the key objectives must be to increase overall levels of R&D. Our survey revealed that 60 per cent of UK firms were actively investing in R&D, but of those that were expenditure equates to only 1 per cent of total sales. The Government has committed itself to achieving a rate of R&D investment equivalent to 2.5 per cent of GDP by 2015. The Lisbon target is for 3 per cent by 2010 in a 2-1 ratio of private to public. Though measures such as university tuition fees will increase resources into the university sector,

The Government should also strongly support at European level, and in its domestic policy proposals, measures to increase the mobility of world-class scientists and researchers. This should include fast-track visa procedures and improving the mutual recognition of professional qualifications.

The current National Employer Training Programme, which deals with a market failure at level 2 skills (the obtaining of 5 GCSE A* – C grades or vocational equivalents), is a direct subsidy to employers designed to capture the increasingly small number of people who leave the

Yet those businesses that are investing in training were also more innovative

the increases will be slight and arguably insufficient. The Government should also review the operation of the R&D tax credit to evaluate whether it is having the anticipated effect on the level of innovation in the UK. If it is not then further attention should be given to the proposals for the identification, dissemination and application of best practice outlined below.

The Lambert Report gives the UK an excellent road map to ensuring that the university and business sectors are both exploiting potential links. We urge that the recommendations of the report be implemented in full. Furthermore we would argue that research funding should be more contingent on embedding commercial exploitation and business linkages.

school and Further Education system without basic and level 2 skills. Though an essential building block for skills acquisition, and with a predicted 85 per cent plus of 22 year-olds likely to achieve level 2 by 2010, level 2 is unlikely to produce any genuine productivity gains for employers and thus the economy as a whole.

What is therefore needed is a sustained move towards level 3 ('A' level or equivalent). If employers' overall failure to train and invest to level 2 is a market failure of sorts (on the basis that employers believe it is the job of the state to provide all with a minimum standard of education) it is harder to argue the same case at level 3. Here what is needed is a more robust partnership between employers, individuals and the Government. Our survey found that median

training spend per employee is just £167 per annum, with the lowest expenditures in agriculture, transport and other community sectors. Yet those businesses that are investing in training were also more innovative. The Government is already piloting level 3 provision in some parts of the country and should consider extending this but more can and should be done.

The new emergent comprehensive system of lifelong learning should enable the new Sector Skills Councils to set some early benchmarks for investment in people

their relationships that the mission, core purpose and personality of an organisation are revealed. Ultimately firms must take ownership of this agenda and increase their investment in this 'factor of production'. Once the metrics that underpin the OFR are established (see above) these are the issues that will begin to dominate board-level agendas and drive performance.

The findings presented here are clear in suggesting that high performing organisations manage their people effectively. They invest in human capital and give employees

People are human beings rather than things

through engagement with the best employers and input in the development of vocational curricula. The Government should ensure that any recommendations made in the Foster and Leitch reviews that boost funding for these institutions and reform the supply side so that it is less bureaucratic are swiftly acted upon. This should help the goal of achieving level 3 and above across as much of the population as possible.

3. People

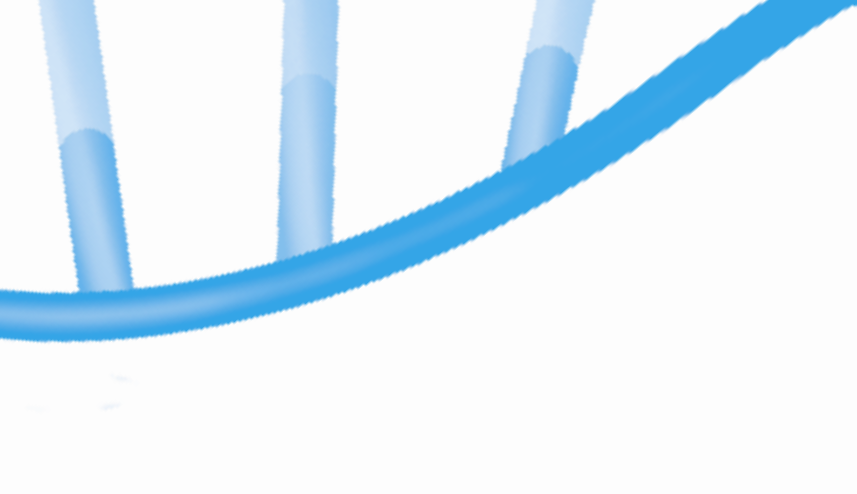
'People are our greatest asset' is an exhausted rhetorical device frequently used by CEOs at AGMs. This suggests that employees are seen principally as another factor of production. Of course, in one sense this is undeniable, but people are human beings rather than things. Work is a fully human activity and it embraces all our skills, talents, capabilities and emotions. Rather than treating workers as an asset it would be truer to say that employees are the organisation. It is through individuals and

real influence over the decisions that affect them most directly. Furthermore, high performance is characterised by giving employees a high degree of autonomy and 'task discretion'. Real empowerment, effective communication with individuals and the opportunity for employees to express their voice collectively are all necessary ingredients in the high performance mix.

But we know that there has been a decline in the quality of working life in the last decade. Workers report more stress, more pressure, fewer opportunities to influence the course of events and (despite the rhetoric of empowerment) less rather than more task discretion. All this is manifested in a 'trust deficit' in many British workplaces that is limiting the possibilities for improved performance.

Some might say that this is entirely the responsibility of employers and government has no role. But legislative steps have already been taken, through the recent





regulations on information and consultation for employees (I&C), to give workers wider access to collective voice. Furthermore, the government has been very clear in linking effective voice mechanisms to high performance and improving productivity.

Much higher priority must therefore be given to making the new institutions work effectively. This demands

Develop a better understanding of what we would describe as a 'pluralist' model of leadership

more than exhortation and Government should increase the resources available to train employer and union representatives participating in these structures, perhaps managed by an arms length public institution with a tripartite management structure. Precedents already exist through the Partnership and Union Modernisation Funds. It would be a missed opportunity if the I&C arrangements were allowed to wither on the vine and the potentially transformative impact of the regulations would disappear.

Implicit in our high success model is an approach to organisational change that demands a very different conception of leadership. There are any number of leadership courses, business school courses and interventions, executive coaches and the rest, but all offer the same broad solution – the success of any organisational initiative depends on the ability of charismatic or inspirational leaders to convince the led to embrace change. This approach ignores the possibility that followers might

have views about where the leaders want to take them and ignores our evidence that successful leaders have a keen appreciation of the need to listen to the concerns of their employees, both as individuals and collectively.

We would recommend therefore that the resources allocated to the ESRC's management research programme should be redirected to develop a better understanding of

what we would describe as a 'pluralist' model of leadership, where leaders value the opinions of the led and even modify their plans as a result. Our evidence is highly suggestive of the finding that sustainable organisational change depends on more than the charisma of the imperial CEO. The DTI should act as a repository of the knowledge emerging from the ESRC programme and, once again should focus on the identification, dissemination and application of best practice.

Furthermore, the DTI should consider establishing a 'Business Leadership' award scheme, which will benchmark performance against the indicators of success drawn from the CPI and other sources. Finally Government can offer a demonstration effect to others in the way it develops appropriate leadership models and styles across the public sector.

As an addendum, there is also a role for Government in the audit and inspection of business education. But

beyond accrediting course quality there is little more that Government can do. Ultimately, this is an area where business must lead.

4. Rebuilding Social Capital

High performing companies embrace partnership between employer, workforce, supply chain and other stakeholders. In other words, they place a high value on social capital at all levels. Unfortunately, too few British companies understand the power of relationships and networks. There is still too much narrow competition and too little collaboration on the problems confronting an industry or sector.

Some progress has been made in developing an institutional framework which encourages collaboration. For example, the DTI's Industry Forums have played a

Informal networks are important too

valuable role in identifying the likely development of an industry, the need for new skills, the impact of technology, the demand for new products and the quest for new markets. These outputs have been influential in shaping companies' understanding of the business environment and how best to respond.

A similar point might be made about the emerging role of the Sector Skills Councils. These are institutions with great potential. According to the government's 21st Century Skills White Paper³⁶, SSCs should undertake high-quality labour market analysis to understand the skill needs of their sector. This is not simply a matter of identifying current employer needs and meeting them, but understanding technological developments and market pressures to meet

future skill needs. In other words, SSCs will have a clear view about the extent to which a sector needs to 'raise its game' to have a sustainable future. This is a major departure in UK policy and it should be welcomed.

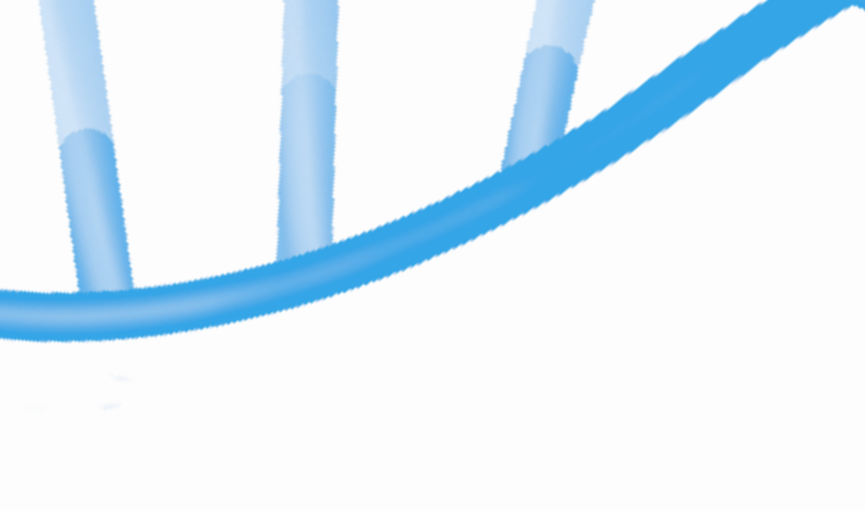
Nevertheless, these look like piecemeal initiatives with no linking narrative. We would argue that government needs to think hard about the best institutional framework to guarantee consistency in policy and implementation. Encouraging the development of more sectoral forums with real standing and influence would be a major step in the right direction. However, it is important that any institutions have a practical focus – they must concentrate on problem solving and performance improvement. Delivery must be the watchword.

Informal networks are important too of course and the DTI should, where possible encourage the development of supply chain partnerships or technology transfer and information exchange both within and across sectors. It is impossible to conjure these relationships out of thin air or legislate them into existence, but the DTI's cluster-mapping process suggests that much more could be done to facilitate more effective collaboration across businesses.

In the past, any process of rebuilding social capital would have raised questions about the role of trade unions. The NEDC was an explicitly tripartite body and trade unions played a central role in its work. However, unions are much less representative than they once were and many parts of the private sector are effectively union-

³⁶The Stationery Office (TSO) (2003)





free. This makes the process of managing change much more difficult, with the likelihood that employers will experience the 'concealed conflict' of sickness absence, or the 'individualised conflict' of employment tribunal claims rather than the overt conflict of industrial action.

We would argue that our findings confirm the importance of social capital in the workplace – it generates trust and reciprocity, making it easier to get things done. The evidence is compelling. A combination

of individual and collective voice can drive high performance in the workplace³⁷. Similarly, effective collaboration between the social partners at national level can legitimise change and help to solve seemingly intractable problems. But if trade unions are not present then who will play the representative role? At this stage it is probably impossible to answer the question, but we highlight it as a concern that both government and employers will need to address in the future.

First we need to understand better the performance code of companies capable of higher performance

³⁷ Coats, op cit

Conclusions

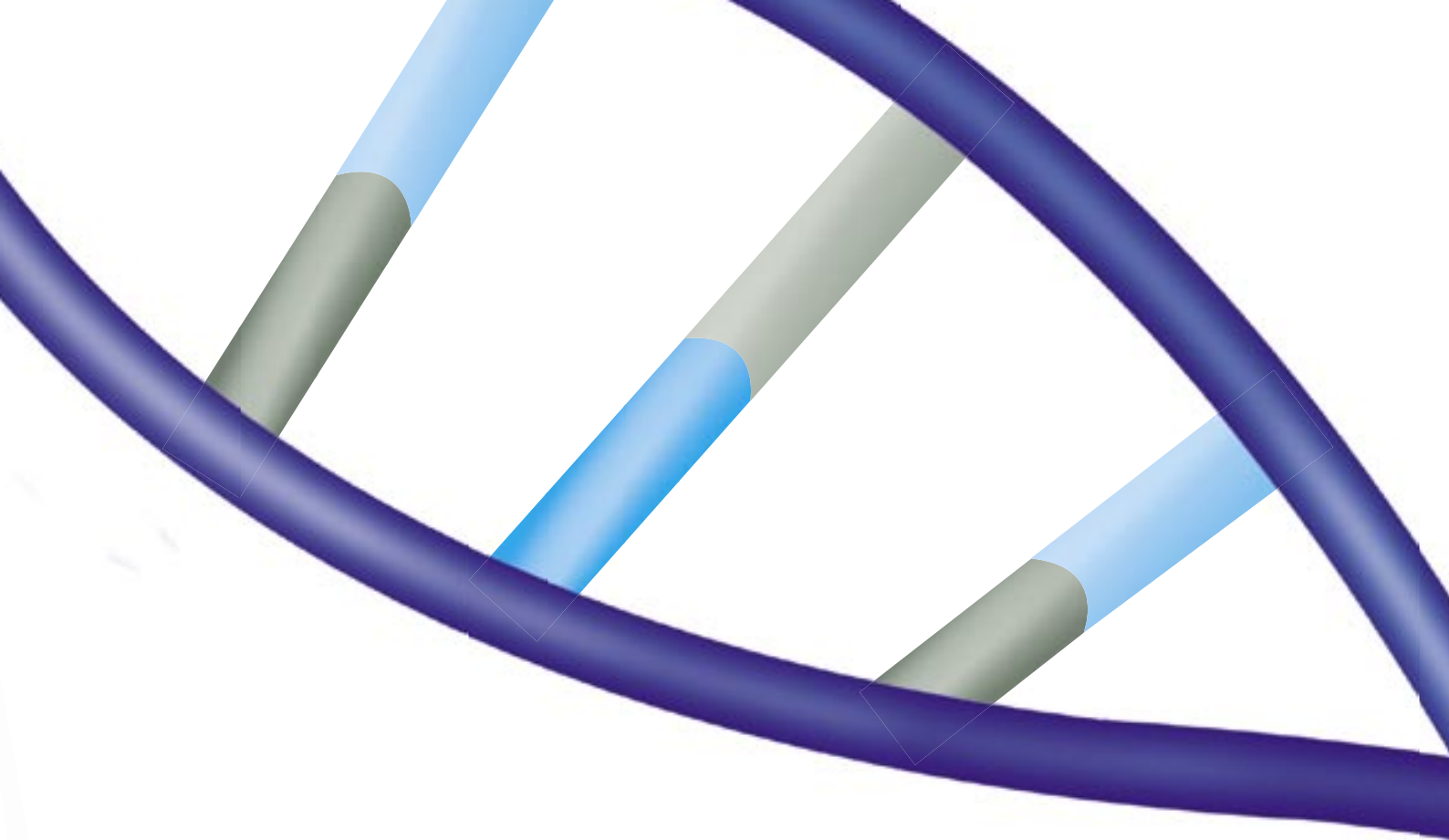
This short report has tried to summarise, explain and then recommend ways in which more UK firms can become higher performers. If the prescriptions emerging from two years of detailed research enable more of our firms to improve their competitiveness then we will all benefit. The UK economy will achieve a higher trend rate of productivity growth over the long-term. We will have more firms working at the forefront of their sectors at a national and international level. And the ensuing additional wealth will help fund better public services.

But there are many barriers to success. First we need to understand better the performance code of companies capable of higher performance. We believe the Company Performance Index (CPI) will help us to do this. Second we then need to overcome the management and leadership challenges to make sure that such firms apply the 'intangible' factors of production in ways that mutually reinforce their impact and that fit the unique historical, geographic and cultural environment of each organisation. Finally, we need Government to support these efforts by creating a better infrastructure for firms to operate in, developing smarter regulation that supports the creation of economic value without sacrificing people or the environment, and by putting higher levels of investment into people and R&D.

It would be naive to suggest that any of this is easy. Nevertheless as our report argues, a mere 10 per cent increase in the number of firms performing at the level at which the best third currently perform will ensure an increase in the trend rate of productivity growth of 0.25 per cent.

The research into the performance code of companies is by no means finished. However over the last three years, The Work Foundation and more than a dozen of the UK's leading companies have begun to create a far better understanding of how to read that code. We all now need to absorb the lessons, begin to apply them and continue the process of building a new generation of sustainable high success companies fit for the challenges of the 21st Century.





Cracking the Performance Code

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