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IN THE AGE OF AMAZON, DOES PRODUCTIVITY MATTER?

PAPER #1 OF THE MCA PRODUCTIVITY CAMPAIGN

YEAR OF DISRUPTION
PRODUCTIVITY CAMPAIGN

IN THE AGE OF AMAZON, DOES **PRODUCTIVITY** MATTER?

MCA Think Tank Director Paul Connolly argues that policymakers are far too complacent about the UK's productivity challenges

The UK's productivity crisis is real, serious and debilitating. MCA research shows that the business community is taking it very seriously indeed. But policymakers and parts of the commentariat are still insufficiently alive to the challenges the crisis poses. They need to wake up.

One response is to suggest that while the productivity challenges facing the UK are well documented, they do not really matter. And this is partly because of who our fellow productivity laggards are. On many productivity measures, including Multi Factor Productivity (the current standard assessment of improvements in output from a static/discounted value of inputs), the UK has been extremely sluggish since 2008. So too have the US and Japan.

The productivity nay-sayers draw attention to that list. The US is the largest economy in the world. Japan, the third largest. The UK the fifth. Maybe productivity isn't such a big deal. These economies are doing ok. Is productivity something policymakers fetishise but which is a red herring economically and in any case of limited concern to actual businesses?

Intriguingly, this point is to some degree echoed by the government's own productivity Czar, Charlie Mayfield, Chair of John Lewis. In an interview for Professional Manager he indicated that business was perhaps less concerned than government about productivity. Moreover, throughout the interview the word 'productivity' could have been replaced by 'efficiency' without any damage to the argumentative thrust. Or is it possible that in the Digital Age we are simply measuring productivity wrongly, as many including Gavyn Davies in a recent article on the US economy suggest?

Consider one of the digital giants of the age. Amazon. Whatever one may think of its business model, its success seems to have little to do with productivity. Rather, it derives from a near-monopolistic expansion and topline growth. Witnessing this, as well as the spectacular revenue growth of the digital integrators, surely the primary preoccupation for business should be to match that achievement, whatever the traditional productivity implications.

Indeed, attempts to match Amazon's business model might have deleterious effects on competitors' productivity. If a dominant retailer in a particular sector found that Amazon muscled in and offered same-day free delivery of the retailer's core products, it would have to match that offer or face losing ground. The logistics and fulfilment costs could erode the business's efficiency, margin and ultimately its profitability. The business could have happy customers and still go out of business. The issue for the business is surely to survive this challenge, whatever the productivity implications.

These points illustrate another productivity issue. Producing cans of beans, hewing coal, building cars: these are easy targets for productivity analysis, since they concern *things*. Many key techniques for improving productivity emerged through analysis of manufacturing processes. They concern getting more products from static input levels through process innovation, improved working practices and efficiency.

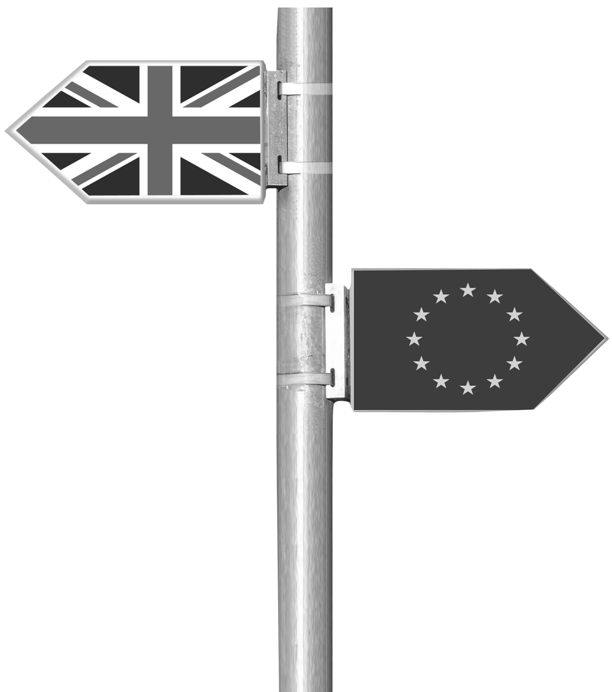
But with services the productivity question is more difficult. The 'product' is customer fulfilment. The customer is sometimes present, often a co-creator of the value. They may even be an eccentric ravager of productivity. Imagine a ticket-sales call-centre operative incentivised by the number of calls per hour who hears an elderly person on the line asking if they can tell them everything that is on in the West End. A good service for this person will seem to wreck their headline performance. How relevant is productivity in service conditions? Might productivity not be in a constantly tense relationship with customer fulfilment, as the Amazon example suggests?

It is worth noting that despite this, the evidence about the service productivity picture from across the globe is mixed. Australia posted four years of MFP growth to 2016. This was despite falls in manufacturing productivity. Gains in physical sectors such as agriculture, and falls in retail, were accompanied by MFP growth in service areas like telecommunications and media.

Of course, it is possible to mitigate or mask a productivity crisis if other factors are in play – but only if they are. Japan is very worried by its productivity challenges not simply because its role in the digital value-chain is as a producer of hardware and retail products. Overall, its economy is much more orientated towards manufacturing exports than the US and UK. It faces a perfect storm of long-hours, worker disaffection, an ageing population and a cultural aversion to immigration. Without an uplift in productivity, over time its output of world-beating products will start to decrease seriously.

Japan's structural factors should ring alarm bells for the UK. Since 2008, the UK has staved off its economic challenges and, since 2013, returned to a consistent pattern of growth. But productivity has had little to do with that. Rather, the economy has experienced an unprecedented period of wage-restraint and low interest rates. Membership of the European Union has ensured access to substantial pools of skilled and competitively priced workers who have in turn swelled aggregate domestic consumption. Live Strategy and others argue that accordingly the UK has grown through creating a low wage, low productivity economy of substantial volume. Brexit could change these dynamics, with unpredictable consequences for growth and productivity.

This explains, for the UK, why productivity in the aggregate will matter. It is not everything. If after Brexit, the UK can find ways of ensuring it retains a supply of competitively priced and high-spending workers and consumers, can restrain interest rates, keep consumption buoyant, and even provide the right investment conditions to create a few digital innovators to rival the US dominance, then all may be well. But the signs are far from good. Brexit is not progressing smoothly. Interest rates are now rising. Growth is stalling. Inflation is consistently higher than pre-Brexit. Sterling has fallen. House prices are depressed and consumer confidence with them. Net migration is decreasing. While rising interest rates may kill off some artificially sustained 'zombie businesses' some commentators blame for poor productivity, they will also inhibit other factors needed to improve the position, such as investment (still very poor) and infrastructure spending (improving, but against a background of an underdeveloped and expensive transport system). And the headline problem remains stark. ONS statistics show that on GDP per hour worked or per worker, the UK lags behind most of the rest of the G7. Worryingly, recent GDP improvements and productivity gains across Europe have not been mirrored in the UK.



So perhaps the best way to view productivity is as OEE have described in their recent work: an inherent good. It is not a panacea. But it provides resilience and enhances capacity. Indeed, I would go further. UK policymakers haven't woken up to the seriousness of the productivity problem. In the context of global economic uncertainty and the self-inflicted travails of Brexit, the UK will need to optimise its economic resilience. If the Brexit negotiations end badly – and who would bet against that? – we will need all the help we can get, just as Japan will need to improve productivity if its demographic timebomb is to be defused.

Even Amazon thinks productivity matters. The company's alleged preoccupation with targets, timed lavatory breaks, and digital monitoring of staff is symptomatic of its interest in maximising the inputs derived from workers. Amazon worries that competitors may emerge, possibly even through regulatory interventions, that expansion may stall and the company will need resilience to withstand the challenge. Hence Amazon's interest in drone delivery systems. Ultimately, the company's margins will improve if it can improve the ratio of inputs to outputs.

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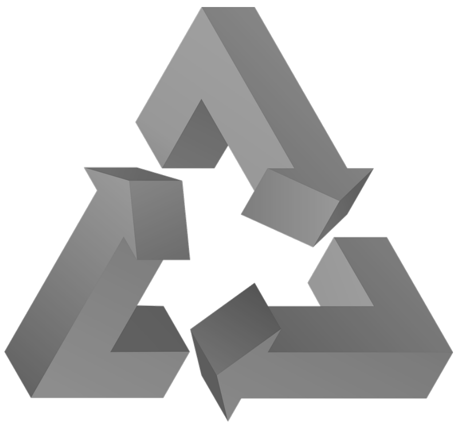
Or should that be outcomes?

Or should that be *outcomes*? And is this a more relevant way of looking at productivity in the service and digital ages? Amazon sells products. But it also sells experiences. It ultimately provides various types of fulfilment. So do other digital giants, from streaming services to transport integrators. So too does even the humblest greasy spoon, where the combination of cheap food, no-nonsense service and a reasonably convivial environment will be what keeps people coming back. Finding ways to create increased value from fewer inputs may be challenging. But it will be essential for those who wish to keep up with Amazon. And it provides a better metric for production overall. Manufacturing more products more cheaply may be productive. But if no one wants them, there is no point.

Indeed, returning to our retailer struggling to match Amazon's delivery reach, an emphasis on outcomes, in which the whole product comprises the goods and services *and* how customers access them, could promote innovation and new approaches to fulfilment. In digital services, it could lead to more transparent and sustainable pricing of digital value. And in our call-centre example, it could ensure a proper balance is struck in the business model between process volume and customer-centricity.

However, enhancing the rate of value-creation in services is difficult, as our call-centre example suggests. The theory of service productivity is underdeveloped. (Though for some extremely useful insights on sales productivity, with potential wider applicability, see Huthwaite's article on the subject). And the failure to develop a more convincing service theory is very problematic for the image of productivity. Too often, the word is simply associated with cost-cutting and job losses – or even the surveillance and control of the low-paid. Linking productivity to outcomes and the fulfilling achievement of those outcomes can start to detoxify the term, connecting it with positives, such as job satisfaction or career adaptability.



An emphasis on outcomes will also be essential for the planet. One thing that is inherently problematic with the inputs to outputs ratio is that it invites waste (as in the example above) or resource exhaustion. If we become fantastically productive in this model, we might well use up the planet's capacity. Hence, sustainability needs packaging to be built into the productivity equation. Getting more for less must start to embrace products themselves, from sustainable and reusable packaging, components and goods, through to the sharing and circular economies. Seen through this lens, the more for less dynamics of productivity move from the arena of an economic optional extra to an essential condition for survival.

In the recent past, it has been fashionable to suggest that the productivity problem is largely a problem of UK SMEs. Policymakers have been happy with this narrative. Government documents, including recent calls for evidence on productivity, suggest that the 'long-tail' of unproductive, undigitised SMEs are a major part of the problem. When we put this point to a gathering of senior management consultants recently, they dismissed it as ridiculous. Recent evidence from the Economic Statistics Centre of Excellence, cited in the FT suggests that this reaction is not misplaced. Some of Britain's historically most successful large corporates may make productivity gains that exceed those in smaller, less successful businesses. But they do so far more slowly than they did prior to 2008, despite their deep digital adoption. Large corporates are part of the problem.

Indeed, business leaders understand this. Working with the research experts VIGA, the MCA recently surveyed CEOs, board members, C-suite representatives, and other senior personnel, from over 100 large-scale enterprises. The findings of our survey will feature in this series of papers. We asked them if productivity really mattered to their business. If, as has been suggested, this is simply a macro policy worry that matters less to businesses, we could have expected a less than 100% result.

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All the senior business leaders ... thought productivity mattered to their firm.

That didn't happen. All the senior business leaders responding to the survey thought productivity mattered to their firm. They ranked it higher than both market share and topline growth, which in turn ranked lower than customer service. Indeed, topline growth, perhaps astonishingly, was selected as the top business priority by only 11% of respondents. than customer service. Indeed, topline growth, perhaps astonishingly, was selected as the top business priority by only 11% of respondents. Moreover, they linked productivity to some very contemporary concerns, such as digital and the improvement of the customer experience.

59% of respondents in the survey indicated that an inputs to outputs ratio remained their preferred approach to understanding productivity. But as we shall see in future papers, both the 41% preferring inputs to outcomes and the underlying preoccupations of respondents with customer service and brand value, suggest a willingness in corporate Britain to explore a productivity of outcomes.

The productivity policy agenda, however, shows little awareness of these subtleties.

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