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The Connected Business

Productivity growth: the crucial link between investment and return

By **Paul Blase** and **John Sviokla**

What's the critical link between investment and shareholder return for any business? Productivity. As the key to growth, it should be top of mind for the C-Suite at all times, and that means facing some tough, interrelated short and long term challenges: converting innovation investments into better products and services; building operating models to improve top and bottom line performance and reinvesting to create the right conditions for the next wave of growth. Getting a positive feedback loop working across these areas to drive productivity growth is a management triathlon, but one worth winning.

Productivity matters because it creates huge value. Across all sectors and at any point in the business cycle, a five per cent uptick in productivity – using earnings before interest, taxation, depreciation and amortisation per employee as a benchmark – leads to an average 11.9 per cent stock appreciation, a positive effect that should catch the eye of any CFO. In some sectors, five per cent productivity growth has coincided with up to a 50 per cent increase in total shareholder return. Numbers like that are hard to ignore. "We need to work on our productivity," a VP at a large asset management firm said to us. Yes they do, and so do you.

The pursuit of productivity is nothing new, of course, but in our complex global and digital economy, ever-changing regulatory and competitive forces make it difficult for the 'c'-suite to drive productivity growth consistently, and the traditional drivers no longer tell the whole story of how to achieve it. We have found that productivity isn't solely determined by industry, isn't just about high growth, doesn't necessarily require headcount reduction, and doesn't only come from new business models.

Management mainstays to increase productivity – automation of routine work, controlled, hierarchical decision making, reliance on "lean methods", optimising function performance – are running out of steam. Today's business environment has more knowledge intensity, complexity, digitisation, codependent business networks, and global integration. It requires new approaches to drive productivity growth ranging from creating flexible platforms that reduce the complexity of creating custom products for segments of customers, to empowering talent with the knowledge to anticipate and resolve customer problems before they show up in social media forums and earn your company a national news headline.

How do we know all this? In PwC's most recent Productivity Stars survey, we asked 300 US company executives for their perspectives on new economy drivers of productivity and the characteristics of "Productivity Stars" – leaders who achieve substantial productivity growth and enviable shareholder return.

Four core themes emerged: consistent productivity growth is critical to shareholder return; executives are not confident about sustaining productivity; productivity growth is viewed as a front office, not a back office, issue and more collaboration is needed from strategy through execution to deliver productivity results.

Consistency wins. The 11 per cent of companies that grew productivity consistently over a five-year time period earned a 19.1 per cent shareholder return per year compared to an average of 4.6 per cent for everyone else. That fact tells us that planning for productivity means doing long-range planning, not indulging in short-term thinking.

Executives aren't confident about sustaining productivity. Four out of five executives felt that productivity growth was important to their success, but only 23 per cent were very confident that they were doing the right things to increase productivity faster than their competitors in the midst of regulatory uncertainties and increased competition for scarce, high-skilled knowledge workers.

Almost 70 per cent of executives are concerned about the availability of key employee skills necessary for their company's growth. "You need to have top rate staff and managers keeping a constant eye on productivity, or it can fall off very fast," a division head at a food and beverage company told us. One business unit president of a services company described the shortage of skilled workers available as "the number one issue we face."

Productivity growth is a front office issue. Four of the five top-ranked business areas that executives expect to drive future productivity growth are front office functions such as sales, marketing, product development, pricing and risk management, not back office functions such as finance and procurement.

More collaboration is needed from strategy through execution. The five most cited collaboration areas executives noted to drive productivity growth are market research (23 per cent), strategic planning (34 per cent), product development (21 per cent), sales & operations delivery (27 per cent) and customer service (27 per cent). Some of these are functions associated with strategy, some are execution oriented – collaboration across them is viewed as the key to continuously improve the operating model to increase productivity through top line and bottom line results.

These findings highlight important focus areas for executives as they formulate their plans to improve shareholder return. You should spend more time thinking about how productivity links directly to growth and how your innovation investments can create a sustainable platform for improving your future productivity. If you don't take a holistic approach to productivity and have no effective way to measure it accurately, you may always struggle to improve shareholder return.

How will you do it? We've developed five concrete steps you can take to make the move toward more sustainable productivity growth, and we've also developed a new kind of productivity benchmark that you can use to evaluate your own management team compared to businesses inside or outside your sector. In our next article, we'll outline the path to improved productivity growth.

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Five steps to sustainable productivity growth

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In Part 1 of our Productivity series, we illustrated the vital link between increasing productivity growth in your company and shareholder return. Our increasingly global, digital, and knowledge-based business environments create more complexity for executives to manage and make it harder to devise and execute plans to sustain productivity growth.

In PwC's most recent Productivity Stars survey, we asked 300 US company executives for their thoughts on the opportunities and challenges presented by new trends on productivity.

Companies may be overestimating how well they are doing – only three per cent put themselves in the bottom quartile of performance. Many companies have a significant opportunity for improvement, yet only 35 per cent of respondents thought that improving productivity was quite important to their business success.

Executives are paying attention to how new drivers such as knowledge intensity, complexity, relationship networks, globalisation, digitisation of products and services, and moving operations to the cloud are impacting productivity, but say they struggle with what to do about them. And only 19 per cent say their companies use integrated financial and operational metrics to drive productivity.

What can you, as a c-suite executive do to improve your business's productivity growth? We've defined five concrete steps you can take to create policies that will drive your productivity growth.

1. Determine how good you are at sustaining productivity growth. The more we've analysed productivity, the more we've come to realise that there needs to be a new way to measure productivity growth over time. PwC's new Productivity Alpha measures how fast the c-suite grows earning before interest, tax, depreciation and amortisation per employee compared to its competition, adjusting for market and industry volatility, stripping away as many secondary and non-essential performance factors as possible.

Why use this kind of measurement? Because it gives a clear idea of how well the c-suite manages the business, netting out its financing or capital structure, to increase its value through converting investments into tangible top line and bottom line over time.

For example, a leading pharmacy retailer invested in its portfolio of offerings by adding mail order pharmacies to drive demand in new segments while expanding productivity through lower operating costs. It invested in adding higher value added services to its retail footprints, changing store layouts to improve customer experience, and upgrading their rewards program to create a platform that is expanding short and long term productivity.

2. Specify productivity improvement in innovation and growth plans. How can your company's core assets create productivity growth inside and outside your current business portfolio while you pinpoint capabilities that will create step-function productivity increases in critical business areas?

Pro-forma planning doesn't cut it. You must dig deep. "We constantly need to innovate. That is key to productivity," the division head of a food and beverage company told us. As an example, a leading global beverages company is exploring the potential of using new sources of customer data from social and mobile channels by proactively reacting to trends that impact types and amounts of beverages consumed such as health or sustainability concerns. It plans to increase productivity by shortening R&D, product development, and forecasting cycles to respond to new trends with products outside the portfolio while minimising brand risks.

3. Simulate productivity growth scenarios and their impact on objectives and measures. Once innovation investments and targeted productivity impacts are identified, it is critical to conduct scenario analyses to test the impact of market forces and operating changes on your productivity growth.

You'll come to understand the complexity of all the interdependent variables you will encounter and determine how to make appropriate adjustments along the way. This is not a "once and done" exercise. It's the connection between strategy and execution.

As an example, a leading global financial services group conducted scenario analysis to assess the market dynamics and operating capabilities needed to become the dominant, industry-wide mobile wallet platform. The scenario analysis helped them determine a sequenced investment path to gain market share while maximising the return of platform investments by using a partnership strategy.

4. Create a shared company business design with an operational path to short, medium, and long-term productivity growth. You should set goals several years out to ensure that productivity growth is prioritised on the agenda, is implemented in phases in the business, and stays on track.

This is the way to move from strategy through execution. How do you plan to embed new drivers of productivity into your business design to get you from point A to point B, specifying how you'll measure it along the way? Recently, an international B2B lender identified a future state operating model to dramatically increase productivity while accommodating plans for growth in new products. The company created target short, medium and long-term business designs with specific client value propositions linked to capability deployment and performance targets to improve credit evaluation, loan acceptance, and servicing productivity by 35-40 per cent over time.

5. Align on a more comprehensive, simplified set of productivity measures. Does your c-suite share a common set of benchmarks to evaluate productivity growth within and across your most critical business areas?

Companies across industries are re-evaluating business intelligence solutions that do a good job reporting but don't necessarily provide insight into how operating drivers impact productivity and financial metrics.

A leading US insurer is using an innovative, flexible large-scale visualisation approach to link investment level, operations drivers, and financial impact. It allows its management team to assess the investment by geographic segment that creates the maximum growth potential, while quickly assessing the impact of operating drivers on conversion productivity such as multi-channel coverage and agent capacity on financial metrics such as maximum loss. It is an end-to-end measurement model to help management grow productivity.

In a world of scarce high-end talent, more operating complexity, and increasing volatility, executive teams should be held accountable for how well they leverage their talent and their resources to create economic value, and how consistently they do it relative to their competition.

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