Articles & Commentaries

p-Watch — Europe

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Competition – Driving Force for Productivity Increase

The competitiveness of a company-or nation-depends on two factors: costs and productivity. "Old economy" industries in western Europe, such as car manufacturing, textiles, steel and ship-building, are subject to continuous restructuring because they compete to a significant extent on costs. So management must pay constant attention to ensuring that their overall labor costs are contained, if not reduced. This often means "exporting" jobs to lower cost countries, particularly those nearby on the perimeter of the European Union (basically the EU-applicant countries). At first sight it would seem attractive to establish greenfield plants in central and eastern European countries where labor costs are between a quarter and one tenth of those within the Union, and labor standards are lower as well.

However, the experience of an increasing proportion of employers is that the poor productivity of such plants makes them at best only marginally more competitive than those they are replacing within the EU. And additional costs arise from their much poorer societal, physical and entrepreneurial infrastructures further discourage foreign investment.

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Moreover, a recent OECD study shows that low core labor standards do not give countries an export advantage, and dismisses fears that foreign investors trigger a "race to the bottom" in labor standards. On the contrary, competition is forcing such companies increasingly to focus on activities that require highly skilled employees and modern infrastructures, including networks of companies. Indeed, the study shows that countries can boost their economic growth and productivity by strengthening core labor standards. For instance, respect for freedom of association (i.e. free trade unions) is associated with success in attracting foreign investment, as is shown by VW investments in the Czech and Slovak Republics.

The significance of such foreign investment and the associated open international competition for boosting productivity is clearly shown in EU countries as well. Thus the British experience of the 1980s was that labor and total factor productivity soar as competition increases. But of late, the rise in value of the pound sterling (£) compared to the German DM (and now the Euro) has led to bitter recriminations by British manufacturing industry that its products cannot compete with those of Euroland. So, it argues, the government should take action to bring down the value of the pound. Indeed, rumors were prevalent in 2000 that Japanese and US investors were looking to continental locations (albeit not just EU) for significant future investments to avoid high British costs caused notably by the high price of the pound.

However, the figures continue to tell the other story: that of the importance of competitive pressure for raising productivity, and, simultaneously, employment. Thus, whereas, in the wake of sterling's ejection from the Exchange Rate Mechanism-the precursor to the Euro-the productivity growth in the mid-1990s was ... zero, in 1999-2000, on the other hand, manufacturing productivity rose by 5 per cent. And in the export-oriented engineering industry, it was by 8 per cent. So there is nothing like competition to raise productivity by forcing the pace of innovation.

The features of good innovation management have been brought out by a recent Anglo-German comparative study of the electronics and engineering industries. Though not path-breaking, this study clearly points to a number of innovation do's and don'ts. To start with, innovation is not synonymous with invention and breakthrough. All types of innovations need to be fostered. Process innovation in particular plays a key role as a source of competitive advantage. Remember Henry Ford! Today's manufacturing companies can benefit in particular from holistic approaches, combining product with services' innovation to reduce overall customer costs. For instance, the customer's car insurance costs can be radically reduced by bolting on (rather than welding) accident-prone car components.

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Moreover, too many development projects should not be running at the same time. By trying to speed up product innovation, companies can fall into the trap of pushing more projects into R&D to increase output. The reality is just the opposite. And companies need to be adept at setting priorities and at continuously learning from one project to the next, which is easier said than done. Overall, innovation management must be the subject of continuous and long-term attention for good performance in a variety of areas ranging from strategy, creativity and ideas management, portfolio management, product management to people management.

On people management and the "productivity front," the change in tone in the European Union is clear at the start of the new millennium when Sweden takes over the presidency from France in 2001. Of the two broad approaches to inducing corporate productivity improvement-reducing the inputs i.e. cost reduction, or increasing the outputs, i.e. innovation-France has tended to plump for the former. It believes that reducing the permitted amount of an individual's labor input would bring more people into economic activity. The French government's policy, therefore, has been the compulsory reduction of the working week from 39 to 35 hours. True, this has helped some "old economy" companies to increase significantly their corporate productivity through focusing on raising capital productivity. Thus, Air France, almost bankrupt in 1998, has doubled the number of its flights, thereby vastly increasing aircraft utilization and simultaneously increasing the number of its employees and bringing about profitability, albeit following a "final" government subsidy of some $3.5 billion to get its house in order. Overall, however, France's unemployment rate remains at a little under 10 per cent.

Sweden, on the other hand (which had the same level of unemployment as France when it joined the Union in 1995), has focused on raising outputs through entrepreneurship. With Finland, it has outstripped not just France and the rest of the EU countries but also the USA in applying for patents for high tech applications. As a result, productivity has soared together with employment; unemployment has dropped to 4 per cent. With the increasing amount of EU policy benchmarking taking place, one can only hope that more governments will emphasize such demand side policies where competition is the supreme driving force for productivity increases.

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