Personal Productivity

Productivity Is Soaring at Top Firms and Sluggish Everywhere Else

by Chiara Criscuolo

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A spirited debate is now under way on the future of technology and productivity. Some argue that the low-hanging fruit has already been picked: the IT revolution has run its course and other new technologies like biotech have yet to make a major impact on our lives. Others see the IT revolution continuing apace, fueling disruptive new business models

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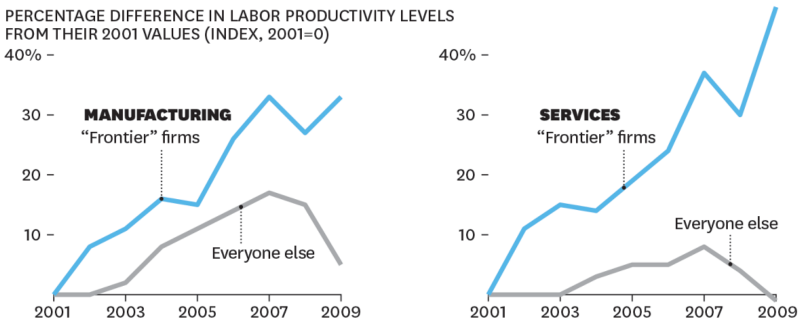
and enabling a new wave of productivity growth across the economy. Either technological progress is slowing down, or it's speeding up. Which view is right? At the OECD, we believe the research from our Future of Productivity project helps to resolve this paradox.

This isn't an academic question. Productivity growth is the most important driver of long-term economic growth and well-being. But after the productivity surge of the late-90s and early-2000s, which was principally based on the development and deployment of information and communication technology (IT), the United States and other OECD economies have witnessed a significant decline in productivity growth. This has been exacerbated by the Great Recession and the weak post-crisis economic recovery. The slower productivity grows, the less prosperous the world will be.

Our research shows that the slow productivity growth of the "average" firm masks the fact that a small cadre of firms are experiencing robust gains. OECD analysis shows that the productivity of the most productive firms – those on the "global productivity frontier" in economic terms—grew steadily at an average 3.5% per year in the manufacturing sector, or double the speed of the average manufacturing firm over the same period. This gap was even more extreme in services. Private, nonfinancial service sector firms on the productivity frontier saw productivity growth of 5%, eclipsing the 0.3% average growth rate. Perhaps more importantly, the gap between the globally most productive firms and the rest has been increasing over time, especially in the services sector. Some firms clearly "get it" and others don't, and the divide between the two groups is growing over time.

The Gap Between the Most Productive Firms and the Rest Is Growing

A look at labor productivity in manufacturing and services.



SOURCE "THE FUTURE OF PRODUCTIVITY," OECD, 2015

The strength of global frontier firms lies in their capacity to innovate, which increasingly requires more than just investing in R&D and implementing technology. It requires the capacity to combine technological, organizational, and human capital improvements, globally.

Seen from this perspective, the productivity problem isn't a lack of global innovation. It's a failure by many firms to adopt new technologies and best practices. Indeed, the main source of the productivity slowdown is not a slowing in the rate of innovation by the most globally advanced firms, but rather a slowing of the pace at which innovations spread throughout the economy: a breakdown of the diffusion machine.

Future growth will depend on harnessing the forces of knowledge diffusion which propelled productivity growth for much of the 20th century. But what keeps firms from adopting the right combination of technological and organizational innovations?

The list of obstacles to diffusion is long. Four key factors need to function well for effective diffusion to take place. First, global connections need to be extended and deepened, so that firms can learn from successful counterparts across the world. This requires trade, foreign direct investment, participation in global value chains, and the international mobility of skilled labor.

Second, new firms need to be able to enter markets and experiment with new technologies and business models. The productivity slowdown coincided with a near-collapse of overall business investment and a slowdown in business dynamism, reflected in a decline in business startups. These trends need to be reversed.

Third, better "matchmaking" is needed across the economy, to ensure that the most productive firms have the resources—labor, skills, and capital—to grow. The larger the frontier firms become, the greater the extent to which their good performance gets reflected in overall economic growth. Unfortunately, the most productive and dynamic firms do not always grow to optimal scale. In some economies, the most advanced firms have productivity levels close to the global frontier, but they are under-sized relative to their peers in other countries. Inefficient resource reallocation—which can be caused by lack of product competition, rigid labor markets, failure to exit, or non-performing loans—doesn't just keep frontier firms from growing. It also slows the diffusion of best practices to other firms.

Fourth, investment in innovation should extend beyond technology to include skills, software, organisational know-how (i.e. managerial quality). Innovation depends on the bundling of these investments, and policy initiatives should reflect that.

There's a lot more policymakers can do to crank up the diffusion machine, much of which is listed in our research. But there are also implications for companies. For firms already at the productivity frontier, new innovations are the key to competitive advantage. But for many others, the goal needn't be inventing something entirely new. A good start would be simply catching up.

Correction: The chart "The Gap Between the Most Productive Firms and the Rest is Growing" was updated on August 28, 2015, to fix a y-axis labeling issue.

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