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What the Most Productive Companies Do Differently

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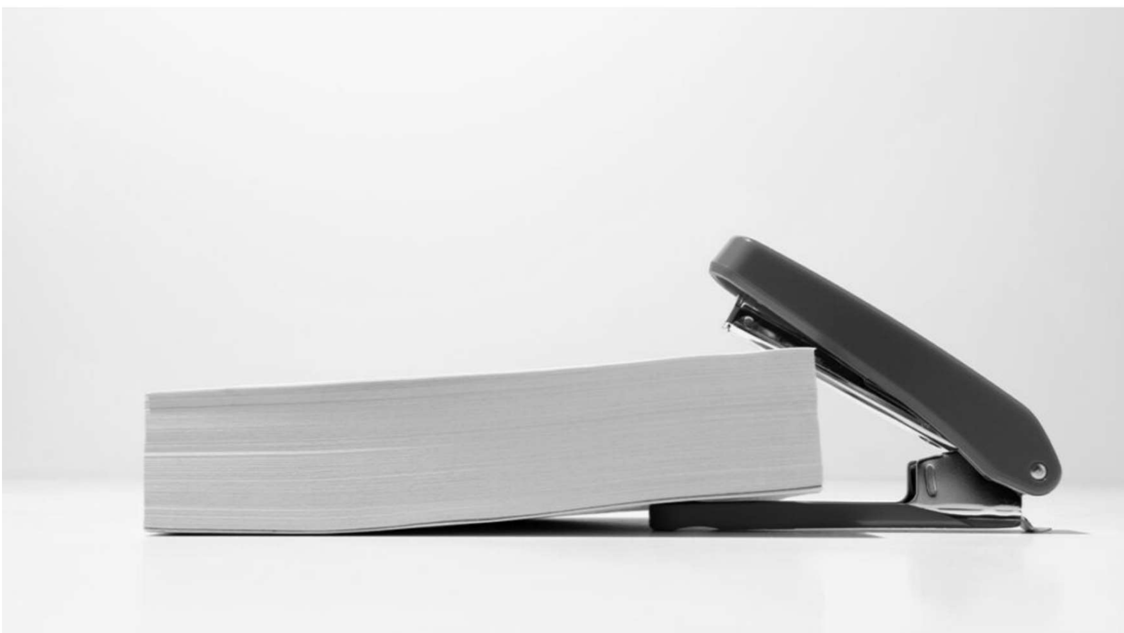

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Summary. A new report from McKinsey Global Institute finds that U.S. productivity growth has slowed in the last 15 years to 1.4% annual growth (as compared to long-term rates of 2.2% since 1948). It also found striking variations in productivity among leading and lagging... **more**

Improvements in labor productivity have been the engine of U.S. economic power and prosperity since World War II. But in the past 15 years, productivity growth has faltered averaging just 1.4% annually, compared to long-term rates of 2.2% since 1948.

These small differences add up: If the United States can get back to the long-term trend, it could be worth $10 trillion in cumulative GDP by 2030. And the benefits of productivity would help the country meet longer-term challenges like the looming national debt, underfunded entitlement programs, and the shift from fossil fuels to renewable energy.

Companies have a starring role to play in this putative productivity miracle. Our research found striking variations in productivity among leading and lagging firms within each sector. Manufacturing provides a particularly stark example, where leading firms operate at 5.4 times the productivity of laggards. Academic researchers have documented similar trends in services, particularly information and communications, which show wide disparities between leading firms and the rest.

Not only are productivity disparities within sectors quite wide — they're also getting wider. Our research shows that in manufacturing, the gap was 25% wider in 2019 than it was in 1989. Some analysts suggest this growing gap is the result of accelerated growth among leading firms coexisting with stagnation among the rest. That's encouraging: It suggests that if those in the rear can match the leaders, the United States could restore productivity growth to historical levels.

These productivity gaps also suggest that firms can raise their own ambitions. Doing more with less, or doing more with the same, shows up in corporate income statements as higher margins and stronger revenue growth. And in aggregate, those performance improvements lead to economy-wide changes in productivity.

Lessons from the Most Productive Firms

For business leaders looking to unlock performance, there's something to be learned by observing the companies at the top of the productivity heap. These frontier firms are usually larger than others (though not always, as we discuss below). They are present across most sectors and geographies.

What they have in common is a playbook with the following four elements:

They capture value from digitization.

From 1989 to 2019, our research finds a strong correlation between sectors' productivity growth and their level of digitization. Other researchers have found a similar connection between firm productivity and digitization; frontier firms are better able to technologically innovate than their peers.

However, many firms investing in technology are not seeing its benefits. McKinsey research finds that firms typically realize only about 25% to 30% of the expected value of their digital transformations. Much of the shortfall comes from not properly updating the firm's strategy and business model to take advantage of new digital strengths.

Frontier firms set bold business goals enabled by technology. They reconfigure their organizations to digitize their operations and capture the benefits of technology, rather than augment existing ways of working. And they drive accountability for results across the organization.

They invest in intangibles.

Frontier firms go beyond technology investments and also place bets on complementary intangibles such as R&D, intellectual property, and the capabilities of their workforce. Our research finds that frontier firms invest 2.6x more in intangibles compared to other firms.

For many of these firms, taking a long-term perspective is critical. These investments likely create a productivity J-curve, in which the early benefits of investments are small, but compound rapidly over time to create outsized long-term value.

They build a future-ready workforce.

Frontier firms also disproportionately secure the skilled talent they need to get the most out of technology, either by attracting top talent or by an in-house investment in employee skills.

Both frontline talent and tech-savvy executives are necessary to successfully navigate the reconfiguration of complex firms. Leaders are winning the talent war by recognizing the value of employee experience, investing in on-the-job training programs, and expanding policies that make it easier for parents and aging workers alike to stay in the labor force.

They adopt a systems approach.

Frontier companies are typically system thinkers, looking for opportunities to access new markets or collaborate creatively with stakeholders.

High-performing firms tend to be more connected to global value chains, giving them access to global markets, ideas, and talent. They collaborate with suppliers and customers to form new ecosystems that benefit from agglomeration effects and create shared pools of value. They also look for opportunities to collaborate more closely with their public-sector counterparts to solve for challenges in skilled talent and physical infrastructure.

America's New Productivity Champions

The opportunity to apply these lessons is wide open to firms of all sizes and shapes. Many frontier firms are part of what we call the Titanium Economy — small, often privately held industrial-technology companies that are among the fastest growing and most profitable enterprises in the country. These companies are often based in smaller cities, sometimes even in rural areas, and present across a variety of sectors.

Take Dot Foods, a foodservice distributor based in Mount Sterling, Illinois, population 2,006. For Dot, everything starts with the employee. “Our volume is off the charts and we can’t staff it… we’re typically 500 employees short,” CEO Joe Tracy told us.

To attract workers, Dot rewrote its shift schedules in ways that give employees more flexibility to take time off. The company invested in automation to do the jobs that no one wants to do, like slinging cases in the freezer on the night shift. It embraced technology throughout the operation and invested time in teaching workers the skills needed to operate the equipment. It worked to integrate logistics with advanced analytics, so that customers receive the products they want as fast as possible. And it acquired ShopHero to give its customers a customized, locally branded e-commerce platform replete with video and photos. Dot Foods is now the nation’s largest foodservice distributor, delivering more than 125,000 products from 1,000 suppliers to all 50 states.

Dot’s growth story is typical of Titanium Economy companies — and the opportunity for others to join them is vast. Recent data indicates that small and medium-size companies are less productive on average than large firms. But in some sectors where niche products or services can be offered at higher price points, small companies can be as productive as their bigger rivals. These data should give plenty of encouragement to business leaders looking to drive improvements in their business.

Neither size nor sector is the full measure of a company’s destiny. To be sure, grocery store owners cannot snap their fingers and suddenly enjoy the profit margins of software makers. But almost all firms can increase their productivity to approximate that of the frontier firms.

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Ultimately, changes in firm strategy and management will have to deliver the gains in productivity needed to get back on the long-term trend and capture the $10 trillion prize. For business leaders, the productivity gap should be ample motivation to raise their own ambitions. Now, it’s also clear that the work they do will ultimately make all the difference to the country’s prosperity and well-being.

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