

It's the way you do IT

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There are two possible explanations for Europe's failure to keep pace with US productivity growth over the last decade. One is that there are innate advantages for businesses in the US; the other is that they are better managed. A new study has found compelling evidence to back the second explanation - throwing the spotlight on to those running Europe's business laggards.

US productivity growth began outstripping Europe's 10 years ago, after decades in which the gap had narrowed. US output per hour grew at an annual rate of 2.5 per cent between 1995 and 2004, compared with 1.5 per cent in the 15 members of the European Union before enlargement.

Research had already shown that the difference lay in sectors of the economy that use technology intensively - especially in retail, wholesale and financial services businesses. Some attributed the growing gap to characteristics of the US business environment, such as greater space for large operations, less regulation or tougher competition. Others believed it was caused by different operating and management practices in US companies.

A definitive answer is given by a new piece of research from the Centre for Economic Performance at the London School of Economics. It was given unique access to UK government data on more than 7,000 private sector establishments in Britain - access for which the Office of National Statistics should be commended.

The researchers found that output per hour in US-owned plants in Britain was almost 40 per cent higher than in British-owned establishments. Some of the difference could be attributed to the greater use of information technology by the US subsidiaries. But most of the gap was explained by the superior use those companies made of their IT - they were able to derive a higher return from their investment.

Nor was this just because foreign-owned plants were intrinsically more productive. UK subsidiaries of non-US multinationals appeared no better able to get the most out of IT than British companies.

The LSE researchers found two important differences in the way US companies were managed. One was that they were more aggressive in their human resources management - in other words, they were quicker to promote top performers and get rid of under-performers. The other was that they devolved responsibility for managing IT to local plants rather than centralising it.

This brings hope to European companies struggling to catch up with the productivity of their US competitors. The gap is not caused by any innate advantages of being US-based, but by investment decisions and - much more important - by management practices. If European managers can learn the lessons from studies such as these, they should be able to raise the returns from IT and narrow the gap.