WP 13

Management matters in retail

WORKING PAPER 13, APRIL 2010

Institute for
COMPETITIVENESS & PROSPERITY

Institute for
COMPETITIVENESS & PROSPERITY

The Institute for Competitiveness & Prosperity is an independent not-for-profit organization established in 2001 to serve as the research arm of Ontario's Task Force on Competitiveness, Productivity and Economic Progress.

The mandate of the Task Force, announced in the April 2001 Speech from the Throne, is to measure and monitor Ontario's competitiveness, productivity, and economic progress compared to other provinces and US states and to report to the public on a regular basis. In the 2004 Budget, the Government asked the Task Force to incorporate innovation and commercialization issues in its mandate.

Working papers published by the Institute are intended to inform the work of the Task Force and to raise public awareness and stimulate debate on a range of issues related to competitiveness and prosperity. The Task Force publishes annual reports to the people of Ontario each November.

It is the aspiration of the Task Force and the Institute to have a significant influence in increasing Ontario's competitiveness, productivity, and capacity for innovation. We believe this will help ensure continued success in creating good jobs, increasing prosperity, and building a higher quality of life for all Ontarians. We seek breakthrough findings from our research and propose significant innovations in public policy to stimulate businesses, governments, and educational institutions to take action.

Comments on this working paper are welcome and should be directed to the Institute for Competitiveness & Prosperity. The Institute for Competitiveness & Prosperity is funded by the Government of Ontario through the Ministry of Economic Development and Trade.

ISBN 978-0-9809783-6-0

Management matters in retail

WORKING PAPER 13, APRIL 2010

Exhibits

Contents

Foreword and acknowledgements

"Strong management is a critical element in the innovativeness of our economy, and hence its productivity and prosperity."

I AM PLEASED TO PRESENT Working Paper 13 of the Institute for Competitiveness & Prosperity. In this Working Paper, we extend our study of the impact of management talent on our economic prosperity. Last year, we presented the results of the first-ever research on the quality of Canada's and Ontario's management in the manufacturing sector. This Working Paper focuses on management capabilities in the retail sector.

Strong management is a critical element in the innovativeness of our economy, and hence its productivity and prosperity. Strong management drives the demand for innovation through well developed and ably executed business strategies; it affects the ongoing supply of high quality innovation by setting research priorities and orchestrating technical resources; and it is key to the financing of innovation by assembling resources and allocating them wisely to promising investments. Research in the United Kingdom indicates that better management leads to higher sales per employee.

But government innovation strategies in Canada do not take adequate account of the importance of management. They still focus on increasing scientific and technical resources that drive new-to-the-world inventions; but they do not adequately consider innovations that create economic value in meeting societal needs by drawing on existing technologies and knowledge. Both are important for our prosperity, and we need public policies that attend to each.

Our findings for the retail sector are consistent with the research on manufacturing management. Better educated managers produce better performance. For manufacturers and retailers, in Canada and internationally, the link between managers' education and business performance is powerful.

We also find that large-scale, multinational retailers are better managed than those focused only on their home market. This holds true in Canada and other countries. Firms that expand globally have dramatically better management, though identifying cause and effect is difficult. More than likely, there is a virtuous circle at work. Firms with global aspirations need effective management to expand, and expanding firms attract better managers.

The research indicates that Canadian retail managers are as effective as their US counterparts whether they are working for a multinational or a domestic-only company. Yet, our overall retail productivity, as measured by sales per employee and our retail wages, trails the US retail sector significantly. So we have to acknowledge that the management of store level operations may not be the major challenge we face in improving our retail productivity. However, the quality of corporate management is an important factor; our Canadian retail sector has generated only one global leader – Couche-Tard – while we have twenty-three global leaders in our manufacturing sector. Other factors, such as population size and density as well as competitive intensity, are also likely at play.

In public policy, we continue to recommend that our innovation strategies become more sophisticated and balanced. We need to recognize that supporting science for new inventions is not enough; we need to create an environment where business people draw on new science and many other disciplines to innovate products, services, and processes. We need to ensure that our markets are as open as they can be to foreign competition and foreign investment, because they improve the level of management and innovation in Canada. And we need to be investing adequately in post secondary education to develop world-class management talent.

We gratefully acknowledge the ongoing funding support from the Ontario Ministry of Economic Development and Trade. We look forward to sharing and discussing our work and our findings. We welcome your comments and suggestions.

Roger L. Martin, Chairman
Institute for Competitiveness & Prosperity
Dean, Joseph L. Rotman School of Management, University of Toronto

Executive summary

CANADA IS ONE OF THE MOST competitive and prosperous countries in the world, as defined by Gross Domestic Product (GDP) per capita. Ontario, in turn, is also one of the most prosperous jurisdictions in the world. Still, we are not realizing our full prosperity potential. For eight years, the Institute has been reporting on a persistent and growing prosperity gap with the United States, which stands at $8,700 for Canada and the United States, and $7,000 for Ontario and our US peer states.

Our major challenge is to raise our productivity and innovation performance. The two sources of higher prosperity are working more hours and producing more output per hour of work. On the former measure, hours worked per capita, we are near the top of developed economies – through a combination of high rates of participation in the labour force, low unemployment rates, and high hours worked per worker. But on the latter measure – that is, the value we add per hour worked – we trail many developed economies.

We have already identified some of the factors behind this poor productivity and innovation performance. While Ontario has a mix of industries that are by their nature productive and innovative, these industries do not operate as effectively as their counterparts in the US economy. Some of these factors relate to broad economic factors – we tend less to live in metropolitan areas, and we are less well educated than our counterparts in the United States. But some other factors relate to how our businesses compete. For example, compared with their US counterparts across the economy, Canadian managers invest less in productivity enhancing machinery and equipment, particularly information and communication technology (ICT), and they produce fewer patents.

Our past research and the work of others indicate that our senior and middle managers do not have fundamentally different attitudes from their US counterparts toward competition, risk taking, and innovation. But our innovation and productivity performance is inhibited by limited management capabilities – such as lower educational attainment and less diffusion of best management practices – and by context – such as lower competitive intensity in the markets and fewer sophisticated customers.

Effective management leads business innovation. Innovation is the result of the ongoing interaction of three elements – the **supply** of innovation, the **demand** for innovation, and the **financing** of innovation – in an Innovation System. These elements are driven by competitive **pressure** and broad **support** that activate the Innovation System. Effective management provides pressure and support across the Innovation System in strengthening demand for innovation, providing supply of innovation, and driving the quantity and quality of financing for innovation. It is safe to conclude, therefore, that management is an important factor in the prosperity of a jurisdiction.

But hard evidence to support this conclusion has been limited. In one research initiative, University of Toronto professor Michelle Alexopoulos has developed a methodology for measuring the diffusion of innovative management techniques, going as far back as Taylor's scientific management in 1911. Her measures track Library of Congress management book publication records, supplemented with counts of relevant academic journal articles, to determine the adoption of management techniques. Her research indicates that increased diffusion of new management techniques is correlated with growth in productivity, measured by Total Factor Productivity (TFP), and prosperity, measured through GDP. She concludes that economic growth results not only from increases in "tangible technology" (R&D, machinery & equipment) as most economists agree; but it also is the result of advances in "intangible technologies," like management techniques and new processes disseminated in part through publications.

In another initiative, in 2008, the Institute partnered with Stanford professor Nick Bloom to extend his pioneering global research in measuring management practices to Canada. His research started as a detailed approach to evaluating how well manufacturing operations have implemented advanced management techniques. It encompassed the level of managers' knowledge of these techniques, the company-wide commitment to setting targets, measuring and monitoring results, and managing people well. In the manufacturing sector, the research had already been conducted in advanced economies, such as the United States, the United Kingdom, and Japan, and developing economies like China, India, and Brazil. The quality of management, as captured by this study, correlates well with firm and industry productivity.

The results of our research were published in the Institute's Working Paper 12, *Management Matters*. We found that the Canadian manufacturing sector is among the best managed in the world. Our production management teams are leaders in implementing specific techniques in the area of Lean Manufacturing. They are solid performers in effecting good performance management, though with room for improvement. But, while they match management teams in other leading economies in people management, Canadian firms trail US practices significantly. Our results also indicated that some of the key variables that drive – or at least are correlated with – better management are education, ownership, and winning global strategies.

In Ontario, our results indicated that the quality of manufacturing management is higher here than in the other regions of Canada, and that the province's results are within statistical range of US results overall. Nevertheless, against the fourteen US peer states we have identified, Ontario under performs, especially in the area of people management – the willingness of managers to keep and promote high performers and to deal promptly with poor performers.

In this Working Paper, we further extend this management research into another important industry in our economy: our retail businesses. In the summer of 2009, a team of analysts at the Institute for Competitiveness & Prosperity interviewed senior managers at 661 retail outlets in total – 409 in Canada, 152 in the United States, and 100 in the United Kingdom. The research was slightly adapted to fit the retail sector, but still remains largely comparable to that in manufacturing in approaches to measuring and monitoring operations performance, setting and achieving performance targets, and managing people.

The results for Canada are encouraging. The overall results indicate that we are among the leaders in retail management, scoring statistically no differently than the United States. Results vary across the three sub-indexes that make up the overall measure. In **operations management**, we stand statistically behind the United States, but ahead of the United Kingdom. In **performance management**, we tie with the United States for the top spot and stay statistically ahead of the United Kingdom. In **people management**, though our score is lower than the US result, it is not statistically different, and we stand statistically ahead of the UK score here as well.

Some of the key variables that are correlated with better management in manufacturing are also important in retail, such as education and global reach. More highly educated management teams out perform other retail managers. Retailers who have successfully expanded beyond their borders are much better managed than those who are still domestic competitors only. We also found that firm size and scale are important in explaining better management – larger retail firms are better managed.

Our results indicate that quality of retail management in Ontario is not statistically different from that in the rest of Canada. Ontario scores statistically worse than our fourteen peer states group; however, unlike our manufacturers, the retailers' disadvantage is strongest in store operations and not statistically significant in performance and people management.

In summary, this Working Paper reinforces our conclusion that management capabilities are important contributors to provincial and national prosperity. And our Canadian retail management is among the best. Ontario, however, while being no different than the rest of Canada, trails the US peers significantly. Overall, our retail businesses have significant opportunities to improve.

The implications for Ontario and Canada are clear:

- If we want an economy built on innovation, we have to include managerial education in our policy development. Developing our scientific and technical skills is important to our prosperity – but not building the capabilities of our managers is an oversight that holds back our prosperity.

- Consistent with the recommendations of the Competition Policy Review Panel, chaired by Red Wilson in 2008, and our own research, we need to encourage an openness to foreign investment in our industries. This Working Paper shows how such investments attract best management practices and performance in our economy.

- At the same time, we need to encourage the global aspirations of our successful companies. In turn, global expansion will drive the development of stronger management in Ontario and Canadian firms.

Strong management delivers prosperity

CANADA IS NOT ACHIEVING its full prosperity potential. Relative to the United States, the economy most similar to ours and our largest trading partner, we have a growing prosperity gap. Canada's lag in GDP per capita grew from $2,600 in 1981 to $8,700 in 2008.[1] This growing gap reflects a failure to reach our full economic potential. It means that our generation has not created as much economic value as possible from the human, natural, and physical resources endowed to us.

A key component of closing our prosperity gap is for Canada to broaden its approach to innovation. Strong management practices are a critical contributor to more innovation. So we need stronger commitment to strengthening the capabilities of our business managers to implement best practices. Following on our work in manufacturing, in this Working Paper, we extend our exploration of management capabilities in Canada and Ontario to the retail sector.

1 2007 Canadian dollars; US dollars converted at 2007 Purchasing Power Parity.

The retail sector is full of innovation. One classic example lies in the success of Walmart and its pioneering introduction of "cross-docking" at its distribution centres. This revolutionary system enabled Walmart to achieve excellent productivity and customer responsiveness without the usual inventory and handling costs attached. By enabling its goods to be continuously delivered to its warehouses, then immediately selected, repackaged and transferred to their stores, Walmart has been able to streamline its inventory pipeline by crossing its goods from one loading dock to another without its goods ever spending valuable time and space in the warehouse.[2] Through effective management and innovation, Walmart was able to transform itself from a small niche retailer to the largest and most profitable retailer in the world today.

Other examples of innovation in retail include big box retailers with a focused, but very expansive product selection, and Carrefour, which ushered in the concept of combining supermarket and department store into one roof, known today as a "hypermarket."

It should be noted that these examples and other specific ones in this Working Paper are from business literature and in no way indicate that they were among the companies we interviewed in our research. Such information is confidential.

The benefits of improved management practices also apply in many other sectors. For example, a *Washington Post* article describes a study conducted in hospitals in the United States, where they implemented a simple management tool, a "surgical checklist" in surgical procedures. The "low-cost, low tech invention" led to a decrease of in-patient deaths by more than 40 percent and a fall in the rate of serious complications of 36 percent. The article captures the essence of this tool very well: "The human brain can't remember everything, so it's best to focus on the complicated challenges and leave the simple reminders to a cheat sheet."[3] Management tools such as the surgical checklist, the equivalent of the retail store's "daily to-do list," are small changes that can substantially decrease the rate of waste in a business – be it of time, resources, or lost revenue because of product shortages.

In this Working Paper, we focus on management capabilities in the retail sector. We define "retail" as those firms engaged in the selling of consumer goods to the public, ranging from automotive and furniture stores to pharmacies, clothing, and grocery stores. We first briefly review the importance of management talent for innovation and prosperity.[4] We then set out key findings from research we have recently conducted into the current state of management capabilities in Canada's and Ontario's retail sector, and how retail fares against the manufacturing sector in Canada, the United States, and the United Kingdom.

Management talent is important in the Innovation System

As we have discussed in previous reports,[5] innovation is a result of the ongoing interaction of three elements – supply, demand, and financing of innovation – in an Innovation System. These elements are driven by competitive pressure and broad support (*Exhibit 1*).

Each of the elements is critical for success, but all three need to work together in balance. The **supply** of innovation includes the factors dedicated to increasing the stock of innovation, including highly qualified personnel, businesses' facilities, resources, and activities. The **demand** for innovation is the combination of customer insistence on new products and process breakthroughs and corporate demand for innovation within a firm. The **financing** of innovation is an important bridge between demand and supply since, even if these two factors are in balance, significant funding is typically required to commercialize new ideas and scientific breakthroughs. Innovation requires pressure and support in each of these areas.

Strong management is important in each element of the Innovation System. The management function includes goal setting, organization building, resource allocation, and monitoring of results. It also includes actions in enterprise finance, sales and promotion, production and delivery, and people development (*Exhibit 2*).

Hence, in building an innovative firm or an innovative economy, management talent matters. Senior managers in successful companies develop strategies where innovation is a critical component. Innovation strategies typically follow one of two paths:

- **Innovation to reduce costs.** Cost reductions can be realized in two ways.
  - First, improved management and operating processes can reduce the producer's costs. For example, Harlequin determined that producing romance novels consistently with the number of pages that coincided with one sheet on the printing press would reduce its printing costs, standardize shipping requirements, and simplify display for the retailer. Harlequin also determined that mail order distribution would cut costs and build

---

[2] G. Stalk, P. Evans, and L. Shulman, 1992, "Competing on capabilities: The new rules of corporate strategy," *Harvard Business Review*, Mar/Apr, 1992, p. 58, available online: http://my.execpc.com/~jpurtell/HBR-CompetingonCapabilities.pdf

[3] *Washington Post*, January 15, 2009, "Surgery checklist lowers death rate", available online: http://www.washingtonpost.com/wp-dyn/content/article/2009/01/14/AR2009011402831.html

[4] For a more extensive discussion see Roger Martin and James Milway, *Strengthening management for prosperity*, Institute for Competitiveness & Prosperity, 2007, available online: http://www.competeprosper.ca/images/uploads/ManagementPaper_May07.pdf

[5] Institute for Competitiveness & Prosperity, Working Paper 12, *Management matters*, March 2009.

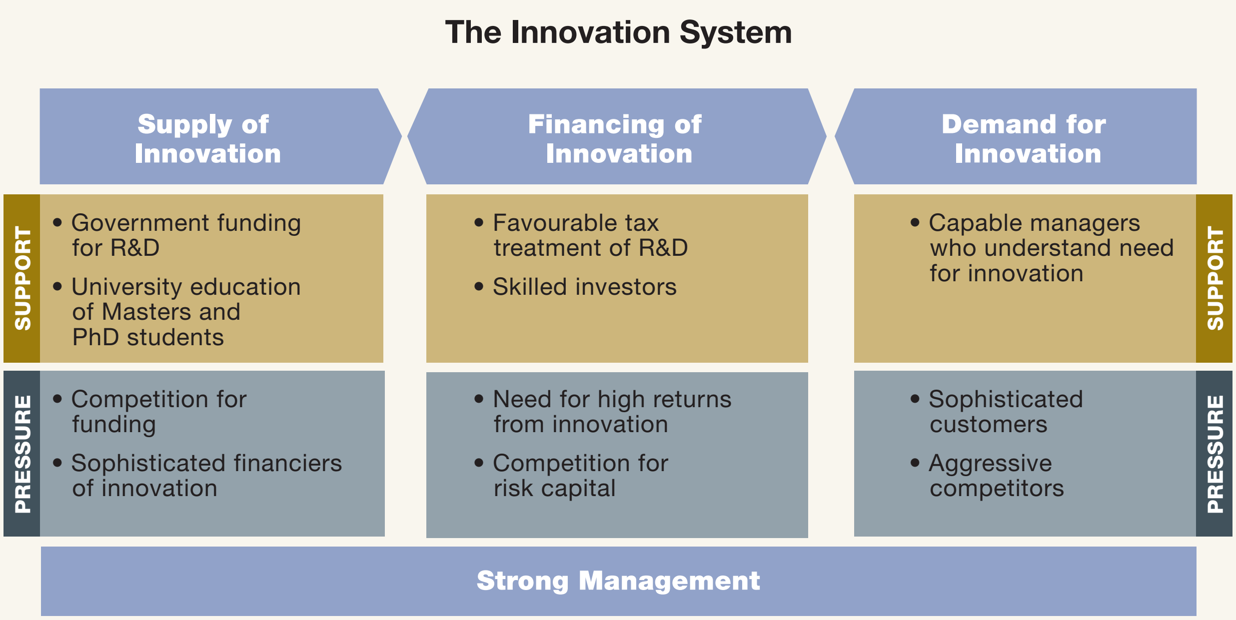
repeat purchase behaviour among loyal customers. The lower operating costs could be passed on as lower prices for consumers. But true innovation means that the producer captures some of the value added by not reducing prices at the same rate as costs.

– Second, innovation can reduce costs for retailers or other parts of the distribution channel. McCain's became one of Canada's global leaders by eliminating the need for restaurants and food service operations to buy whole potatoes and peel them. Instead, they could buy fully prepared frozen fries from McCain's and simply finish the frying.

- **Innovation to enhance customer experience.** Four Seasons, the world's leading luxury hotel chain, has succeeded by relentlessly studying what its guests wanted and by improving the customer experience. Cirque de Soleil, the world's leading circus company, recognized the customers' experience of circuses left much to be desired and reinvented the circus world to delight them.

Such innovations draw as much on management capabilities – competitive analysis, customer research and segmentations, cost analysis – as they do on technological capabilities. Indeed, our research into high technology firms in Canada shows that, as these firms succeed and mature, the importance of technical skills at the top of the organization is matched by the importance of other skills, including management capability.[6] And below the CEO level, evidence is mounting that the economy is requiring greater numbers of sophisticated conceptual thinkers and those with the strong analytic and people skills required to lead innovation and upgrading.[7]

Exhibit 1 **Pressure and Support drive all three elements of the Innovation System**



Source: Institute for Competitiveness & Prosperity.

6 The Strategic Counsel, "Assessing the Experience of Successful Innovative Firms in Ontario," 2004, p. 31, available online: http://www.competeprosper.ca/images/uploads/InnovationInterviewStudyRep.pdf

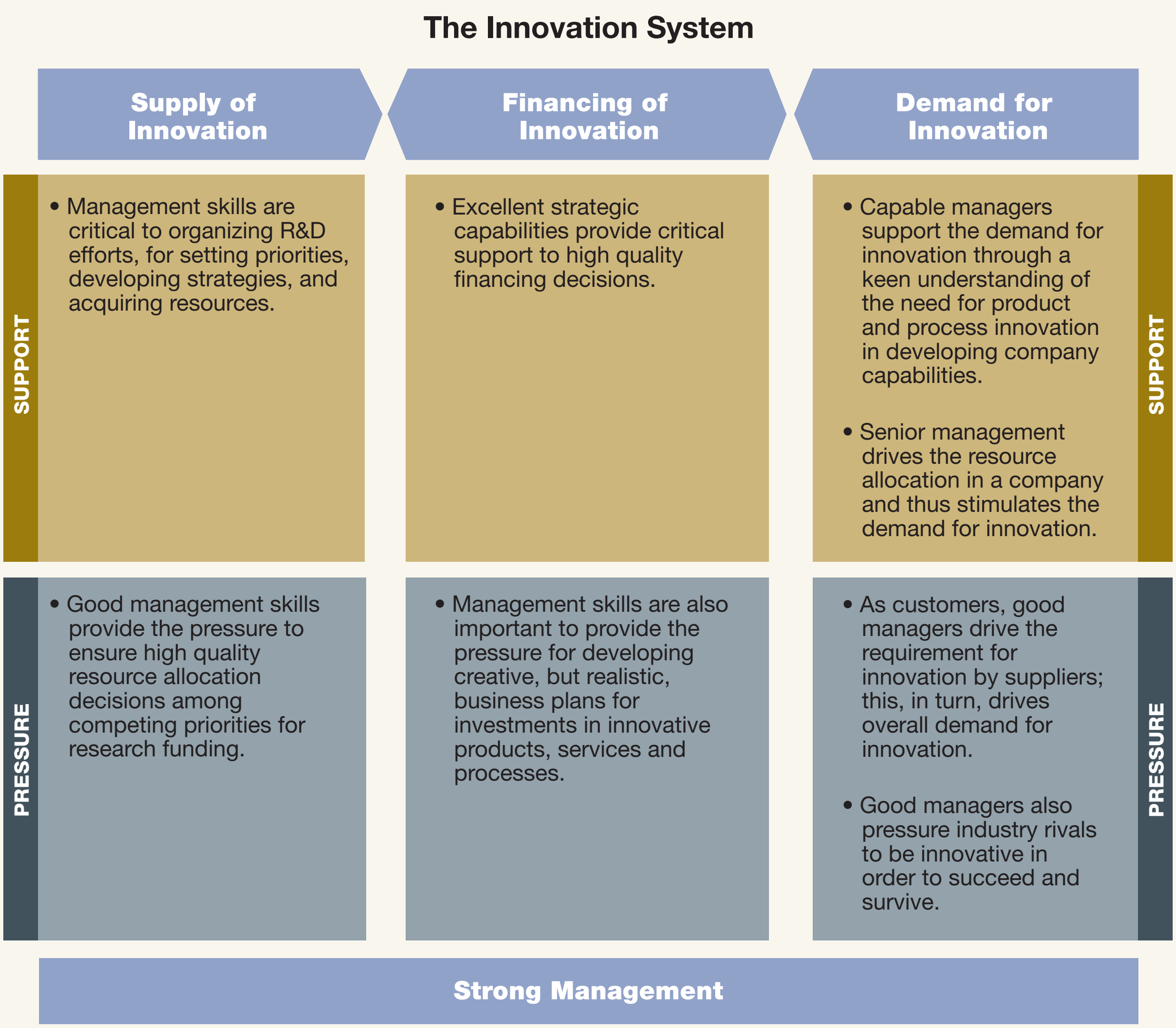
7 *Ibid*, p. 41

Canada lacks sufficient sophisticated management capabilities

An important opportunity for improving Canada's innovation and productivity performance is to strengthen management talent in our economy. In our research over the years, we have consistently found that our managers generally have lower educational attainment than their US counterparts, and CEOs of our largest corporations are less likely to have formal business education at the graduate level.[8] Half of US managers have a bachelor's degree or above compared to just over a third of Canadian managers (*Exhibit 3*). Further, innovative, high-tech firms report disadvantages in access to management talent as a key constraint.[9]

A key part of Canada's prosperity under performance is attributable to its lack of management talent. Management skills are a critical complement to science and engineering skills in creating a high quality supply of innovation, driving sophisticated demand for innovation, and putting in place the required quantity and quality of financing to make the Innovation System work effectively.

Exhibit 2 **Managers play an important part in creating Pressure and Support in all elements of the Innovation System**



Source: Institute for Competitiveness & Prosperity.

8 Institute for Competitiveness & Prosperity, Working Paper 6, *Reinventing innovation and commercialization policy in Ontario*, October 2004, p. 40
9 R. Martin and J. Milway, *Strengthening management for prosperity*, p. 11

Management innovation delivers higher productivity

Contemporary research often focuses on two measures of productivity:

- output per unit of labour input, such as hours worked or employment; and
- total factor productivity (TFP), which measures the extent to which actual economic output is higher than capital and labour employment data would suggest.

Many researchers and policy makers believe that productivity changes are intimately linked to changes in technology in the traditional sense; that is, productivity growth results from improvements in machinery, equipment, or techniques of production. Thus, the key to higher productivity is technological advances, as evidenced in higher R&D expenditures or more patents.

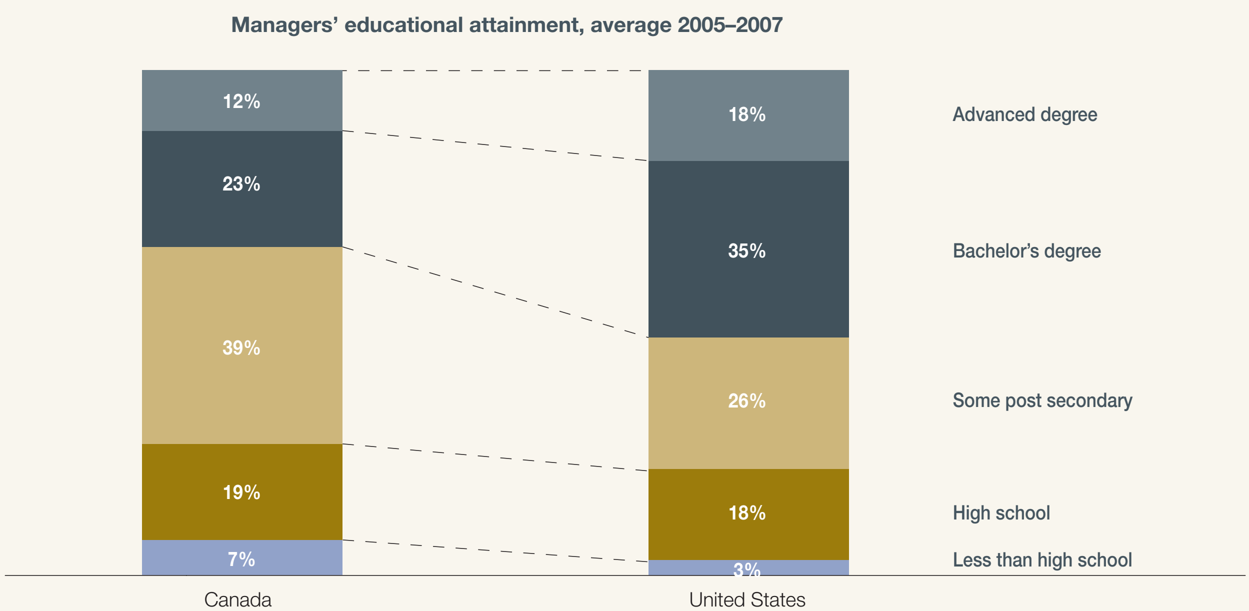
Professor Michelle Alexopoulos of the University of Toronto presents an alternative, though less intuitive, view.[10] She argues that anything that improves producers' *ability to transform* inputs into final goods and services deserves the title "technology." For her, productivity is indeed influenced by the traditionally understood types of technology – such as machinery and new products – that she calls "tangible." But productivity is also influenced by "intangible" technology – such as management techniques and production processes. She posits that it is important to distinguish between these two types of technologies, since they affect the types of policies governments may want to put in place.

It is generally agreed among management experts that changes in intangibles – such as corporate work rules, team structures, communication channels, morale, or managerial leadership – raise productivity and workforce efficiency. While this is not a controversial statement, quantifying the effect of improvement in management techniques at the aggregate level is extremely difficult because of measurement issues.

Professor Alexopoulos' measure tracks the development and diffusion of management techniques through a count of Library of Congress management book titles, supplemented with counts of relevant academic journal articles. She has demonstrated that changes in management techniques are an important factor in US productivity growth.[11]

With the index of management book publications serving as a proxy for diffusion, her regression analyses reveal that available management books are positively associated with growth in an economy's TFP and GDP. In particular, following the introduction of a new management technique that causes a 10 percent increase in new management books, GDP and TFP

Exhibit 3 **Canadian managers are less well educated than their US counterparts**



Source: Institute for Competitiveness & Prosperity analysis based on Statistics Canada, *Labour Force Survey,* and U.S. Bureau of Labor Statistics, *Current Population Survey*

[10] M. Alexopoulos and T. Tombe, "Management Matters," forthcoming working paper, University of Toronto.
[11] *Ibid.*

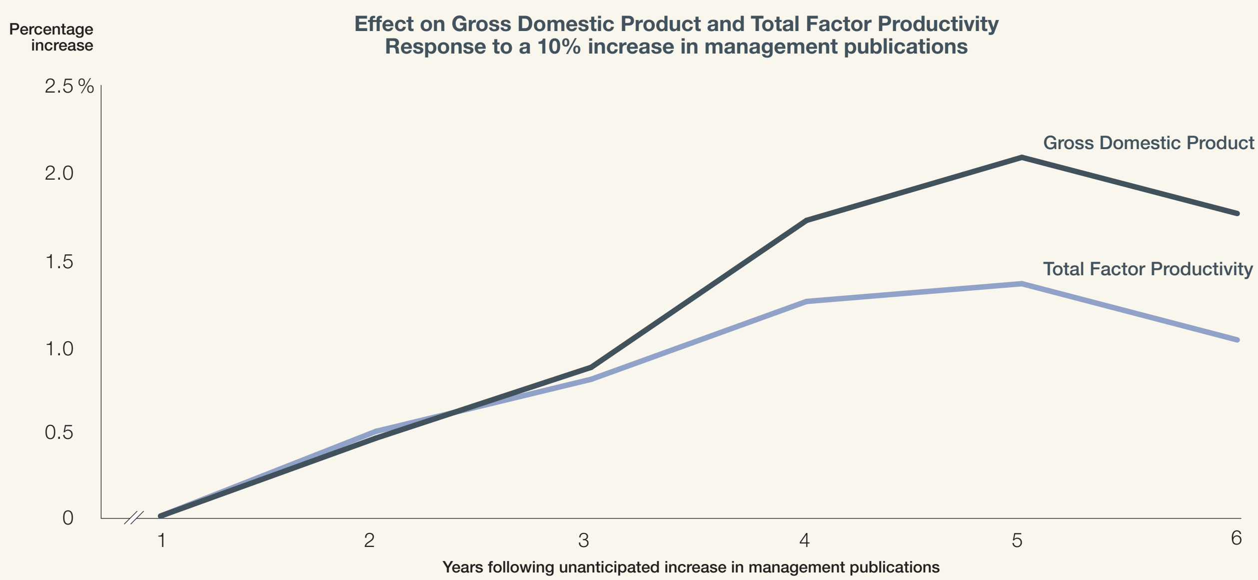
grow at statistically significantly higher rates than average for approximately six years. In fact, the impulse response estimates suggest that by year five, GDP would be 2.1 percent higher and TFP would be 1.4 percent higher in an economy with innovation in management techniques (*Exhibit 4*).

A 2 percent increase in our GDP per capita would increase average disposable income per family by $1,500 in Canada and Ontario.[12] Alexopoulos does not assert that the research definitively leads to this direct impact – but it does suggest that improved management has a significant effect on a region's or nation's prosperity.

She concludes that Canadian managers, have access to the same resources as our American neighbours, but many lack the expertise to employ the most productive management innovations. Increasing the number of graduates from economics, business, or management programs and raising funding for research in business management and related fields may help alleviate this deficiency. This kind of "business R&D" is to management what science is to engineering, and deserves more attention from the government.

It is intuitively likely that stronger management capabilities lead to more innovation and higher prosperity. But the impact of management capabilities on regional prosperity has not been well studied. Our research and that of others indicate that management matters. The development of improved management techniques, their diffusion, and their implementation by capable managers lead to higher prosperity.

Exhibit 4 **New management techniques are associated with increases in productivity and prosperity**



Source: M. Alexopoulos and T. Tombe, "Management Matters," forthcoming working paper, University of Toronto.

12 Calculation based on a 2 percent increase in the Canadian 2008 income per capita, personal disposable income as a percentage of GDP, and average household size.

Management practices can be measured

CLEARLY, GOOD MANAGEMENT is an important factor in firm innovation and productivity and, to the extent that a region's firms are well managed, overall prosperity will be higher. But economists and management researchers have paid little attention to measuring effective management practices and their impact on firm productivity. A major stumbling block has been the lack of useful, consistent measurements of the quality of management across firms and countries. While researchers recognize the importance of effective management, they typically refer to it as an empirically unobservable variable in their research to account for the differences in productivity across firms within the same country and industry.

International research evaluates management practices

To fill this research gap, professors Nick Bloom, John Van Reenen, and Raffaela Sadun developed a methodology to measure management practices first within a manufacturing operation,[13] and now have expanded this methodology to include

13 See, for example, N. Bloom and J. Van Reenen, "Measuring and Explaining Management Practices Across Firms and Countries," NBER Working Paper No. 12216 and N. Bloom, J. Van Reenen, "Why do Management Practices Differ across Firms and Countries?" *Journal of Economic Perspectives*, Vol. 24, No. 1, pp. 203–244.

the retail sector as well as forthcoming research on management of schools and hospitals. They have applied this methodology since 2004 and have interviewed over 7,000 firms in eighteen countries,[14] including developed economies, such as the United States, Germany, and Japan, and developing economies like China, India, and Brazil. The Institute collaborated closely with Professor Bloom to interview Canadian manufacturing firms through the summer of 2008. In 2009, the Institute further collaborated to extend the methodology to the retail sector, for the first time in a large-scale project, including Canada, the United States, and the United Kingdom.

Bloom, Van Reenen, and Sadun's method to measure management practices in the firm is based on an interview evaluation tool that scores firms on a scale of 1 to 5, indicating from worst practice to best practice across eighteen management practices, developed originally by McKinsey & Company, a leading international management consulting firm. The management practices cover three distinct, but related areas of management:

- **Adopting effective operations management approaches.** How well have firms implemented retailing management systems that are generally regarded by academics and consultants as best practice? "Lean Retailing" is a fairly recent concept derived from the original "Lean Manufacturing," which is generally regarded as the most effective management system. Based on the production methods developed by Toyota, but applicable beyond the automotive (and manufacturing) industry, Lean achieves highly efficient operations through a relentless drive to reduce waste of time and resources. It is characterized by an ethos of continuous improvement, backed by close tracking of the operation to identify problems and improvement opportunities.

- **Managing targets effectively.** Do firms' management teams set stretch yet realistic targets, monitor performance against these targets, and take corrective action when necessary? Effective management in this area means that companies are finding the right balance of targets to aspire to for maximum achievable performance. Setting targets too low means under performance; setting them too high will discourage improvements by workers and managers. Effective management also means determining how to measure performance and to follow through with actions when targets are not met.

- **Managing people well.** Are companies promoting and rewarding employees based on performance, and systematically trying to hire and keep their best employees? The cliché that people are a firm's most important asset is true. Skilled workers and effective people management together are an important element of productivity in firms and across the economy. Well managed firms are able to attract and retain their top talent through effective reward and incentive programs. They also deal effectively with problem performers.

Professor Bloom and his team designed the research process according to rigorous academic research standards. Our analysts, who were business and economics students, were trained to conduct the interviews consistent with analysts in other countries. We randomly selected retail locations for telephone interviews from a comprehensive industry list of firms categorized by Standard Industrial Classification (SIC) retail codes.[15]

The analysts conducted telephone interviews that lasted an average of fifty-seven minutes with the most senior store managers available and occasionally district managers. Through a series of structured, but open-ended questions, the analysts scored each company on a scale of 1 to 5, across eighteen factors. These results generated scores on each of the three factors described above, which in turn generated an overall score for the quality of management at the operation. The structure of the retail interview followed the manufacturing one, in which sixteen out of the eighteen topics were comparable between the two sectors.

Analysts also "double scored" four-fifths of the interviews. That is, while one analyst conducted the interview, another, who was not taking part in the interview, listened and independently scored the company. Subsequent comparisons of the scores showed a high degree of consistency between analysts.

We conducted interviews from June to August 2009 from a central location in Toronto. To ensure the comparability of the retail scores with the previous year's manufacturing scores, our analysts were trained using the same methodology, and two analysts from the previous year's manufacturing project returned to supervise and double-score the interviews.

Thus we conclude that, as much as possible, the retail interviews were scored in the same way as those in the manufacturing sector, and therefore are comparable to the rest of the management sample. Further, the distribution of completed interviews across Canada and the United States matches the distribution of actual retail locations.

---

14 For more information on the research methodology, see Professor Nick Bloom's website: http://www.stanford.edu/~nbloom/index_files/Page371.htm

15 Based on the Dun & Bradstreet database, using SIC codes 50–57 and 59. For more information, see http://www.dnb.ca/

Lean Retailing is best practice operating strategy

Lean Retailing is an example of a best practice operating strategy that management needs to adopt to maximize the efficiency of the retail operation process.

What is Lean Retailing?

Business success lies in effective management. This is especially critical today, as retailers continue to face the increasing challenge of competing against falling prices alongside rising operating and labour costs. Now, more than ever, retailers are turning toward adopting a more Lean approach in their management operations to improve profitability.

But what is Lean Retailing? Lean Retailing refers to the operating strategy that seeks to maximize efficiency by identifying and eliminating waste. It focuses on simplifying the work process to eliminate wasted effort, time, materials, and motion. By adopting a Lean approach, managers who employ these tools and principles are able to reduce non-value adding activities, detect and prevent problems early, and improve overall operating flow.

Where did Lean Retailing originate?

Pioneered by Toyota Motor Corporation, the concept of Lean was conceived as a set of tools and methods to eradicate waste and inefficiency in their manufacturing system, famously known now as the Toyota Production System (TPS). This revolutionizing manufacturing strategy fuelled Toyota's rise from a cash-strapped company to becoming one of the most successful automobile manufacturers in the world.

Today, the Lean approach has evolved from the manufacturing industry to apply to operations of all kinds, including those in insurance companies, hospitals, airline maintenance organizations, government agencies, retail industries, and many others.[16] In the retail sector, the same Lean approach has now developed to improve operations flows; these principles are known as Lean Retailing.

How does Lean Retailing work?

At the core of Lean Retailing is a dedication to the elimination of waste. Similar to the manufacturing sector, the major types of waste targeted by the Lean approach include excess inventory, product defects, unnecessary motion, under used employees, and wait times. Managers can now apply similar tools and principles to identify these forms of waste to improve their operations efficiency. These Lean techniques include:

- *Simplifying work design*. Organizing individual work processes to be more feasible and manageable so that these efforts have clear start and finish points
- *Using "pull" to drive replenishment*. Ensuring that the supply of goods is pulled by actual demand of customers as opposed to forecast or estimated demand so that inventory levels are kept low and space is conserved
- *Removing bottlenecks through the supply chain*. Eliminating inefficiencies to shorten delivery times, lower transportation costs and defects, and improve product flow and operational performance
- *Eliminating wasted effort, time, materials, and motion*. Identifying the core value of operations by eliminating excess motion, time, and materials used in the process flow to reduce and prevent extra work, problems and wait times

Why is Lean Retailing important?

To win in this increasingly competitive environment, retailers need to adopt a relentless focus on delivering value cost effectively. For, despite steadily falling prices, store operating costs are trending upwards because of more expensive operating overheads and labour costs as well as higher investments in shop fittings to match increasing trends to improve the customer experience.[17] Retailers must pursue a Lean perspective in their core operations, including best practices in operations management, performance management, and people management. (See *A guide to best practices in Lean Retailing.*) Doing so will produce a more efficient cost structure, more productive workers, less waste, lower effort, and shorter wait times – all of which generate significant improvements in store profitability and customer satisfaction.

Today, more and more businesses are focusing on streamlining their key operations to reduce unnecessary processes and waste and to improve customer experience. Lean Retailing is a best practice that, once implemented, can improve productivity and contribute to higher overall economic performance. Our research allows us to measure the quality of retail management through the lens of Lean Retailing – and to provide guidance for retailers in identifying and implementing Lean Retailing best practices.

---

[16] S. Corbett, "Beyond Manufacturing: The evolution of Lean production," *McKinsey Quarterly*, 2007, 3, pp.94-96.
[17] Jean-Baptiste Voisin, "The 'Industrial revolution' of European retailers in underway," *McKinsey Quarterly*, 2004, available online at: http://www.mckinsey.com/practices/retail/knowledge/index_full.asp?startval=20&sort=title

A guide to best practices in

Lean Retailing

For each topic in the study, we define the best practice and provide an example drawn from the 661 retail interviews conducted across North America and Europe

Operations management

ADOPTION OF LEAN PRACTICES

STORE OPERATIONS

Has the store implemented all the major Lean store operations practices? For example, does the manager have a standard to-do list to follow daily? Is there an automated inventory control system determined by the pull of demand? Is the backroom organized systematically?

Example of best practice: A Canadian bookstore has a point-of-sale system that automatically orders an item as soon as it is sold. The managers and employees check off every item on their set to-do list every morning. The manager has a "store clock," where she plans for what is happening in the store every hour of the day. Some inventory is kept, and what is on hand in the backroom is organized by aisle with bin codes, keeping the backroom clutter-free.

SCHEDULING

Has the store implemented all major Lean scheduling practices? Is the scheduling done automatically, based on store traffic and transactions data? Are there defined roles within the staff?

Example of best practice: Scheduling at a US supermarket is based on a computer system that is linked to its sales results system. The computer system bases the schedule on transactions per hour and allocates more labour to peak hours. Roles in the store are clearly defined, and employees rarely have to respond to unexpected traffic increases.

RATIONALE FOR LEAN RETAILING TECHNIQUES

What was the reasoning behind the adoption of any or all Lean Retailing techniques? Were managers implementing changes because all their competitors were doing it? Did managers believe it would merely reduce costs and thus decided to make the switch? Or did Lean fit the businesses' goals, which often include increasing quality, reducing waste, and reducing injuries while increasing profits?

Example of best practice: A UK specialty apparel store introduced techniques to improve customer service, raise product availability, decrease waste, and increase efficiency and productivity.

PROCESS PROBLEM DOCUMENTATION

If an operational/procedural problem in the store occurs, what happens? Do managers wait for problems to happen to address them or do they search for ways of improving processes and avoiding potentially costly product shortages or mistakes? Is there a specific way that shop floor workers, who are executing most of the tasks, can suggest process improvements?

Example of best practice: A UK supermarket uses a checklist system for checking the store every hour. Managers document all issues and have weekly business strategy meetings to discuss them and identify solutions. Action plans encompass targeted completion dates and everything is reported to corporate headquarters. There is a standard system whereby employees can suggest improvements, and managers review them weekly with potential rewards for the employee whose suggestion gets implemented.

OPERATIONS PERFORMANCE TRACKING

What types of Key Performance Indicators (KPIs) are the managers tracking? For example, do managers only track sales per day or does the set of KPIs include a comprehensive list of all productivity factors, such as average transaction value and conversion rates? And are these KPIs available for all to see, or is it only the senior managers who are privy to this information?

> *Example of best practice:* A Canadian bookstore manager tracks all major performance indicators daily, weekly, monthly, and yearly. Sales are tracked by shift, and if targets are not being met, the manager follows up immediately with the sales staff to improve performance. All information is posted for employees to see and updated as new data become available.

OPERATIONS PERFORMANCE REVIEW

Does a manager review KPIs with other managers and staff? Is there a meeting to review them? Who is involved in these meetings? Who gets to see the results of this review? What are the typical next steps after a meeting?

> *Example of best practice:* A hardware store in Canada has weekly management meetings to review the basic KPIs, and routinely invites floor staff to attend as well. Every meeting, they create a follow up plan with five to six main points they have to focus on in the coming week with specific timelines and accountability. Results are tracked daily and shared with employees in small team huddles and storewide meetings twice a week. The managers keep a scorecard to help track how they are doing.

OPERATIONS PERFORMANCE DIALOGUE

Here managers are asked to describe a KPI meeting. Is there a set structure to the meeting; for example, a set agenda used every week? If KPI data are needed to discuss specific issues, are the data always available? Do discussions lead to the root cause of problems?

> *Example of best practice:* The manager at an American general merchandise store has a set agenda for the meetings (part of it from corporate, part of it open to managers' discretion), which is distributed ahead of time. All involved are expected to have reviewed it and to come prepared for discussion. Problems are identified and conversations are only finished when the root cause is found. The manager often uses root cause analysis tools such as fishbone diagrams and the 5Ys.[a] All items are documented and followed up on.

CONSEQUENCE MANAGEMENT

How do managers deal with a business unit that is under performing? What are the consequences for the under performing unit? Are there parts of the business that seem to fail repeatedly to carry out agreed actions?

> *Example of best practice:* A general merchandise store in Canada has a computerized system where follow-up plans are logged. Outstanding items are flagged (red, yellow, or green). In-store issues have a "sundown rule," where problems need to be fixed by sundown. External issues require progress reports, and status is frequently reviewed until the item is no longer red-flagged.

[a] 5Ys is a management technique used to solve problems by asking "why" five times. By the time the fifth why is asked, the root cause of the problem has already been found.

Performance management

TYPES OF GOALS

What types of goals are set for the company? Are there specific goals for the store? Are there any non-financial goals?

> *Example of best practice:* A hardware store in Canada has a range of financial and operational goals in place, and also has specific non-financial goals for community involvement (charitable donations/fundraising) and environmental targets. The manager was concerned with "making money" but felt that supporting their community was just as important.

INTERCONNECTION OF GOALS

Is there a clear motivation behind the goals? For instance, does the company clearly communicate goals, such as "we want to be the leader in the industry" or "we want to grow by 4 percent in the next two years"? How are the goals cascaded down to the individual workers? For example, are workers aware of how their work fits within the larger framework of the company?

> *Example of best practice:* The motivation behind a US general merchandise store's goals is to create shareholder value and deliver customer satisfaction. Corporate headquarters divides goals by region, division, and store. The manager then further divides those goals by department and individual associates, so that all have personal targets linked to the store's overall goal. Company goals are communicated through storewide meetings and newsletters.

TIME HORIZON

What is the time scale of the targets? Do managers focus more on short-term or long-term goals? Do the short-term goals form a "staircase" to the long-term goals?

> *Example of best practice:* A Canadian department store has daily, weekly, quarterly, annual, three- and five-year goals and ten-year strategic goals. The goals are all linked in a staircase; if the store meets all the short-term goals, they will inevitably meet the long-term goals.

SETTING STRETCH GOALS

How tough are the goals? Do managers feel pushed by them? Are any goals obviously too easy or too hard? In other words, are there goals that are always met and some that are never met? Do all departments have the same level of difficulty in the targets or do some get off easy?

> *Example of best practice:* A UK clothing store has rigorous goals for all departments, based on a specific store growth plan. The manager feels the targets are very tough, but attainable. She meets them between 75 to 80 percent of the time.

CLARITY OF GOALS

Do all employees in the store know what their personal targets are? Does anyone complain that the targets are too complex – that is, not that they are too stretching, but that they are difficult to understand? Is performance between teams or shifts openly compared to others?

> *Example of best practice:* A Canadian bookstore manager sets clear individual targets for her employees and keeps them accountable to them during weekly huddles. She posts performance in the break room and employees are encouraged to compare individual performance, as the manager believes this leads to friendly competition.

INSTILLING A TALENT MINDSET

Do senior managers discuss attracting and developing talented people? Do managers get any rewards for the talent pool they create? Are managers held accountable for creating a talent pool?

> *Example of best practice:* Managers at an American department store participate in university/college job fairs, and actively seek talented people to join the company. The company has a "human capital report," and the number and quality of the people a manager hired are important in his appraisal and affect (positively or negatively) his bonus at the end of the year.

People management

REWARDING TOP PERFORMERS

How does the appraisal system work? How does the bonus system work? Are there non-financial rewards? How do these systems compare to the competitors' systems?

> *Example of best practice:* An American hardware store holds appraisal meetings every six months – one full appraisal meeting and one update meeting. There is a bonus for both shop floor employees and managers, based on a review of personal performance. For the shop floor employees, there is a reward system where employees get "stars" in a staircase structure for outstanding performance. For each set number of "stars," there is a financial reward. When employees reach the highest level, they get a gift. There are also gift cards/movie tickets and other financial rewards for good customer service performance.

ADDRESSING POOR PERFORMANCE

If a worker is continuously under performing, what is the course of action? Is there a set procedure that is followed? How long would under performance be tolerated?

> *Example of best practice:* A US department store has a performance improvement plan, whereby managers meet with poor performers, identify their improvement opportunities, develop a plan, and give them tools to make them work more effectively. Once under performance is identified, weekly meetings are set up to update the status. The manager tries to retrain and/or move the employee to other departments, but under performance is only tolerated for a maximum of three months.

PROMOTING HIGH PERFORMERS

If a worker is exceptionally good, can he or she be promoted on a fast track? Are top performers routinely identified and developed? Is length of service unduly important in promotions?

> *Example of best practice:* An American grocery store has a formal career path plan for all employees and a succession plan for managers. Promotions are based solely on performance, and tenure does not play a role. The manager uses regular performance appraisals to identify top performers and look for "diamonds in the rough." The company has a mentoring program that trains the best to be future managers, and encourages workers to take courses outside the store.

ATTRACTING HIGH PERFORMERS

Does the company offer a distinctive work environment that is attractive to top talent?

> *Example of best practice:* An American hardware store offers competitive wages, strong performance incentives, and clear career paths. The managers believe it is important to get employees involved in the decision-making process to make them feel like a valued part of the company.

RETAINING HIGH PERFORMERS

What special practices are in place to retain top performers who want to leave the company?

> *Example of best practice:* A hardware store manager in Canada keeps an eye on the top employees and, if they seem unhappy or are thinking about leaving, senior management will meet with them to discuss their career. For a top performer, the manager would adjust hours, increase pay, and offer more responsibility. The manager mentioned an example where he helped the employee's mother move to their town so they could live closer together and the employee would stay with the company.

Canada's retailers score well but have opportunities to improve

CANADA'S RETAIL MANAGEMENT PRACTICES score well. Across the three countries, Canada ranks second, though statistically there is no difference with the US, which is the leader on management performance. The UK trails both Canada and the US significantly (*Exhibit 5*). These results are quite different from those in the manufacturing management research, where Canada significantly trailed the US.

A reason for the convergence between the two countries' scores in the retail sector could be the prevalence of US-owned multinational firms in the Canadian retail sample, when compared to the manufacturing sample. The average score for Canadian domestic retail firms is 2.79 (on the five point scale), 0.64 points or 18 percent lower than that of US multinationals operating in Canada.[18] In the manufacturing sample, the difference is only 0.25 points or 7 percent lower.[19] While the proportion of US-owned firms as a percentage of the Canadian sample is fairly close in both the manufacturing and retail samples,[20] these multinationals have a larger and more positive effect on Canadian retail than on manufacturing. In fact, nearly 60 percent of the top 10 percent of high-scoring Canadian retail

18 The score of the 87 American multinationals operating in the Canadian sample is 3.43.
19 The denominator here included only US- and Canadian-owned companies in the manufacturing sample, so the two percentages are comparable. The US score is 3.36 and the Canadian score is 3.11.
20 The proportion of US firms in the Canadian sample is approximately 21 percent for retail and 18 percent for manufacturing.

firms are US-owned, while the entire bottom 10 percent are Canadian-owned (*Exhibit 6*).[21] In the Canadian manufacturing sample, only about 20 percent of the top 10 percent of the high-scoring firms are US-owned.

Among smaller firms, that is, those employing between 100 and 5,000,[22] both Canada and the US trail the UK. This further indicates that the Canadian and US advantage is largely attributable to large-scale chain stores. Bloom and Van Reenen suggest that most of the difference in the management score across countries is a result of the "tails" of the distribution – that is, the best and worst managed firms.[23] If we are to close Canada's prosperity gap with the US, improving the management practices in our Canadian-owned retail sector represents a significant opportunity.

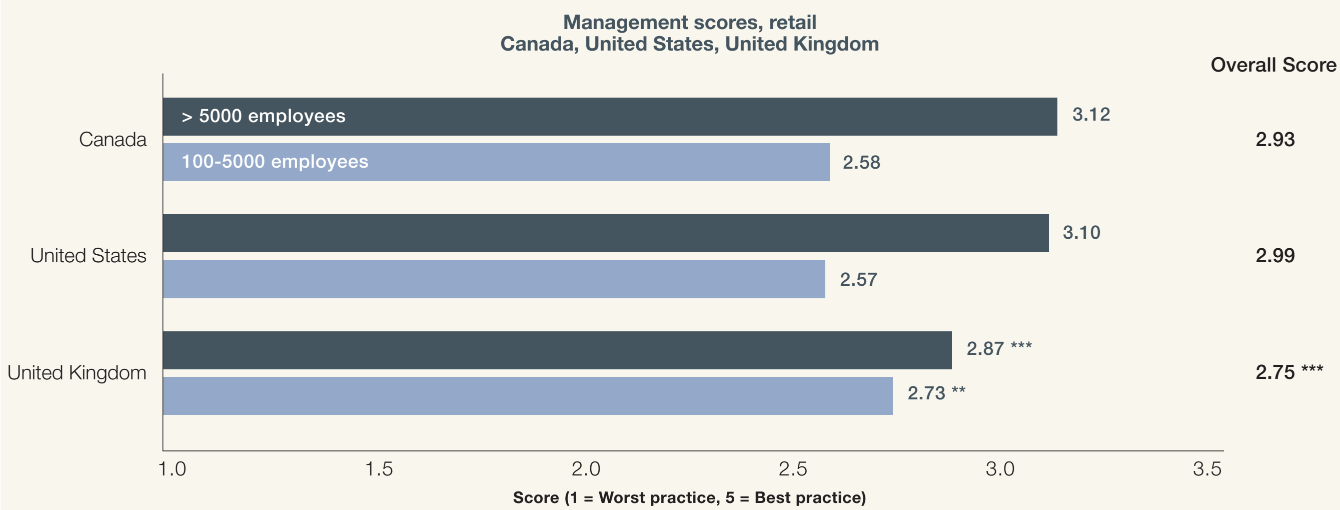
In the manufacturing research, Bloom *et al*. found that better management capability, as reflected by the overall management score from the study, was correlated with firm productivity, as well as country productivity.[24] We found that result to hold for Canada's manufacturing industries as well.[25]

In the retail sector, we continue to find the same pattern. In the UK, the only country where public and private firm-level data are available, we found very strong statistical evidence that a higher management score was significantly linked to firm productivity, as measured by sales per employee.[26] The results suggest that firms with a one-point higher average management score – for example, a firm with a score of 4 versus a score of 3 – have about 36 percent higher labour productivity, even after taking into account industry and general statistical noise.[27] We recognize that these results are indicative, not conclusive, and that correlation does not imply causality. Nevertheless, better management practices in an industry are associated with higher productivity.

The link between cross-national management quality and retail industry-wide productivity is not straightforward. While our management scores are very similar, the productivity of Canada and the US retail industries differs – sales per employee are 33 percent higher in the US and average wages are 35 percent higher.[28] We are able to determine that our retail industries are very similar in their make-up (i.e., the percentage of industry sales in each sub-sector like clothing or furniture). We are unsure of the extent of the differences in other factors such as store traffic.

We can conclude that our retail managers are as capable as their US counterparts at the store level and, since productivity differences exist between the two countries in the retail sector, the role of operating management may not be a significant factor in explaining this productivity gap. Our research methodology does not test for merchandising and marketing management, which are

Exhibit 5 Canada's retail management matches US performance



Note: These scores include all topics (1-18). Sample sizes for 100-5000 employees are: US 29, Canada 130, UK 78.
*** denotes statistically different from Canada at the 1% level; ** at the 5% level; * at the 10% level.
Source: Management Matters dataset. Institute for Competitiveness & Prosperity analysis.

21 55 percent of the top 20 percent of firms are US-owned.
22 The sample does not include firms below 100 employees to avoid skewing data results, as management practices of firms with less than 100 employees may not be comparable to those in larger firms.
23 Bloom and Van Reenen, "Why do Management Practices Differ across Firms and Countries?"
24 Nick Bloom, Stephen Dorgan, John Dowdy, John Van Reenen, "Management Practice & Productivity: Why they matter," 2007, p. 5, available online at: http://www.stanford.edu/~nbloom/ManagementReport.pdf.
25 Institute for Competitiveness & Prosperity, *Management Matters*, p. 30.
26 The log of sales per employee is a very basic measure of firm productivity and its use may be questioned in the retail sector, as there is substantial variance within the sector itself. However, this heterogeneity is controlled for in our regressions through the US SIC 4-digit codes, which allow us to use with confidence ln(sales/employee) as a productivity measure.
27 The coefficient does not change significantly when we control for capital per employee and share of employees with a university degree. General noise includes characteristics such as day of week, time of day, seniority of the manager, and tenure.
28 Institute of Competitiveness & Prosperity analysis based on data from Statistics Canada and US Bureau of Economic Analysis.

more important in a retail setting than in manufacturing, or for overall strategy robustness.

Where can Canadian retailers improve?

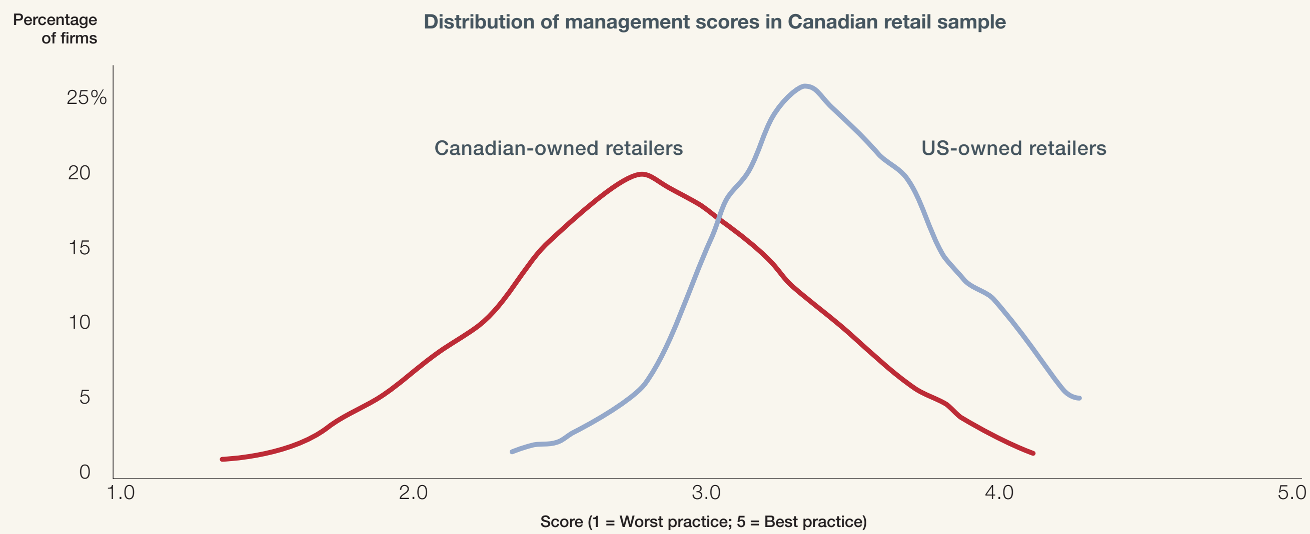
Overall, Canada has among the best retail management capabilities. The overall management score is based on research results in three areas – operations management, performance management, and people management.

Operations management: Implementing Lean Retailing processes

In operations management, Canada ranks second overall, and the score is statistically different from that in the US (*Exhibit 7*). Upon closer inspection, we see there are specific operations management areas where we fared worse than others.

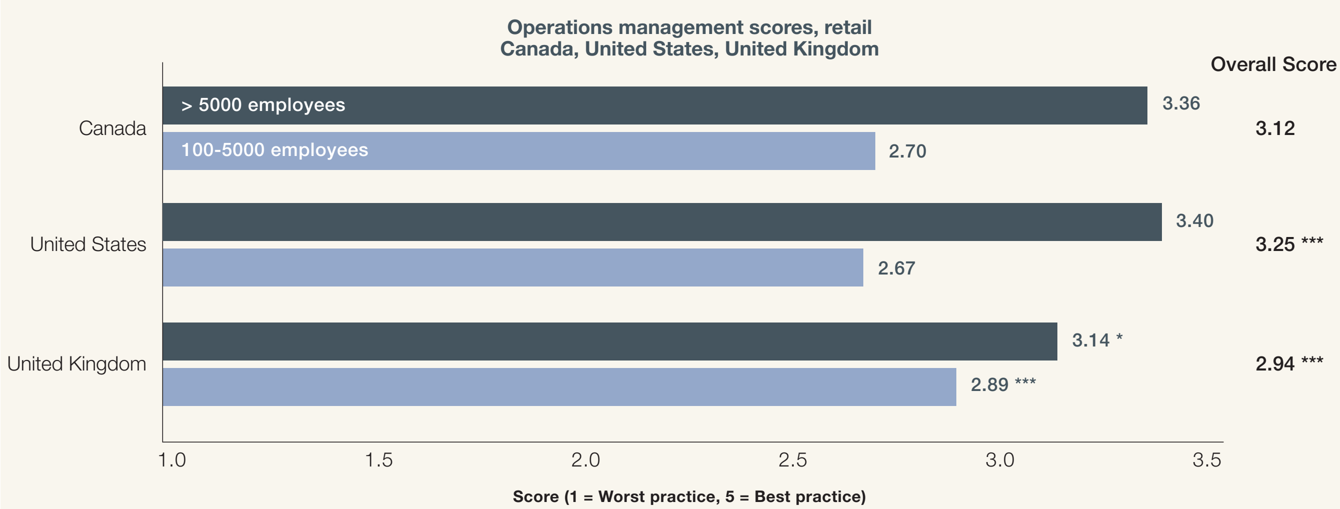
In operations management, Canada is statistically behind the leader in five areas but statistically no different in three (*Exhibit 8*).

Exhibit 6 **Most of Canada's best managed retail operations are US-owned multinationals**



Source: Management Matters dataset. Institute for Competitiveness & Prosperity analysis.

Exhibit 7 **Canada trails the US in adoption and implementation of best practice operations processes**



Note: For detailed list of operations management questions, see Exhibit 8. *** denotes statistically different from Canada at the 1% level; ** at the 5% level; * at the 10% level.
Source: Management Matters dataset. Institute for Competitiveness & Prosperity analysis.

Exhibit 8 **Canada lags world's best performers in most operations management questions**

Operations Management Canada's relative performance*	Worse than leader (US)	No different from leader	Leader	Ranking out of 3 countries
OVERALL SCORE	✓			2
Adoption of Lean Retailing: Store Operations ***Best practice:*** Business processes have been transformed to meet the needs of the business. The store processes would be considered best practice for the industry ***Worst practice:*** Few Lean Retail operations have been introduced (or have been introduced in an *ad hoc* manner)	✓			3
Adoption of Lean Retailing: Store Scheduling ***Best practice:*** Business processes have been transformed to meet the needs of the business. The store processes would be considered best practice for the industry ***Worst practice:*** Few Lean Retail operations have been introduced (or have been introduced in an *ad hoc* manner)	✓			2
Rationale for the adoption ***Best practice:*** Lean was introduced to meet business objectives ***Worst practice:*** Lean was introduced to catch up to competitors		✓		2
Process problem documentation ***Best practice:*** Exposing problems is integral to individuals' responsibilities rather than *ad hoc* solutions ***Worst practice:*** No process improvements are made when problems occur	✓			2
Operations Performance tracking ***Best practice:*** Performance is continuously tracked and communicated to all staff using a range of visual tools ***Worst practice:*** Tracking is *ad hoc*, and measures being tracked do not indicate directly if overall business objectives are being met	✓			3
Operations Performance review ***Best practice:*** Performance is continuously reviewed, based on indicators tracked; follow up ensures continuous improvement ***Worst practice:*** Performance is reviewed infrequently and only success or failure is noted		✓		2
Operations Performance dialogue ***Best practice:*** Regular performance conversations focus on addressing root causes. Purpose, agenda, and follow-up steps are clear to all ***Worst practice:*** Relevant data are often not present at meetings or discussion is based on data that is not meaningful. Agenda and purpose are not clear		✓		1
Consequence management ***Best practice:*** Failure to achieve agreed targets drives retraining or moving individuals around ***Worst practice:*** Failure to achieve agreed targets does not carry any consequences	✓			2

* At the 10 percent significance level.
Source: Management Matters dataset. For further survey work, see Nick Bloom and John Van Reenen, "Measuring and Explaining Management Practices Across Firms and Countries," *Quarterly Journal of Economics*, November 2007; Institute for Competitiveness & Prosperity analysis.

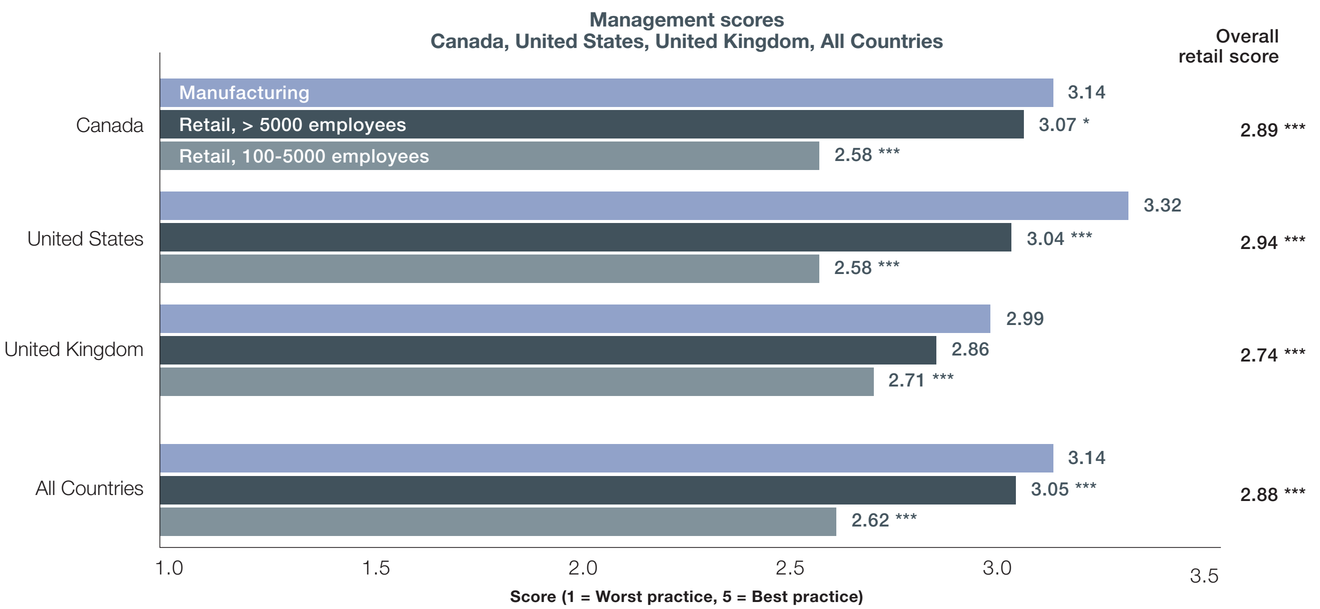
Manufacturers lead retailers in Lean management

ACROSS CANADA, the US, and the UK, manufacturing management is significantly better than retail management (*Exhibit A*).

When looking at the average management scores across the sixteen common topics,[a] we find that manufacturing firms are significantly better managed than retail firms in general, as well as across each of the three countries present in both industry samples. Furthermore, there is an even larger difference when we restrict the sample to companies between 100 and 5,000 employees.

Manufacturers out perform retailers in thirteen of sixteen areas covered in the retail and manufacturing interviews (*Exhibit B*).

Exhibit A Manufacturers are better managed than retailers in the three countries surveyed



Note: These scores are comparable for the two sets of interviews and differ slightly from the results in Exhibit 5.
*** denotes statistically different from manufacturing at the 1% level; ** at the 5% level; * at the 10% level.
Source: Management Matters dataset. Institute for Competitiveness & Prosperity analysis.

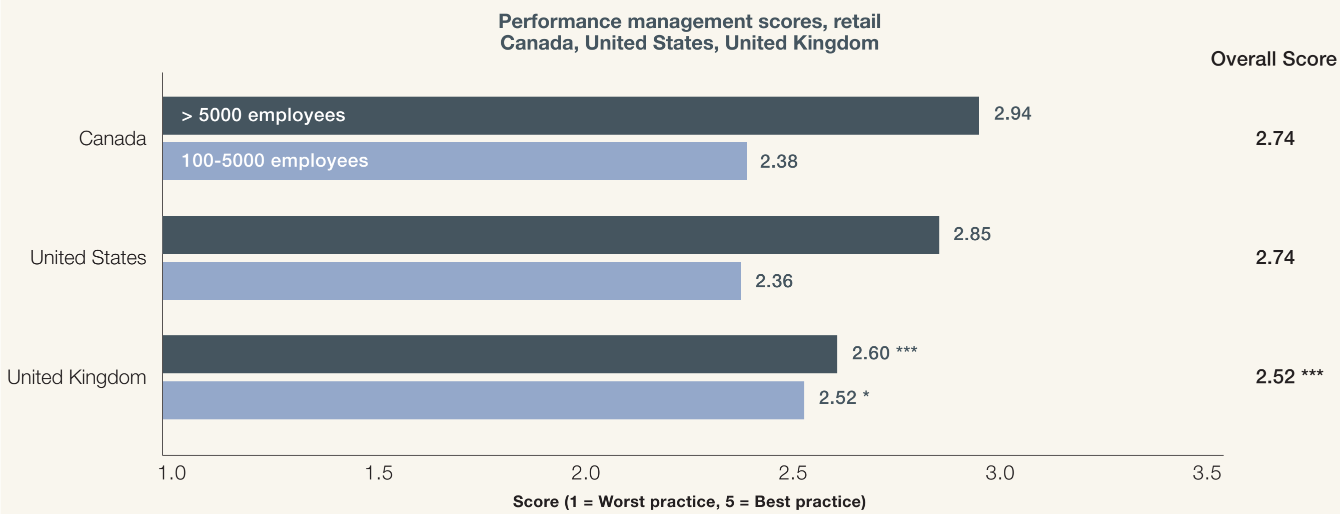
[a] Except for the first two of the eighteen topics – Adoption of Lean Retailing I/II and Rationale for adoption – we used the same methodology in the retail interview as in the manufacturing interview. Thus, the other sixteen topics are directly comparable. And when comparing retail and manufacturing industries, we re-calculated the average management scores including only these topics.

Exhibit B **Manufacturers out perform retailers**

	Better industry in adopting lean management practices	Anecdotal evidence heard in interviews
OPERATIONS MANAGEMENT		
Process problem documentation	Manufacturing	Retailers often lacked set procedures for documenting and tracking process problems as well as employee suggestions. We often heard managers claim that an "open door" policy was the best option instead of a systematic process.
Operations performance tracking	Manufacturing	Retailers were as good as manufacturers when it came to officially recording store performance, but were lacking in structures to monitor and share that information continuously with all employees.
Operations performance review	Manufacturing	Retailers were as good as manufacturers in periodically reviewing their progress, but standard follow-up plans were not often adopted.
Operations performance dialogue	Manufacturing	Retailers had regular meetings, but often did not have a set structure to their meetings, including a previously circulated agenda to ensure all were prepared. Retailers also used standard root-cause analysis tools (such as fishbone diagrams and the 5Ys) less often than manufacturers.
Consequence management	Manufacturing	Few retailers had solid consequence management, where they would continue to follow-up on plans which were not enacted assigning priorities and moving/retraining people when necessary.
PERFORMANCE MANAGEMENT		
Types of goals	Manufacturing	Manufacturers fared better in types of goals, as many retailers reported not having anything but financial and operational goals.*
Interconnection of goals	Manufacturing	Retailers were also worse in communicating the targets to all employees, and giving individuals something to strive for.
Time horizon	Manufacturing	Retail managers were very focused on the short run, many not having anything further than one-year goals. Some mentioned corporate headquarters perhaps having longer goals, but they would not be privy to that.
Setting stretch goals	Manufacturing	Retailers often claimed they were not challenged and surpassed goals regularly, while manufacturers reported having more stretch goals that were difficult, yet attainable.
Clarity of goals	No difference	Retailers were no different than manufacturers when it came to how clear goals are, and communicating individual people or team's performance: but most shied away from public displays as a means of inducing competition.
Instilling a talent mindset	Manufacturing	Managers in retail were less likely to be evaluated and rewarded for (or held accountable to) the talent pool they built. Many retail managers agreed that "having a good team is the reward," instead of having a set incentives structure for managers to bring and retain top talent to the company.
PEOPLE MANAGEMENT		
Rewarding top performance	No difference	For bonuses and performance-related rewards, manufacturers and retailers are at par. It is worth noting, however, that Canadian retailers scored significantly better than Canadian manufacturers here, and the UK and the US scored significantly worse than their manufacturers.
Addressing poor performance	Manufacturing	Retailers were worse than manufacturers at having a set structure and moving employees to other positions or out of the company faster.
Promoting high performers	No difference	Retailers were no different than the manufacturers when it came to identifying, developing and promoting top performers.
Attracting high performers	Manufacturing	Retailers were worse at creating an environment that is attractive to good employees.
Retaining high performers	Manufacturing	Retailers were worse at doing everything they could to convince a top performer to stay in their company.**

* It is worth noting that this was more of a UK phenomenon, while in Canada and the US, many larger retailers had very comprehensive community involvement and environmental targets which were as important to the managers as their financial goals. Canadian retailers were statistically better at this than Canadian manufacturers.
** Only Canadian retailers were on par with the manufacturers.
Source: Management Matters dataset. For further survey work, see Nick Bloom and John Van Reenen, "Measuring and Explaining Management Practices Across Firms and Countries," *Quarterly Journal of Economics*, November 2007; Institute for Competitiveness & Prosperity analysis.

Exhibit 9 Canada is among the leaders in best practice for setting and managing goals



Note: For detailed list of performance management questions, see Exhibit 10. *** denotes statistically different from Canada at the 1% level; ** at the 5% level; * at the 10% level.
Source: Management Matters dataset. Institute for Competitiveness & Prosperity analysis.

Exhibit 10 In performance management, Canada scores very well, but still has improvement opportunity

Performance Management Canada's relative performance*	Worse than leader (US)	No different from leader	Leader	Ranking out of 3 countries
OVERALL SCORE		✓		1
Types of goals ***Best practice:*** Goals are a balance of financial and non-financial goals ***Worst practice:*** Goals are exclusively financial or operational		✓		1
Interconnection of goals ***Best practice:*** Corporate goals increase in specificity as they cascade through the business units ***Worst practice:*** Individual workers are not aware of how their contribution is linked to corporate goals		✓		2
Time horizon ***Best practice:*** Short-term goals are set so that they become a staircase to reach the long-term goals ***Worst practice:*** Top management's main focus is on short-term goals		✓		1
Setting stretch goals ***Best practice:*** Goals are demanding for all divisions, and are grounded in solid economic rationale ***Worst practice:*** Goals are either too easy or impossible to achieve		✓		1
Clarity of goals ***Best practice:*** Performance measures are well defined and well communicated; worker performance is made public to induce competition ***Worst practice:*** Performance measures are complex and not clearly understood; worker performance is not made public	✓			3
Instilling a talent mindset ***Best practice:*** Senior managers are evaluated and held accountable on the strength of the talent pool they actively build ***Worst practice:*** Senior management do not communicate that attracting, retaining, and developing talent is a top priority		✓		2

* At the 10 percent significance level.
Source: Management Matters dataset. For further survey work, see Nick Bloom and John Van Reenen, "Measuring and Explaining Management Practices Across Firms and Countries," *Quarterly Journal of Economics*, November 2007; Institute for Competitiveness & Prosperity analysis.

Performance management: Setting and managing effective goals
In performance management, overall, Canada is tied with the US for the top spot, and is significantly ahead of the UK (*Exhibit 9*). This result is similar if we look at only the larger companies with more than 5,000 employees, but is reversed for smaller companies, where smaller UK operations are better managed than their Canadian and US counterparts.

Companies were scored on six questions related to setting and managing goals effectively. Canada achieved statistical parity in all areas, except one: clarity of goals (*Exhibit 10*).

People management: Attracting and retaining top talent, addressing poor employee performance effectively
In managing people in retail stores, Canada is not statistically different from the US (*Exhibit 11*). This is an encouraging result, but when we look closer, there are areas where we perform very well and others where we lag significantly.

Companies were asked questions in five areas related to how well they manage their employees. Canada scored worse than the best performer in two areas, and no different in two areas. Canada's score was statistically above the other two countries in the area of retaining high performers – that is, doing everything possible to keep a star performer in the company (*Exhibit 12*).

Public policy and business strategies lead to strong management

Several important factors besides operations, performance, and people management influence the management and productivity of Canadian retail companies.

Education matters
When assessing the results across the set of manufacturing firms worldwide, Bloom *et al.* find that in firms with higher management scores, a higher proportion of their workforce tends to have at least a post secondary education.[29] We also found this in our own work here in Canada.[30] In the retail sector, we found this pattern again (*Exhibit 13*). Firms with higher management scores in our full retail sample, that is, a score of 4 and above, tend to hire more managers with university degrees when compared to the firms with the lowest management scores of 1 to 2. Within Canada, the pattern is even more pronounced, with the top scoring companies having double the percentage of university graduate managers when compared to the bottom scoring companies.

Multinationals matter
In previous work, we have cited the evidence that multinational firms out perform domestically focused firms on several dimensions – productivity, wages, and R&D.[31] Multinational firms have expanded because of superior business models. The management research indicates that multinational corporations are better managed than non-multinationals in all sampled countries around the world in the manufacturing sector. This result continues to hold for the retail sector. Across all countries in the manufacturing sector, Bloom *et al*. find that "the presence of multinationals within a region serves to assist in the transfer of best practice to local firms… possibly through the migration of employees and knowledge and through commercial interactions

Exhibit 11 **In people management, Canada is not statistically different from the US**

Note: For detailed list of people management questions, see Exhibit 12. *** denotes statistically different from Canada at the 1% level; ** at the 5% level; * at the 10% level.
Source: Management Matters dataset. Institute for Competitiveness & Prosperity analysis.

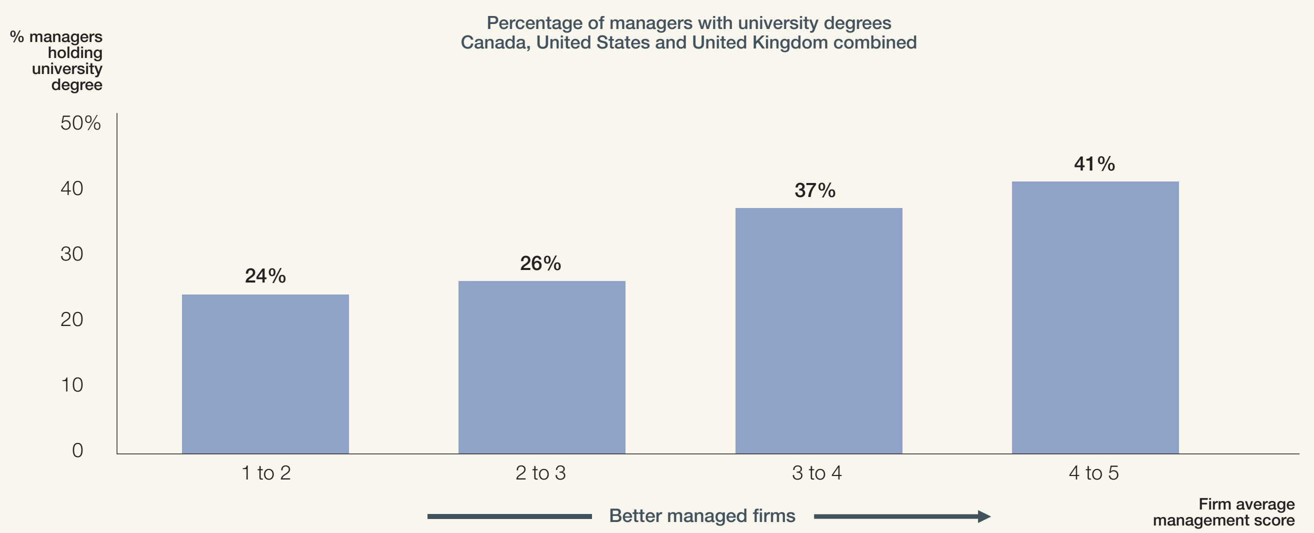
29 Bloom *et al*, "Management Practice & Productivity: Why they matter"
30 Institute for Competitiveness & Prosperity, *Management matters*, p. 39
31 Institute for Competitiveness & Prosperity, Working Paper 11, *Flourishing in the global competitiveness game*, September 2008, pp. 27–28

Exhibit 12 **In people management, Canada performs well**

People Management Canada's relative performance*	Worse than leader (US)	No different from leader	Leader	Ranking out of 3 countries
OVERALL SCORE		✓		1
Rewarding top performers ***Best practice:*** The firm provides ambitious stretch targets with clear performance related accountability and rewards ***Worst practice:*** People within the firm are rewarded equally irrespective of performance level		✓		1
Addressing poor performance ***Best practice:*** Poor performers are moved to less critical roles or out of the company as soon as weaknesses are identified ***Worst practice:*** Poor performers are rarely removed from their positions	✓			3
Promoting high performers ***Best practice:*** Top performers are actively identified, developed, and promoted ***Worst practice:*** People are promoted primarily upon the basis of tenure	✓			3
Attracting high performers ***Best practice:*** The firm provides a unique value proposition to encourage talented people to join the company instead of the competitors ***Worst practice:*** Competitors offer stronger reasons for talented people to join their companies		✓		2
Retaining high performers ***Best practice:*** Managers do whatever it takes to retain top talent ***Worst practice:*** Managers do little to try to keep the top talent			✓	1

* At the 10 percent significance level.
Source: Management Matters dataset. For further survey work, see Nick Bloom and John Van Reenen, "Measuring and Explaining Management Practices Across Firms and Countries," *Quarterly Journal of Economics*, November 2007; Institute for Competitiveness & Prosperity analysis.

Exhibit 13 **Better managed firms have more educated managers**



Source: Management Matters dataset. Institute for Competitiveness & Prosperity analysis.

between the two groups."[32] Further, they calculate the obvious effect of economies of scale – in other words, sheer company size – which accounts for only a quarter of the difference between multinationals and non-multinationals. This result is reinforced in the retail sector across the three countries sampled.

This result is particularly noteworthy because all the large multinationals operating in Canada and the US in our sample are US-owned. The average score for the Canadian-owned firms is 2.79, while that for the US-owned, non-multinational firms is 2.80 (*Exhibit 14*). Thus the quality of management of domestic firms in both countries is very similar.

Similar to the general results, manufacturing multinationals are also better managed than retailing multinationals. Individually, this holds for the multinationals operating in the US and the UK, but not in Canada. Scores for retail multinationals operating in Canada are not statistically different from those for manufacturer multinationals.[33]

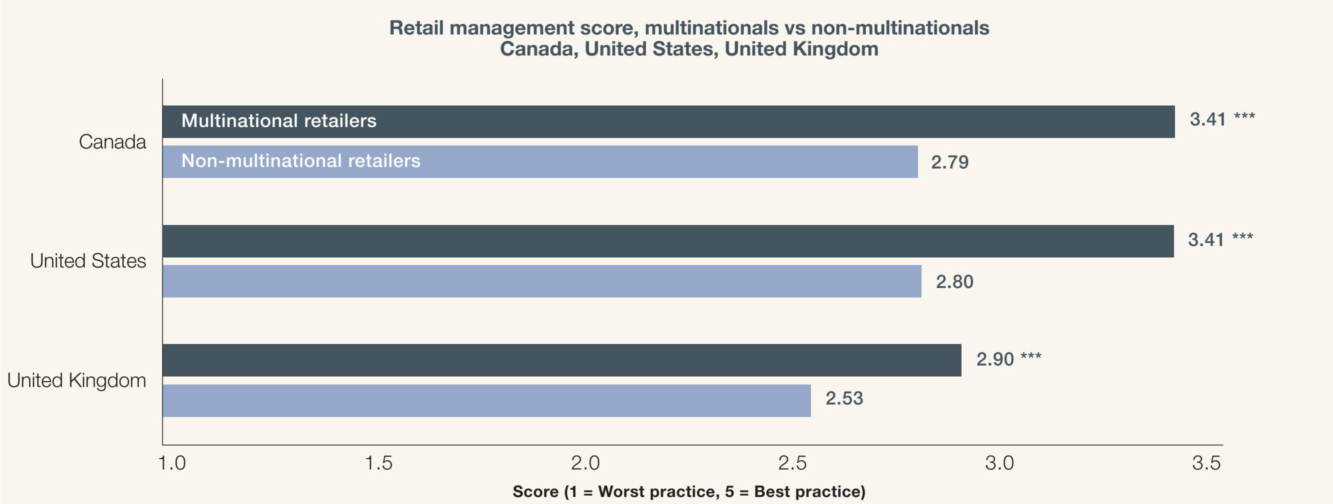
Global leaders matter

The indication that the Canadian management score is strongly influenced by large US chain stores further supports the importance of creating globally competitive firms, and building an environment in which they flourish. In previous work, the Institute has identified Canada's 86 global leaders.[34] In our manufacturing management research, the 23 global leaders in our sample were dramatically ahead of other multinationals and domestically focused companies in the quality of their management. But only one of our global leaders is a retailer, Couche-Tard. (See *Couche-Tard, Achieving global leadership through effective management of people, logistics, and financial resources*.) Aspiring for global leadership can put a firm in a virtuous circle. To realize global success, the firm needs to strengthen its management talent. In turn, strong management helps to achieve global leadership. If we want more global leaders, we need stronger managers. And if we want stronger managers, we need more global leaders.

A recent report by Deloitte, a professional services organization, ranked the top 250 global retailers by gross annual sales. Out of these top companies, 95 were US-owned, while only 11 were Canadian-owned. Of the US-owned companies, almost half had operations outside of the US, while only two of the Canadian companies had operations outside Canada.[35] Furthermore, the report estimates that in the long run, "retailers operating in more countries have grown sales nearly two percentage points faster than retailers operating in only one or 2 countries."[36] Clearly, Canadian retailers are falling behind in aiming for global leadership and reaping the benefits of a global strategy.

In the past, few Canadian retailers have attempted expansion into the US. And the ones who did, often failed. To this day, our retailers have not succeeded in expanding outside of the Canadian market with the same success as their counterparts in the US. In the retail sector, it is the expansion of stores into large chains that usually leads to a strong position in a market sector.

Exhibit 14 **Multinationals out perform non-multinationals in all countries**



Note: All MNE scores are significantly better than the non-MNE scores.
*** denotes statistically different from non-multinational retailers at the 1% level; ** at the 5% level; * at the 10% level.
Source: Management Matters dataset. Institute for Competitiveness & Prosperity analysis.

32 Bloom *et al.*, "Management Practice & Productivity: Why they matter," p. 7.

33 US multinationals make up 40 percent of all multinationals in the Canadian manufacturing sample. The score for US manufacturer multinationals is 3.36, very similar to the US retail multinationals' score.

34 For more information on our global leaders research, see http://www.competeprosper.ca/index.php/canada_global_leaders.

35 The two companies are Couche-Tard and Jean-Coutu; both of these companies' foreign operations were in the United States.

36 Deloitte & Touche, *Global Powers of Retailing*, 2008, available online: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/dtt_globalpowersretailing.pdf

Historically, Canada has had more independent retailers than the US,[37] and our smaller market size is likely one aspect that hinders the ability of local retailers' expansion and chain store creation. That is, even if a store begins its expansion successfully, it will reach a point of market saturation quicker than a similar store venturing the same type of expansion in the US.

David Burns makes the argument that the distinctive historical immigration policies of the two countries contributed to the smaller incidence of chain stores in Canada when compared to our neighbours.[38] In the US, the national philosophy has been the "melting pot," in which US immigrants tend to assimilate to the local cultures and customs. Meanwhile, Canada's philosophy has been the "mosaic," celebrating diversity and encouraging people to preserve their individual cultures. Since chain stores are usually very similar, if not identical, in design, store front, and product availability, communities of more homogenous customers like those in the US are much more conducive to this type of expansion than a community encompassing sets of subcultures and distinctive customers with many different tastes and needs. In short, the Canadian market has been less favourable to the US retailers' "cookie-cutter" expansion approach.[39]

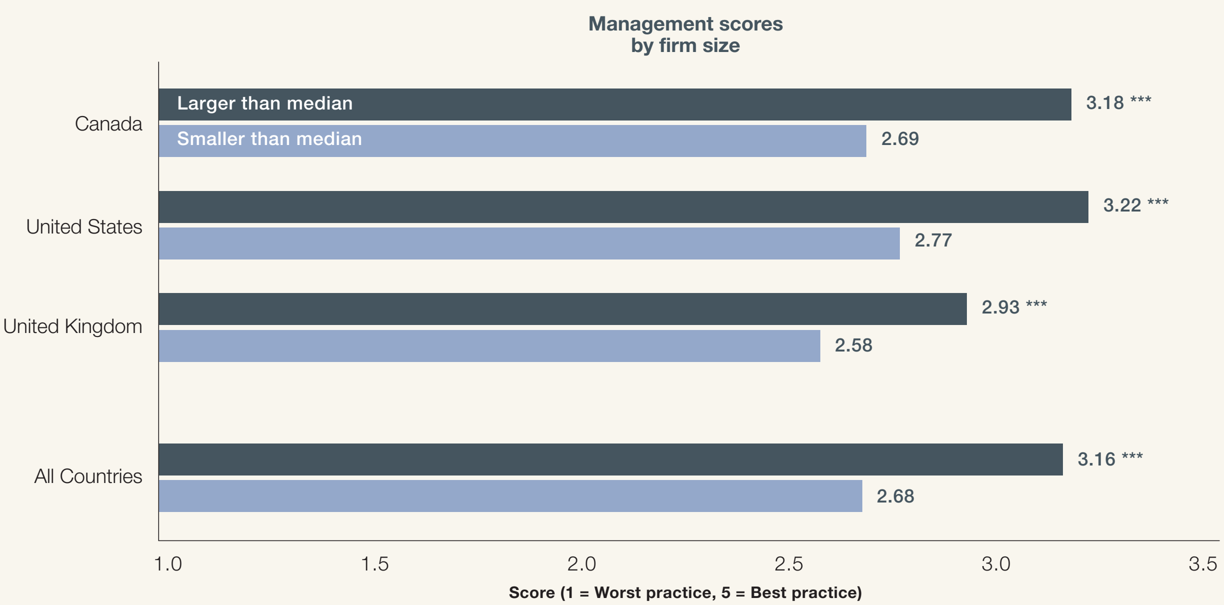
Furthermore, given the geographic distribution of Canada's population, a higher percentage of Canadians are closer to US retailers than vice versa. US retailers also had the advantage of Canadian customer exposure to their brands, after the 1991 introduction of the GST provided a stimulus to cross-border shopping.[40]

Historically, US retailers have had advantages over Canadian retailers because of their large market, population trends, and Canadian familiarity with their stores and products. If Canadian retailers are to succeed in achieving global leadership, they must be more creative and strategic to compensate for these disadvantages. Strong management both at retail stores, which understand local customers, and at headquarters, where management sees the big picture, is crucial.

Size matters

When we restrict the sample to firms with 100-5,000 employees, the UK score remains practically the same, while the Canadian and US scores drop significantly (see *Exhibit 5*). This again supports the idea that the Canadian and US advantage is largely due to large-scale chain stores. To illustrate, across Canada and the US, retail firms with 10 retail outlets or fewer have an average score of 2.54 and on average 390 employees. The score rises substantially to an average of 3.09 for firms with 100 outlets or more, and they employ an average of approximately 340,000 employees throughout their entire chain.

Exhibit 15 **Larger firms tend to be better managed**



Note: *** denotes statistically different from smaller than median at the 1% level; ** at the 5% level; * at the 10% level.
Source: Management Matters dataset. Institute for Competitiveness & Prosperity analysis.

37 S. Rineheart, D. Zizzo "The Canadian and US retailing sectors: important changes over the past 60 years," *Journal of Retailing and Consumer Services*, 2:1, 1995, p. 44
38 D. Burns, "Retailing in Canada and the US: historical comparisons," *The Service Industry Journal*, 15:4, 1995
39 *Ibid*.
40 Al Chatterjee, "Cross-border shopping: Searching for a solution," *Canadian Business Review*, 1991, 18:4

When we look at the scores above and below the median sized firms across the full sample,[41] it becomes very clear that there is both a statistically significant and also very sizeable difference in scores (*Exhibit 15*).

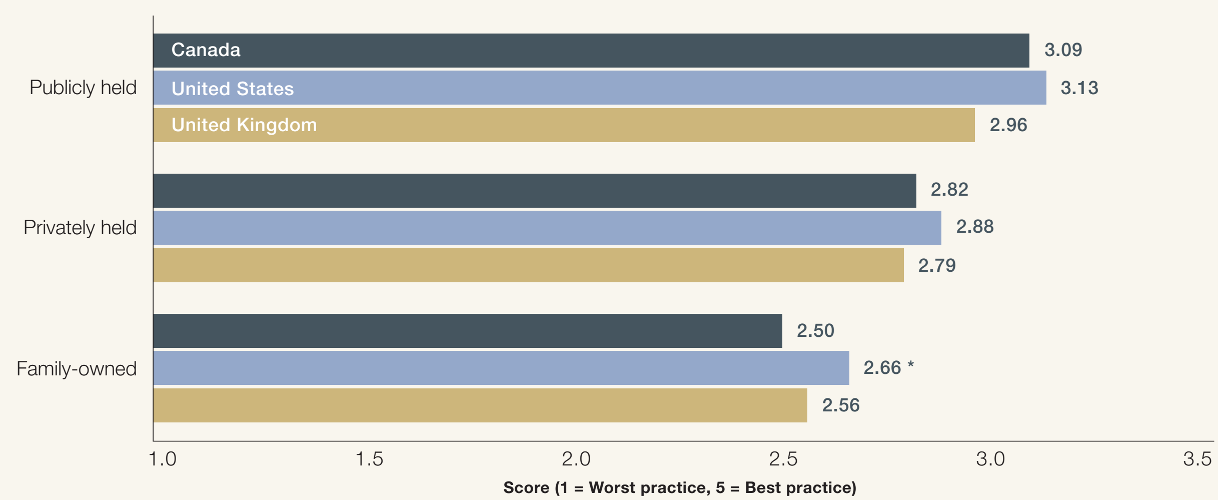
Ownership matters

As we found in the manufacturing sector, publicly held retail firms achieved significantly better scores than privately or family-owned firms[42] (*Exhibit 16*). US family firms are significantly better managed than both Canadian and UK family firms.

Our research into retail management in Canada indicates that, at the store level, our managers are among the best. Our management teams have room for improvement in implementing specific operations techniques in the area of Lean Retailing. They are solid performers in effecting good performance management. And they are statistically no different than the leader in people management, the United States. Our results also indicate that education, global leadership, size and ownership are among the variables that drive – or at least are correlated with – better management in the retail sector. This research provides a solid foundation for determining improvement opportunities and areas of further research in the management of our retail firms and our nation's productivity and prosperity.

Exhibit 16 **Publicly held firms are significantly better managed than privately held or family-owned firms everywhere**

Management scores, retail ownership
Canada, United States, United Kingdom



Note: Excludes private equity (too few observations).
*** denotes statistically different from Canada at the 1% level; ** at the 5% level; * at the 10% level.
Source: Management Matters dataset. Institute for Competitiveness & Prosperity analysis.

41 The median firm size across the full sample is 20,000 employees; in the US it is 100,000 employees, while the Canadian number stands at 25,000, and the UK at only 1,320.

42 The "Private" label does not include private equity firms as there were none in the US and UK sample. However, it is worth noting that retailers owned by Canadian private equity firms seemed to be as well managed as (and sometimes better than) Canadian publicly held firms.

Couche-Tard

Achieving global leadership through effective management of people, logistics, and financial resources

ALIMENTATION COUCHE-TARD INC. is the only retailer on the Institute's list of Canadian global leaders[a] – one of the five largest in its market segment in North America.

From humble beginnings in 1980 as a small convenience store in Laval, Québec, Couche-Tard has risen to become the largest independent convenience store retailer in Canada and the second largest in North America. It has a total of over 5,900 stores in its network and earns annual revenues of $15.8 billion.

Behind the counters of its large, bright, and modern convenience stores is a synchronized series of effective management structures and strategies that have placed Couche-Tard ahead of the pack in its industry. Through strong capital and managerial support, Couche-Tard gives its stores a significant competitive advantage, especially against its smaller competitors.

From its early days of growth, it had important strengths in managing a decentralized environment, streamlining decision-making processes and providing instructors to teach their employees customer service relations, management, and merchandising as well as offering courses in leadership, motivation, and communication in collaboration with the local community college.[b]

Couche-Tard built from this strength to acquire Silcorp and its Mac's stores in 1997. It began its US expansion in 2001, with the acquisition of the Bigfoot retail chain from Johnson Oil in the US Midwest. Its most significant US acquisition was of Circle K and its 1,663 outlets in 2003. One analyst describes Couche-Tard's acquisition strategy as well disciplined and well executed. Couche-Tard has built a solid base to finance its acquisitions through conservative financing approaches. It has chosen to own and manage its stores directly rather than through franchising. And it invests on an ongoing basis to modernize its stores.[c]

Couche-Tard's success in transforming the mom and pop industry from higher priced necessity item stores to convenience groceries is also a result of its adoption of Lean Retailing techniques in its distribution and key operations. In 2000, the company established a single distribution centre to respond to increased shipping volume and to replace its reliance on various wholesalers and direct store delivery methods. This enabled the company to gain greater control of its supply chain, standardize product and delivery quality, and take advantage of greater economies of scale, benefitting from lower prices from bulk buying, shipment costs, and hedging opportunities.[d] Couche-Tard has also made further efforts in simplifying its work design, through the installation of an information-management system, linking cash registers, distributors, and manufacturers with its head office – creating a "pull" to drive replenishment, and eliminating wasted effort, problems, and wait times.

Couche-Tard has also engaged in a new and highly innovative project involving sophisticated robotics technology to pick products by the unit, enabling the company to fine tune their current just-in-time process for those products with a shorter shelf life, namely fresh goods and bakery items.[e] This logistics capability supports the successful IMPACT (Innovation-Marketing-People-Alimentation-Couche-Tard) program, in which stores can strategically adapt products to match the "socio-economic and cultural uniqueness" of local communities.[f]

Couche-Tard takes pride in ensuring that their management strategy enables them to be flexible and adaptable in an ever-changing external environment. This is a skill they will need to sustain to remain the success story they are today.

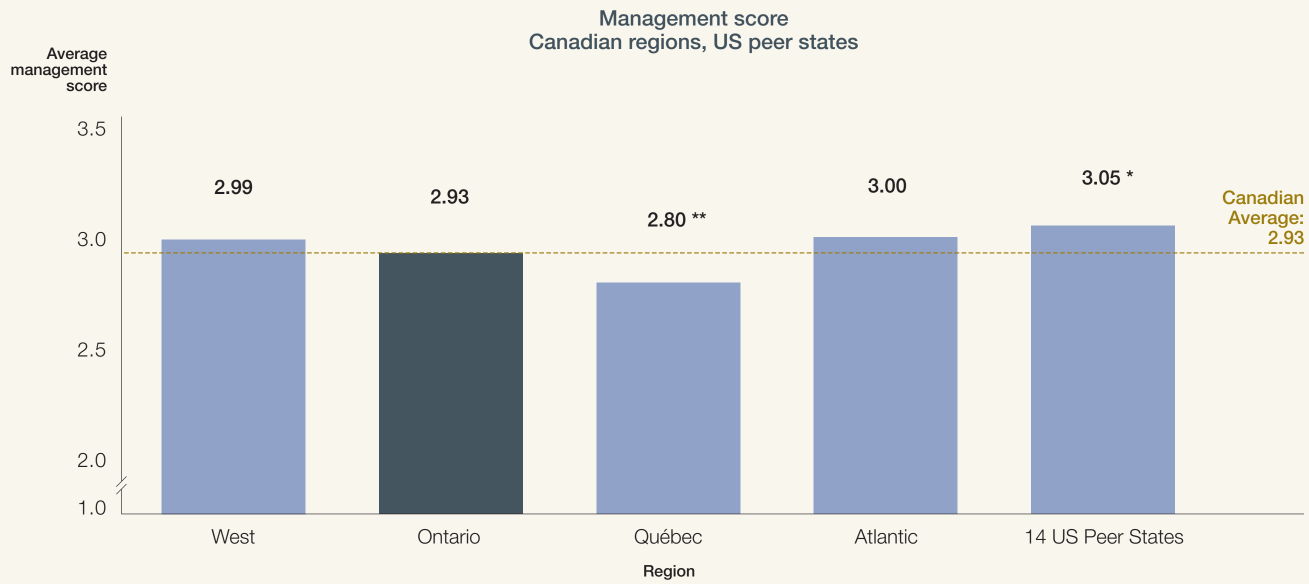
[a] Task Force on Competitiveness, Productivity and Economic Progress, *Navigating through the recovery*, Eighth Annual Report, November 2009, pp. 64–65
[b] L. Millan, "King of the corner store," *Canadian Business*, Vol. 70, Issue 12, 1997, p. 101
[c] Martin Landry, "Alimentation Couche-Tard Inc.," *Research*, Desjardins Securities, October 9, 2008
[d] J. Shanahan, "Making distribution more convenient," *Logistics Management*, 2004, Vol. 43, No. 2, p. 57
[e] C. Girard, "Couche-Tard: Acquisition, Development and Integration: Logistics and Retail" *Logistics Magazine*, 2005 Vol. 8, No. 1, p. 20
[f] Couche-Tard's Commercial Strategy, IMPACT program, available online: http://www.couchetard.com/commercial-strategy.html

Ontario trails US peers and matches most other Canadian regions

ON AVERAGE, ONTARIO RETAILERS rank below their Canadian counterparts, though not statistically significantly, and significantly higher than Québec retailers. And they trail their US peer state counterparts significantly (*Exhibit 17*).

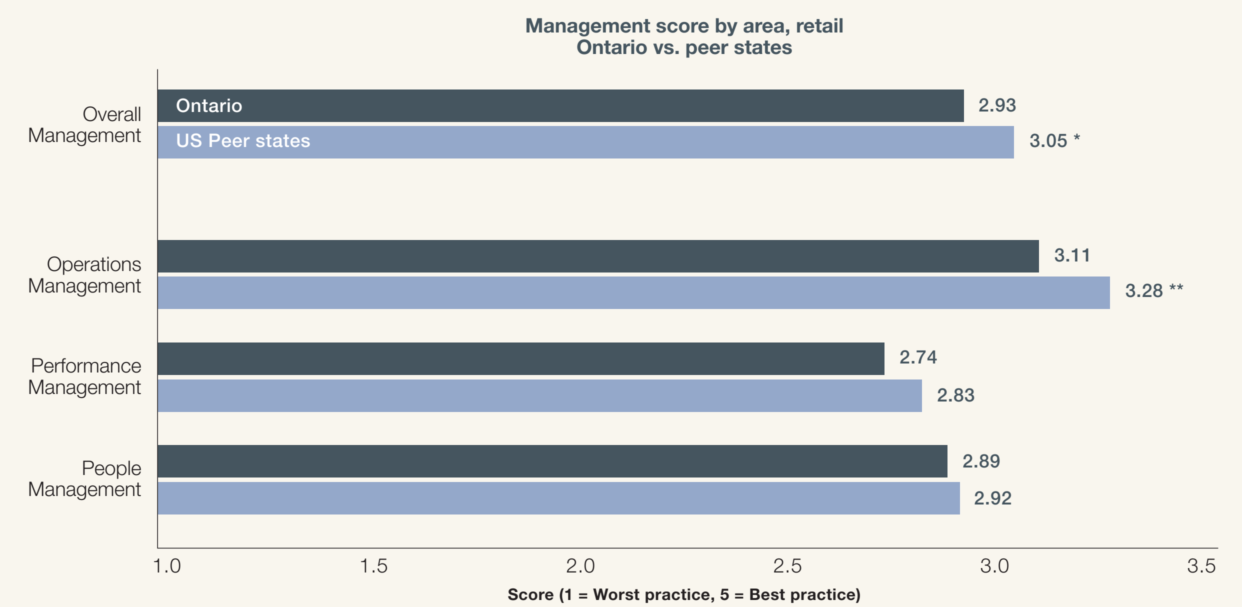
Across the three elements of good management, Ontario does best in operations management approaches, though it fares significantly worse than the US peer states. Ontario scores less well in performance and people management, but is not statistically different from US peers (*Exhibit 18*).

Exhibit 17 Ontario retailers trail US peer states, and match Western and Atlantic Canada



Note: *** denotes statistically different from Ontario at the 1% level; ** at the 5% level; * at the 10% level. The US peers' score is higher than the overall US score of 2.99.
Source: Management Matters dataset. Institute for Competitiveness & Prosperity analysis.

Exhibit 18 Ontario under performs counterparts in US peer states, particularly in operations management



Note: *** denotes statistically different from Ontario at the 1% level; ** at the 5% level; * at the 10% level.
Source: Management Matters dataset. Institute for Competitiveness & Prosperity analysis.

In operations management, Ontario scored statistically worse than the peers in five out of eight areas, and no different in three (*Exhibit 19*). There is clearly room for improvement here.

Similar to the Canadian result, while Ontario managers are not statistically worse than the peer state group, they significantly trail the best performer in one area of performance management: ensuring clarity of goals (*Exhibit 20*).

Exhibit 19 **In operations management, Ontario retailers lag peer state counterparts**

Operations management Ontario's relative performance	Worse than peer group average	No different than peer group average	Better than peer group average
OVERALL SCORE	✓		
Adoption of Lean Retailing: Store Operations ***Best practice:*** Business processes have been transformed to meet the needs of the business. The store processes would be considered best practice for the industry ***Worst practice:*** Few Lean retail operations have been introduced (or have been introduced in an *ad hoc* manner)	✓		
Adoption of Lean Retailing: Store Scheduling ***Best practice:*** Business processes have been transformed to meet the needs of the business. The store processes would be considered best practice for the industry ***Worst practice:*** Few Lean retail operations have been introduced (or have been introduced in an *ad hoc* manner)	✓		
Rationale for the adoption ***Best practice:*** Lean was introduced to meet business objectives ***Worst practice:*** Lean was introduced to catch up to competitors		✓	
Process problem documentation ***Best practice:*** Exposing problems is integral to individuals' responsibilities rather than *ad hoc* solutions ***Worst practice:*** No process improvements are made when problems occur	✓		
Operations Performance tracking ***Best practice:*** Performance is continuously tracked and communicated to all staff using a range of visual tools ***Worst practice:*** Tracking is *ad hoc*, and measures being tracked do not indicate directly if overall business objectives are being met		✓	
Operations Performance review ***Best practice:*** Performance is continuously reviewed, based on indicators tracked; follow-up ensures continuous improvement ***Worst practice:*** Performance is reviewed infrequently and only success or failure is noted	✓		
Operations Performance dialogue ***Best practice:*** Regular performance conversations focus on addressing root causes. Purpose, agenda, and follow-up steps are clear to all ***Worst practice:*** Relevant data are often not present at meetings or discussion is based on data that is not meaningful. Agenda and purpose are not clear		✓	
Consequence management ***Best practice:*** Failure to achieve agreed targets drives retraining or moving individuals around ***Worst practice:*** Failure to achieve agreed targets does not carry any consequences	✓		

Source: Management Matters dataset. For further survey work, see Nick Bloom and John Van Reenen, "Measuring and Explaining Management Practices Across Firms and Countries," *Quarterly Journal of Economics*, November 2007; Institute for Competitiveness & Prosperity analysis.

In the area of people management, we scored statistically worse in three out of five areas, while we were not statistically different in one. Similar to the Canadian result, this is the only place where we achieved a score statistically better than the peer group – in retaining our top performers (*Exhibit 21*).

Our research indicates that retail managers in Ontario and Canada are among the best. Nevertheless, there is room for improvement. A key part of the solution to our under performance in prosperity is in talent management. Efforts to improve management skills will pay dividends in innovation and productivity and ultimately our prosperity.

Exhibit 20 **In most areas of performance management, Ontario retailers are not statistically different from counterparts in peer states**

Performance management Ontario's relative performance	Worse than peer group average	No different than peer group average	Better than peer group average
OVERALL SCORE		✓	
Types of goals ***Best practice:*** Goals are a balance of financial and non-financial goals ***Worst practice:*** Goals are exclusively financial or operational		✓	
Interconnection of goals ***Best practice:*** Corporate goals increase in specificity as they cascade through the business units ***Worst practice:*** Individual workers are not aware of how their contribution is linked to corporate goals		✓	
Time horizon ***Best practice:*** Short-term goals are set so that they become a staircase to reach the long-term goals ***Worst practice:*** Top management's main focus is on short term goals		✓	
Setting stretch goals ***Best practice:*** Goals are demanding for all divisions, and are grounded in solid economic rationale ***Worst practice:*** Goals are either too easy or impossible to achieve		✓	
Clarity of goals ***Best practice:*** Performance measures are well defined and well communicated; worker performance is made public to induce competition ***Worst practice:*** Performance measures are complex and not clearly understood; worker performance is not made public	✓		
Instilling a talent mindset ***Best practice:*** Senior managers are evaluated and held accountable on the strength of the talent pool they actively build ***Worst practice:*** Senior management do not communicate that attracting, retaining, and developing talent is a top priority		✓	

Source: Management Matters dataset. For further survey work, see Nick Bloom and John Van Reenen, "Measuring and Explaining Management Practices Across Firms and Countries," *Quarterly Journal of Economics*, November 2007; Institute for Competitiveness & Prosperity analysis.

Exhibit 21 **In people management, Ontario retailers lead in retaining high performers**

People management Ontario's relative performance	Worse than peer group average	No different than peer group average	Better than peer group average
OVERALL SCORE		✓	
Rewarding top performers ***Best practice:*** The firm provides ambitious stretch targets with clear performance related accountability and rewards ***Worst practice:*** People within the firm are rewarded equally irrespective of performance level		✓	
Addressing poor performance ***Best practice:*** Poor performers are moved to less critical roles or out of the company as soon as weaknesses are identified ***Worst practice:*** Poor performers are rarely removed from their positions	✓		
Promoting high performers ***Best practice:*** Top performers are actively identified, developed, and promoted ***Worst practice:*** People are promoted primarily upon the basis of tenure	✓		
Attracting high performers ***Best practice:*** The firm provides a unique value proposition to encourage talented people to join the company instead of the competitors ***Worst practice:*** Competitors offer stronger reasons for talented people to join their companies	✓		
Retaining high performers ***Best practice:*** Managers do whatever it takes to retain top talent ***Worst practice:*** Managers do little to try and keep the top talent			✓

Source: Management Matters dataset. For further survey work, see Nick Bloom and John Van Reenen, "Measuring and Explaining Management Practices Across Firms and Countries," *Quarterly Journal of Economics*, November 2007; Institute for Competitiveness & Prosperity analysis.

Opportunities to strengthen management

IN WORKING PAPER 12, we detailed management's role in the manufacturing sector. In this Working Paper, we have expanded our work to show management matters in the retail sector as well.

Strong management is critical to achieving excellence in innovation and productivity, since it drives the demand for innovation, leads to high quality supply of innovation, and ensures effective financing of innovation. Canada has invested significantly in establishing some of the building blocks for innovation. But, while these efforts are necessary, they are not sufficient. We need to enhance federal innovation policy with an adequate focus on strengthening our management capabilities. Government policy, provincially and federally, can enhance the quality of our management capabilities.

Broaden innovation policy to include management skills

As we have seen in our past research, our public innovation policy emphasizes the hard sciences and does not recognize the importance of innovation in business and management processes. Our competitiveness and prosperity are built on a solid base of excellence in the sciences. And leading high technology firms are founded by science and engineering graduates. But successful innovation requires a balance of science and other skills. These other skills are important to achieve a successful transition from start-up to thriving businesses.

In Ontario, we have seen innovation policy move in this direction. The *Ontario Innovation Agenda* released in April 2008 explicitly acknowledges that innovation is most effective when the process is customer or market driven.[43] As well, it sees innovation as neither demand-pull nor supply-push, instead recognizing that it is an interactive and iterative process.

This is a welcome development in the provincial government's approach to innovation. But the initiative needs to go further in elevating the importance of management skills on their own account. Currently, the government sees commerce skill as something that needs to be developed and taught across sectors and disciplines. Rather, innovation policy should promote the importance of management skills in their own right – then capable managers will effectively collaborate with capable scientists and engineers.

Overall, the Ontario government needs to recognize the distinction between true innovation and science-based invention. Both are important for productivity and prosperity – but in balance. We look forward to the ongoing development of Ontario's innovation policy.

At the federal level, we see an orientation toward the hard sciences in the granting councils related to innovation. Research grants for business school academics represent an insignificant portion of funding overall and within the Social Sciences and Humanities Research Council (SSHRC). Scholarships bypass students in graduate business education programs almost entirely because the professions are not included within the mandate of the granting councils.

In the 2010 federal budget, Ottawa highlighted its innovation initiative, where it continued its misdirected focus on invention through the hard sciences and humanities. As one example, the budget increased funding for the research granting councils by $32 billion. Of this increase, $29 billion was directed to the Natural Science and Engineering Research Council (NSERC) and the Canadian Institute for Health Research (CIHR). Only $3 billion was directed to social sciences and humanities through SSHRC.[44]

Until our federal and provincial governments recognize the need for a balance between hard sciences and the humanities and between science and engineering and management skills, their efforts will lead to more inventions, but with inadequate innovations in the market by Canadian businesses.

---

43 Ontario Ministry of Research & Innovation, *Ontario Innovation Agenda*, 2008, available online: www.ontario.ca/innovation

44 Finance Canada, *Budget 2010: Leading the way on jobs and growth*.

Both the federal and provincial governments need to strengthen their commitment to business education. We have a significant gap versus our US counterparts in business degree holders – and this gap is the result of fewer spaces in our schools, not the lack of demand by students. More alarming is the lower educational attainment of those in management occupations, irrespective of field of study. Just over a third of our managers have a university degree, compared to half in the United States. If we believe that education is important to the development of human capital and prosperity, this situation seems competitively dangerous.

Embrace international competition in our economic policy

Our research provides more evidence on the beneficial impact of international competition. Multinational firms are better managed and, as we have seen in our previous research, they invest more in R&D and pay higher wages. In retail, as well as manufacturing, firms with operations in more than one country were on average better managed. They were also much larger, with significantly higher employment numbers. Unfortunately, the case we found in manufacturing – where we found that several of Canada's global leaders are exceptionally well managed – did not repeat itself in retail. We have a substantially smaller domestic market than the United States or the European Union, which presents a challenge for small- and medium-sized companies to expand. Government policy must focus on these firms and lend support to those trying to expand and overcome the disadvantage of our geography and demographics.

Our research points out that restrictions on foreign investment have hindered the quality of management in our businesses. We need to ensure that these impediments are appropriately recognized in our public policy in the retail industry.

Ensure businesses aspire to excellence in management

Businesses have the key role to play in inspiring managers to excel.

Strong management is critical to greater innovation success and higher productivity. Our research and studies by our international colleagues indicate that productivity performance at the manufacturing firm and industry levels is affected by strong management. We have further strengthened this conclusion with evidence in the retail sector. It is not a stretch to draw a similar conclusion for other sectors of the economy. Our business leaders have to strive for better educated and trained managers and increase pressure and support for the adoption of the most advanced and sophisticated management techniques.

Global leadership is driven by great management, and great management is achieved by global leaders. As we have concluded in past reports, the best weapon against hollowing out is for more of our businesses to strive for global leadership. Excellence in management is inextricably linked to global leadership – so, as we urge our business leaders to aspire to global leadership, we are, by necessity, urging them to strengthen their management capabilities.

Our study of retail management gives important insights into the end game for global competition. We saw a picture of two solitudes of Canadian retailing. We saw Canadian-owned, domestically focused retailers, with dramatically inferior management teams to international firms competing in Canada. But we also saw international firms in Canada managed as well as their counterparts in the United States. Retailing has gone much further toward a global end game where the vast majority of well managed firms are multinationals. But this will happen in industry after industry across Canada. Where we have previously had three kinds of firms – Canadian-owned domestic firms, Canadian-owned multinationals, and foreign-owned multinationals – we are migrating to a world where we will only have the two types of multinationals. Firms operating only in their domestic market, Canadian or otherwise, will slowly but surely disappear and the disappearance will be because global firms are better managed.

If we desire a healthy number of Ontario- and Canadian-owned multinationals, we need our businesses and public policy to operate knowing that management matters. Otherwise, we will be left with only foreign-owned multinationals operating here.

Better management in our domestic firms represents a significant improvement opportunity. Our research indicates that the largest gap in our management performance is between the US-owned multinationals operating in Canada and our domestically owned and operated firms. Firms that have succeeded in expanding outside of their local market do so with strong management and superior business models. The research indicates that small retailers are not as well managed as large retailers. We need to ensure that our small business policies are aimed at encouraging growth, and not simply owner lifestyle.

We have a solid base of well managed retailers in Ontario and Canada – in fact, our retail managers are among the best. Yet we can do better. By improving our public policy environment and by encouraging our business leaders to strive for stronger management, we can encourage more innovation to create globally competitive businesses – and realize our full prosperity potential.

References

Alexopoulos, M. and T. Tombe, "Management Matters," forthcoming working paper, University of Toronto

Bloom, N. and J. Van Reenen, "Why do Management Practices Differ across Firms and Countries?" *Journal of Economic Perspectives*, Vol. 24, No. 1, pp. 203–244

– (2007) "Measuring and Explaining Management Practices Across Firms and Countries," NBER Working Paper No. 12216

– and S. Dorgan, J. Dowdy (2007) "Management Practice & Productivity: Why they matter," available online: http://www.stanford.edu/~nbloom/ManagementReport.pdf

Burns, D. (1995) "Retailing in Canada and the US: historical comparisons," *The Service Industry Journal*, 15:4, 1995

Chatterjee, A. (1991) "Cross-border shopping: Searching for a solution", *Canadian Business Review*, 18:4, 1991

Corbett, S. (2007) "Beyond Manufacturing: The evolution of Lean production," *McKinsey Quarterly,* available online: http://www.mckinseyquarterly.com/Beyond_manufacturing_The_evolution_of_lean_production_2033

Deloitte & Touche (2008) Global Powers of Retailing, available online: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/dtt_globalpowersretailing.pdf.

Finance Canada (2010) *Budget 2010: Leading the way on jobs and growth*

Dun & Bradstreet database (2009), available online: http://www.dnb.ca/

Girard, C. (2005) "Couche-Tard: Acquisition, Development and Integration: Logistics and Retail" *Logistics Magazine*, Vol. 8, No. 1, 2005

Landry, M., "Alimentation Couche-Tard Inc.," *Research*, Desjardins Securities, October 9, 2008

Martin, R. and J. Milway (2007), *Strengthening management for prosperity*, Institute for Competitiveness & Prosperity, available online: http://www.competeprosper.ca/images/uploads/ManagementPaper_May07.pdf

Millan, L. (1997) "King of the corner store," *Canadian Business*, Vol. 70, Issue 12

Ontario Ministry of Research & Innovation, *Ontario Innovation Agenda*, April 2008, available online: www.ontario.ca/innovation

Rineheart, S. and D. Zizzo (1995) "The Canadian and US retailing sectors: important changes over the past 60 years," *Journal of Retailing and Consumer Services*, 2:1

Shanahan, J. (2004) "Making distribution more convenient," *Logistics Management*, Vol. 43, No. 2

Stalk, G., P. Evans, and L. Shulman (1992) "Competing on capabilities: The new rules of corporate strategy," *Harvard Business Review*, available online: http://my.execpc.com/~jpurtell/HBR-CompetingonCapabilities.pdf

Statistics Canada (2009) Labour Force Survey, available online: http://www.statcan.gc.ca/

The Strategic Counsel (2004) "Assessing the Experience of Successful Innovative Firms in Ontario," available online: http://www.competeprosper.ca/images/uploads/InnovationInterviewStudyRep.pdf

United States, Department of Labor (2008) Bureau of Labor Statistics, Current Population Survey, available online: http://www.bls.gov/

Voisin, J-B. (2004) "The 'Industrial revolution' of European retailers in underway," *McKinsey Quarterly*, available online: http://www.mckinsey.com/practices/retail/knowledge/index_full.asp?startval=20&sort=title

Washington Post, January 15, 2009, "Surgery checklist lowers death rate," available online: http://www.washingtonpost.com/wp-dyn/content/article/2009/01/14/AR2009011402831.html

Previous publications

Institute for Competitiveness & Prosperity

Working Papers

Working Paper 1 – *A View of Ontario: Ontario's Clusters of Innovation*, April 2002
Working Paper 2 – *Measuring Ontario's Prosperity: Developing an Economic Indicator System*, August 2002
Working Paper 3 – *Missing opportunities: Ontario's urban prosperity gap*, June 2003
Working Paper 4 – *Striking similarities: Attitudes and Ontario's prosperity gap*, September 2003
Working Paper 5 – *Strengthening Structures: Upgrading specialized support and competitive pressure*, July 2004
Working Paper 6 – *Reinventing innovation and commercialization policy in Ontario*, October 2004
Working Paper 7 – *Taxing smarter for prosperity*, March 2005
Working Paper 8 – *Fixing fiscal federalism*, October 2005
Working Paper 9 – *Time on the job: Intensity and Ontario's prosperity gap*, September 2006
Working Paper 10 – *Prosperity, inequality, and poverty*, September 2007
Working Paper 11 – *Flourishing in the global competitiveness game*, September 2008
Working Paper 12 – *Management matters*, March 2009

Reports on Canada

Partnering for investment in Canada's prosperity, January 2004
Realizing Canada's prosperity potential, January 2005
Rebalancing priorities for Canada's prosperity, January 2006
Agenda for Canada's Prosperity, March 2007
Setting our sights on Canada's 2020 prosperity agenda, April 2008
Opportunity in the turmoil, April 2009

Task Force on Competitiveness, Productivity and Economic Progress

First Annual Report – *Closing the prosperity gap*, November 2002
Second Annual Report – *Investing for prosperity*, November 2003
Third Annual Report – *Realizing our prosperity potential*, November 2004
Fourth Annual Report – *Rebalancing priorities for prosperity*, November 2005
Fifth Annual Report – *Agenda for our prosperity*, November 2006
Sixth Annual Report – *Path to the 2020 prosperity agenda*, November 2007
Seventh Annual Report – *Leaning into the wind*, November 2008
Eighth Annual Report – *Navigating through the recovery*, November 2009

Should you wish to obtain a copy of one of the previous publications, please visit **www.competeprosper.ca** for an electronic version or contact the Institute for Competitiveness & Prosperity directly for a hard copy (see inside back cover for details).

Institute for
Competitiveness & Prosperity

How to contact us

To learn more about the Institute and the Task Force please visit us at: www.competeprosper.ca

Should you have any questions or comments, you may reach us through the web site or at the following address:

The Institute for Competitiveness & Prosperity
180 Bloor Street West, Suite 1000
Toronto, Ontario M5S 2V6
Telephone 416.920.1921
Fax 416.920.1922

Executive Director

James Milway
416 920 1921 x222
j.milway@competeprosper.ca

Researchers

Tamer Azer
416 920 1921 x228
t.azer@competeprosper.ca

Katherine Chan
416 920 1921 x231
k.chan@competeprosper.ca

Anam Kidwai
416 920 1921 x238
a.kidwai@competeprosper.ca

Lloyd Martin
416 920 1921 x223
l.martin@competeprosper.ca

Aaron Meyer
416 920 1921 x224
a.meyer@competeprosper.ca

Adrienne Ross
416 920 1921 x230
a.ross@competeprosper.ca

Ying (Sunny) Sun
416 920 1921 x227
s.sun@competeprosper.ca

Project Team

Daniela Scur Project Manager
Jack Bolland Supervisor
Sean Brandreth Supervisor
Blaise Bolland
Joshua Booth
Vadim Dorfman
Raswinder Gill
Alison McMeekin
Nikolina Miljevik
Alam Aguilar-Platas
Scott Sameroff

Design **Hambly & Woolley Inc.** www.hamblywoolley.com
Illustration **Blair Kelly**

Institute for
Competitiveness & Prosperity

978-0-9809783-6-0