Driving profitable growth: A study of essential management practices

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Abstract

Purpose – The purpose of this paper is to examine how different management practices drive profitable growth and business success in Danish companies.

Methodology/approach – Both qualitative and quantitative research are conducted to study the relationships between eight general mangemement practices and key performance results. A survey among large companies in Denmark and the companies' key performance results forms the empirical basis for the study. Two central key performance results are 'increase in turnover' and 'return on invested capital'. It can be argued that sustained increase in turnover and high return on invested capital at the same time indicate profitable growth and return to shareholders in the long run.

Findings – The findings provide evidence that the eight management practices are linked to key performance results. The high-performing companies differentiate significantly from the low-performing companies with regard to how well they do the management practices**.** All eight mangement practices are essential in producing profitable growth.

Research limitations – This study is limited to the eight identified management practices in large Danish companies.

Practical implications – This study has clear implications in terms of identifying and measuring the importance of essential management practices which influence profitable growth and thereby separating the facts from the fads.

Originality/value – The study identifies and measures eight essential management practices and links these to actual key performance results.

Key words: Profitability, Growth, Key performance results, Management practice, Denmark

Paper type: Research paper

Introduction

Sustainable and profitable growth is central for most companies. In the 1990s the focus of international business was on growth to a large extent without even considering profitability. After 2001 and econimic doldrums the pendulum went towards earnings, primarily through streamlining and rationalization. In recent years focus has been on profitable growth through a balanced otimization of the business instead of unilateral focus on growth or streamlining. This assesment is supported by a study on market related opportinities, challenges and efforts among the 500 largest Danish companies (Jørgensen & Grønholdt, 2005; Grønholdt & Martensen, 2005). This study is conducted in 2004 by the Danish management consulting company Stig Jørgensen & Partners (www.sjp.dk) and Copenhagen Business School (www.cbs.dk). Back then 65% of the interviewed top managers stated that their primary focus was on balanced optimization of the business, only 16% stated to have a one-sided focus on rationalization/streamlining, and 19% had a unilateral focus on organic growth.

The challenge for most companies is therefore to achieve sustainable and profitable growth. New management ideas, principles and tools – some are only buzz-words - heat up and fizzle out. Which ones are critical for companies when it comes to outperforming the competitors? While academics and executives debate the mix of management tools and techniques that companies must implement to achieve high performance, there is a growing urgency to identify the common practices that separate the leaders from the laggards. The purpose of this paper is to examine how different management practices drive profitable growth and business success in Danish companies.

This research is initiated and conducted as a joint research project with Stig Jørgensen & Partners and Copenhagen Business School.

Research framework

On the basis of an extensive study of literature we have chosen to lean our analysis approach onto the Evergreen Project reported under the powerful headline: *What really works* (Joyce, Nohria and Roberson, 2003a, 2003b; Nohria, Joyce and Roberson, 2003). The purpose of the study was to find the management practices that truly can help a company to be great – to achieve evergreen business success. This five-year study involved leading academics at business school faculties of 10 universities and leading consultants in a systematic analysis of the practices that create business winners. In the study, more than 200 well-established management practices that were expected to affect business success - ranging from broad areas (e.g. strategy and innovation) to specific practices (e.g. 360-degree performance reviews and supply chain management) - were identified. The Evergreen team analyzed 160 companies over a 10 year period (from 1986 to 1996). First, it was examined how each of the more than 200 management practices were employed in each company (scored on a 5-point scale from ‘poor relative to peers’ to ‘excellent relative to peers’). Then documents were collected and analyzed (e.g. financial statements, newspaper and magazine articles, governments filings and analysts’ reports) concerning these companies in order to estimete their total return to shareholders. Taken together, these two sets of analyses give the oppourtunity of a cause-effect analysis in search of the management practices that directly correlate with superior performance.

Joyce, Nohria and Roberson (2003a) (Nohria, Joyce and Roberson, 2003) identify eight general management practices correlating strongly with sustained business success. These essential management practices, in the authors' own words, are:

- **Strategy**: Devise and maintain a clearly stated, focused strategy
- **Execution**: Develop and maintain flawless opeational execution
- **Culture**: Develop and maintain a performance-oriented culture
- **Structure**: Build and maintain a fast, flexible, flat organization
- **Talent**: Hold on to talented employees and find more
- **Innovation**: Make industry-transforming innovations
- **Leadership**: Find leaders who are committed to the business and its people
- **Mergers and partnerships**: Seek growth through mergers and partnerships

The study find, that the first four practices are the "primary management practices" representing the fundamentals of business, and the last four are "secondary management practices". Sustained success is associated with high scores (e.g. excellence) in all four of the primary management practices and in any two of the four secondary mangement practices. From this examination emerged the 4 + 2 formula that is the heart of the publications from the Evergreen project: 4 + 2 equals business success. Joyce, Nohria and Roberson (2003a, p. 23) state that the 4 + 2 formula is a set of approaches that "tell managers precisely where to focus their efforts and where not to". The study reveals that "a company that consistently follows this formula has better than a 90% chance of sustaining superior business performance" (Nohria, Joyce and Roberson, 2003, p. 44). As a supplement to the results of their extensive study Joyce, Nohria and Roberson (2003a) have develped a list of behaviors that supports excellence in each practice, discuss examples of winning companies and losing companies, and present a set of core readings for each of the eight management practices.

In a review of the book *What Really Works* (Joyce, Nohria and Roberson, 2003) Miller writes (2004, p. 83): "It is the most comphrehensive and exiting single piece of empirical research on the subject, I have ever encountered. The authors provide compelling evidence and reasoning to support the assertion that a management's actions did indeed act as key causal factors in the corporate results eventuated…"

Research methodolgy

The Evergreen research has inspired us to study the relationships between these eight essential management practices and key performance results for Danish companies. For reasons of triangulation, both qualitative methods and quantitative methos are used for the collection of data. Initially, explorative and qualitative research is conducted in the autumn of 2006 through depth interviews with 34 top managers from the 150 largest Danish companies. The purpose is to check the face validty of the eight management practices in a Danish context, to validate the research framework, and to develop a questionnaire for the following survey. The overall conclusion is that the eight essential management practices make sense and is assested as drivers for profitable growth by large Danish companies – ofcourse with a variation in degree of importance. Most important is the classic desciplines as strategy (including strategy development and implementing), leadership and execution. Clarification on results from the qualitative research are reported and discussed by Jørgensen et. al (2007).

A questionnaire is designed consisting of 53 survey questions capturing the eight essential management practices. The questions are based on Joyce, Nohria and Roberson's (2003a) operationalization of the eight management practices, other literature studies, practical experiences together with results from the qualitative research. The questions are formulated as statements to which the respondent was asked to evaluate: "how well do the following statements fit your company for the past five years?" on a 7-point scale (from 'not at all' to 'extremely well').

With regard to investigating what really drives return on invested capital and increase in turnover, a survey was conducted during January 2007. The data included 190 interviews with top managers from top 1000 companies in Denmark, and the respondents expressed their perception of the extent to which the eight management practices has been deployed in their company.

The answers were linked to the companies' key performance results in the years 2001-2005 based on data from financial statements. We use the companies' actual performance results and the annual average over the five-year period. The sample was reduced to a total of 144 companies, as financial data were incomplete or not available from 46 companies.

Two central key performance results are 'increase in turnover' and 'return on invested capital (ROIC)'. It can be argued that sustained increase in turnover and high return on invested capital at the same time indicate profitable growth and return to shareholders in the long run. Figure 1 presents a map combining these two key performance results. We have chosen to measure a company's performance results in relation to the business median, so in fact we distinquish between the top 50% and the bottom 50%. Within an industry, each company may be placed in one of four cells in such a map, and the four cells can be interpreted in useful ways giving the platform to characterize four different types of companies with various strategic challenges.

		Return on invested capital	
		Bottom 50%	*Top 50%*
Increase in turnover	*Top 50%*		**High-performers**
	Bottom 50%	**Low-performers**	

Figure 1. Caracterizing high-performing and low-performing companies

The upper-right cell contains high-performing companies that are among the 50% best of their industry when it comes both to increase in turnover and return on invested capital.

On the other hand, the lower-left cell consists of low-performing companies, characterized by being among the 50% worst in the industry when it comes to both performance results. Those companies face challenges in both increase in turnover and return on invested capital compared to the other companies in the industry.

Companies in the lower-right cell only face challenges within return on invested capital while companies in the upper-left cell face the challenge to create increase in turnover.

The distribution of the 144 sampled companies is as follows: 48 high-performers, 47 low-performers, 23 in the lower-right cell, and 26 in the upper-left cell.

Findings and discussion

Data analyses have been carried out to assess the included management practises and their relationship to financial performance. One analysis approach is to compare high-performming companies' and low-performing companies' scores on the eight management practices. Table 1 shows both high-performers' and low-performers' answers to selected survey questions reflecting areas of the eight management practices.

All differences between high-performers and low-performers are significant (tested by a two-group z test for equality of proportions; all p's < 0.1) and this comparison clearly confirms that the high-performers differentiate significantly from the low-perfomers with regard to how well they work at their management practices. The five greatest differences between high-performers and low-performers are obtained on these survey questions:

- Our company is very capable of doing business regardless of the market conditions (strategy); difference 30%-point, relative difference 107%.
- The corporate culture inspires everyone to do their best (culture); difference 29%-point, relative difference 81%.
- We have a very well established set of company values (culture); difference 27%-point, relative difference 71%.
- Our corporate culture contributes to attracting, keeping, and developing new talents (talent); difference 25%-point, relative difference 109%.
- Top management pay is directly dependent on the economic performance of the company (leadership); difference 25%-point, relative difference 76%.

Two relative differences are extremely great, indicating that the high-performing companies are twice as good as the low-performing companies to

- have capability of doing business regardless of the market conditions (strategy)
- attracting, keeping, and developing new talents (talent)

Table 1. High-performers' and low-performers' scores on selected survey questions

"How well do the following statements fit your company for the past five years?" is evaluated on a	High-	Low-	Dif-	

7-point scale (from ‘not at all’ to ‘extremely well’). The table shows the percentage answering ‘very well’ or ‘extremely well’	performers	performers	ference	z value
Strategy				
There is a strong relation between our vision, mission, and the corporate strategy	71	51	20	1.97 **
We are focused on long term strategies rather than short term solutions	63	45	18	1.74 **
We monitor and adjust the corporate strategy continuously	65	51	14	1.33 *
The strategy implementation process is deeply rooted across functional borders of the organization	31	17	14	1.63 *
Our company is very capable of doing business regardless of the market conditions	58	28	30	3.01 ***
Execution				
We deliver products/services that consistently meet the customers demand	69	53	16	1.56 *
Culture				
The corporate culture inspires everyone to do their best	65	36	29	2.79 ***
We have a strong customer oriented corporate culture	58	45	13	1.33 *
We have a result oriented corporate culture	69	47	22	2.17 **
We have a very well established set of company values	65	38	27	2.57 ***
When errors and mistakes are made we use it for learning and improvement purposes	48	34	14	1.38 *
Structure				
We are organized according to the most important value creating processes for the customers	36	21	15	1.60 *
We are organized according to main customer segments	58	38	20	1.95 **
The organization ensures the necessary resources	46	32	14	1.39 *
Talent				
Our corporate culture contributes to attracting, keeping, and developing new talents	48	23	25	2.49 ***
We have training and educational programmes for employees at all organizational levels	29	13	16	1.96 **
Leadership				
Top management gives room for self management	71	54	17	1.65 **
Top management pay is directly dependent on the economic performance of the company	58	33	25	2.44 **
Innovation				
Our innovation process is very consumer driven	38	20	18	1.93 **
We have an established and formalized innovation process, which is cross functional	21	7	14	2.03 **
The gap between planned and realized innovations have diminished	21	11	10	1.35 *
Mergers and partnerships				
We continuously evaluate the opportunities for entering new strategic partnerships	48	33	15	1.52 *

* Significant at 10% level, one-tailed ($p < 0.1$)
** Significant at 5% level, one-tailed ($p < 0.05$)
*** Significant at 1% level, one-tailed ($p < 0.01$)

An indication of the importance of the eight management practices is obtained by studying the average differences between the survey question answers within each management practice. When doing this the biggest average differences between high-performers and low-performers are gained for strategy, culture, leadership, and talent with average differences 19-

21, e.g. somewhat similar. These management practices discriminate mostly between high-performers and low-performers. So it is the classic areas, which separate the biggest Danish companies in creating profitable growth.

Conclusions

Findings and contribution to the field

The study quantifies and measures eight management practices and links these to actual key performance results. The eight management practices make good sense to Danish top managers. We analyze the relationships between the eight management practices and financial results, and in this way the data presented in the paper provide evidence that the eight management practices are linked to key performance results. The findings reveal that high-performing companies - compared to low-performing companies - work better on all eight management practices, and that all eight mangement practices are essential in producing profitable growth. Successful companies ought to master the management practices.

Limitations and suggestions for further research

This study is limited to the eight identified management practices. It is posssible that an alternative structure of management practices – or other management practices – may provide even more powerful conclusions. In here lies a suggestion for further research.

The study is conducted among large Danish companies. However, we believe that many of the findings are transferable to other companies which could be interesting to examine more closely.

In this study actual key performance results collected from the companies' financial statements over a five-year period has been used. These key numbers may of course be influenced by strategic and financial considerations, acquisitions, mergers, etc., and therefore results from financial statements may not be accurate for all companies with regard to our objective. This involves the key numbers of company specific and industry specific conditions as well. Therefore it can be valuable to take a closer look into measuring business success and profitable growth. This could be a relevant direction for further research.

After a further research into these areas it may be possible to carry through a model-based analysis to document even stronger connections and new relationships between management practices and profitable growth. This will also have even stronger managerial implications.

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