

Capability vs. Productivity: Identifying the weaknesses in the UK Retail Industry



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The Advanced Institute of Management Research (AIM) develops UK-based world-class management research. AIM seeks to identify ways to enhance the competitiveness of the UK economy and its infrastructure through research into management and organisational performance in both the private and public sectors.

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Current AIM research projects focus on:

UK productivity and performance for the 21st century.

How can UK policymakers evaluate and address concerns surrounding the UK's performance in relation to other countries?

National productivity has been the concern of economists, government policymakers, and corporate decision-makers for some time. Further research by scholars from a range of disciplines is bringing new voices to the debates about how the productivity gap can be measured, and what the UK can do to improve the effectiveness of UK industry and its supporting public services.

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Adapting promising practices to enhance performance across varied organisational contexts.

How can UK managers disseminate their experience whilst learning from others?

Improved management practices are identified as important for enhancing productivity and performance. The main focus is on how evidence behind good or promising practices can be systematically assessed, creatively adapted, successfully implemented and knowledge diffused to other organisations that will benefit.

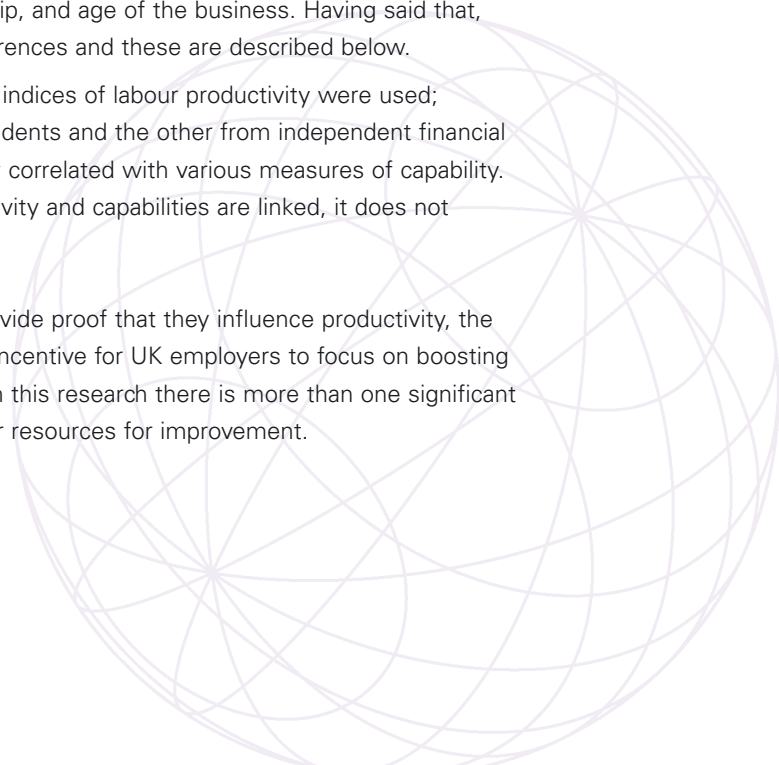
Part of a broad study looking at productivity in the UK retailing industry, this research looks at the capabilities of UK retailers in detail, and explores the relationship between these capabilities and productivity.

The research, which collected data from 1,000 UK retail businesses, revealed the following:

- UK retailers believe they are strong in the areas of Marketing and Operations, but weak in the areas of Human Resources, and Rewards and Incentives.
- The top three capabilities by % of businesses were: providing customers with high quality products and services; providing customers with value for money; and pricing products competitively.
- The bottom three capabilities by % of businesses were: routinely giving feedback to shop-floor staff on their performance; identifying and promoting good people; empowering shop-floor staff to take responsibility and make operational decisions.
- There are some weaker areas among the Marketing and Operational capabilities, however. In particular: advertising and promotions; gathering and listening to customer feedback; empowering shop-floor staff to take responsibility and make operational decisions; and using shop-floor systems and processes that are clear and well-understood.
- Equally, there are some areas within Human Resources and Rewards and Incentives where retailers score in the top to mid range: retaining good staff, training staff in product knowledge, plus praising and encouraging staff.
- Overall, many retailers profess a lack of capability in a number of key areas. One-third to one-half of businesses, for example, reported that they have less than a great deal of capability in 8 of the top 10 capabilities.
- In general the pattern of capabilities varied little according to the size of business, industry sub-sector, and ownership, and age of the business. Having said that, there were some significant differences and these are described below.
- With respect to productivity, two indices of labour productivity were used; one gathered from survey respondents and the other from independent financial information. Both are significantly correlated with various measures of capability. Whilst this indicates that productivity and capabilities are linked, it does not prove it.

Although the above points do not provide proof that they influence productivity, the correlation shown provides a strong incentive for UK employers to focus on boosting capabilities. Based on the evidence in this research there is more than one significant area where retailers can channel their resources for improvement.

UK retailers believe they are strong in the areas of Marketing and Operations, but weak in the areas of Human Resources, and Rewards and Incentives.



introduction – the retail productivity gap

There is evidence to suggest that in some cases a substantial productivity gap exists between retailers in the UK and those elsewhere, such as the USA and France. This places UK retailers in a relatively weak position and at the same time suggests that there is much that UK retailers can do to improve productivity. Obviously it would benefit both the UK economy and UK retailers if UK retailers were able to become more productive, and in doing so close the productivity gap with retailers abroad.

In order to improve productivity, first we need to identify those factors that might be contributing to the productivity gap. As part of a broad study, our research has looked at a number of different aspects of the UK retailing industry including, in this particular instance, the capabilities of retailers and any connection between these capabilities and productivity.

Case study research and consultation with retail experts led to the identification of five core functional areas, and within these areas a number of capabilities were assessed. The five areas were as follows:

- **Human Resources** – for example, the capabilities to attract, train and appraise staff;
- **Operations** – for example, the capabilities to control waste, manage suppliers and work in teams;
- **Rewards and Incentives** – for example, the capabilities to provide a good reward package, provide incentives, and praise and encourage staff;
- **Marketing** – for example, the capabilities to provide customers with high quality goods and services, price products competitively and have a strong brand in the market place;
- **Leadership and Change** – for example, the capabilities to implement new initiatives and provide leadership throughout the business.

By looking at the prevalence of a range of capabilities within these five areas the objective was to answer a number of distinct questions, perhaps the most important being what levels of capabilities were reported by retailers. At the same time we wanted to find out how long businesses have demonstrated at least a great deal of capability, whether retailers' capabilities varied with other factors such as the size of the business, and crucially, whether there was any correlation between the retailers' capabilities and their productivity.

The survey

The survey data was collected through telephone interviews with senior managers in 1,000 retail organisations based in the UK of ten or more employees.

The survey included questions covering a range of areas. These include:

- the business environment within which the organisation operates, detailing, for example, information such as the retail sub-sector, the total number of employees, the country of ownership, the number of selling branches, and the overall selling area;
- the levels of the 34 capabilities across retailers;
- the nature of the workforce, including details of the number of full-time equivalent employees, the extent of trade union membership, and the proportion of shop-floor staff with a degree;
- indicators relating to the way in which internal processes operate within the business, such as annual training hours per employee, and the number of management levels;
- aspects of customer demand, including the percentage of internet sales, and the extent of unpredictable variation in customer demands;
- a small number of financial performance variables such as annual sales turnover and gross profit.

Businesses surveyed were drawn from six of the seven retail sub-sectors defined in the UK's Standard Industrial Classification (SIC) system, category 52. The sub-sector 'Repair of personal and household goods' was excluded from this study.

Table 1: Sampling frame used in the survey

UK SIC code	Description of Sub-sector	Number of Employees			
		10-49	50-249	250+	Total
52.1	Retail sale in non-specialised stores	148 (1,985) 7.5%	38 (210) 18.1%	18 (100) 18.0%	204 (2,295) 8.9%
52.2	Retail sale of food, beverages and tobacco in specialised stores	155 (1,750) 8.9%	19 (100) 19.0%	4 (35) 11.4%	178 (1,885) 9.4%
52.3	Retail sale of pharmaceutical and medical goods, cosmetic and toilet articles	53 (840) 6.3%	14 (80) 17.5%	9 (20) 45.0%	76 (940) 8.1%
52.4	Other retail sale of new goods in specialised stores	369 (7,255) 5.1%	112 (745) 15.0%	31 (285) 10.9%	512 (8,285) 6.2%
52.5	Retail sale of second-hand goods in stores	7 (145) 4.8%	3 (10) 30.0%	0 (0) 0.0%	10 (155) 6.5%
52.6	Retail sale not in stores	10 (480) 2.1%	8 (65) 12.3%	2 (30) 6.7%	20 (575) 3.5%
52	Total	742 (12,455) 6.0%	194 (1,210) 16.0%	64 (470) 13.6%	1,000 (14,135) 7.1%

In each cell: Number of responses (population) proportion of population surveyed %

For each business the interview was conducted with a senior manager who holds responsibility for operations, whether it was the Owner-Manager in a small business or the Operations Director in a larger enterprise.

The survey responses were then matched business-by-business to their most recently reported financial statements.

Table 2: Categorised list of capabilities

Capabilities	Capability Description
HR	1 Attracting strong candidates for job vacancies
	2 Selecting good members of staff
	3 Retaining good staff
	4 Training staff in customer service & selling
	5 Training staff in product knowledge
	6 Developing staff to the best of their abilities
	7 Thoroughly appraising staff on a regular basis
	8 Identifying & promoting good people
	9 Managing 'poor performers'
OP	10 Ensuring staff rotas match the times customers are shopping
	11 Controlling waste (e.g. damage & losses)
	12 Ensuring stock is on the shelves & available at the right time
	13 Managing suppliers effectively
	14 Communicating with staff
	15 Listening to staff
	16 Empowering shop floor staff to take responsibility & make operational decisions
	17 Solving problems quickly on the shop floor
	18 Working in teams on the shop floor
	19 Working flexibly on the shop floor
	20 Using shop floor systems & processes that are clear & well-understood
RI	21 Providing a good reward package (both monetary & non-monetary)
	22 Providing incentives that motivate staff to improve performance
	23 Praising & encouraging staff
	24 Providing clear targets for shop floor staff
	25 Routinely giving feedback to shop floor staff on their performance
MK	26 Providing customers with high quality products & services
	27 Pricing products competitively
	28 Providing customers with value for money
	29 Having a strong brand or image in the market place
	30 Gathering & listening to customer feedback
	31 Advertising & promotions (including visual merchandising)
LC	32 Implementing new initiatives to improve the business
	33 Providing leadership throughout the business
	34 Learning from competitors

Key to capability categories: HR = Human Resources; OP = Operations; RI = Rewards and Incentives; MK = Marketing; LC = Leadership and Change

(i) What levels of capabilities are reported by retailers?

One of the main objectives of the survey was to establish the levels of capabilities in UK retailers (see Figure 1 on page 10, which shows the percentage of businesses reporting their level of capability in each area).

There are significant differences in the levels of capability reported across the 34 different areas. For example, businesses report they are significantly more capable in Marketing, than they are in Human Resources.

Levels of Capability

For each capability the respondents were asked, "In the UK at present, how capable is your business?" using the following response format:

Level 1: No real capability;

Level 2: A small amount of capability;

Level 3: A moderate amount of capability, but it can be patchy and inconsistent across the business;

Level 4: Quite a lot of capability, but it can be patchy and inconsistent across the business;

Level 5: A great deal of capability;

Level 6: Excellent, truly world class and consistent across all parts of the business.

The highest levels of capabilities are reported for Marketing. For example, 75.6% of businesses report that they are at level 5 or 6 in providing customers with high quality products and services. Other Marketing capabilities that retailers are strong at include providing customers with value for money (71.3%), pricing products competitively (61.5%) and having a strong brand or image in the market place (57.2%).

Operational capabilities are rated nearly as highly. For example, 57.2% of businesses report themselves at level 5 or 6 in ensuring stock is on the shelves and available at the right time, and more than half of businesses rated themselves at level 5 or 6 for managing suppliers effectively, ensuring staff rotas match the times customers are shopping, working flexibly on the shop floor and solving problems quickly on the shop floor.

There are weaker areas among the Marketing and Operational capabilities, however. The lowest capability levels are observed for: advertising and promotions; gathering and listening to customer feedback; empowering shop-floor staff to take responsibility and make operational decisions; and using shop-floor systems and processes that are clear and well-understood.

It is clear that there is scope for improvement. Many retailers surveyed profess a lack of capability in a number of key areas. One-third to one-half of businesses, for example, reported that they have less than a great deal of capability in eight of the top ten capabilities.

Human Resources, and Rewards and Incentives, are the two areas where retailers believe that they have the weakest capabilities. Between 45% and 31% of the retailers reported no real capability, a small amount of capability or a moderate amount of capability (which can be patchy and inconsistent across the business) in providing incentives to motivate performance, managing poor performers, attracting strong candidates, thoroughly appraising staff on a regular basis, developing staff to the best of their abilities, providing clear targets for shop-floor staff, providing a good reward package, routinely giving feedback to shop-floor staff on their performance, promoting good people, and empowering shop-floor staff to make operational decisions.

Having said that, there are some areas within Human Resources and Rewards and Incentives where a relatively high proportion of retailers score in the top to mid range, notably: retaining good staff, training staff in product knowledge, and praising and encouraging staff.

Figure 1: Capability by % of businesses at each capability level

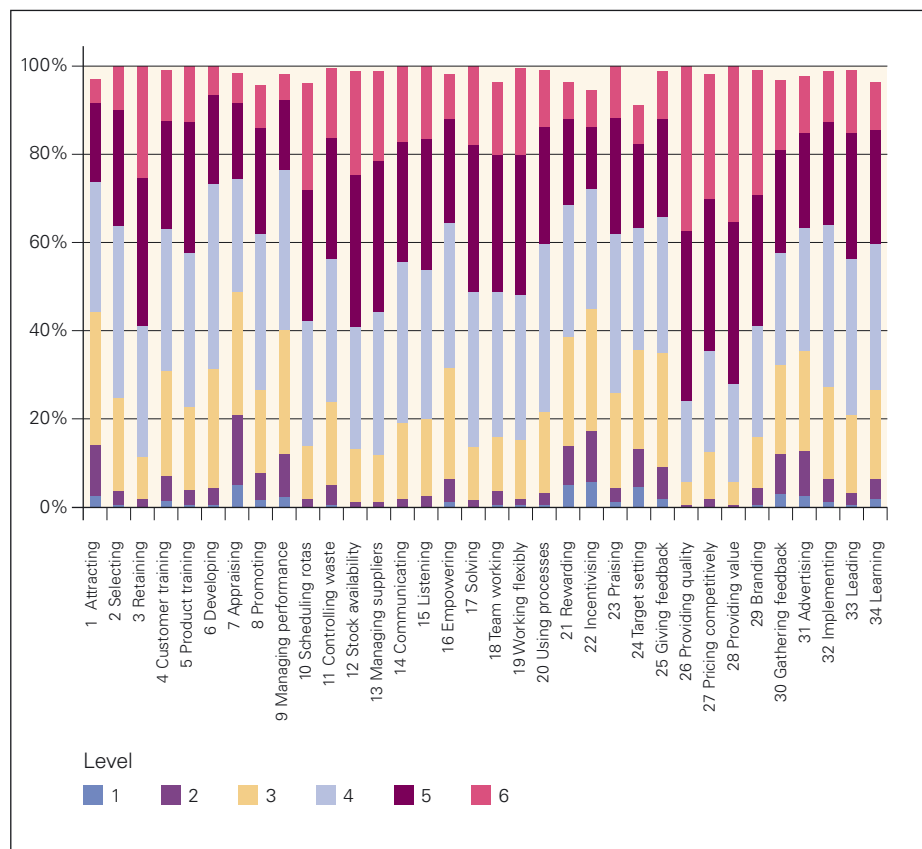


Table 3a: Top ten capabilities, by % of businesses at level 5 or 6, plus % at Level 1, 2 or 3

Top Ten Capabilities				
Category	Item	Capability Description	Level 5 or 6 (%)	Level 1, 2, or 3 (%)
MK	26	Providing customers with high quality products and services	75.5	5.9
MK	28	Providing customers with value for money	71.3	6.2
MK	27	Pricing products competitively	61.5	12.7
HR	3	Retaining good staff	59.0	11.2
OP	12	Ensuring stock is on the shelves and available at the right time	57.2	13.1
MK	29	Having a strong brand or image in the market place	57.2	16.1
OP	13	Managing suppliers effectively	53.8	12.2
OP	10	Ensuring staff rotas match the times customers are shopping	53.6	14.3
OP	19	Working flexibly on the shop floor	50.5	15.1
OP	17	Solving problems quickly on the shop floor	50.4	14.2

Table 3b: Bottom ten capabilities, by % of businesses at level 5 or 6, plus % at Level 1, 2 or 3

Bottom Ten Capabilities				
Category	Item	Capability Description	Level 5 or 6 (%)	Level 1, 2, or 3 (%)
RI	22	Providing customers with high quality products and services	21.6	44.9
HR	9	Managing 'poor performers'	21.9	39.7
HR	1	Attracting strong candidates for job vacancies	22.8	43.8
HR	7	Thoroughly appraising staff on a regular basis	23.6	48.4
HR	6	Developing staff to the best of their abilities	26.2	31.5
RI	24	Providing clear targets for shop floor staff	26.7	35.6
RI	21	Providing a good reward package	27.4	39.0
RI	25	Routinely giving feedback to shop floor staff on their performance	32.1	34.5
HR	8	Identifying and promoting good people	33.0	26.8
OP	16	Empowering shop floor staff to take responsibility and make operational decisions	33.7	31.1

(ii) Capability maturity

Where at least a great deal of capability (level 5 or 6) was reported, we also investigated for how long capability at that level had been established. Once again, the top ten longest established capabilities at a high level tended to belong to either Marketing or Operations, whereas the bottom ten were predominantly Human Resource capabilities, with two Rewards and Incentives items having the shortest durations.

This pattern strongly suggests a positive relationship between the level of capability and how long that capability has been in place. For those businesses that reported high levels of capability, level 5 or more, the average period at which a capability had been established at a high level was 17.4 years.

One possible reason for this relationship could be that there are strategic management priorities common to retailers, and over time the capabilities relevant to those priorities are given more attention in terms of developing them to a high level.

(iii) Additional factors

As well as looking at capabilities across all the retailers that we surveyed, we looked at a number of specific factors to see if there were any significant patterns related to those factors. The factors were: the size of business (comparing small, medium and large businesses); the retail sub-sector; whether or not the business was family-owned; whether or not the business was British-owned (as opposed to foreign-owned); whether or not the business was owned by a Group; when the business was founded; and how long the current ownership structure had been in place.

In general, the findings show that the levels of reported capabilities do not vary systematically by size of business, sub-sector, pattern of ownership, or how long the business or current ownership structure has been in operation.

That does not mean, however, that there are not some variations regarding certain specific capabilities. With business size, for example, there were a number of capability differences between small retailers and medium or large retailers. Small businesses reported higher levels for retaining good staff and listening to staff, and lower levels for providing clear targets for staff and thoroughly appraising staff on a regular basis. This may be because smaller businesses find it easier to use relatively informal ways of managing their staff.

There were also sectoral differences. Retailers in 'Other retail sale of new goods in specialised stores,' achieved a significantly higher level of capability than those in 'Retail sale in non-specialised stores,' across eight capabilities. These capabilities were predominately focused on Rewards and Incentives, and Marketing.

The pattern of capabilities suggests that retailers in this sub-sector typically develop an empowered, knowledgeable and motivated staff, who in turn pride themselves on providing customers with high quality products and services at competitive prices. Our findings suggest that these highly tailored retailers are more aware of the need to differentiate themselves from the competition through effectively developing and maintaining capability in these areas.

Another significant difference was that retail businesses in 'Pharmaceuticals and medical goods' displayed differences on four capabilities, most notably reporting lower levels on two Marketing capabilities.

Ownership also makes a difference. British-owned businesses reported higher capability in retaining good staff, and lower capability in providing clear targets for shop-floor staff, than foreign-owned businesses. Family-owned businesses reported a higher capability at Listening to staff, and a lower capability at providing clear targets for shop-floor staff, than non-family owned businesses. Finally, group-owned retailers reported higher levels of providing clear targets for shop-floor staff and advertising and promotions than non group-owned businesses.

How long the business had been going was also a factor. Younger businesses reported capability strengths in attracting strong candidates for job vacancies, managing poor performers, praising and encouraging staff, and providing leadership throughout the business. These findings suggest that younger retailers have developed strengths in these areas to a higher level more quickly than older retailers.

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(iv) Productivity

Finally, we looked at the correlation between the capabilities and productivity. As performance measures we used self-reported data in the form of sales turnover for the most recently reported financial year, along with the numbers of full-time equivalent staff employed, expressed as the Sales Turnover per Full Time Equivalent (ST/FTE). We also used data on labour productivity from independent financial reports to create an index of Sales Turnover/ Staff Employed (ST/SE).

Positive correlations were found between the scores on the capabilities and both indices of productivity, ST/FTE and ST/SE. Looking first at the correlations with self-reported Sales Turnover/ Full Time Equivalent (ST/FTE), it is apparent that the three sets of capabilities – Leadership and Change, Operations, and Marketing – are significantly positively related.

All five of the sets of capabilities, and the overall index of capability, are significantly related with the independently measured Sales Turnover per Staff employed (ST/SE).



Note, however, that correlations of this kind do not allow conclusions to be drawn regarding a causal relationship between capabilities and productivity.

conclusion – from capability to productivity

A number of points arise from our research.

First we find that, while there is significant variation in the levels of reported capabilities of retailers in the UK, there are particular strengths in both Marketing and Operational capabilities. These are strengths that almost certainly reflect the strategic priorities that have been pursued within retail businesses.

At the same time, UK retailers report significantly lower levels of capability in Human Resources and Rewards and Incentives. These relative weaknesses may also be a consequence of the strategic priorities that retail businesses have set themselves.

With regards to the level of capabilities, there is a substantial scope for improvement for retailers in the UK. This is particularly the case in the areas of Human Resources, Rewards and Incentives, and Leadership and Change, with significant numbers of businesses reporting that they have moderate capabilities or less in these areas. The weaknesses reported in areas such as Human Resources, Rewards and Incentives, and Leadership and Change, may reflect a strategic lack of attention to, and focus on, the 'people aspects' of retailing. This can be seen as a major strategic opportunity for improvement.

As for variations within the sample, of the businesses surveyed there are some small but significant differences. For example, smaller businesses report higher capability than medium and large businesses at retaining good staff and listening to staff. On the other hand, they are worse at providing clear targets for staff and thoroughly appraising staff. Similarly there are some minor differences according to sub-sector and ownership: British-owned versus foreign owned, family-owned versus not, and group-owned versus not. There are also small differences by age of the business.

With respect to productivity, the two indices of labour productivity that were used – one gathered from survey respondents and the other from independent financial information – are significantly correlated with various measures of capability. Whilst this suggests the two may be linked, it does not provide proof.

It does suggest, however, that an improvement in capabilities may feed through to an improvement in productivity, providing a strong incentive to focus on boosting capabilities in the retail industry.

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