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Managing Expectations: How Better Managed Firms Make Better Macro and Micro Forecasts

Takafumi Kawakubo, LSE/ESCoE, t.kawakubo@lse.ac.uk

Nicholas Bloom, Stanford University, nbloom@stanford.edu

Paul Mizen, University of Nottingham, paul.mizen@nottingham.ac.uk

Rebecca Riley, ESCoE, r.riley@niesr.ac.uk

Tatsuro Senga, Queen Mary University of London, t.senga@qmul.ac.uk

John Van Reenen, LSE, j.vanreenen@lse.ac.uk

ESCoE, in partnership with the ONS, conducted the largest UK Management practices and Expectations Survey (MES) and linked this to administrative firm panel data on productivity for manufacturing and non-manufacturing sectors. Consistent with work in other countries we document (i) significant variation of management practices across firms; (ii) a positive association of structured management with firm size and foreign ownership, and a negative correlation with firms who are family owned and family run; (iii) that productivity is higher in firms with more structured management. Uniquely, the survey asks firms to make macro forecasts of GDP in the following year. We find that better managed firms make more accurate macro forecasts even after controlling for their size, age, industry and other factors. Similarly, better managed firms are more accurate in their forecasts about their own growth when their forecasts are compared with actual outcomes. These results suggest that one of the reasons for the superior performance of better managed firms (fact (iii) above) is that they make more accurate forecasts and are therefore less likely to make sub-optimal choices of inputs and strategic decisions.

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JEL Classification: L2, M2, O32, O33.

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The managerial ability to accurately forecast future economic conditions may well be related to firm performance. This paper tests this directly by taking data from the Management and

Expectations Survey (MES hereafter) executed by the Office for National Statistics (ONS), documenting a new set of empirical facts on the relationship between management practices and firm performance. The MES is the largest ever survey on management capabilities in the UK covering both manufacturing and non-manufacturing firms, with its survey design adopted from the established format of the World Management Survey (WMS).1 Moreover, the MES collects expectations data at the business level, building on the US Management and Organizational Practices Survey (MOPS) and the Atlanta Fed Survey of Business Uncertainty (SBU).

The MES survey attempts to measure three aspects of firms' management practices: (1) monitoring -- how well does the firm monitor its operations and use this information for continuous improvement using something like key performance indicators (KPIs)? (2) targets -- are the firm's targets stretching, tracked and appropriately reviewed? (3) incentives -- is the firm promoting and rewarding employees based on performance, managing employee under-performance and providing adequate training opportunities?2 The MES was closely aligned to the US MOPS conducted by the Census Bureau.3 Based on the response to each question, we retrieve the management score for each firm using an identical methodology to the US MOPS, ensuring to be able to facilitate comparisons internationally.

The MES also collects firm-level expectations of turnover, expenditure, investment and employment growth for 2017 and 2018. In particular, the survey asked respondents to report

their 2018 expectations using a 5-point bin, assigning a probability to each bin, for each of the four firm-level indicators. It also asks businesses to provide their UK economy wide GDP forecast using, in the same bins as the Bank of England's survey of external forecasters. This allows us to evaluate business forecasts against professional forecasters.

A set of stylized facts emerging from the MES can be summarized as follows:

1) Management practices vary substantially across firms – the 10th percentile of firms lacks robust monitoring or feedback processes, has limited performance incentives or employee training, while the 90th percentile are as well managed as leading firms internationally.

2) Management practices are strongly associated with superior firm performance – faster growth, higher productivity and greater levels of profits.

3) Management practices score higher in larger, non-family-owned, and foreign-owned firms. The superior management scores in this group heavily reflects their lack of a left-tail of poorly managed firms. In contrast, small family-owned domestic firms are overrepresented amongst badly managed firms.

4) Uncertainty around future expectations for firms own sales growth and national GDP growth is lower in better-managed firms.

5) The accuracy of sales and national GDP growth forecasts are robustly higher in better-managed firms, as well are larger and older firms. This suggests one channel for superior management

practices to raise firm productivity is through improved forecasting – they are better at predicting (and presumably planning for) the future.