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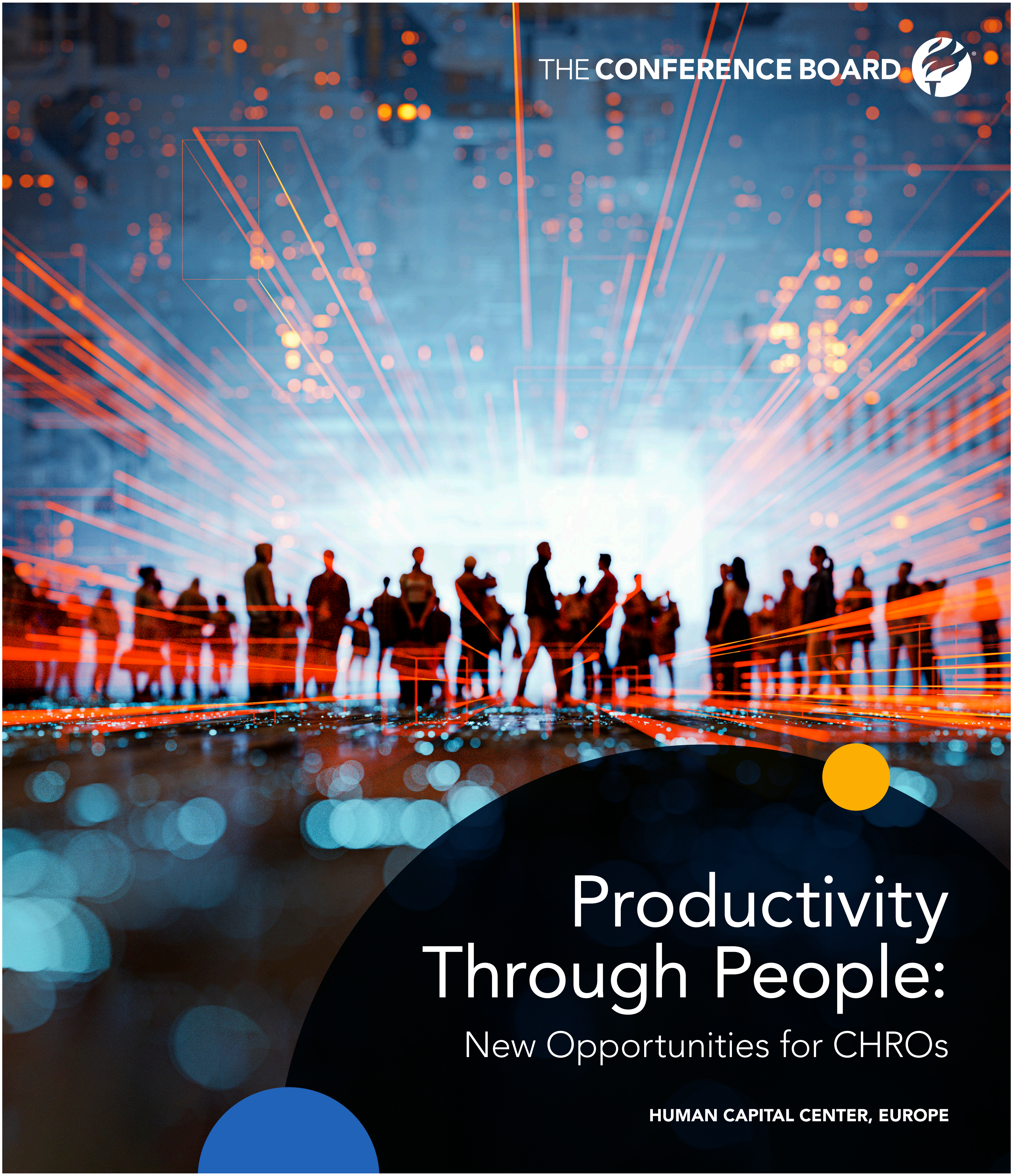

Productivity Through People:

New Opportunities for CHROs

HUMAN CAPITAL CENTER, EUROPE

In partnership with: THE PRODUCTIVITY INSTITUTE

Productivity is achieved by optimally using resources to effect better outcomes for people, firms, and the economy. However, for almost two decades, measured productivity growth has been persistently weak in Europe and other advanced economies.

As the workplace transforms, chief human resource officers (CHROs) have new opportunities to activate six specific people-based levers to spur productivity and bring their insights to the C-Suite to contribute to a more strategic discussion on productivity.

This report was created in partnership with The Productivity Institute, a UK-based research institute.

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- **Productivity growth is vital for business growth, economic progression, and improved living standards and social well-being.** For a firm, productivity growth increases competitiveness through lower prices and/or better-quality products, frees up resources to invest, and creates greater opportunity to enhance stakeholder value. Productive firms have a talent advantage as productive workers are highly engaged, and are attracted to and stay with high-performing and growing businesses. CHROs who focus their people strategies on productivity can improve business outcomes, and enhance talent attraction and retention.
- **Mobilize the people function.** As part of their productivity strategies, CHROs may need to build a new understanding and narrative about productivity among human resources (HR) leaders. Our discussions revealed that HR leaders often have siloed approaches to productivity or may lack a common understanding of what it is. A consistent and strategic narrative around people-based productivity can energize and align leaders around shared concepts, levers, and metrics of productivity.
- **Human capital strategy can help to close the productivity gap compared to the top performing firms.** A large gap exists between the top 10% of corporate performers and medium performers in the same industries—and the gap is widening, Evidence from leading firms suggests that the most productive firms succeed partly through better management practices, as well as more engaged and skilled workers. CHROs therefore play a critical role in strategizing for productivity growth.
- **CHROs can improve people's productivity through six key human capital drivers:**
  - Skills building;
  - High-quality leadership and management;
  - Transformative work design (increasingly enabled through technology adoption and artificial intelligence [AI]);
  - Organizational agility and resilience;
  - Diversity; and
  - Worker well-being and engagement.

  CHROs need to review their strategies for people-based productivity to ensure they are capitalizing on these drivers.

- **Bringing the voice of HR to the C-Suite matters.** To ensure a strong voice in C-Suite discussions on productivity, CHROs must provide a cohesive strategic narrative emphasizing the importance of a people-centric approach to drive overall business productivity. In the face of competing functional priorities, CHROs can help C-Suite colleagues to unite around a company-wide strategy that creates stakeholder value, and addresses urgent economic, social, and environmental concerns.

Why Firm Productivity Growth is Vital

Productivity growth matters for business performance[1] as it increases competitiveness through lower prices and/or better quality products. It frees up resources to invest and create stakeholder value for employees, investors, customers and communities. Conversely, persistent low levels of productivity in developed economies are a major threat to individual businesses. Firms with poor productivity performance are less resilient to negative shocks such as high inflation and black swan events or supply chain disruptions, and are less able to benefit from positive developments such as a new technologies because they generally lack the ability to quickly adapt.

Productivity also improves talent attraction and retention. As they grow, high-performing firms tend to create more jobs, pay better wages, invest in career development, adopt technologies to enhance jobs and work practices and, in a virtuous cycle, better attract talented workers. Productive workers have high levels of job satisfaction and engagement and are motivated to work for, and remain with, high-performing and growing businesses.[2]

However, business productivity is often poorly understood. Traditional definitions and measurements focus on efficiency measures[3] and, while useful, provide little insight into the underlying drivers of productivity and how these can be leveraged to create value for stakeholders and the firm itself.[4]

Mobilizing the People Function

Our discussions with HR executives revealed an inconsistent understanding of productivity due to siloed thinking and jostling HR functional priorities. This lack of shared perception can potentially dilute HR's ability to convince people leaders of the importance of productivity growth.

As one HR executive acknowledged, "I do not think [HR leaders] have enough understanding about the people side of productivity to make an impact ourselves or influence other leaders across the business."

To build a credible and impactful productivity strategy, CHROs may need to change mindsets and assumptions within their own function, and help their teams think more broadly and strategically about HR's role in accelerating productivity growth

> *"HR has a direct responsibility for productive people, leaders, and culture. An integral part of the strategy is deciding what kind of culture and leadership we want, and what is the company we want to build? HR can influence leaders in the way they think about productivity."*

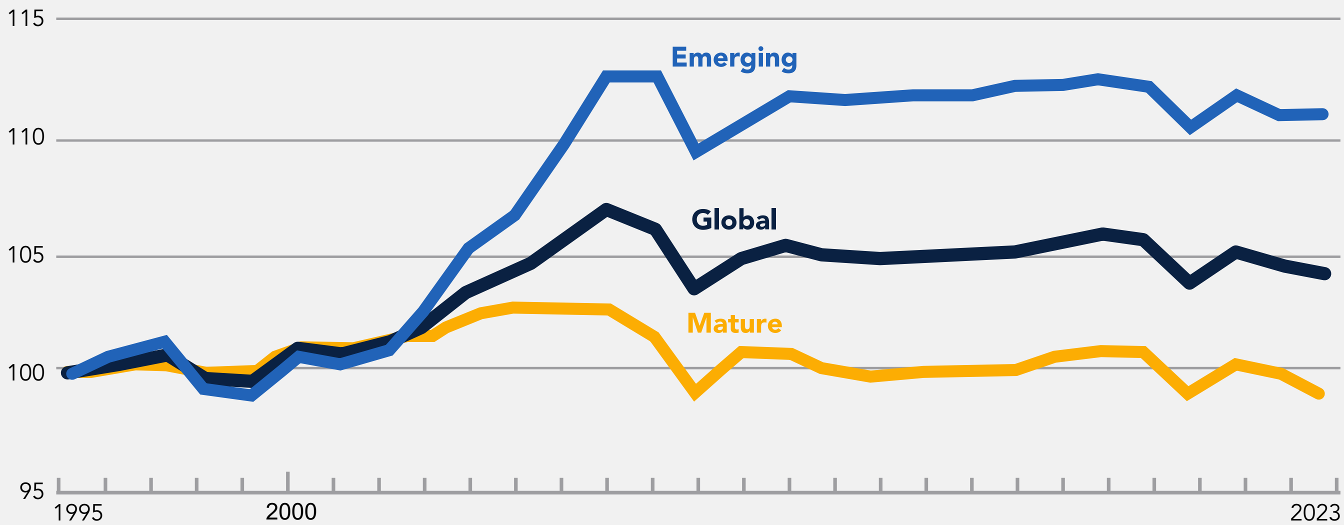
Productivity Growth Continues to Flatline—But Human Capital Strategy Can Help Accelerate its Expansion

Despite advances in technology and the development of the digital economy, productivity growth continues to be weak in many countries (see Figure 1). The reasons are varied and complex and include supply-side shocks (supply-chain disruptions and stagflation); transformational challenges (the climate crisis, inequality, and aging); and counter-productive policies (bad regulations and tax policy).

Figure 1

Despite advances in technology, productivity growth continues to flatline

Global, mature, and emerging economies, total factor productivity (index, 1995=100)



Source: Total Economy Database™, The Conference Board, April 2023

Some firms have managed to thrive despite these headwinds. A significant gap exists between the top 10% of high-productivity companies and medium performers—and the gap is growing. One 2019 study from the Center of Economic Performance across 10 countries showed that a firm with average productivity performs at about one-third of the level of the 10% most-productive firms.[5]

The reasons for such notable differences in productivity are complex but the sectors to which firms belong generally have a large bearing: sectors that have experienced above-average productivity growth include ICT, wholesale and retail, manufacturing, finance and agriculture. Sectors that have performed below the overall economy average, or even seen a decline include utilities, transport, education, entertainment, restaurants and construction.

[6] Analysis by The Productivity Institute suggest five overarching drivers of firm productivity, the final two of which are people based (see Figure 2):

- Innovation and digital adoption;
- Marketing and communications to turn the brand into an asset;

- Access to finance;
- Worker skills, engagement, and well-being; and
- Management competencies.[7]

Figure 2

Five key drivers of business productivity

Source: The Productivity Institute, *Strategic Productivity for the Leadership Team,* September 2022

Research by the Organization for Economic Cooperation and Development (OECD) found that the human side of business productivity, such as managerial and employee skills, and gender and cultural diversity, accounts for an average of one-third of the labor productivity gap between the most productive firms and the median performers.[8]

This evidence adds up to a mandate and opportunity for the CHRO and the people function to help improve firm productivity.

> *"HR needs to be strong in its conviction that productivity ultimately depends on people. Other factors such as technology and investment matter, but it is people that put all the pieces together to impact productivity".*

The Six Key Drivers of People-Based Productivity: New Opportunities for CHROs

In an increasingly digital and fast-changing business environment, CHROs and people leaders have new opportunities to enhance the performance and impact of individual workers and teams. CHROs need to review their strategies for people-centric productivity to ensure they are fully capitalizing on these drivers.

Figure 3

Six key drivers of people-based productivity

Source: The Productivity Institute and The Conference Board [9]

Skill-building strategies

Skills gaps and mismatches mean that firms must give urgent priority to their skill-building strategies if they are to make the most of the opportunities offered by digital technologies.

The most productive firms are those with a more highly skilled workforce. Based on an analysis of the top 10% performers compared with middle performers and "laggards" within the same industry, OECD research showed that[10]:

- Across countries, high skilled employees account for an average of one-third of the workforce in top-performing firms, about twice as much as in the least-productive firms in the same industry.
- Top-performing firms employ a larger share of employees with high levels of specific cognitive (e.g. STEM skills) and noncognitive skills (e.g. management and communication) skills.
- However, these firms also do a better job of "skills complementarities," effectively combining the skills of high- and medium-skilled workers.

It can be tempting to look externally to help plug labor and skills shortages, but this may be a costlier option than investing in training and developing employees. One 2023 study from Stanford Institute for Economic Policy Research showed that external hires are paid about 20% more than reskilled workers, while effective reskilling can bring a productivity uplift of 6–12%—with especially strong results in larger enterprises.[11]

Takeaway CHROs can make a strong case for investing in skill-building initiatives and resources. Research by The Conference Board shows that a skills-based approach is a major change effort and provides the following advice:

- **Explicitly link a skills-based approach to business priorities,** such as the firm's current strategy, competitive capability, competition for talent, and the return on investment of skills building.
- **Build strong capability in data analytics and draw on technology** to produce more granular and ongoing skills intelligence and real-time labor market skills data.
- **Enhance internal mobility** for upskilling and reskilling. Fast-evolving AI-based talent marketplace platforms help match people with work that best uses their skills.
- **Use pilots and experiments to build momentum and buy-in.** Start where there is greatest energy for change or where the need for skill building is most urgent.
- **Establish strong C-Suite governance** to oversee sponsorship building and business-wide partnerships. Expect senior operational leaders to be accountable for skills capability and partner with HR leaders on implementing skills initiatives.

Management capability

There is strong evidence that high-quality management has a disproportionate impact on firm productivity. The OECD estimated that the typical company could narrow its productivity gap with the average frontier firms by up to 16% by increasing both the proportion and quality of its managerial workforce. Key findings from the OECD include the most productive firms have a higher proportion of managers in the workforce compared to average and low performers (18% compared to 11% of managers within "laggards in knowledge-intensive firms) and a higher proportion of highly skilled managers. The researchers surmise that managers in the top performing firms may be better able to identify business opportunities, stay abreast of technological developments, and implement organizational change.[12]

A longitudinal World Management Survey of management practices and organizational performance over 35 countries shows that firms with "better" management practices have better performance: they are larger, more productive, grow faster, have higher stock market evaluation and have higher survival rates.[13] Productivity-enhancing management practices fell into five categories: operations management, performance management, monitoring and target setting, leadership, and talent management.[14]

In terms of management and leadership, the focus is generally on senior management. However, line management is often a critical factor in connecting worker well-being and engagement to better performance, and much mileage can be made here to ascertain the needs of the organization and its staff are properly matched.[15]

> *"It is very important to create an environment where leaders can challenge themselves; and where they give more freedom to employees in how they work, how they create value, and more space to question and innovate."*

Takeaways HR plays an important role in driving this productivity lever, having prime responsibility for management and leadership development; talent and succession-planning processes; and benchmarking the firm's quality of management, leadership, and bench strength. CHROs can review models and training curricula to ensure managers and leaders have the skills and behaviors needed to support productive individuals and teams.

Transformative job design

Job design, the defining and optimizing of roles and responsibilities within a company, has long been a primary role of the HR function. However, advancements in digital technology and notably the recent acceleration of AI development has important implications for people's tasks: some are being replaced or enhanced by the technology, while for others AI has created the opportunity to introduce new tasks and work patterns.

The evidence to date suggest that individual workers are rapidly experimenting with and adopting generative AI tools to optimize their productivity to work faster, more efficiently, and smarter by using the technology on higher-value tasks such as ideation or predictive data analysis.[16] One global study revealed the use of generative AI is "exploding", with nearly 60% of white-collar employees reporting using generative AI on a weekly basis; uptake was highest in India and the UAE.[17] But there is also much anxiety about the adoption of AI as one large study found, with workers concerned about potential loss of jobs, privacy considerations, the loss of human connection, or that AI applications be misused or relied on too much.[18]

However, if companies want to achieve large-scale, transformative productivity gains, they will need to redesign work, jobs, and organizational structures. HR has a key role to play in helping developing an AI strategy for work transformation and human capital management, embedding AI best practices into workflows while ensuring ethical standards for worker privacy and well-being.

The "where" of work is also being transformed as . Remote work is transforming how work is organized and its overall effects on productivity are still undetermined. While individual workers tend to claim to be more productive out of the workplace; The Working from Home Research Project found that fully remote work reduced productivity by as much as 10% compared to fully in-person work. Companies are experimenting with different hybrid work models, however, it is too early to determine the effects of hybrid work schedules on productivity.[19]

Job design has recently been integrated into a broader concept of "good work" stressing the importance of job quality on productivity.[20] On the basis of 40 studies, five of seven key dimensions of "good work" (pay and benefits; job design; health, safety, and psychosocial well-being; voice and representation; and work-life balance) were found to have a positive effect on productivity.[21]

Takeaways Consider strategies to strengthen trust between leaders and employees to help both the transition to hybrid work—where managers have less visibility of their teams—and any significant workplace transformation, especially using AI and other digital technologies. CHROs can consider the following actions:

- **Create transparency regarding workplace transformation.** Foster trust by communicating change plans, being honest about risks and opportunities, and encouraging dialogue and collaboration to ease workforce anxiety.
- **Support managers in the shift to hybrid work** by encouraging a new mindset about how and when work is performed, and practical ways to support their team.
- **Integrate trust-building strategies into leadership development,** emphasizing open communication, ethical decision-making, and genuine care for employees.

Agility and resilience—both for people and the organization

Business volatility, a combination of both negative and positive shocks (the latter of which includes the new wave of digital technologies) has raised uncertainty for business growth and investment, and therefore has the potential to impact productivity in different ways.

C-Suite Outlook 2024: Leading for Tomorrow from The Conference Board shows that CEOs around the world are most concerned about an economic downturn, recession, and inflation. The survey also found that CEOs intend to fuel longer-term growth through investment in innovation, technology (AI in particular), and workforce upskilling. While nearly 90% of CEOs and CHROs believe AI will increase productivity, innovation, and creativity, they acknowledge work is needed to create an organizational culture and structure to maximize AI's productivity.

To both manage the risks and realize the opportunities of technology adoption, a key priority for leaders should be a relentless focus on the agility and resiliency of organizations and their people. Research from The Conference Board shows that CEOs define an agile organization as one with a cadre of effective and engaged change leaders who support resilient employees capable of adapting to change. CHROs identified change leadership and the use of data analytics to inform decision-making in the organization as key traits of an agile business.[22]

> *"We are using AI to streamline processes and boost productivity in manufacturing, using drones for maintenance to improve safety, and utilizing 3D printing for spare parts. But a big barrier is people's inability to imagine work differently, and integrate technology effectively and productively."*

Takeaway While agility and resiliency is not the sole responsibility of the HR function, the role of people leaders in the organization is critical for integrating and operationalizing those concepts in the organization's strategy. Indeed, HR executives may have to be in the driver's seat to lead the company to a high level of agility and resilience. Given that resilience helps workers navigate change and uncertainty, CHROs can focus on resilience-building strategies.

Diverse workforces

A diverse workforce comprising employees of different genders, ages, cultures, and life experiences is a key driver of both innovation and productivity. Research has found that companies that have above-average diversity along multiple dimensions (e.g., gender, education, origin) have 19% higher innovation revenue.[23]

Employers sometimes assume that an aging workforce could be a drag on productivity. However, a multigenerational workforce can increase productivity; for example, firms with a 10% higher share of older workers are 1.1% more productive and have 4% less staff turnover compared to the average firm, provided they have age inclusive strategies such as flexible working options, and early interventions to maximize health and well-being.[24]

Leadership diversity in terms of gender and cultural background is also associated with higher productivity.[25] Increasing the proportion of female senior leaders helps productivity, particularly in firms with very low representation. For organizations with females comprising less than 5% of senior managers, increasing the share to 20% would increase firm productivity by on average of 1.4%. The opportunity for such productivity gains could be significant in Europe, given that in 2023, 18% of executive teams in the STOXX Europe 600 index had no women executive directors.[26]

> *"Diversity is critical, not just in terms of gender and ethnicity, but also diversity of thought and experience. As part of this, trust and well-being help create a productive culture."*

Takeaway CHROs can make explicit the link between diversity, equity, and inclusion (DEI) strategies and productivity growth. Such a link can help defuse some of the backlash against DEI being seen in some countries, such as in the US.

CHROs can prioritize specific diversity-based levers through the following steps:

- **Nurture cross-generational working.** Consider cross-generational mentoring and reverse mentoring and training for managers to avoid age bias.
- **Offer practices that support workers across all generations,** as well as life and career stages such as mid-career reviews, phased retirement, and flexible work.
- **Monitor age inclusion** through age-related data on key talent processes such as candidate sourcing, recruitment, retention, training, and internal job mobility.
- **Undertake a comprehensive analysis of the talent pipeline** to consider how to attract and retain women, especially in the critical mid-career stage. Consider extending return-to-work programs from mid-career to senior executive women.
- **Work with nomination committees** to overhaul processes to ensure diverse board recruitment and succession planning; report regularly on progress.

Worker well-being

Worker well-being is considered both central to responsible business and a key condition for people to be at their best at work. The evidence of the link between employee well-being and productivity is strong:

- An extensive analysis of 339 research studies showed that well-being has a positive correlation with company and employee productivity and customer loyalty, and a strong negative correlation with staff turnover.[27]
- Analysis of different dimensions of well-being revealed that:
  - higher levels of subjective well-being can be linked to greater labor productivity;
  - social well-being enhances collaboration;
  - poor physical well-being is linked to lower productivity through absenteeism;[28] and
  - Mental ill- health reduces productivity and higher levels of stress can lead to employee burnout.[29]

Takeaway CHROs can make a strong business case for sustained investment in employee well-being initiatives. Research from The Conference Board provides the following insights into embedding well-being into workforce practices and cultural behaviors:

- **Ensure a holistic definition of well-being** that reflects different dimensions of well-being (physical, financial, social etc.) that supports productivity and matters to employees.
- **Keep making a strong business case** for sustained investment and commitment in well-being. Draw on evidence and internal data to show the link between employee well-being and productivity.

- **Extend responsibility for well-being beyond HR to the whole organization.** Recruit executive sponsors from across the business to collectively define well-being goals aligned with business strategy, execute the plan, and measure results.
- **Train managers and hold them accountable for well-being by integrating it into performance management systems.** Both immediate supervisors and employee communications play a central role in operationalizing well-being.

Bringing HR's Voice to the C-Suite

As the work by The Productivity Institute shows, the major drivers of business productivity—people, technology adoption, innovation processes, and capital investment—are all cross-functional, requiring CEOs and their teams to agree where they should prioritize their efforts to achieve sustained productivity growth. Therefore, at the end of the day, productivity has to be a leadership discussion in the C-Suite.[30]

To ensure a strong voice in C-Suite discussions on productivity, CHROs must provide a cohesive strategic narrative for people-based productivity. Such a narrative should emphasize why people-based levers are important to overall business productivity; and how they inform people strategy, investment, key performance indicators, and other metrics.

Just another way to "squeeze more juice from the lemon"?

The organization's productivity "story" must attract, not alienate, employees. As one executive emphasized, "Employees can see discussions about productivity as just another way to squeeze more juice out of the lemon." Workers may assume their workloads will increase, or that there is a hidden agenda about automation and potential job layoffs.

A narrative on productivity will be meaningful and resonate when it connects with and reinforces cultural values and behaviors, and corporate purpose. For example, aligning productivity with corporate sustainability goals and values will help create a vision of growth that is sustainable and inclusive, taking into account stakeholders' interests. Tying productivity to a larger purpose is also an important means of engaging employees. One executive, for example, commented:

> *"Our new CEO made a big impact by starting to talk about productivity in the context of leaving the business in a better state for the next generation. The idea of leaving a positive legacy resonated with people."*

About This Report

The insights for this publication were created in partnership with The Productivity Institute, a UK-based research institute, as part of its ongoing work into how business leaders understand and enhance business productivity. Through a series of Chatham House discussions, we discussed the nature of people-based productivity with approximately 30 human capital executives from leading multinational companies in Europe.

About the Authors

Bart van Ark,
Senior Advisor, Economy, Strategy, and Finance Center;
Managing Director, The Productivity Institute

Marion Devine,
Principal Researcher, Human Capital Center, Europe
The Conference Board

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