

# The missing X-factor

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The recent financial and macroeconomic crisis is putting our welfare society under pressure, and it is widely acknowledged, that we not only have a problem in relation to firms competitiveness but also with regards to the productivity in most parts of society. Not surprisingly, these two sets of challenges are related, as the deterioration in Denmark's competitive performance seems to be linked to a rise in relative unit labor costs, reflecting both relatively higher wage growth and weaker productivity growth in Denmark than abroad

The problem of slow productivity growth, compared to e.g. Sweden, has existed in Denmark since the mid-1990s. As a consequence, the Government has established a Productivity Commission of independent experts who are to come up with ideas proposals for productivity promoting measures. Further, the Confederation of Danish Industry has established a productivity board entitled »Gearing up, Denmark« to offer advice, which emanate directly from the everyday life of businesses, to the government's productivity commission, and to inspire other companies and the public sector to speed up their productivity development. We welcome both initiatives.

While the statistics clearly demonstrate that the productivity growth is lower in Denmark than in comparable countries the sources behind this difference are more of a mystery. Competiveness may be threatened due to high wage level, high level of taxation and all kinds of rules and regulations posed upon the private sector. But is the lacking productivity to be explained only by unfavorable framework conditions?

It is tempting to assume that private companies are run as efficiently as possible and that public sector firms as well thrive to be efficient. Thus being as productive as possible within the technological possibilities available. Although this assumption is at the core of classical economics, it is well known that exceptions are widespread. The question we wish raise is what role and responsibility management has in increasing productivity? It is not only a matter of the single managers competencies but also what are the incentives and what conditions do the framework conditions offer for managers to increase the efficiency of firms.

The Productivity Commission has in October 2012 issued a pamphlet raising a number of questions regarding the allocation of resources in our educational system and towards research and development activities, just to highlight a few of the key issues. Also they point attention to the role of regulations in promoting or inhibiting competition both in the private sector and as a possible barrier for efficiency in the public sector. The basic question, we will single out, is what motivational aspects and incentives hinder productivity improvements if they are technically possible?

This debate is, of course, not new. Back in 1966 Harvey Leibenstein published an intriguing article called »Allocative Efficiency vs. X-efficiency«, see Perelman (2011) for a retrospective perspective on the issue. The term *X-efficiency* referred to »an initially undefined type of efficiency« (Leibenstein 1966, p.392). The major element of X-efficiency was in Leibenstein's view motivation and incentives and he basically questioned whether market forces could be assumed to ensure allocative efficiency. While the objective of Leibenstein (1966) was to demonstrate that firms shielded from competition will not be efficient, he also opened the theory of the firm for behavioral theory and to motivation and incentives within firms. Thus, effectively putting the role of management on the agenda in discussing efficiency and productivity.

In terming X-efficiency, Leibenstein was inspired from a passage in Leo Tolstoy's War and Peace which observed that »[t]wo armies may be identical in every observable respect..., yet one army, in possession of an intangible 'X-factor', will soundly defeat the other« (quoted in Leibenstein 1976, p. vii). This unknown factor acted in Tolstoy's theory of war as the intangible force that was more important than the commander in chief, the place where the troops are stationed, and the number of cannon. Producing as efficiently as possible is a mandatory requirement if we are to achieve a growth rate comparable to other countries. We, in Denmark, are apparently in need of a lot of X-factor and hopefully the hidden factor will be unraveled in the work of the Productivity Commission.

It is clear from the pamphlet that measuring productivity in the public sector represents a particular challenge as the core of the services produced in the public sector are not sold on market either because they are so-called pure public goods or because it has been politically preferred to provide the services free of charge or below their marginal cost, even though they in principle could be provided by markets, i.e. they are quasi-public goods. Among the questions that can be raised – as is also done by the Productivity Commission – are not only how productivity improvements in the public sector can be achieved but also how we should measure and understand productivity. These questions are by themselves important and need much more attention if we are to improve productivity more radically. Presently public sector managers have been focusing on two issues, namely public welfare innovation and performance management in order to make the public sector more productive and efficient.

Returning to Tolstoy, he proposed that the *morale* of the troops was the unknown X-factor and that a formula including morale could unlock the secrets of warfare. So, what exactly do morale mean in organizational life? We need to believe in winning and we need to genuinely believe that it is possible to perform better. That it is possible to improve productivity in our own organizations. In organization theory the term self-efficacy is at the core in understanding what motivates performance at the individual level. In order to perform at our uttermost best we need to believe that we have the possibility to do so – and not that it is impossible to improve because of lack of resources, high taxes and downsizing in municipalities. No team could have won the European Handball Championship for men in 2012 if not the players and the coach had believed that it was possible.

#### References

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