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Solving the productivity puzzle: the role of demand and the promise of digitization

DR. JAN MISCHKE

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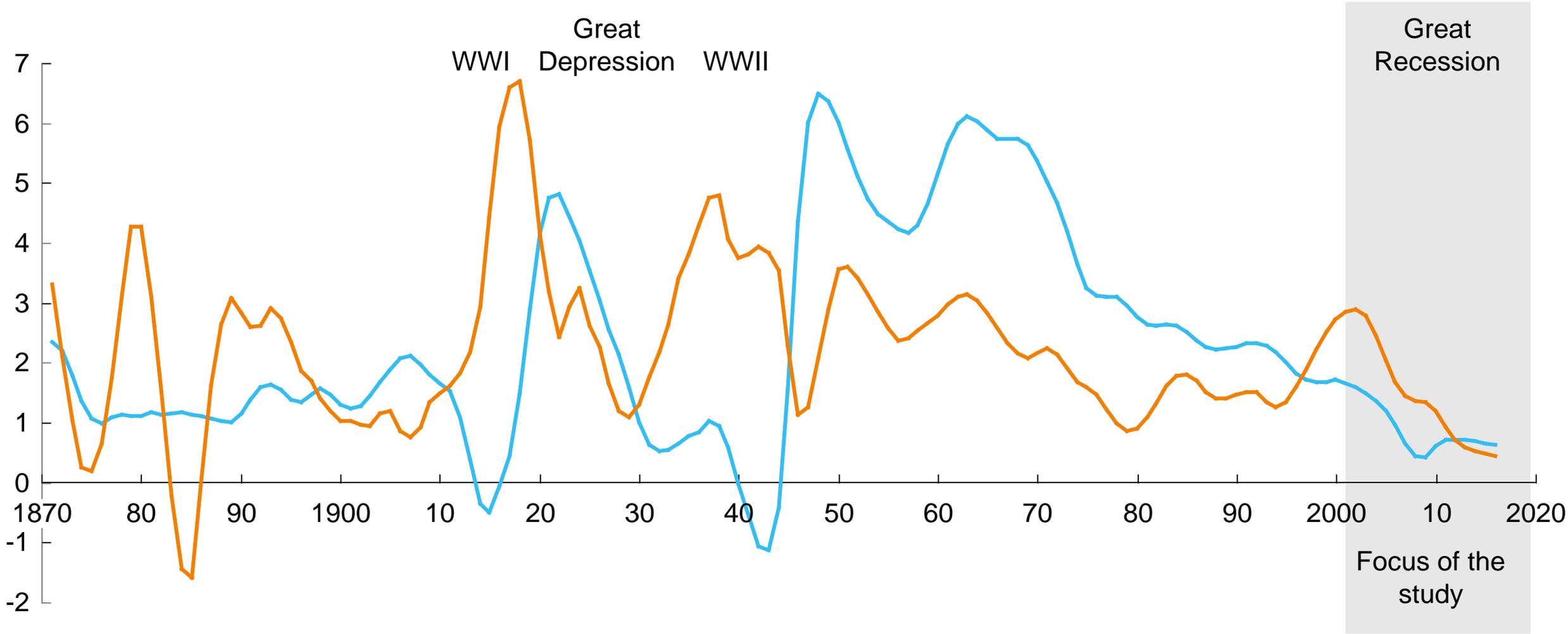
Rated #1 Think Tank 2016 (private sector category) by the Global Think Tank Index, University of Pennsylvania

Productivity growth has fluctuated over time; it has been declining since the 1960s and today stands near historic lows

Trend line of labor productivity growth, total economy

% year-over-year

Europe USA





Three waves
collided to
drag down
productivity
growth

There are many schools of thought on the drivers of the productivity growth decline



Mismeasurement



Mix shift to low productivity sectors



Financial constraints and rise of zombie firms



Increasing business concentration

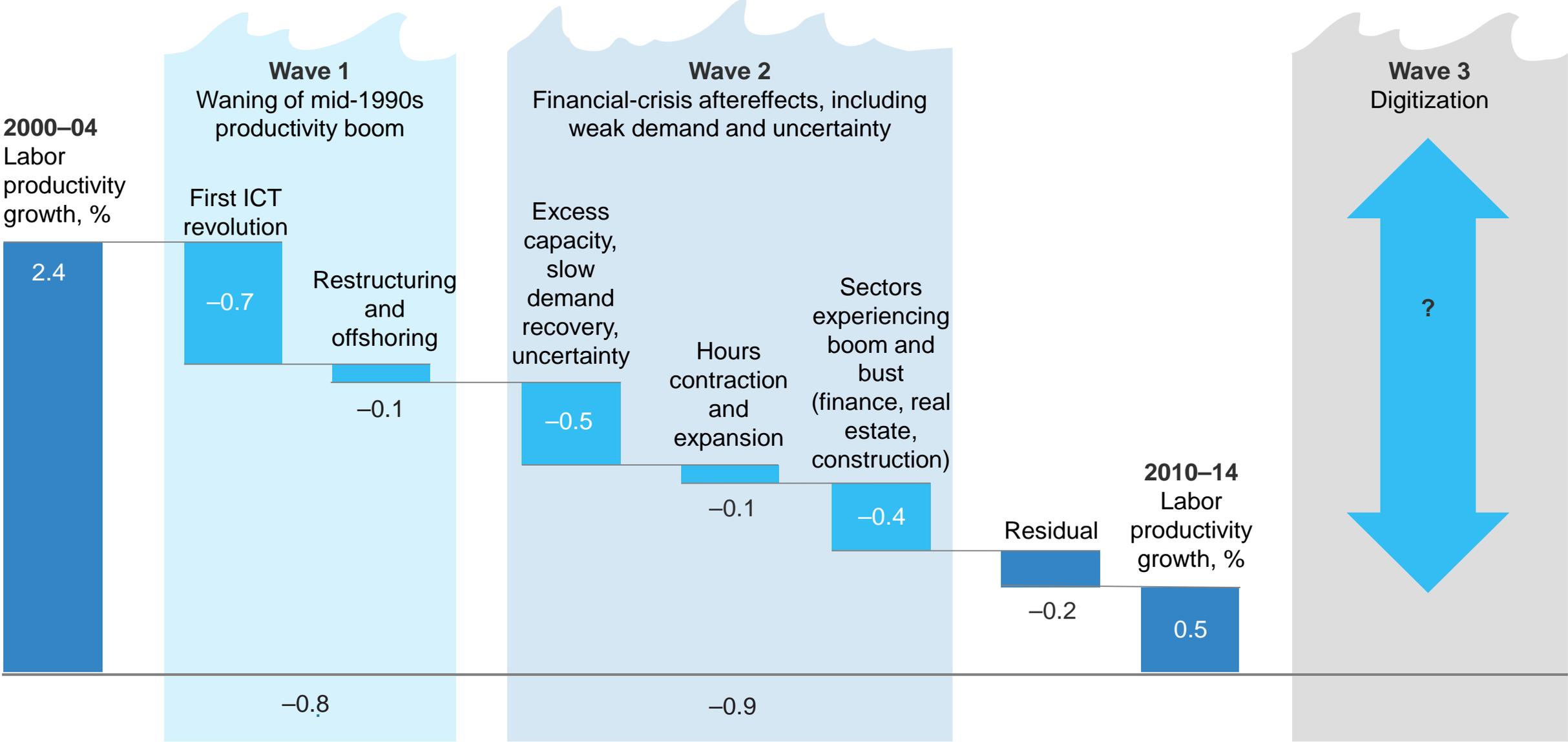


Techno-pessimism



Declining firm dynamism and divergence of the frontier

In our research, three waves explain the bulk of the decline in productivity growth



The impact of each wave varies across countries

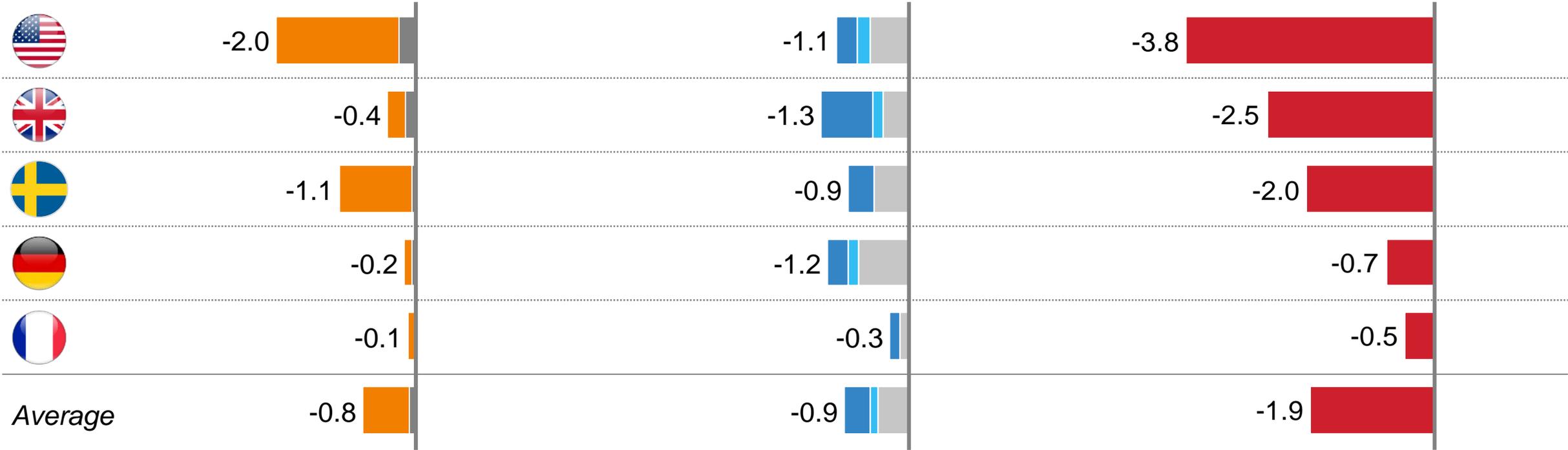
Percentage point contribution to the decline in productivity growth from 2010-14 vs. 2000-04

- First ICT revolution
- Sectors experiencing a boom / bust (finance, real estate, construction)
- Restructuring and offshoring
- Financial crisis-related hours contraction & expansion
- Excess capacity, slow demand recovery, uncertainty

Waning of a mid-1990s productivity boom
Manufacturing, ICT, Retail, Utilities

Financial crisis aftereffects
Mfg., Retail, Utilities, Finance, Real estate, Construction

Total change in productivity growth

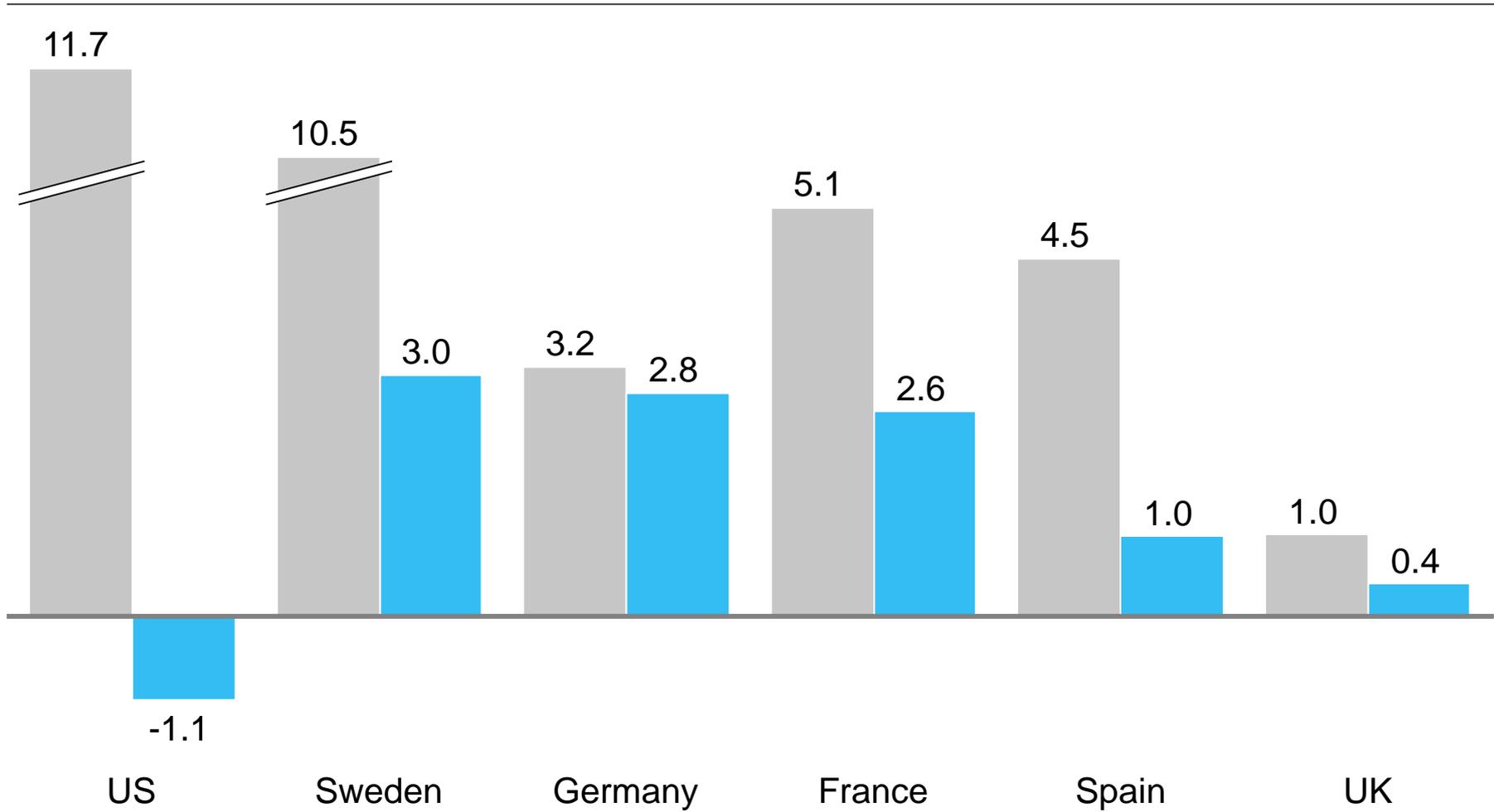


Wave 1: Waning of the ICT boom played a role in the productivity growth decline (tech sector example)

TFP growth in technology manufacturing

Percent

■ 2000-2004 ■ 2010-2014

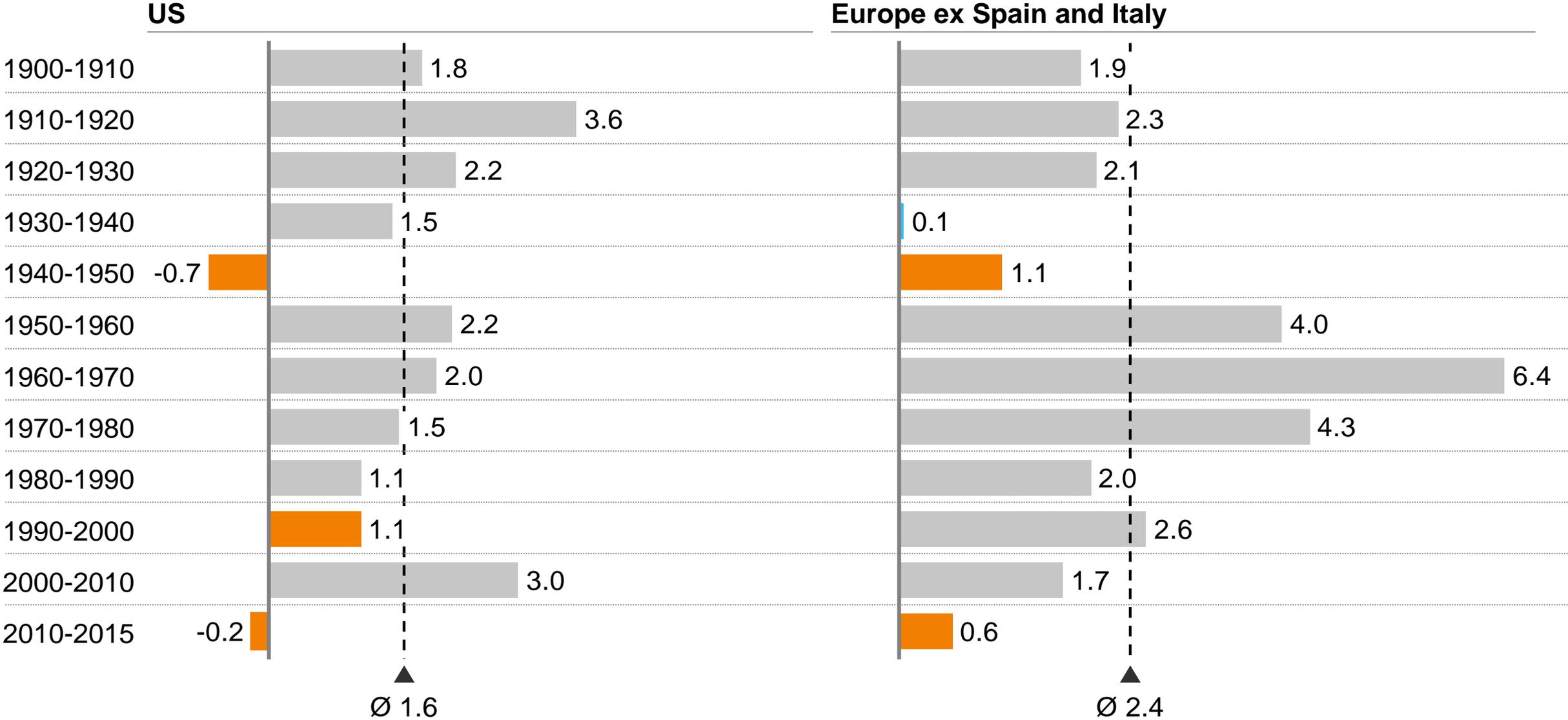


- Reasons**
- Exceptional boom in tech productivity growth at the turn of the century
 - Complexity of innovation
 - Change in setup of, demands on, and measurement of the tech industry

Wave 2: The recent period of weak capital intensity growth is among the weakest since 1900

Capital intensity growth, Compound annual growth rate, Percent

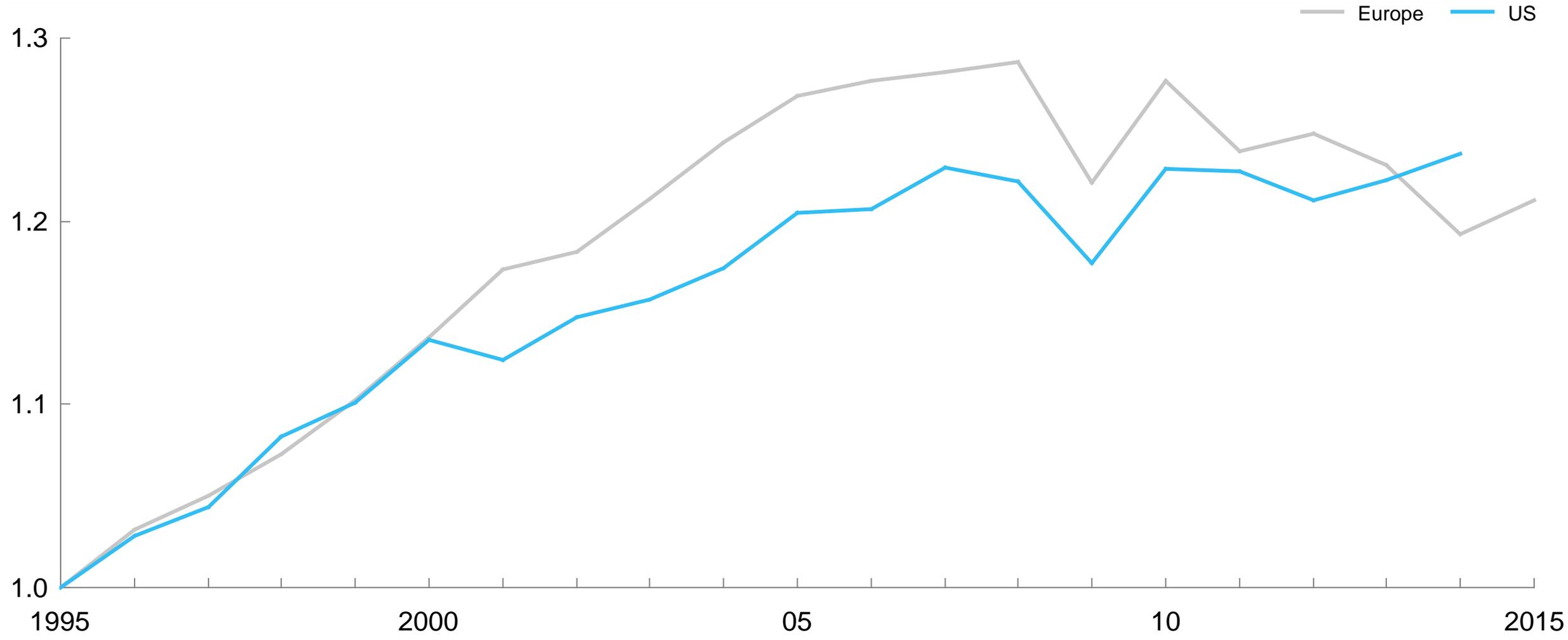
Lowest three periods of growth



Wave 2: Weak demand growth also impacted productivity through affecting economies of scale (utilities example)

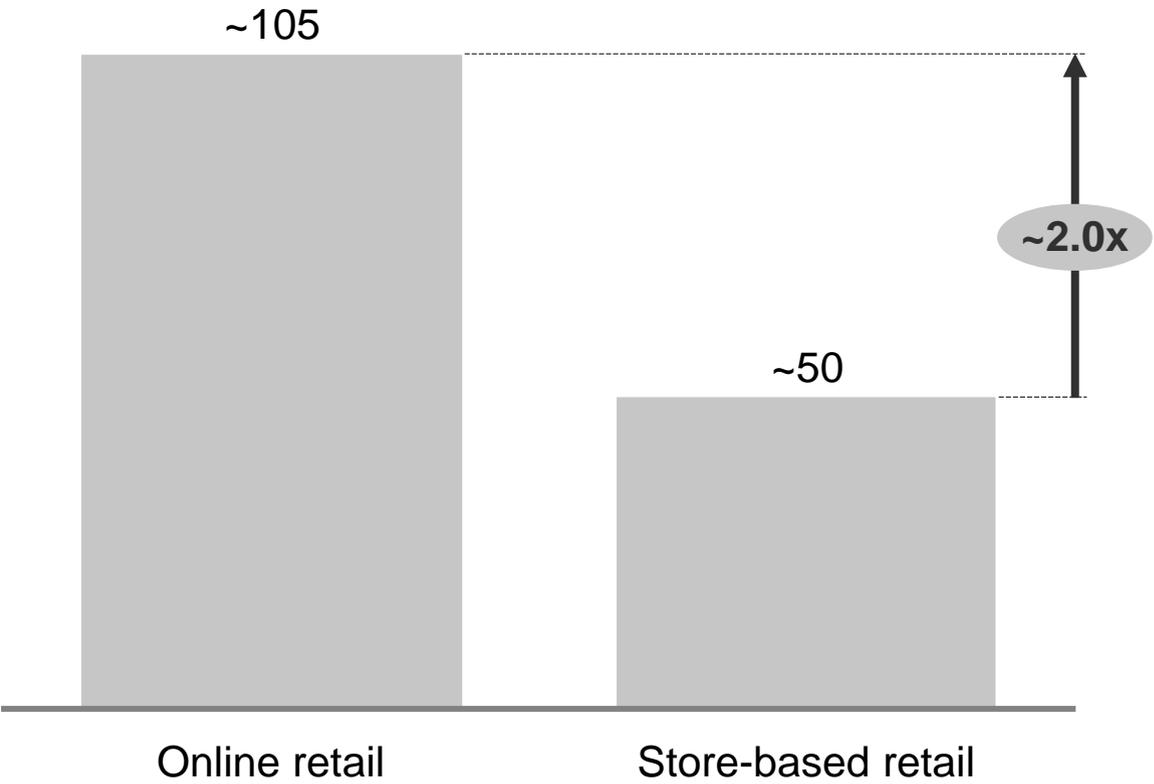
Energy consumption (MWh)

Index, 1995 = 1

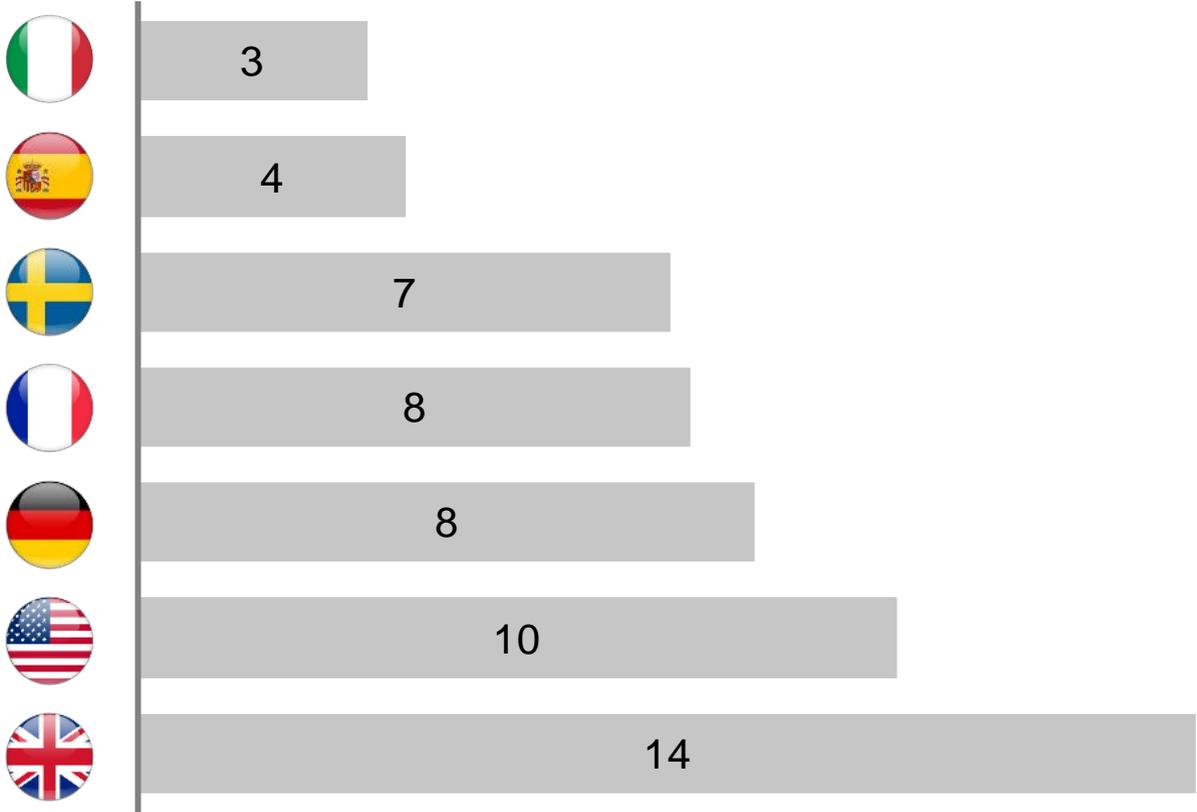


Wave 3: Online sales are more productive than offline, but they still represent a small segment of total sales (retail example)

Productivity (Sales- COGS/employee)
In \$K



Share of online sales
% of total retail sales (excl. sales tax)



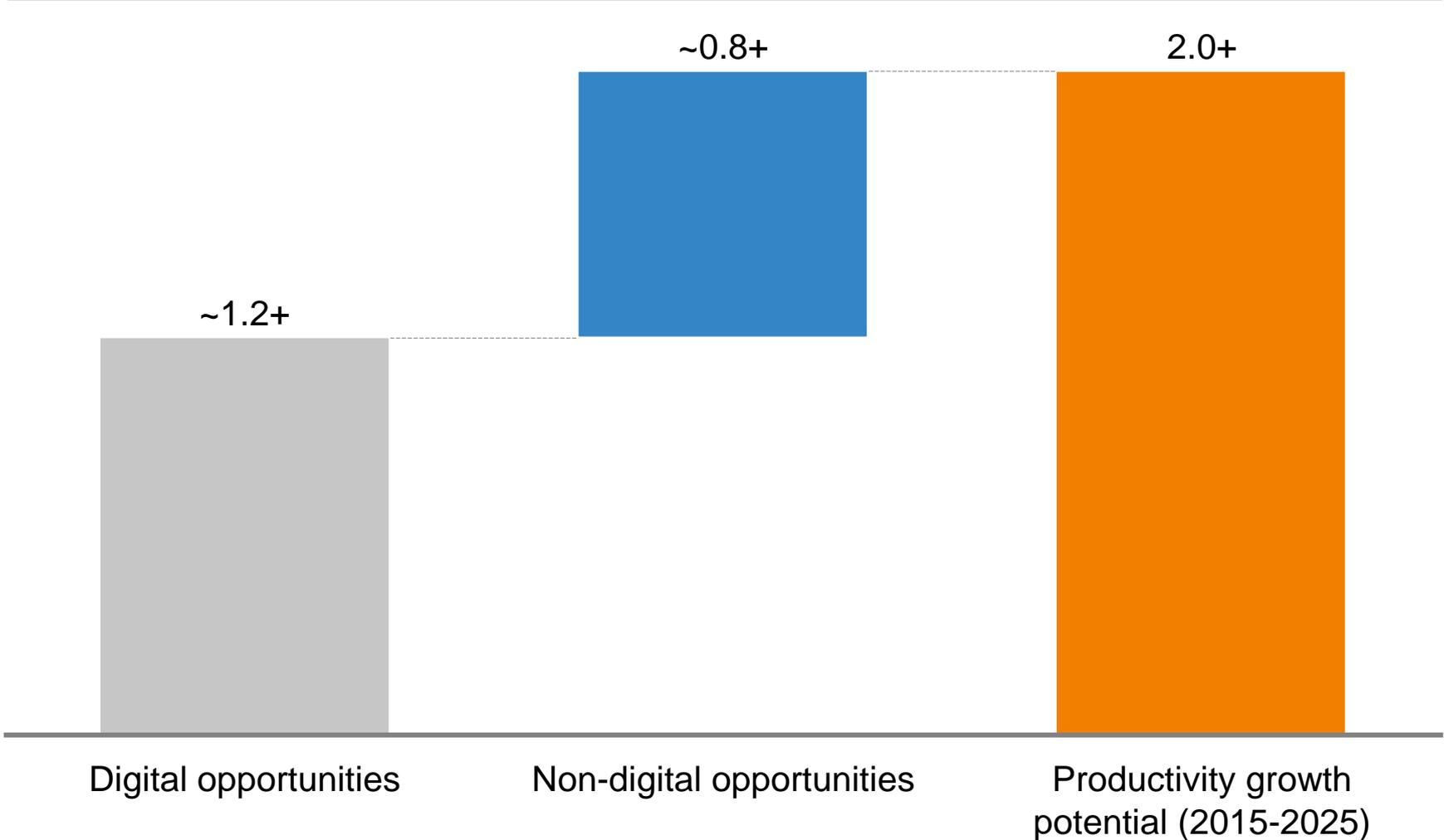
This transformation also comes with lags and transition costs (e.g., initial duplication of structures and investment, cannibalization of incumbent's business)



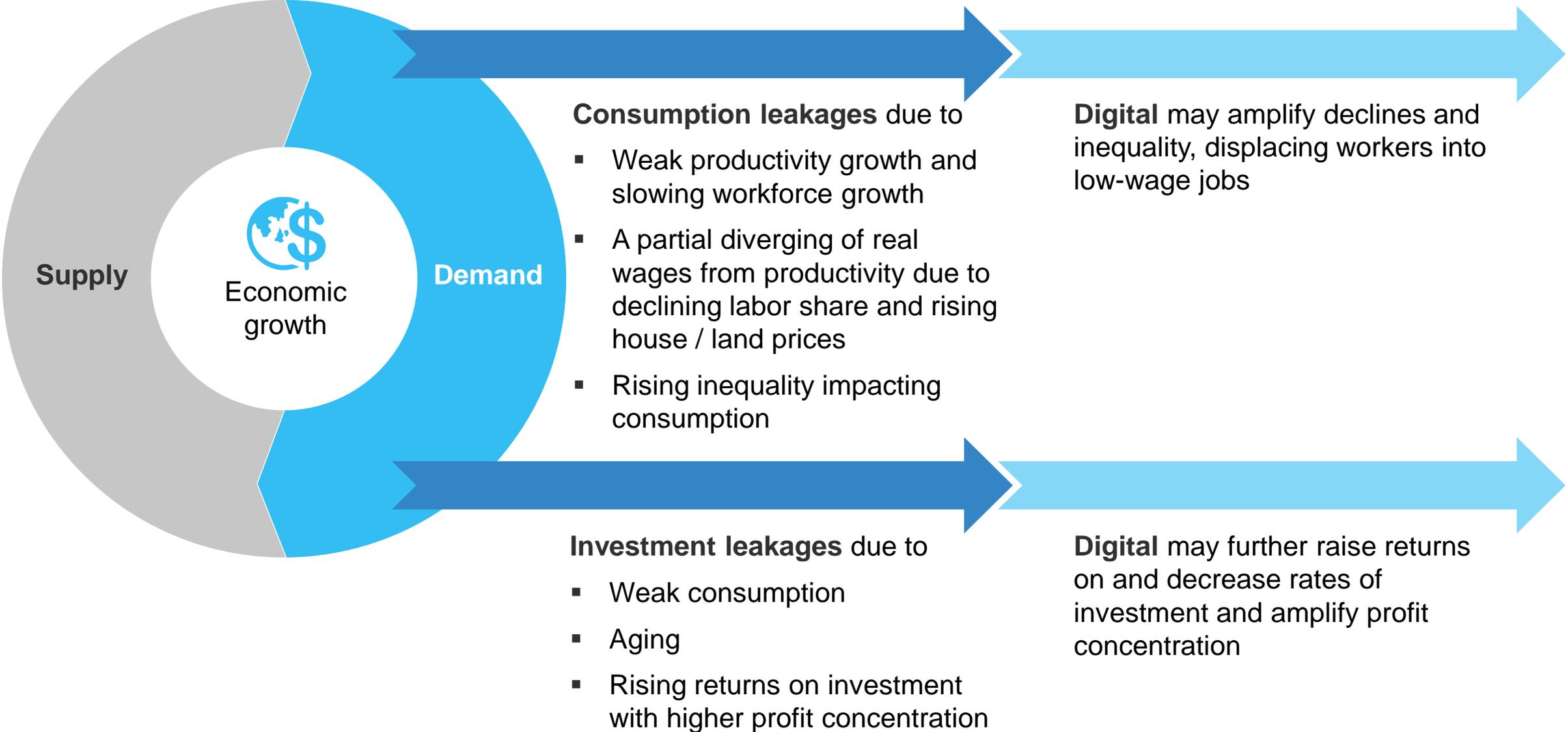
Boosting productivity growth will require a dual focus on promoting sustained demand growth and digital diffusion

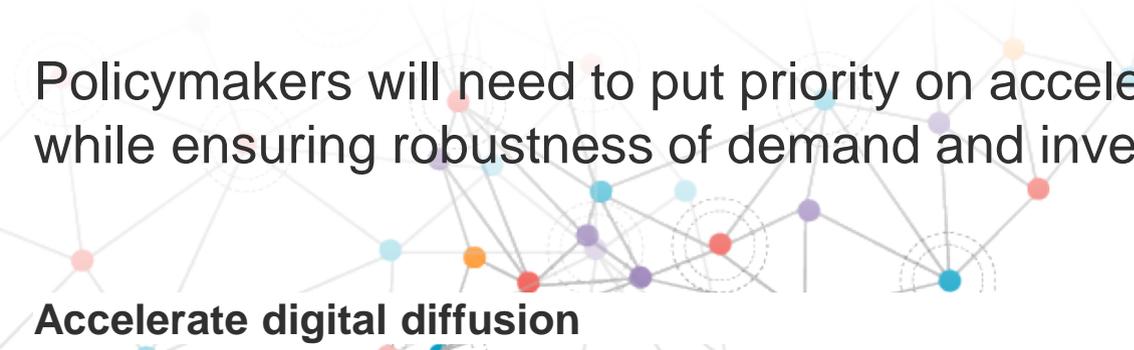
Unlocking demand growth and promoting digital diffusion may deliver annual labor productivity growth above 2 percent

United States and Western Europe, Productivity growth potential,
Percentage points



Long-term demand leakages could act as a drag on productivity growth and may be further amplified by digital





Policymakers will need to put priority on accelerating digitization while ensuring robustness of demand and investment

Accelerate digital diffusion

- **Digitize government** and leverage public procurement to lead by example
- Invest in **digital infrastructure**, ecosystems, and education
- Drive digital adoption in **SMEs**
- Clarify **regulation** and standards
- Ensure **global connectivity**
- Carefully monitor competition around “**winner-takes-most**” platforms and step in where needed

Ensure robust demand and investment

- Focus on productive **public investment** as a fiscal priority
- Unlock **private investment**
 - Reduce financial, regulatory, and political risk for businesses
 - Remove land market barriers for residential investment
- Grow the **purchasing power of low-income** consumers and strengthen the link between productivity, wages, and consumption
- Support **worker training and transition**





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