

Symposium on Harrison's "Lean and Mean": A Productivity Perspective

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The underlying thesis of this book is that the conventional wisdom regarding small companies is wrong: large firms and their suppliers generate most of the meaningful new jobs and innovations.¹ Furthermore, large companies are more "flexible" than small companies. Flexibility is defined in three ways. Functional flexibility refers to work tasks, redeployment of resources, technology adoptions, and reconfiguration of relationships with suppliers. Wage flexibility involves the ability to adjust wages and benefits (usually, in a downward direction) without too much difficulty. Numerical flexibility relates to outsourcing and the use of contingent workers. Each of these has enabled firms to become "lean and mean," and thus, more competitive in the global marketplace.

The author is not satisfied with the efforts large firms have undertaken to improve efficiency. They must become even more flexible or their foreign rivals will consistently outperform them. To reach this goal, they should grow in size and scope, by forming more strategic alliances and developing close, nurturing relationships with a vast network of suppliers. Professor Harrison believes that firms cannot achieve this without assistance from the federal government. He advocates an industrial policy that encourages the formation of a vast intercorporate network of interlocking companies that span many industries and countries. The prototypical firm in this framework is the Japanese keiretsu.

The author is very careful in marshaling his facts to support this policy initiative. I would like to offer several suggestions that might make

his argument even more compelling. My primary focus is on the relationship between flexibility and productivity, since the desirability of this proposal depends to a large extent on whether it improves economic efficiency. Most economists would agree that wage and numerical flexibility raise productivity. Whether the author's proposed model would increase functional flexibility, and that this in turn, would raise productivity, is much less clear.

For example, the role of unions should be considered in much greater detail, since they play an important role in this model. The author implies that an increase in union power would be desirable. However, unions have often resisted efforts to increase wage and numerical flexibility. This is especially important given that these measures often create anxiety among workers, which could reduce the quality of effort and productivity. Does it really seem likely that union intransigence regarding work rules and the use of contingent workers would diminish under a "keiretsu-like" system? If unions can effectively shut down the system, do they have an incentive to compromise on issues relating to flexibility? More importantly, won't unions resist labor-saving technological innovations, which are an important source of productivity growth?

The author also implicitly assumes that a "keiretsu-like" system will generate large positive externalities. This is not obvious to me based on my understanding of the literature on R&D spillovers. I would like to see more reflection on the mechanics of technology transfer and the spillover mechanism that could ultimately lead to an improvement in economic performance. The author should also comment on an issue that has puzzled economists for a long time. Empirical researchers (see Lichtenberg and Siegel, 1991) have found that privately-financed R&D improves

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productivity, while federally-financed R&D does not.² While this result may be due to measurement error, it is important to note that the author's proposal would significantly raise federally-funded R&D. Therefore, it is incumbent upon the author to explain in great detail how these federal R&D projects will stimulate productivity growth.

Efforts to increase flexibility could also substantially raise costs and increase risk. For example, the company must share some of the burden imposed on its network of suppliers during periods of declining demand. Although this plan may lead to a more stable business environment, firms will still be subject to business cycle fluctuations. The author also implies that this system will reduce managerial "myopia" and lead to a greater emphasis on long-term capital investment. However, it is possible that *overinvestment* in R&D or capital could result, especially if a substantial proportion of the cost is subsidized by the government. There may also be a major "free-rider" problem.

The author must also consider some of the practical difficulties in implementing his strategy. This policy requires some profound changes in business education. Under this framework, managers must have a global perspective and a willingness to cooperate with firms in the same industry. They must also listen to their workers, which is incompatible with the standard autocratic style of management that pervades large American firms. Professor Harrison should cite recent changes in the curricula of our nation's business schools that complement his proposed strategy. Flexible firms will also need workers who can keep pace with changes in technology. To promote this process of continuous learning, firms will have much higher training costs. Still, it is inevitable that some workers and firms will be displaced by new technologies.

Another difficulty in implementing this plan is that it is clearly antithetical to the spirit of our antitrust laws. Thus, I would also expect a great deal of political opposition from groups with legitimate concerns about the concentration of power, and those who are simply locked out of the system. Then there is the potential for government corruption. In discussing the Japanese keiretsu, the author cites a "crisis of legitimacy within the

ruling political party" in Japan, without noting that some of these problems were caused by bribery scandals involving firms in the keiretsu. Isn't it likely that the same sort of situation would arise in the U.S.?

Most of the author's discussion of flexibility and the empirical evidence relate to manufacturing, which constitutes about 20% of GNP and a much smaller proportion of the workforce.³ For example, the work at the Census Bureau by Dunne *et al.* focuses on manufacturing only, and could be biased towards large establishments, since small startup firms are less likely to be sampled. Because of limitations in the types of data that are collected, it may not be accurate to draw inferences for services based on these findings.

Despite the difficulties in measuring economic activity in the service sector, I would like to see more discussion of the implications of the proposed strategy for service sector firms. It seems to me that the author wants to target several high-tech manufacturing industries. Can we expect the same benefits to arise from greater flexibility in such industries as financial and communication services? Would the industrial policy initiatives be similar for services? If not, how would things be modified? For example, opportunities for economies of scale and scope may be much more limited in these sectors.

I also find it strange that there is very little discussion of the tremendous improvement in manufacturing performance in the 1980s and 1990s. To a large extent, we have regained our competitiveness in a wide range of strategically important high-tech manufacturing industries. If so, why do we need to tinker? There is also some evidence that the Japanese are moving away from the Keiretsu system, in response to a slowdown in economic performance. A recent article in *Forbes* (see Eisenstadt) suggests that firms at the bottom of the "pyramid" are becoming disillusioned with the rigidity of the keiretsu system. A new class of prosperous entrepreneurs is emerging to overcome some of the inefficiencies, and they are using American entrepreneurs as role models. I'm not sure what the implications of this are, but the author should discuss this trend in greater detail.

Professor Harrison has produced a provocative

book that challenges the orthodoxy regarding small firms. He does an excellent job of outlining the benefits of flexibility, which is likely to be an important source of competitive advantage in today's highly competitive global marketplace. My only reservation about the book is that there needs to be more reflection on the *costs* of greater flexibility and the difficulties in implementing this bold strategy.

Notes

¹ A recent working paper by Baily, Bartlesman, and Haltiwanger (1994) entitled "Downsizing and Productivity Growth: Myth or Reality?" confirms one aspect of the author's hypothesis, at least in the manufacturing sector. The authors find that establishments with higher employment contributed as much to overall productivity growth in the 1980s as those plants that were downsizing.

² We also found no evidence of a positive correlation between firm size and the rate of return on R&D investment.

³ Of course, the author is correct when he points out that many workers who are classified in services are actually working for manufacturing firms.

References

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