By Arief Budiman

More bang for your buck: Improving productivity in Indonesia

"Lean" operations and approaches can help Indonesia improve productivity and gain a competitive edge.

Indonesia has made enormous strides in the past decade, emerging today with a strong, diversified economy and as a serious player on the international stage. Can it build on that progress? The rupiah has come under pressure, food and fuel price hikes have pushed inflation, and growth has slowed.

Time and again, studies have shown that productivity improvement is the single biggest factor driving long term, sustainable growth. However, Indonesia's labor and capital productivity is low, below most countries in the region. As a result, Indonesia is losing its competitive edge when compared with its ASEAN neighbors. In the manufacturing sector, for example, low levels of labor productivity undermine Indonesia's cost advantage, and countries such as Malaysia and Thailand outperform despite their higher wages. Malaysia in fact does more than twice as well as Indonesia on labor productivity. In the World Economic Forum's 2013-2014 Global Competitiveness Report, Indonesia posted one of the largest improvements in the country rankings at 38, but still trails Singapore at 2, Malaysia at 24 and Thailand at 37. The report, which assesses the competitiveness of 148 economies, showed Indonesia's weak performance in some critical areas: efficiencies in the labor market (103rd), technology readiness (75th), and rigidities in labor practices along with the low participation of women in the workforce (115th). In other words, there is a lot Indonesia can do to become more competitive.

If the economy is going to sustain high growth, it needs to be driven by higher productivity. To achieve this, Indonesia must make more and better use of its labor and capital resources.

How do inefficiencies persist in a country with a booming working-age population and a robust consumer driven economy? The country's infrastructure and skills gaps are well known. There is a third key factor which deserves particular attention: process productivity. How can organizations design and operate their businesses so that their resources, whether labor, capital or technology, are used most effectively?

While there are many ways to improve productivity, research by McKinsey & Company has shown one of the greatest opportunities across all sectors is for organizations to adopt lean management principles and techniques. "Lean" is one of the biggest management ideas of the past 50 years. It has transformed how companies think about operations—starting in assembly lines and other factory settings and moving into services. And it can be the key to driving a more productive Indonesia.

Essentially, it is taking the waste out of processes, enabling continuous improvement by delivering value efficiently to customers and making customers the top priority, encouraging employee empowerment, discovering better, more standardized and more collaborative ways of working, and connecting strategy and goals with meaningful purpose.

Practically, it entails redesigning entire value chains to eliminate functions and processes that are redundant or don't add value; investing in labor saving tools, equipment and technologies; improving the quality of employee capabilities; setting clear tracking and measurement tools; and implementing mechanisms for continuous improvement. In the past few years alone, we've observed lean's successful application to mortgage processing in India, customer-experience improvements in a Colombian pension fund, better and faster processing of political-asylum requests in Sweden, and the streamlining of business services in the United Arab Emirates. Put simply, it is about finding ways to work smarter.

Consider, for example, one Indonesian company that used the "lean" approach to get more out of its machinery with rationalization of the plant, closer supervision and regular updates. The company was able to save more than $300 million and generate better returns as a result.

In another example, a major Indonesian company used "lean" to redesign its service delivery model significantly reducing the number of days it required to deliver and install products—a tedious process that involved several technician visits and inspections and delays with payments processing.

"Lean" can be used across all sectors including banking, government, energy, mining, consumer services, telecommunications, construction, food and transportation. What's more, new technologies and new ways of gathering product performance data and customer insights are making it easier for organizations to learn what their customers truly value. Savvy companies link this information back to product design and marketing, for example, to better serve their customers. The detailed level of insights and unprecedented amount of data offers even greater potential for eliminating waste and for increasing value.

"Lean" is, however, hard to implement. For Indonesian companies, the priority should be to:

- Rethink organization structures to avoid silos, encourage transparency, and establish a governance structure that enables quick decision making;
- Assess existing processes for ways to apply standardization, quality assurance, and maintenance excellence
- Build skills and capabilities with a focus on shifting behaviors and attitudes for lasting change; and
- Develop strong and effective management systems that reward performance.

Raising productivity doesn't need to be at the expense of jobs and employment. Indonesia has posted significant productivity gains across sectors at the same time that employment has increased in 35 of the past 51 years. Yet despite such strong progress, average labor productivity across sectors is still only around half of Malaysia's.

Transforming Indonesia into a more-productive economy will require common-sense approaches such as reorienting business processes, and substantial initiatives including rethinking strategies across sectors. Approximately 80 percent of the productivity gap with Malaysia is explained by the manufacturing, retail trade, transport and telecommunications, and agriculture sectors. If Indonesia can lift its productivity to the level of Malaysia, the economic benefit will be huge.

Arief Budiman is a Partner in our Jakarta office.