INSEAD

R & D

ARE YOU (REALLY) MANAGING FOR VALUE?

by

P. HASPESLAGH*
T. NODA**
and
F. BOULOS†

2000/67/SM

* The Paul Desmarais Chaired Professor in Partnership and Private Enterprise, and Professor of Business Policy at INSEAD, Boulevard de Constance, 77305 Fontainebleau Cedex, France.

** Assistant Professor of Strategy and Management at INSEAD, Boulevard de Constance, 77305 Fontainebleau Cedex, France.

† Executive in Residence at INSEAD, Boulevard de Constance, 77305 Fontainebleau Cedex, France.

The authors gratefully acknowledge the financial support provided by The Boston Consulting Group for this research project.

INTRODUCTION

Intensifying competition, globalizing capital markets, and increasingly active and powerful institutional investors whose managers are themselves engaged in a do-or-die performance battle, are all putting huge pressure on corporations to deliver value to their shareholders, regardless of their corporate or cultural heritage. For senior executives in Seoul, Munich, Toronto, Paris, New York and yes, even Tokyo, delivering shareholder value has become a mandatory and inescapable task.

As usual when put to new tests, managers turn to emerging management practices to help them respond to their new challenges. In the battle for shareholder value, the savior that managers have turned to is a practice that has become widely known as Value Based Management (VBM).

VBM owes its roots to longstanding financial theory, which states that a business creates value only when its returns exceed its cost of capital. The true measure of profitability of a business then is the net profit left over after deducting a charge to account for the cost of the capital utilized[1], a measure commonly known as Economic Profit. Starting from this simple premise, consulting firms with significant VBM consulting practices have been engaged in a tussle to establish their specific version of Economic Profit as the "best", in an effort to establish their own market space. This metrics war, which has been ongoing for the past several years, has magnified VBM's financial image among managers even further.

One view of VBM, reflecting this finance pedigree, claims that a corporation essentially needs to get two things right. First, it must adopt an Economic Profit metric as a key measure of corporate and business performance. Second, incentive compensation must then be tied to agreed-upon improvement targets in this Economic Profit metric. The logic behind this approach is that if you point managers in the right direction, by adopting an Economic Profit

[1] As defined by the Capital Asset Pricing Model, which states that the cost of capital is the weighted average of the after tax cost of debt and the cost of equity. The cost of equity is composed of a risk free rate plus a market risk premium, adjusted for the specific (systematic) risk of the equity of the company.

measure, and then reward them on the basis of that same measure, you can sit back and watch good things happen inside the organization.

While this view of VBM is compelling in its simplicity and elegance, we suspected that there was more to VBM than that. If VBM was both so simple and powerful, why was it that many VBM companies were reporting mediocre success and were abandoning the practice while others seemed to have benefited greatly from its adoption? And why did so much hype and counter hype surround VBM, from those who claimed that it was a miracle cure to others who warned that adopting VBM would mean the end of collaboration, innovation and growth and would put organizations on a path toward competitive oblivion?

To answer these questions, we started two years ago with in-depth fieldwork in some of the leading VBM practitioners in North America, the UK, Continental Europe and Asia to explore why so many companies seemed to have so much trouble responding to the shareholder value challenge, and why some companies reported deriving great benefits from VBM while others failed to realize on its promise. To complement this field research we then conducted a comprehensive survey of the world's largest companies (1862 companies with 1999 sales above US$2 billion) to explore the various approaches to managing for value that are currently in use and to sketch out the emerging leading edge value-creating practices (see Tables 1-4 for the characteristics of the VBM companies in the survey).

It turns out that VBM is not only spreading across the globe and is widely practiced by various types of companies in a wide variety of sectors, but it has indeed moved well beyond the narrow financial definition and is in fact a practice covering a broad set of management processes. For its leading edge practitioners on three continents, companies that have practiced VBM effectively and for a long time, VBM is a holistic management approach that encompasses redefined goals, redesigned organizational structures and systems, rejuvenated strategic and operational processes, and even revamped human resources practices. In short VBM induces change in organizations that once were trapped in a multitude of internal value-destroying practices. This holistic practice of VBM is in sharp contrast to the finance-driven appearance that VBM has taken on in the past and that still permeates in a few quarters.

VBM's full power is unleashed when, after several years of concentrated effort, all of the company's main management processes have become fused together under the overriding objective of pursuing shareholder value, a state that we will call the *VBM Way of Life*. The ultimate result in leading edge users is a remarkably rejuvenated corporation, whose culture has been transformed as behaviors at all levels are altered (see Table 5 for VBM's benefits and Table 6 for VBM's impact on employee behavior). That a holistic approach to VBM can lead to impressive results is illustrated by the story of Cadbury Schweppes under the leadership of John Sunderland (see Insert).

From Tonnes to Economic Profit at Cadbury Schweppes

Cadbury Schweppes, one of the UK's most venerable companies with roots dating back more than 200 years is a good example of how VBM as a Way of Life can stretch a solid but under performing company to step out of the box and become a value-creating company. Under Sir Dominic Cadbury's leadership in the 1980s and into the mid-1990s, the company had grown to become a respected global player in two product areas: soft drinks and confectionary, striving for critical mass in both businesses, a drive for growth epitomized in the confectionary business' focus on volume growth (a million tonnes was the goal). Yet despite its successes based on size and growth, CS' share price performance did not follow suit.

Appointed as Cadbury's new CEO in September 1996, John Sunderland decided that Cadbury's languishing share price was a problem that needed attention. He also felt that he needed to mobilize his company toward fairly radical change by creating a sense of urgency among Cadbury's employees and managers. His method of choice for sounding a wake up call was to declare, at his first meeting with investment analysts and institutional investors, that he would put his personal commitment behind the goal of doubling Cadbury's share price within five years (later reduced to four years). Given Cadbury' share price uninspiring performance in the previous six years, especially against the likes of The Coca-Cola Company's, and his own previous orientation as a business manager to volume-oriented goals, this statement was bold. More to the point it was a clear signal to Sunderland's own organization that things were about to change. His intention to energize the troops and create a swell of momentum would soon be vindicated.

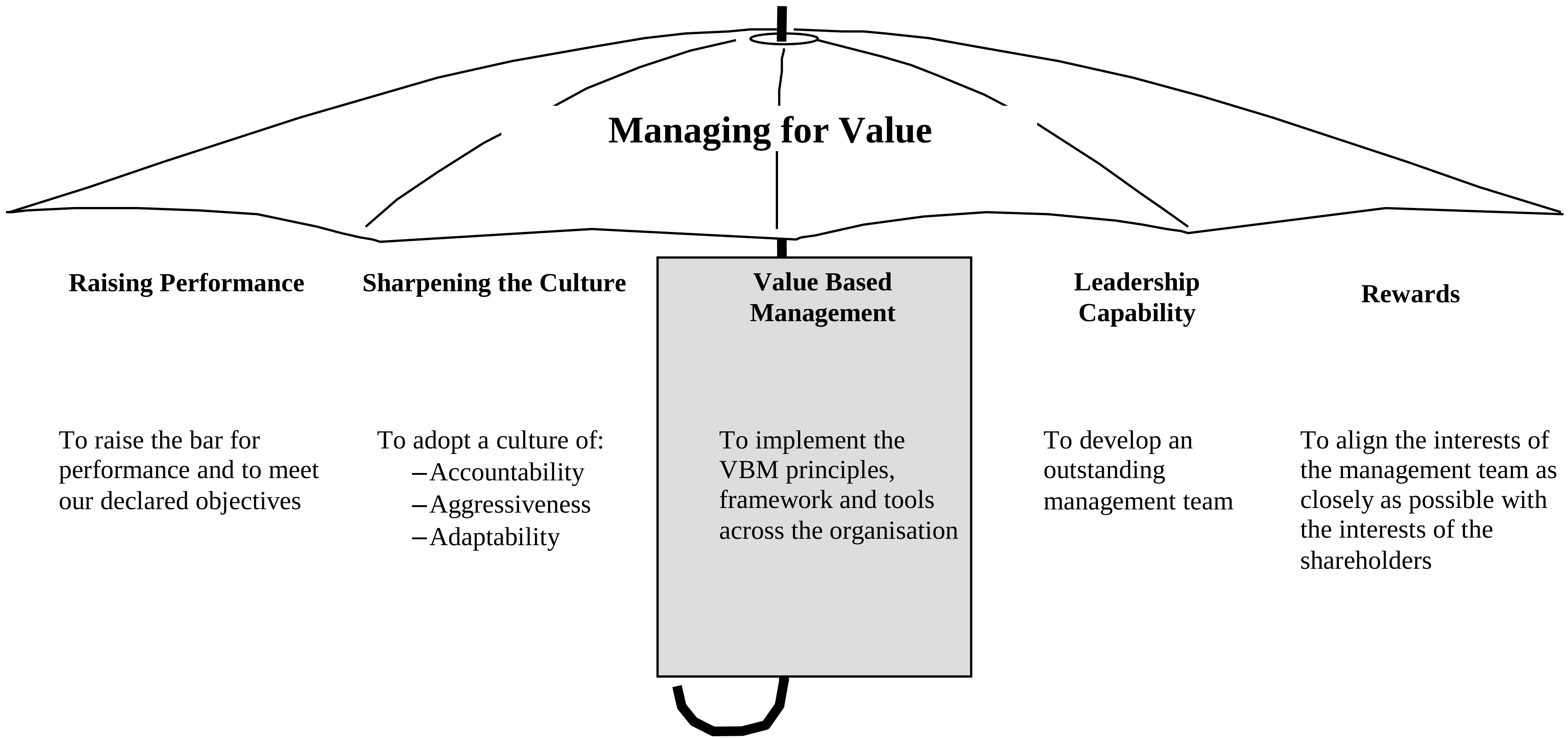
To follow up on his commitment to double Cadbury's share piece, Sunderland decided to implement a VBM program that he called "Managing for Value". One of his first steps was to appoint a VBM project manager, who then proceeded to work closely together with representatives of all corporate functions, including strategy and human resources, to implement VBM. Next he selected two units to act as pilots. He subsequently extended the Managing for Value program throughout the rest of Cadbury Schweppes, starting off with a Company-wide strategic audit to identify the 10 highest "value at stake" issues.

Over the next two years, Cadbury undertook a systematic effort to implement VBM. The VBM strategy development process would lead to some fundamental changes in the way the businesses planned their future. Every strategy discussion to challenge, complement or confirm management's previous ever-present intuitions was now anchored in a solid fact base. The basic measurement tool was to impose a capital charge on top of an ABC costing system to produce so-called Value Based Costing (VBC). At the core of its new Business Management Process was a set of leading indicators for the businesses, the so-called Key Performance Indicators (KPI, analogous to what we call 'value drivers'). Managing the organisation according to KPIs meant defining forward-looking measures for all activities, forecasting them, and explaining the variance between the forecast and the actual results. These

KPIs were cascaded down in actionable and measurable items in the organization, to determine if employees were performing in line with their commitments.

Ultimately the main thrust of the VBM program was aimed at changing people's behavior, by improving their leadership skills and sharpening the company's culture, and by positioning VBM as an holistic change effort, as symbolized by the so-called MFV "umbrella concept" (see exhibit). Managing for Value meant putting all managers through a leadership evaluation process to improve each manager's ability to self-calibrate his performance against the expectations communicated in the MFV philosophy and the leadership imperatives. A core element of the new value-driven HR management was to transform a status-oriented culture into a skill and task-driven one.

After two years of MFV, the first observable financial outcomes at Cadbury Schweppes were encouraging. The implementation was still in its early stages but the stock market had noticed the changes and voted its approval. Cadbury's share price performance under Sunderland's leadership between 1996-1999 had beaten the performance of its peer group by a good margin. While this was good news, Sunderland was under no illusion that much remained to be done to become a consistent and sustained top value creator over the long term.



Source: Cadbury Schweppes Managing for Value program.

For firms contemplating implementing VBM and for others currently engaged in that process, our research findings suggest five streams of actions that CEOs and their senior management teams must take in order to reap VBM's full benefits.

1. COMMIT TO VALUE AND THEN STAY THE COURSE

Large corporations are growing ever more difficult to manage every day. Despite the revival of the focused corporation, large companies today typically employ tens of thousands of people in a wide range of businesses. While these businesses may be related through vertical integration or the sharing of assets, or through the leveraging of key skills and competencies, the large firm's complexity and wide scope effectively mean that the vast majority of its employees feel largely unconnected one from another, from top to bottom and across.

The Challenge of Focusing the Large Corporation

As a result the CEO of a large corporation has a very basic challenge on his hands: how to communicate the essence of his company so as to provide his employees with the necessary focus on what truly matters: the creation of value. Many have chosen to define the purpose of their companies in one or two sentences focused on, for example, "delighting" their customers, or on achieving a broad and lofty objective, such as becoming the "best" in class or "biggest", in the hope that these words would provide the necessary inspiration and focus for the company. Yet judging by the number of companies that fail to create value on a consistent basis despite the flourish of their vernacular, it would appear that such words often fail to connect with and inspire those to whom they are intended, or that they simply fail to provide a sufficient link with shareholder value.

Other CEOs choose a more direct route by proclaiming their commitment to shareholder value. Of course simply saying that you're committed to shareholder value is no guarantee for success either. While extolling the virtues of shareholder value publicly has certainly become a necessity in the Anglo Saxon countries, and is even being heard occasionally in Continental Europe, we still see a large number of CEOs who pay only lip service to the notion of shareholder value. They talk the talk but don't walk the walk. It could be that, notwithstanding the shareholder value pronouncements in their annual reports, deep down they are unwilling to fully endorse the notion because a singular commitment to shareholder value would conflict too much with their belief system.

Or they may actually believe in shareholder value but are reluctant to trumpet this belief widely and loudly for fear of creating unnecessary conflicts inside the company or within the community at large. In some parts of Continental Europe and in Japan, for example, it is still viewed as in bad taste, if not unacceptable, for a CEO to discuss shareholder value openly, let alone to declare it the overriding commitment of the corporation.

<u>Shareholder Value Is the Driving Force</u>

Yet making shareholder value the driving force of your company is precisely what you must try to do.

Comprehensive Set of Actions. Our research establishes clearly that to realize VBM's benefits, companies must commit to a comprehensive set of actions over a long period of time that make shareholder value the driving force, if not the explicit stated purpose of the corporation.

A very early step in this commitment is invariably the adoption of Economic Profit as *the* measure of corporate and business unit performance, and the linking of incentive pay of senior line executives to improvements in this economic profit metric. This is of course analogous to what the financial VBM protagonists preach. However, for or all but a few of the VBM companies that we have observed, adopting economic profit and linking it to incentive compensation is only the beginning of a long-term comprehensive process lasting several years toward the VBM Way of Life. Because it involves all key management processes and large numbers of managers and employees, this process takes a long time to mature. We found that some benefits materialize early, but keep improving over time, e.g., VBM has an immediate impact on making employees appreciate that capital has a cost. We also saw some benefits realized only several years after initial implementation, e.g., VBM's impact on improving communication between Corporate and the business units (Table 7 shows the improvement in problems experienced for VBM users classified by number of years that VBM has been practiced).

Somewhat to our surprise, companies reported few disadvantages from the practice even in areas where non-users expected VBM to have a negative influence. Non-users in our survey expect VBM to have a slightly negative impact on growth initiatives, innovation and collaboration. In fact VBM users reported no negative impact from VBM in any of these areas, if anything a small positive impact was reported, on average. That most VBM users reaped sizeable benefits is underscored by the fact that only five companies in our sample of 115 VBM users reported that VBM would become less important to them, and only one of these reported having discontinued the practice altogether.

Explicit, Implicit or Multiple Stakeholders Commitment? Committing to shareholder value and developing a comprehensive set of actions toward VBM as a Way of Life is essential to obtaining VBM's full benefits, as we found out and as we will show in the rest of this article. But is it important to commit to shareholder value *explicitly*, by openly proclaiming it both internally and externally as the *raison d'être* of your company, or is it enough to commit to shareholder value *implicitly* while focusing on making the right strategic decisions and letting value happen as a consequence? Going further still, is it possible to create and sustain shareholder value *while embracing the multiple stakeholder approach* popular in Japan, in many parts of Continental Europe, and even in some pockets of the Anglo Saxon world?

This question is important because many non-Anglo Saxon CEOs are still uncomfortable at waving the shareholder value flag, yet at the same time they are searching for a way to respond to the shareholder value challenges imposed by the global environment in which they operate. The CEO of a Continental European company with a publicly-traded subsidiary in North America pointed out to us that he was much more subdued in his commitment to shareholder value in Europe than in the US by saying: "I also drive differently in the USA than I do in

Europe". The communication challenge to make shareholder value work for you rather than against you in some environments is very real.

The importance of this challenge is underscored by our finding that the explicit commitment to shareholder value is highly correlated with self-reported improvements in relative share price performance (see Table 8).

Our data also suggests that companies with more than one year of experience with VBM that were making an *explicit* commitment to shareholder value reported greater success at implementing VBM than ones which were *implicit* in their commitment or which adopted the balanced *stakeholder* approach (see Table 9).

Yet as it spreads from the Anglo Saxon economies to Continental Europe and Asia, more companies are trying to realize VBM benefits while avoiding to be explicit and loud about their commitment to shareholder value (see Table 10). Will it be possible for these companies to reap VBM's full benefits? Only time will tell, as the most recent adopters in Europe/Asia will need another 2-3 years of experience with VBM before its impact can be fully assessed.

While an extensive discussion of this important question is beyond the scope of this paper, the experience in the USA and the UK, where VBM has been practiced the longest, suggests that the answer to this question will not be straightforward. On the one hand as we expected, responses from the USA and UK show a high correlation between implementation success and explicit focus on shareholder value (see Table 11). Yet in Continental Europe and Asia where explicit commitment to shareholder value is yet to become the accepted norm, many point out that the advantages conferred by an explicit commitment to shareholder value may be largely negated by the disadvantages they would experience if they moved away from the multiple stakeholder approach, for example a loss of harmony among the various stakeholder groups. That being said, we point to the results of our research, which are clear on the advantages of having an explicit commitment to shareholder value; advantages that we believe even the companies in these economies would benefit from.

First, our fieldwork in Continental Europe suggests that straddling the shareholder value fence could well undermine the internal and external credibility of a VBM program and is very likely to delay favorable market reaction until tangible actions show results. This was recently illustrated to us by the remarkable turnaround of Siemens, which can be traced at least partly to a VBM effort initiated a few years ago, but whose external, if not internal, impact was undermined initially by the CEO's reluctance to depart from the company's stakeholder doctrine.

Second, there is little doubt in our minds that an explicit commitment to shareholder value does focus everyone's attention toward one common goal that everyone can understand, can work toward and, perhaps most critically, can use internally to make trade-offs among conflicting strategic priorities and choices. This ability to focus and to make trade-offs in a dispassionate value-creating manner becomes all the more important the bigger, the more complex, and the more geographically disparate the company is. With global companies employing tens or even hundreds of thousands of employees working in sometimes as many as 100 countries, the CEO needs a simple but powerful way to focus his troops on what really matters, and explicit commitment to shareholder value appears to provide that singular focus in a very effective manner.

As part of this commitment, the power of setting and communicating stretch shareholder value goals should not be underestimated, as many companies have experienced since Sir Brian Pitman, the then-CEO of Lloyds (later to become Lloyds TSB), illustrated so well nearly 15 years ago. Pitman initially committed to doubling shareholder value every four years, later shortened to three years.

Introduction of VBM: CEO-led and Company-Wide

So what's the best way to introduce VBM in your organization and who should lead the effort? The introduction of VBM can occur from any of a number of entry points: the CEO, CFO, Chief Planning Officer or other senior executives. Our survey results indicated that the main driving force behind VBM typically tended to be either the CEOs (57%) or the CFOs (28%).

Regardless of its entry point, however, what's key if VBM is to spread successfully throughout the organization is for the program to become a company-wide initiative and not to remain "boxed" in any one department. If the program stays with the finance department, for example, it may have a tendency to become too focused on the numbers, the metrics and the adjustments from accounting to economic profit. The best applications we saw were ones where the CEO was heavily committed personally in the VBM program with a full time senior executive in charge of the day-to-day implementation of the program. His main function is to involve and coordinate activities among all key departments – not only finance, accounting and control but also strategic planning and human resources management, as well as of course the business units themselves. He's also responsible for ensuring consistency in how VBM is applied throughout the company and in collaborating with line managers of pilot projects in the early phase of the program.

In summary, our message to the CEO is to:

1. Make shareholder value the driving force of your company ***explicitly***.
2. Use shareholder value to align your company's internal and external communication systems. This means talking the same shareholder value language to everybody inside and outside the company.
3. Set a stretch shareholder value target to energize your company and communicate your commitment to value.
4. Appoint a senior executive in charge of day-to-day VBM implementation reporting directly to the CEO.
5. Commit to a comprehensive VBM program and prepared to stay the course for several years before VBM becomes a Way of Life.

2. REDEFINE THE ROLE OF THE CORPORATE OFFICE AS VALUE CREATORS

Capital markets pressure and increased global competition do not of course stop at the CEO's suite. For managers in the corporate office, these pressures translate into challenges to justify the value creation logic of their overall corporate strategy. Somewhat ironically, discussions about corporate strategy quickly draw attention to the corporate office's own contributions to shareholder value creation. Managers in the corporate office are often regarded as wasteful overhead who, under the guise of coordination and control, end up constraining rather than helping the businesses.

Corporate Strategy Trapped in Past Wasteful Decisions

In many companies corporate managers do indeed struggle with their role as guardians of value. The markets is ruthless and swift in how it evaluates companies, and beware for those who have assembled a messy portfolio of products and businesses through past capricious investments. Despite their drive of recent years toward focus and simplification, our survey reveals that many executives still do not have a clear picture of where value is created or destroyed in their companies, and in fact more than 70% of the VBM companies in our survey cited this problem as one they were specifically trying to fix by adopting VBM.

But even companies that can identify where they destroy value often have difficulty in taking remedial action. Personal stakes and priorities of corporate executives, pride and emotional attachment to pet businesses all make it hard to reach a clear agreement on what to do. Institutional investors may prod and raise questions about the most obvious and egregious value-destroying units, but the comfort zone with the status quo within managerial ranks is thick, allowing them to evade, weave and bop. Unless they eventually get into a financial or credibility crisis with the market, most companies lack the burning platform that is needed to convince corporate executives to put aside their personal egos, stop looking at past commitments and start focusing on how to create value in the future.

Make Your Corporate Office Active Value Creators

Our research suggests that VBM can help corporations re-define the role of their corporate offices as the primary guardians of value by bringing them back as active value creation actors at the corporate center. This redefined role takes shape principally in two ways. First the corporate center takes an active role in weeding out or turning around value-destroying activities ("stop the bleeding", as one CEO put it). And second, the corporate office then moves on to initiate value-enhancing initiatives directly from the corporate center.

Weeding out the losers. In its early phase, VBM leads to a ruthless and dispassionate weeding out of value destroying units in the corporate portfolio. In company after company we saw examples of VBM-led analysis, which was often presented in charts that revealed and pinpointed in a stark, graphical way the value destroying as well as the value-creating units. This analysis inevitably confronted executives and managers about the reality of their businesses and gave them a wake up call to jolt them out of their rut (see statement #22 in Table 5). For example in Boots, a British manufacturer and retailer of drugs and consumer goods, the VBM analysis revealed that value was created in a very different part of the company than was commonly believed.

Value analysis often leads to revealing insights and provokes action. In the mid-1990s the then-Daimler-Benz discovered that over 60% of its businesses were actually conspiring to lower the company's market value. This type of finding is not uncommon among early VBM adopters. Although such analysis always leads to heated discussions about how corporate assets should be allocated and the impact on some units of taking action in others, executives and managers find it hard to argue with the data that value analysis provides (statement #15 in Table 5). To rebut the findings, or to argue that a particular value destroying activity is temporary and is a needed investment for the future, the managers under scrutiny must present an alternative view based on logical and objective analysis. As the leader of one of Dow Chemical's 15 global units told us: "there is no place to hide with VBM".

Diagnosis based on VBM analysis is only a starting point for developing a new value-creating corporate strategy, and how companies deal with the implications of this analysis varies. In some companies the portfolio diagnosis triggers a series of divestments. Lloyds (now Lloyds TSB) for example initially divested most of its businesses outside of retail banking, and also sold off most of its international operations. As Sir Brian Pitman, then Lloyds' CEO recalled: "The more we sold businesses the more our share price went up." Other companies choose to apply the heat on their businesses but give their managers a grace period for turning their businesses into value-creating shape. This was the approach taken by Juergen Schrempp, Daimler-Benz's CEO, who gave his value-destroying businesses 18 months to meet the hurdle of covering a 10% cost of capital. The value analysis therefore not only provides the impetus for divestments, but can also be the trigger for businesses to start realizing their value potential (see Table 12 for VBM's Way of Life Impact on Strategic Decisions).

Initiating Value Creation From The Corporate Center. While weeding out value destruction or setting existing businesses on a course of value creation is essential to re-orient corporations back on course, this may not be enough to win in today's global economy. The name of the game today is not merely to create value, but to be among the top value creators among one's peers on a sustained basis. This tough and relentless relative performance standard is of course the same one imposed on institutional investors and is now being demanded of corporations themselves. Relentless rivalry thus continuously raises the hurdle of value creation, and makes it a moving target. This phenomenon may be why we observe a cluster of value-driven users in some industries. Kao, one of the early VBM adopters in Japan, competes head-on with the USA's Procter & Gamble and Europe's Unilever in the global consumer packaged goods industry. According to Mr. Shotaro Watanabe, Kao's senior executive vice president, the introduction of VBM at Kao was motivated by the restructuring and strategic re-direction of its rivals, which were guided by the principles of VBM in Mr. Watanabe's view.

One common response in VBM companies is for the corporate office to once more take the lead in identifying and generating value creating opportunities that shift the corporate strategy. Once the core portfolio is cleaned up and the bleeding of value has been stopped, or at least largely stemmed, VBM's discipline is subsequently unleashed on exploring new acquisitions, new market entry opportunities and the promotion of corporate brand equity. These emerge as new corporate strategic priorities as the companies shift their attention toward accelerated growth. Lloyds' acquisition of TSB and subsequently of Scottish and Widows, and Dow Chemicals' pending acquisition of Union Carbide are clear examples of corporate initiatives to prolong the value creation dynamic.

Aligning Structures and Systems

While corporate value analysis looks deceptively simple in retrospect, getting there can be a complicated exercise, as many respondents pointed out in open-ended comments. Companies should spend enough time reflecting on what businesses they are in, or more precisely on the type and number of value centers that they ought to have, given VBM's requirements. A retailing company for example may conclude that it makes sense, from a VBM perspective, to separate its real estate assets from its bread-and-butter retailing business. A company structured along geographical lines may need to redefine its structure to mirror the global nature of its competitors. In all cases companies must decide how far down the organization they can realistically push balance sheet responsibility.

Calculating economic profit requires that the corporation's assets be allocated to its value centers, an exercise which unless done with purpose and determination risks being mired in political haggling about the numbers, thereby sidetracking and even stalling the VBM process. At Dow, after a period of discussion about allocations, the company's senior executives stepped in with a relatively straightforward method and put an end to the debate. Various economic profit metrics require a large number of complicated adjustments from standard accounting conventions, as suggested by their creators. In practice, companies typically make do with a handful of adjustments relevant to them. The theme of Keep it Simple came through loud and clear in the respondents' comments. Introducing Economic Profit also requires the computation of the cost of capital, not only across businesses but also across a range of continents. Here again the benefits of simplicity appear to outweigh the merits of hard-to-justify theoretical purity.

Successful implementation of VBM analysis, however, does require corporate managers to review the logic of their corporate strategy. As long as the businesses are completely separate from each other, the analysis is pretty straightforward. However, if businesses make products that carry the same corporate brand, use the same logistics and distribution channels, or share technologies, the analysis gets complicated but also becomes a process of (re-) discovering the corporate strategy's logic.

Despite fostering a more active role for the corporate office in value creation, VBM actually helps corporate executives and managers not to become overwhelmed by the complexity and magnitude of their task. In practice VBM assists corporate managers to focus their limited time and attention on selected areas, where the potential is greatest to add value, either through the weeding out of value destruction or through the pursuit of value-adding opportunities.

In summary, our message to the CEO is to:

1. Use value analysis to pinpoint value-destroying businesses, and then act decisively either by divesting the businesses or by putting them on clear probation.
2. Review the businesses you are in carefully then create value centers at the lowest level where assets can be allocated meaningfully.
3. Keep economic profit and cost of capital measures simple.
4. Keep in mind that value creation can come as much from improving already profitable businesses as from eliminating value destroying ones.

3. MAKE YOUR BUs TAKE CHARGE OF THEIR VALUE-CREATION POTENTIAL

Although under VBM corporate managers can assume an active role in value creation by pushing for divestitures, and by pursuing acquisitions and new market entry opportunities, the primary drivers for value creation still remain the individual businesses themselves. The key challenge of managing for value lies in how to harness the creativity of business managers, promote their entrepreneurial instincts and empower them to take the lead in identifying and exploiting value creating opportunities. And while the business managers are the key actors in this challenge, the corporate office has another role to play, this time as a partner and facilitator for the businesses.

The Seesaw Between Decentralization and Centralization

Although decentralization and empowerment sound like common sense, implementation of these objectives puts corporations face to face with a classic dilemma. On the one hand, because they are closest to their markets, business managers are best positioned to develop and implement strategies for their operations. On the other hand it is corporate managers, far removed and with limited knowledge of the markets, who have the ultimate authority to allocate the resources necessary to implement these strategies. The challenge facing corporations is how to develop the appropriate decision-making balance between the businesses and the corporate office in such a way as to optimize the corporation's overall value creation efforts.

Corporations have historically dealt with this challenge by going through seesaw cycles that have seen the pendulum swing between too much decentralization and too much centralization of decision-making. At one end of the pendulum swing, they foster entrepreneurship and growth, at the other end it's profitability and optimized resource allocation. Somehow they never manage to stay long enough at the mid-point of the swing to realize enough of the two objectives at the same time.

Stuck with this dilemma and conditioned by the seesaw swings, corporate manages and business managers often end up in a very distant relationship with limited trust in each other. A mentality of "us versus them" sets in with each discounting or doubting the other's intentions.

Classic planning and resource allocation processes have often failed to bridge this divide. In many companies strategic planning remains to this day a paper exercise that does not involve real sharing of information or trust between business managers and corporate managers (see Table 13).

Business managers use the planning cycle to go through a ritual to advocate their *de facto* strategy with little serious consideration for alternatives. Corporate managers find it difficult to compare different strategies for different businesses, as they are faced with a classic "apples and oranges" problem. Even if strategic plans are of high quality and are given due consideration by corporate managers, the whole exercise is neutered latter on when the time comes to actually allocate resources. Here companies will fall back on their old practices of funding discrete projects stacked in a pile, based as much on the track record of the sponsoring executive or his skill at stick handling his favorite projects through the system, or based on the interests and hunches of corporate executives. While apparently rigorous economic analysis invariably accompanies the project requisitions for capital, the assumptions underlying the economic analysis are inevitable colored and influenced by these various postures. It is little wonder that strategic planning has been declared dead by many.

VBM Strikes the Right Balance

Our research suggests that VBM seems to at least mitigate, if not completely resolve, this classic dilemma in three ways. First, VBM helps business managers sharpen their strategic thinking capabilities and reduce or eliminate the previous downside of a decentralized strategy development process. This in turn helps corporate managers develop confidence in the business managers and their strategies. A virtuous cycle is then created. Second, VBM pushes corporate and business managers to re-define the nature of their relationship under the common objective of maximizing value by assigning each group new complementary roles and responsibilities. This new relationship in turn enables the corporation to retool its strategic planning and resource allocation practices in support of this new corporate-business partnership.

Stretching the strategic thinking capabilities of business managers. Far from being a tool primarily designed for corporate executives to drive top-down portfolio restructuring decisions, the leading edge VBM practice that we observed is built essentially on a philosophy of decentralization and empowerment. Dow Chemical, which implemented VBM under the leadership of Bill Stavropoulos as COO in 1993 and later on as CEO in 1995, restructured its previously geographically based company into 15 global units divided into over 100 value centers. It then decentralized strategy development to the global units and value centers. Each value center was pressed to undertake a comprehensive analysis of the underlying attractiveness of its business segment and its own relative competitive position, and to come up with a few strategic options. A team of business managers, typically the general manager and his key functional managers, had to work together to produce and present an evaluation of each option based on how much economic profit it would create over its life. Similarly, Hoya, a Tokyo-based optical glass manufacturer and one of the most advanced VBM implementers in Japan, engineered a radical organizational change. Many corporate managers—planning managers and even human resource managers—were transferred to the businesses to support the philosophy of decentralized strategy development. Indeed, a significantly reduced size of the corporate office virtually guaranteed that the remaining corporate managers could not intervene in the strategy development process. It was now in the sole hands of the businesses themselves.

Building a new corporate-business value partnership. Our research suggests that VBM, when implemented successfully, helps corporations re-define the nature of the corporate-business relationship and forges a new balanced partnership between them. The corporate office does not dictate to the businesses anymore, but neither do the businesses have a free reign to do as they please. This new relationship has five important features:

First, the new VBM-induced decentralization thrust does not lead to the *laisser-faire* policy that proved to be deficient in the past during the decentralization swing phases of the pendulum. Under VBM managers in the corporate office, while small in number, still exercise important influence over the bottom-up strategy development processes. For starters, the CEO's stretch shareholder value goals set the stage for everyone: The bar is raised high and it stays high. This is then followed by the adoption of the same VBM framework by the whole corporation, which imposes a certain way of doing things, grounded in value-creation, on all businesses. Of course the corporate office has a lot to do with the design and implementation of this framework, providing it with another point of influence on the process. Ultimately corporate managers become known as the VBM internal experts and act as coaches to the business units seeking advice and assistance.

Second, VBM imposes heavy requirements on upgrading MIS systems to provide data and information to users. Companies like Daimler, Dow and Hoya all invested heavily in their MIS systems to produce standardized and consolidated systems across their companies. Our survey data shows that these are not isolated examples (See Table 14).

Corporate managers are, of course, able to access this information directly if they wish to verify facts or to follow up on issues that may have arisen in discussions with the businesses. The senior executive team continues, of course, to retain the ultimate say over the funding of strategic alternatives.

Third, VBM revitalizes two-way dialogue between corporate and business managers, and enhances learning between them. The common language of value, now shared by all managers, facilitates meaningful communication (statements #13 and #16 in Table 5) and reduces posturing and game playing (statement #9 in Table 5). A common language and enhanced communication help everyone develop mutual confidence in the chosen strategies often because of a very precise understanding of market and competitive factors affecting not only their own businesses but also their competitors'. As a business manager in one of the global units at Dow Chemical commented: "based on our relative cost assessment, we had come to the conclusion that one of our competitors should exit the market. When that unit was subsequently put on the market for sale, we all felt more comfortable about our own strategy".

Fourth, VBM pushes business managers toward zero-based strategic assessment and challenges them to do away with timid incremental approaches. Challenging but realistic stretch goals, the insistence on presenting a range of real strategic options, and the improved clarity of their own relative competitive positioning all nudge managers toward more creative choices. Once these choices are presented by all businesses to the corporate office for review, discussion and ultimately approval and funding, VBM then brings new discipline to the resource allocation processes (statements #11 and #15 in Table 5) and improves the ability to allocate resources toward their best use (statement #19 in Table 5). In computing the economic value of strategic alternatives, both corporate and business managers are able to compare multiple strategic alternatives with different risk/return profiles in a meaningful way. Choosing alternatives between entering the Chinese market and consolidating distribution channels in Europe now becomes comparing "apples" and "apples" not "apples" and "oranges". The process gains great transparency.

Of course such discipline does not necessarily reduce the uncertainty inherent in strategic decision-making. VBM is not a crystal ball, but at least the disciplined discussions that it engenders improve the quality of decision-making and reduce somewhat the odds of committing strategic mistakes that ought to be avoided in advance (statement #10 in Table 5).

Fifth, ultimately the new corporate-business relationship is grounded in the fact that for the first time companies are actually committing to the funding of complete strategies over a period of years rather than funding discrete projects as part of the annual capital expenditure approval parade. As a minimum advanced VBM companies at least tie strategy and the project approval process more closely (see Table 15), as well as strategy and budgets (see Table 16). In the end this tighter coupling of strategic planning, resource allocation and budgeting under VBM represents a remarkable revenge of strategic planning.

In summary, our message to the CEO is to:

1. Set challenging goals for businesses to break them loose of incremental thinking
2. Decentralize strategy development processes while at the same time linking strategy development tightly with resource allocation.
3. Challenge businesses to come up with several true value-creating strategic alternatives.
4. Use the new VBM-centric language to facilitate communication and learning between the corporate office and businesses.
5. Upgrade MIS to assist managers in strategy development while at the same time enabling corporate managers to maintain influence over the decentralized processes.

4. TURN EACH EMPLOYEE INTO A VALUE CREATOR

The VBM Way of Life spreads in an organization in stages. It starts with the senior executive team. Then it goes through the corporate office and the front line business managers, typically at the general management level and one level below. Eventually it aims to reach nearly everyone in the firm. This challenge of turning literally tens of thousand of employees into value creators cannot be underestimated, yet for those who succeed the rewards are worth it.

The Unreceptive Employee Mindset

VBM's biggest benefits are realized when companies are successful in downloading and spreading the VBM philosophy and way of life deep inside the organization. In some cases companies use VBM only as a trigger to sell a few businesses or justify shutdowns that were planned in the first place. In other companies we saw VBM being perceived as the finance director's pet project, at the same time that the manufacturing director was deep into a total quality program and the human resource department was launching an apparently unconnected leadership development initiative. Clearly such practices will not go very far in turning employees into value creators, and may even backfire by deepening existing cynicism about change efforts in general.

Even if they fully intend to push VBM deep inside the organization, companies will find it easier said than done. For starters the majority of managers and all employees work at a level where you cannot measure Economic Profit directly. This means that for them there is no direct link between their day-to-day activities and Economic Profit. You will have to find other ways to bring them into the shareholder value fold. Then it is very possible that your managers and employees have seen management practices come and go in the past. As a result a large number will be highly skeptical of VBM and will view it as the "flavor of the month" Even if your employees and lower level managers are open to the idea of adopting a new management practice the vast majority are not likely to possess enough financial and strategic analysis skills to understand and immediately grab onto concepts like the cost of capital and economic profit. At Dow Chemical, for example, fewer than 5% of its almost 40,000 employees (including managers at fairly senior levels) could provide an accurate definition of economic profit or the cost of capital prior to VBM's rollout (currently this figure is more than 80%, according to senior Dow executives).

VBM: A Toolkit for All Employees

Yet the benefits of having the whole organization mobilized for value are substantial and justify the effort and investment required to make it happen. Corporations will find it difficult to realize fully on shareholder value unless strategic decisions taken higher up can be turned into action, or better still, until strategic actions (decisions that impact value) are decentralized as far down as possible.

Value Drivers Link Operations with Strategies. VBM can help align strategy and operations by effectively providing a VBM-based educational and training toolkit for large numbers of your managers and employees. This toolkit helps employees understand how their day-to-day actions can influence shareholder value. It does so by enabling employees at organizational levels where economic profit cannot be measured directly[2] to identify and assess the operational factors that have the greatest influence on the creation of economic profit within their business units. These operational factors are the so-called 'value drivers' (see Table 17).

The toolkit also contains guides on how to develop choices, how to evaluate these choices and how to select the best one by learning how to make trade-offs based on value creation principles. It teaches thousands of people that capital is not free but rather that it has a cost that must be covered before value is created. Our research shows clearly that VBM Way of Life companies invested heavily in training and development, for their managers and substantial numbers of their employees (see Tables 18 & 19).

We have seen the value drivers exercise produce impressive results at, for example, DaimlerChrysler where production employees in DASA, the company's aerospace division,

[2] Units for which discrete financial statements cannot be produced.

learned how to deal with issues like whether to accept certain external contracts for work and how to balance line capacity and changeovers, all with a firm view to maximize value.

The exercise of determining value drivers in turn provides a whole new take on the business strategy process. Reaching agreement on the key value drivers for the business or certain activities forces a very concrete discussion among the business team members about what drives the business, what customers want, what competitors are doing, and other important strategic and operating factors affecting value. At one diversified retailing company the corporate office had kick started the discussion by providing a general template of the main financial and operational drivers that are considered 'naturals' in the industry, e.g., sales per square foot and inventory turnover. After the managers and employees of each of the retailing formats went through their own brainstorming session, they emerged with very idiosyncratic drivers, illustrating not only the specificities of their particular segments segment, but also their assessment of their own relative competitive positioning and market segment characteristics. What materialized in the end was a clear template of the shared beliefs about what creates success in various parts of the business both long-term and short-term, and who in the organization was able to affect what. As such the value driver process itself acts as a 'bonding' mechanism among employees and between employees and their supervisors.

In all successful cases that we have observed, corporations maintained internal control of this phase of value driver determination, even if they had relied earlier on consulting firms to help them introduce VBM and implement it at the corporate level. Some told us that the credibility of the training sessions depended a great deal on who was doing the training. Production workers at Daimler, for example, seemed to trust their foremen most in learning about VBM.

VBM Fosters Behavioral Changes. If committing to value creation as the purpose of the corporation is essential to focus everyone in the company on what truly matters, it is only when literally thousands of people translate this focus into tens of thousands of meaningful actions that value is actually created. Companies that are successful in downloading VBM deep and wide throughout their organizations report important positive changes in the behavior of their employees (see Table 6 for a listing of Impact of VBM on employee behavior). VBM users reported all an increase in personal accountability, improved morale, the likelihood of taking the initiative and increases in the employees' skill sets. However, these benefits came at the expense of a slight increase in the stress level of the employees, not surprising given that decision-making is being pushed farther down. Improved employee behavior leads in turn to significant benefits to the company that come in the form of interests that are aligned along shareholder value at all levels of the organization.

Making Employees Buy Into VBM

Valuable as the VBM toolkit is, it is not a self-teaching mechanism, and you will have to convince your employees to try it out and use it. Once they use it, you then have to reinforce its importance to both the company and their personal careers.

Communication, Communication and Communication. To download value deep in the trenches will require first of all relentless communication about VBM, why it's being introduced and the logic behind turning the company into a VBM company. You will have to convince your skeptical organization that VBM is not a codeword for layoffs (although layoffs may in fact end up occurring as a result of your VBM program). This will mean that the senior executive team, led by the CEO, will have to make communicating about VBM one of their top strategic priorities for a sustained period of time, meaning several years. We have seen communication come in all forms, for example in the form of face-to-face meetings as Sir Brian Pitman, Lloyds TSB's chairman did in going from branch to branch meeting with small groups of employees (without their supervisors). We have seen CEOs participate in training sessions along side their executive teams and managers. Some companies made heavy use of their intranet to spread the VBM gospel. Others distributed CD-ROMS and videos. The important point to keep is that you cannot communicate too much: As one respondent put it: "communicate, communicate and communicate". And the more visible the CEO is, the better.

Linking Compensation with VBM: The Final Loop. There is one final critical step required to close the VBM loop inside organizations to ensure success: linking incentive compensation to shareholder value. Of course in the Anglo Saxon world, and increasingly in Continental

Europe and even Japan, stock options have become a key feature of executive compensation quite independently from VBM. In this respect the VBM and non-VBM companies in our survey look alike. Where successful VBM companies differ substantially from others is in how they extend the link of compensation to shareholder value beyond a limited number of senior executives to include a large number of employees (see Table 20).

For large numbers of employees, bonuses that are contingent on achieving certain targets in the key value drivers provide the link with shareholder value. In addition, other targets for the business and personal objectives are also important factors in setting the amount of the annual bonus. Interestingly, the size of the bonuses does not make a difference between success and failure in implementing VBM. What's key is to reward widely, not necessarily heavily (see Table 20). At lower organizational levels, the bonus amounts that are linked to shareholder value that we saw were typically modest, in the order of 10%-20% of the annual salary. However these can still act as powerful motivators to large numbers of employees who, for the most part, may have never participated in bonus programs before and who need to see a tangible link between their actions and how they are rewarded, both financially and psychically.

In summary our message to the CEO is to:

1. Make VBM communication a central part of your own and senior executive team's priorities.
2. Develop and administer a comprehensive tailor-made training program for a large number of employees.
3. Make extensive use of value drivers to establish the link between shareholder value goals, corporate strategic choices and operational day-to-day activities. Focus on not only understanding diagnostic (past) value drivers but also on determining prescriptive (forward-looking) drivers.
4. Link incentive compensation to value drivers. Reward widely, not necessarily heavily, throughout the organization.

5. MAKE VBM A TRUE WAY OF LIFE

The VBM Way of Life program consists of several concrete steps going from goal setting to linking incentive pay with Economic Profit. A good deal of the program's effectiveness has to do with how it helps align existing management processes and systems under the shareholder value umbrella (the metaphor that Cadbury Schweppes coined), for example the alignment of strategic planning with resource allocation and then with operations through value drivers. The VBM Way of Life passes from commitment and goal setting, to corporate and business strategy re-definition, decentralization of decision-making and, finally, linkage of performance and incentive systems.

Yet in the end it's not acronyms, structures, systems or processes that create value. People do. And no amount of re-jigging of the organization structure or development of new management processes and systems will by itself lead to value creation unless the people inhabiting these structures and using these processes and systems have the proper mindset to set about creating value for their organization. Simply put people must be open for value and embrace it as a Way of Life.

Satisfactory Under Performance

We have observed that many companies that fail to create value on a consistent basis operate in a state that can best be described as "Satisfactory Under Performance". Companies in that state are rarely in danger of financial failure, on the contrary their balance sheets are often in very good shape. Still their competitive positioning is invariably in steady rather than precipitous decline. Satisfactory Under Performers become enveloped in a permanent condition characterized by complacency and comfort, the absence of real accountability, and the discouragement of initiative taking. A culture of avoidance is present and dominates. One telltale sign of companies operating in this state is a consistent record of under performing their peer group on financial measures including, of course, on the creation of shareholder value.

Unless the company succeeds in breaking out of this state, permanent Satisfactory Under Performance is guaranteed and a long period of steady decline sets in.

VBM Changes the Culture

We have observed many companies operating in Satisfactory Under Performance that fail to read the signs of decline all around them and end up becoming acquisition targets or they simply fade over time. Some have broken out of that state under the determined and forceful leadership of a newly appointed CEO. Others that have turned to VBM as a Way of Life and have implemented it successfully have reported success in breaking out of the culture of mediocrity and avoidance and have set themselves on a new course, rejuvenated and strengthened. They point to the changes in their people's behavior (see Table 6 for changes in employee behavior).

We believe that there are three principal reasons why VBM can be an effective cultural transformation agent.

VBM provides focus and clarity as the overriding guiding principle, which is needed to break the organization out of its paralytic state. Several respondents stated that VBM succeeded because it provided everyone in the company with a new way of thinking as well as a clear statement of goals.

VBM provides repeated reinforcement of shareholder value as the glue binding the company's structure, various management processes and systems. At each step toward VBM as a Way of Life, as the organization's structure, management processes and systems are re-aligned along shareholder value principles, a clear and powerful signal of the new way of doing things permeates the organization, reinforcing the step preceding it and setting the stage for the next phase of the program.

VBM puts a big onus on people to spend time together to implement the program successfully. The reality of VBM as a Way of Life is that it takes a long time to achieve and it involves a large number of people in the company. The CEO and other senior executives are highly visible, as a precondition of success. The corporate staff is involved in revamping systems and in preparing and leading training sessions. Nearly everyone participates in training sessions, either as trainer or trainee, which puts people shoulder to shoulder discussing VBM, what it means, why it's important to adopt and how to implement it. General managers get together with their business unit functional managers to figure out new value creating options for their businesses. Supervisors get together on the floor shop with their workers to hammer out which value drivers influence Economic Profit the most and how to manage the plant accordingly. And on it goes. After 3-4 years of doing this, day in and day out, it's not surprising that a new culture finally "takes". The fact that incentive pay is also linked to VBM is simply icing on the cake, not enough by itself to change the culture, but a final powerful reinforcing message about shareholder value and as the last link in the VBM Way of Life program.

Manage and Advertize Success

CEOs looking for VBM as a potential agent for cultural transformation should make every effort to start the process on a winning note. This is essential in this case as VBM will ultimately end up involving nearly everyone and early success must be evident and clearly visible to break down the organizational inertia built up over time. Companies like Dow, Cadbury and Daimler all focused on picking one operation as a VBM pilot before full rollout. In each case the leader of that pilot was picked with great care. In Cadbury's case, the head of Trebor Bassett, the company's confectionary subsidiary, volunteered to be the first VBM convert. He was eager to try a new way to break his unit out of the complacency that had gripped the whole company. Similarly at Dow, the head of the Plastics Products Group in the early 1990s suggested to Bill Stavropoulos, Dow's COO at the time who would later become CEO, that his unit engage one of the VBM consulting firms to assist it in introducing and implementing a VBM program.

The second important step is to celebrate successes and communicate them as widely as possible throughout the organization, to increase momentum behind VBM and to build credibility around the program. In this, the CEO will continue to play an important role of chief VBM cheerleader, but should also be assisted by other executives and by managers lower down who have achieved good results with VBM and are eager to share their successes with others.

It is also important for CEOs and the executives running the VBM program to have a realistic sense of what VBM can achieve and what it cannot, and of the timetable involved. You must have a very clear sense of what benefit will accrue and when. This is important because if expectations are set too high or too early, some may be disappointed at what they perceive to be a deficient or unsuccessful program and may be tempted to abandon it.

In summary, our message to the CEO is to:

1. Create a nucleus of change that's guaranteed to succeed.
2. Communicate success stories widely in the organization.
3. Assume the role of chief VBM cheerleader.
4. Have a realistic sense of the benefits and limitations of VBM and of the timetable of the program.

A FINAL WORD: STAYING AHEAD

Our research shows clearly that companies that adopt VBM as a holistic agent of change report substantial tangible benefits. Among these benefits are important indicators of employee behavioral changes, which end up aligning employees with the value creation objective, and significant improvements in the corporate-business relationship. We also found that companies that feel that they have implemented VBM successful have re-aligned their management processes and systems from top to bottom with value creation. Overall then successful VBM companies that pursue VBM as a Way of Life show a high degree of satisfaction with the results.

But a basic question still remains: Do these changes in processes and behavior contribute to shareholder value creation, as VBM promises? After all shareholder returns is the name of the game and is the whole reason for considering VBM in the first place. More fundamentally can VBM create sustained superior shareholder returns over the long term, or are its effects transitory?

Successful Implementation, Benefits, Process Changes and TSRs Correlate

In our survey we assessed VBM's impact on shareholder returns primarily on the basis of the respondents' self-assessments of how significant they felt VBM had been in resolving their relative share price performance problems. We also developed our own external measure of relative share price performance to validate the respondents' self-assessments
The results of this analysis show strong correlation between implementation success, impact of VBM on relative TSRs, and the range of benefits and behavioral impacts, and organizational and process changes discussed throughout this article (see Table 21 for a discussion of our methodology).

How Long Can You Stay Ahead?

While our research is clear about the long-term benefits derived by successful VBM companies, and we have found that these benefits appear to translate into improved TSRs, the challenge to stay ahead in terms of TSR performance is a very tough one to meet over the long term. Take The Coca-Cola Company as an example. One of the earliest VBM companies and acknowledged to be one of the greatest value creators under the late Roberto Goizuetta, Coke's share price has fallen on hard times in the past few years. Part of the reason for the recent underperformance is, ironically, due to the fact that Coke achieved so much success in the period roughly 1980-1997. Put differently, Coke's superlative performance under Goizuetta spoiled investors, who then came to expect even greater success and built these high expectations into its share price. When disappointments came, the share price tumbled.

Like Coke, companies today are forced to respond to unrelenting high shareholder expectations, which keep rising the more successful companies are. At the same time in their own competitive arenas, hyper-competition between rivals pushes the hurdles higher still, as companies continuously benchmark their performance against the new standards and push themselves hard to meet or surpass them. It's a race that never ends. The challenge for companies then is how to stay ahead by achieving sustainable long-term profitable growth (a subject that we are exploring currently), for that appears to be the only way to satisfy shareholders and to therefore ensure sustained superior shareholder value creation. Although we are less sanguine about VBM's ability to foster innovation and growth, essential ingredients for the pursuit of profitable growth, we are certain of one thing: VBM when applied properly as a holistic agent of change will solve a great deal of your problems and will put your company's profitability back on track. At the very least, VBM will build a profitable springboard from where you can embark on the next phase of your journey toward sustained shareholder value creation.

Table 1 - Distribution of VBM and Non-VBM Companies by Nature of Business

Colour * Nature of the Business Crosstabulation

			Nature of the Business				
			Disciplined Capital Allocation	All Three Factors	Leverage Key Skills	Innovate and Technological Leadership	Total
Colour	VBM Companies	Count	47	35	17	10	109
		% within Colour	43.1%	32.1%	15.6%	9.2%	100.0%
	Non-VBM Companies	Count	21	25	22	7	75
		% within Colour	28.0%	33.3%	29.3%	9.3%	100.0%
Total		Count	68	60	39	17	184
		% within Colour	37.0%	32.6%	21.2%	9.2%	100.0%

Table 2 - Survey Respondents by Zone

	Frequency	Percent
Anglo Saxon	114	42.5
Continental Europe	92	34.3
Japan and S. Korea	62	23.1
Total	268	100.0

Table 3 - VBM Companies by Zone

	Frequency	Percent
Anglo Saxon	57	49.6
Continental Europe	45	39.1
Japan and S. Korea	13	11.3
Total	115	100.0

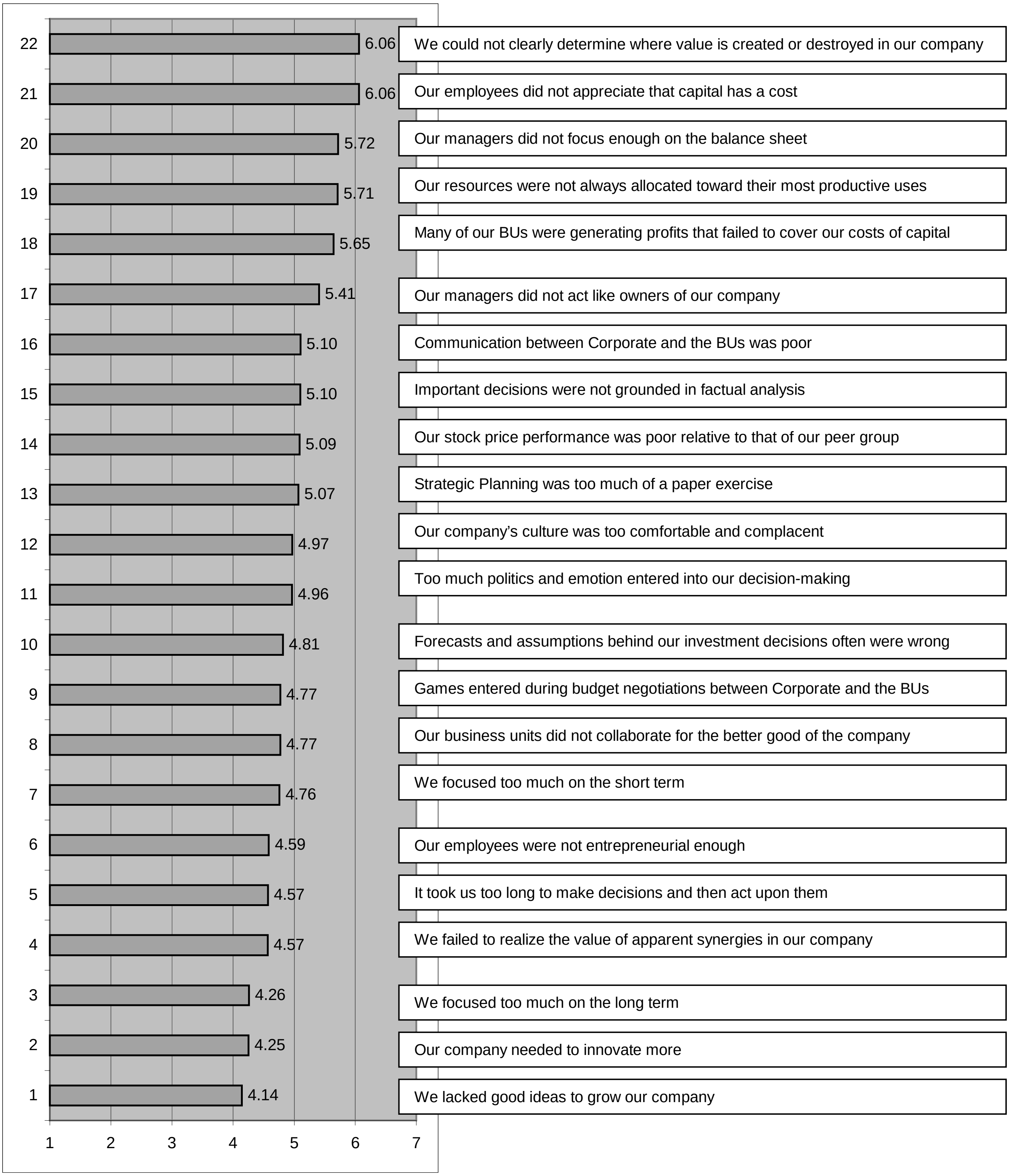
Table 4 - VBM Companies by Geographic Zone and Length of Time of Usage

Geographic Zone * Year of VBM Introduction Crosstabulation

			Year of VBM Introduction			
			Long Time User	Medium Time User	Recent User	Total
Geographic Zone	Anglo Saxon	Count	18	15	19	52
		% within Geographic Zone	34.6%	28.8%	36.5%	100.0%
	Continental Europe	Count	4	15	24	43
		% within Geographic Zone	9.3%	34.9%	55.8%	100.0%
	Asia and Rest	Count	1	2	9	12
		% within Geographic Zone	8.3%	16.7%	75.0%	100.0%
Total		Count	23	32	52	107
		% within Geographic Zone	21.5%	29.9%	48.6%	100.0%

Long time Users = Adopted VBM before 1995
Medium term users = adopted VBM between 1995-1997
Short term users = Adopted VBM after 1997

Table 5 – VBM Way of Life Benefits



1 = VBM was highly INEFFECTIVE in resolving problem **7 = VBM was highly EFFECTIVE in resolving problem**

Table 6 - VBM's Way of Life Impact on Employee Behavior

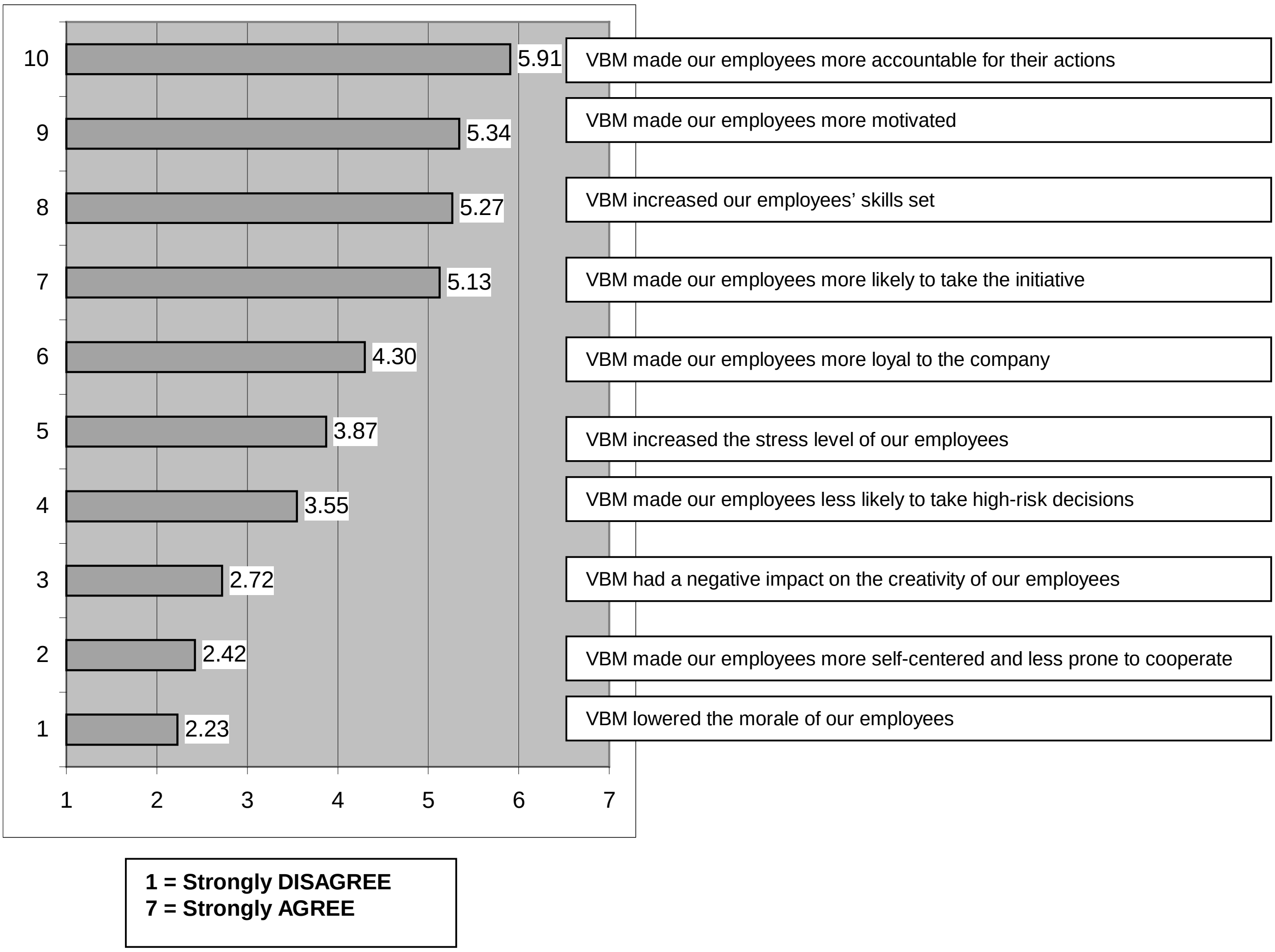


Table 7

Impact of VBM by Length of Time of Practice

We divided VBM companies into three groups based on the length of time they have been practicing VBM. Long Term users implemented VBM prior to 1995, Medium Term users in the period 1995-1997, and Recent Users after 1997. All companies were asked to indicate how serious each of a series of 22 problems were for them TODAY and just PRIOR to VBM's adoption, based on a 1-7 scale where 1 = Not a problem (Today or Before VBM) and 7 = Very Serious problem (Today or Before VBM). The difference between these responses is an indication of improvement or worsening in each the problems following VBM's adoption. We then compared the answers for the improvement/worsening of problems for the three categories of VBM users. For example in the table below, PRICE represents the improvement/worsening in the following problem:

" Our stock price performance is poor relative to that of our peer group"

As the table indicates, Long Term users reported an improvement in that period equal to 1.00 vs. 0.58 and 0.50 (on a 7 point scale) respectively for Medium Term and Recent users. The greater the number, therefore, the greater the improvement in that problem since VBM's adoption. The following legend details the statements in the survey corresponding to the variables in the tables below. Bold-faced variables indicate benefits whose results were highly significant statistically, i.e., the T-test between the means of the Long-Term Users and Recent Users results were significant at the 95% level.

PRICE	Our stock price performance is poor relative to that of our peer group
BUCOC	**Many of our business units are generating profits (or rates of return) that fail to cover the cost of capital**
COMMUNI	**Communication between Corporate and the Business Units is poor.**
PAPER	**Strategic Planning is too much of a paper exercise**
STFOCUS	**We focus too much on the short term**
APPRCOC	**Our employees do not appreciate that capital has a cost**
TOOLONG	**It takes us too long to make decisions and then act upon them**
GROWTH	We lack good ideas to grow our company
INNOVATE	Our company needs to innovate more
LTFOCUS	We focus too much on the long term
COLLAB	**Our business units do not collaborate for the better good of the company**
VALUECR	**We cannot clearly determine where value is created or destroyed**
OWNERS	**Our managers do not act like owners of our company**
FACTUAL	**Important decisions are not grounded in factual analysis**
EMOTION	**Too much politics and emotion enter into our decision-making**
ENTREPRE	Our employees are not entrepreneurial enough
CULTURE	Our culture is too comfortable and complacent
SYNERGY	**We fail to realize the value of apparent synergies in our company**
FORECAST	**All too often the forecasts and assumptions upon which our investment decisions are made turn out to be wrong**
GAMES	**Too many games enter into target setting during budget negotiations between Corporate and the businesses**
RESOURCE	**Our resources are not always allocated toward their most productive use**
INCOME	**Our managers focus too much on the income statement and not enough on the balance sheet**

Case Summaries

Mean

Year of VBM Introduction	PRICE	BUCOC	COMMUNI	PAPER	STFOCUS	APPRCOC	TOOLONG
Long Time User	1.00	2.68	2.32	2.16	1.60	2.84	.84
Medium Time User	.58	1.58	1.33	1.36	.39	2.25	.31
Recent User	.50	.65	.80	.71	.22	1.67	.18
Total	.64	1.39	1.31	1.24	.59	2.11	.37

Case Summaries

Mean

Year of VBM Introduction	GROWTH	INNOVATE	LTFOCUS	COLLAB	VALUECR	OWNERS	FACTUAL
Long Time User	.84	.32	.78	1.52	3.08	1.88	2.24
Medium Time User	.50	.42	.36	.90	2.67	1.73	1.41
Recent User	.36	.32	.54	.54	2.20	.80	.68
Total	.51	.35	.54	.88	2.54	1.33	1.26

Case Summaries

Mean

Year of VBM Introduction	EMOTION	ENTREPRE	COMPLACE	SYNERGY	FORECAST
Long Time User	1.80	.68	1.28	1.36	1.24
Medium Time User	.87	.59	1.09	.79	1.00
Recent User	.78	.22	.82	.34	.49
Total	1.05	.44	1.01	.71	.82

Case Summaries

Mean

Year of VBM Introduction	GAMES	RESOURCE	INCOME
Long Time User	1.96	1.80	1.80
Medium Time User	1.03	1.53	1.64
Recent User	.31	.76	.86
Total	.91	1.23	1.31

Table 8

Raison d'etre of the Company * Self Reported Impact of VBM on Relative Share Price Performance Crosstabulation

			Self Reported Impact of VBM on Relative Share Price Performance			
			VBM Highly Effective	No Impact	VBM Highly Ineffective	Total
Raison d'etre of the Company	Explicit Shareholder Value Creation	Count	24	6	6	36
		% within Raison d'etre of the Company	66.7%	16.7%	16.7%	100.0%
	Implicit Shareholder Value Creation	Count	6	9	5	20
		% within Raison d'etre of the Company	30.0%	45.0%	25.0%	100.0%
	Multiple Stakeholders Approach	Count	4		6	10
		% within Raison d'etre of the Company	40.0%		60.0%	100.0%
Total		Count	34	15	17	66
		% within Raison d'etre of the Company	51.5%	22.7%	25.8%	100.0%

Kendall's Tau-b statistical significance = 0.009

Table 9

Success of VBM's Implementation * Raison d'etre of the Company Crosstabulation (Pre 1999 VBM Companies Only)

			Raison d'etre of the Company			
			Explicit Shareholder Value Creation	Implicit Shareholder Value Creation	Multiple Stakeholders Approach	Total
Success of VBM's Implementation	Low Success	Count	8	8	5	21
		% within Raison d'etre	18.6%	33.3%	35.7%	
	Medium Success	Count	17	11	5	33
		% within Raison d'etre	39.5%	45.8%	35.7%	
	High Success	Count	18	5	4	27
		% within Raison d'etre	41.9%	20.8%	28.6%	
Total		Count	43	24	14	81
		% within Raison d'etre	100.0%	100.0%	100.0%	

Kendall's Tau-b statistical significance = 0.065

Table 10

Geographic Zone * Raison d'etre of the Company Crosstabulation

			Raison d'etre of the Company			
			Explicit Shareholder Value Creation	Implicit Shareholder Value Creation	Multiple Stakeholders Approach	Total
Geographic Zone	Anglo Saxon	Count	38	13	6	57
		% within Geographic Zone	66.7%	22.8%	10.5%	100.0%
	Continental Europe	Count	16	19	9	44
		% within Geographic Zone	36.4%	43.2%	20.5%	100.0%
	Japan and S. Korea	Count	2	7	4	13
		% within Geographic Zone	15.4%	53.8%	30.8%	100.0%
Total		Count	56	39	19	114
		% within Geographic Zone	49.1%	34.2%	16.7%	100.0%

Kendall's Tau-b statistical significance = 0.000

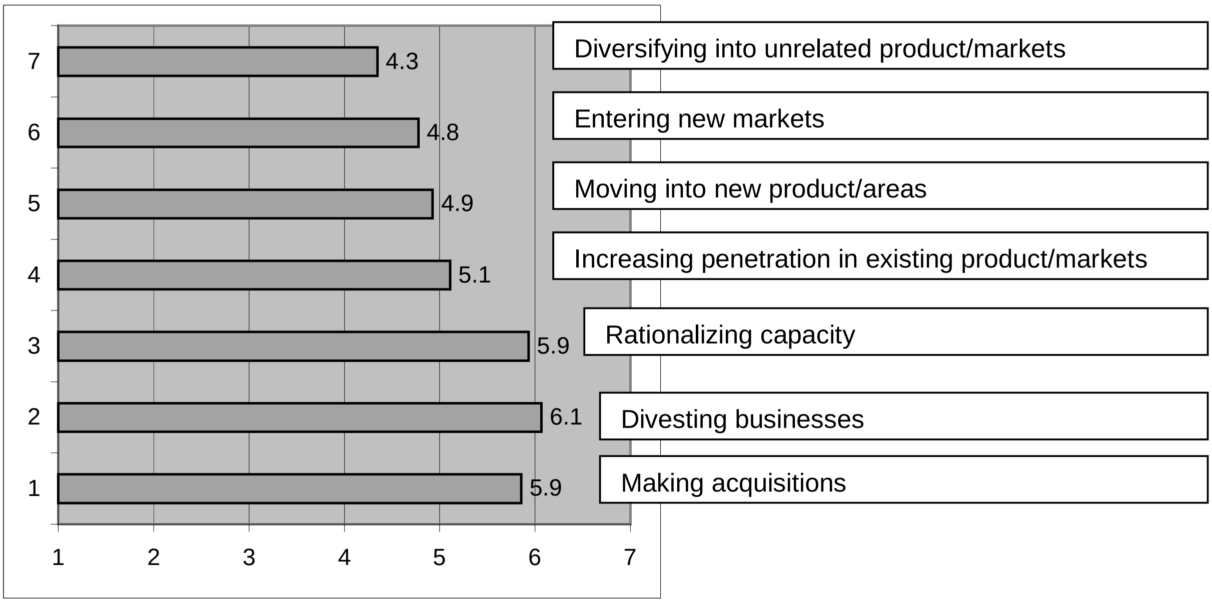
Table 11

Success of VBM's Implementation * Raison d'etre of the Company Crosstabulation (USA and UK Only)

			Raison d'etre of the Company			
			Explicit Shareholder Value Creation	Implicit Shareholder Value Creation	Multiple Stakeholders Approach	Total
Success of VBM's Implementation	Low Success	Count	5	5	2	12
		% within Success of VBM's Implementation	41.7%	41.7%	16.7%	100.0%
	Medium Success	Count	10	2		12
		% within Success of VBM's Implementation	83.3%	16.7%		100.0%
	High Success	Count	8	2		10
		% within Success of VBM's Implementation	80.0%	20.0%		100.0%
Total		Count	23	9	2	34
		% within Success of VBM's Implementation	67.6%	26.5%	5.9%	100.0%

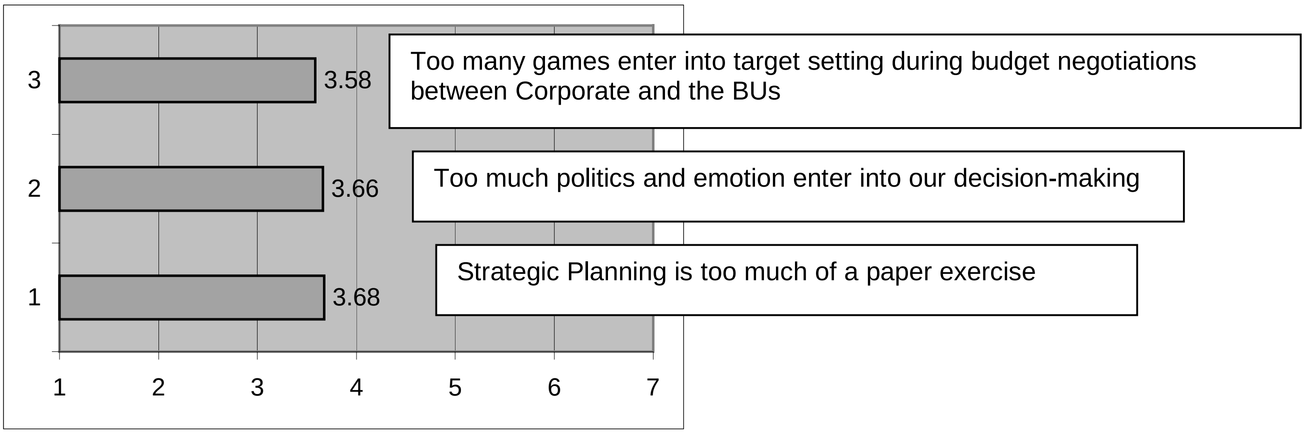
Kendall's Tau-b statistical significance = 0.055

Table 12 - VBM's Way of Life Impact on Strategic Decisions



1 = VBM's impact is very NEGATIVE	**7 = VBM's impact is very POSITIVE**

Table 13 - Problems Experienced by Non-VBM Users



1 = This is not a problem for us today **7 = This is a very serious problem for us today**

Table 14 - VBM and MIS Investment

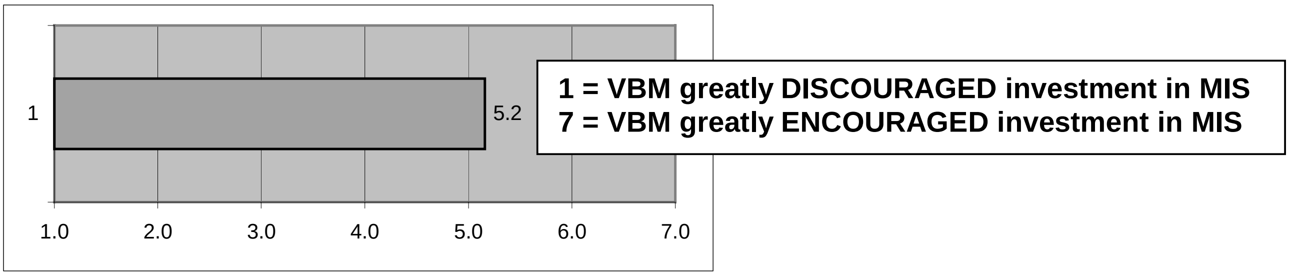


Table 15

Success of VBM's Implementation * Funding Strategies vs Projects Crosstabulation

			Funding Strategies vs Projects			
			We basically fund strategies	We fund projects, but fit with strategies is important	We basically fund discrete projects	Total
Success of VBM's Implementation	Low Success	Count	5	20	5	30
		% within Success of VBM's Implementation	16.7%	66.7%	16.7%	100.0%
	Medium Success	Count	24	15	3	42
		% within Success of VBM's Implementation	57.1%	35.7%	7.1%	100.0%
	High Success	Count	17	14	2	33
		% within Success of VBM's Implementation	51.5%	42.4%	6.1%	100.0%
Total		Count	46	49	10	105
		% within Success of VBM's Implementation	43.8%	46.7%	9.5%	100.0%

Kendall Tau-b significance = 0.001

Table 16

Success of VBM's Implementation * Budgets and Strategic Plans Link Crosstabulation

			Budgets and Strategic Plans Link			
			Our budgets and strategic plans are closely integrated	Strategic plans provide useful information for budgets	Budgets and strategic plans are independent processes	Total
Success of VBM's Implementation	Low Success	Count	11	10	9	30
		% within Success of VBM's Implementation	36.7%	33.3%	30.0%	100.0%
	Medium Success	Count	26	11	5	42
		% within Success of VBM's Implementation	61.9%	26.2%	11.9%	100.0%
	High Success	Count	23	9	1	33
		% within Success of VBM's Implementation	69.7%	27.3%	3.0%	100.0%
Total		Count	60	30	15	105
		% within Success of VBM's Implementation	57.1%	28.6%	14.3%	100.0%

Kendall Tau-b significance = 0.003

Table 17

Success of VBM's Implementation * Value Drivers Use Crosstabulation

			Value Drivers Use		
			No	Yes	Total
Success of VBM's Implementation	Low Success	Count	10	19	29
		% within Success of VBM's Implementation	34.5%	65.5%	100.0%
	Medium Success	Count	11	31	42
		% within Success of VBM's Implementation	26.2%	73.8%	100.0%
	High Success	Count	2	31	33
		% within Success of VBM's Implementation	6.1%	93.9%	100.0%
Total		Count	23	81	104
		% within Success of VBM's Implementation	22.1%	77.9%	100.0%

Kendall Tau-b significance = 0.003

Table 18

Success of VBM's Implementation * Management Team Training Crosstabulation

			Management Team Training					
			<10%	10%-25%	26%-50%	51%-75%	76%-100%	Total
Success of VBM's Implementation	Low Success	Count	4	5	6	7	8	30
		% within Success of VBM's Implementation	13.3%	16.7%	20.0%	23.3%	26.7%	100.0%
	Medium Success	Count	2	4	3	6	27	42
		% within Success of VBM's Implementation	4.8%	9.5%	7.1%	14.3%	64.3%	100.0%
	High Success	Count		5	1	7	21	34
		% within Success of VBM's Implementation		14.7%	2.9%	20.6%	61.8%	100.0%
Total		Count	6	14	10	20	56	106
		% within Success of VBM's Implementation	5.7%	13.2%	9.4%	18.9%	52.8%	100.0%

Kendall's Tau-b significance = 0.002

Table 19

Success of VBM's Implementation * Employee Training Crosstabulation

			Employee Training					
			<10%	10%-25%	26%-50%	51%-75%	76%-100%	Total
Success of VBM's Implementation	Low Success	Count	21	5	2	2		30
		% within Success of VBM's Implementation	70.0%	16.7%	6.7%	6.7%		100%
	Medium Success	Count	14	10	10	3	3	40
		% within Success of VBM's Implementation	35.0%	25.0%	25.0%	7.5%	7.5%	100%
	High Success	Count	6	12	8	4	3	33
		% within Success of VBM's Implementation	18.2%	36.4%	24.2%	12.1%	9.1%	100%
Total		Count	41	27	20	9	6	103
		% within Success of VBM's Implementation	39.8%	26.2%	19.4%	8.7%	5.8%	100%

Kendall Tau-b significance = 0.000

Table 20

Success of VBM's Implementation * Percent of Employees Participating in Bonus Program Crosstabulation

			Percent of Employees Participating in Bonus Program					
			<10%	10%-25%	26%-50%	51%-75%	76%-100%	Total
Success of VBM's Implementation	Low Success	Count	15	5	2	3	4	29
		% within Success of VBM's Implementation	51.7%	17.2%	6.9%	10.3%	13.8%	100.0%
	Medium Success	Count	12	8	7	4	11	42
		% within Success of VBM's Implementation	28.6%	19.0%	16.7%	9.5%	26.2%	100.0%
	High Success	Count	7	7	1	1	16	32
		% within Success of VBM's Implementation	21.9%	21.9%	3.1%	3.1%	50.0%	100.0%
Total		Count	34	20	10	8	31	103
		% within Success of VBM's Implementation	33.0%	19.4%	9.7%	7.8%	30.1%	100.0%

Kendall Tau-b significance = 0.003

Table 21

Our Methodology

To help us understand why some companies succeeded in attaining great benefits from implementing VBM while others reported limited or no benefits and ended up abandoning the practice, we divided our VBM respondents into three roughly equal groups based on their answers to the following question:

"How successful was your company's implementation of VBM?"

We labeled the three groups "High", "Medium" and "Low" success. We found that the High group reported attaining greater benefits from VBM than the Low group on *all* of the 22 problems listed in the insert in page 40, and that these differences were statistically significant in all but three cases (at the 95% level). Similar results were observed for a variety of other benefits, including the impact of VBM on employee behavior, on strategic decisions, on growth and innovation, and on promoting strategic investments. We also found that the High success companies "looked" different from the Low success group on characteristics such as whether they embraced shareholder value explicitly as their *raison d'être*, how visible the CEO and other senior executives were during implementation, the degree of integration and alignment of systems along VBM's principles, the amount and extent of training they provided to their employees, and several other factors that we discuss in the main body of our article.

As for the bottom line of delivering shareholder value, High success companies reported a significant improvement in their share price performance (relative to that of their peer group) after implementing VBM. Low success companies actually indicated deterioration in their relative share price performance. To validate these self-reported results, we measured the average annual Total Shareholder's Returns (TSR)[3] for VBM companies[4] for two three-year periods: immediately prior to and after implementing VBM. We then developed an average *relative* TSR[5] by comparing the companies' TSRs with those of their peer industry groups. Companies that experienced an improvement in their relative TSR performance after implementing VBM were highly correlated with companies that self-reported that VBM had a positive impact on their relative share price performance, and this result was highly significant statistically (0.000). In other words, our observations based on external public data validated what the companies were self-reporting

[3] TSR is defined as the sum of the change in share price plus all dividends paid during the period, all divided by the share price at the beginning of the period.
[4] We excluded recent VBM adopters from this sample, companies that implemented VBM after 1997, on the basis that it's too early to assess VBM's impact on their TSR. Also some private companies or companies that merged did not have data from which to compute TSRs.
[5] The average relative TSR for the period is equal to the average TSR for the company minus the average TSR for its peer group.

REFERENCES ON VBM

Bannister, R. J., Jesuthasan, R., "Is Your Company Ready for Value-Based Management?", The Journal of Business Strategy, March-April 1997, pp. 13-15

Birchard, W., "Metrics for the Masses", CFO Magazine, May 1999

Bose, P. and Morgan, A., "Banking on Shareholder Value: An Interview with Sir Brian Pitman, Chairman of Lloyds TSB", The McKinsey Quarterly, 1998 Number 2, pp. 96-105

Bruckner, K., Leithner, S., McLean R., Taylor, C. and Welsh, J., "What is the Market Telling You About Your Strategy?", The McKinsey Quarterly, 1999 Number 3, pp. 98-109

(The) Boston Consulting Group, Meeting the Value Challenge, The Boston Consulting Group Inc., 1995

(The) Boston Consulting Group, Shareholder Value Matrix, The Boston Consulting Group Inc., 1996

(The) Boston Consulting Group, The Value Creators, A Study of the World's Top Performers, The Boston Consulting Group, 1999

Copeland, T., Koller, T. and Murrin, J., Valuation: Measuring and Managing the Value of Companies, Second edition, New York: John Wiley & Sons, 1996

Ehrbar, A., EVA: The Real Key to Creating Growth, New York; John Wiley & Sons, 1998

Goizueta, R. C. "Why Share-Owner Value?, The Coca-Cola Company website

Guyon, J., "Europe's New Capitalists", Fortune Magazine, February 15, 1999, pp. 106-110

Handler, S. A., "The Emphasis on Value-Based Strategic Management in UK Companies", Journal of Strategic Change, Vol. 1, 1992, pp. 19-37

Kimball, R. C. "Economic Profit and Performance Measurement in Banking", New England Economic Review, July-August 1998, pp. 35-53

Kissell, M. " A Passion for Value", Marakon Associates Commentary, 1998

McTaggart, J. M., Kontes, P. W. "The Governing Corporate Objective: Shareholders Versus Stakeholders", Marakon Associates Commentary, 1994

McTaggart, J. M., Kontes, P. W. and Mankins, M. C. The Value Imperative: Managing for Superior Shareholder Returns, New York: The Free Press, 1994

Milano, G. V., Stern, E., Fencl, T. and Piza, N., “Internet Valuation: Why Are The Values So High”, EVAluation, Volume 2, Issue 1, February 2000

Rappaport A. “New Thinking on How to Link Executive Pay with Performance”, Harvard Business Review, March-April 1999, Vol. 77, Issue 2; pg. 91, 11 pgs.

Rappaport, A., Creating Shareholder Value: A Guide for Managers and Investors, revised and updated, New York: The Free Press, 1998

Shaked, I., Michel, A. and Leroy, P., “Creating Value Through E.V.A.. – Myth or Reality”, Strategy, Management, Competition, Fourth Quarter 1997, Issue 9, pp. 41-52

Stewart, G.B., III, The Quest for Value, New York: HarperCollins, 1991