

Value-Based Management for Valuing Values in Organisations



India has been known world over as the abode of rich values, spirituality and bliss. Its essence lies in the realization of we, i.e. entire humanity is considered a family. Happiness rests inside us if we have positive feelings for others, which results into external peace and harmony. Advent of materialism has polluted the fabric of the value system in all walks of our life. Business history, for example, is replete with evidences of deterioration in forms of increasing fraud, scandal, misappropriation, bribery and so on. We are one of the most corrupt countries in the world, which is a testimony of the erosion of our values. Such a situation urgently calls for some value-based management system which this article makes a case for. This article explains its various aspects including its benefits, limitations, uses and so on. Read on...



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Introduction

That the Indian subcontinent from time immemorial has been the abode of values and spiritual bliss is confirmed by a variety of evidences. Indian value system or spirituality has shown the beacon light of wisdom and harmonious peaceful coexistence to the rest of the world. But with the advent of materialism, our value-system has changed. Business is part and parcel of a society, and, therefore, that makes no exception to the system of change.

Business management has been an evolving concept changing its perspective and meaning over the period. While Mary Parker Follett defined management as the art of getting things done through people (Follett 1941), modern thinkers consider that as a science of getting things done along with others. Henry Ford says: *Bringing people together is beginning, keeping people together is progress and working with people is success.* How to manage an organisation to serve the desired

purpose(s) has been a subject of much discussion and concern among organisational thinkers and practitioners. Depending on the changing perspective of business management, value-based management (VBM) has been a management approach discussed much in the recent past and has been receiving attention and action increasingly in both principle and practice. Supporters of this approach appreciate it as one of the most effective approaches in creating and maximising values for the shareholders of an organisation. It helps combine everyone’s self-interest around the company’s bottom line and corporate value (Nabina Saha, 2009). Being a relatively recent approach, not much is known about the authenticity of this approach. Whatever knowledge is so far available in this subject is highly scattered and as such our understanding about the approach is inadequate and far from satisfactory.

What is VBM?

Before we try to define VBM, let us first understand what value is. Value is general belief tinged with moral flavour containing an individual’s judgmental ideas about what is good, right or desirable. Milton Rokeach (1973), a pioneer in studying and classifying human values as terminal values and instrumental values, defined value as *a specific mode of conduct or end-state of existence is personally or socially preferable to an opposite or converse mode of conduct or end-state of existence*. Value also means, thus, what is worth and meaningful in totality. Values serve as a foundation for ethical conduct of business corporations.

There is an ongoing polemic regarding the metrics that should be used in VBM. As such, VBM has been defined differently by different thinkers. Nonetheless, it is found that most definitions of VBM are, by and large, a sign of the same way of thinking. According to J. Simms (2001), *value-based Management is essentially a management approach whereby companies’ driving*

philosophy is to maximise shareholder value by producing returns in excess of the cost of capital. Another leading consultancy defines VBM as *a management approach which puts shareholder value creation at the centre of the company philosophy. The maximisation of shareholder value directs company strategy, structure and processes, it governs executive remuneration and dictates what measures are used to monitor performance.* According to T. Leahy (2000), *value-based Management says, in a nutshell, the key to increased shareholder value lies in the integration of strategic planning, performance measurement and compensation.*

Definitions of VBM can be broadly classified into two dimensions: single, i. e. shareholder dimensions and multiple, i.e. stakeholder dimension. In the former, VBM is considered as a management approach that ensures maximum value for shareholders. Under this dimension, VBM includes:

1. *Creating Value:* Ways to actually increase or generate maximum future value
2. *Managing for Value:* Governance, change management, organisational culture, communication, leadership
3. *Measuring Value:* Valuation

Under multiple dimensions, VBM is considered as a comprehensive approach to managing the activities of an organisation, to ensure that stakeholder return is maximised in terms of profits, return on investment, loyal customers, and satisfied employees or, in the case of government departments, satisfied tax payers and service users. Accordingly, VBM aims to provide consistency of various dimensions but not limited to:

- corporate mission (business philosophy)
- corporate strategy (courses of action to achieve corporate mission and purpose),
- corporate governance (who determines the corporate mission and regulates the activities of the corporation),
- corporate culture,
- corporate communication,
- performance management processes and systems, and
- reward processes and systems.

Now, we can profitably define VBM as management system in which entire organisation is focused, measured, compensated for creating value for all stakeholders such as shareholders, customers, employees, vendors, government and society. Thus,

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VBM is a holistic approach of creating, managing, and giving values to all stakeholders of an organisation as mentioned in Table 1:

Table 1: VBM and Values for Stakeholders

Stakeholders	Values
Organisation	<ul style="list-style-type: none"> Encouraging an innovative organisational climate with free and frank exchange of ideas. Demonstrating high level of personal integrity and modesty.
Shareholders	<ul style="list-style-type: none"> Protecting and safeguarding their investment. Ensuring them a fairly high rate of return
Employees	<ul style="list-style-type: none"> Understanding and acceptance the needs as well as rights. Providing adequate wages, good working condition, job security, and collective effective machinery for speedy redressal of employee grievances. Scope for suitable opportunities for promotion and self-development. Inculcating, creating and developing a sense of belongingness to organisation and team spirit among co-workers and camaraderies.
Customers	<ul style="list-style-type: none"> Providing quality products and services at fair prices. Fulfilling its commitments impartially and courteously with sound business principles.
Government	<ul style="list-style-type: none"> Confirm and contribute to the national interest as mentioned in government policy.
Society	<ul style="list-style-type: none"> Ensure the effective use of natural resources. Assist in community affairs. Render needed assistance during natural hazards.

Why VBM?

In ever-changing and competitive business environment, managers are confronted with increasing and varied kinds of challenges to perform their agent role to ensure optimum use of scarce resources, on the

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one hand, and generate maximum return on investment for owners, on the other (D. S. Young & S. F. Byrne, 2001). While those challenges reveal inefficiencies in the existing management approaches, those also underline the need for an integrated management tool to face the challenges called VBM. The major drivers resulting interest in VBM include but not limited to the following only:

1. Research findings reveal that explicit focus to shareholder value which was, however, less explicit till 1990s, enable organisations to perform better and other stakeholders also do not suffer at the hands of shareholders (Copeland et al, 2000).
2. Just as traditional method of performance evaluation based on past financial performance has undergone change to an integrated evaluation method dubbed as Balanced Scorecard (R. S. Kaplan & D. P. Norton, 1996), the changed objective of management from “managing for earning to managing for creating value” has necessitated the evolution of an integrated approach of management dubbed as VBM (Stern Stewart, 1999).
3. Modern organisations are looking for an approach that serves as many purposes as possible. The VBM approach is argued to subsume or render unnecessary most, if not all, other types of performance measures at the corporate and strategic business unit levels. They, therefore, contest the principle of different accounting for different purposes (M. Bromwich, 1998).
4. It is mainly the institutional investors, who traditionally were passive investors, have begun exerting influence on corporate management to create maximum value for shareholders.
5. Of late, increasing attention has been paid to linking executive compensation to shareholder returns, i. e. values.

An attempt has been made in the following Table 2 to justify the need for value based management in the present scenario hovering in Indian organisations.

**Table 2: Business Scenario: Past vis-à-vis Present
The Backdrop**

<i>The Past</i>	<i>The Present</i>
<ul style="list-style-type: none"> India the abode of spiritual bliss since time immemorial. Society characterised by happiness, health, and honesty, also called <i>Ram Rajya</i>. Feeling of <i>WE and OUR</i> Realisation of <i>One for All and All for One</i> <i>Sarva Jan Hitay, Sarva Jan Sukhay</i> <i>Vasudheva Kutambakam</i> World as one family. 	<ul style="list-style-type: none"> Degradation in moral values continuously toward downturn. People suffering from hunger, health, dishonesty, mistrust, etc. Feeling of <i>I and Me</i>. Few Haves, many <i>Haven'ts</i>. Increasing corruption, frauds, and scandals, cheating, distrust, etc. <i>Ram Rajya</i> replaced by <i>A. Raja type Rajya</i> Business is not exception to such radical change. Business almost paragon of corruption, frauds, scandals, and cheating.

That necessity is the mother of invention to replace the present greed-based management by value-based management can be well justified by the following black humour in that gag about operation theatre (Moid Siddiqui, 2005): *The operation was successful but the patient died*. Why was the operation successful? Because it met the defined criteria. Why did the patient die? Because the defined criteria was wrong for the particular operation or patient.

Benefits of VBM

VBM benefits the stakeholders of an organisation in various ways as mentioned below:

- Management:** VBM enables management to move from the autocratic approach to participative one mainly based on value for all stakeholders of organisation. In a sense, management moves with a balanced approach valuing the values for all.
- Employees:** An organisation that operates following the cardinal principles of VBM empowers its employees as workers as well as owners. VBM creates an organisational culture where employees find their work more satisfying and economically rewarding.
- Labor Unions:** VBM changes the labour union’s approach from an utter hostile to seer helping one in deciding and solving organisational matters

involves in more interest of the parties involved. Labour unions can also contribute to deliver a higher level of economic justice and far greater rights for their members than the "crumbs" now bargained for within the framework of traditional labor-management bargaining system.

- Organisation:** Organisational evidences are available to confirm that more the management approach is value-driven and value-based, more the stakeholders’ interest are unified and multiplied. This happens because VBM improves both employee and customer satisfaction which ultimately result in increased sale, increased revenue, and increased profit. Profit serves as oxygen for the survival and growth of an organisation.

In nutshell, valuing or caring for the values of all stakeholders, in turn benefits business. How? Consider a Chinese proverb here: *A little bit of fragrance clings to the hand that gives you roses*. In other words, do good to others and we will have good for ourself too *i.e.* what goes around comes around.

Limitations of VBM

However, there are some limitations too:

- VBM being a holistic management system requires cultural change in the organisation and changing culture is a large-scale initiative.
- Implementation of VBM involves considerable time and other resources which are always not feasible for all organisations.
- Implementation of VBM in letter and spirit requires top management support which is, however, not always there.
- Use of VBM also necessitates comprehensive training and consultancy which are quite costly to bear by most of the organisations.
- VBM helps companies in achieving higher level efficiency but does not encourage collaborative relationships among various units of organisation.

It is due to the above reasons that no perfect VBM model could be invented so far.

Methods in VBM

Though several methods have been used in VBM, following are the four principal ones:

- Marakon Approach:** This approach was proposed by Marakon Associates, an inter-national management consultancy firm in 1978. This approach is based on market-to-book ratio. Here,

the market value refers to the long-term equilibrium market value.

2. **Alcar Approach:** LEK/Alcar Consulting Firm proposed this approach of VBM. According to this approach, a business strategy evaluation involves the following steps:

Step 1: Forecasting the operating cash flow stream for the strategic business unit (SBU) during the planning period.

Step 2: Discounting the operating cash flow with weighted average cost of capital.

Step 3: Finding the present residual value of SBU at the end of the planning period.

Step 4: Determining the total shareholder value.

Step 5: Calculating the pre-SBU value.

Step 6: Finally, determining the ultimate value credited by the strategy.

3. **McKinsey Approach:** This approach proposed by McKinsey & Company involves the following key steps in VBM:

1. Ensuring the supremacy of the proposition of value maximisation.
2. Finding the actual key drivers of the organisation.
3. Selecting and establishing the most appropriate management process.
4. Implementing the system of VBM in letter and spirit to fulfill its purpose.

4. **Economic Value Added (EVA) Approach:** This approach was proposed and pioneered by Stern Stewart & Company. EVA is profit after cost of capital and is also known as super profit. A positive EVA indicates that a business is not only earning, it is earning enough to satisfy the providers of fund. Thus, EVA as a performance measure is better than accounting profit. However, one of the objections raised against EVA is that it is entirely based on current income and does not measure the present value of earnings.

While different methods of the VBM have their own fan clubs, each camp argues that its measures are the best duly supported by evidence. Nonetheless, EVA method seems to have received more attention and gained more popularity in the corporate world. This was, in fact, triggered by a feature article in *Fortune* published in 1993 that called the EVA today's hottest financial idea (Shawn Tully, 1993). Since then, increasing references to EVA have appeared in *Fortune*, *Wall Street Journal*, *The London Times*, and a number of special-interest magazines. While

Peter Drucker (1995) referred to EVA as a measure of "total factor productivity, Robert Boldt, an investment officer at CalPERS, a leading pension fund believes that only EVA gives a real picture of value creation (Prasanna Chandra, 2001).

VBM in Practice in India

Now, it also seems in logical sequence to investigate into the practice of VBM in the Indian corporations. Gita Piramal selected the top legendary business houses in India on the basis of following seven VBM criteria:

1. Not rags to riches, not because of their personal triumphs but for the The impact of organisational work and effort on thousands of ordinary lives.
2. Producing globally qualitative products and services.
3. Modern mind, i. e., traders think of today's profit, an industrialist looks at tomorrow's balance sheet but a legend thinks of the next generation.
4. Go beyond the boundary to encourage others to become entrepreneurs and start their own businesses.
5. Do not trudge on easy and smooth road to prosperity but hack roads through jungles, build factories in villages, transform barren tracts of land into profitable assets, change mind-sets, and pioneer industry or services.
6. Exhibit strong commitment to the spread of education.
7. Practice patriotic entrepreneurship to make their felt around the world.

The VBM practices of some of the prominent Indian organisations are shown in the following Table 3:

Table 3: Values Practiced in the Indian Organisations

Name	Founder	Parameters
TATA Group	J. R. D. Tata	<ul style="list-style-type: none"> • Tata ethos-ideals and traditions • Sound and straightforward business principles. • Commitment towards the interests of the shareholders. • Health and welfare of the employees. • Generous towards people.

Name	Founder	Parameters
Reliance Group	Dhirubhai Ambani	<ul style="list-style-type: none"> • Huge production and best quality of output with cheapest price. • Think big, think fast, think ahead. • Introduced the equity cult to thousands of ordinary Indians.
AMUL	Vergheese Kurien	<ul style="list-style-type: none"> • Professionalisation of farming followed with innovative process. • Use of qualitative equipment. • Constructive social change in rural areas. • Empowering the rural masses. • Information and infrastructure.
Birla Group	G. D. Birla	<ul style="list-style-type: none"> • Commitment to untested values. • Humanity and tolerance for the weaknesses of others. • Taking risks.
ZEE TV	Subhash Chandra	<ul style="list-style-type: none"> • Fully committed to current concepts such as shareholder value, and value-based management (including out-sourcing, employee stock options etc.). • Quality products at competitive prices. • Challenged government vision of what people want from electronic entertainment.
Bombay Spinning Mill	Cawasji Nanabhoy Davar	<ul style="list-style-type: none"> • Factory system with factory labor. • Led the way for other entrepreneurs to enter industry.
Mittal Steel	L. N. Mittal	<ul style="list-style-type: none"> • Unique mix of cultures in the management team: takes best from each country.

Name	Founder	Parameters
		<ul style="list-style-type: none"> • Open discussions - Asks everyone to tell top management what problems are and what should be the solutions. Then instills discipline that what has been decided must be done perfectly.
Infosys	N. R. Narayana Murthy	<ul style="list-style-type: none"> • Ethical business practices and transparency.
World Tel	Satyen (Sam) Gangaram Pitroda	<ul style="list-style-type: none"> • Access to telephone lines for ordinary people.

Source: Gita Piramal: *The Millennium Special: The Past the Present & the Future*

To sum up, VBM practices relate to the organisational aspects such as ethics and transparency, innovativeness, financial performance, quality of product and services, global competitiveness and people practices, and talent management. It has a mission to achieve the objectives in an environment of fairness, honesty and courtesy towards clients, employees, vendors and society at large. Business history is replete with evidences that business that runs with values survive and thrive, and those that run with self-interest only ultimately fizzle out and flounder in due course of time. Businesses' relentless pursuit for profit, call it greed, is very beautifully demonstrated by the following little story as narrated by Moid Siddiqui: *A young innocent girl would stand at the graveyard waiting for a dead body to come so that her father, who was a grave digger, would earn enough money to pay for the day's meals. If no dead body came to the graveyard, the family would go hungry that day. So, each time the girl looked through the window and saw a dead body coming into the graveyard, she would experience immense pleasure. A strange smile would hover on her face. One day when her own father died, people saw the same strange smile on her face.*

Lessons from VBM Experiences

Many companies in India have joined the VBM bandwagon and the key lessons we have learnt

so far from the experiences of VBM adopters can be:

- *Top management support and involvement is essential.* Experiences are available to mention that in order to make the implementation of VBM successful, the needed and timely support from the top management like CEO and CFO is a must condition. Without their active and enthusiastic support and involvement, the philosophy and implementation of VBM is doomed to fail.
- *A good incentive plan is necessary.* A good incentive plan in terms of its link between performance and compensation has been a key and critical element in any VBM programme to become it successful. A good incentive plan is characterised by the features like objectivity, simplicity, variability and definitiveness, i. e. no discrimination.
- *Employees should be properly educated and trained.* One can not think of success of VBM programme without its understanding by employees. Therefore, employees must be imparted proper training that justifies the need for improving productivity of capital, explains the basics of VBM programme, exemplify how VBM system can contribute to value creation for shareholders.
- *Choice of metric per se is not critical.* The metric chosen and circumstances of the company should duly match. Myers (1997) has beautifully exemplified this: *Much as hitting a good golf shot depends more on how you strike the ball than on what brand of club you use, achieving success through the use of any performance metric will depend more on how well you apply it than on which one you use.*
- *VBM works well in areas conducive for it.* It does not benefit all firms equally but ones which stand conducive for it. A firm's conduciveness that depends on factors such as the availability of substantial assets so far not productively employed, has diversified into too many areas beyond core competencies and companies that depend more on physical capital than intellectual capital.
- *There is a need for customised VBM system.* This simply means that one size does not fit all. VBM adopters review the VBM tools of different adopters and customise their own application. Based on their survey of VBM practices across companies, Martin and Petty reported: *Finally, we found that many managers do not accept what the vendors say at face value. They learn from the consultants but then*

adapt the methods to fit their own situation. In fact, in most cases, firms develop their systems in-house rather than hiring a consulting firm.

Potentials for VBM in India

There is an immense potential for VBM in Indian companies, as most of the Indian companies have substantial but underutilised physical assets as reflected in their low productivity of capital. Liberalisation, privatisation and globalisation have heightened the competition since 1991 onwards forcing the companies to review and restructure their portfolios for creating and achieving greater value. Especially, ordinary shareholders earning low level of returns in recent years have been poking corporate management to increase the value of their investment.

Concluding Remarks

VBM as a new performance device has been gaining increasing use and popularity world wide including India. In the new era of survival of the fittest in totality, valuing values of company as well as of various parties called 'stakeholders' are treated as an asset. Companies, whether private or public, profit-making or non-profit-making, banking or trading, have to frame ethical and honest values satisfying the needs of their vendors including employees, customers and other stakeholders. Increasing number of companies have been realising the relevance of practicing value-based management for better performance. Infosys founder N. R. Narayana Murthy, an advocate of value management, says: *I'm a capitalist in mind, a socialist at heart. Murthy recalls: There was one situation in Karnataka where an officer wanted us (i.e. Infosys Technologies Limited) to bribe him. He told us to pay ₹4 lakh to him and save ₹36 lakh or pay ₹40 lakh to the Government. We paid ₹40 lakh to the Government. He goes on: One's clearest conscience is the softest pillow to have a sound sleep.* To conclude, winners stand firm on values but compromise on petty things while losers stand firm on petty things but compromise on values.

In today's highly competitive business environment, there is a greater need, incentive and compulsion for Indian companies to focus more on value creation. Considering the relevance of VBM in real-value creation, VBM will emerge a more dominant business theme in Indian business organisations in the years to come. Sooner it happens, better will it be for the Indian organisations. ■