NRI Papers No.56 October 15, 2002

The Current State of Value-Based Management in Japan and the Road Map for Success

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1. In addition to business strategies, superior corporate management also has a substantial impact on increasing corporate value.
2. Based on a survey of all listed companies, Nomura Research Institute, Ltd. (NRI) identified 15 Key Factors for Success (KFS) in fields. They include: (1) approach toward management; (2) corporate governance; (3) decision-making processes; (4) plan, do, check and act (PDCA cycle); and (5) raising awareness with respect to increasing corporate value by verifying the potential factors for successful value-based management.
3. These 15 Key Factors include the clear commitment of the president concerning the orientation of management, careful linking of budgets and policies, the establishment of clear appraisal standards for executive compensation, and a higher degree of understanding of value-based management throughout the company.
4. NRI is developing systematic solutions for building appropriate decision-making mechanisms for the re-deployment of current business resources, and means to carry out management subsequent to such changes. In particular, emphasis is given to the use of the balanced scorecard approach as a method for strategically rebuilding the PDCA cycle, which serves as the foundation of management.
5. Management reform requires a seemingly contradictory approach of maximizing the benefits of past efforts through continuous reinforcement, while constantly taking on new challenges.

I Analysis of Value-Based Management in Japanese Companies

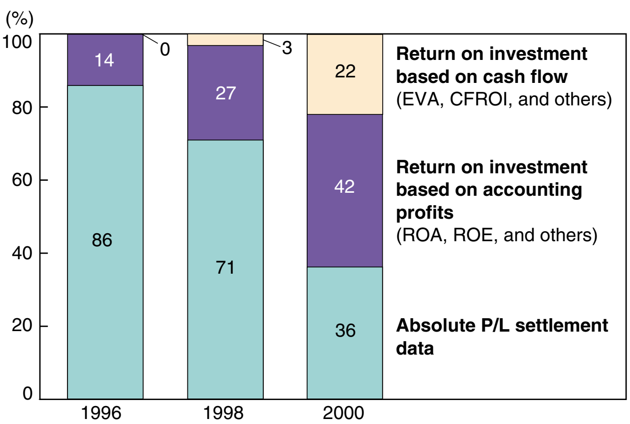
1 Increasing Recognition of Value-Based Management

Value-based management (VBM) has been attracting increasing attention in Japan in recent years. The concept is not dictated by accounting profits alone, but also employs other management indicators such as economic value added (EVA),[1] in which capital costs are included in measuring corporate activities that increase corporate value.

According to surveys by the Nomura Securities Co., Ltd. Financial Research Center, there has been a rapid increase in recent years in the percentage of major companies that emphasize return on investment based on cash flow (EVA and cash flow return on investment (CFROI)) in addition to return on equity (ROE) and return on assets (ROA) based on accounting profits as the primary indicators of financial performance (see Figure 1). Thus, management recognition of the importance of capital costs has certainly increased.

However, this is not necessarily reflected in actual results. A comparison of data for the United States and Japan in the 1990s indicates ROE figures of 16 percent for the United States and 7 percent for Japan in 1990. This ROE gap has since widened to 26 percent for the United States and 3 percent for Japan in 2000 (averages for S&P 500 companies in the United States and Nomura 400 companies in Japan, excluding financial firms in both nations).

Figure 1. Financial Indicators Considered Important by Major Companies



Notes: (1) Percentage of companies citing these indicators as the key financial indicators; (2) CFROI = cash-flow return on investment; EVA = economic value added; P/L = profit and loss statement; ROA = return on assets; ROE = return on equity.
Source: "Results of Interviews with 100 Major Companies" (May 1998 issue) and "Results of Interviews with 50 Major Companies" (November 2000 issue) of Corporate Finance Report, Nomura Securities Co., Ltd. Financial Research Center.

What accounts for these growing discrepancies? The reason likely lies in the fact that specific management system methodologies for their improvement are lacking even though management indicators that recognize capital costs are prescribed.

The authors also studied specific methodologies for increasing corporate value through on-site consultation and discussion with many companies, leading to the construction of a hypothesis for a proper management approach to increasing corporate value. A survey was then carried out to test this hypothesis. Specifically, a number of multiple-choice questions were formulated to investigate "proper management system stances for increasing corporate value" as perceived by NRI, and the responses were used to determine whether they had a significant impact on differences in corporate value.

2 Survey of Listed Companies

The survey was carried out in January 2002 for all companies listed on the Japanese stock exchanges. Questionnaires were sent to 2,652 companies, and valid responses were received from 519 companies (for an effective response rate of 19.6%).

By industry (the 33 industrial classifications of the Tokyo Stock Exchange), only electrical equipment (11.2%) and wholesaling (10.0%) accounted for more than a 10-percent share of all responses. Therefore, the survey is not to be deemed as skewed by the response rate of any particular industry. Other than these two industries, construction (5.8%), chemicals (6.6%), machinery (7.7%), retailing (8.5%), and services (8.7%) accounted for more than a 5-percent share of all responses.

Additionally, by scale of consolidated sales (for fiscal 2000), companies with ¥100 billion in sales accounted for approximately 40 percent of the total, and companies with ¥500 billion in sales accounted for 11.6 percent.

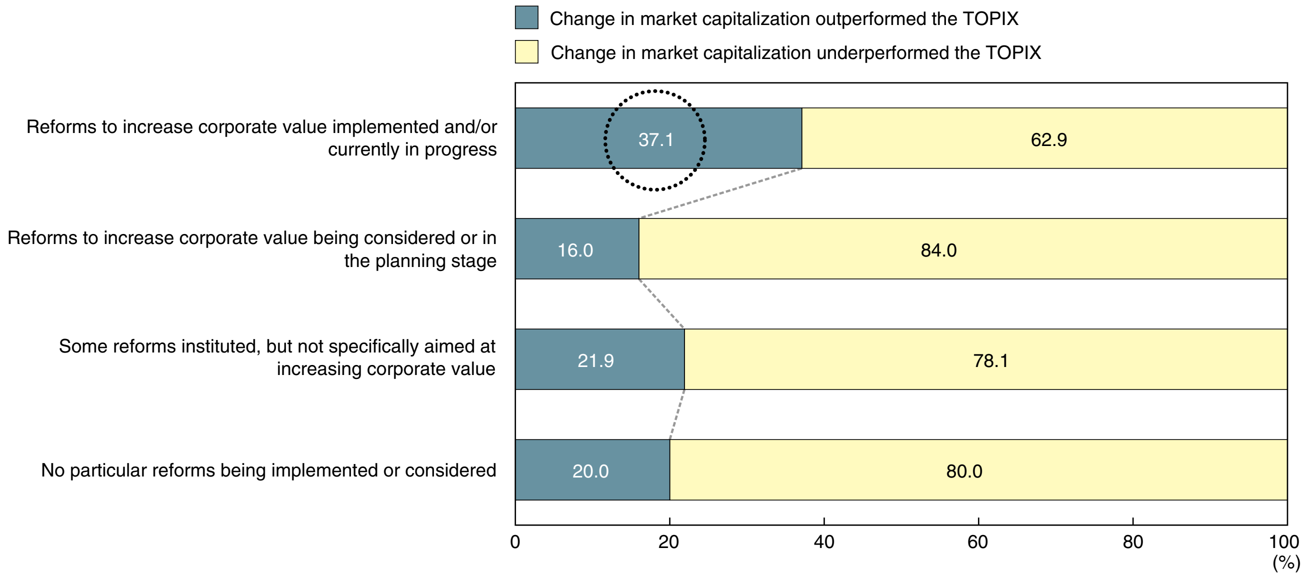
As a survey of this scale on these types of research themes is unprecedented, this research is significant in itself.

3 The Current State of Management Reform for Increasing Corporate Value

One of the first questions asked was: "Has your company instituted any management reforms for the purpose of increasing corporate value (financial value and current market capitalization) over the medium and long term since the late 1990s?" In response, 57.8 percent of companies replied: "Management reforms for increasing corporate value have been implemented and/or are currently in progress."

Objective market data were used for comparison purposes to verify whether management reforms for increasing corporate value were effective. After

Figure 2. Implications of Management Reforms in Terms of Market Capitalization



Notes: (1) Excluding companies for which March 1997 market capitalization data could not be obtained; (2) TOPIX = Tokyo Stock Price Index.

discussing the types of indicators to use for comparison, current market capitalization was ultimately adopted. Specifically, analyses were carried out to determine whether changes in market capitalization from March 1997 through March 2002 exceeded the change in the Tokyo Stock Price Index (TOPIX) during the same period.[2]

As shown in Figure 2, some 40 percent of the companies that have implemented and/or are currently implementing management reforms to increase corporate value outperformed the TOPIX in terms of market capitalization. This level can be said to be clearly higher than companies that were not implementing reforms or that were only considering reforms.

Companies that have implemented or are currently implementing reforms geared to increasing corporate value and whose change in market capitalization outperformed the TOPIX were termed "VBM companies" (82 companies). Companies whose change in market capitalization underperformed the TOPIX were termed "non-VBM companies" (264 companies), whether or not any reforms were implemented.[3] The hypothesis was then tested in terms of points for the success of value-based management by comparing the differences between the two groups in the survey responses.

It is important to note that the terms "VBM company" and "non-VBM company" are used only for convenience in carrying out analysis presented in this paper. As such, the classifications cannot be used as absolute determinants of the success or failure of value-based management. For example, while there are companies that have instituted reforms designed to increase corporate value whose change in market capitalization only slightly outperformed the TOPIX, they cannot be considered to have been successful in value-based management. Conversely, the opposite is also true.

This classification is not intended to group companies as "winners" or "losers," but rather to identify important points in management system by comparisons of the two groups. Hence, market capitalization is used as an objective criterion for comparison.

II The Current State of Value-Based Management and 15 Key Factors for Success

The questionnaire contained questions concerning the management system in five areas. These are: (1) approach toward management; (2) corporate governance; (3) decision-making processes; (4) plan, do, check, and act (PDCA cycle); and (5) raising awareness with respect to increasing corporate value.

These five areas reflect the authors' thinking about value-based management. In short, clarifying the orientation of management (Item 1), followed by proper redeployment of business resources (Items (2) and (3)) are essential for increasing corporate value. Additionally, it is also necessary to use the redeployed resources to effectively and efficiently manage business activities (Item 4).

As a result, every employee must properly understand the actions that need to be pursued to increase corporate value (Item 5).

The 15 Key Factors for the success of value-based management were identified in accordance with these five perspectives (see Figure 3). A chi-square test was used to verify whether the difference in responses between VBM companies and non-VBM companies

Figure 3. Fifteen Key Factors for Successful Value-Based Management

Items for which there was a difference in responses between VBM companies and non-VBM companies were identified as Key Factors for successful value-based management as listed below.

Approach	1. Company president explicitly makes a commitment both inside and outside the company concerning individual orientation toward corporate management in terms of the priority given to the interests of specific stakeholders.
Corporate Governance	2. Outside directors accepted from organizations other than companies or banks that have trading or capital relationships with the company, and external checks are in place. 3. In investor relations, efforts are made to increase the frequency and time of briefings to investors, and the period from settlement of accounts to the announcement of results is shortened. 4. Managerial and executive functions are separated (low percentage of directors with concurrent executive responsibilities, and a high percentage of operating officers compared to directors and auditors).
Decision-Making Processes	5. Managerial meetings function fully and properly as deliberative forums. 6. There are clear guidelines for investment decisions, and investments are governed by these guidelines. 7. Net present value (NPV) is employed as the primary indicator in guidelines for investment decisions.
PDCA Cycle	8. EVA indicators, ROE, ROCE, ROA, and other capital efficiency indicators are used in intermediate planning. 9. Formulation of policies and budgets is coordinated. 10. Agreement of organizational objectives and the objectives of unit supervisors. 11. Progress on organizational objectives and measures for attainment are reviewed during each term. 12. Results of term-end review are provided as feedback for planning of the next term. 13. The performance-based portion of compensation is sufficiently large if such a compensation system is adopted. 14. Clear standards exist for performance appraisals of executives.
Raising Awareness	15. Understanding of corporate value management is not limited solely to headquarters staff, but extends to all ranks of employees.

Notes: IR = investor relations; PDCA = plan, do, check and act; ROCE = return on capital expenditures; VBM = value-based management.

was statistically significant, and only items meeting a 20-percent significance level were listed.

This survey focused on management system aspects; specific business strategies are excluded from consideration. Of course, management system and business strategies are both essential for increasing corporate value, as corporate value cannot be fully addressed solely through aspects of the management system. Nevertheless, by focusing on the management system alone, it should be possible to reveal any correlation between increasing corporate value and the management system if a sufficiently large sample is used to mitigate the differences caused by individual business strategies (i.e., the law of large numbers).

1 Approach toward Management

Point 1	Company president makes a clear commitment concerning individual orientation toward corporate management

The question included in the survey: "Which group of stakeholders, i.e. shareholders, customers, employees, or other stakeholders, does your company give priority to in management?"

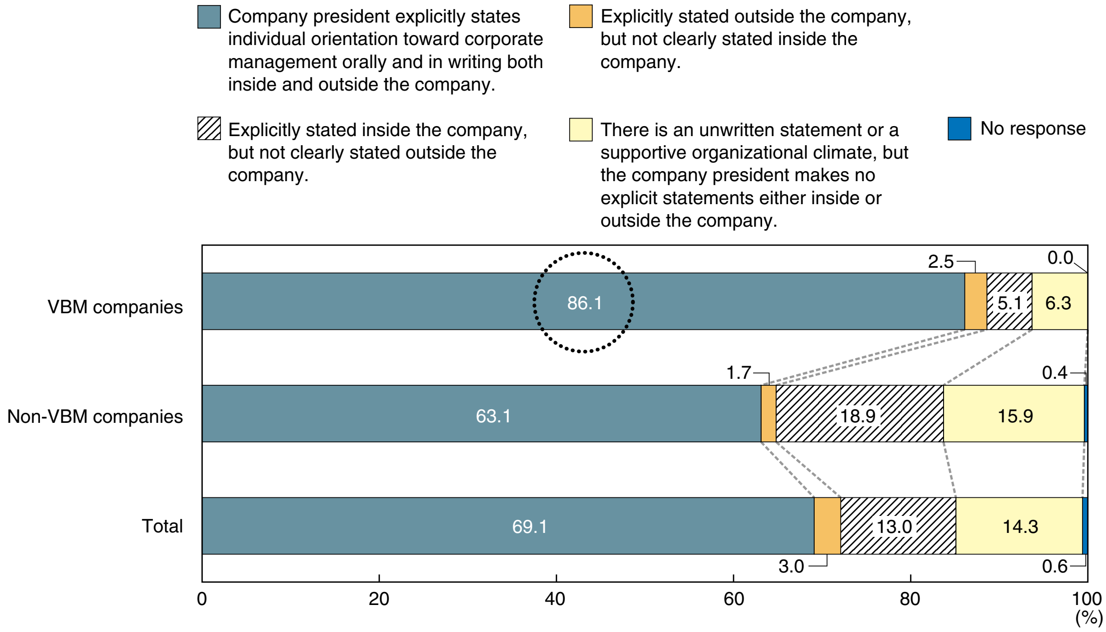
The most common response (76.7%) was: "We do not give priority to any specific stakeholders, as we emphasize balancing the interests of multiple stakeholders." was the most common. With respect to this question, no significant difference was observed between VBM companies and non-VBM companies. The response "Priority is given to increasing shareholder value and interests," which clearly shows an emphasis on shareholder interests, was reported by no more than 13.4 percent of VBM companies.

Regardless of the company's emphasis on specific stakeholder interests, however, a difference between VBM companies and non-VBM companies was observed in response to the question: "Does the company president or directors with representation rights make explicit statements inside and outside the company?"

The percentage of companies responding, "The company president makes explicit oral and written statements both inside and outside the company" was higher for VBM companies (see Figure 4).

Internal corporate activities must be coordinated effectively to maximize utilization of limited business resources and produce positive results. This analysis suggests that the commitment of the company president is important for properly conveying and confirming the orientation of management.

Figure 4. Company's Approach to Announcing Corporate Management Orientation



2 Corporate Governance

Point 2 Proper external checking mechanisms function vis-à-vis important decision-making processes within the company

The questionnaire asked: "What approach is used to ensure that external checks and balance functions are applied to management?" The multiple choice answers to this question included outside directors, advisory boards, personal advisors to top management, and other mechanisms.

The responses indicated that companies that had instituted external checks and balance functions represented about 50 percent of both VBM companies and non-VBM companies, suggesting that little difference exists between the two categories of companies. When examined in detail, however a significant difference emerges between the two groups in the response to the statement: There are outside directors from organizations other than companies or banks that have trading or capital relationships with the company" (12.2% for VBM companies, 4.5% for non-VBM companies).

There also was no clear difference between the two groups in the statement: "There are outside directors from companies or banks that have trading or capital relationships with the company" (29.3% for VBM companies, 33.7% for non-VBM companies, suggesting that the latter group actually had a higher implementation rate).

As "outside directors from organizations other than companies or banks that have trading or capital relationships with the company supposedly provide greater external "checks," how can the difference between the two groups in the response be interpreted? The authors believe that there is a difference in the level of checks and an impact on increasing corporate value even though both are considered to be external checking mechanisms.

Point 3 Concerted efforts in investor relations

The questionnaire asked: "What approaches are used in investor relations to enhance accountability to investors?" The multiple choice answers included "Specialized unit and staff for investor relations," "Greater frequency of presentations and broader dissemination of information within Japan and overseas than in the past," and "Greater time devoted to Q&A sessions during briefing sessions" (see Figure 5).

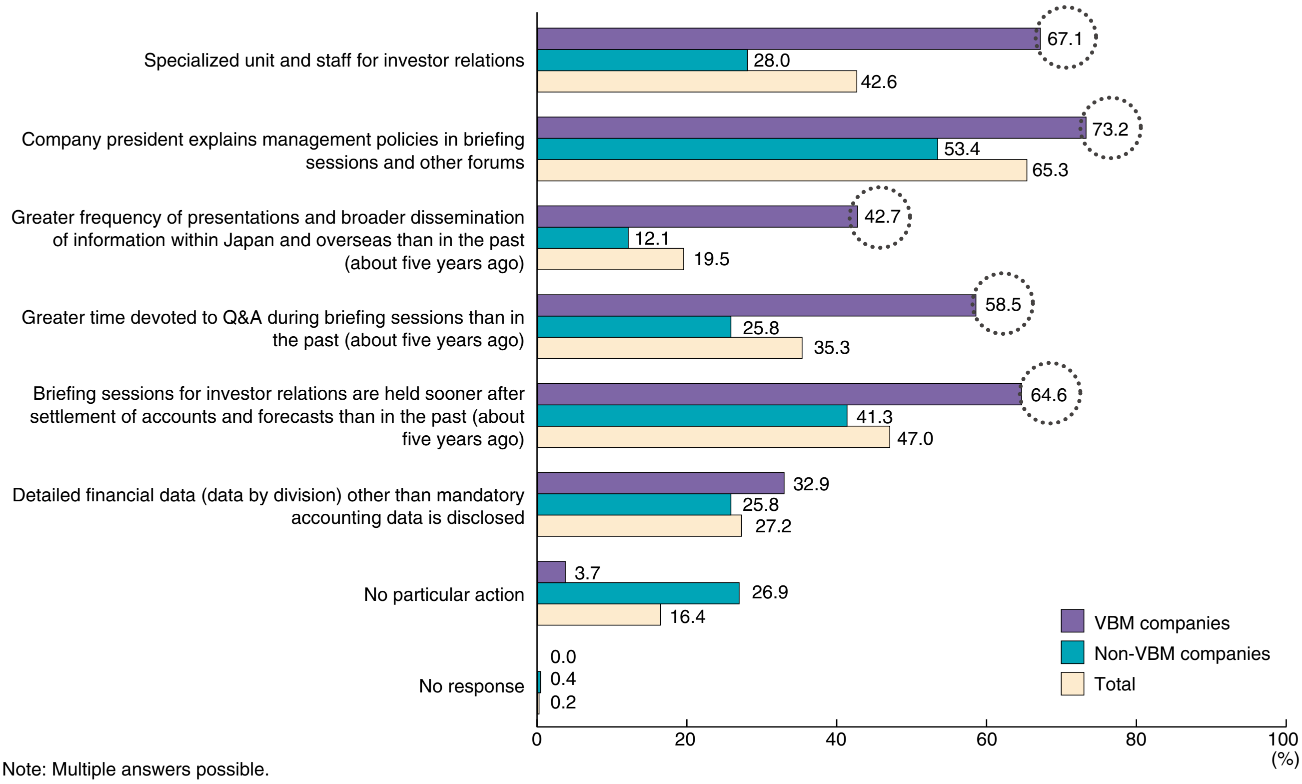
Rather than specific measures for investor relations, we are attempting to determine the company's level of awareness of investor relations in increasing corporate value and the approaches for improving IR activities. The results reveal a difference in the approaches of VBM companies and non-VBM companies toward a considerable number of IR activities.

Of course, market confidence is not something that emerges as the result of investor relations activities alone. However, the survey results have reconfirmed that investor relations are definitely an important element.

Point 4 Proper functioning of internal checks (separation of managerial and executive functions)

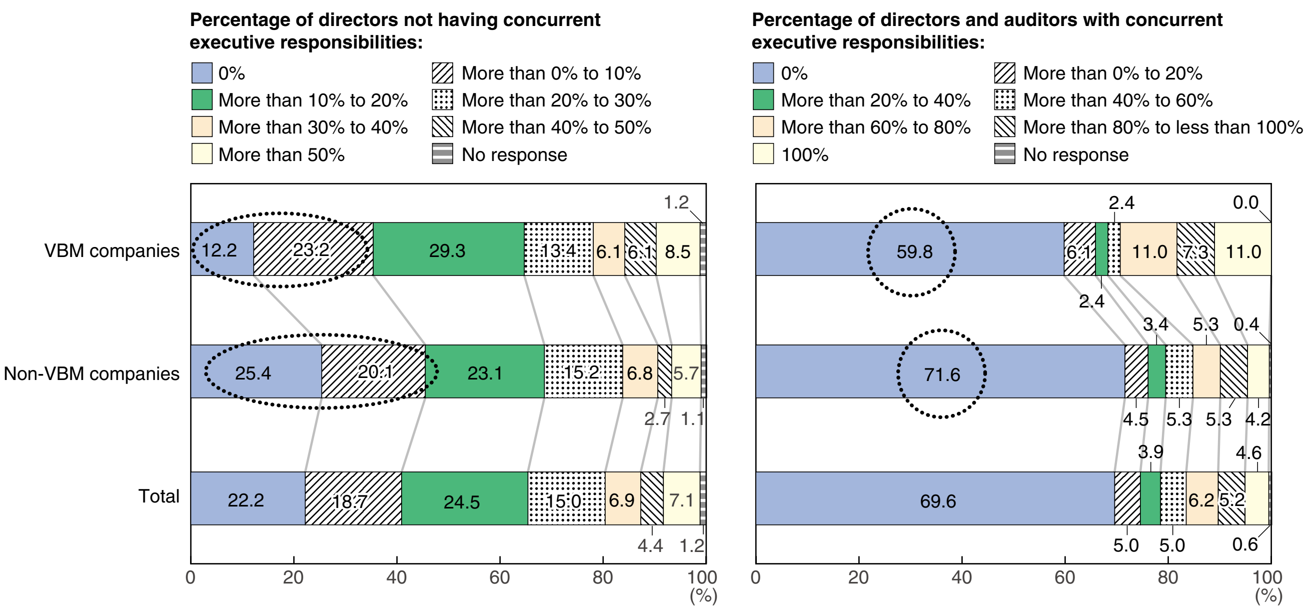
The questionnaire asked about the number and ratio of directors who do not have concurrent executive responsibilities (i.e., joint appointments as directors and division heads or managers) and the number of directors with concurrent executive responsibilities. These results are tabulated for VBM companies and non-VBM

Figure 5. Approach to Investor Relations



Note: Multiple answers possible.

Figure 6. Separation of Managerial and Executive Functions



companies to determine percentages with respect to all directors, or all directors and auditors (see Figure 6).

First, the percentage of directors not holding concurrent executive responsibilities tends to be lower for non-VBM companies (managerial and executive functions were not separated in this analysis).

Additionally, a review of the number of operating officers as a percentage of directors and auditors reveals that a higher percentage of non-VBM companies have not appointed operating officers. These results suggest that properly functioning internal checks are important for a stable increase in corporate value.

3 Decision-Making Processes

Point 5	Proper functioning of the highest decision-making organs as deliberative forums

The questionnaire asked how decision-making is carried out in board of directors meetings and other high-level decision-making organizations (management conferences, managing director meetings, and other forums). Questions about high-level decision-making organizations other than the board of directors were added because boards of directors are largely limited to making formal decisions in Japan. The actual deliberations and discussions occur in different forums.

In fact, a review of the survey results concerning the operation of board of directors meetings shows that 62.2 percent of responding companies stated "Informal deliberations are completed beforehand among parties concerned, and open debate is limited." This trend was the same for VBM companies and non-VBM companies.

However, a difference emerged regarding the operating status of high-level decision-making organizations other than the board of directors. The percentage of companies responding, "The reviewers and proposal initiators, or reviewers, engage in vigorous debate," was 63.2 percent for VBM companies, surpassing the 57.0 percent for non-VBM companies. This fact suggests that proper functioning of the important decision-making forums of the company is essential for better decision-making and increasing corporate value.

Of course, corporate culture determines whether vigorous debate occurs in decision-making forums and the results of previous informal discussions are fully scrutinized. Although some consider this issue is not worth raising, there is certainly room for increasing the effectiveness of decision-making by distributing materials before discussions, inviting outside directors to management conferences, and establishing a set of rules so that explanations and discussions can be shared by outside directors as well.

Point 6 Establishment of clear standards for decision-making

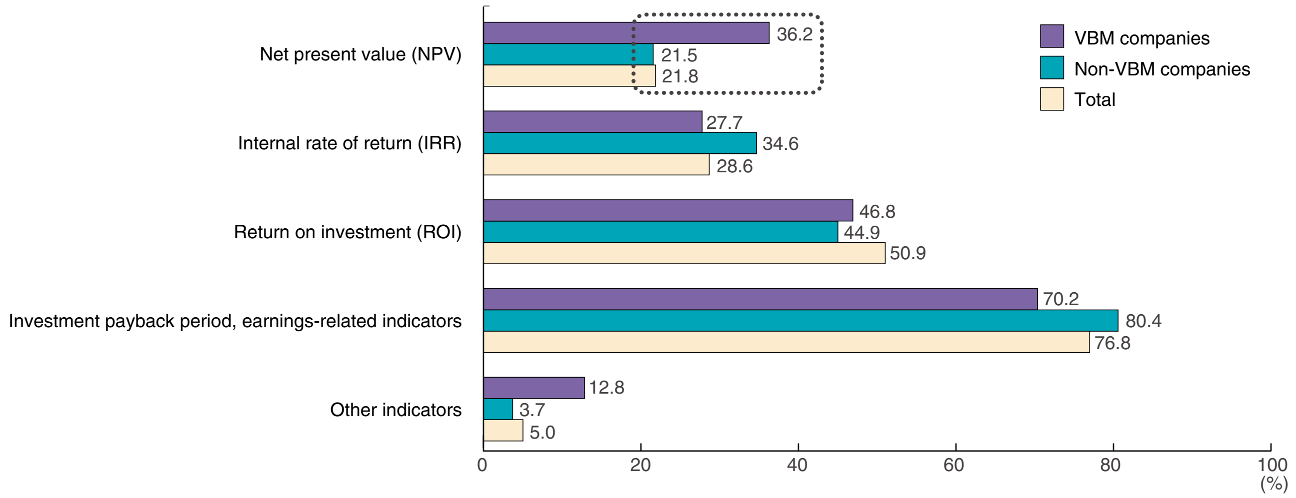
This survey addressed investment criteria, which are believed to have a substantial impact on corporate value, and asked the question: "Are there guidelines for decision-making on investment proposals (investment in projects and capital investments, not including research and development and other regular investments) in your company?" The response, "There are clear guidelines, and only proposals meeting those guidelines are sent up to decision-makers and decision-making organizations," was higher for VBM companies (31.7% for VBM companies, 17.0% for non-VBM companies). Conversely, the response, "There are no such clear guidelines," was higher for non-VBM companies (41.5% for VBM companies, 59.5% for non-VBM companies).

Final decisions on investments are made by decision-makers or decision-making organizations. Results from the analysis of these responses do not suggest that "human factors should be excluded from investment decisions, and that decisions should be made mechanically." Indeed, human judgment remains as important as ever, and also ensures the quality of investment proposals when groups of people examine them through a screening process. Stated differently, the results suggest the importance of avoiding situations where decision-makers must deal with numerous proposals of limited value, and ensuring that adequate time is devoted to important decisions.

Point 7 Use of criteria closely related to corporate value in investment decisions

The questionnaire asked companies that have guidelines for investment decisions: "What are the main indicators used as investment decision criteria of your

Figure 7. Indicators Used as Investment Decision Criteria



Note: Multiple responses possible.

company?" Net present value (NPV), internal rate of return (IRR), return on investment (ROI), investment recovery period, and other earnings-related indicators were listed as multiple-choice responses to determine the indicators used (see Figure 7).

A marked difference between VBM companies and non-VBM companies was observed in the use of net present value. Net present value is the sum of preceding annual cash flows adjusted with respect to a hurdle rate (minimum acceptable rate of return). If this hurdle rate is treated as the return demanded by the capital market, then it is possible to make investment decisions in line with trends in the capital market.

For example, investment proposals with negative NPVs will reduce corporate value even if accounting profits are gained. It is believed that the use of clear indicators closely linked to increases and decreases in corporate value in investment decisions plays an important role in realizing management practices geared to increasing corporate value.

4 PDCA Cycle

Point 8 Prescribe indicators that express capital efficiency as financial indicators in medium-term planning

The questionnaire asked about the types of financial indicators (indicators serving as financial targets) prescribed in intermediate planning (multiple responses possible), and also how they are used as indicators in explanations to investors and other external presentations.

A relatively clear difference between VBM companies and non-VBM companies was observed with respect to economic value indicators such as EVA, as well as ROA, ROCE (return on capital employed), ROE, and other indicators of capital efficiency (see Figure 8).

EVA is based on cash flow, while ROA and other similar indicators are based on accounting profits. Despite this difference, both are similar in that the concept of capital efficiency is included.

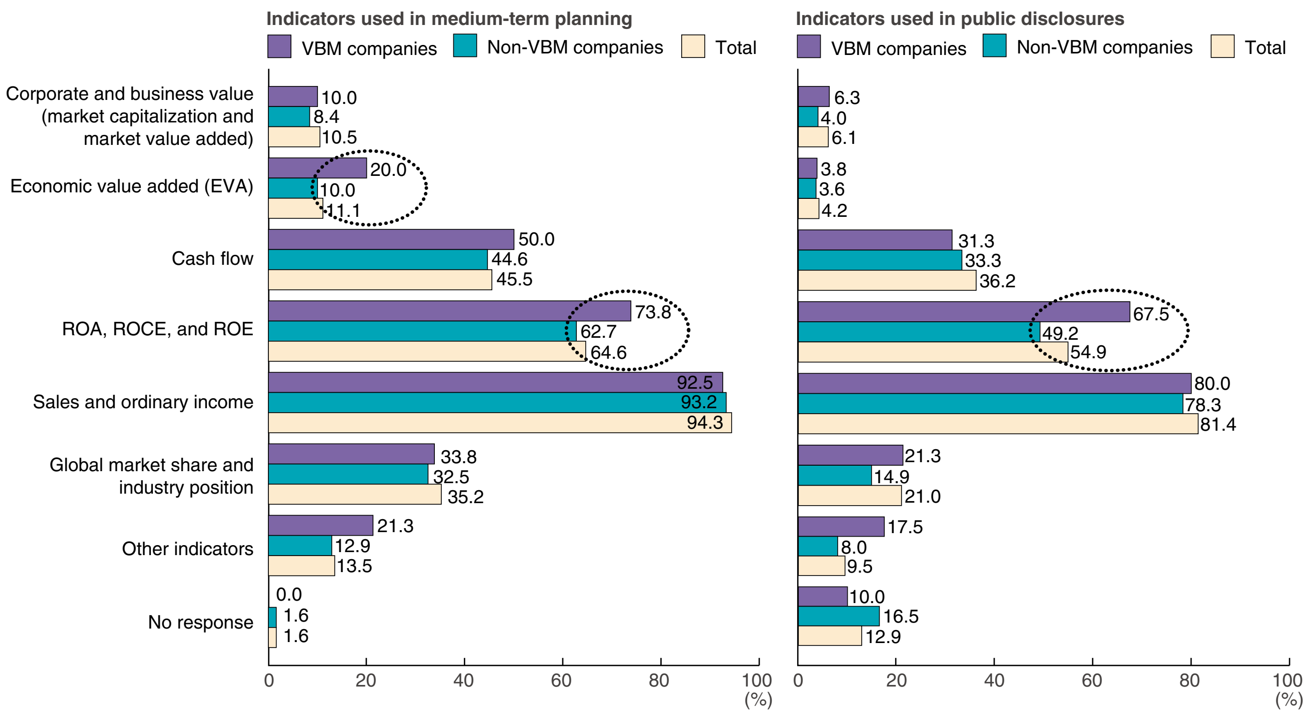
While there are many detailed definitions of corporate value, it is perceived in essence as financial value by shareholders. This result thus suggests that the first step in increasing corporate value is to establish indicators that recognize capital efficiency in intermediate planning.

Point 9 Intricate linkage of policy measures listed in fiscal year plans and the supporting budgets

The questionnaire asked: "To what extent are policy measures listed in fiscal year plans and budgets for executing these linked measures?"

A higher percentage of VBM companies tended to state that "Policy measures and budgets are formulated and decided in parallel, so funding is present for measures included in fiscal year plans" (70.7% for VBM companies, 50.4% for non-VBM companies).

Figure 8. Indicators Used in Medium-Term Planning



Notes: (1) Multiple answers possible. Tabulation results only for companies formulating intermediate plans; (2) MVA = market value added.

This is further evidence that the intricate linkage of these two elements is important in increasing corporate value, as execution of effective measures also entails costs.

Further consideration of this point is necessary. In fact, the response rate for "Policy measures and budgets are formulated and decided in parallel, so funding is present for measures committed to by fiscal year plans" was much higher than expected (54.7% of all responding companies). In the consulting experience of the authors, the formulation of policy measures and budgets is not fully linked in many companies. Although policy measures may be defined, many of them cannot be implemented without proper budgets. Because this situation has been observed in many companies, the 54.7 percent response rate was surprising.

Internal discussions within NRI yielded varied opinions concerning this point. Some measures may be of limited scale that fit the operational budgets of organizational units, and others may exceed that range. Generally, it is easy to link policy measures and budgets for the former, but it is difficult for the latter. The reason for the many responses that policy measures and budgets are linked to each other may be that many companies assumed the former situation.

Certainly, the latter kind of policy measures, i.e. those not covered by operational budgets of organizational units, were envisioned when the questionnaire was formulated, indicating that the survey needs to be reconsidered. Of course, this does not negate the importance of the linkage between policy measures and budgets for successful value-based management, and this issue will be addressed in the future.

Point 10 Alignment of organizational objectives and the objectives of unit supervisors

The issue concerning the extent of linkage between organizational objectives and the objectives of unit supervisors was addressed. The "level" of the organization was identified in the questionnaire as groups that can have a significant impact on corporate performance, which generally comprise companies, operating divisions, functional divisions, and units that are one rank lower in the organizational hierarchy.

The result shows that the response rate for "Objectives of unit supervisors are all established based on the objectives of their units, so both are essentially the same" was higher for VBM companies (75.6% for VBM companies, 64.4% for non-VBM companies). On the other hand, non-VBM companies had a relatively high response rate for "Unit supervisors add their own individual goals to organizational objectives (19.5% for VBM companies, 32.2% for non-VBM companies).

This result suggests that organization supervisors at higher levels can have a significant impact on corporate performance by adopting organizational objectives as their own and concentrating on attaining these objectives.

Additionally, with respect to the matching of organizational objectives with those of supervisors, specific items that should be added as organizational objectives are presented below.

The questionnaire asked: "What items are established by your companies as fiscal year objectives of revenue-producing divisions (operating divisions, sales divisions, and separate companies)?" The multiple-choice answers were: (1) numerical financial objectives + numerical non-financial objectives (performance improvement rate, acquisition rate for required skills, and others): (2) only numerical financial objectives; (3) numerical financial objectives + qualitative (vague) policy objectives; and (4) no particular clear objectives are stated.

Management of only the final financial results is insufficient for sustained increases in corporate value. As we believe that non-financial items tied to financial results also must be set as specific objectives and evaluated, we had thus anticipated that a significant difference between VBM companies and non-VBM companies would be observed for answer (1).

However, the response results were essentially the same for both groups (the response rate for answer (1) was 39.0 percent for VBM companies, and 37.1 percent for non-VBM companies, while the response rates for other answers were also essentially the same for both groups). This result suggests that adding financial targets and quantitative non-financial objectives as organizational objectives is not a sufficient condition for success in value-based management.

What should be done? The current survey does not provide any more information. Nevertheless, what is important is the validity of indicators and items used as objectives. The debate centers on how to establish key performance indicators (KPIs), which the authors believe should be selected from the viewpoint of linkage to organizational strategies.

The balanced scorecard introduced in Chapter 3 is a useful method in this regard. At this juncture, however, we would point out the importance of conducting sufficient discussion concerning its validity when establishing indicators and specific targets.

Point 11 Conduct interim reviews of progress on organizational objectives and methods to achieve such goals

The questionnaire asked about interim reviews of organizational objectives. The results indicated that VBM companies had a higher response rate for "Unit supervisors and their superiors (high-level managers, officers, and executives) discuss progress on organizational objectives and methods to achieve such objectives during the term" (85.4% for VBM companies, 75.0% for non-VBM companies). This suggests that revisions in accordance with results confirmed during the term represent a valid method for ensuring the final results.

Point 12 Provide performance review results for the current term as feedback for formulating plans for the next term

In response to the question: "How are the results of the term-end organizational performance review linked to formulation of plans for the next term?" VBM companies had higher response rates for (1) plans for the next term are formulated based on the term-end organizational performance review, and (2) plans for the next term must inevitably be formulated before the term-end organizational performance review, but attempts are made to ensure linkage between the two (19.5% for choice (1) and 73.2% for choice (2) by VBM companies, and 15.9% for choice (1) and 67.8% for choice (2) by non-VBM companies.

Like the interim review of point (11), it is believed that the formulation of plans for the next term based on a review of the current term will improve the quality of corporate strategy, thus ultimately increase corporate value.

Point 13 Use of well-defined, performance-based compensation

The questionnaire asked companies that have introduced performance-based compensation for managerial positions (somewhat less than 60% of the responding companies): "What percentage of the compensation of corporate managers under the performance-based compensation system is actually based on performance?" Answers were received concerning the average percentage of the performance-based component of compensation for company managers, operating division managers, and managers of functional units (at the appraisal rank most frequently given to employees).

The results indicated a trend among many VBM companies for high percentages with respect to the performance-based component of compensation (see Figure 9).

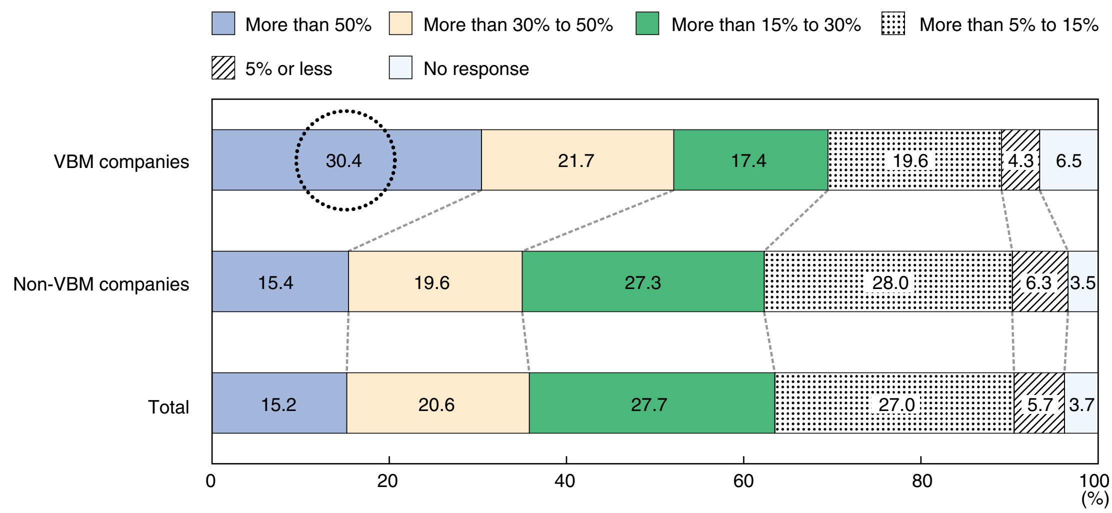
Of course, these results cannot be used to determine the appropriate level of the performance-based component of compensation. However, well-defined, performance-based compensation is important if results are crucial.

Point 14 Establishment of clear performance appraisal standards for executive compensation

Based upon our consulting experience, we felt that many companies do not necessarily adopt a performance-based compensation system for directors, even though the compensation of non-directors, including managers, is based on performance. This survey addressed this issue as well, and supported the perceptions of the authors. VBM companies had a higher response rate for "Compensation of directors is clearly linked to overall company performance, and the rules are also clear" (12.2% for VBM companies, 8.0% for non-VBM companies). On the other hand, non-VBM companies had a higher response rate for "The mechanism for performance appraisal of directors is not clear at all" (23.2% for VBM companies, 35.4% for non-VBM companies).

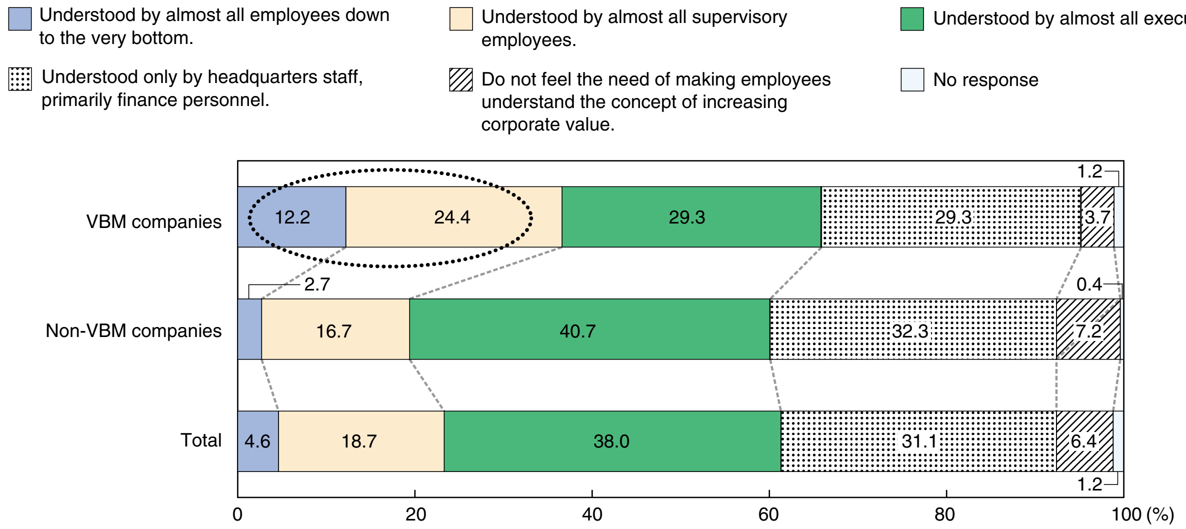
This suggests that introducing performance-based compensation will not produce positive results unless it is applied consistently across the board in accordance with the duties and responsibilities of individual employees.

Figure 9. Percentage of Performance-Based Compensation



Notes: (1) Tabulation results for companies that have introduced performance-based compensation for managerial positions; (2) average percentage of the performance-based component of compensation for company managers, operating division managers, and managers of functional units (at the appraisal rank most frequently given to employees).

Figure 10. Understanding the Importance of Increasing Corporate Value



5 Raising Awareness with Respect to Increasing Corporate Value

Point 15 Increase company-wide understanding of value-based management

The questionnaire asked: "Up to what level of employees in your company understand the proper ways to work towards increasing corporate value?"

The results showed that VBM companies had higher response rates for "Understood by all employees down to the very bottom" and "Understood by almost all supervisory employees," indicating a broader range of employees have such understanding (see Figure 10).

Business strategies for increasing corporate value are ultimately realized through the actions of each employee. Therefore, company-wide understanding of the proper ways to work towards increasing corporate value is crucial.

How should this difficult task of promoting understanding be achieved? The authors believe that it is important to create mechanisms that help employees better understand how their own work and objectives are positioned within company and organizational strategies to increase corporate value. Specific methodologies will be discussed elsewhere. We believe that it can be achieved by combining the balanced scorecard, which is a performance appraisal system for organizations, with MBO (Management by Objectives) among individuals.

III A Management Methodology for Increasing Corporate Value

Points for success in value-based management were considered by combining the survey results with objective capital market data. It is axiomatic that superior business strategies are essential for increasing corporate value. However, focusing only on aspects of the management system also has a clear and significant impact on corporate value.

What should be done to effectively implement the 15 Key Factors for Success of Value-Based Management? NRI's approach to and the framework for VBM solutions (a management methodology for increasing corporate value) are explained in this section.

1 NRI's Approach to and Framework for VBM Solutions

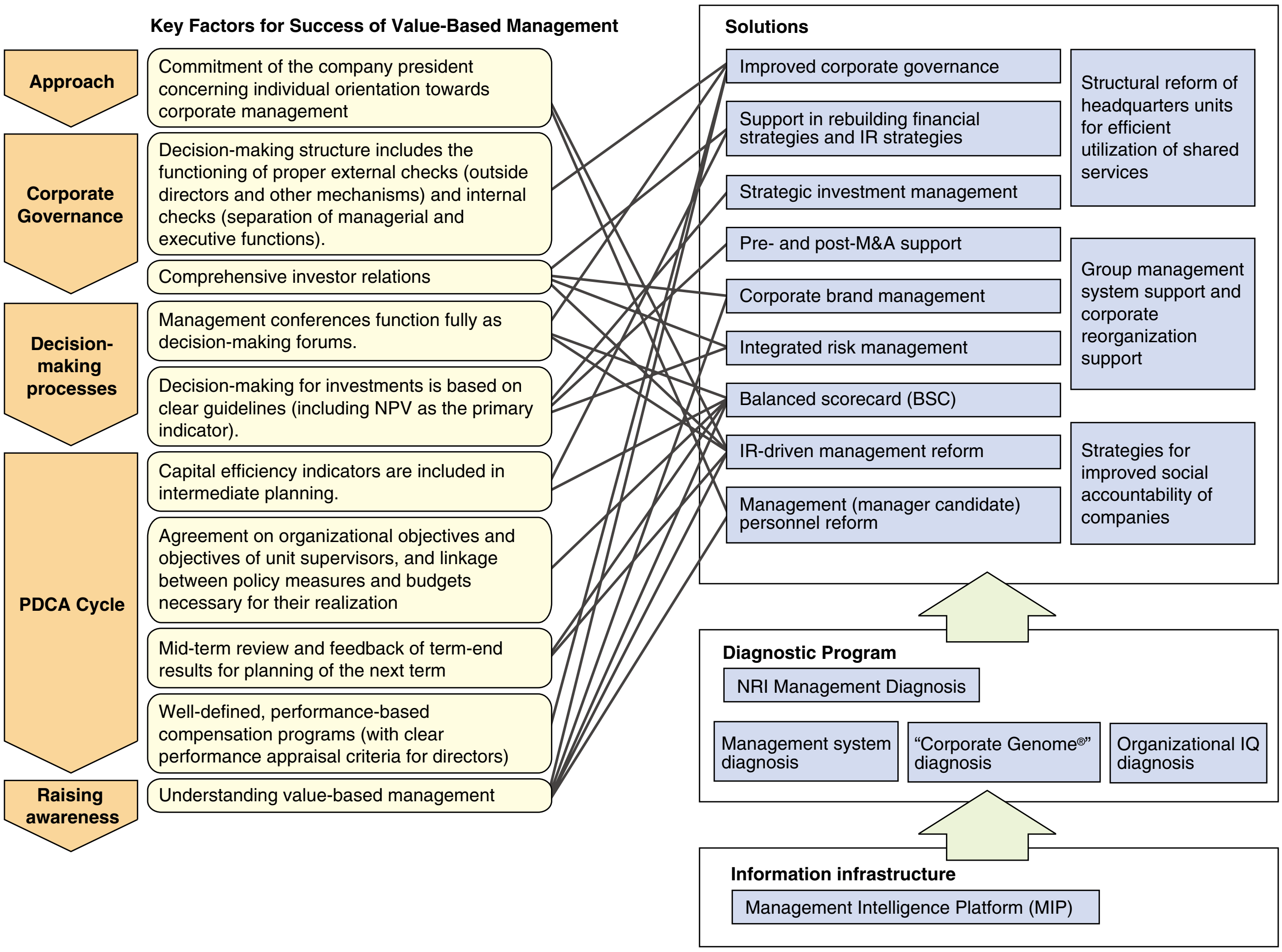
Currently available VBM solutions can be summarized as shown below.

- Re-organization of the business portfolio through value assessment standards (EVA, NPV, and others).
- Slimming of the organization and creating high added value through sharing of services by headquarters units (spin-off of accounting, general affairs, and other office services to promote efficiency by providing compensation for such services).
- Creation of a tree diagram of management system indicators closely geared to value assessment standards (devolution of corporate-level EVA to lower-level organizational units).

The authors do not deny the effectiveness of these types of solutions, but focus more on the following points.

- How are mechanisms for proper decision-making regarding redeploying existing business resources created? Clear evaluation standards are just one element of the solution.
- How should corporate management be carried out after redeploying business resources? How can genuine PDCA be realized?

Figure 11. VBM Solutions Provided by NRI



Note: M&A = mergers and acquisitions.

Based on this philosophy, NRI has developed and further enhanced many solutions for increasing corporate value.

The NRI-VBM Solutions Map in Figure 11 is a systematic summary of those solutions. Effective solutions for the various factors are positioned according to the category of success factors identified by the survey (approach, governance, decision-making processes, PDCA, and raising awareness).

These groups of solutions are drawn from the conventional services offered by the consulting divisions of NRI for more than 10 years to more recent solutions that are currently attracting much attention among client companies. Individual solutions will be explained elsewhere. Nevertheless, both the conventional services and the newer solutions employ NRI's unique approaches and methodology, which include knowledge gained from on-site consulting.

In particular, the balanced scorecard (BSC[4]) for strategically rebuilding the PDCA cycle, which is the foundation of the management system, has performed outstandingly at nearly 30 companies in the past four years, and is becoming the core solution for increasing corporate value. This methodology is not just a fad; its penetration among major Japanese companies has accelerated since around fiscal 2001.

2 Solutions Alone Do Not Produce Effective Reforms

All of these solutions are, in principle, designed to address problems (associated with management systems), but on their own are insufficient to achieve management reform. The company's current management must be objectively evaluated to determine the most effective solution (or combination of solutions) for increasing the company's corporate value. NRI therefore often conducts NRI Management Diagnoses before beginning a management reform project (see Figure 12).

This is a series of diagnostic programs that include objective diagnoses by consultants of the client company's finance and investor relations, governance, brand management, risk management, PDCA cycle, personnel and employee development systems, management accounting system, management information systems, corporate genome[5] (organizational culture),

Figure 12. NRI Management Diagnoses

NRI Management Diagnosis

Financial and IR diagnosis	The composition of the main assets and liabilities is checked from a practical perspective based on the company's unique business characteristics and the appraisals of capital markets to clarify intermediate and long-term financial issues.
Corporate governance diagnosis	The basic structure of corporate governance, performance indicators, monitoring, and current executive compensation status are evaluated in terms of increasing corporate value.
Brand management diagnosis	The company's unique corporate brand is evaluated through surveys of consumers, employees, and other stakeholders to address brand management issues.
Risk management diagnosis	The business risks of the company are defined and classified, and risk management conditions are evaluated.
Management system diagnosis (PDCA cycle diagnosis)	Methods for establishing planning committees, staff support systems, performance appraisal methods, and other operational bottlenecks are clarified for more effective formulation and execution of business plans.
Personnel and human resources development system diagnosis	Employee satisfaction levels and awareness of personnel appraisal, treatment (salary, promotion, and advancement), assignment, development, and other personnel systems are fully determined to address the personnel management issues of the company.
Management accounting system diagnosis	The characteristics of business operations, financial importance, and bookkeeping and documentation control conditions are surveyed to identify problems in basic data, if any, for quicker decision-making.
Management information system diagnosis	Systems are comprehensively evaluated from strategies to architectural design and usage conditions to address issues for building efficient management information systems.
Corporate Genome® diagnosis	The vitality of the organization is evaluated through questionnaires for objective positioning of the company's corporate culture.
Corporate citizenship diagnosis	The company's social accountability activities are evaluated in terms of increasing corporate value.
Organizational IQ diagnosis	The company's decision-making processes, delegation of authority, organization, knowledge sharing, and other management system issues are fully examined to evaluate the information processing and execution capabilities of the organization.

corporate social responsibility, organizational IQ, and many other management system elements. The management strengths, weaknesses, and points that lead to structural vicious circles are then clarified, so that a detailed reform plan for solving the problems can be drawn up.

NRI's database of case studies of Japanese companies that it has assisted in many areas is a vital part of this diagnostic program. The database is not used merely to identify problems during the diagnostic process, but also to compare best practices (the most advanced examples). Specific recommendations can then be made based on objective data and the causes of a structural problem or weakness.

The results of these NRI Management Diagnoses often continue to be used as a road map for management reform for many years.

3 Management Reform Strikes a Balance between Continuity and Innovation

Finally, let us outline our views on the proper approach to management reform.

All reforms, not only the innovation of corporate management to increase value, involve a never-ending process, as evidenced by our work for thousands of client companies and our on-site experience in consulting on reforms.

Top management often fails to follow up on a management reform that has just been completed, preferring instead to immediately initiate new reforms within the company. This happens in almost every company. However, top management must not overlook how past reforms are functioning now.

Many company officers we interview comment: "We've finished that reform and have started a new one." However, if past initiatives are neglected they will not take root and employees will become skeptical about new campaigns and reforms. Such skepticism saps the vitality of the organization and dissipates the sense of crisis.

Top management and other company officers need to strike a balance between maximizing benefits through continuous activities to enable past reforms to take root, while constantly searching for the seeds of new reforms.

(1) EVA is performance indicator and registered trademark of the Stan Stewart Company, a US management consulting firm.
(2) This five-year period was chosen for the analysis

because value-based management first became generally recognized in Japan in the mid-1990s. A period of this duration is necessary for proposing, implementing, and producing outcomes. AURORA, a database built and operated by NRI, is used to obtain market capitalization data.

(3) The lack of agreement between the total number for both comparison groups and total number of responding companies arises because some companies did not implement reforms to increase corporate value yet their market capitalization performance outperformed the TOPIX, and because the March 1997 market capitalization data could not be obtained for some firms.

(4) Assuming that organizational performance is not defined solely by financial performance, this employs a non-financial multidimensional perspective for definition, involving customers, internal company business practices, training and growth (personnel development and building of company infrastructure). This corporate management methodology, which attempts to carefully balance these factors, has now broadly penetrated Japanese companies. Additionally, detailed explanations of the balanced scorecard can be found in "Toward the Establishment of Consistent Management System" (Toru Morisawa and Toshiaki Kono, *Knowledge Creation and Integration*, NRI, Spring 1999), "Innovations in Corporate Philanthropy: Adopting Balanced Scorecard Methodologies to Build Strategy and Evaluation Systems" (Eiko Ibuki, *Knowledge Creation and Integration*, NRI, October 2001), and "Building Performance Measurement Systems with the Balanced Scorecard Approach" (Toru Morisawa, *Knowledge Creation and Integration*, NRI, December 2001).

(5) Corporate genome is a registered trademark of the Nomura Research Institute.

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As a leading think-tank and system integrator in Japan, Nomura Research Institute is opening new perspectives for the social paradigm by creating intellectual property for the benefit of all industries. NRI's services cover both public and private sectors around the world through knowledge creation and integration in the three creative spheres; "Research and Consulting," "Knowledge Solutions" and "Systems Solutions."

The world economy is facing thorough structural changes led by the dramatic growth of IT industries and the rapid expansion of worldwide Internet usage—the challenges of which require new concepts and improvement of current systems. NRI devotes all the efforts to equipping the clients with business strategies for success by providing the best in knowledge resources and solutions.

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