Do South African managers focus on the creation of shareholder value?

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Self-administered questionnaires were sent to executive level managers of randomly chosen Johannesburg Stock Exchange (JSE) listed companies. Respondents were tested for their understanding and implementation of shareholder value practices. The majority of respondents were at a senior management level. It was found that shareholder value management is still regarded as a financial management tool and not understood to be a framework for the integration of financial and strategic planning using the economic model of the firm. The majority of respondents allocate resources on a project by project basis and use the top-down approach in the setting of financial targets resulting in a concentration of value around a few business units in the company's portfolio. Strategic plans are not generally evaluated according to shareholder value potential. A shortcoming is the use of accrual accounting measures in financial planning and for the setting of performance targets. A limited number of respondents had full financial and operational autonomy in their business units and performance targets were mostly short term (less than three years) in nature.

Vraelyste is aan bestuurslui op uitvoerende vlak van maatskappye wat op die Johannesburgse Effektebeurs genoteer is, gestuur. Seleksie het op onwillekeurige wyse plaasgevind. Respondente is vir hul begrip en implementering van praktyke aangaande aandeelhouerwaarde getoets. Die meerderheid van die respondente was senior bestuurslui. Daar is bevind dat die bestuur van aandeelhouerwaarde steeds as 'n finansiële bestuurselement beskou word, en nie as raamwerk vir die integrasie van finansiële en strategiese beplanning wat die maatskappy as ekonomiese model gebruik nie. Die meerderheid van die repondente wys hulpbronne op 'n projek-tot-projek basis toe met 'n bo-na-onder benadering ten opsigte van finansiële doelwitformulering. Dit het tot gevolg dat waarde rondom 'n paar sake-eenhede gesentreer word. Strategiese planne word nie normaalweg op grond van die potensiaal van aandeelhouerwaarde geëvalueer nie. 'n Tekortkoming is die gebruik van tradisioneel-rekeningkundige maatstawwe by beplanning en by die bepaling van prestasiedoelwitte. 'n Beperkte aantal respondente was finansieel en operasioneel outonoom in hul sake-eenhede en prestasiedoelwitte was meestal kort termyn van aard (minder as drie jaar).

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Introduction

Shareholder value management is a philosophy of management, the principal objective of which is to generate returns to shareholders which exceed the company's cost of capital, thereby maximizing long term economic value. It had its beginnings in developments over the past 40 years in strategy consulting, corporate finance and investment management. According to McTaggart,

> 'the developments in strategy consulting and finance were ultimately combined to create an integrated framework by which large companies could more effectively manage their businesses' (1990a: 19).

Strategic planning came into its own in the late 1960s when management faced an increasingly complex business environment. Two important techniques were introduced, the experience curve and the growth share matrix developed by the Boston Consulting Group. According to James,

> 'the successful use of these techniques bred a level of confidence to the point where top management frequently abdicated responsibility in selecting a strategy. Thus, the strategist, originally an advisor, began to dominate decisions related to the physical production and sale of goods and services' (1984: 57).

A crisis developed in the 1980s as many of the strategic planning concepts used with success in the 1970s were found to be no longer reliable and, in many cases, resulted in strategic failures. Factors contributing to such failures were the narrow focus of business strategies, the inadequacy and misapplication of strategic concepts, implementation difficulties and blind faith in strategies (James, 1984: 57–60).

Alongside the developments in strategic planning, a number of developments were taking place in the investment management area. Shareholder value is traditionally measured using the accounting model of valuation. This model sets share prices by capitalizing a company's earnings per share (EPS) at an appropriate P/E multiple. P/E multiples however, adjust to changes in the quality of a company's earnings making it necessary to adopt a more reliable measure of valuation (Stewart, 1991: 22).

The failure to understand how share prices are set makes it difficult for executives to reach sensible decisions regarding business strategies, acquisitions and divestitures, financial structure, dividend policy and bonus plans (Stewart, 1991: 21). In particular EPS, still commonly regarded by management as the principal yardstick by which the stock market prices shares, is normally not a reliable indicator of value, because the effects of accounting convention may help to engineer earnings (Copeland, Koller & Murrin, 1990: 82). For example, expenses that should be deducted to save taxes may be deferred to boost reported earnings and unusual write-offs could be taken in one year to avoid a bad investment decision from affecting reported earnings over a period of time.

Studies which show that accounting earnings are not well correlated with share prices, that the manipulation of accounting convention to contrive earnings does not improve share prices, and that the market looks at the long-term cash flow impact of management's decisions, not the short-term earnings impact, provide evidence to support the view that the market looks at the long-term economic value that is created by a company and not the reported accounting earnings (Copeland *et al.*, 1990: 83).

Ultimately, shareholder value can be managed by understanding that share prices are determined by the expected cash to be generated over the life of a business and the riskiness of these cash receipts (Copeland *et al.*, 1990: 93; and Stewart, 1991: 4). A value is assigned to a company in the capital markets by discounting the expected future cash flows of the company at an appropriate discount rate which reflects the aggregate risk particular to those cash flows. The value of the company can be managed by optimizing the cash flow value of the individual business units making up the company. A business unit's cash flow is in turn maximized by managing its assets and improving its economic profitability over time. This depends on the characteristics associated with its product markets and is a function of strategy, industry structure and competitive position. The link between the economic profitability of a business unit's product markets, its cash flows and the cash flow value of the group is the key to the management of shareholder value.

The impact that managing for increased shareholder value is having on current thinking in corporate finance circles is demonstrated by a plethora of articles appearing in business periodicals such as *Fortune* magazine. For example, in the article featuring leaders of the most admired corporations (Fortune, 1990), it was reported that at Coca-Cola 'the most noteworthy change under Chairman Roberto C. Goizueta has been a shift in focus from boosting sales to maximising shareholder returns'.

The maximization of shareholder returns was again prominently featured in *Fortune* (1993a) where the concept of Economic Value Added (EVA),[1] used to calculate the value a company generates over and above its cost of capital, is discussed. Furthermore, it is suggested that EVA will become a competitive advantage to companies using it and major United States corporations such as Coca-Cola, AT&T, Quaker Oats, Briggs & Stratton and CSX that have adopted the concept, have shown substantial increases in market value since the adoption of EVA.

The ranking of America's best wealth creators (Fortune, 1993b) in terms of Market Value Added (MVA), a measure closely related to EVA, highlights the deficiencies of other traditional performance measures such as turnover, profits, return on equity and market capitalization.

Research conducted by Stewart (1992: 23) showed that market value added by companies (over and above their original capital) correlates best with EVA. Traditional measures of corporate performance such as Return on Equity, EPS growth and dividend growth fared very much worse.

Four areas in managing for shareholder value can be identified, which, when applied to a company, can result in better management of shareholder value (McTaggart, 1989: 3). The first two relate specifically to strategy in a diversified company, namely corporate (or company-wide) strategy and business unit (or competitive) strategy (Porter, 1988: 35). The third and fourth concern strategies relating to organizational structure and management processes, respectively.

Alberts & McTaggart (1984: 138) suggest that corporate strategy is concerned with three questions, namely what businesses the company should be in; which businesses should be divested from the current portfolio; and how much capital to allocate to the portfolio of businesses over time?

The traditional approach for capital allocation is based on integrating the company's investment decisions and balancing the company's business unit portfolio. The balancing of the company's business unit portfolio means that corporate level planners strive to achieve a balance between units that generate cash and the fast growing units that consume it. The value-based approach for capital allocation, on the other hand, consists of choosing the highest value strategy from alternative strategy options without the need for a balanced portfolio, and thereby decentralizing capital spending decisions to each business unit.

At the level of the strategic business unit, there are two elements to the development of strategy: determining the market segments in which the businesses should participate and determining how best to compete in each of these segments. The business unit's participation is determined by the profitability of the particular market segment and the business unit's competitive position. By developing alternative operating strategies for a market segment, it becomes possible to choose from several viable strategies.

The profitability of a company's products and the markets they serve, play an important role in identifying value drivers, which are the sources of sustainable competitive advantage. The identification of value drivers is the most important element in the strategy development because it focusses management's attention on the characteristics of the business that have the most leverage, both in terms of competitive advantage and value creation. Most value drivers in a strategic business unit are derived from its core assets and skills.

Examples of core assets include a brand franchise, favourable retail locations, access to raw materials, a patented product technology and a low cost core body. Examples of core skills include a higher volume, more disciplined approach to purchasing, a lower cost manufacturing process, a faster distribution system, a more highly trained and motivated sales force and a better managed, more productive R&D team.

A business unit which is value based is characterized by five factors. The first concerns the strategy development process which is geared towards the creation of value. The second is the linking of a business unit's strategic position to its prospective financial performance. The third involves the use of value drivers to develop alternative strategies. The fourth requires the use of relative value to choose from different strategies and the last concerns the linking of the chosen strategy with a performance management plan.

In a value-based company, control by the corporate centre is exercised through the creation of an internal capital market. The objective of the market is to allocate resources to businesses in a way that provides strategy driven control and reward mechanisms.

As a result of following an integrated management process, the strategic plan represents both a funding commitment and a performance contract between the corporate shareholder and the management of businesses. The strategic plan is also used to set performance targets based on value drivers and makes the control process a product of strategy rather than the strategy being the product of the control process. The performance targets in turn are used to design the incentive compensation program for each business.

Once the value-based management processes have been implemented, the organizational structure is adjusted to reflect the natural value centres within the portfolio of businesses. A value centre is the smallest unit within a company for which an independent strategy can be developed and valued. Individual roles and responsibilities are also changed to manage shareholder value within the company.

Little published material exists on the current use of shareholder value management. Coopers and Lybrand, Deloitte (1991) commissioned a survey which assessed the current use by management of shareholder value principles in the United Kingdom. It was found that top management mostly used shareholder value measures for major business decisions. On the other hand, the major financial institutions, which invested in the companies, expected top management to make more frequent use of shareholder value measures for routine planning and management and for reporting to investors. Although two thirds of the companies in the sample studied used the concept of shareholder value, only one in six made full use of it for planning and reporting purposes. However, it appeared that shareholder value measures would become more important for management purposes in the future, especially for the larger companies.

Companies often claim to operate for the benefit of their shareholders, but they rarely demonstrate how this will be achieved. This observation, coupled with the absence of research on the subject as it pertains to the South African corporate environment, leads to the question: do South African managers focus on the creation of shareholder value?

Answers to the following questions were sought:

1. Do senior managers of South African companies understand the principles by which shareholder value can be managed?
2. What aspects of shareholder value management are commonly practised?

Methodology

A questionnaire comprising three parts was constructed. Part A was designed to collect details of the interviewee and the company. It generated seven nominal responses. Part B was designed to measure the respondent's understanding and appreciation of shareholder value principles. This understanding was tested quantitatively using matrix-type questions. Respondents were asked to rank on a Likert scale their agreement/disagreement with eleven statements reflecting shareholder value principles. The eleven ordinal responses were rescaled using Correspondence Analysis in order to convert the ordinal into interval data so as to ensure the appropriate weighting of the Likert scale responses.

The last part (C) of the questionnaire was designed to measure the extent to which shareholder value management principles were practiced. The reliability of the answers to the questions in this section depended on the understanding the respondents had of the constructs used to describe shareholder value practices. The questions were designed to provide both quantitative as well as qualitative data and consisted of a combination of two answer (yes/no) and contingency formats. Altogether 33 nominal responses were generated. Where relevant, the contingency format provided additional information to respondents' *yes* or *no* answers. This qualitative aspect was useful in assessing whether respondents understood the concepts associated with value-based management. An outline of the questionnaire may be found in the appendix.

Questionnaires were sent to a systematic random sample of 222 companies which was drawn from a sample frame of 657 JSE listed companies. The sectors omitted from the sampling were the curtailed gold operations, the development capital and venture capital markets. The average response rate was 23%. The response rate per JSE sector is shown in Table 1. A Chi-square goodness of fit test demonstrated that the distribution of companies by the JSE sector in the sample was not dissimilar to the JSE population as a whole.

Although the questionnaires were targeted at Chief Executive Officers, provision was made for other directors and/or senior management to respond. Altogether 72% of the respondents were senior executives, 28% were at the level of executive chairman and 26% were managing directors. Table 2 shows the numbers of respondents grouped by company turnover.

Results

Understanding of shareholder value principles

On rescaling the Likert scales of the eleven attitude questions using correspondence analysis the values obtained were 1, 1.61, 3.45, 4.7 and 5, respectively, thus showing a marked degree of skewness in the data.

Sharehold versus *stakeholder interest*

The majority (88%) of respondents believed that it was management's primary responsibility to look after the interests of the shareholders. At the same time, most respondents (54%) felt that the interest of other stakeholders would be compromised if the focus of a company was solely oriented towards the interest of the shareholders.

Table 1 Questionnaire response rate

JSE sector	Total JSE	No. sent	No. received	Response rate
Mining	102	31	5	16%
Financial	154	51	11	22%
Industrial	401	140	34	24%
Total	657	222	50	23%

Table 2 Company size distribution of sample

Turnover	Number of respondents
Less than R50 m	8
R50 to R149 m	6
R150 to R499 m	5
R500 to R1500 m	12
More than R1500 m	17
Total	48

Shareholder value driven compensation

Most respondents (76%) were of the opinion that management's compensation should be tied to shareholder returns.

Determinants of shareholder value

Altogether 88% of respondents agreed that shareholder value is destroyed if the return on capital is lower than the company's cost of capital. This demonstrated their understanding of the factor most crucial in the creation of shareholder value.

Applicability of shareholder value management

Three quarters of the respondents were of the opinion that equity concentration did not prevent South African companies from applying shareholder value management and a like percentage were of the opinion that shareholder value management was no fad.

Common perceptions in managing shareholder value

Well over half the respondents (62%) believed that EPS was a reliable measure of corporate performance. When respondents were asked whether the market places emphasis on short-term developments in valuing shares and whether shareholder value management is a financial management tool, 54% and 58%, respectively, agreed. It is important to note, however, that for the latter two statements an appreciable number of respondents gave neutral responses (28% and 32%, respectively). This would indicate further agreement (in view of the skewed Likert scales) and hence a poor understanding of the above-mentioned issues in relation to value-based principles.

Managing company value

Altogether 78% of respondents believed that the value of a business is determined by the present value of future projected cash flows discounted at a risk-adjusted cost of capital. A lower number of respondents (46%) were of the opinion that a company's share price could be managed.

Practice of shareholder value management

The practice of shareholder value management was evaluated by the responses to questions concerning the company's need to develop value creating strategies at the corporate and the business unit levels, and the implementation of these strategies at the organisational level using the appropriate organisational structures and management processes.

Corporate strategy

Value creation tends to be concentrated: The allocation of resources at the project level and the setting of corporate financial targets using the top-down method leads to the phenomenon of cross-subsidization. In this process, cash is diverted from value-creating businesses to value destroying businesses and value ends up being concentrated in a few businesses within the company's portfolio (McTaggart, 1990b: 2).

Evidence suggesting that value may be concentrated in a few business units is obtained when analysing the responses to the corporate strategy questions. It was reported by 54% of respondents that they allocate capital on a project by project basis, and that the allocation of resources is based on IRR (38% of respondents) and payback (20% of respondents), which is typical of a project by project approach.

It was found that 30% of respondents use top-down goals in the setting of corporate financial targets. Although the majority of respondents (52%) indicated that the setting of targets happens through a process starting at the business unit level, only 18% of respondents confirmed the two-way interaction between the corporate centre and the business unit. It was also consistent with the above-mentioned responses that only 38% of respondents reported 50% or more of the company's capital earning a return above the company's cost of capital. Furthermore the majority of respondents (62%) reported an inferior performance relative to their JSE sector.

Measures of corporate financial performance: Much of the concentration effect at the corporate level may have occurred because of companies' continued reliance on accounting rather than economic model measures. The measurement of value creation with the wrong accounting-based rulers has been quoted by Reimann (1987: 16) as one of the reasons why so many companies have not detected the destruction of shareholder value.

Earnings, ROI and EPS were found to be the predominant measures of corporate financial performance amongst South African companies (57% of the total responses). This may account, in part, for the inferior performance reported by some respondents. Other accounting-based measures like RONA and ROE were mentioned in a further 26% of responses. The economic model measure, Economic Value Added, only featured in 15% of the responses

Capital structure: Many of the respondents (62%) reported having excess gearing capacity but few were willing to take on more debt in order to decrease the firm's cost of capital. The main reasons proffered were the company's preference for being cash flush, the lack of good investment opportunities, the effect debt would have on financial ratios and the perception that additional debt does not lower, but would in fact increase, the cost of capital.

Corporate acquisitions: The majority of respondents (54%) were found to have an acquisition process conducive to shareholder value creation. Only 26% of respondents indicated omitting two or more of the three processes involved in acquisitions to ensure the creation of shareholder value, namely the quantification of the control premium, the setting of the plan to recapture the premium and the nomination of a person to be responsible for achieving the strategic and financial targets prior to the acquisition taking place.

Business strategy

Value tends to be even more concentrated at the business unit level because it is difficult to identify the sources of value without allocating shared costs and assets. The traditional approach to strategy formulation at the business unit level has consisted of focussing on objectives such as, amongst others, market share, gaining a competitive advantage and becoming a low cost producer (McTaggart & Favaro, 1990: 3). The principal shortcoming of the traditional approach to strategy formulation was the lack of emphasis on value creation, which could only be rectified by linking the strategic and financial planning in an integrated manner.

The value-based approach requires the business unit to first consider its strategic position in terms of market structure and competitive position whereafter the value of the current strategy is evaluated using discounted cash-flow techniques. By knowing the value of the current strategy and the relative value contribution of the market segments in which the business unit operates, it becomes possible to isolate value drivers.

An increased focus on the value drivers in a business can subsequently lead to the development of alternative, higher value business strategies. The value-based strategies can furthermore be used as a basis for performance management (McTaggart & Favaro, 1990: 5).

Integration of financial and strategic planning: Altogether 84% of respondents claimed to integrate the strategic and financial planning functions. On closer inspection however, it was revealed that companies understood such integration to mean the elementary translation of the strategic plan into accounting-based numbers instead of the present value of future cash flows.

In the majority of cases, resources were allocated in line with the strategic plan and the setting of budgets was in line with the previous year's strategic plan. Although this approach is correct, shareholder value can only be created if the strategic plan leads to a positive net present value for the company. Such an evaluation can only be made if the strategic plan is quantified in economic value terms, not in accounting terms.

Knowledge of market structure and competitive position: The majority of respondents (54%) claimed knowledge of the profitability of the markets in which they operated and their competitive position in these markets. They had information relating to their competitor's market position and profitability and reviewed from time to time their participation in these markets.

Most respondents therefore appeared to have sufficient knowledge to tie their business units' strategic position to their prospective financial potential in terms of economic value added. It is proposed that the reason why respondents are unable to take this knowledge to its logical conclusion is due to the use of accounting instead of economic value information. This proposition is consistent with the fact that there was no evidence that companies knew the current value of their business unit strategies.

Value drivers: Respondents were generally unfamiliar with the term value drivers as the sources of sustainable competitive advantage.

Value-based performance management plan: It was found that the strategic plan was only used by 28% of respondents as a basis for the setting of long-term (three to five year) performance targets. In the short term, the majority of respondents (82%) used the business unit's strategic plan as a basis for performance targets and 60% said that remuneration depended on hitting the targets set in the business plan. This finding is only meaningful in terms of shareholder value creation if the plan being implemented has a positive net present value.

Organisation structure

The findings of the survey in terms of organisation structure indicated a partial adherence to value-based principles of management. The majority of respondents reported that their business units were structured along strategically independent lines and that these business units had a full financial expression through separate income statements and balance sheets.

Obvious weaknesses in terms of shareholder value, however, were the limited percentage of respondents (50%) that had full financial and operational autonomy in their business units and the number (42%) reporting the use of free negotiation to set transfer prices. These weaknesses are typical of companies that have a strong tendency towards centralized corporate decision-making and they suggest additional reasons for the observed phenomenon of value concentration at the corporate level.

Management processes

Altogether 38% of respondents admitted that the practice of allocating resources was part of a short-term (less than three years) management contract whereby management undertook to perform according to the business plan, whereas 22% indicated that the allocation of resources is part of a long-term management contract. A further 36% said that no management contract existed in the process of allocating resources. This finding is consistent with the previous finding regarding the short-term nature of commitment by management to the meeting of performance targets.

Although the majority of respondents (82%) reported that resource allocation was based on the value to be created for shareholders, it was previously observed that strategies were not translated into value-based parameters such as cash flow. One therefore cannot be sure that respondents allocate capital on the basis of strategies that have been evaluated in terms of shareholder value. It seems more likely that the strategies are implemented with the intention of creating shareholder value, rather than knowing the value potential of the strategy.

Two thirds of respondents use accounting-based yardsticks and only one third use cash flow-based rulers to measure management's performance. Although the majority of respondents (66%) claim to link executive remuneration with the creation of shareholder value, it is unlikely that in practice this is true for most respondents because of the use of accounting-based information to measure management's performance.

Conclusions

The impressive response from top levels of management has given the findings of this research added significance. The majority of respondents were at an executive management level.

Although agreement largely exists on management's primary duty, which is to look after the interest of the shareholder, it was also felt that the interests of other stakeholders would be compromised if the sole focus of management was based on shareholder interest. Knowledge of shareholder value was demonstrated by a majority support for shareholder value-driven compensation and for the applicability of shareholder value management. The financial determinants of shareholder value were also well understood but respondents were less comfortable with the thought of being able to manage company value.

Shortcomings in the understanding of shareholder value principles were revealed over issues concerning EPS as a reliable measure of corporate performance, the perception by most respondents that the market places emphasis on short-term developments in valuing shares and shareholder value management as a financial management tool, rather than an integrated financial and strategic planning tool.

At the corporate strategy level, it was found that the majority of respondents allocated resources on a project by project basis using IRR and payback, and used the top-down approach in the setting of financial targets using accounting-based measures such as earnings, ROI and EPS. Both practices were largely responsible for the concentration effect of value around a few businesses in the company's portfolio. The majority of respondents shied away from the use of debt to lower the company's cost of capital, some for reasons such as the effect debt has on financial ratios and the impression that more debt increases the cost of capital, and others, for reasons of wanting to be cash flush and the lack of good investment opportunities.

Although the majority of respondents claimed that their strategic and financial planning was integrated at the business level, the explanations of the methodology employed to accomplish the integration made it clear that SBUs generate only one strategic plan and do not choose from alternative plans based on their relative shareholder value potential. SBUs are furthermore not in a position to evaluate the strategic plan in terms of the value it will create for the shareholder because of the use of accrual accounting instead of economic value measures.

It is suspected that the allocation of resources at the business level continues to be misdirected towards SBUs with weak strategic positions resulting in a similar degree of concentration of value around a few markets within the SBU concerned. This effect was previously noted at the corporate level, where only 38% of respondents reported that 50% or more of their company's capital was earning a return greater than the cost of capital.

Clearly, a major stumbling block in the value creating process at both corporate and business strategy levels remains the use of accrual accounting methods in the generation of financial plans. Accounting-based measures are ultimately misleading in terms of shareholder value creation (Reimann, 1987: 16).

In terms of the management processes, when superficially viewed, companies tend to observe value-based practices such as the linking of strategic planning and budgeting, the allocation of resources based on the value it will create for the shareholder, the undertaking by management to perform according to the business plan, albeit a short-term plan, and the practice of linking executive remuneration with the value that is created for the shareholder. The above-mentioned management processes are only effective in terms of shareholder value creation once the yardstick is based on economic value parameters. Until companies learn to express their strategic plans in terms of such measures, the allocation of resources towards profitable plans will remain a hit and miss affair. Only then can management's performance be measured and rewarded in terms of the value created as part of a longer term management contract.

Note

1. EVA is the Trademark of Stem, Stewart & Co, New York.

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Appendix

Questionnaire Part A: Interviewee and company details

A1 Name (optional)
A2 Job Title
A3 Company (optional)
A4 Your management level:
Executive Management (CEO,COO,CFO,MD)
Other Director
Senior Management
Other: (please specify)
A5 Your current area of responsibility in the company:
Accounting/Finance
General Management/Strategy

Human Resources/IR
Information Systems
Marketing/Sales
Operations/Production
Other: please specify

A6 JSE sector in which company is listed

A7 Total Turnover:
Less than R50 million
R50 million to R149 million
R150 million to R499 million
R500 to R1500 million
More than R1500 million

Part B

Listed below are eleven statements which have a bearing on the application of shareholder value principles. Please answer the question by indicating, in your general experience, the extent to which you agree or disagree with the statements made.

The scale is from 1 = disagree strongly to 5 = agree strongly.

B1. The primary purpose of corporate management is to look after the interest of the shareholders.

B2. If the focus of a company were solely oriented towards the interest of the shareholder, the interests of other stakeholders such as employees and customers would be compromised.

B3. The concept of managing for shareholder value is just another fad.

B4. Shareholder value is destroyed when the economic return on capital (both debt and equity capital) is less than the cost of capital over time.

B5. Earnings per share (EPS) is a reliable indicator of corporate performance.

B6. The executives' and business manager's long-term compensation should be directly tied to returns to shareholders.

B7. The value of a business is determined by the present value of future projected cash flows discounted at a risk-adjusted cost of capital.

B8. The market places emphasis on short-term development in valuing shares as opposed to longer term financial prospects.

B9. Shareholder Value Management is a financial management tool.

B10. A company's share price can be managed over time.

B11. Shareholder value management cannot be applied in South Africa because equity ownership is concentrated amongst a few large corporations.

Part C

C1. At what level does your company allocate capital resources? Tick one of the following:
a. on a project by project basis
b. on a SBU basis
c. on a group by group basis where each group would comprise of several SBUs
d. other, please specify

C2. On what basis does your company allocate capital resources? Tick one of the following:
a. estimated sales growth
b. IRR
c. the net present value of the allocation
d. the payback of the allocation
e. Other, please specify

C3. In what manner are corporate financial targets set?
a. From the top-down with across the board targets for growth, cost reduction and capital spending
b. From a consolidation of individual SBU targets (i.e. from the bottom up)
c. Other methods, please describe

C4. Please rate what you consider to be the three most important measures of corporate financial performance by placing a **1** in the box for the most important, a **2** for the second most important and a **3** for third most important measure.
Earnings and earnings growth
Earnings per share
Return on investment
Return on equity
Return on net assets
Value index = Ratio of Market to Book Value
Economic Value Added (measure of return over & above the cost of Capital)
Other, please specify

C5. Do you know what percentage of capital in the company allocated amongst the various businesses in your current portfolio earns a return superior to the company's cost of capital?
If yes, please indicate percentage.

C6. Does your company carry excess gearing capacity?
If yes, can you improve the company's cost of capital by taking on more debt? Please explain.

C7. Has your company's share price consistently outperformed the relevant JSE sector index in the last five years?
If yes, by approximately what percentage?

C8. When your company makes acquisitions, do you quantify the control premium that will be paid?

C9. When your company makes an acquisition, do you set a plan to recapture the premium paid?

C10. When your company makes acquisitions, do you nominate the person who will be responsible for achieving the strategic and financial targets prior to the transaction taking place?

C11. Do you integrate financial and strategic planning at the business level?
If yes, How?
If no, please explain where the responsibility for strategic and financial planning lies.

C12 a. Do you evaluate the profitability (current and expected) of the markets in which you participate as part of strategic planning?
b. Do you know how changes in structural characteristics of the markets you participate in influence profitability?
c. Do you regularly re-evaluate your decision to participate in a market?

C13 a. Do you evaluate your profitability (current and expected) relative to your competitors as part of your strategic planning?

b. Do you know how changes in structural characteristics of your markets influence the profitability of your competitors'?

C14. Please give examples of key value drivers in your portfolio of businesses that impact on profitability.

C15. Does approval of a strategic plan mean approval for resources (capital and people) over the planning period?

C16. Is the following year's budget for each business unit set in the previous year's strategic plan?

C17. If a group of key corporate and operating managers in your company were asked to identify the three to five value drivers in each business, would there be consensus?

C18. Does approval of a business unit's strategic plan commit the head of the business to performance targets for the next year?

C19. Does approval of a business unit's strategic plan commit the head of the business to performance targets for the following years (i.e., three to five years out)?

C20. Does remuneration at the head of the business unit level depend on hitting the targets?

C21. Are your business units structured along unique activity, product and customer lines? Please explain.

C22. Strategic Business Units have full financial and operational autonomy?

C23. Do your Strategic Business Units have a full financial expression through a separate income statement and balance sheet?

C24. Are transfer prices between business units based on one of the following:

cost excluding depreciation
cost including depreciation
free negotiation (internal and external)
other, please explain general practice.

C25. Is the strategic planning process coupled to capital and annual budgeting?

C26. Is resource allocation based on the value it will create for the shareholder?

C27. Is resource allocation part of a management contract whereby management undertake to perform according to the business plan? If so, is the management contract long term (longer than three years)?

C28. Is the performance of management measured in terms of the cash flow generated and/or by accounting measures such as earnings? Please comment.

C29. Is executive remuneration tied to the creation of value? If not, why?

C30. Is remuneration at the operational level tied to targets that have been dictated by value creating strategies? If so, does this approach still apply if such targets are suboptimal e.g. operating plant at lower efficiencies to coincide with targets determined by the value creating strategy.