

Value Based Management: An Indian Prospective

Abstract

Although businesses exist to create value for their owners, corporate executives and managers do not always act to maximize shareholder value, because of perceived conflicts with other goals. Shareholder value does not necessarily conflict with good citizenship toward employees, customers, suppliers, the environment and the local community. Value-based management strategies have been around as long as business has existed. At a minimum such a system required (1) the full support of the top executives; (2) a link between behavior and compensation; (3) the employees' understanding of the system; (4) a capital market focus; and (5) the realization that a VBM metric is only a measure of success and un-success itself. Value based management provides an effective process to maximize value in line with the owners' and end users' requirements. Every useful performance metric attempts to measure changes in shareholder value, this does not always happen. This paper explores why this is and provides arguments for their systematic use.

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Introduction

Not only do technology businesses need to attain bigger scale, obtain enabling technology and recruit talented, qualified people, they have to do it faster and more efficiently than their competitors”

Tim Miller

Recent years have seen a plethora of new management approaches for improving organizational performance: total quality management, flat organizations, empowerment, continuous improvement, reengineering, kaizen, team building, and so on. Many have succeeded—but quite a few have failed. Often the cause of failure was performance targets that were unclear or not properly aligned with the ultimate goal of creating value. Value-based management (VBM) tackles this problem head on. VBM aligns a company's overall aspirations, analytical techniques, and management processes with the key drivers of value. The thinking behind VBM is simple. The value of a company is determined by its discounted future cash flows. Value is created only when companies invest capital at returns that exceed the cost of that capital. VBM extends these concepts by focusing on how



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companies use them to make both major strategic and everyday operating decisions. Properly executed, it is an approach to management that aligns a company's overall aspirations, analytical techniques, and management processes to focus management decision making on the key drivers of value.

Literature Review

Value based management is the management approach that ensures corporations are running on values (normally maximizing shareholders value). Value based management includes all the three of the following:

1. Creating values (ways to actually increase or generate maximum future value, strategy).
2. Managing for values (governance, change management, organizational culture, communication, leadership); and
3. Measuring values (valuation).

Value based management aims to provide consistency of the corporate mission (business policy), the corporate strategy, corporate governance, corporate culture, corporate communication, organization structure, decision processes and systems, performance management processes and reward processes and systems. Value based management can be simply stated as management system in which entire organization is focused, measured, compensated for creating value for stakeholders (i.e., customers, shareholders, employees, vendors). Value-Based Management (VBM) is a customer-focused system built upon shared principles and core values, which is designed to instill an ownership culture within an organization. The value based management is managing and giving values to all stakeholders. They are as follows-

Organization

- Encouraging a working climate with innovation & free exchange of ideas.
- Demonstrating personal integrity & humanity.

Shareholders

- Protecting and safeguarding their investment.
- Ensuring them a fair return

Employees

- Understanding & acceptance of the needs and rights.
- Providing adequate wages, good working condition, job security, effective machinery for speed redressal of grievances.
- Suitable opportunities for promotion and self development.
- Creating a sense of belongingness & team spirit through their close link with management.

Customers

- Products with proven quality at fair price.
- Fulfilling its commitments impartially and courteously with sound business principles.

Government

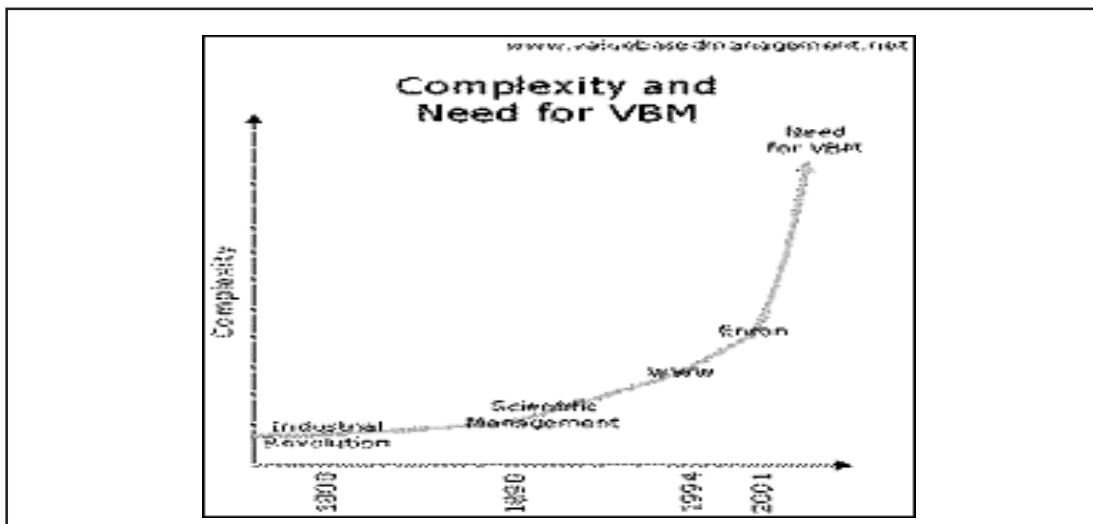
- Confirm national interest as mentioned in government policy.

Society

- Effective use of natural resources
- Assistance in community affairs.
- Assistance during natural hazards.

Value Based Management: A Historical Perspective

The history and development of Value Based Management (VBM) and the growth of internal and external corporate complexity over time are highly interrelated. This is only logical if one realizes that VBM is basically a philosophy enabling and supporting maximum value creation organization.



Before the industrial revolution, companies were relatively small and their internally complexity was low. Also the external environment of companies was relatively stable and clear. Value creation was relatively straightforward, simple and obvious. There was no need for VBM.

Implicit VBM (1800-1890)

The earliest forms of implicit “VBM” dated back to the end of the 18th century, when, by mechanizing and by the Industrial Revolution, it was possible to achieve economies of scale through investing in machines and hiring workers. The dislocation of facilities made direct supervision harder and insight into the efficiency and productivity of the production process became more important. During the 19th century, these methods gradually improved, using improved transportation and communication mechanisms available. These systems were aimed at promoting and evaluating the efficiency and productivity of decentralized production processes and not on measuring and managing value creation as such.

Explicit VBM (1890-2000)

At the end of the 19th century, Alfred Marshall sees profit as the residual income accruing to a firm's owner, a return to the investment of his own capital and to the pains he suffers in exercising

his “business power” in planning, supervision and control. Frederick Taylor (1911) and Harrington Emerson develop Scientific Management (using detailed physical manufacturing standards, enabling a simple translation to financial standards).

Corporations become more complex with a diversified product assortment and activities. Allocation of assets over the various activities and as a result, better information on these activities becomes more important. Management Accounting introduces Return on Investment (ROI), at first, only at top management level for allocating resources and judging performance. In 1938, Grant makes some references to using the time value of money for deciding among investment options. In 1954, Dean publishes an article in the HBR about use of Discounted Cash Flow (DCF) practically for valuing investment proposals and other decisions. Later, also methods are introduced such as residual income, responsibility accounting and transfer pricing. Professional Investing – In 1964, Sharpe introduces the Capital Asset Pricing Model (CAPM) and in 1973 Black and Scholes introduce their formula for calculating the value of financing options. In 1964, Peter Drucker writes “Managing for Results” and in 1986, Alfred Rappaport writes his ground breaking book “Creating Shareholders Value”. In 1994, Jim Taggart uses the term “Value Based Management” in his book “The Value Imperative: Managing for Superior Shareholders Returns”. From now on, thinking in Shareholders value term is firmly rooted in business and corporate strategy.

Management Control

Management Control can be defined as the process oriented to verify:

- The **advancement status** of the planned objectives;
- The **efficacy and efficiency** of the organization through the analysis of the resources, costs and proceeds.

Management Control has not to be seen as an activity of the administration area’s exclusive competence, but rather as a process which involves, at the appropriate levels of responsibilities, all the company’s functions.

As with all processes, **Management Control** is constituted by different elements, connected to each other:

- The **structure** (personnel charged of the duty of control),
- The **tools** (general accounting, analytical accounting, budgeting, reporting, income statement analysis),
- The **procedures** (coordination, optimization).

The **Management Control** acts through the following phases in sequence:

1. **Planning**, where for any company’s unit a set of objectives must be defined, that is of specific expected results, which need to be: understandable, agreed, measurable in extent and time, reachable, consistent with one another and with the available resources.
2. **Programming**, where a programme is drawn up in order to get the planned objectives, taking into account the internal and external restraints to the company,
3. **Result checking**, where it is measured whether each company’s unit has achieved or not the assigned objectives,
4. **Shifting analysis**, where the possible shifting between objectives and results is analysed,
5. **Corrective action implementation**, in order to optimise the units’ behaviour against the planned objectives.

To realize a project of **Management Control** it is necessary to carefully evaluate the reference context where it is intended to be applied and in particular:

- The diffusion of the Management Control culture into the company,
- The availability of appropriate computer and accounting systems

Elements of Value Based Management

Value creation is the basis of all our processes. Key elements of this philosophy are:



- Prioritization of investment funds:
 - to ensure better correspondences between allocation of resources and strategy
- Tightening of capital expenditure discipline:
 - to focus on supporting strategic potential within business units
- Introduction of value based management tools:
 - to measure results in terms of profitability and capital input throughout the organization, and increase understanding of how value is created
- Introduction of performance related pay systems at all levels of the company in the near future will further encourage creation of value

Benefits of Value Based Management

1. **Benefits of VBM for Management:** By moving from an autocratic to a more participatory, value-based mode, a company's leadership can spread around some of management's typical operational "headaches."
2. **Benefits of VBM for employees:** A workplace that operates according to the principles of Value-Based Management empowers employees as workers and as owners. VBM creates a corporate culture where work can be more satisfying and economically rewarding.
3. **Benefits of VBM for Labor Unions:** VBM involves the transformation of labor unions, offering labor representatives new and more important roles than they have played within the adversarial wage system culture. Unions can help deliver a higher degree of economic justice and far greater rights for their members than the "crumbs" now bargained for within the framework of traditional labor-management bargaining.
4. **Benefits of VBM for the Company as a Whole:** Experience within a growing number of companies indicates that the more that people's self interests are unified within a management system reflecting the principles of Value-Based Management, the greater customer and employee satisfaction will be. From this can flow increased cost savings, increased sales, and increased profits.

Value Based Management in India Context

Today, value based management is very important and the aspects are ethics and transparency, innovativeness, quality and depth of management, financial performance, quality

of product and services, global competitiveness and people practices & talent management. The bright example is the ranking made for the top 25 companies as shown below:-

- INFOSYS Technologies has bagged the number one position and for the fourth time it is again in the row, a record of sorts (2001, 2003, 2004, and 2006)
- The survey also reveals that reliance is rated on second on financial performance but has been pegged at 10th on ethics and transparency. Nevertheless, the fact that reliance did not slide down a lot further despite the Ambani family washing dirty hands in public is a testimony to the mystique of Ambani brand. Reliance is the only company that has featured in the top 10 of every most respected company's survey since 1983.
- Another fascinating fact found was that, people tend to express respect for the Tata Group as a whole and not for any individual TATA company. I.e. only 'Tata'. It was in second position in infrastructure sector. It has done well in ethics and transparency.
- SBI the country's biggest bank with nearly 14000 branches was in third position in banking sector due to use of technology and focusing more on medium sized business and advertising campaign.
- Increasing competition and internal strife have turned AMUL slightly bitter but it remains a force to reckon with due to better quality of products.

Current Rank	Previous Rank	Company	Total Score	Innovative Ness	Quality And Depth of Management	Financial Performance	Ethics ' And Transparency	Quality Of Product & Services	People Practices & Talent Management	Global Competitiveness
1	1	Infosys Technology	18,124.2	2,230.2	2581.0	2778.2	2772.3	2315.7	2623.4	2823.4
2	3	Wipro	10,218.5	1,052.7	1,435.9	1551.4	1590.3	1235.5	1636.6	1716.1
3	2	Reliance Industries	9,118.8	1,276.5	1,317.5	1969.6	1021.4	1007.4	1132.5	1393.9
4	9	ICI Bank	8,911.2	1,528.3	1,381.8	1211.6	1166.9	1200.5	1229.6	1192.5
5	13	Tata Consultancy Services	8,474.5	822.8	1,232.0	1210.3	1445.7	976.6	1323.3	1463.8
6	5	Maruti Udyog	7,690.9	1,012.1	1,069.6	1010.5	1047.2	1357.7	1061.2	1132.5
7	21	ITC	7,154.2	938.5	1,167.3	1120.4	1004.4	943.4	1116.0	864.2
8	7	HDFC Bank	7,097.9	1,091.9	1,126.3	956.3	1076.4	1000.2	1029.5	817.6
9	12	Tata Motors	6,357.9	647.9	982.8	780.2	1202.3	997.5	848.2	899.0
10	14	Larsen & Tourbro	6,331.8	662.2	924.8	940.0	1027.5	926.4	937.4	913.6
11	23	Nokia India	6,286.2	1,213.4	700.1	605.6	675.3	1156.2	887.4	1048.0
12	26	Bharati Airtel	5,969.4	1,064.6	872.3	902.7	690.0	880.1	822.8	737.0
13	17	Oil And Natural Gas Corporation	5,952.3	687.1	944.9	996.6	836.6	694.3	799.2	993.2
14	8	Jet Airways	5,860.9	978.2	797.1	532.1	689.0	1086.4	805.6	972.5
15	18	Hero Honda Motors	5,798.3	863.8	763.0	993.0	697.9	915.1	784.4	781.2
16	15	Tata Steel	5,751.9	499.2	846.9	765.0	1182.6	736.2	850.0	872.1
17	4	Hindustan Lever	4,863.1	629.0	780.0	621.3	716.3	707.8	811.1	597.6
18	11	GCMF(Amu L)	4,659.2	967.7	625.0	450.1	721.9	923.4	527.0	444.1
19	10	Ranbaxy Laboratories	4,433.2	655.9	622.9	692.6	561.7	639.0	630.4	630.7
20	20	Bajaj Auto	4,309.2	689.1	629.2	725.7	551.3	675.9	474.9	563.2
21	24	Citi Bank	4,155.7	746.7	680.4	495.1	412.0	568.3	695.2	558.0
22	16	State Bank Of India	3,939.8	451.7	578.9	699.8	703.7	478.7	494.2	532.8
23	6	Dr. Reddy's Laboratories	3,527.2	624.1	495.0	630.1	428.2	432.1	445.3	472.3
24	32	New Delhi Television	3,457.7	618.8	489.8	395.9	417.0	592.1	573.3	370.8
25	22	Indian Oil Corporation	3,431.0	426.0	497.1	574.1	489.7	491.8	480.0	472.3

Source: Business World, 5 June, 2006 p.54

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- Infosys manages to snatch top slot in this ranking criterion. It stands for integrity, trust and excellent HR practices. Infosys is the company that is not just a back office of international companies, but the companies that can be trusted to provide customized solution that have international excellence. It has been rated as one of the most “innovative” companies in the world.
 - TATA brand represents a sense of nationalization, reliability, assurance and a true value for money. Today, the brand Tata can be termed as a brand that represents leadership with trust. The heritage of Tata to return to the society that it earns has evoked trust amongst the consumers, employees, shareholders and the community.
 - Reliance today, conveys a titanic empire emerging as a true blue multinational .In spite of the de-merger and the controversy in early 2006, when the two Ambani scions Anil and Mukesh decided to go separate ways, the emergence of Reliance, with definite conviction, does reflect the parallel rise of the nascent Indian private sector from behind the shadow of the public sector enterprises.
 - SBI is today hailed as the big daddy of Indian banks as it touches the lives of people from Kashmir to Kanya Kumari and building the nation with the enormous welfare activities. The bank has evolved today as a synonym of trust, reliability, and credibility. From a fuddy-duddy sluggish employee image to the image of being customer friendly, India’s largest bank SBI has come a long way providing various products and services. The investors are emotionally connected with the tagline of SBI “*We have the power of SBI*”.

Findings

From the table specifying the value based management in various companies, we are able to have a brief knowledge about their strategies framed to satisfy their stakeholders. Software Company Infosys who bagged the first prize in value management this year gives importance to the values of each party for the financial and social enhancement of the company. On the other hand, Tata Company which is largest company in Steel sector has framed various programmes for each party for increasing the efficiency and satisfaction of interested parties. Reliance after its division between two brothers has not reduced the value management. In the same way other companies specified like State Bank of India, Life Insurance Corporation, SAIL have framed their values keeping in consideration the parties’ values and organizational values.

But are the companies really rendering the responsibilities in true sense? No. We can prove this by specifying Tata companies’ fulfillment of national objectives on the condition that the competitions from other companies and international companies are minimized. Reliance entering into a scam in oil sector specifies that they are failing in standing to their own values. State Bank of India Strike of employees for salary enhancement shows their dissatisfaction on their own bank. Amul declaring an artificial scarcity of product brings an environment of distrust among the customers. By specifying the values in the website and annual report does not mean that the companies are really standing to the values rather they should practice it in an honest and fair way.

Suggestions

The Indian corporate houses should be conscious to give values to all the stakeholders basically the customers and community classes; and the value based management can be made with the following four principles-

- Commerce with morality
- Business with responsibility
- Management with humanity
- Administration with principle

Conclusions

It is rightly said by Shiv Khera, Management Consultant, "Winners stand firm on values but compromise on petty things. Losers stand firm on petty things but compromise on values". Value Based Management is introducing a new era where values of company as well as the various parties interested 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 which satisfy the needs of the vendors such as employees, customers, and other stakeholders. For example: - Infosys Leader Mr. Nagawara Ramarao Narayana Murthy says "I'm a capitalist in mind, a socialist at heart" and is awarded the first position in value management this year. In 21st century the winners in order to stand the global competition always plan to stick to the fundamental values, no matter what the situation. Again when our value systems are not clear, getting what we want will be a bigger tragedy. The story of Midas says it all. Distorted values leads to tragedy like the king who had a lot of money but still wanted more of money for which he asked god to make everything gold what he touches and thereafter he touches her daughter who turns gold. This means that we should have some value systems but that value system should be focusing on right things for right reason. Value Based Management in Indian context has grown not out of the realization of its tangible benefits but out of the compulsions at the marketplace.

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