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Results

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Say it loud, say it proud: "Shareholder Value!"

On our minds

"Leadership, in the memorable phrase of the poet Rudyard Kipling, requires the ability to 'trust yourself when all men doubt you.'"

Luc Luyten
Partner
Bain & Company

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by Didier Reynders
Deputy Prime Minister
and Minister of Finance
of Belgium

Remember the phrase "creating shareholder value"? The expression nearly died of shame after WorldCom's Bernie Ebbers made quarterly stock analyst presentations by pointing to a nearly vertical share-price chart and challenging: "Any questions?"

That's why Microsoft's recent decision to pay out US$75 billion in dividends over the next four years was so refreshing. CEO Steve Ballmer left no doubt about the future of shareholder value: "I'm confident we have some of the greatest dollar growth prospects of any company in the world."

Restoring public trust in business is essential. But far more important is performance itself. In an analysis of publicly traded companies around the world, Bain & Company found that, from 1992 to 2002, those failing to earn more than their cost of capital destroyed US$1.7 trillion of value. By contrast, major fraud cases over the last three years destroyed US$200 billion of value.

Fraud cases don't just dominate the headlines; their fallout makes senior managers more risk-averse. Because of scandals like WorldCom's, many CEOs shy away from bold actions. Instead, they're preoccupied with distractions.

The first is countering the charge that all senior executives are crooks who justify their crimes by citing shareholder value. Many CEOs understand they can't win this debate. So they remain silent. They deal, instead, with the hassles of Sarbanes-Oxley, Congress's attempt to legislate trust, and the Higgs rules in the U.K.

Besides Mr. Ballmer, another exception is Caterpillar Inc.'s CEO Jim Owens. Mr. Owens, whose farming and construction equipment company hasn't missed a dividend since 1925, announced two increases last year—in fact, since 1993, it has increased its dividend tenfold. He called this part of Caterpillar's "ongoing commitment to improve shareholder value."

A second CEO distraction is corporate image. CEOs spend more and more time on the reputational front, promoting good deeds in an effort to be seen as "giving back."

No one would argue against social responsibility. But Nestlé's chief executive, Peter Brabeck-Letmathe, whose tenure has seen the company's shareholder return grow in double digits each year for a decade, has tired of being on the defensive. He recently asked, "Is the implicit idea behind "giving back" that companies incur a debt to society simply for being successful? In my view, the first priority for any CEO is to ensure the creation of long-term shareholder value."

Yet a third CEO preoccupation encompasses geopolitical risks, terrorism and the global economy. For instance, US companies increasingly worry about the "American-ness" of their brands overseas. In Saudi Arabia, where American products are threatened by boycotts, Procter & Gamble has long produced Tide detergent locally. Recently, P&G changed its packaging: "Made in Saudi Arabia" now appears prominently on the label, and in Arabic.

CEOs have to reclaim their agenda. Consider the example of Gillette. The company missed Wall Street forecasts for 14 quarters before Jim Kilts became CEO in 2001. Mr. Kilts refused to provide specific earnings guidance. Predictably, analysts responded by questioning Gillette's stability.

But Mr. Kilts had gained a mandate to make long-term shareholder value his touchstone. Two years later, when cash flow had doubled to US$1.7 billion, analysts changed their tune. The moral is that CEOs must have the confidence to set long-term goals and the will to communicate them clearly.

CEOs must earn public trust the old-fashioned way—through performance. That's what Jim Kilts did. That's what Peter Brabeck-Letmathe and Steve Ballmer have done. And by promising "continued shareholder satisfaction," that's what Caterpillar's Jim Owens plans to keep on doing. Ultimately, the trust that companies build through continuous, solid performance outshines every other consideration.

The leadership corridor

Management feature

"The true test of any company's leadership development is the caliber and depth of its senior management ranks."

Vijay Vishwanath
Partner
Bain & Company

"Kraft has achieved a high level of shared understanding by tightly tying its leadership development to its business model."

Christophe De Vusser
Manager
Bain & Company

When Coca-Cola was looking for someone to fill its top job last year, three of the handful of CEOs rumoured to be on the short list shared strikingly similar backgrounds. Mattel's Robert Eckert, Hershey's Richard Lenny, and Gillette's Jim Kilts all cut their managerial teeth at Kraft.

That's no coincidence. Over the past two decades, Kraft has been a prodigious producer of big cheeses. In addition to Mattel, Hershey, and Gillette, its alumni have held the top posts at Sears, Quaker Oats, Campbell Soup, Young & Rubicam and Marks & Spencer. While most companies struggle to develop one or two outstanding general managers in a generation, Kraft has become a CEO machine.

The secret lies in Kraft's management development process. In many firms, development programs are run in carefully controlled hothouses, apart from the daily work of the organization. Executives are enrolled in a series of topical courses or put through an intensive study of case material. But when you grow leaders in a hothouse, you end up with hothouse flowers: they look like perfectly good executives, but they wilt when exposed to the elements.

At Kraft, leadership development isn't an isolated process. It takes place on the job and, more important, for the job. As promising managers advance, they're presented with a series of challenges through which they learn how to apply Kraft's business model in varying circumstances. Created by former CEO Mike Miles and his human resources chief John Tucker in the 1980s, the Kraft development process can be described as a *leadership corridor* that runs through the business. The corridor, according to the many Kraft-trained executives and alumni we interviewed, has three major stages. Each focuses on a dominant principle of Kraft's business model—assuming bottom-line responsibility, practicing loose-tight management, and putting the company's interests first. By the time managers complete the last stage, they're well versed in the major challenges facing the company and ready to step into senior executive roles.

Kraft gives young executives extraordinarily broad authority, even in their earliest assignments. The dominant development principle in a Kraft manager's early years is "bottom-line responsibility." That ties in to the bedrock idea of the company's business model: that cost reduction is not a one-off, reactive program but rather an ongoing, strategic process for freeing up cash to invest in marketing. Cost cutting, in other words, provides the fuel for brand building.

> "The dominant development principle in a Kraft manager's early years is 'bottom-line responsibility.'"

The broad focus is reflected in the roles and titles Kraft gives its up-and-coming managers. At most consumer products companies, fledgling executives are given posts as "brand managers" focused heavily on advertising initiatives aimed at boosting sales. At Kraft, such executives are called "category business directors" and are expected to focus not just on marketing but also on controlling costs.

Leadership development at this early stage concentrates on building a deep understanding of the supply side. It often involves day-to-day dealings with commodity markets, manufacturing and cash management. According to current and former Kraft executives we've interviewed, it isn't unusual for category business directors to find themselves out in the middle of agricultural fields talking to farmers or down on factory floors troubleshooting a production glitch with machine operators.

This stage of the corridor has two touchpoints. The first is *exposure to outside talent*. Kraft has made a concerted effort to graft top talent from outside the organization into its management ranks. The resulting cross-fertilization of strong business ideas and practices has been essential to Kraft's success, and young managers throughout the organization are evaluated on their openness to seek out and learn from the "outsiders." The second touchpoint is *exposure to top managers*. Kraft keeps its number of management levels to a minimum to ensure that junior managers have access to their superiors. The manager of a particular business unit is, for example, free to bypass a division head and raise a critical issue directly with the CEO.

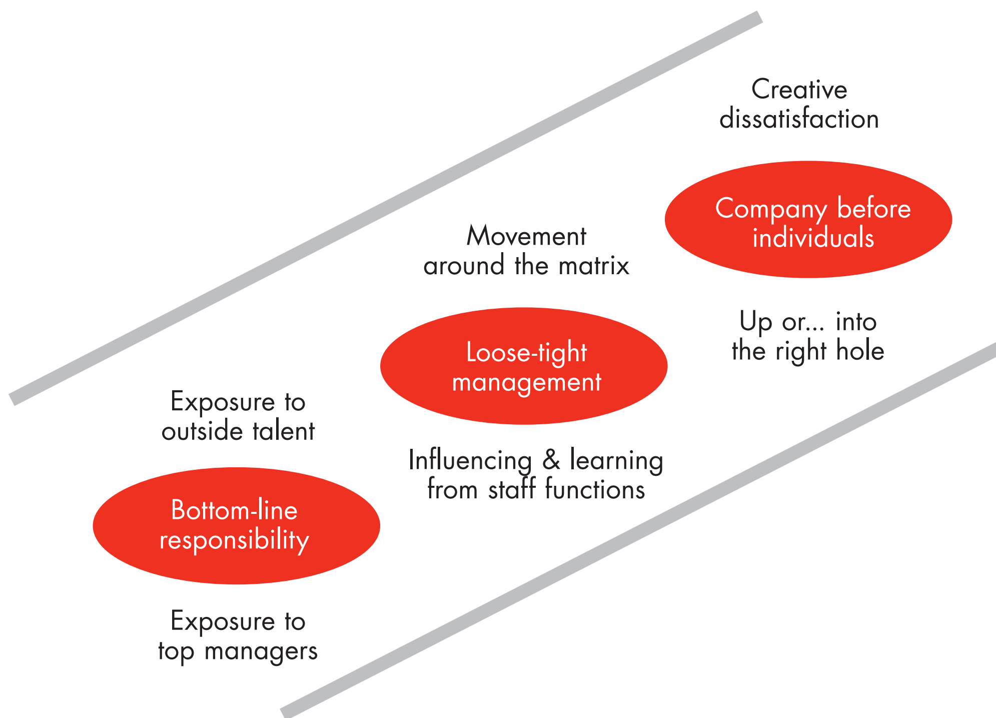

Figure 1:
Kraft's leadership corridor

Once young managers have developed a broad view of the business, Kraft lets them take action. The dominant principle at this phase is "loose-tight management."

The company imposes tough financial objectives, but it gives managers enormous leeway in figuring out how to hit the targets. Former Kraft CFO Gary Coughlan says that the approach reduces bureaucracy and encourages personal initiative. "If you did the job right, you didn't have to write a lot of memos," he recalls. "Once you showed your competence, you were left alone, and you were then able to develop your own style."

But Kraft managers don't stay put for long. Another of the company's development principles is to move executives quickly through line and staff posts. Former co-CEO Betsy Holden told us that Kraft's top executives have more than 20 years' experience with the company on average, yet have typically been in their current roles only about two years. The unusual career path taken by Ed Smeds is typical. A staffer who started in Human Resources, Smeds became CFO for Kraft and then made a jump over to the line, as general manager for Australia and then Canada. Before retiring, he moved back to the staff side to run purchasing and logistics.

Mid-career managers are also encouraged to focus on influencing and learning from staff functions. Kraft line managers recognize that the expertise of the operational staff is critical to their success. The operational staff doesn't report to the line managers, so interactions between the two are based on influence rather than authority.

Management development at Kraft is nothing like the kind of succession planning that hinges on identifying and nurturing "leadership personalities". The company inculcates leadership not as a personality cult but as an ingrained habit of putting the company's interests first and helping colleagues succeed. Recalls Bob Morrison, a Kraft alum who went on to head Quaker Oats, "We weren't hot dogs. We just tried to do things a little better every day."

Making it to the end of the corridor requires an attitude that goes beyond welcoming challenge to actually seeking it out. Call it *creative dissatisfaction*. Senior executives at Kraft are expected to constantly look for ways to improve the company's products and processes.

Can other companies follow Kraft's lead? Yes and no. Management development at Kraft is tailored to the company's business strategy, so it would be a mistake to try to replicate it blindly. What's right for Kraft is unlikely to be right for another company.

But it is possible to adopt the basic approach. Any company can think carefully about its strategy and the principles underpinning it. Any company can chart a career course for managers that reinforces those principles. And any company can give its young executives the responsibility to think and act like well-rounded chief executives.

"The company gives managers enormous leeway in figuring out how to hit targets."

Bain & Company Belgium, Inc.
Blue Tower - 24th Floor
Avenue Louise 326
B - 1050 Brussels
www.bain.be

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For more information: Anja Wittrup • T: 32 (0)2 626 2612 • anja.wittrup@bain.com

Balancing act

Guest interview

Interview with
Didier Reynders
Deputy Prime Minister
Minister of Finance
of Belgium

Belgium's Finance Minister always has a lot on his plate. There are the local issues: balancing the budget, boosting entrepreneurship, funding a growing pension burden. There are the European concerns: tax competition against new EU member states, lack of fiscal restraint from economically important neighbours, an increasingly mobile labour force. And, of course, there are the global worries: foreign exchange rates, the price of oil, trade imbalances. But Didier Reynders seems quite capable of seeing the positive side of any problem. In an interview in his office, he discusses his key priorities.

As Finance Minister, what are your most pressing concerns?

"In Belgium, the high deficit level of 13 percent in 1981 had such a shock effect that since then, it has been a tradition to have a very good budgetary policy. We've had a balanced budget for four years in a row now."

What about the falling dollar?

"It's customary to use the dollar to improve trade or budgetary situations. If a country has a very bad trade situation, the exchange rate is one solution, but not the only one. It's impossible to organize that effort against only one currency. We need to have a better common vision on that problem at the international level—working through the G7, the central banks, and so on. And that is our message to the US authorities."

Does competition within the EU pose a problem?

"Tax competition with new member states in Eastern Europe is more difficult than it was some years ago, when countries from the south of Europe joined the EU, although the situation is similar. I see the enlargement to 25 states as a positive. When Spain, Portugal and Greece first joined the EU, there were concerns about the arrival of products coming from those countries. But slowly it became clear that it further strengthened the European Union, whilst opening up new markets for Belgian products. And the same will apply for Central and Eastern European countries."

"Regarding taxation levels, I'm personally in favour of a harmonization of taxes—especially corporate taxation. First, we need to have the same basis; there are some proposals from the European Commission on that. Second, it may be useful to have some minimum and maximum taxation levels. For example, if a country lowers its taxes below a certain percentage, it would not be entitled to additional structural funds. Ireland has been a large recipient of European funds—last year the contribution represented 3% or 4% of its GDP. It's difficult to explain things to someone who has lost his job to another country because that country lowered its level of taxation by using structural funds that came from taxes he has paid."

"It will be virtually impossible to stay at such a low level of taxation in a lot of countries. They are currently benefiting from a low level of social security and social measures. But if you're organizing for a more developed economy, you must meet requests for the same level of social protection as in other developed nations. It is possible also to have a harmonization of social policy, and if it is not due directly to some common rules, it may stem from pressure from the workers themselves."

What efforts is Belgium making to stimulate its economy?

"For small and medium-sized enterprises (SMEs) in Belgium, we're trying to organize a simplification of the start-up procedures. It's a very difficult process. And with e-business and e-government, it will be easier to do. We have more and more SMEs—in response to the shift from industry to services and because of the rising number of R&D start-ups around the universities. We try to help them grow."

"We need to further entrepreneurship and make it possible to start a company without too many administrative hurdles. We also need to explain that it's not a problem to fail. In the US, it is possible to fail in one enterprise and start another. The mentality in Europe is that if your company fails, you cannot start another. This needs to change, to create more openness to entrepreneurship. But this is more difficult in some ways because we are trying to change a mentality along with changing the rules. It's easier sometimes to just change the rules."

Interview conducted by Craig Winneker