Value-Based Management with Corporate Social Responsibility

Second Edition

John D. Martin

J. William Petty

James S. Wallace



Contents

Part I Value-Based Management, Corporate Social Responsibility, and the Purpose of the Corporation

1	The Purpose of a Corporation	5
	Adam Smith and the Invisible Hand	6
	A Stakeholder Perspective	7
	Value(s)-Based Management: A Middle Ground	8
	Summary: Creating Firm Value—Think Value(s)-Based	
	Management	10
	Appendix 1A: John Mackey and Milton Friedman on the	
	Goal of the Firm	13
2	The Elements of Value-Based Management	17
	Wealth Creation Is Not Universal	18
	The Proper Design of a V _s BM Program	20
	Alternative Valuation Paradigms: Earnings versus	
	Discounted Cash Flow	22
	Connecting Business Strategies with the Creation of	
	Firm Value	23
	Summary	24

x CONTENTS

3	The Need to Measure What You Want to Manage	26
	The Need for a Single Metric	27
	Total Shareholder Return	29
	Total Market Value	30
	Accounting-Based Metrics	3:
	Think Economic Profits, Not Accounting Profits	32
	Summary	37
	Appendix 3A: Accounting versus Economic ROIC	39
	Appendix 3B: More Problems with Accounting-	
	Based Metrics	42
Part II	The Finer Details of Value-Based Management and Corporate Social Responsibility	
4	Free Cash-Flow Valuation: The Foundation of	
	Value-Based Management	49
	The Beginning for Value-Based Management: Free	
	Cash Flows	50
	What Is Free Cash Flow?	51
	Calculating a Firm's Free Cash Flow	5
	Calculating the Investors' Cash Flows	50
	Free Cash Flow and Firm Valuation	55
	Valuing the Firm: Framing the Analysis	56
	Free Cash Flows, but for How Long?	56
	Forecasting Free Cash Flows	57
	Computing a Firm's Intrinsic Value	6
	Determining the Discount Rate	63
	The Value Drivers: Digging Deeper	6.
	Summary	68
5	Pick a Name, Any Name: Economic Profit, Residual	
	Income, or Economic Value Added	69
	The Fundamental Concept: Residual Income or	
	Economic Profits	70
	Residual Income and Free Cash Flow	7:
	An Illustration of Valuation	7.
	A Comparison of the Residual Income and Free Cash	J
	Flow Approaches	7
	"Fine-Tuning" Residual Income with EVA	7
	What Is EVA?	7
	Measuring a Firm's EVA	7:

	CC	ONTENTS	хi
	Calculation MODAT and Control		70
	Calculating NOPAT and Capital		79
	From EVA to MVA More Than a Financial Exercise		83 87
	Summary		91
	Appendix 5A: The Equivalence of the Residual Income		21
	and Discounted Dividends Valuation Approaches		93
	Appendix 5B: An Illustration of the Computation of EVA		95
	Appendix 5C: Performance Evaluation Using CFROI		101
6	Corporate Social Responsibility: Putting the S in		
	Value(s)-Based Management		103
	The Moral Argument for CSR		104
	The Economic Argument for CSR		104
	CSR within a VBM Framework: The Academic Evidence		106
	Driving the Value Drivers		108
	Red Mountain Retail Group: Creating Value through		
	Relationships		108
	Southwest Airlines: The Employee Comes First		110
	Herman Miller, Inc.: Creating Wealth through Design		
	and Innovation		111
	Whole Foods Market, Inc.: Creating Wealth through		
	Whole Foods, Whole People, and Whole Planet		112
	Sony Blames Economic Value Added Mentality for		
	Its Woes		113
	Summary		116
	·		
Part III	VBM Applications		
7	Project Evaluation Using the New Metrics		121
	Example Capital Investment Project		122
	Traditional Measures of Project Value		122
	Using EVA to Evaluate Project Value Creation		124
	Fixing the Problem		124
	Unequal Cash Flows and Positive NPV		127
	Summary		127
	Appendix 7A: The Equivalence of MVA and NPV		132
8	Incentive Compensation: What You Measure and		
	Reward Is What Gets Done		133
	All-Too-Common Mistakes		136
	Creating a Culture of Ownership		139

xii CONTENTS

Part IV

9

Determining a Firm's Compensation Policy	142
What Should the Level of Compensation Be?	142
How Should Pay Be Linked to Performance?	143
Formula for Determining Incentive Pay	143
Single-Period Performance Measures and	140
Managerial Incentives	146
Managerial Decision Horizon and the Use of EVA	146
Extending Managerial Horizons	150
	150
How Should Employee Compensation Be Structured? Fairness as an Additional Characteristic of a Firm's	131
Compensation Policy	152
Summary	152
•	155
Appendix 8A: Whole Foods Market Executive	155
Compensation Discussion and Analysis	100
Lessons We Have Learned	
Lessons We Have Learned	
Lessons Learned	163
VBM Studies Based on Archival Data	164
VBM Studies Based on Survey Data	165
Factors Critical to the Success of VBM	166
More Recent Survey Evidence	168
Current CSR Research	171
Summary	172
Epilogue: Where We Are Now	175
Notes	181
References	187
Index	193