





High-performance business | Methodology

Measuring high performance

By Patricia Anslinger and Tim Breene

What determines superior business performance? Accenture's industry-specific, multi-screen analytic framework, grounded in total shareholder return, offers a distinct new perspective on value creation.

■ How is it that despite a punishing operating environment and a soft equity market, some companies continue to create significant value for their shareholders?

These select public companies, which Accenture calls high-performance businesses, outperform their peers in total return to shareholders, revenue growth and spread performance (return on invested capital minus weighted average cost of capital) over three-year, five-year and seven-year time frames. And they have achieved high performance regardless of secular trends in their industries. Clearly, these superior companies have learned to transcend circumstance.

One of the key objectives of Accenture's high-performance business initiative is to help companies understand and methodically emulate these model companies—that is, *to learn from one another*, whatever their own context, industry or history. Our contention from the outset has been that the drivers of high performance are identifiable and measurable. More important, they are replicable, given sufficient time and commitment.

Industry-specific

This initiative is certainly not the first attempt to identify the drivers of superior business performance. But we believe our effort is substantively different—especially in our emphasis on industry-specific analysis.

In our experience, companies learn from one another in two major ways. They can follow the examples of leaders in their own industry, with the relevance of the lesson learned directly correlated to the degree of direct peer competition. Or they can learn from companies,

regardless of industry, that have mastered a particular function, such as supply chain management, finance and accounting, or marketing. While Accenture is in the midst of an extensive study of the functional characteristics of high performance (the Accenture Mastery Benchmark research series), in this article we focus on industry-specific characteristics.

There are, of course, other critical but less quantifiable factors that can have a direct and significant impact on a company's performance, including public policy, fraud and mismanagement, litigation and other so-called soft issues. These factors, however, are beyond the scope of this article. As we discuss our methodology for identifying high-performance businesses—or more precisely, companies with high-performance characteristics—it should also be noted that for Accenture, this effort is not an end in itself but rather a means to identify specific behaviors and practices that drive value creation. Hence the emphasis here is not on naming specific companies.

The primary obligation of public companies is to compensate shareholders for their investment risk by share price appreciation and dividends. At Accenture, this total return to shareholders is the ultimate measure of value creation for publicly traded companies. As a denominator of value, total shareholder return offers the immediate advantage of providing comparable data on listed companies, as well as a widely accepted definition of results. In addition, it has been our experience that superior total return to shareholders strongly correlates to other key indicators of operating performance, such as growth in revenues and attractive return on invested capital.

The choice of measurement periods for total return to shareholders is, of course, critical. To define high performance by the most relevant criteria, Accenture uses a combination of three-year, five-year and seven-year horizons as its primary value screens.

Longer-term shareholder return analyses tend to overweight older industry sectors, while omitting newer sectors and companies that have become major engines of economic growth. We have chosen shorter time horizons to ensure that results reflect performance during the recent recession (three years) and include the average industry cycle of a company in the S&P 500 (seven years); we have added an intermediate screen (five years) to ensure consistency. Accenture has to date applied its high-performance business analytic methodology across 18 of today's largest industries to identify basic drivers of value within sectors, as well as sector leaders (see table, page 26).

True value

But capital markets are only semi-efficient. Although total return to shareholders is almost always directionally correct as an indicator of value, we have found it incomplete as a single measure. As an absolute number at any one point in time, total return to shareholders may not, in fact, reflect a company's true value. A company in a major turnaround, for example, might actually deliver superior returns over the short term—although the apparent value creation would be inflated by the company's low baseline performance.

Therefore, to further refine our efforts to identify high performance, we applied a second screen—operating measures, specifically profitable-revenue growth and spread

performance. With these additional measures, about 18 percent of the companies in this sample qualify as high-performance businesses.

In its use of spread criteria, this analytic approach goes beyond traditional margin-focused measures to include an operating perspective. Spread (ROIC minus WACC) measures management's ability to generate greater than expected investor returns.¹ (ROIC, in turn, measures the after-tax operating cash flow returns on the capital provided to management by debt and equity investors; WACC is a blended measure of risk-based expectations for debt and equity investors.) A company is in a position to create value when management generates positive spread—that is, when management generates ROIC above the expectations of investors that are reflected in the WACC.

Our research indicates that it is hard to overstate the importance of industry as a determinant of high performance. By this, we do not mean the correlation of a company's superior total return to shareholder performance and its good fortune in being part of a younger, more rapidly expanding industry sector. There are, in fact, high performers in what might seem from an investment perspective to be unattractive industries.

Our total return, profitable-revenue growth and spread screens are all derived from peer group comparisons, and to qualify as a high-performance business, a company must rank above the median in its peer group in all three criteria.

¹In the case of financial services firms, the appropriate measure is return on equity minus cost of capital.

It is hard to overstate the importance of industry as a determinant of high performance.

We did make some company-specific exceptions based on close evaluation of historical operating performance. Some businesses with exceptionally high total return to shareholders may for very particular reasons have had spread or profitable-revenue results slightly below the industry median. Some of these companies have invested heavily in future growth, and thus underperformed peers that were focused solely on cost cutting. Others may have different product mixes that affect revenue growth rate comparisons with peers.

Notwithstanding these exceptions, peers must generally serve similar customers with similar products and services to provide the most valid comparative measures. To be assigned to an industry, we required that the industry represent the company's major line of business, producing at least 50 percent of its revenue. If a major division of a conglomerate is widely considered a major player but does not pass this 50-percent-revenue standard—Procter & Gamble's food division comes to mind—we used a high-performance business screen of profitable-revenue growth and spread for the division, not total return. We

also defined peers by the geographic markets in which industries operate: Are they primarily regional or global in nature?

Drilling deeper

The dynamics of certain industries encourage the creation of long-term shareholder value in particular ways. To accurately identify true high performance, we modified our basic methodology to account for these factors.

In the global pharmaceuticals industry, for example, where share prices are based heavily on implied future value (that is, growth expectations) from drug R&D pipelines, Accenture also looked at future-value components of total return to shareholders to determine high-performance attributes. (For a related article, see page 28.) In the utilities sector, where nimble adaptation to regulatory shifts is an attribute of high performance, Accenture used a “market environment scorecard” to factor in the value of strategic positioning, regulatory relationships and financial flexibility. In the industrial equipment sector, a very capital-intensive sector with an attendant long business cycle, Accenture has added

The high-performance universe

Accenture has to date applied its high-performance business analytic methodology across 18 of today's largest industries to identify basic drivers of value within sectors.

- Automotive
- Alcohol & tobacco
- Banking
- Capital markets
- Food & beverage
- Freight¹
- Health plans
- Hypermarkets
- Insurance²
- Lodging
- Oil & gas
- Personal care
- Pharmaceuticals
- Rail
- Steel
- Tour operators
- Utilities
- Wireline

¹ Analyzed in three subsegments: integrators, high asset and low asset

² Analyzed in three subsegments: multi-line, property/casualty and life

a 10-year total return performance screen to its standard 3-year, 5-year and 7-year reviews.

As Accenture builds a high-performance business research database, we continue to pilot even more industry-specific analytic efforts to accurately identify the attributes of superior companies. In some complex industries, where fundamentally different operating models prevail within subsegments, we have taken peer comparison to the appropriate subsector level.

In the energy sector, for example, we are applying our performance screens among, respectively, vertically integrated global super-majors, independent upstream producers and state-operated downstream distributors. In the freight industry, we studied high-performance business attributes among integrators, high-asset movers and low-asset movers. And in the consumer products sector, we are studying the food, personal care, and alcohol and tobacco segments separately.

There are industries, of course, that have staked their perceived value on global scale and the successful amalgamation of different business models. A case in point is financial services, where universal providers now strive to offer bundled insurance, investment banking, asset management and brokerage services to both institutional and retail customers. From a capital markets perspective, these companies define their own value creation at the corporate-umbrella level, regardless of the particular mix of operational business models. Accenture has done likewise, benchmarking the performance of these financial giants at the trans-operational, corporate-parent level.

Finally, nothing is less useful than yesterday's best practices. Certain industries have undergone radical structural change during the past decade, making the application of high-performance lessons from even five years ago irrelevant. In these dynamic industries, Accenture has begun to examine high performance not only by peer benchmarking standards but also by longitudinal analysis of shifting industry conditions.

In the US healthcare provider sector, for example, we measured companies over a 13-year period covering three industry inflection points. The research revealed that high-performance business drivers changed, from tightly managed care in the 1990–1995 period, to product flexibility and open-plan models in the 1995–2000 period, to administrative cost management skills in the 2000–2003 period; we are now identifying what the markets indicate will be the drivers during the next three to five years. We are currently conducting the same kind of era analysis in the US wireline telecommunications sector—again with a goal of identifying current or near-term drivers of value as well as historic ones.

In response to client requests, we are building a high-performance framework that we think is distinct from any of its predecessors. Grounded in a rigorous, shareholder return-oriented analytic methodology, it is designed to deliver precise, focused insight—lessons that are specific to different industries and business models, and to current circumstances. ■

About the authors

Patricia Anslinger is a New York-based partner who is the global lead of the mergers and acquisitions/corporate

strategy unit of the Accenture Strategy & Business Architecture service line. Ms. Anslinger has advised on more than 150 M&A engagements of all sizes, involving friendly and leveraged buy-outs, takeover defense, joint ventures, alliances and divestitures. Her most notable work revolved around providing advisory services in the Compaq–Hewlett-Packard merger agreement.

patricia.anslinger@accenture.com

Tim Breene is Accenture's chief strategy officer and is responsible for the company's Growth & Strategy function. He is also a member of the Accenture Management Committee, Executive Committee and Global Leadership Council. Since joining the company in 1995, Mr. Breene has held a number of senior positions, including managing partner of Accenture Strategic Services, managing partner of the company's global service lines and group chief executive of the Accenture Business Consulting capability group. Mr. Breene is based in Boston.

tim.breene@accenture.com