The officer of every corporation should feel in his heart—in his very soul—that he is responsible, not merely to make dividends for the stockholders of his company, but to enhance the general prosperity and the moral sentiment of the United States.

– Adolphus Green, founder, Nabisco

Jarden Corporation grew its revenues from $305 million in 2001 to $4.7 billion in 2007. This growth earned it a spot on the Fortune 500 for the first time. Much of this growth was achieved through the acquisition of underperforming brands. The company now markets more than 100 brands. These include many recognizable names—Sunbeam, Oster, Hoyle, Mr. Coffee, Rawlings, Crock-Pot, and First Alert.

Despite this impressive growth, however, the company’s shares lost half their value during 2007–2008. Clearly, the overall decline in the stock market had a lot to do with this. Nonetheless, a declining stock price inevitably raises concerns.

A sharp contrast is provided by Kleiner Perkins Caufield & Byers, one of the top venture capital firms in Silicon Valley. The firm that bet on Genentech, Compaq, Sun, Netscape, Amazon, and Google has made billions of dollars for its investors and generated impressive returns for them.

1 See Fortune, July 7, 2008.
Like it or not, it’s a stock-market driven world. Those who produce handsome returns for their investors are celebrated. CEOs who don’t deliver high returns are under pressure. Whether they grew profits through efficiency measures or boosted the top line through acquisitions matters little. They may make outstanding products of high quality and may have well-organized manufacturing plants equipped with the latest technology. They may have great employees. But if the firm’s stock price stagnates, it is in trouble. The ultimate score card is the stock price!

So an obvious question is: How well does the Competing Values Framework (CVF) do in terms of positioning the company for good growth—growth that boosts the stock price?

When it comes to relating growth strategy to stock price, the CVF has to overcome the shortcomings of most measurement approaches. Most measurement devices used to assess organizational performance do not account for the tensions inherent in managing for the short run as well as the long run; or the tensions in managing predictability as well as innovation; or managing for fast payout as well as for future strength.

The CVF, on the other hand, identifies criteria of performance in each of the four quadrants, and thus incorporates these very tensions. We have conducted extensive empirical research into the relationship of the CVF with shareholder value. The findings of the research are striking:

- There is a high statistical correlation between the variables of the CVF and contemporaneous cross-sectional variations in market-to-book-value ratios of (publicly traded) companies. In other words, the CVF explains well which companies will produce the most market value for every dollar invested by their shareholders (book value).
- Investing based on the CVF also yields attractive returns. Investing in a (value-weighted) portfolio of firms that are in the top quintile based on their competing values rankings consistently yields returns that are well above market returns as well as the returns required to compensate investors for the risk they bear from investing in these top-quintile portfolios.
DESIGNING THE EMPIRICAL TESTS

There are two types of empirical tests that we have conducted: contemporaneous and predictive. Each is described below. In these tests, we assigned two variables (representing dimensions of value creation) to each of the four quadrants and then chose a proxy for each of these eight variables, as explained in Figure 3.1.

A few words on these proxies are in order. Let us start with the Control quadrant. The two measures of value creation in this quadrant are quality and efficiency. Ideally, we would like to measure quality by directly assessing the quality of the firm’s products and services. However, this is not feasible given the number of firms in our database. So we made the assumption that the higher the firm’s product quality, the higher will be the price premium it will be able to command and thus the higher will be its gross margin, defined as (sales revenue minus cost of goods sold) divided by sales revenue.

As for efficiency, many measures are possible. The one I focus on is how efficiently the firm manages its asset base. I thus use the classic

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2 The summary here is adapted from the discussion in Competing Values Leadership (Kim Cameron, Jeff DeGraff, Robert Quinn, and Anjan Thakor), Edward Elgar Publishing, 2006.
definition of asset efficiency as our proxy, *asset turnover*—defined as sales—divided by assets in a given year.

Now consider the Compete quadrant, where the two measures of value creation are profit and speed. By profit, we mean *economic profit* rather than accounting net income, which is subject to all sorts of manipulations and distortions, as the events in 2002 with WorldCom, Enron, Tyco, and others have aptly illustrated. The commonly used notion of economic profit is Economic Value Added (EVA), which is defined as Net Operating Profits After Tax (NOPAT), minus a capital charge, where capital charge equals the firm’s weighted-average cost of capital times Net Assets Deployed.³

By speed, we mean the speed with which initiatives are executed and hence economic profit is improved. We thus create a proxy for speed by the change in the firm’s EVA growth rate from one year to the next, over a five-year time period.

Turning to the Create quadrant, the two measures of value creation are growth and innovation. A fairly conventional view of growth is used; it is the rate at which the company’s sales are growing. Thus, the proxy for growth is sales growth.

Innovation is something we would ideally like to assess by measuring the success of the company’s innovation efforts in terms of its products, services, and business designs. This is difficult to do directly given data limitations. So, an indirect approach is taken. As has been done in some recent finance research, a firm’s “idiosyncratic stock return risk” is used as a proxy for its innovativeness. The idea is as follows.

A firm’s stock returns are driven by two factors: its co-movement with the overall market (or economy) and its idiosyncratic circumstances. The more innovative the firm becomes, the more different it looks from the rest of the herd—the overall market. Hence, the greater is the influence of its own idiosyncratic factors in driving its stock returns relative to the influence of the overall market.

³ Net Assets Deployed is typically defined as net total assets of accumulated depreciation and amortization minus noninterest-bearing current liabilities (e.g., accounts payable).
We measure idiosyncratic stock return risk by measuring the standard deviation of the firm’s idiosyncratic returns—that is, the difference between its actual returns and the portion of the returns that can be explained by co-movement with overall market return. This is sometimes referred to as *alpha*.

The final quadrant is Collaborate, where the measures of value creation are knowledge and community. Organization knowledge is a highly complex variable and difficult to measure directly. So, it is better to focus on knowledge that leads to perceptions of future value creation, since the unique knowledge the organization possesses today, to the extent that it has value relevance, should lead to value creation in the future.

Thus, the proxy for knowledge is *future growth value*, which is defined as the differences between the firm’s current market value (which impounds investors’ expectations of future value creation) and what its market value would be if its profits (NOPAT) did not grow. That is, it is the portion of the firm’s current market capitalization that is attributable to expectations about future growth. These expectations are driven by the unique knowledge assets the firm has.

As for community, what we really want to measure is one of the softest aspects of the organization: the quality of its internal community. We have the instruments with which we can do this if we were to go inside an organization and interview employees. This, however, is not possible from a database as large as the one used in this analysis.

So it is convenient to assume that the greater the impact an individual employee has on the success of the organization, the more “relevant” that employee will feel. And the greater the sense of personal relevance, the greater will be the sense of “ownership” and internal community. Thus, community is proxied by a variable defined as sales/number of employees. The more the organization sells per employee, the greater the sense of community.

These proxies are not perfect, of course, but they serve as approximations of objective financial measures in each of the quadrants. Inasmuch as publicly available financial data were used for data on these companies, these proxies are about as well as you can do.
This book’s Appendix provides a summary of these proxies and the various quadrants. Figure 3.2 provides an intuitive link between the quadrants of the CVF and the firm’s stock price.

Rather than focusing on the four individual quadrants, it is also interesting to examine how well different companies and their industries score in all of those quadrants. To do this, we first calculate the eight CVF performance metrics for all publicly listed companies in the United States.

We then rank these companies in each dimension by calculating a percentile score for each company in each dimension. The best performer in each dimension is assigned the maximum score of 1; the worst
A performer receives a score of 0. The industry scores in each dimension are obtained as the average scores of all the firms in that industry.

Figure 3.3 shows CVF profiles of four companies: Leapfrog Enterprises, Sirius Satellite Radio, Wal-Mart, and General Electric. It is clear that educational toy company Leapfrog Enterprises is very strong in the Yellow quadrant and outperforms its industry both in community and in knowledge. Sirius Satellite Radio is a Yellow–Green company: It scores extremely well in community, knowledge, innovation, and growth, and by far outperforms its industry in each of those dimensions. Wal-Mart is a Red–Blue company: It shows superb performance in the areas of efficiency and profit, respectively scoring equally well as and outperforming the general merchandise industry. General Electric is
clearly a Blue company: it scores extremely high in profit and speed; while the entire industry tends to score very well on profit, GE outperforms its peers in terms of speed.

It is interesting to note that Leapfrog Enterprises and General Electric score extremely well in one quadrant, while Sirius Satellite Radio and Wal-Mart show great performance in two quadrants. Comparing the pictures, it is clear that superb performance in one quadrant is associated with mediocre performance in the diagonally opposite quadrant.

This is not a coincidence. I have examined the CVF profiles of all listed companies and have found this to be true for many companies. There are exceptions, of course. But the point is that it is hard in practice to do well in diagonally opposite quadrants.

The graphs in Figure 3.3 were created using each firm’s performance in eight individual areas. It is also possible to calculate each firm’s overall CVF ranking. We do that by calculating each firm’s average score in the eight individual areas. The firm with the highest average performance in all areas is assigned the highest rank of 1; the firm with the worst average performance receives a rank of 0.

These overall CVF rankings allow us to compare the stock price performance of the highest ranking (e.g., top 20%) CVF companies with the performance of the overall market. Figure 3.4 does exactly that. It compares the performance of two portfolios: the competing values top 20% versus the stock-market portfolio.

**FIGURE 3.4**
Stock-market performance versus CVF portfolio performance.
Lessons

If investors had invested $1000 in the two portfolios on December 31, 1992, and subsequently reinvested the dividends every year until December 31, 2006, they would have fared by far the best if they had invested in the CVF portfolio. As can be seen in the figure, the competing values top 20% portfolio would be worth more than $11,500 whereas the average stock portfolio would only have increased to close to $4500.4

LESSONS

There are two simple lessons to be learned from this chapter.

■ Using the CVF, and particularly its link to value creation and your firm’s stock price, you can develop a better appreciation of your growth strategy and better alignment of the organization with this strategy.

■ The CVF successfully identifies the dimensions in which a company needs to perform in order to create shareholder value. Any company that wishes to determine where its biggest bang for the buck is likely to be in terms of improving performance can use the CVF at the company level to do this. That is, the CVF can tell you what to do to get the most from your focused strategy.

In the chapters that follow, we consider various illustrations of this approach for individual companies. This can be helpful in determining the market-valuation impact of any growth strategy—a useful thing to know for any publicly traded company. And private companies can rely on the fact that if these growth strategies produce value for public firms, then they are worth considering even for private firms.

4 Figure 3.4 is comparable to Figure 6.3 in Competing Values Leadership: Creating Value in Organizations (Cameron, Quinn, DeGraff, and Thakor, 2006). While both figures show a strong outperformance by the competing values portfolio, the dollar values do not match for two reasons. First, Figure 6.3 shows the competing values top 25% (rather than top 20%) portfolio. Second, some variable definitions (and hence competing values rankings) were changed.
Reflection Exercise

As a leader in your organization, please choose a number from 1 to 5 to assign to each statement in Exercise 3.1.

Based on your answers, create a picture like the one shown in Figure 3.5, plotting a point on each ray that corresponds to the score you gave on that dimension. Compare this to Figure 2.6, the intent of our growth strategy graph, from Chapter 2 and write down your observations about how your growth strategy intent matches up with your organizational capability to grow.

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<thead>
<tr>
<th>Exercise 3.1</th>
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<th>3</th>
<th>4</th>
<th>5</th>
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<td>(i) Our organization is better than others in the industry in terms of the strength of its community.</td>
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<td>(ii) Our organization is better than others in terms of its ability to continuously generate new knowledge.</td>
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<td>(iii) Our organization is better than others in terms of its ability to innovate.</td>
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<td>(iv) Our organization is better than others in terms of its ability to grow the top line.</td>
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<td>(v) Our organization is better than others in its ability to respond quickly to market opportunities.</td>
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<td>(vi) Our organization is better than others in terms of its ability to generate profits and create shareholder value.</td>
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<td>(vii) Our organization is better than others because of its efficiency and planning.</td>
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<td>(viii) Our organization is better than others in the quality of the products and services it provides.</td>
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FIGURE 3.5
The capability behind our growth strategy.