THE BOSTON CONSULTING GROUP

Balancing Act

Implementing an Integrated Strategy for Value Creation

THE 2005 VALUE CREATORS REPORT

BCG | REPORT

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About This Report

This research report is a product of the Corporate Finance and Strategy practice of The Boston Consulting Group. **Eric Olsen** is a senior vice president and director in BCG's Chicago office and global leader for integrated financial strategy. **Daniel Stelter** is a senior vice president and director in BCG's Berlin office and global leader of the Corporate Finance and Strategy practice. **Frank Plaschke** is a manager in BCG's Munich office and project leader of the Value Creators research team.

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Preface

Halfway through the first decade of the twenty-first century, global capital markets have yet to fully recover from the collapse of the late-1990s financial bubble. The five-year average annual total shareholder return (TSR) for the 613 companies in the 2005 Value Creators rankings was a disappointing –4 percent, reflecting the decline in investor expectations as markets corrected for the unsustainably high valuations of the bubble period. (For a detailed description of TSR, see the sidebar "The Components of Total Shareholder Return.")

And yet the news is not all bad. Poor TSR performance on average hides quite good performance in improving fundamentals. The average improvement in company fundamental value (the underlying value of a company's businesses) in this year's Value Creators sample was 7 percent per year. And the best companies combined even greater improvements in fundamental value with equivalent improvements in investor expectations and cash payouts to investors to rack up a top-quartile median TSR performance of 20.9 percent per year. The very best performers had annual returns of 40 percent and higher.

Looking to the future, however, many companies face a dilemma. On the one hand, profitability and free cash flow have been restored after the recession. Companies have pruned excess costs and rationalized their portfolios. They have cash and more solid balance sheets, and they are ready to grow. On the other hand, many find themselves in mature or maturing industries. Unless they can find ways to innovate or create advantage, growth from market share gains will likely come at the price of eroded margins. And investors have become more risk averse, more focused on cash payout, and in general more resigned to lower market-average TSRs. They are closely scrutinizing each company they invest in rather than trying to surf broad sector-oriented investment themes as they did in the past. Even the most growth-oriented investors have become choosier and more conservative.

In such times, we believe it is important for every company to conduct a systematic reexamination of its value-creation strategy. Among the questions senior executives need to ask:

- What are our assumptions about how our company creates value?
- Are those assumptions accurate?
- If so, are they likely to hold true in the future?
- What is the best value-creation strategy for our company, given factors such as its competitive situation, industry context, and current valuation multiple?

Balancing Act: Implementing an Integrated Strategy for Value Creation is the seventh annual report in the Value Creators series published by The Boston Consulting Group.[1] Each year, we publish detailed empirical rankings on the performance of the world's top value creators and distill managerial lessons from their success. We also highlight key trends in the global economy and world capital markets and describe how these trends are likely to shape future priorities for value creation. Finally, we introduce new or improved analytical tools developed by BCG for managing value creation.

In last year's Value Creators report, we made the case for what we termed an *integrated* value-creation strategy.[2] When defining a value creation strategy, we argued, it is critical to understand the linkages across a company's fundamental-value engine, its valuation multiple in the market, and its financial policies, such as dividend payout and capital structure.

In this year's report, we explain how companies can go about actually implementing such a strategy. We describe BCG's recent work helping companies craft a more integrated approach to value creation, and we focus on the hands-on challenges of putting an integrated value-creation strategy

1. Previous reports are available at http://www.bcg.com/corporatefinance/cfs_value.html.

2. See *The Next Frontier: Building an Integrated Strategy for Value Creation,* the 2004 Value Creators report, December 2004.

into practice. We believe that this integrated approach is a distinct improvement on existing approaches because it focuses managerial attention on the tradeoffs that executives must manage in what is a highly dynamic value-creation system. We also believe that this integrated approach holds lessons for all managers—irrespective of industry and starting position and of whether or not their companies happen to be top performers.

The report has five main sections:

- In the first section, we review the three main dimensions of value creation and explain why companies need to address them in a coordinated manner.
- Next we describe how to create a comprehensive TSR fact base to inform management decisions about value creation strategy.
- Third, we explain how companies can quantify the TSR potential of their business plans, debate alternative value-creation scenarios, and arrive at a detailed integrated strategy.
- Fourth, we highlight some key issues in translating an integrated value-creation strategy into managerial processes such as strategic planning, budgeting, and incentive compensation.
- We end the report, as we do every year, with detailed rankings of this year's Value Creators—for the world as a whole and for 12 global industries.

THE COMPONENTS OF TOTAL SHAREHOLDER RETURN

The most comprehensive (and by now the most widely accepted) measure of value creation is *total shareholder return* (TSR). TSR measures the change in a company's stock price, plus its dividend yield, over a given period of time. There are three basic drivers:

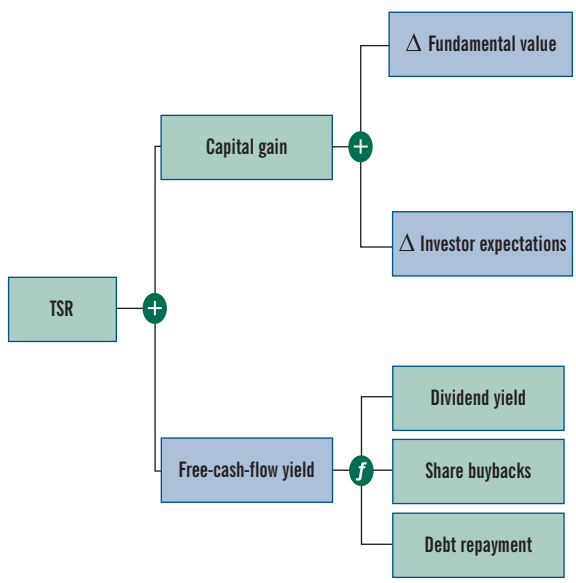
Changes in Fundamental Value. Fundamental value represents the discounted value of the future cash flows of a business, based on its margins, asset productivity, growth, and cost of capital.

Changes in Short-Term Valuation Driven by Investor Expectations. How the capital markets value a company's fundamental performance can also increase—or decrease—a company's TSR in the short term. Investor expectations are measured by a company's expectation premium (the difference between its actual stock price and the price derived from an analysis of its underlying fundamentals) and can be further analyzed by comparing a company's valuation multiple with that of its industry peers.

Changes in the Distribution of Free Cash Flow to Investors. A company can also improve its TSR by distributing cash to investors. For example, dividends contribute directly to TSR. But dividend payouts, as well as share repurchases and debt payments, can also contribute indirectly by affecting a company's valuation multiple.

Fundamental value, investor expectations, and free cash flow are integral parts of a dynamic value-creation system. Changes in any one can affect the others. The basic challenge of value creation is to understand the linkages among these three components and manage the tradeoffs across them to ensure that management actions are mutually reinforcing rather than contradictory.

THE MOST COMPREHENSIVE MEASURE OF VALUE CREATION IS TOTAL SHAREHOLDER RETURN



SOURCE: BCG analysis.

The Three Dimensions of Value Creation

The discipline of value management has made considerable progress in recent years. Yet despite that progress, value creation remains as much an art as a science.

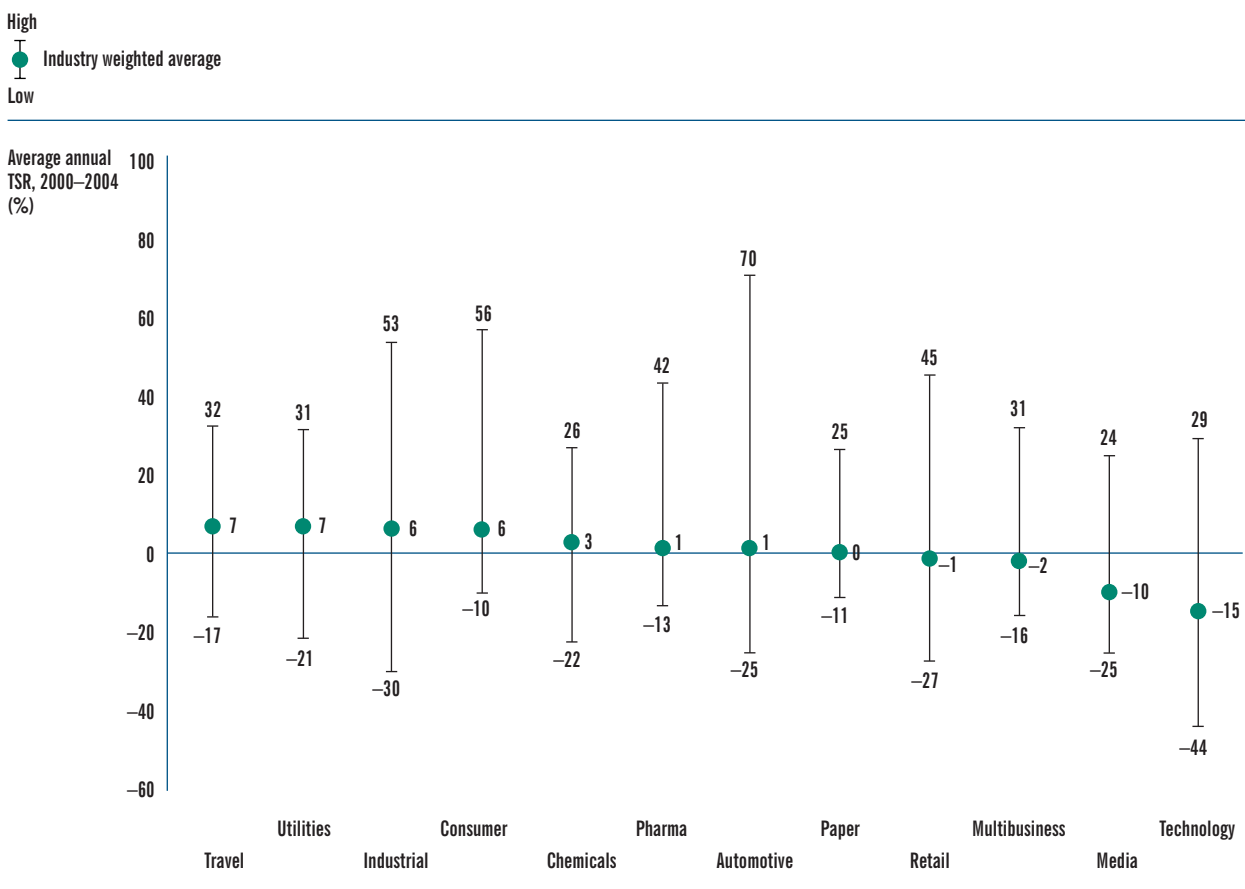
To be sure, there are always some companies, irrespective of industry, that are able to beat the market average. Exhibit 1 shows the wide variance in returns for the 12 industries in this year's Value Creators rankings. The five-year weighted average annual TSR ranges from 7 percent in travel and in utilities to –15 percent in technology. But the best performers in these industries racked up TSRs that were considerably higher—anywhere from 24 percent in media and entertainment to 70 percent in automotive. This finding illustrates that there is no such thing as a disadvantaged industry, that every industry has top performers that vastly outperform the market average. (For a detailed description of our sample, see "Appendix: The 2005 Value Creators Rankings," page 26.)

For the same company to create above-average value year after year, however, remains an extremely difficult task. We analyzed the ten-year TSR performance of 2,020 companies from 1995 to 2004 and compared it with each company's national stock-market average. About a quarter of the sample, 522 companies, were able to beat the market in six of the ten years, but less than 100 did so for eight. And only a single company beat its national market average for all ten years.

This difficulty should come as no surprise. After all, capital markets continuously incorporate investor expectations of future performance into a com-

EXHIBIT 1

IN EVERY SECTOR, THE TOP PERFORMERS SUBSTANTIALLY OUTPERFORM THE INDUSTRY AVERAGE



SOURCES: Thomson Financial Datastream; BCG analysis.

pany's stock price, forcing companies to find new ways to beat investor expectations. Despite the attractiveness of focusing on a single value-creation metric—whether earnings per share (EPS) or economic profit—there is no silver bullet, no single lever that managers can pull year after year.

Rather, value creation is a complex and multidimensional challenge. First, a company's senior executives must develop a detailed plan for improving fundamental value in a way that is competitively advantaged over the long term. Second, they must understand how investors are likely to value the company's performance in the short term. Third, they need to define clear priorities for using the cash the company generates—what portion to hold as cash, what portion to reinvest, what portion to return to investors or debt holders. Most important, they must do all these things in a *coordinated* fashion, anticipating the way changes in any one area can affect the others and managing complex—and often controversial—tradeoffs both within and across these three key dimensions of an integrated value-creation system.

Value creation is a bit like walking a tightrope: it is very easy to lose one's balance.

It's a bit like walking a tightrope: it is very easy to lose one's balance and fall off on one side or the other. And yet as any visitor to the circus will tell you, the skilled performer can do it—and make it look easy. The trick in achieving an equivalent balancing act in value creation is to develop a truly integrated value-creation strategy, one that addresses the three dimensions of value creation in a holistic way. Let's consider each of those dimensions in turn.

Changes in Fundamental Value

Improvements in fundamental value are at the core of value creation. They are the day-to-day focus of most management teams—and rightly so. More than two decades of research in corporate finance have shown that fundamental value drives a company's total shareholder return over the long term, accounting for roughly 60 percent of TSR. And of all the factors contributing to fundamental value, by far the most important is revenue growth.[3]

But as most executives know, growth in revenue is no panacea. In order for growth to deliver improved TSR, it must be profitable growth. And investors must see it as sustainable. So managers must ask themselves hard questions about tradeoffs:

- Should we pursue additional growth opportunities even if they come at the price of lowering our margins or return on investment?
- If growth is indeed the answer, should we stick to organic growth or pursue more aggressive opportunities through M&A or alliances?
- Or should we perhaps settle for lower growth in order to sustain higher margins?

Over the past few decades, the field of value management has developed a variety of metrics to help managers quantify these tradeoffs. For example, cash-based metrics such as cash flow return on investment, cash value-added, and total business return are considerably more precise as measures of a company's improvement in fundamental value than traditional accounting yardsticks such as earnings per share because they incorporate all relevant information about growth, margins, asset productivity, and the cost of capital. As a result, they have become a standard part of the corporate finance lexicon at many companies.

And yet even the best of these fundamental-value metrics still do not explain all of a company's TSR performance. They are not designed to capture how capital markets actually value a company's fundamental performance or the contribution to TSR of actual cash payouts such as dividends. As a result, when executives wrestle with tradeoffs about growth versus margins or organic growth versus M&A, they also need to evaluate the effect those decisions have on the other two dimensions of the value creation system: changes in the company's valuation multiple and its cash-flow payout.

3. See *The Next Frontier: Building an Integrated Strategy for Value Creation,* the 2004 Value Creators report, December 2004, p. 25. BCG research suggests that investors consider growth so important that they don't care whether it is organic or acquisitive, just as long as it is profitable. See *Growing Through Acquisitions: The Successful Value Creation Record of Acquisitive Growth Strategies,* BCG report, May 2004.

Changes in a Company's Valuation

Improvements in fundamental value are the main source of TSR in the long term. But in the short term, changes in how the market values a company's fundamental performance at any given moment in time can increase—or decrease—TSR. These changes in valuation are reflected in a company's valuation multiple, usually expressed as some ratio—for example, the ratio of price to earnings (the P/E multiple) or the ratio of market value to earnings before interest, taxes, depreciation, and amortization (the EBITDA multiple). A company's valuation multiple reflects the impact of investor expectations on the company's TSR. Our research suggests that for top-quartile companies, improvements in the valuation multiple are the most important contributor to near-term TSR.[4]

A company's multiple can be a significant enabler of—or constraint on—its value-creation strategy.

But a company's valuation multiple is also an important piece of its long-term value-creation strategy. A company's valuation multiple, relative to industry peers, is an important signal of how investors evaluate factors such as growth potential, risk, quality of earnings, and the sustainability of competitive advantage. In this respect, it can be a significant enabler of—or constraint on—a company's value-creation strategy. A below-average multiple can raise a company's cost of capital. It can also put a company at a disadvantage when it comes to acquisitions (because its stock will be a relatively weaker acquisition currency), thus limiting one important pathway to growth. It can even increase the risks of takeover by signaling to competitors that a company is undervalued relative to its peers.

The specific drivers of valuation multiples will vary by industry and by the makeup of a company's investor mix. Still, there are three simple rules about multiples that apply across all industries:

Risk and sustainability are key. Most investors interpret management actions and company performance in terms of their impact on risk and on the sustainability of the company's results. Put another way, from the perspective of investors, *how* managers improve fundamental value is as important as *how much* they improve it—sometimes more important. A company that takes on substantial debt to fund a major expansion or erodes its brand by cutting prices to gain market share may find that the market responds negatively, even if cash flow increases.

Track record matters. Investors reward consistency of performance. The credibility of a management team that has consistently exceeded investors' expectations and delivered above-average performance can itself create a premium in the company's relative valuation multiple. At the same time, should such a team disappoint investors' expectations, it is likely to be punished even more severely.

Not all investors are alike. Depending on their investment style, investors value specific strategic decisions, operational tradeoffs, and financial policies differently. Therefore the precise impact of management decisions on a company's valuation multiple will depend on what kind of investors dominate the company's investor mix. It's critical that a company's value-creation strategy be aligned with the specific priorities of its dominant investor group.

So even as a company defines a strategy to improve fundamental value, it must also anticipate the likely responses of investors to that strategy and try to predict how those responses will affect the company's valuation multiple. Managers must address questions such as:

- How does our current market value compare with what our fundamental value suggests it should be? Are we fairly valued?
- What factors determine relative valuation multiples in our industry? Which of those factors can we influence—and how should they affect our strategy?
- What are the priorities of our current investor mix? Does our current strategy align with those priorities? If not, what adjustments can we make? Should we consider changing our strategy or migrating to a different type of investor?

4. See *The Next Frontier: Building an Integrated Strategy for Value Creation,* the 2004 Value Creators report, December 2004, p. 25.

BCG has developed new metrics to help companies measure the impact of investor expectations on a company's stock price. In 2001, we introduced the *expectation premium,* a technique for measuring the difference between a company's actual stock price and the price derived from a discounted-cash-flow analysis of the underlying fundamentals.[5] And in last year's report, we described a technique we call *comparative multiple analysis* for identifying the critical drivers of multiples in a company's industry peer group.[6] (For an example of the kind of insight into value creation that comparative multiple analysis makes possible, see the sidebar "The Value-Creating Power of a Strong Brand," page 12.)

Many companies have unrecognized opportunities to increase shareholder value by improving their valuation multiples. But it's important to keep in mind that maximizing the multiple is not necessarily the goal. By developing a more fine-grained understanding of the impact of management decisions on the multiple, companies can also avoid moves that unintentionally damage it. As always, every company should view its valuation multiple in the context of a comprehensive TSR agenda that integrates improvements in the multiple with improvements in fundamental value as well as with an appropriate payout of cash to investors.

Changes in the Distribution of Free Cash Flow

Improving a company's fundamental value generates cash. Companies face the choice of reinvesting that cash (through internal investments or acquisitions) or distributing it to debt holders and stockholders (through debt repayment, share buy-backs, or dividends). Such distributions contribute directly and indirectly to TSR.

Take the case of dividends. Dividends returned to investors are an integral part of the calculation of TSR. But dividends can contribute indirectly as well. Investors have expectations not only for a company's capital gains but also for how much free cash flow it ought to distribute. Whether or not a company pays dividends, and at what level, can have an effect on its valuation multiple. For example, increasing dividend payout can raise a company's multiple by reducing perceived risk, by adding credibility to the quality or sustainability of the company's earnings, and by signaling management's commitment to shareholder value. What's more, a meaningful payout of free cash flow (whether through dividends, share repurchase, or debt retirement) can also discipline a company's strategy to improve fundamental value—for instance, by creating competition for cash, by increasing the pressure to improve profitability, and by making it more likely that only the most promising investment projects go forward.

For all these reasons, any value-creation strategy must include priorities for the best use of free cash flow. For example:

- How much cash should we reinvest in the business? How much should we pay out to investors and debt holders? How will the choice affect our growth prospects, our valuation multiple, and our TSR?
- What are our priorities for cash payout—debt reduction, share repurchase, or dividend payment?
- How do investors and credit-rating agencies value the excess cash on our current balance sheet? Is it adding to or eroding TSR?
- Are investors giving us full value today for our expected generation of free cash flow in the future? If not, what policies or actions would allow us to get more credit for that potential?

It is important to remember, however, that—like fundamental value or the valuation multiple—free cash flow is just one part of the TSR equation. It can be a route to improving near-term TSR or to assuring the consistency of long-term TSR. But it is not necessarily the best endgame value-creation strategy—except perhaps for mature companies opting for consistent but modest (slightly above average) TSR performance.

Of course, it is one thing to understand that value creation is the product of an integrated system. It is quite another to actually develop an integrated value-creation strategy. To do so, senior executives must put in place a structured process for analyzing the specific dynamics of value creation in their company and industry, debating the key tradeoffs across

5. See *Dealing with Investors' Expectations: A Global Study of Company Valuations and Their Strategic Implications,* Value Creators 2001, November 2001.

6. See *The Next Frontier: Building an Integrated Strategy for Value Creation,* the 2004 Value Creators report, December 2004, pp. 29-32.

THE VALUE-CREATING POWER OF A STRONG BRAND

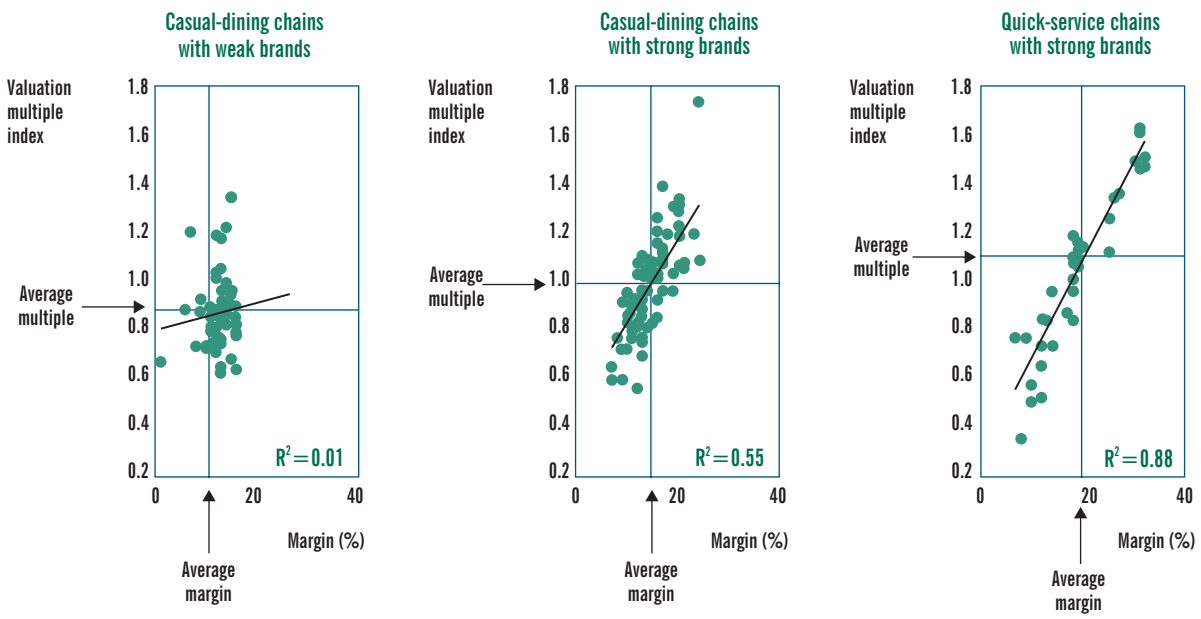
Most managers understand intuitively that a strong brand is a great advantage when it comes to creating value over the long term. A strong brand creates competitive barriers that give a company the pricing power to command a premium for its products or services. Given these perceived benefits, one would expect strong brands to have higher margins (assuming the company is cost efficient) and higher valuation multiples.

In an effort to quantify the value of brands for a U.S. restaurant chain, The Boston Consulting Group analyzed the impact of brand strength on relative valuation multiples in the U.S. restaurant business. We studied the correlation between margins and relative valuation multiples in two segments of the industry: casual-dining restaurants and quick-service restaurants. We further divided the casual-dining segment into chains with relatively weak brands, as reported in consumer surveys, and those with relatively strong brands. (All the companies in the quick-service segment, which includes major corporations such as McDonald's, Wendy's, and Yum! Brands—the owner of such well-known U.S. chains as Pizza Hut, Taco Bell, and KFC—were perceived as strong brands by consumers.)

As the exhibit below illustrates, the strong brands in our sample did have somewhat higher margins and multiples, on average, than the weak brands. But the really interesting finding concerns what is going on within each of the three segments. Each group of companies has a wide variation in valuation multiples. For the casual-dining restaurants with weak brands, there is little correlation between the level of the multiple and the size of the margins. The data points (each plotting a company's margin against its multiple for a given year) are all over the map, and the correlation coefficient (R^2) is a mere 0.01, which means that margin level explains only 1 percent of the variation in multiples in the sample. In other words, investors do not systematically reward these companies when they improve their margins, most likely because they do not believe that such improvements are sustainable.

For the strongly branded companies in both the casual-dining and quick-service segments, however, there is a much stronger correlation between margin improvement and multiples. The R^2s for these segments are 0.55 and 0.88, respectively. Not only are

IN THE U.S. RESTAURANT BUSINESS, STRONG BRANDS SHOW A CLEAR RELATIONSHIP BETWEEN MARGINS AND VALUATION MULTIPLES



SOURCE: BCG analysis.

NOTE: R^2=correlation coefficient.

the valuation multiples of these companies higher on average, they are also highly sensitive to changes in gross margin. When a company has a strong brand, each incremental improvement in margin delivers more bang for the buck in valuation multiple. A low margin, however, can lead to a valuation multiple that is actually below the average for companies with weak brands. In effect, the stronger the brand, the more important margins become as a determinant of the multiple.

This analysis confirms that a strong brand can provide a major advantage when it comes to a company's valuation multiple—but only if the brand also delivers high margins. One critical implication is that executives at strongly branded companies must carefully manage any tradeoffs between growth and margins. When increased growth leads to so massive a decline in margins that it seriously erodes the multiple, what looks like a good strategy to grow earnings may end up undermining TSR rather than improving it.

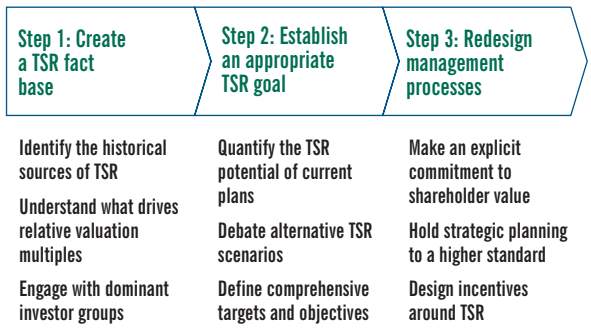
the entire value-creation system, and aligning the organization around a value creation strategy that effectively balances those tradeoffs. There are three basic steps in this process. (See Exhibit 2.)

- Create a comprehensive fact base of the critical drivers of TSR in your company and industry
- Establish an appropriate TSR goal by quantifying the value-creating potential of your existing business plans and debating alternative TSR scenarios
- Redesign key management processes in order to translate value creation strategy into the priorities and practices of your organization

We will consider each of these steps in detail in subsequent sections of the report.

EXHIBIT 2

COMPANIES CAN FOLLOW A THREE-STEP PROCESS FOR IMPLEMENTING AN INTEGRATED VALUE-CREATION STRATEGY



SOURCE: BCG analysis.

Creating a TSR Fact Base

Most companies monitor their value-creation performance over time. Relatively few, however, create a fact base deep enough to help them fully exploit the dynamic factors that drive value creation in their company and industry. Creating this fact base isn't just a data-collection exercise. Its purpose is rather to expand management perspectives, challenge assumptions about what drives TSR, and quantify the key tradeoffs facing the company.

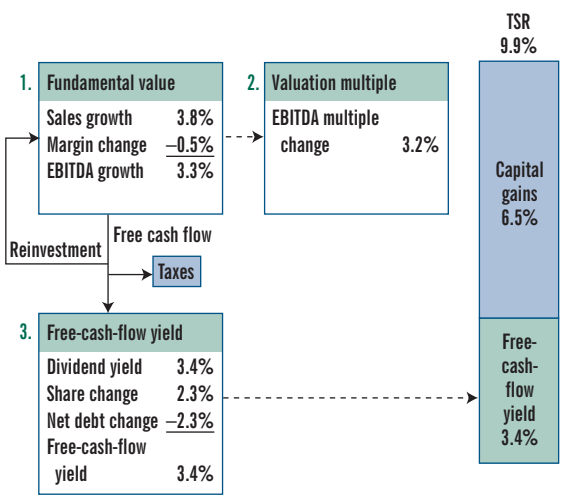
Identify the Historical Sources of TSR

The first step is to understand the historical sources of TSR in your company and industry. BCG has developed a model for identifying the contribution of each of the three dimensions of value creation to a company's TSR in a given period of time. (See Exhibit 3.)

This TSR decomposition model uses the combination of sales growth and change in margins (resulting in growth in EBITDA) as a rough indicator of a company's improvement in fundamental value (box 1 in Exhibit 3).[7] It then uses the EBITDA multiple—the ratio of enterprise value (the market value of equity plus the market value of debt) to EBITDA—to calculate the company's valuation multiple, a rough measure of a company's future expectations (box 2).[8] Finally, the model tracks the distribution of free cash flow—dividend yield, change in shares outstanding, and net debt change—to investors (box 3).

EXHIBIT 3

BCG'S DECOMPOSITION MODEL ALLOWS A COMPANY TO IDENTIFY THE SOURCES OF ITS TSR



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; BCG analysis.

NOTE: Numbers are for illustration purposes only; contribution of each factor shown in percentage points of annual TSR.

Using this model, companies can analyze the sources of TSR for the overall market, their peers, and themselves over a given period of time. For purposes of illustration, Exhibit 4 portrays the decomposition profile for the 613-company industry sample in this year's Value Creators rankings. The exhibit shows both the average decomposition for the sample as a whole and for the top decile.

For both groups, sales growth was an important contributor to TSR—accounting for 10.1 percentage points of TSR for the top decile and 4.7 percentage points for the sample as a whole. But what truly differentiated the top-decile companies was the fact that improvements in the valuation multiple and reductions in debt contributed positively to TSR (8.7 and 5.6 percentage points, respectively), whereas for the sample as a whole the impact of these factors was negative. In other words, the actions of the top performers improved all three levers, while average performers saw erosion in their valuation multiples and delivered negative free-cash-flow yields.

Another lesson companies learn when they use this model is that there are many paths to superior value creation. Exhibit 5, on page 16, compares the TSR performance of four competitors for the ten-year

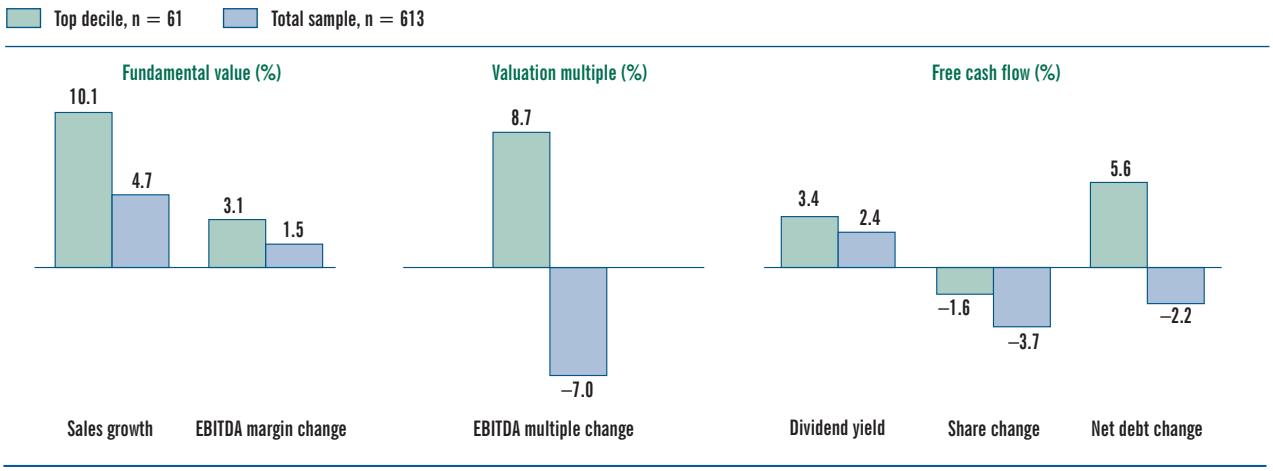
7. In past reports, we criticized some companies' overreliance on EBITDA as a value management metric. (See *Succeed in Uncertain Times: A Global Study of How Today's Corporations Can Generate Value Tomorrow,* Value Creators report 2002, November 2002, pp. 19–20.) Because it leaves out key expenses such as capital expenditures, EBITDA is a less reliable measure of profitability than cash-based measures such as cash flow return on investment and cash value-added. And because it neglects the balance sheet, it is not really an accurate proxy for a company's free cash flow. However, EBITDA is still commonly used by investors as an indicator of a company's earnings-growth potential. As long as it is not a company's sole or primary value-management metric for planning purposes, it still has analytic value.

8. There are many ways to measure a company's valuation multiple, and different metrics are appropriate for different industries and different company situations. For the purposes of this study, we have chosen the EBITDA multiple in order to have a single measure to compare performance across our global sample. For a specific client project, of course, we would analyze the most meaningful multiple for the company and industry in question.

EXHIBIT 4

THE TOP PERFORMERS IMPROVED ON ALL THREE DIMENSIONS OF TSR

TSR Decomposition Profile, Global Sample, 2000–2004



SOURCES: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

NOTE: Bars show contribution of each factor in percentage points of five-year average annual TSR.

period from 1995 to 2004. All four companies delivered an annual average TSR of 15 percent—well above the market average. Yet they used quite different means to achieve that excellent result.

Company A, for example, delivered strong improvements in fundamental value, especially sales growth. These improvements accounted for a full 14 of the company's 15 percentage points of annual TSR. Company D, by contrast, emphasized paying dividends and retiring debt. These financial moves contributed 7 percentage points of TSR, nearly half the company's total. Finally, Company C's value creation was relatively balanced. Improvements in fundamental value delivered 8 percentage points of TSR; changes in the company's valuation multiple supplied an additional 4 points; and contributions of free cash flow accounted for 3 points.

Just as different companies pursue different value-creation strategies during a given time period, an individual company's strategy can vary considerably across different periods. Exhibit 6, on page 16, illustrates how one company cumulatively outperformed its peers over a 20-year period. The decomposition of the company's TSR performance shows four distinct eras of value creation.

The cumulative TSR gap between the company and its peers increased during each of the first three eras, spanning the period from 1985 to 1999. Although the specific drivers of TSR varied during each era, the company managed the combined impact of all levers better than its direct peers. In the most recent era, however, the company accelerated its sales growth (largely through M&A) but at the price of a decline in margins, a decreasing multiple, and negative free cash flow. As a result, the company's cumulative TSR declined while that of its peers grew slightly. This performance caused the company's senior executives to reconsider the wisdom of their recent growth strategy. Understanding the patterns of a 20-year history of value creation has helped management fine-tune its value-creation strategy for the next era.

The point is simple: a company's value-creation strategy cannot be static. It is important both to understand where the company is coming from and to anticipate what aspects of the value creation system will be most important at any given moment in time. This is partly a function of macroeconomic conditions. But it is also a function of the company's own value-creation life cycle. The more nuanced an understanding executives have of their company's long-term TSR history, the less likely they are to continue pursuing a value creation strategy long after the conditions that led to it have disappeared.

Understand What Drives Relative Valuation Multiples

Another key component of a comprehensive fact base is to develop a detailed understanding of what drives

EXHIBIT 5

THERE ARE MANY DIFFERENT PATHS TO SUPERIOR VALUE CREATION

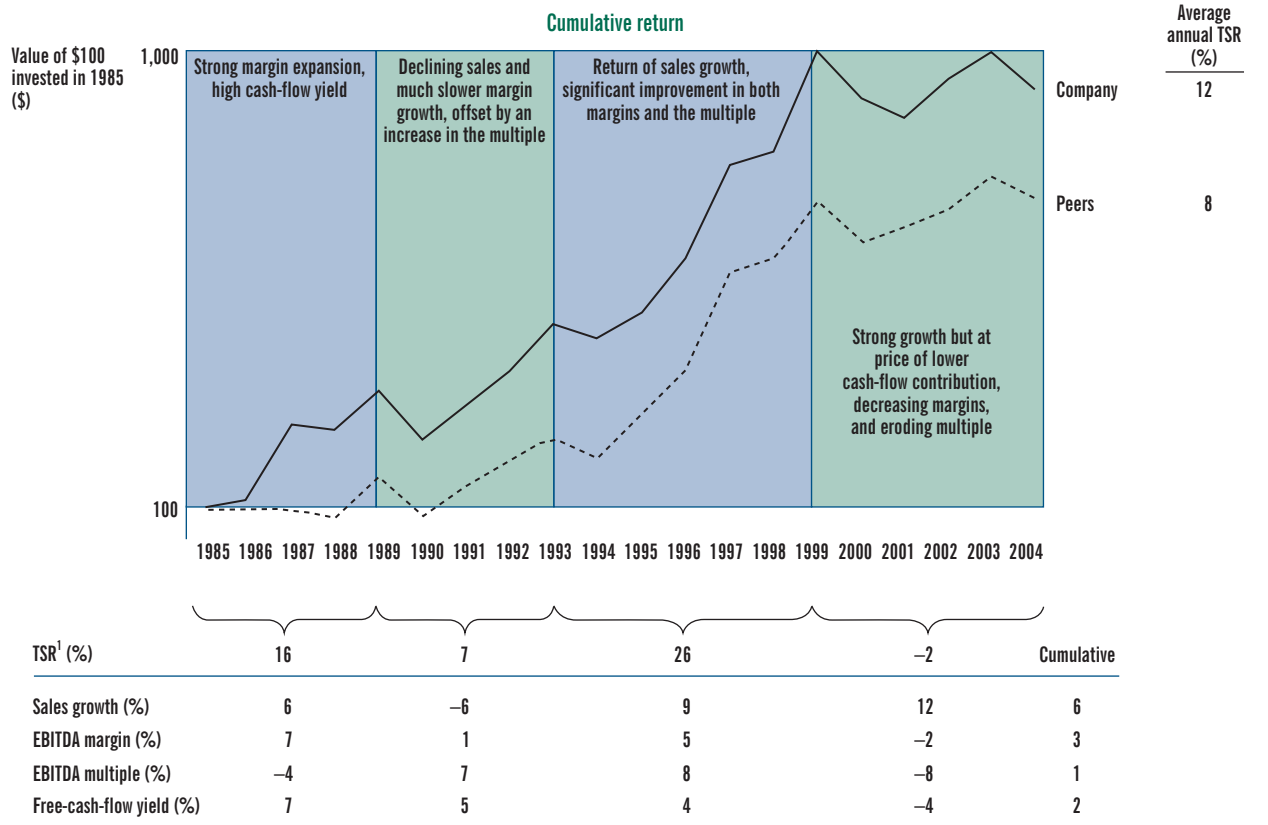
		Company A	Company B	Company C	Company D
1 Fundamental value	Sales growth (%)	11	16	5	1
	Margin change (%)	3	–4	3	1
	EBITDA growth (%)	14	12	8	2
2 Valuation multiple	EBITDA multiple change (%)	–3	4	4	6
3 Free-cash-flow yield	Dividend yield (%)	4	7	2	6
	Share change (%)	–1	–2	1	–1
	Net debt change (%)	1	–6	0	2
	Cash flow yield (%)	4	–1	3	7
Total shareholder return	Total TSR (%)	15	15	15	15

SOURCES: Compustat; BCG analysis.

NOTE: Contribution of each factor shown in percentage points of ten-year average annual TSR (1995–2004).

EXHIBIT 6

MOST COMPANIES EMPHASIZE DIFFERENT LEVERS OF VALUE CREATION OVER TIME



TSR[1] (%)	16	7	26	–2	Cumulative
Sales growth (%)	6	–6	9	12	6
EBITDA margin (%)	7	1	5	–2	3
EBITDA multiple (%)	–4	7	8	–8	1
Free-cash-flow yield (%)	7	5	4	–4	2

SOURCES: Compustat; BCG analysis.

NOTE: Decomposition shown in percentage points of average annual TSR.

[1]All numbers represent compound annual growth rate.

relative valuation multiples in your industry. For example, BCG's *comparative multiple analysis* uses statistical regressions to identify correlations between the range of multiples in a given industry and a comprehensive set of financial and operational variables—including growth, profitability, risk, sustainability, and uses of free cash flow. Using this approach, executives can accurately identify what differentiates multiples in their industry and take action to improve their own company's multiple relative to peers.

To understand the value of this approach, consider the example of a European industrial-goods company whose stock consistently lagged the industry index despite several years of aggressive growth. What explained this below-average performance?

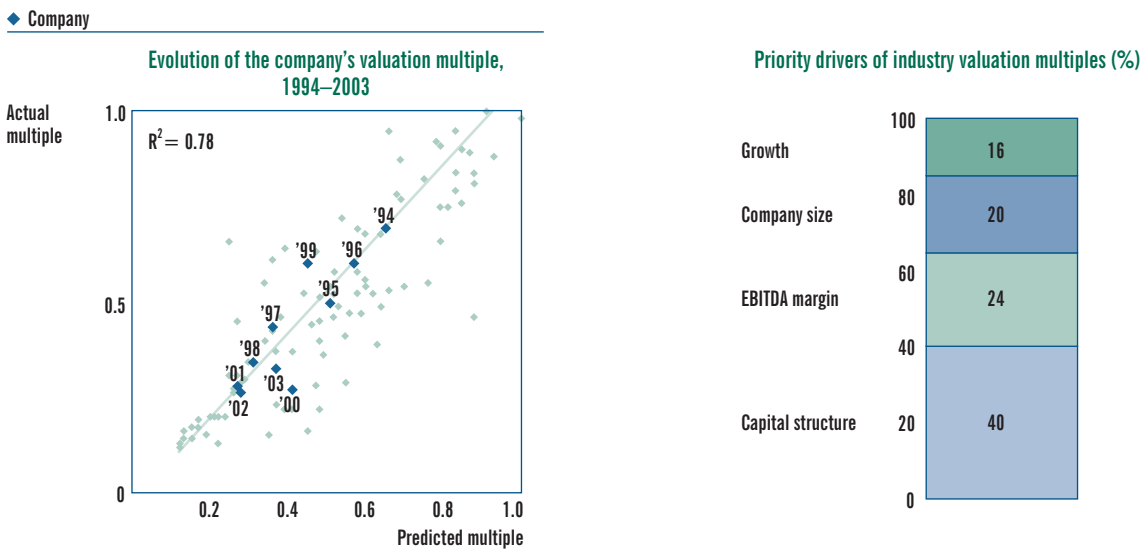
To shed light on this question, we analyzed the factors driving relative valuation multiples in the company's peer group over a ten-year period. A regression analysis revealed that the most important factors were the capital structure (specifically, the level of debt), the size of the EBITDA margin, and company size. (See the bar chart in Exhibit 7.) Growth was a relatively weak driver because most companies in this industry had returns below the cost of capital, so investors saw no extra value from investments to increase growth. Unfortunately, the company had increased its debt in order to fund aggressive growth, but without increasing its margins and return on invested capital.

The scatter diagram in Exhibit 7 shows the result. The diagram plots the actual price-to-revenue multiples of the company's peer group against the predicted multiples derived from the regression analysis (each diamond representing a single company for a single year). The correlation coefficient (R^2) is 0.78, which means that the model predicts 78 percent of the actual variation of multiples in the industry—a relatively strong correlation. The blue diamonds show the path of the company's multiple over the ten years of the analysis. In effect, by taking on more debt in order to fund growth, the company had unwittingly embarked on a value creation strategy that steadily lowered its valuation multiple relative to its peers. This decline was also a clear signal that investors did not have confidence in the ability of companies in the sector to create sustainable fundamental value through expansion funded by debt—a signal subsequently confirmed in interviews with investors.

Once management developed an in-depth understanding of the factors affecting the company's multiple, it was able to make some midcourse corrections in its value-creation strategy. The company recently sold off a low-margin business and used part of the cash to pay down debt. And it

EXHIBIT 7

OVER TEN YEARS, A EUROPEAN COMPANY'S VALUE-CREATION STRATEGY CAUSED ITS VALUATION MULTIPLE TO DECLINE



SOURCE: BCG analysis.

NOTE: Each diamond plots a company's actual multiple for a given year against the multiple predicted by the regression analysis. (R^2=correlation coefficient.)

shifted its focus from investing in growth to improving the capital efficiency of its remaining businesses. These moves have pushed the company's profitability above the cost of capital, which, in combination with a less leveraged capital structure, should help to improve its valuation multiple in the years ahead.

Engage with Dominant Investor Groups

As the above example suggests, a third and final component of creating a comprehensive fact base is identifying your dominant investors and listening closely to what they have to say. This is partly a matter of quantifying the mix of investor styles (value, income, growth at reasonable price, aggressive growth, and so forth) and identifying those that are overweighted—compared with market, industry, or peer-group averages—and therefore most attracted to your current value proposition. (For an example, see Exhibit 8.)

But in addition to quantifying the investor mix, it is essential to engage in a rich dialogue with dominant investor groups. The senior team must go beyond what the company typically does in its investor-relation activities and analyst calls and take the time to understand investors' attitudes and requirements. Fair disclosure requirements may limit the depth of information that management can divulge. But there is no law against asking investors good questions and listening carefully to their answers: Who owns your shares and what are their priorities? Are your current plans in sync with those priorities? Do existing or desired investors find your plans credible? Savvy investors have strong—and often illuminating—views on all these questions.

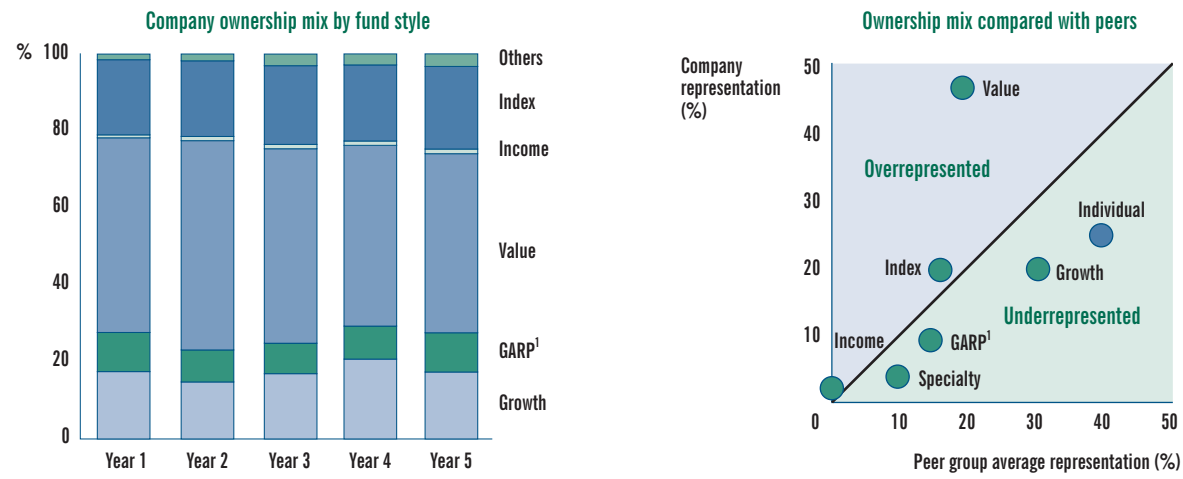
It's important to remember, however, that learning more about what investors really want doesn't mean letting them determine your value-creation strategy—any more than learning about what customers really want means letting them determine your product strategy. The goal is rather to ensure that a company's strategy is informed by the perspectives and requirements of its investor base, and then to work over time to achieve alignment between strategy and shareholders.[9]

In our experience, developing a TSR fact base of this kind helps build an in-depth understanding of the value creation dynamics of the company and its industry. It also helps to create a level playing field where the critical challenges and tradeoffs can be quantified and objectively debated in management ranks. Finally, the fact base helps to ground discussions about a company's TSR goals and to shape a more constructive dialogue about future TSR achievement.

9. See "Treating Investors Like Customers," BCG Perspectives, June 2002.

EXHIBIT 8

IDENTIFYING A COMPANY'S DOMINANT INVESTOR GROUPS IS A KEY INPUT TO A VALUE CREATION STRATEGY



SOURCES: Thomson Financial Carson; BCG analysis.

[1]GARP=growth at reasonable price.

Establishing Appropriate TSR Goals

Once senior executives have assembled a comprehensive fact base, they are in a position to establish the right TSR goals for the company in the light of its particular opportunities and capabilities. That's not simply a matter of choosing an aggressive goal—say, top-quartile status in the company's peer group. By definition, relatively few companies will meet that hurdle, and even fewer will achieve it consistently over time. Setting the right target is more a matter of developing a healthy balance between stretch goals and goals that are consistently achievable. It is an iterative process that requires assessing the expectations of investors and board members and the core assumptions of the senior management team; testing those expectations and assumptions against existing business plans; and thoroughly debating alternative value-creation scenarios. The result will be a detailed understanding of the company's value-creation priorities and objectives, along with a clear sense of how to sequence the right steps over time.

Executives at one company began to question the assumption that aggressive growth was necessary.

Quantify the TSR Potential of Current Plans

The obvious first step is to use the new understanding of value creation developed in assembling the fact base to test the value-creating potential of the company's current business-unit and corporate strategic plans. Given what you now know about your company, industry, and investors, what kind of TSR can current plans deliver? What adjustments are possible and how much would they change the result?

The major challenge here is to extend the typical analyses that most companies do in order to capture the impact of plans on the full range of TSR drivers. For example, consider the recent experience of the senior management team at a $15 billion consumer company. A review of the company's business plans had revealed that prospects for growth were relatively poor. The executives worried that lack of growth would erode the company's valuation multiple and were considering some rather aggressive M&A moves to expand the company's growth rate beyond what existing business units could deliver. But the proposed acquisitions would require a considerable outlay of capital and, as a result, posed significant risks for a management team with relatively little experience in M&A.

As they went through the process of developing a comprehensive TSR fact base, however, the executives began to question the assumption that aggressive growth was necessary. A thorough review of their industry's performance history showed that the consistent top performers had only average growth rates. What's more, an analysis of the company's investor mix showed that the dominant group consisted of value investors, who typically do not value growth as much as improving profitability and free cash flow. Management's misgivings about the need for aggressive growth were confirmed and quantified by an analysis of relative multiples in the industry, which revealed that the main drivers were margins and cash payouts. In short, far from being essential, new top-line revenue growth was expensive, risky, and neither a priority for the company's value investors nor a quantifiable driver of its valuation multiple.

Armed with this new understanding of value creation dynamics in their industry, senior executives took a fresh look at the company's business plans. They concluded that with a bit of fine-tuning to optimize margins, and using the cash they had accumulated for potential acquisitions to boost payout of free cash flow instead, they could improve their annual delivery of TSR from 11 percent to 15 percent. Given that the five-year S&P 500 outlook was 8 to 9 percent, and the peer-group forecast was 7 to 13 percent, this 15 percent TSR would be an excellent result. The board agreed, and this new goal became the company's five-year TSR target.

Debate Alternative TSR Scenarios

Of course, not all companies will be so fortunate. It sometimes happens that the process of quantifying a company's TSR potential will identify gaps between management's aspirations for TSR performance and what the company's current plans purport to deliver. In some cases, plans may appear to meet the goal, but executives are not confident that the organization can really produce. In other cases, the plans will actually fall short of the TSR objective. Although the existence of such a gap is sometimes merely a sign of a healthy tension between existing plans and achievable stretch goals, it is often a signal that the company needs to expand its value-creation opportunity set.

Every company needs to step back, put its cards on the table, and debate its value-creation strategy.

That's why it is important for every company to step back periodically, put all its cards on the table, and systematically reassess and debate its value-creation strategy. One effective way to frame the debate is to contrast your current plan with alternative TSR scenarios that represent significant departures from it. For example, compare a low-risk strategy designed to deliver modestly above-average TSR over the long term with a more aggressive strategy designed to achieve top-quartile status or higher in the near term. Should the business go for aggressive growth or should it become a machine for generating free cash flow? Should the company maximize near-term P/E? EPS growth? Return on capital employed? Cash flow payout?

Every company's answer to these questions will be different depending on its starting point. Whatever scenario you choose to develop, at least one should represent a stretch departure from your current plans, and one should represent a more conservative or incremental departure. And each scenario should explicitly address the following questions:

- If we pursued this strategy, what would we do differently to improve fundamental value?
- How would this strategy affect our current valuation multiple or lay the foundation for improving our future multiple?
- What will be the impact of this strategy on how investors value our current cash holdings and future free cash flow?
- Given our starting-point capabilities and reputation with investors, what are the relative risks inherent in this strategy and what is its probability of success?
- What result will this strategy generate—top-quartile stretch TSR or steady above-average TSR?

In some respects, the scenarios a company explores will be genuine alternatives. For example, different scenarios will appeal to very different kinds of investors. But it's also important to remember that what sometimes look like hard-and-fast tradeoffs at first may, on closer examination, turn out to be unnecessary compromises waiting to be broken. In some situations, for instance, paying out more cash to investors may be the best way to discipline the organization to invest in only the most promising—and profitable—growth opportunities. The result may be both a higher dividend yield and increased profitable growth.

The purpose of debating such scenarios is to get the senior management team to articulate its priorities and beliefs. Does your team really believe that the organization can achieve top-quartile TSR in the next three to five years? Or is it more likely to achieve TSR that is consistently two to three percentage points above the peer-group average for the next decade? Where you finally end up is less important than considering all the alternatives and having a rigorous debate.

Define Comprehensive Goals and Objectives

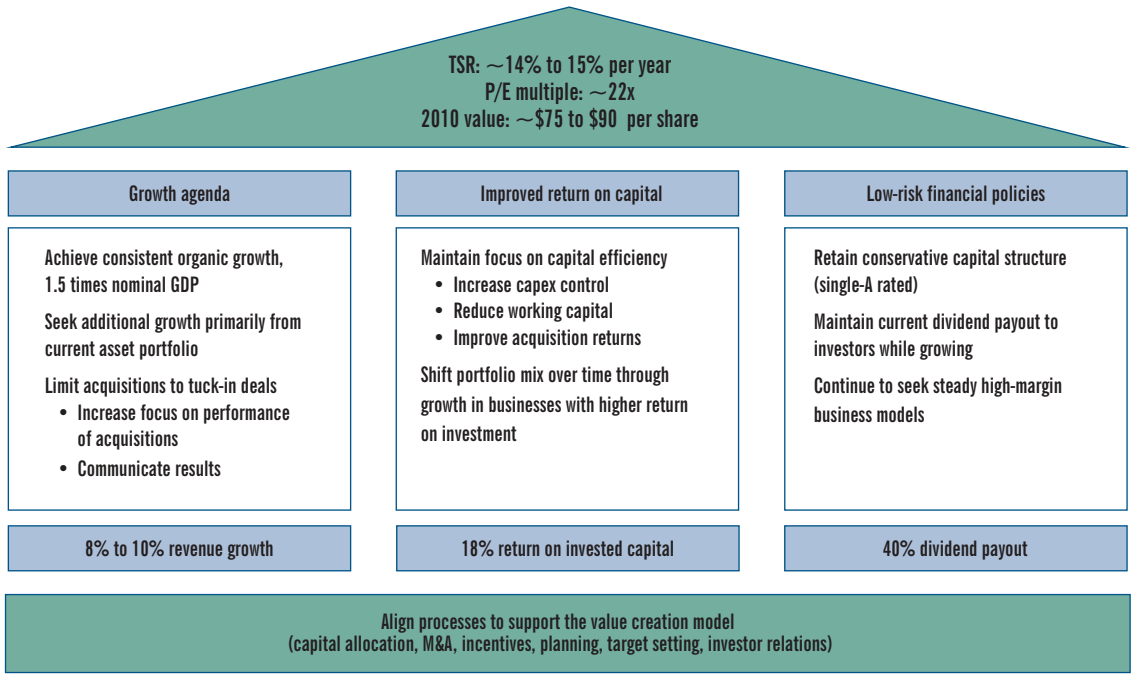
The ultimate goal is to develop a detailed value-creation strategy—and a set of self-reinforcing actions for achieving it—that the entire team understands and is willing to endorse. The senior team at one large information-services company likened the challenge to choosing "what kind of house we want to live in." What's more, they visualized their strategy as an actual house—with their TSR goals as the roof, the top priorities and objectives as the pillars, and the key managerial

processes necessary to realize the vision as the foundation. (See Exhibit 9.)

In deciding "what kind of house we want to live in," however, it's important to remember that it may take a number of carefully sequenced steps to get it built. For example, growth may be the ultimate long-term goal, but before a company can achieve it, other preliminary moves may be required. (For an example, see the sidebar "Getting Ready to Grow," page 22.) Clearly defining and sequencing all the necessary steps are critical in building an integrated value-creation strategy.

EXHIBIT 9

DEFINING A VALUE CREATION STRATEGY MEANS DECIDING "WHAT KIND OF HOUSE WE WANT TO LIVE IN"



SOURCE: BCG analysis.

NOTE: Numbers are for illustrative purposes only.

GETTING READY TO GROW

Many executives equate value creation with growth—and for good reason. Profitable growth is the chief long-term driver of TSR. But that doesn't necessarily mean that building a company's value-creation strategy around growth is the right thing to do at any given moment. There are many situations in which a company can create value by other means. And although growth is essential in the long term, a company must first make sure it is ready to grow. Often, a value creation strategy needs to step up to growth in a sequenced way.

Consider the example of a major U.S. consumer-products company. For nearly 20 years, the company's TSR lagged the market average. A large part of the problem was that the company's valuation multiple was among the lowest in its peer group. Frustrated with this situation, executives assumed that growth was the key to improving the multiple and made some high-profile acquisitions to boost earnings per share. And yet these moves had little impact.

In fact, the company's value-creation challenge was more complicated than executives initially thought. An analysis of the company's investor base showed that value investors predominated and that these investors were not rewarding the company for growth. At the same time, the company's management team had yet to establish the kind of track record that would attract more growth-oriented investors who might have welcomed an aggressive growth strategy. As a result, the company's moves had little impact on its weak multiple, trapping the company's stock price in a suboptimal equilibrium.

The solution was to reframe the company's value-creation strategy in terms of three sequential steps. Given the dominance of value investors in the company's investor mix, the first step was to optimize the company's multiple and free-cash-flow yield. Before it could even think about growth, the company needed to prune low-margin businesses and reinvest in businesses with higher margins; minimize capital expenditures; reduce selling, general, and administrative expenses; and limit acquisitions to tuck-ins with a relatively high hurdle rate. At the same time, it had to boost dividends and limit debt, all the while emphasizing management's commitment to the priorities of value investors in its investor-relation activities.

In parallel, however, the company also needed to start getting ready to grow. In the near term, that meant building some key internal platforms that would be necessary for an eventual growth agenda. For example, the company needed to put in place new processes and capabilities to support organic growth and innovation, and to make sure it had the right managerial skills and incentives to encourage growth.

As the company's relative valuation multiple (and its management's reputation among investors) began to rise under the impact of its new financial policies, the company could also start appealing to more growth-oriented investors. For example, it could make a clear distinction between those business units and brands that would *fund* future growth and those that would be the *engines* of such growth. It could also make some prudent acquisitions that would be accretive to TSR.

The ultimate goal, to be implemented three to five years down the road, is a full-fledged growth agenda: to increase M&A as the multiple increases, to continue migrating the business portfolio to more growth-oriented but relatively low-risk businesses, and, over time, to acquire a reputation for the kind of advanced management capabilities that deliver consistent performance and earn credibility with investors.

Redesigning Management Processes

No matter how detailed or strategically sound, an integrated value-creation strategy is not complete until it has been translated into the organization's internal managerial processes, incentives, and metrics. And yet, in our experience, many companies fail to implement this final step. Rethinking the full range of processes—including strategic planning, budgeting, capital allocation, and management performance incentives that have grown up over years and, sometimes, over decades—can be daunting. But unless a company seriously addresses the challenge, it runs the risk of being unable to align its organizational culture with its value-creation strategy. There are three key leverage points where sustained managerial attention can make a significant difference.

TSR achievement occurs in eras, not quarter by quarter or even year by year.

Make an Explicit Commitment to TSR

The first step is to make an explicit—and public—commitment to shareholder value and to a specific TSR target. Without such a strong commitment, few companies will stretch their organizations to reach their full potential. Indeed, according to a BCG-sponsored INSEAD research study of 117 companies that had instituted value management systems, those that made an explicit commitment to managing for shareholder value were more than twice as likely to actually deliver superior TSR.[10]

Senior executives must actively communicate their value-creation strategy not only to analysts and investors but also to employees, in particular making sure that all key corporate and business-unit executives understand the company's value-creation goal and know what its implications are for their areas of responsibility. Do line managers have a clear view of the priorities for their business units? Do they understand what levers of value creation they are responsible for? Do they know what the company's financial strategy will mean for their use of capital?

Hold Strategic Planning to a Higher Standard

The second key leverage point is strategic planning. In order to get the organization focused on value creation, a company must also hold its strategic-planning process to a much higher standard.

Most companies typically develop new plans on an annual basis. But TSR achievement occurs in eras, not quarter by quarter or even year by year. Plans need to set consistent priorities that will guide management practice for the next three to five years. Adopting this longer time frame does not prevent the organization from making incremental course corrections from year to year in order to respond to changes in the competitive environment.

Most business plans consist of many initiatives. But only a single set of numbers gets reported to the senior team. This inconsistency makes it difficult to gauge the effect of each initiative on the final outcome. The solution is to insist that business units develop a *base case* plus *overlays*. The base case is a forecast of what will happen if the present momentum remains unaffected by new initiatives or investments. The overlays are separate scenarios describing the effects of each different initiative on the momentum forecast. This approach allows a company to evaluate initiatives not as a set but as alternatives to one another or as sequential priorities. It makes the plan more visible and forces business unit executives to think through the specific consequences of each strategic undertaking.

Finally, the long-term targets of a business plan are too often just that—order-of-magnitude goals rather than actual commitments for which managers are held accountable. In order to align the organization on value creation, long-term strategic plans can't just be exercises in thinking; they must define actual commitments. They must have teeth for future delivery, not just vague targets that will

10. See Philippe C. Haspeslagh, Tomo Noda, and Fares Boulos, "Managing for Value: It's Not Just About the Numbers," *Harvard Business Review*, July 2001.

be forgiven or forgotten during next year's planning cycle.

Once a company has created a more robust and longer-term planning process, it becomes much easier to address another common weak spot: the disconnect between planning and budgeting. In most companies, line managers do the planning and finance does the budgeting. And because budgeting usually happens after planning, it tends to get the last word. But a company should manage to plans and strategies, not to budgets. The annual budget should chart the near-term steps required to deliver the plan.

Redesign Incentives Around TSR

An all-important third leverage point is a company's incentive compensation system. A key principle here is to decouple a significant portion of executives' long-term compensation from negotiated plan or budget targets and link it directly to their actual contribution to TSR.

When managers know their compensation depends on plan performance, they tend to come up with modest near-term targets and unrealistically ambitious long-term goals. Since the system has no memory, they rarely suffer the consequences of setting unrealistic out-year goals and then failing to meet them.

The better approach is to define the relevant operational metrics that actually drive the business's contribution to TSR and then reward managers for their performance against these metrics. In some cases, a company can get where it needs to go by using existing financial metrics—operating income, say, or return on invested capital. But in many cases, it is necessary to introduce more formal value-management metrics—for example, cash flow return on investment, total business return, or cash value-added. Whatever set of metrics your company chooses, however, make sure to incorporate them also in supporting processes such as planning and budgeting, resource allocation, employee performance reviews, and investor communication.

By taking these three steps, executives can begin to embed an integrated value-creation strategy in their organization. What's more, they often find not only that they can take advantage of the full range of levers for generating TSR but also that they have developed a powerful language with which to raise the quality of the strategic debate about value creation—between the senior team and the company's board, between corporate and line management, and between the company and its investors. Building an integrated value-creation strategy is the best way to keep pace with the challenges—and the opportunities—of value creation in today's stock-market environment.

Ten Questions Every CEO Should Know How to Answer

In conclusion, we offer ten questions about value creation strategy that every CEO should know how to answer. The questions synthesize the basic arguments and recommendations made in this year's report in a concise format.

1. *Do you understand the historical sources of your company's TSR?* How has the way you create value evolved over time?

2. *What fundamental value will your current plans generate in the future?* Is that performance really defensible given the competitive dynamics of your industry? Is it enough to meet your TSR objectives?

3. *What are the current market expectations embedded in your stock price?* Is there a gap between what you can deliver and what your investors expect? If so, do you have a plan for closing it?

4. *What drives valuation multiples in your industry?* Why is your multiple at its current level relative to industry peers?

5. *What are the key tradeoffs for your company between improving fundamental value, optimizing your valuation multiple, and distributing free cash flow?* Do you have a plan for managing those tradeoffs?

6. *Who are the dominant investors in your company and what are their priorities?* Are your plans in sync with their investment goals? Do they find your value-creation strategy credible?

7. *What is an appropriate TSR target given your company's situation?* What is the appropriate tradeoff between risk and returns given your starting point, investor mix, capabilities, and opportunities? Is your target ambitious enough to focus and stretch your organization over the next three to five years?

8. *How will you close the gap between the TSR your current plans are likely to generate and the TSR targets that you have set?* What are the implications for your business strategy and financial strategy?

9. *What are the consequences of your company's value-creation strategy for line managers and their business units?* Do they know what they must deliver to achieve your TSR target? Have you translated that target into operational metrics and goals that they can actually influence? Are they genuinely accountable for reaching these targets?

10. *Are management processes such as planning and budgeting, resource allocation, and incentive compensation aligned with your value-creation strategy?* Do they surface the right tradeoffs for management discussion? Do they appropriately balance short-term and long-term priorities?

Appendix: The 2005 Value Creators Rankings

The 2005 Value Creators rankings are based on an analysis of total shareholder return at 613 global companies for the five-year period from 2000 through 2004.

To arrive at this sample, we began with TSR data for some 5,000 companies provided by Thomson Financial Worldscope. We eliminated all companies that were not listed on some world stock exchange for the full five years of our study or did not have at least 25 percent of their shares available on public capital markets. We also eliminated certain industries from our sample—for example, financial services.[11] We further refined the sample by organizing the remaining companies into 12 industry groups and establishing an appropriate market-valuation hurdle to eliminate the smallest companies in each industry. (The size of the market valuation hurdle for each individual industry can be found in the tables in "Industry Rankings," beginning on page 33.) Finally, we also applied one more filter to our sample to identify the best-performing large global companies: a market valuation hurdle of $25 billion. This gave us 119 large-cap companies. In "Global Rankings," on pages 29 to 32, we show the results for both our 613-company sample and this large-cap sample.

The global and industry rankings are based on five-year TSR performance from 2000 to 2004.[12] We also show TSR performance for 2005, through September 30. In addition, we break down TSR performance into key operational and financial metrics. First, for every company and industry, we calculate the growth (or decline) in fundamental value and in expectation premiums for the five-year period 2000 to 2004. Second, we break down TSR performance into the six investor-oriented financial metrics used in the BCG decomposition model described on page 14. Both analyses can be found in the rankings.

The average annual return for the 613 companies in our sample was a disappointing –4 percent. This negative return is largely a result of the fact that the starting point of our five-year period was the height of the late-1990s financial bubble and thus reflects the massive loss of value after the bubble burst and the expectation premiums of companies returned to more realistic levels.

What kind of improvement in TSR was necessary to achieve top-quartile status, given those market averages? The exhibit "Average Annual Total Shareholder Return by Quartile, 2000–2004" on page 29 arrays the 613 companies in our global sample according to their five-year TSR performance. In order to achieve top-quartile status, companies needed to post an average annual TSR of at least 13.8 percent. The very best performers had returns of 40 percent and higher.

However, poor TSR performance on average hides quite good performance in terms of improvement of fundamentals. The exhibit "Changes in Fundamental Value and Expectation Premiums, 2000–2004" on page 30 uses a discounted-cash-flow analysis to compare the trend in fundamental value and expectation premium for three groups: the 613 companies in our global sample, the 61 companies in the top-performing decile of this sample, and the top ten global performers. The sample as a whole improved its fundamental value by 7 percent per year; however, this improvement in fundamentals was counteracted by the major meltdown in expectations, which declined by 18 percent per year.

The top decile improved its fundamental value by 12 percent annually. What's more, these companies were able to reverse what in 1999 was a negative expectation premium of 8 percent (in other words, the market valued these companies at 8 percent less than one would expect from an analysis of their fundamental value) and turn it into a positive expectation premium of 22 percent in 2004. As a result, they achieved an average annual TSR of 29 percent.

11. We chose to exclude financial services because measuring value creation in the sector poses unique analytical problems that make it difficult to compare the performance of financial services companies with companies in other sectors. For BCG's view of value creation in financial services, see *Succeeding with Growth: Creating Value in Banking 2005,* BCG report, May 2005.

12. TSR is a dynamic ratio that includes price gains and dividend payments for a specific stock during a given period of time. To measure performance from 2000 through 2004, 1999 end-of-year data must be used as a starting point in order to capture the change from 1999 to 2000, which drives 2000 TSR. For this reason, all exhibits in the report showing 2000–2004 performance begin with a 1999 data point.

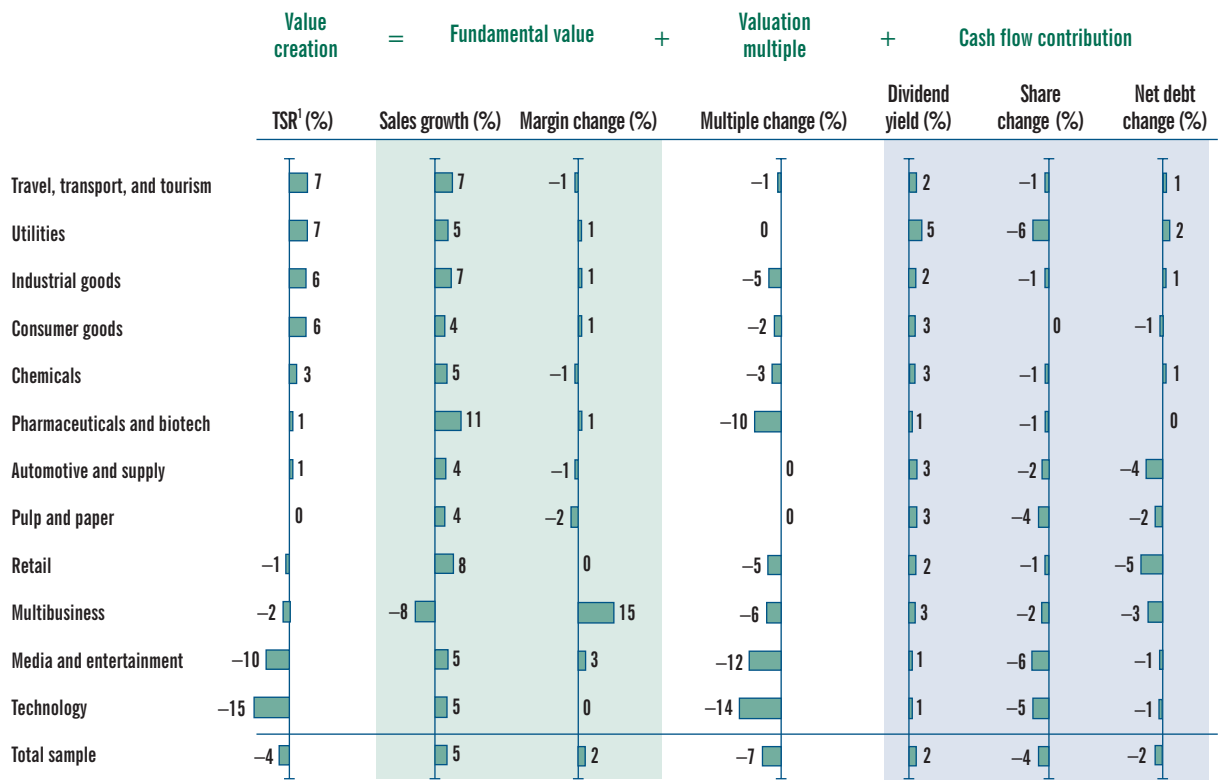
Finally, the top ten global performers were able to use a truly extraordinary growth in fundamental value (29 percent per year) to exceed investor expectations and rack up an astounding 90 percent improvement in expectation premiums. The average annual TSR of the top ten was 47 percent.

There were also interesting variations across the 12 industries in our sample. Exhibit 10, below, and Exhibit 11, on page 28, show the decomposition of TSR performance by industry for the sample as a whole and for the top ten companies in each industry, respectively. A few key trends stand out:

- Top-line growth is the major driver of value creation for many industries. For example, in all but two industries, sales growth was by far the most important contributor to TSR.
- Margins, by contrast, were relatively less important. With the exception of two negative-TSR sectors—multibusiness and media and entertainment—margin improvement was a negligible contributor to TSR.
- In some industries—for example, pharmaceuticals and biotech—returns from healthy growth were offset by massive declines in valuation multiples. Although sales growth was responsible for 11 percentage points of TSR in pharmaceuticals, changes in multiples were responsible for the loss of 10 percentage points, giving the industry a five-year average annual TSR of 1 percent.
- The top ten in most industries did a much better job of paying out cash than the average performers. In the automotive-and-supply sector, for example, these payouts contributed about 12 percentage points, on average, of total TSR.
- In general, the top performers successfully managed all three levers of value creation. Only two industries—retail and technology—failed to deliver positive returns in all three areas.

EXHIBIT 10

FOR THE BEST-PERFORMING INDUSTRIES, TOP-LINE GROWTH IS A MAJOR DRIVER OF VALUE



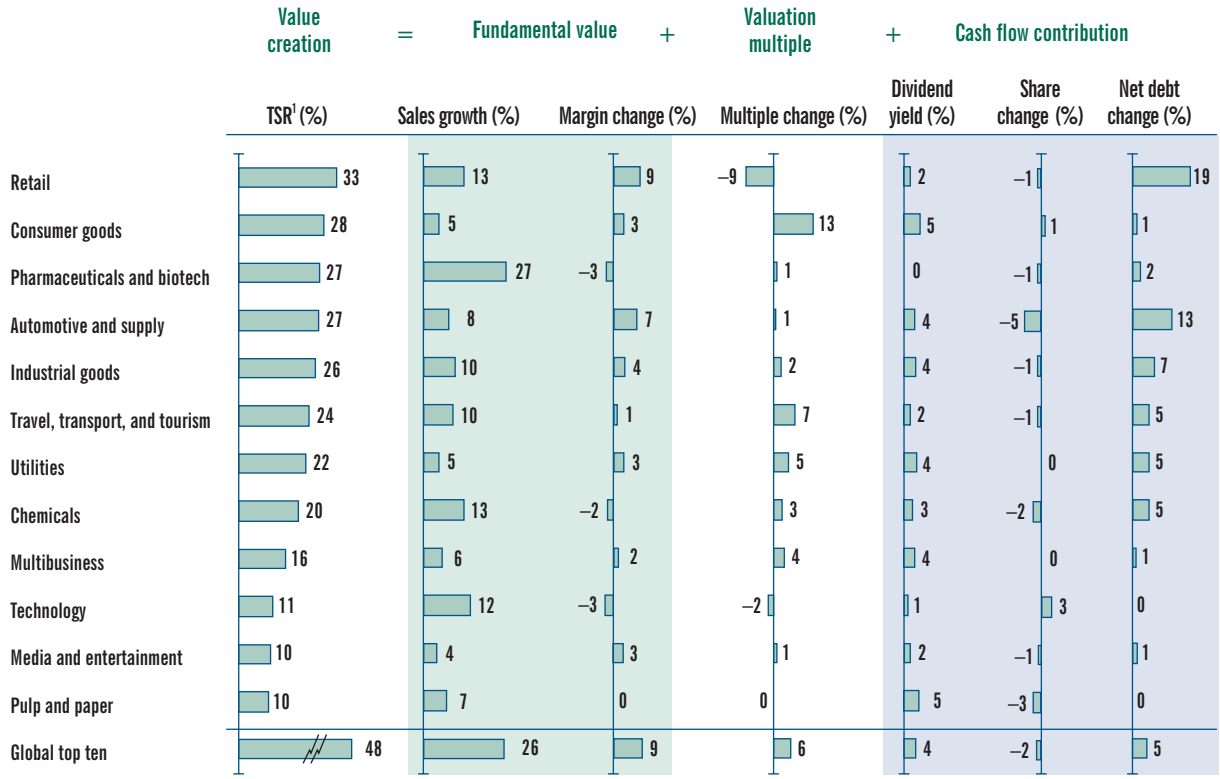
SOURCES: Thomson Financial Worldscope; Thomson Financial Datastream; Bloomberg; annual reports; BCG analysis.

NOTE: Decomposition shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[1]Five-year average annual TSR (2000–2004) for weighted average of respective sample.

EXHIBIT 11

THE TOP INDUSTRY PERFORMERS SUCCESSFULLY MANAGE ALL THREE LEVERS OF VALUE CREATION



Sources: Thomson Financial Worldscope; Thomson Financial Datastream; Bloomberg; annual reports; BCG analysis.

Note: Decomposition shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[1]Five-year average annual TSR (2000–2004) for weighted average of top ten companies.

Global Rankings

Total Industry

THE GLOBAL TOP TEN, 2000–2004

							TSR Decomposition[1]						
#	Company	Country	Industry	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	HYUNDAI MOBIS	SOUTH KOREA	AUTOMOTIVE	69.7	5.411	13	35	24	–15	13	–2	15	30.2
2	HARMAN INTL. IND.	UNITED STATES	CONSUMER GOODS	55.7	8.506	62	15	8	24	0	2	7	–34.7
3	NOK	JAPAN	AUTOMOTIVE	55.3	5.424	47	10	13	18	2	0	14	2.5
4	DR HORTON	UNITED STATES	INDUSTRIAL GOODS	52.9	9.414	14	30	11	4	2	–6	12	13.9
5	VALE DO RIO DOCE	BRAZIL	INDUSTRIAL GOODS	48.5	36.643	26	33	2	1	9	0	4	28.1
6	ESPRIT HOLDINGS	HONG KONG	RETAIL	44.5	7.242	30	24	8	8	4	–1	1	26.2
7	PETSMART	UNITED STATES	RETAIL	44.1	5.184	39	8	20	15	0	–4	4	–36.4
8	VARIAN MEDICAL SYSTEMS	UNITED STATES	PHARMACEUTICALS	42.1	5.795	49	18	9	15	0	–2	2	–7.3
9	ENTERPRISE INNS	UNITED KINGDOM	RETAIL	41.0	5.335	25	41	5	4	3	–8	–4	5.5
10	ST. JUDE MEDICAL	UNITED STATES	PHARMACEUTICALS	40.5	14.992	59	17	2	19	0	–1	5	8.4

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 613 global companies.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

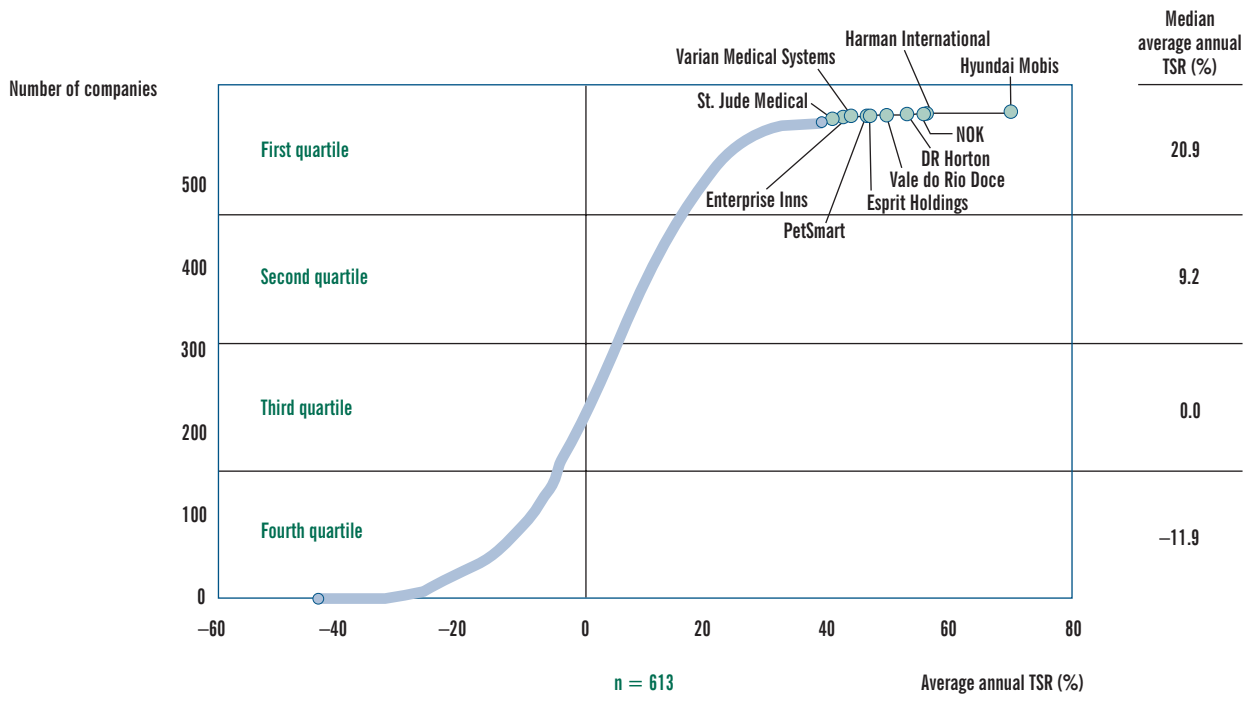
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

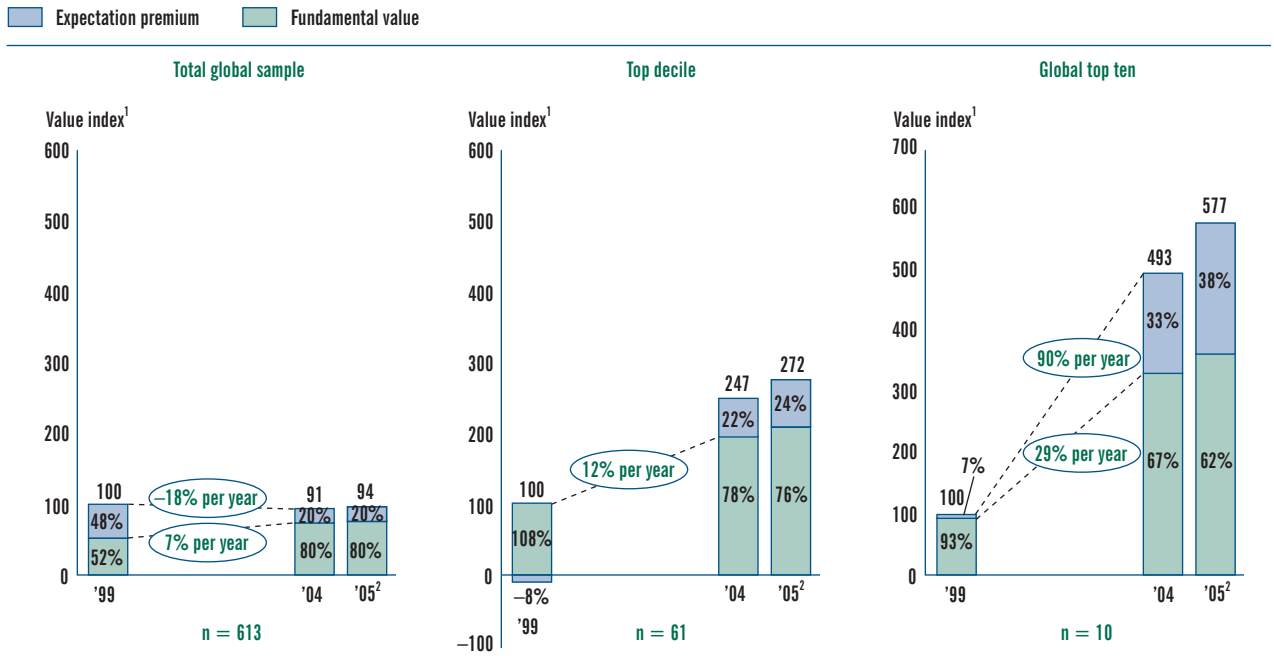
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data; values shown for top ten companies only.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

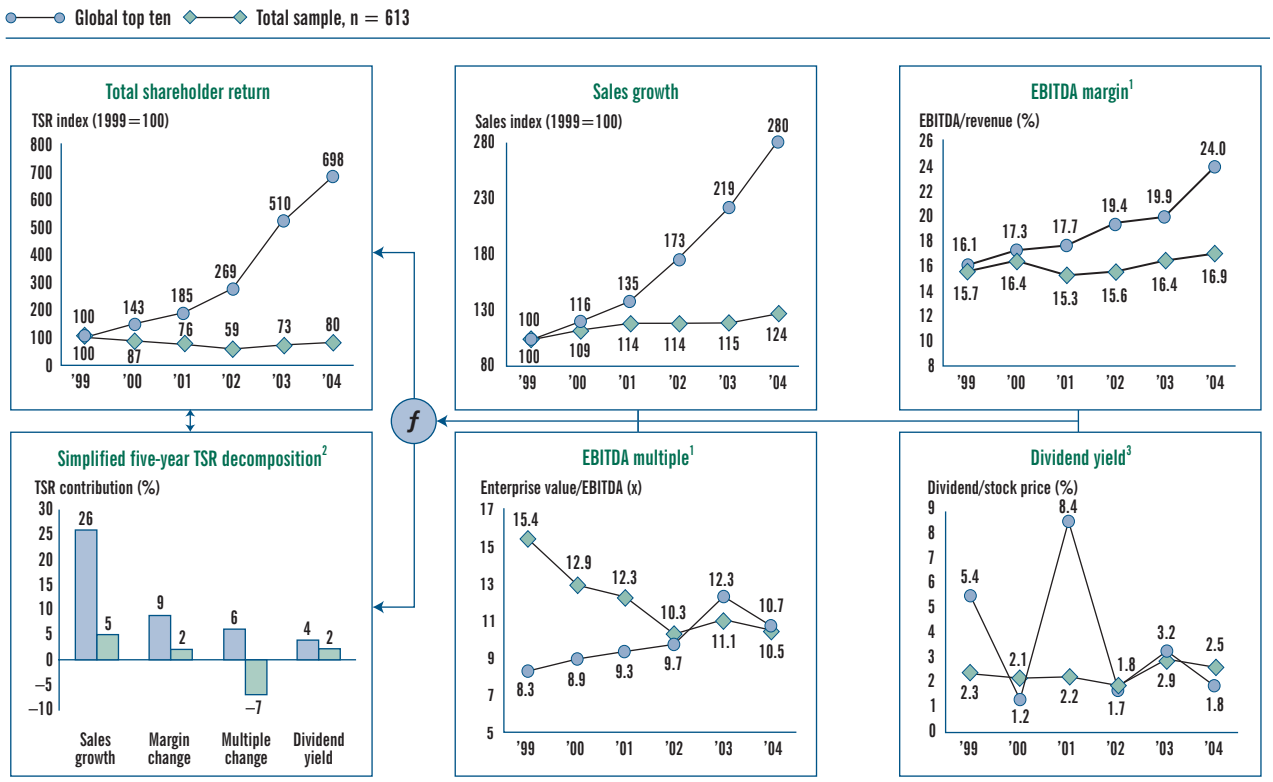


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS GLOBAL SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

THE LARGE-CAP TOP TEN, 2000–2004

							TSR Decomposition[1]						
#	Company	Country	Industry	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	VALE DO RIO DOCE	BRAZIL	INDUSTRIAL GOODS	48.5	36.643	26	33	2	1	9	0	4	28.1
2	EBAY	UNITED STATES	RETAIL	30.0	77.123	90	57	27	–48	0	–6	0	–36.9
3	BRIT. AMERICAN TOBACCO	UNITED KINGDOM	CONSUMER GOODS	29.0	34.111	6	4	4	6	9	3	3	20.0
4	ALTRIA GROUP	UNITED STATES	CONSUMER GOODS	28.7	125.413	20	1	3	15	8	3	0	11.1
5	BOSTON SCIENTIFIC	UNITED STATES	PHARMACEUTICALS	26.6	30.021	27	16	4	6	0	0	2	–34.8
6	EXELON	UNITED STATES	UTILITIES	24.3	29.129	1	21	3	4	4	–15	8	25.6
7	NISSAN MOTOR	JAPAN	AUTOMOTIVE	24.3	44.903	9	2	13	–4	2	–7	18	12.1
8	CATERPILLAR	UNITED STATES	INDUSTRIAL GOODS	19.0	33.440	34	9	2	2	3	1	2	18.7
9	TESCO	UNITED KINGDOM	RETAIL	14.4	44.085	28	12	1	2	3	–3	–1	–0.9
10	LOWE'S	UNITED STATES	RETAIL	14.3	44.503	39	18	8	–10	0	–1	0	9.9

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 119 global companies with a market valuation greater than $25 billion.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

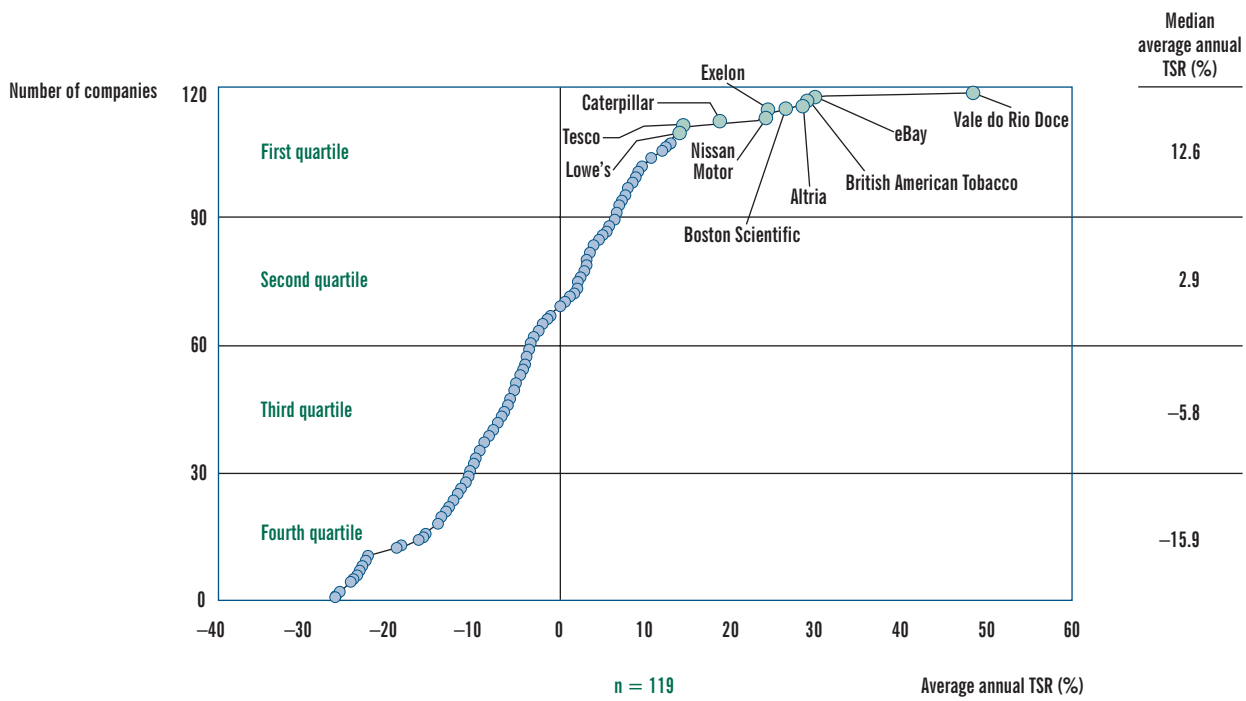
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

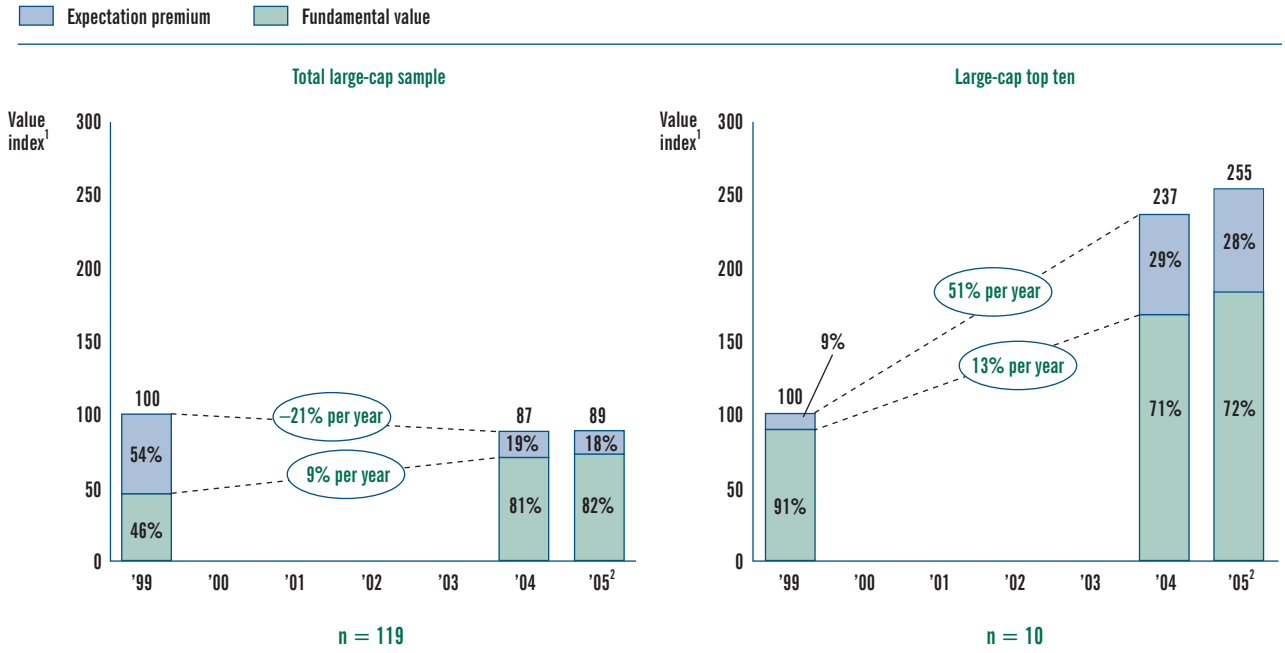
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

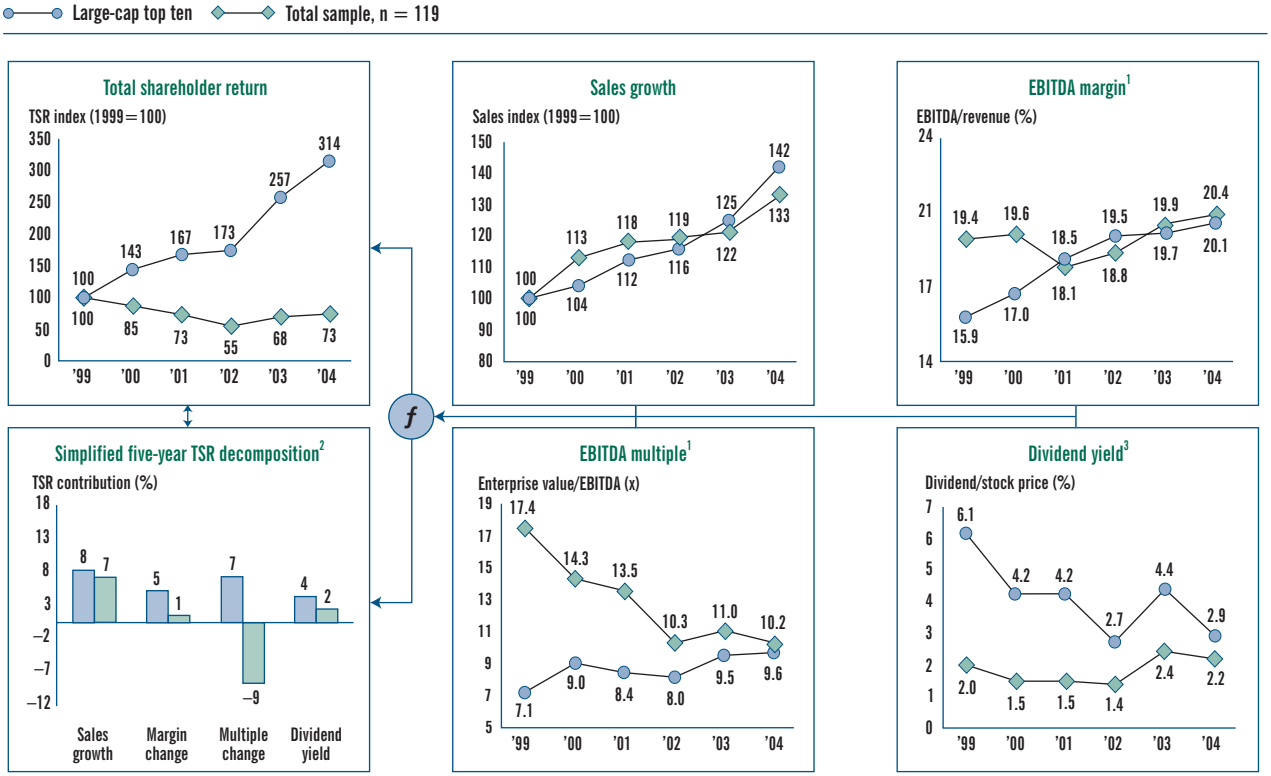


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS GLOBAL SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

Industry Rankings

Automotive and Supply

THE AUTOMOTIVE TOP TEN, 2000–2004

						TSR Decomposition[1]						
#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	HYUNDAI MOBIS	SOUTH KOREA	69.7	5.411	13	35	24	–15	13	–2	15	30.2
2	NOK	JAPAN	55.3	5.424	47	10	13	18	2	0	14	2.5
3	PACCAR	UNITED STATES	37.3	13.981	17	5	6	11	5	0	10	–13.1
4	STANLEY ELECTRIC	JAPAN	30.0	3.226	25	10	12	0	1	1	7	2.9
5	HYUNDAI MOTOR	SOUTH KOREA	29.6	11.775	–11	17	–1	5	6	–2	4	48.3
6	JSR	JAPAN	29.6	4.763	32	6	11	6	1	0	6	6.4
7	NISSAN MOTOR	JAPAN	24.3	44.903	9	2	13	–4	2	–7	18	12.1
8	BORGWARNER	UNITED STATES	23.3	3.043	19	8	–3	7	2	–1	12	1.6
9	CONTINENTAL	GERMANY	21.0	7.641	2	7	4	0	3	–3	9	46.0
10	TATA MOTORS	INDIA	20.7	4.204	38	19	14	–15	2	–7	7	6.3

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 47 companies with a market valuation greater than $3 billion.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

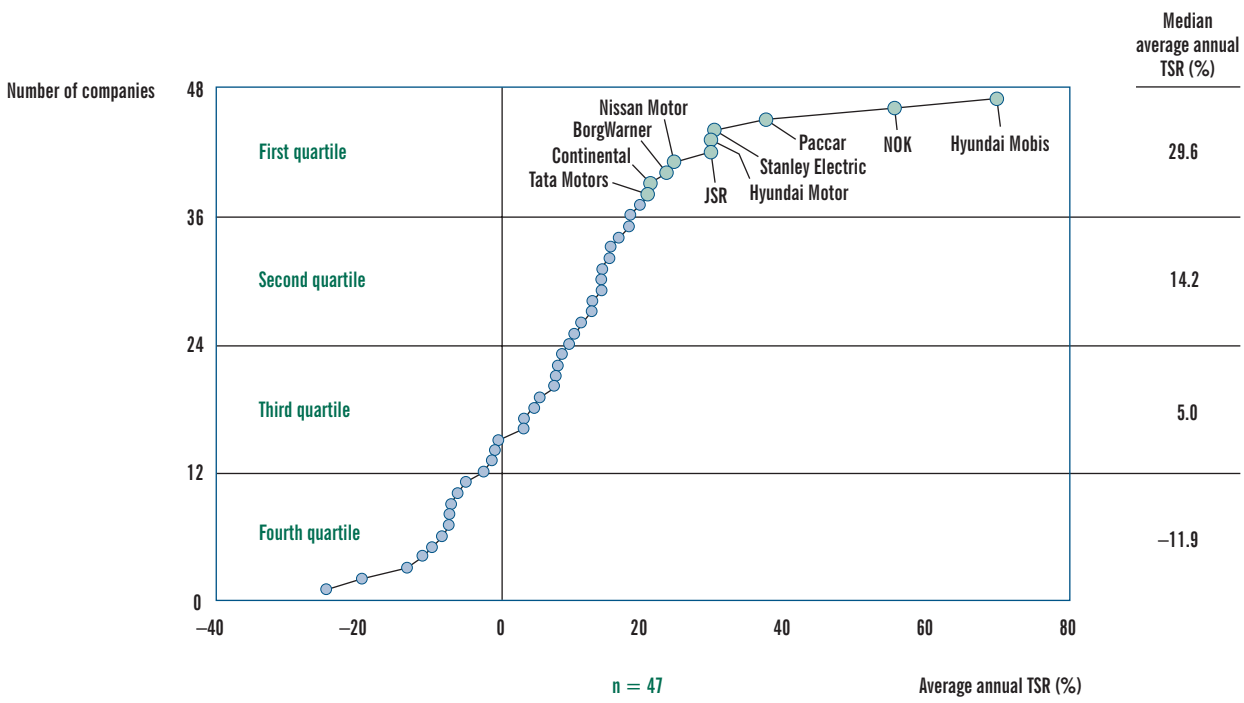
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

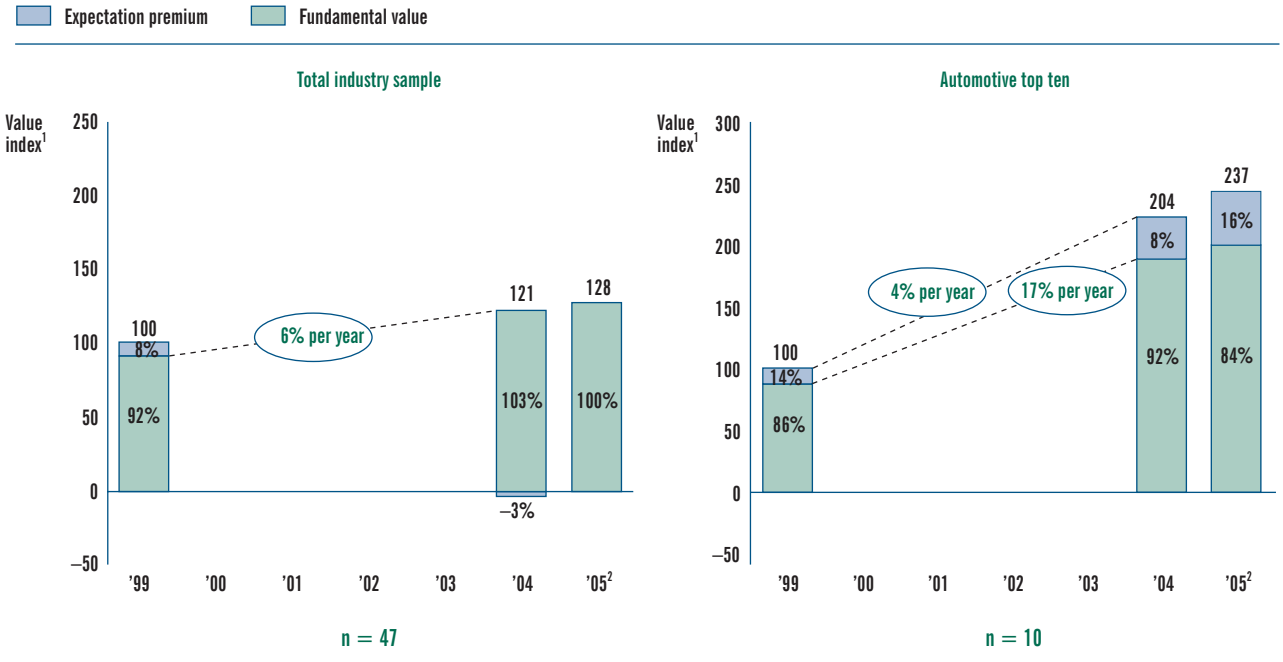
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

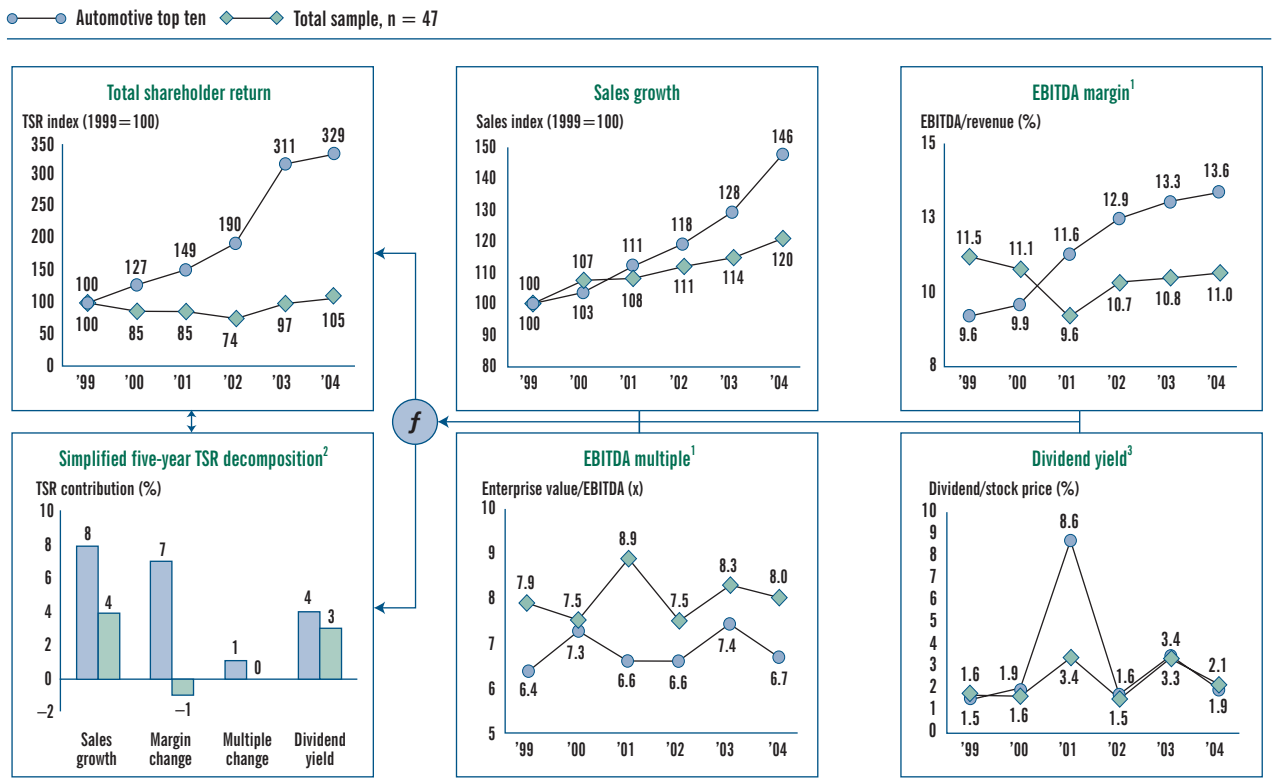


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

THE CHEMICAL TOP TEN, 2000–2004

						TSR Decomposition[1]						
#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	POTASH CORP OF SASKATCHEWAN	CANADA	25.6	9.167	25	9	1	11	2	–1	4	15.9
2	ORICA	AUSTRALIA	25.3	4.366	27	3	6	8	6	0	3	3.3
3	LYONDELL CHEMICAL	UNITED STATES	25.1	6.986	12	9	–21	26	7	–15	19	–3.7
4	FORMOSA CHEM. & FIBRE	TAIWAN	20.4	9.309	23	24	13	–23	4	–1	5	–1.9
5	RELIANCE INDUSTRIES	INDIA	19.6	17.147	31	34	–6	–5	2	–8	4	47.9
6	PACTIV	UNITED STATES	18.9	3.754	27	2	3	1	0	3	11	–31.2
7	NOVA CHEMICALS	CANADA	16.3	3.988	–18	12	–10	3	1	2	8	–30.3
8	SIGMA-ALDRICH	UNITED STATES	16.1	4.174	38	6	2	0	1	8	0	0.7
9	AIR PRODUCTS & CHEMICALS	UNITED STATES	13.8	13.177	29	8	–3	4	2	–1	4	–2.7
10	BEMIS COMPANY	UNITED STATES	13.6	3.111	30	8	–2	4	3	–1	1	–13.5

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 43 companies with a market valuation greater than $3 billion.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

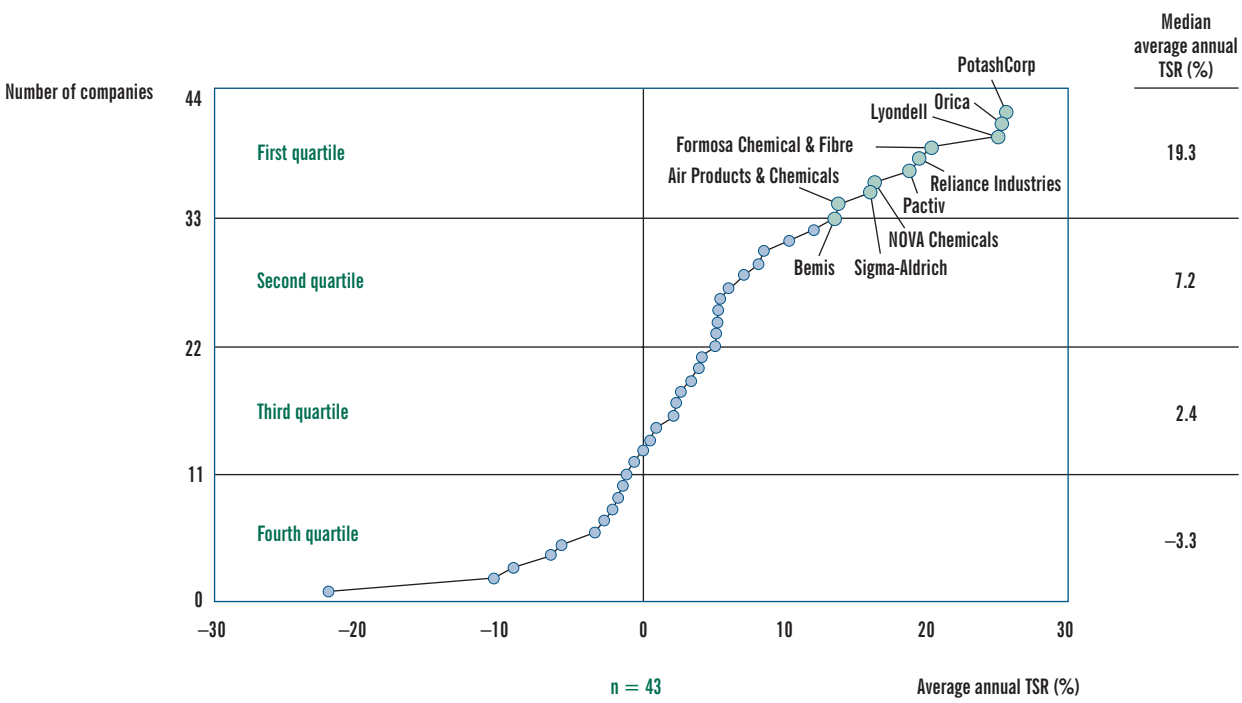
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

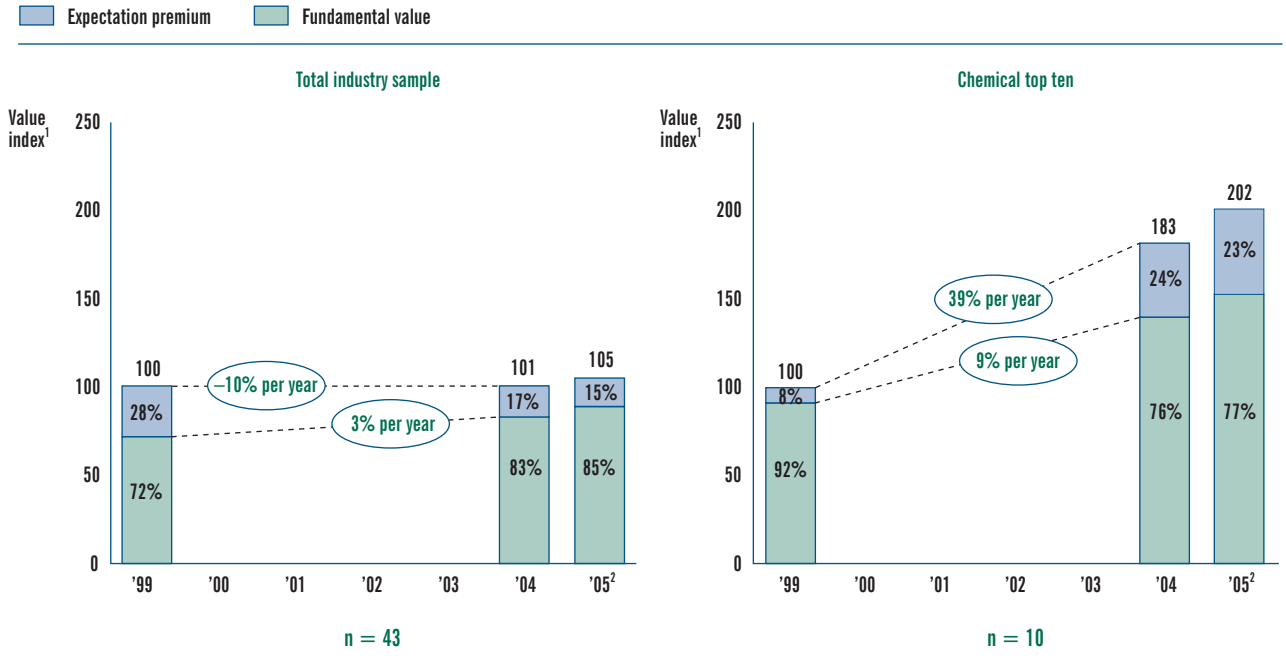
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

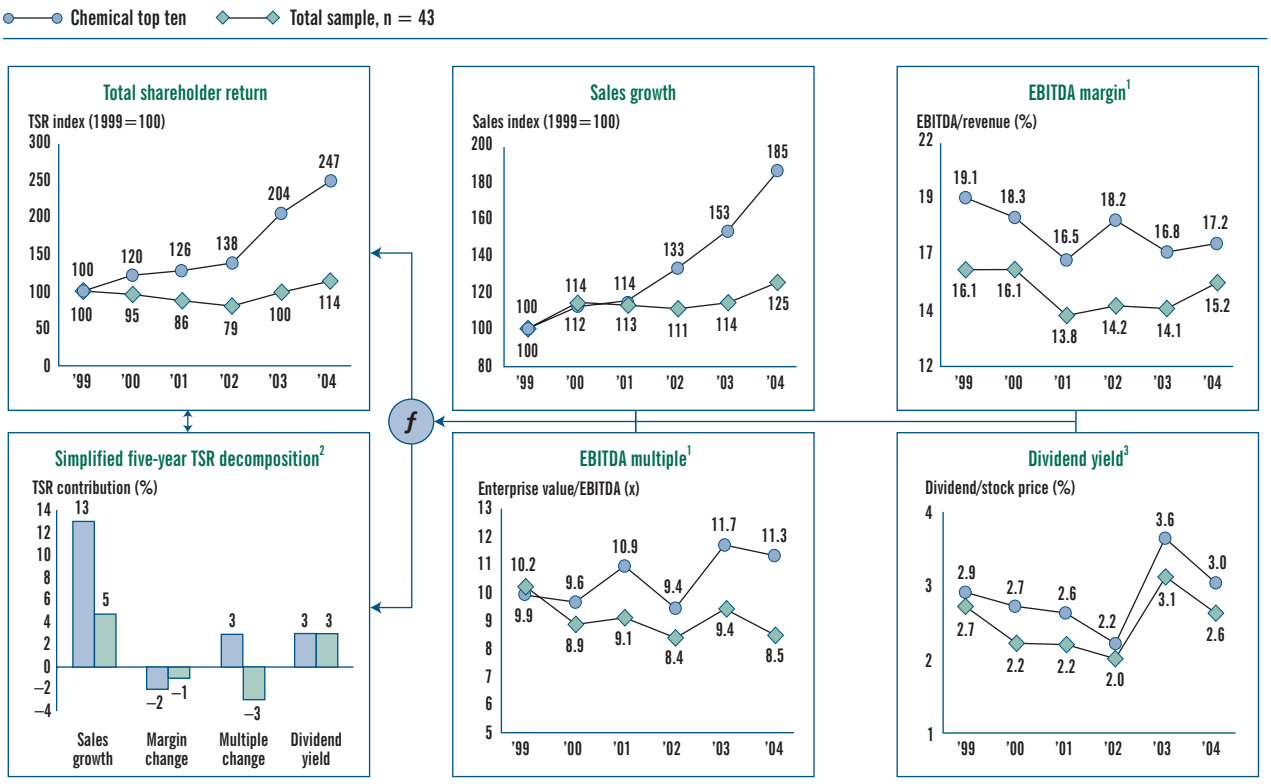


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

THE CONSUMER GOODS TOP TEN, 2000–2004

						TSR Decomposition[1]						
#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	HARMAN INTERNATIONAL	UNITED STATES	55.7	8.506	62	15	8	24	0	2	7	–34.7
2	GALLAHER	UNITED KINGDOM	32.6	9.209	26	21	–10	14	8	0	0	10.2
3	IMPERIAL TOBACCO	UNITED KINGDOM	32.4	18.483	20	21	–1	6	5	–3	4	7.0
4	BRIT. AMERICAN TOBACCO	UNITED KINGDOM	29.0	34.111	6	4	4	6	9	3	3	20.0
5	ALTRIA	UNITED STATES	28.7	125.413	20	1	3	15	8	3	0	11.1
6	RECKITT BENCKISER	UNITED KINGDOM	25.6	19.380	45	6	10	5	4	–3	4	7.9
7	PERNOD-RICARD	FRANCE	24.0	9.587	26	0	16	3	4	1	1	12.4
8	ALTADIS	SPAIN	22.2	11.519	23	21	5	–6	3	1	–2	–0.1
9	ASSOCIATED BRITISH FOODS	UNITED KINGDOM	21.6	10.975	15	4	2	11	4	0	1	2.6
10	FORTUNE BRANDS	UNITED STATES	21.4	11.126	31	7	4	3	3	3	2	13.0

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 55 companies with a market valuation greater than $7.5 billion.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

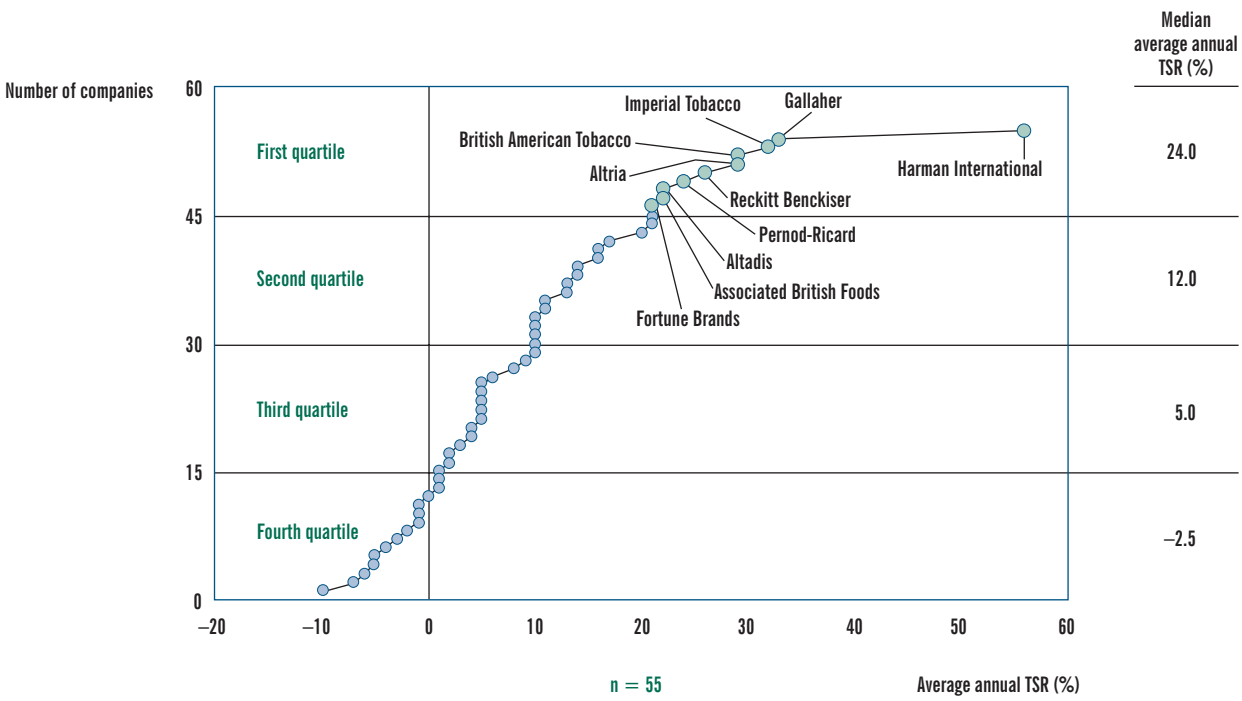
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

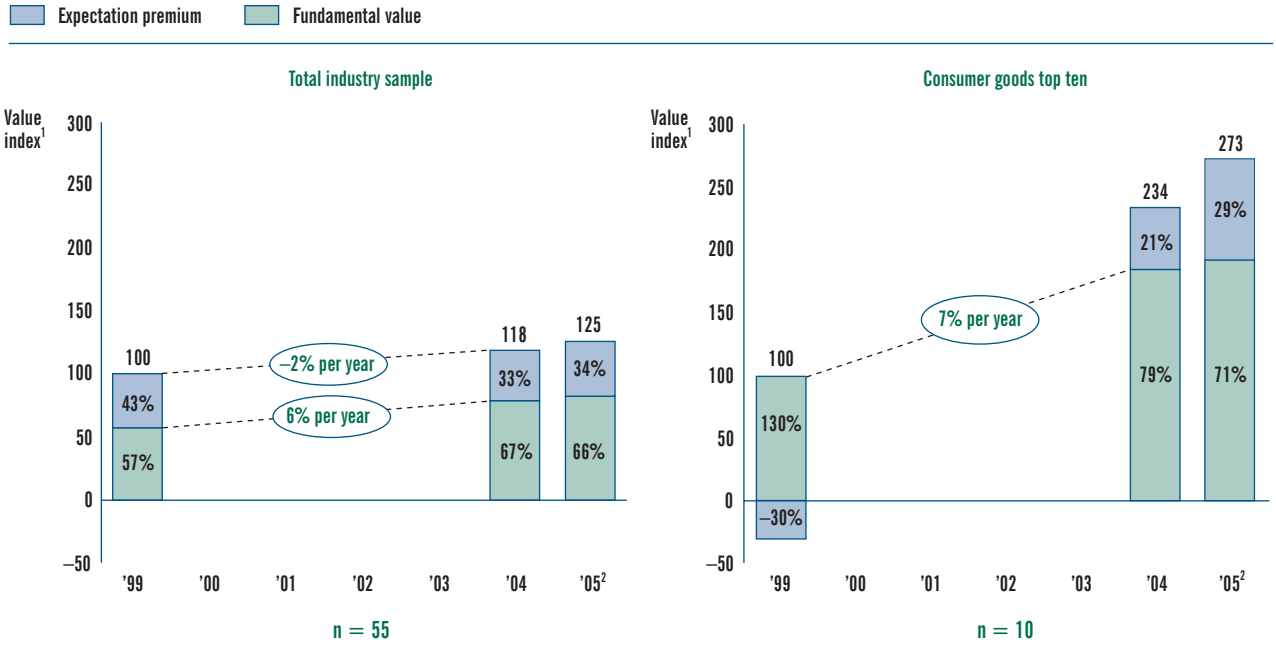
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

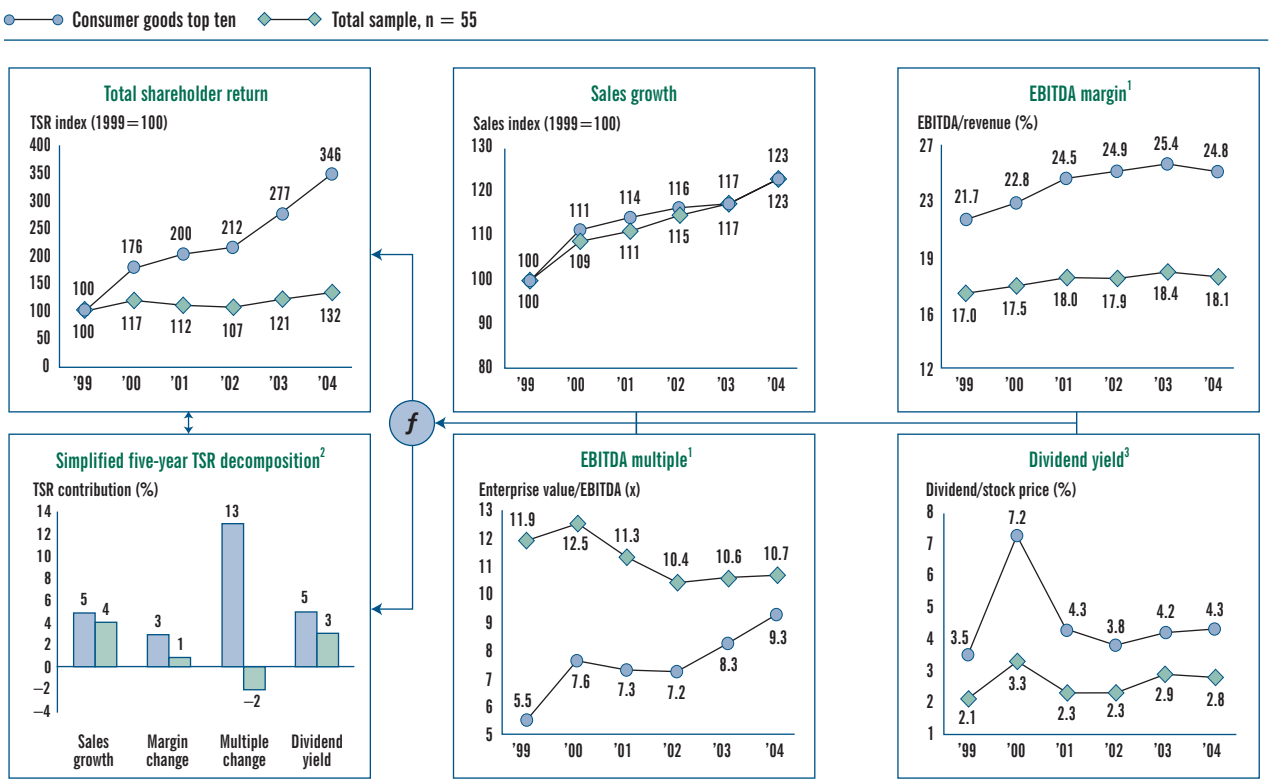


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

THE INDUSTRIAL GOODS TOP TEN, 2000–2004

						TSR Decomposition[1]						
#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	DR HORTON	UNITED STATES	52.9	9.414	14	30	11	4	2	–6	12	13.9
2	VALE DO RIO DOCE	BRAZIL	48.5	36.643	26	33	2	1	9	0	4	28.1
3	SIAM CEMENT	THAILAND	29.3	7.537	20	14	0	–5	3	0	18	1.1
4	ROCKWELL AUTOMATION	UNITED STATES	25.6	9.126	29	–9	–2	30	3	1	3	6.6
5	LOCKHEED MARTIN	UNITED STATES	22.1	24.591	38	7	–6	7	2	–2	15	10.3
6	AMERICAN STANDARD	UNITED STATES	22.0	8.864	24	6	0	6	0	0	10	9.3
7	VINCI	FRANCE	21.6	9.978	12	16	19	1	5	–16	–3	47.7
8	EATON	UNITED STATES	20.7	10.991	34	4	–1	9	3	–1	7	–12.2
9	CHINA STEEL	TAIWAN	19.7	10.716	–11	16	6	–12	8	0	3	–14.5
10	CATERPILLAR	UNITED STATES	19.0	33.440	34	9	2	2	3	1	2	18.7

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 59 companies with a market valuation greater than $7.5 billion.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

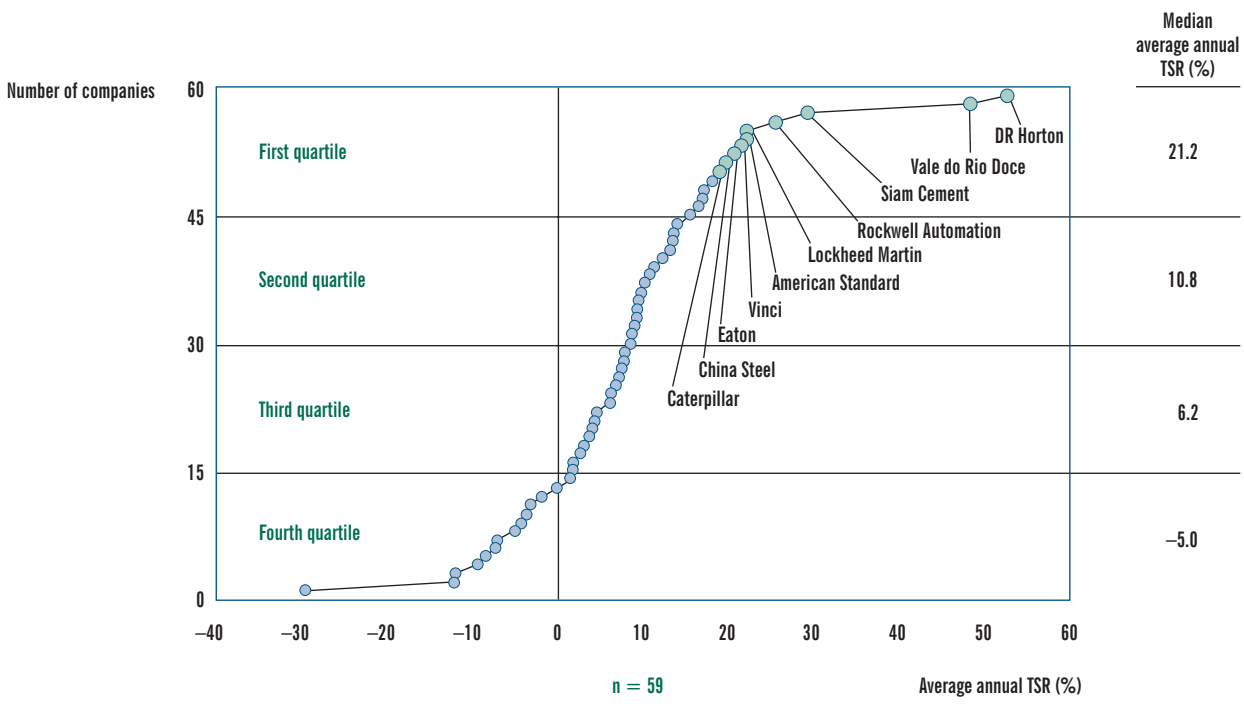
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

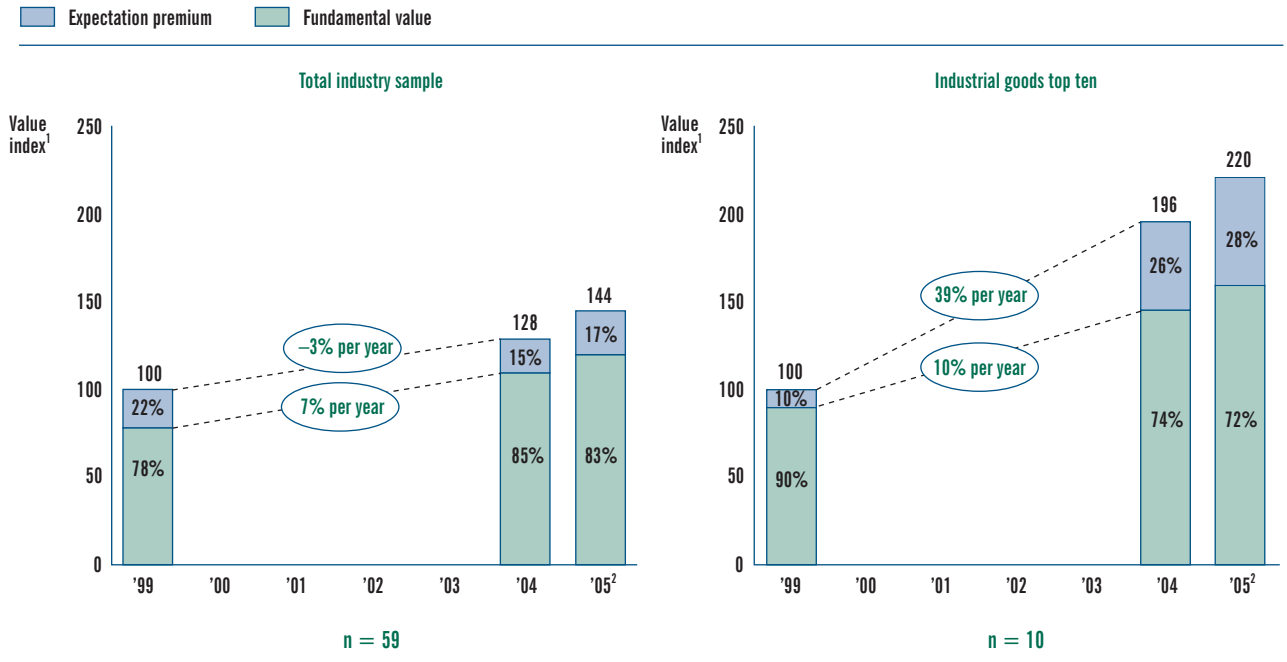
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

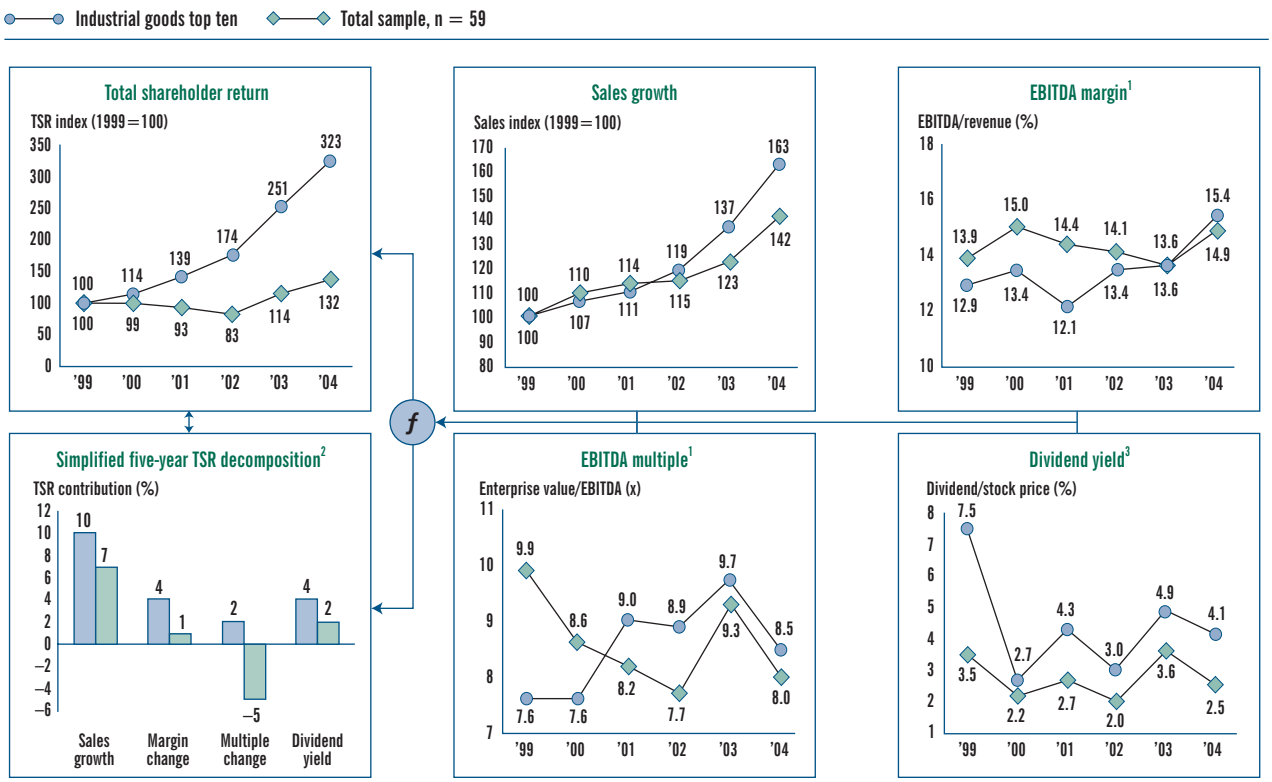


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

THE MEDIA AND ENTERTAINMENT TOP TEN, 2000–2004

						TSR Decomposition[1]						
#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	ELECTRONIC ARTS	UNITED STATES	24.0	18.833	22	19	13	–6	0	–4	2	–5.2
2	EW SCRIPPS	UNITED STATES	17.6	6.099	41	7	–1	9	1	–1	3	2.5
3	WASHINGTON POST	UNITED STATES	13.1	7.714	36	8	–2	4	1	0	2	–17.8
4	RR DONNELLEY	UNITED STATES	11.4	7.750	21	6	–3	13	4	–12	4	4.7
5	PUBLISHING & BROADCASTING	AUSTRALIA	10.8	8.768	36	18	2	–13	2	0	2	–3.1
6	MCGRAW-HILL	UNITED STATES	10.0	17.383	43	6	4	–4	2	1	2	1.9
7	THOMSON	CANADA	4.8	23.113	33	5	2	–2	2	–1	–1	7.0
8	KNIGHT RIDDER	UNITED STATES	4.2	5.155	29	0	–3	5	2	1	0	–10.7
9	TOPPAN PRINTING	JAPAN	3.8	7.761	–20	1	–1	0	2	2	0	4.1
10	LAGARDÈRE	FRANCE	2.1	9.020	–9	2	6	–5	3	–2	–2	12.9

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 40 companies with a market valuation greater than $5 billion.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

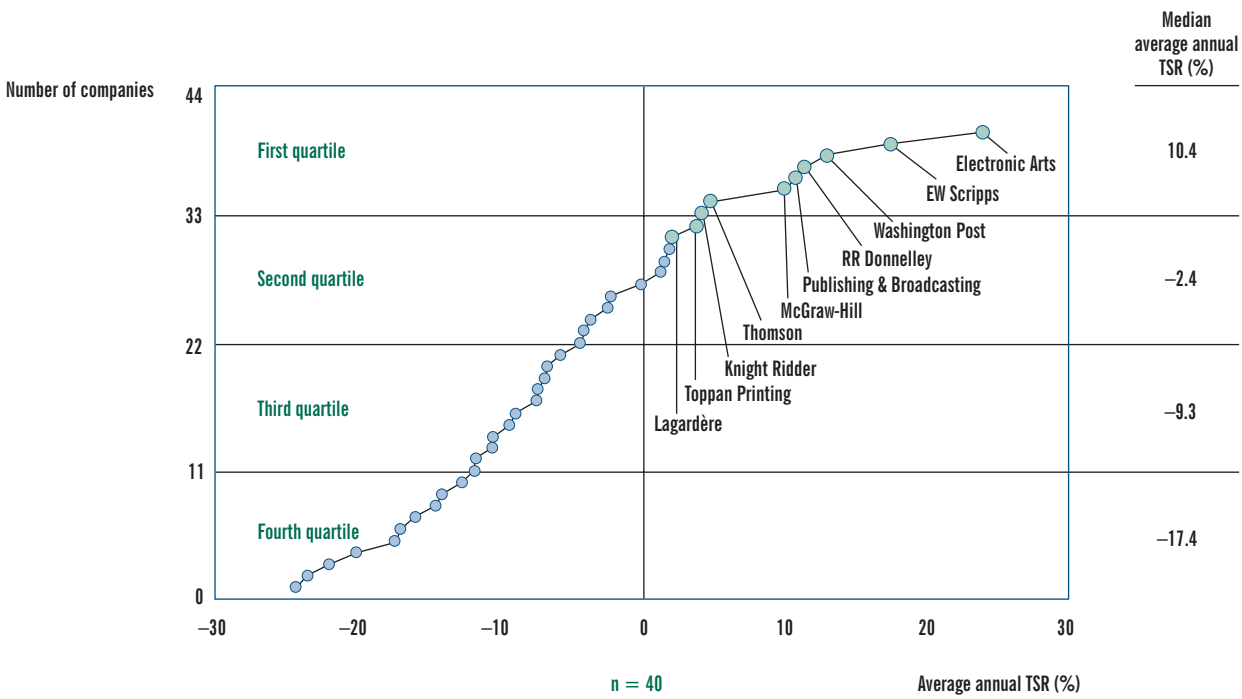
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

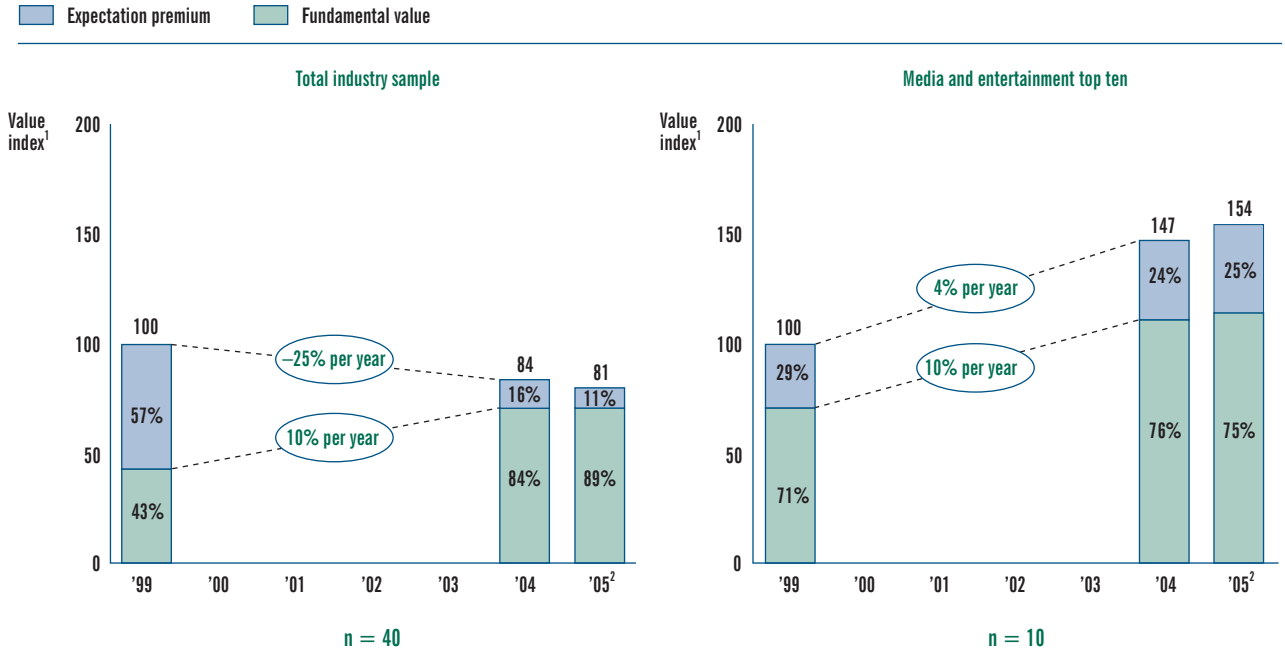
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

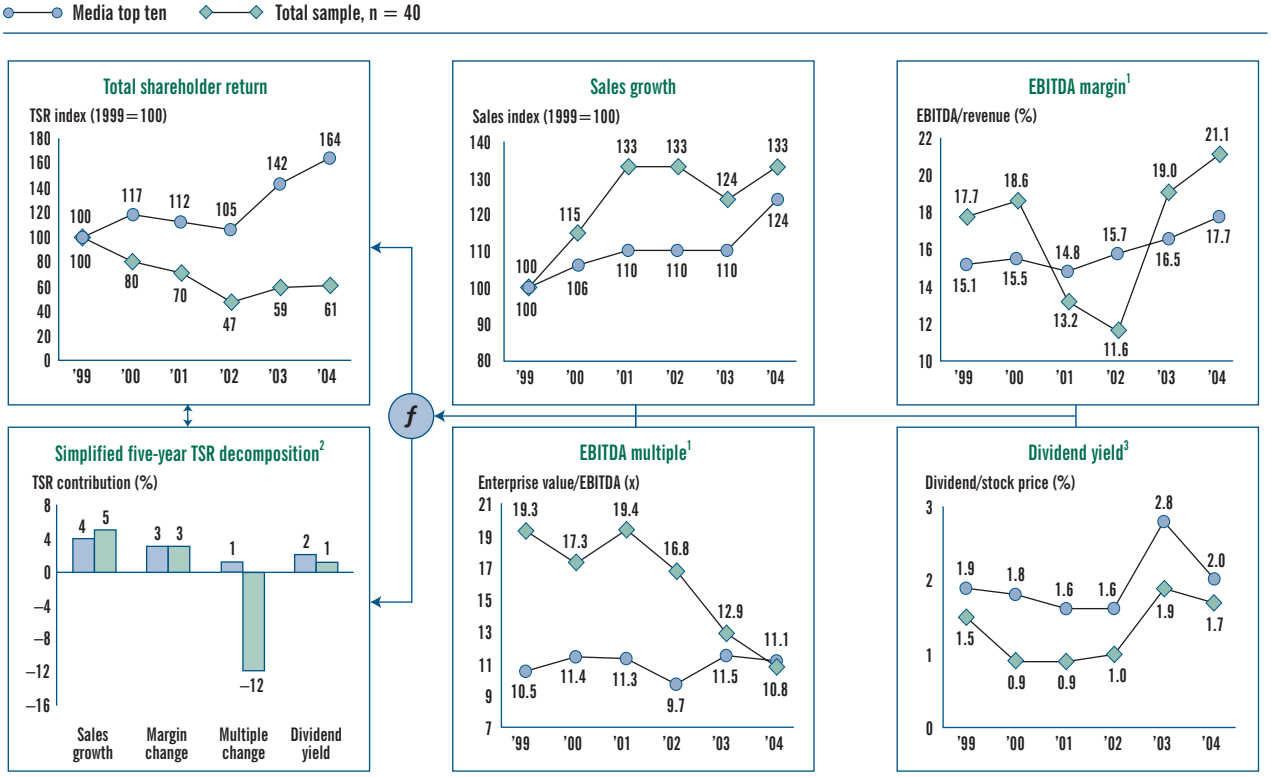


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

THE MULTIBUSINESS TOP TEN, 2000–2004

						TSR Decomposition[1]						
#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	WESFARMERS	AUSTRALIA	31.3	11.403	30	21	9	2	6	–7	1	0.5
2	KEPPEL	SINGAPORE	24.0	3.974	22	–1	–7	42	5	0	–15	51.7
3	BARLOWORLD	SOUTH AFRICA	24.0	3.716	26	14	3	0	5	3	–1	6.4
4	ITT INDUSTRIES	UNITED STATES	21.9	7.796	42	8	0	10	2	–1	3	30.9
5	DANAHER	UNITED STATES	19.1	17.718	50	17	0	4	0	–2	–1	–9.8
6	ITC	INDIA	16.0	7.406	40	14	3	–4	2	0	1	49.9
7	3M	UNITED STATES	13.2	63.894	41	5	3	1	2	1	1	–10.4
8	WHARF HOLDINGS	HONG KONG	13.0	8.580	–4	3	–1	1	4	0	5	14.6
9	IMPERIAL HOLDINGS	SOUTH AFRICA	12.9	3.580	29	27	–7	–9	3	0	–1	29.2
10	TOMKINS	UNITED KINGDOM	12.1	3.489	17	–12	0	10	7	4	3	11.9

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 34 companies with a market valuation greater than $3 billion.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

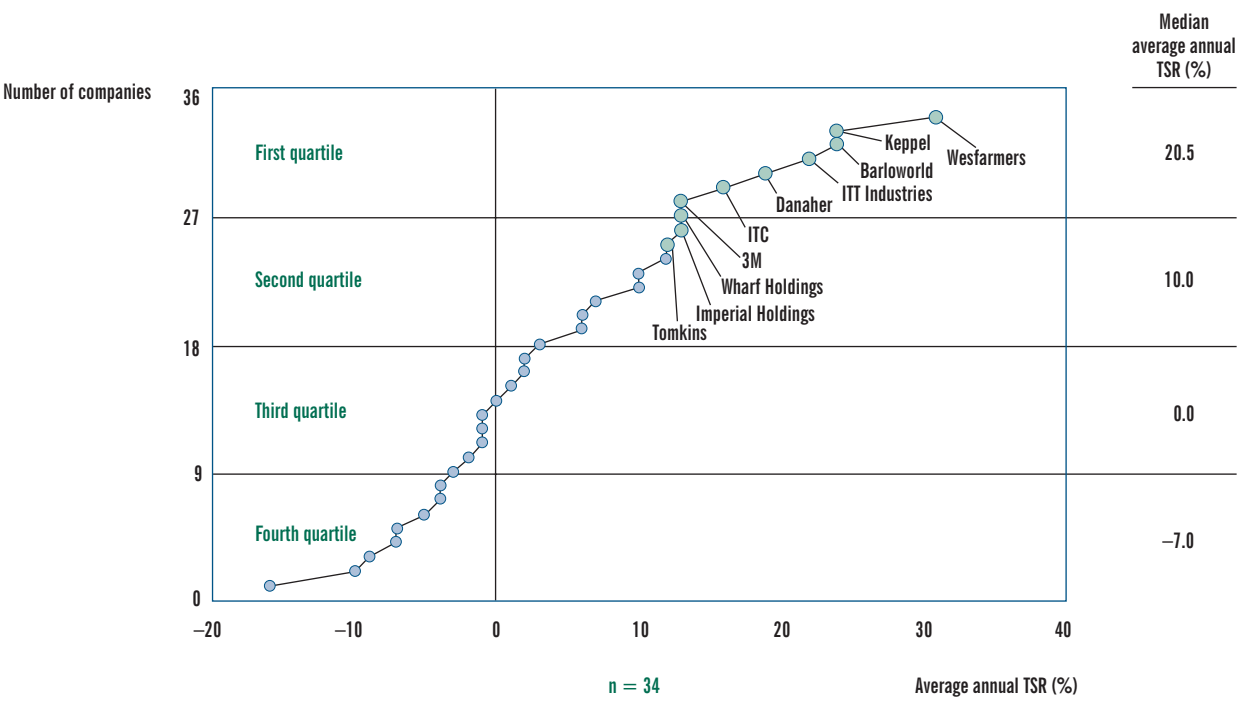
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

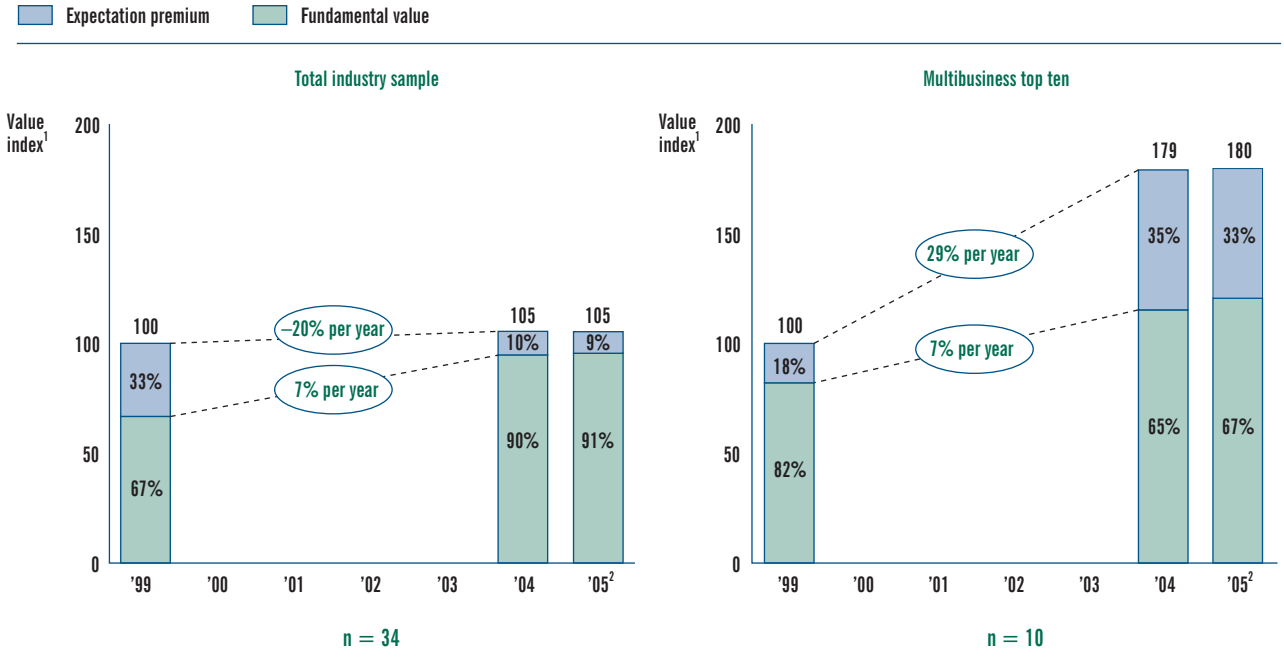
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

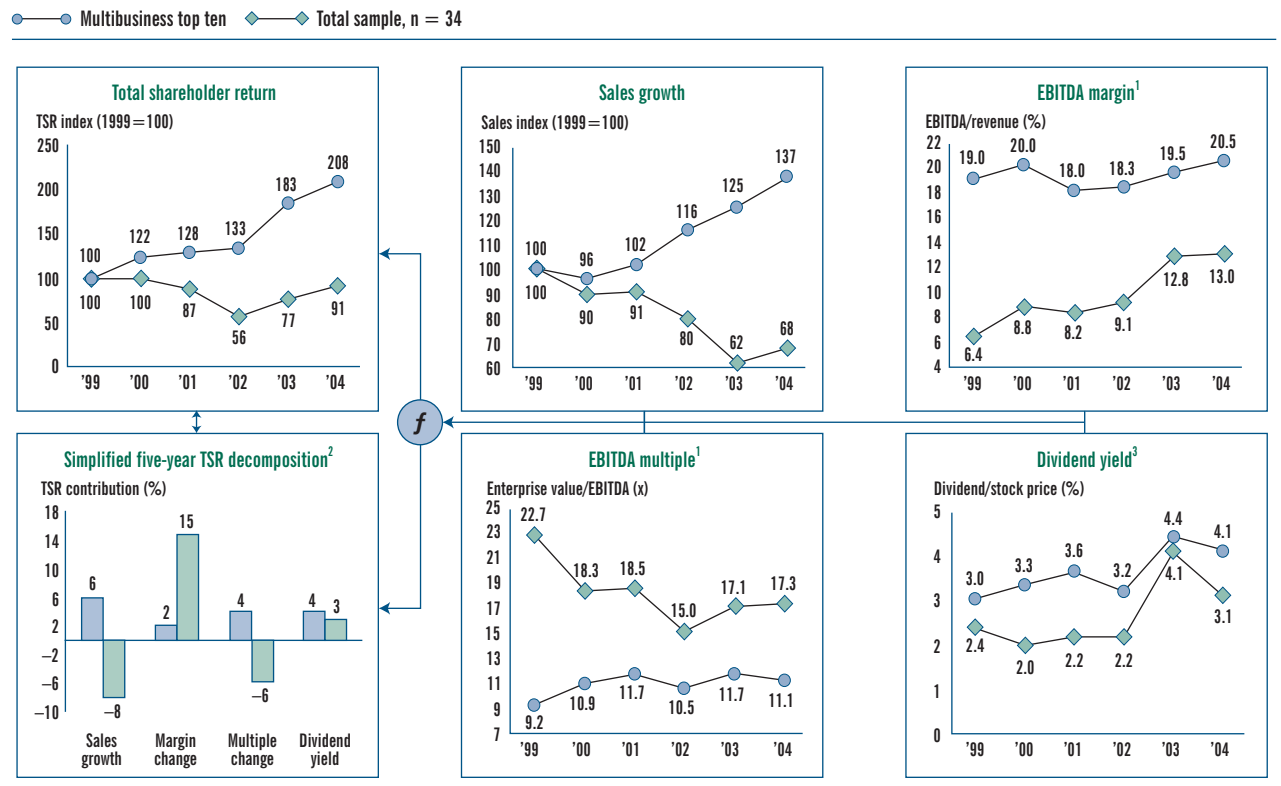


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

THE PHARMACEUTICAL AND BIOTECH TOP TEN, 2000–2004

						TSR Decomposition[1]						
#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	VARIAN MEDICAL SYSTEMS	UNITED STATES	42.1	5.795	49	18	9	15	0	–2	2	–7.3
2	ST. JUDE MEDICAL	UNITED STATES	40.5	14.992	59	17	2	19	0	–1	5	8.4
3	LABORATORY CORP	UNITED STATES	40.1	6.892	11	13	12	9	0	–20	26	–4.2
4	GILEAD SCIENCES	UNITED STATES	38.9	15.148	36	44	0	0	0	–5	1	28.6
5	PATTERSON	UNITED STATES	32.4	5.953	37	19	7	8	0	0	–2	–9.3
6	AMERISOURCEBERGEN	UNITED STATES	31.2	6.168	–12	38	–6	6	0	–15	8	33.1
7	BOSTON SCIENTIFIC	UNITED STATES	26.6	30.021	27	16	4	6	0	0	2	–34.8
8	FOREST LABORATORIES	UNITED STATES	23.9	16.527	18	33	26	–34	0	–2	1	–6.6
9	STRYKER	UNITED STATES	22.8	19.398	40	16	8	–4	0	–1	4	4.9
10	SMITH & NEPHEW	UNITED KINGDOM	21.7	8.854	41	7	4	6	2	4	–1	–7.9

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 60 companies with a market valuation greater than $5 billion.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

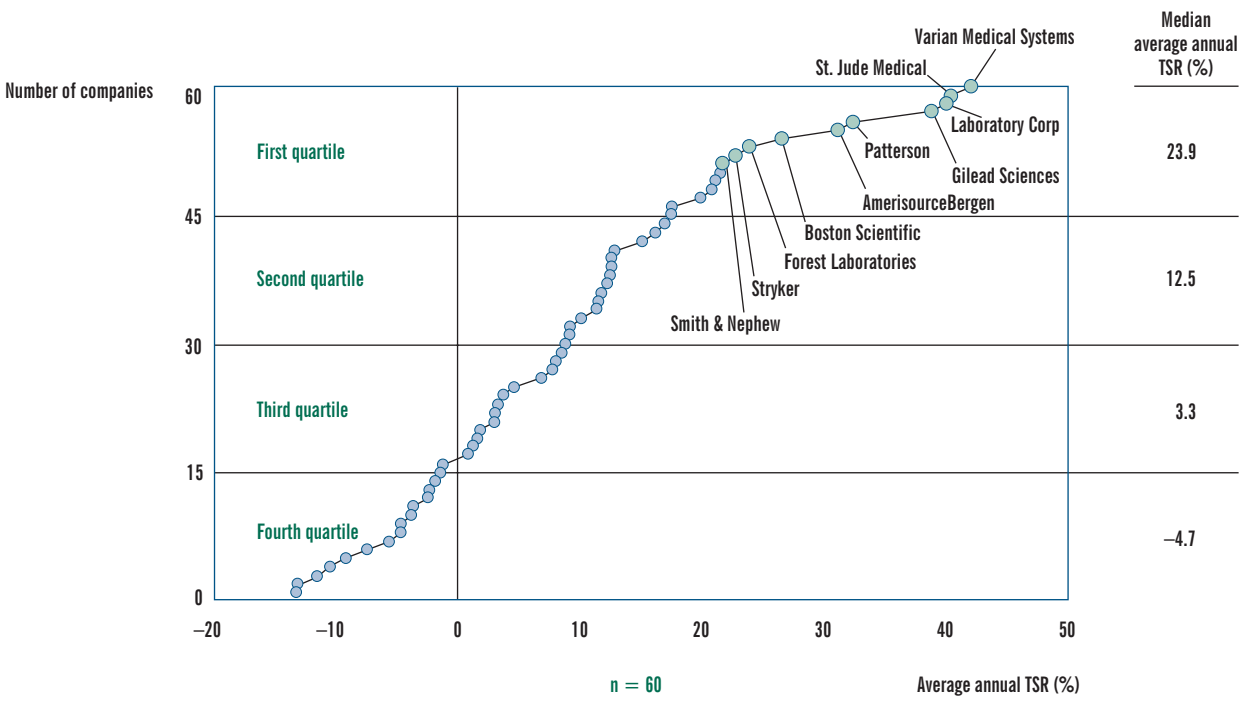
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

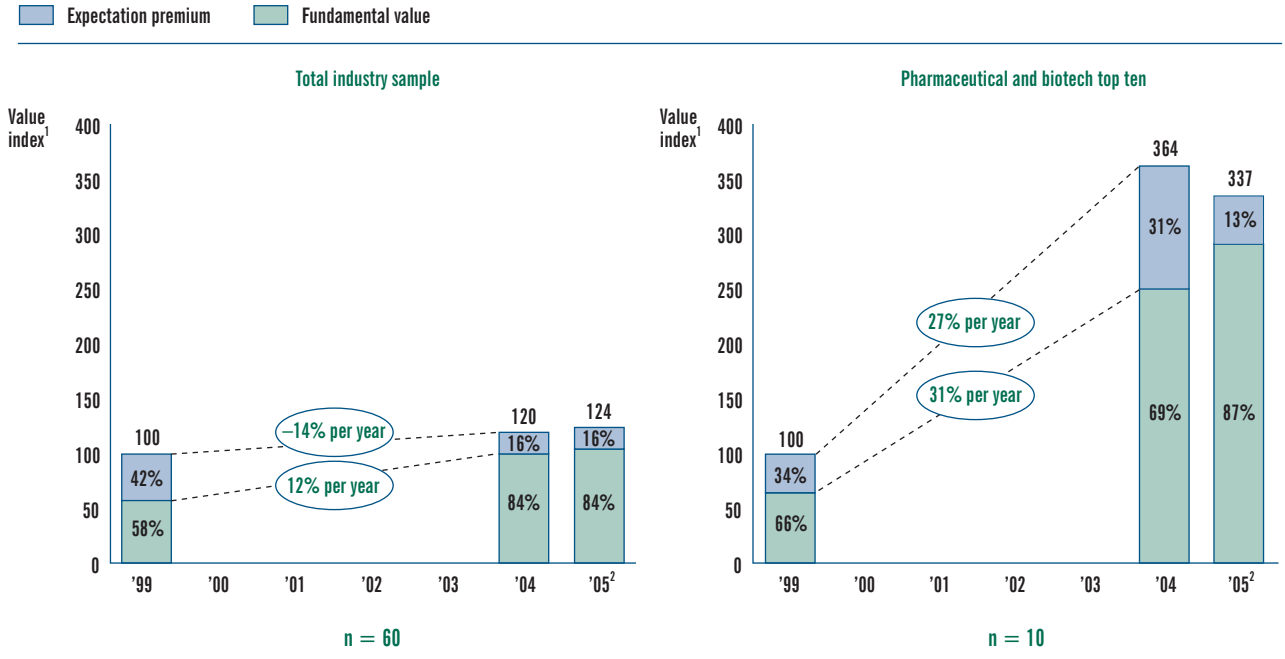
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

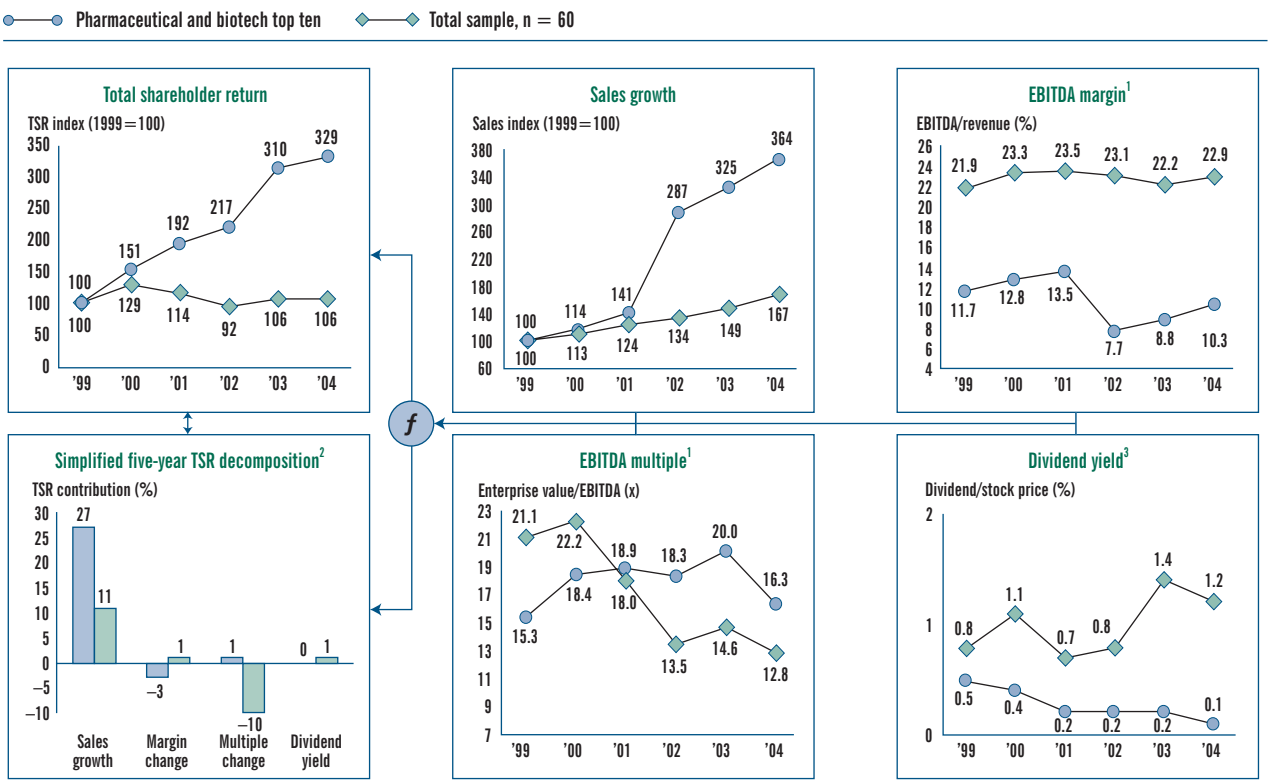


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

THE PULP AND PAPER TOP TEN, 2000–2004

						TSR Decomposition[1]						
#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	MAYR-MELNHOF KARTON	AUSTRIA	25.4	1.815	4	10	1	1	3	4	6	–2.7
2	VOTORANTIM CELULOSE	BRAZIL	25.3	1.637	–42	25	3	–5	4	–1	0	–28.1
3	EMPRESAS CMPC	CHILE	22.4	4.900	–16	12	1	3	3	0	4	14.0
4	SAPPI	SOUTH AFRICA	8.7	3.522	8	3	–6	4	2	1	4	–9.0
5	DAIO PAPER	JAPAN	7.2	1.086	–19	5	14	–10	1	2	–5	–4.5
6	HOLMEN	SWEDEN	6.3	2.550	0	–5	0	–2	12	1	0	11.3
7	SVENSKA CELLULOSA	SWEDEN	5.9	8.591	–6	7	–3	–1	4	0	0	–1.1
8	TEMPLE-INLAND	UNITED STATES	3.6	3.830	–1	4	–4	4	3	–1	–3	16.9
9	PORTUCEL	PORTUGAL	3.1	1.324	–5	24	–4	–1	2	–12	–7	14.9
10	DS SMITH	UNITED KINGDOM	2.5	1.072	–9	6	–2	–1	6	–2	–3	0.9

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 23 companies with a market valuation greater than $1 billion.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

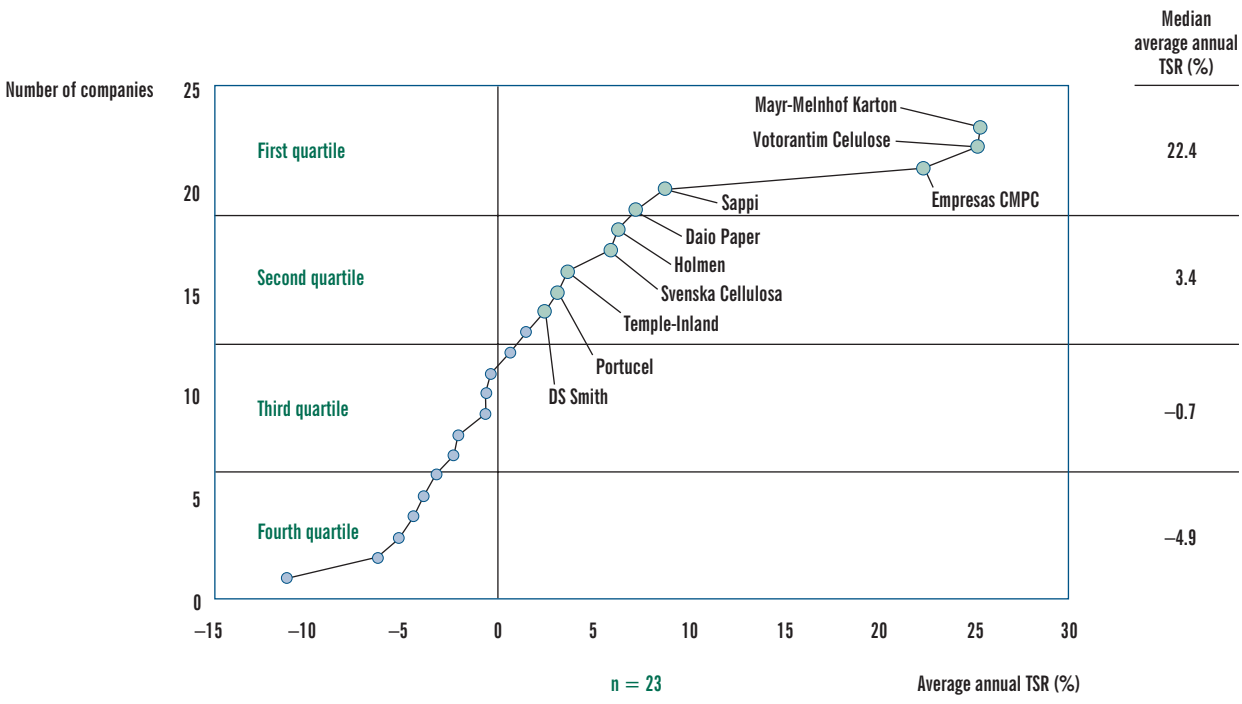
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

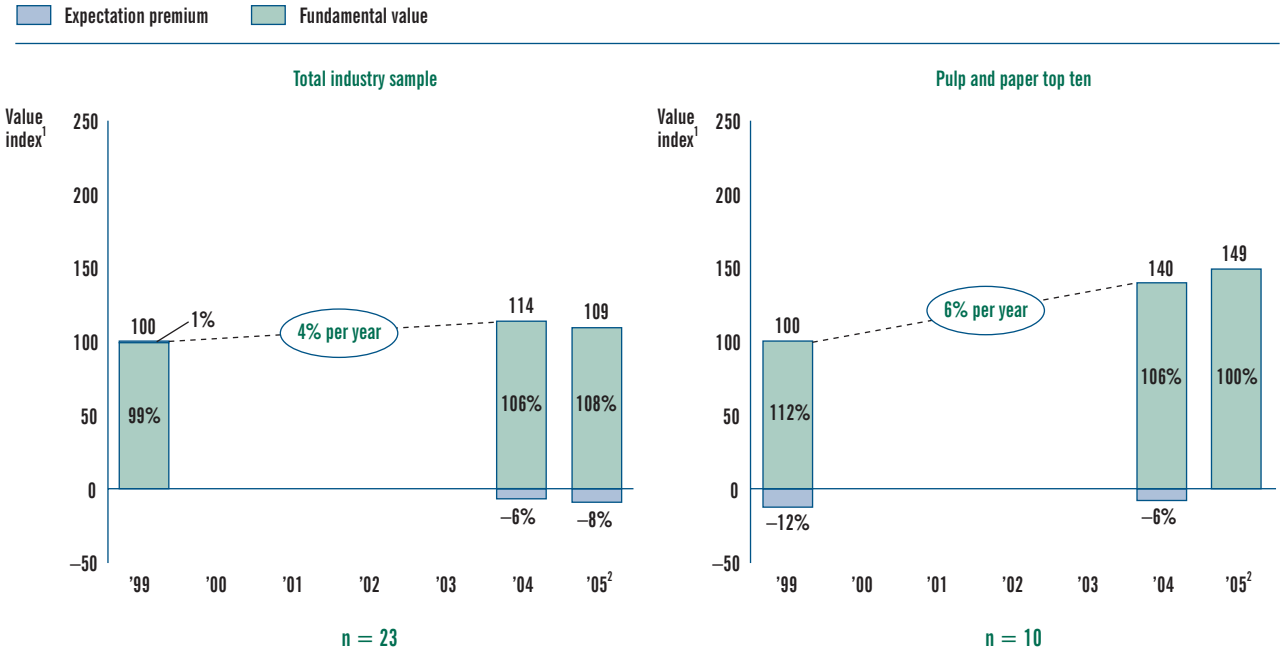
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

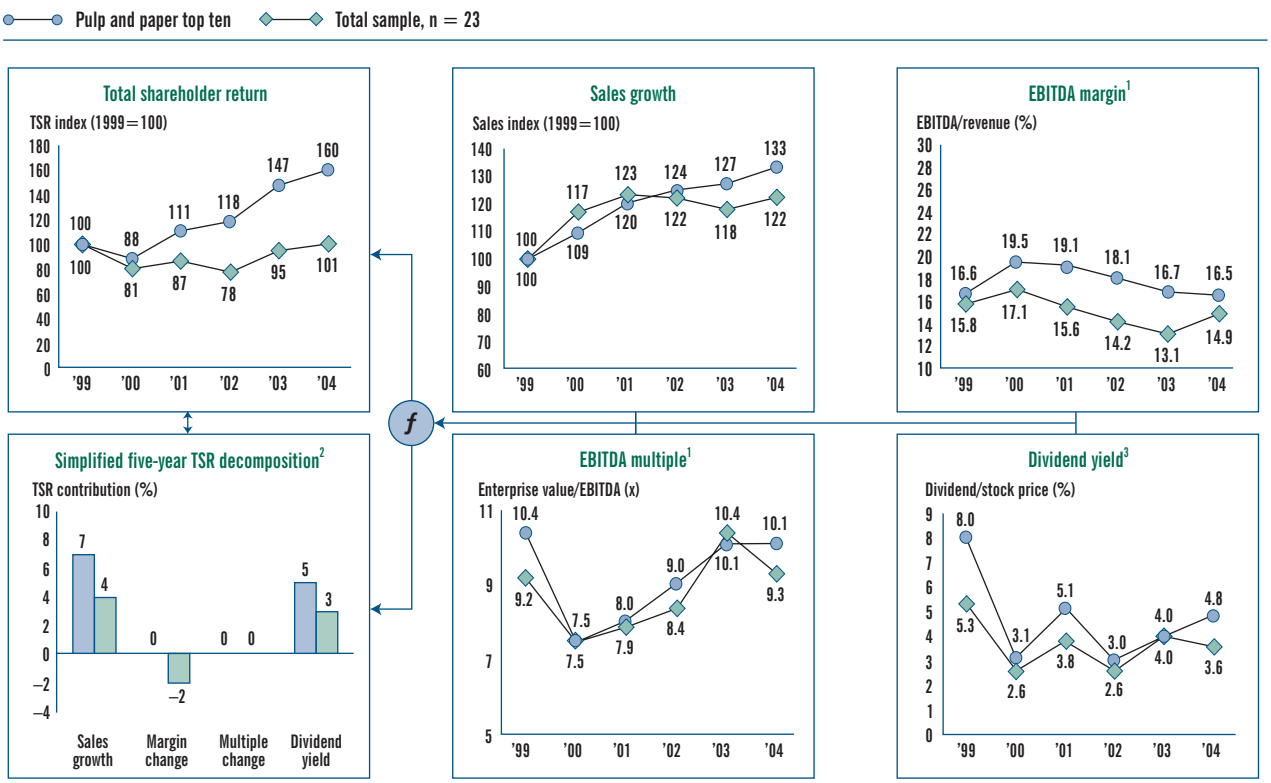


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

THE RETAIL TOP TEN, 2000–2004

#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	TSR Decomposition[1]: Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	ESPRIT HOLDINGS	HONG KONG	44.5	7.242	30	24	8	8	4	–1	1	26.2
2	PETSMART	UNITED STATES	44.1	5.184	39	8	20	15	0	–4	4	–36.4
3	ENTERPRISE INNS	UNITED KINGDOM	41.0	5.335	25	41	5	4	3	–8	–4	5.5
4	SHINSEGAE	SOUTH KOREA	39.9	5.207	–4	26	11	7	1	–5	0	42.0
5	STARBUCKS	UNITED STATES	38.8	24.943	64	26	1	–13	0	–2	27	–26.0
6	WHOLE FOODS MARKET	UNITED STATES	32.9	5.968	51	22	1	9	0	–3	4	38.8
7	EBAY	UNITED STATES	30.0	77.123	90	57	27	–48	0	–6	0	–36.9
8	WOOLWORTHS	AUSTRALIA	27.5	11.876	36	9	4	6	4	3	1	12.7
9	NEXT	UNITED KINGDOM	26.6	7.674	21	16	4	–2	4	7	–2	–12.7
10	GUS	UNITED KINGDOM	26.3	16.814	28	6	4	6	6	0	5	–4.9

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 63 companies with a market valuation greater than $5 billion.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

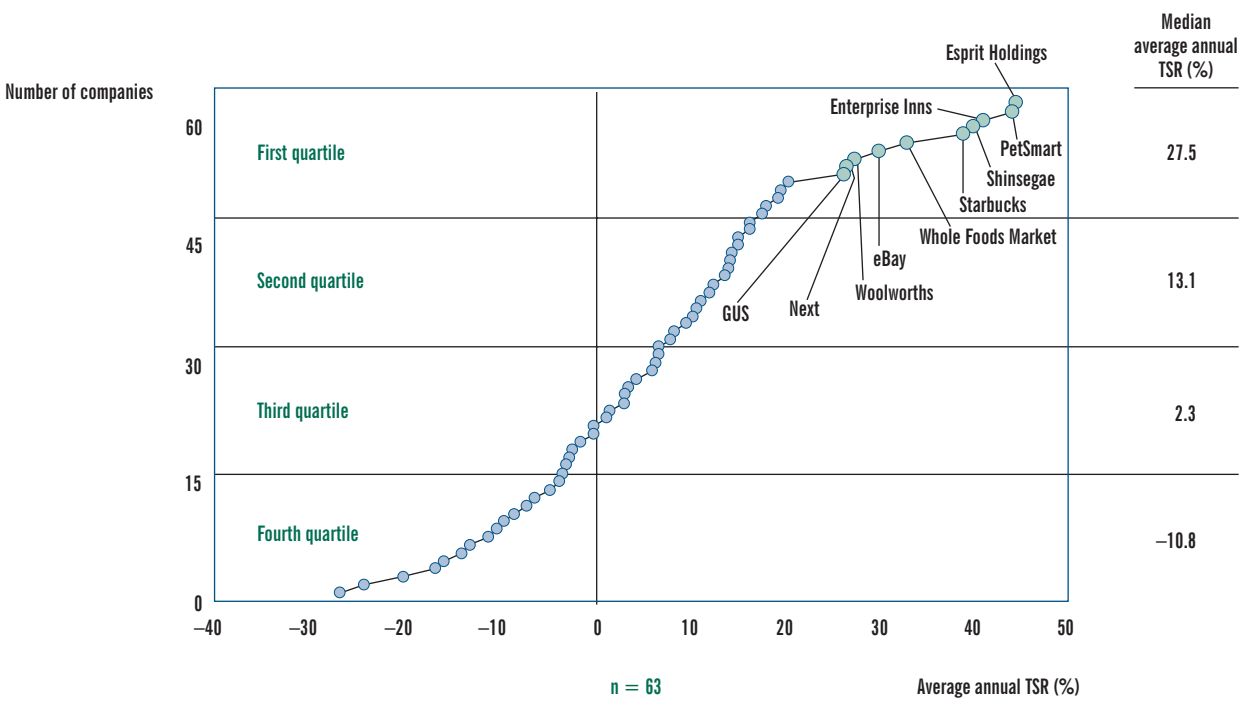
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

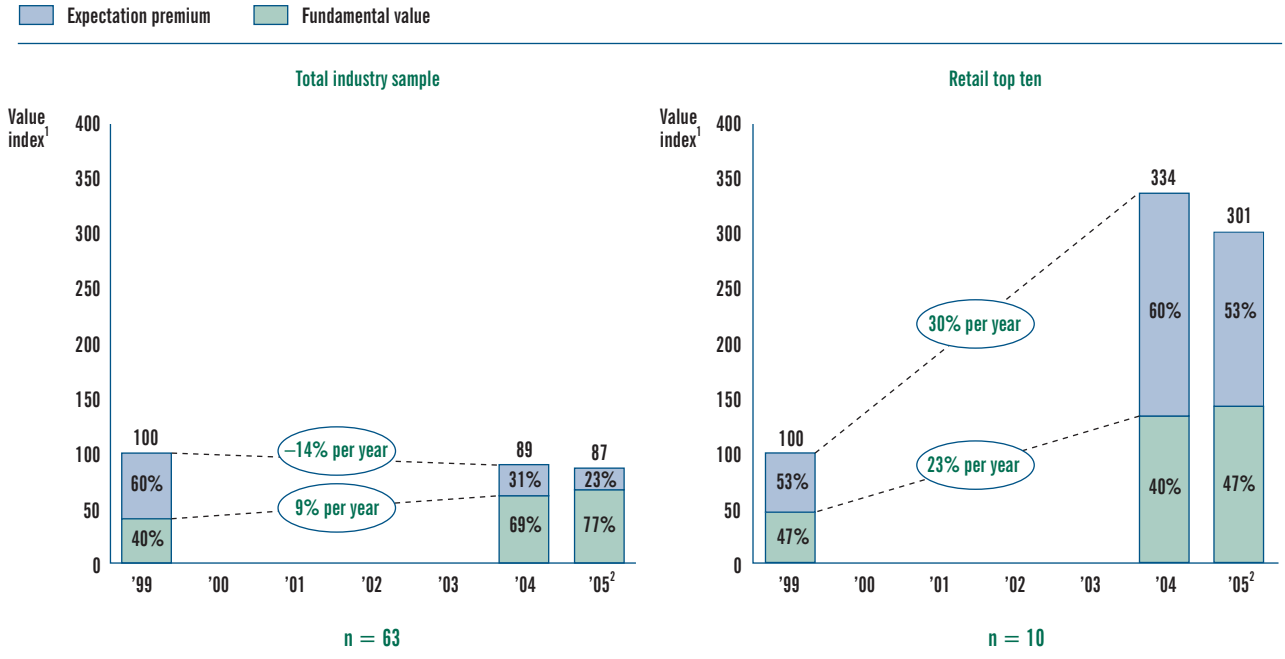
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

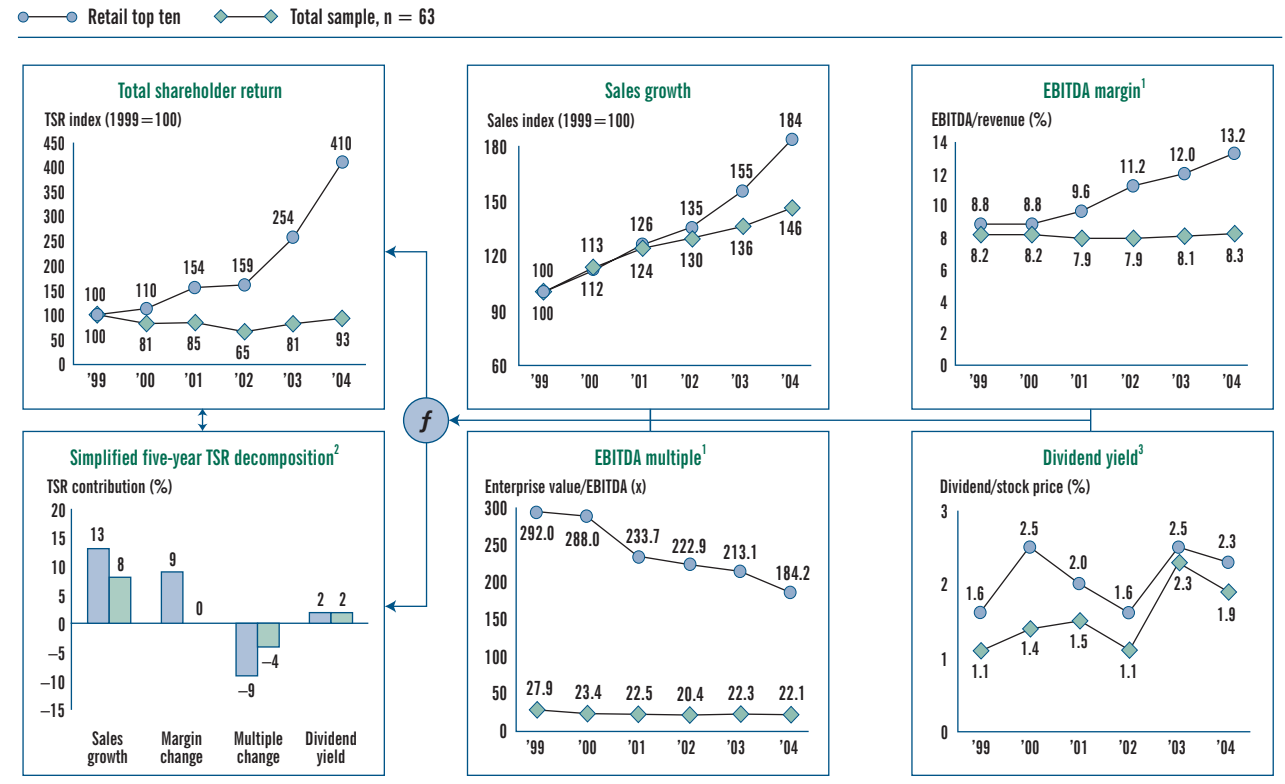


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

THE TECHNOLOGY TOP TEN, 2000–2004

						TSR Decomposition[1]						
#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	SYMANTEC	UNITED STATES	28.5	16.337	55	26	15	–5	0	–6	–1	–17.2
2	RESEARCH IN MOTION	CANADA	24.3	15.475	81	53	5	–26	0	–8	1	–9.1
3	ADOBE SYSTEMS	UNITED STATES	13.5	14.971	64	11	3	0	0	0	0	–11.1
4	MTN GROUP	SOUTH AFRICA	13.3	11.336	43	36	7	–13	1	–19	2	15.9
5	SAMSUNG ELECTRONICS	SOUTH KOREA	13.0	71.008	15	20	–5	–4	2	2	–1	33.5
6	HON HAI PRECISION INDUSTRY	TAIWAN	10.3	14.316	45	48	–15	–19	1	–4	–1	27.8
7	HOYA	JAPAN	8.3	11.590	52	6	6	–7	1	2	1	29.8
8	TELEFONOS DE MEXICO	MEXICO	8.0	15.353	–19	2	–3	6	3	6	–5	1.6
9	CANON	JAPAN	7.2	43.783	0	6	10	–13	1	0	4	6.4
10	APPLE COMPUTER	UNITED STATES	4.6	25.893	51	6	–5	6	0	–4	1	61.8

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 89 companies with a market valuation greater than $10 billion.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

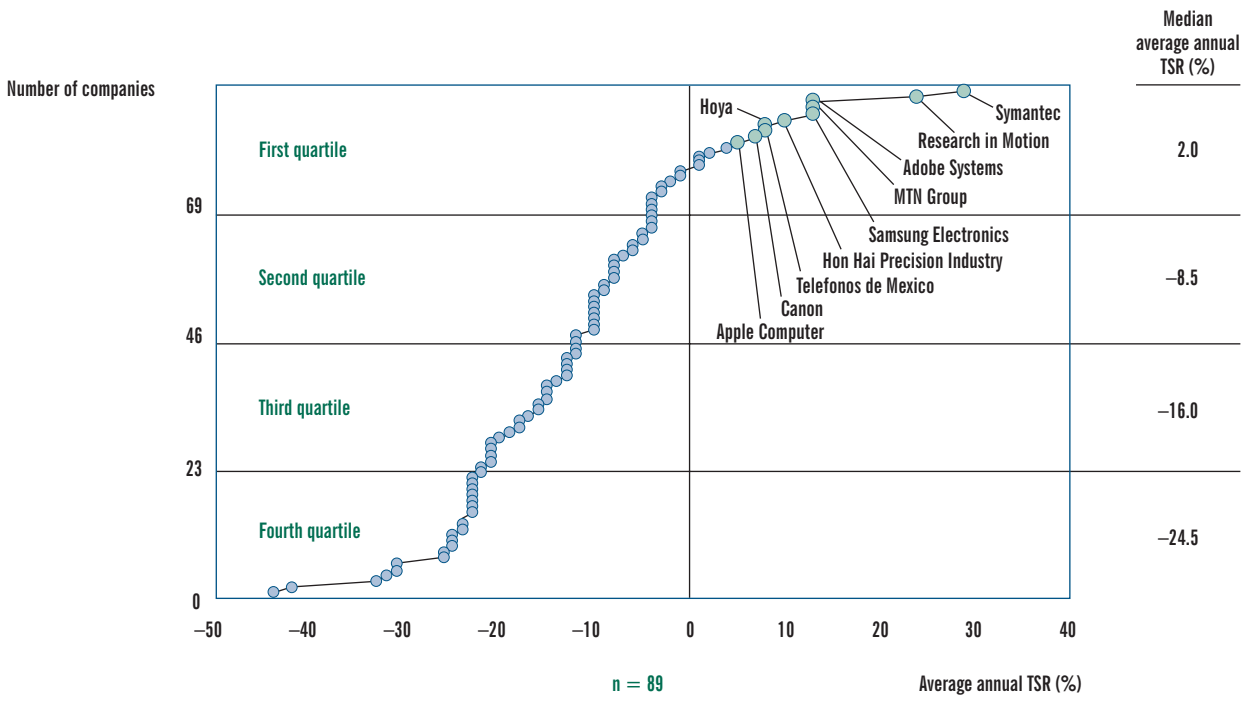
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

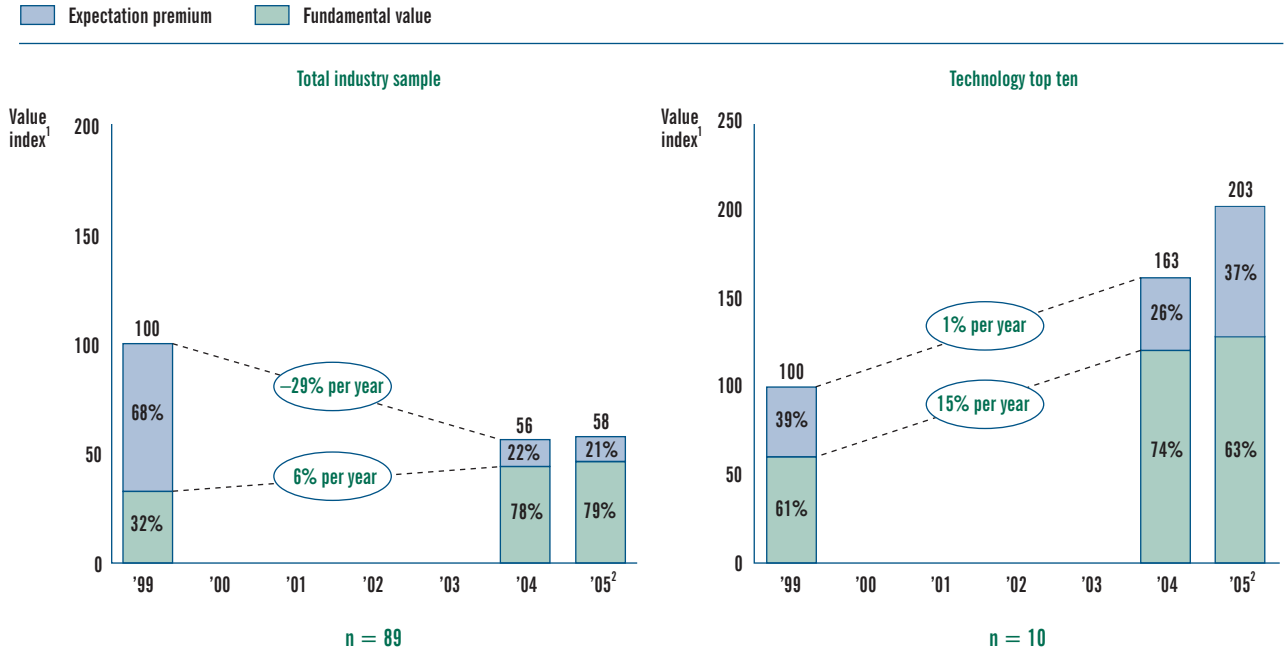
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

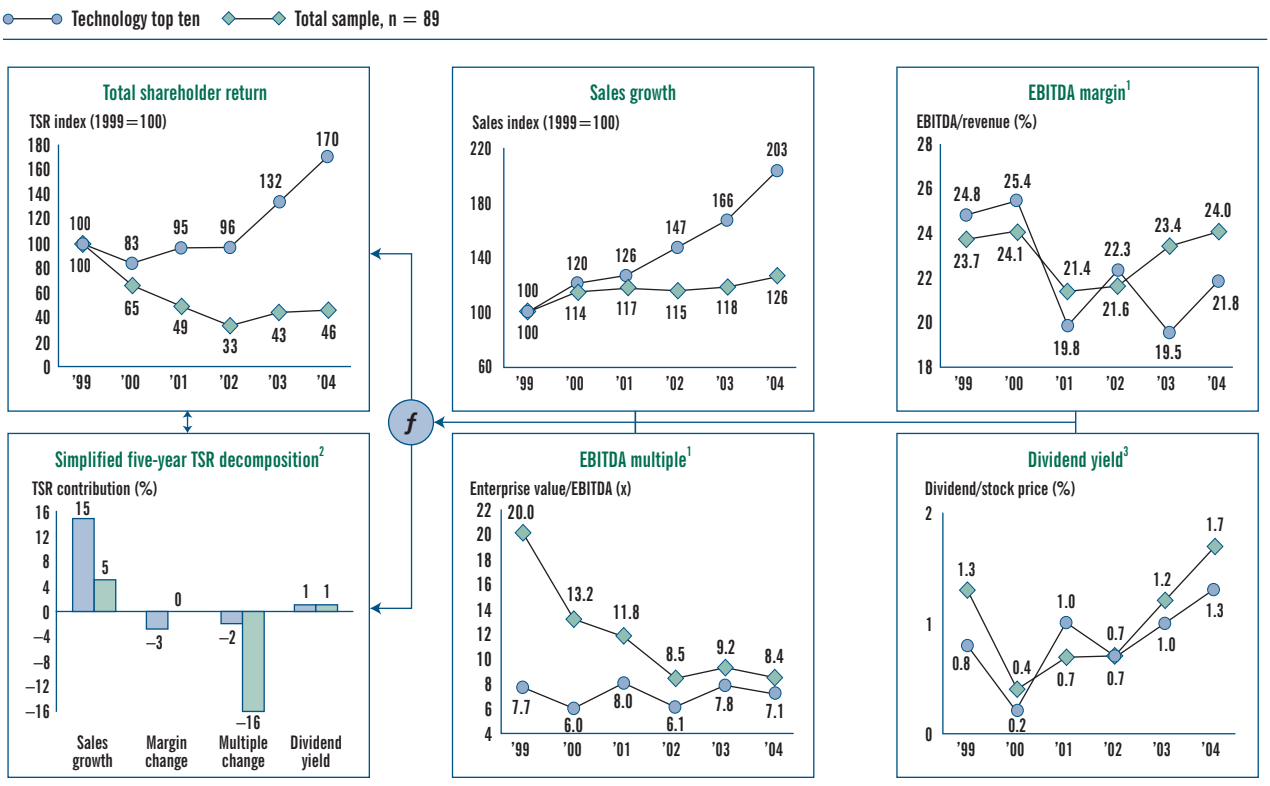


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

THE TRAVEL TOP TEN, 2000–2004

						TSR Decomposition[1]						
#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	MITSUI OSK LINES	JAPAN	31.8	6.610	20	4	1	–2	3	–1	27	47.3
2	AUTOSTRADE	ITALY	26.7	13.592	6	4	9	15	3	0	–5	10.2
3	CANADIAN NATL RAILWAY	CANADA	25.0	17.632	–6	6	9	3	2	2	4	11.6
4	MGM MIRAGE	UNITED STATES	23.7	10.170	26	25	0	4	0	–4	–1	16.1
5	STARWOOD HOTELS	UNITED STATES	22.9	12.105	28	7	–11	16	3	–2	10	–6.3
6	MALAYSIA INTL SHIPPING	MALAYSIA	22.3	7.551	27	7	–2	11	5	0	3	22.3
7	HARRAH'S ENTERTAINMENT	UNITED STATES	21.3	7.496	23	9	0	8	1	2	1	–3.5
8	EXPEDITORS INTL	UNITED STATES	21.1	5.955	29	18	0	2	1	–1	1	–3.1
9	ABERTIS INFRAESTRUCTURAS	SPAIN	20.4	10.737	17	25	–1	5	4	–10	–3	57.6
10	HILTON HOTELS	UNITED STATES	19.7	8.778	32	14	–7	–2	1	–1	14	–6.1

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 42 companies with a market valuation greater than $5 billion.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

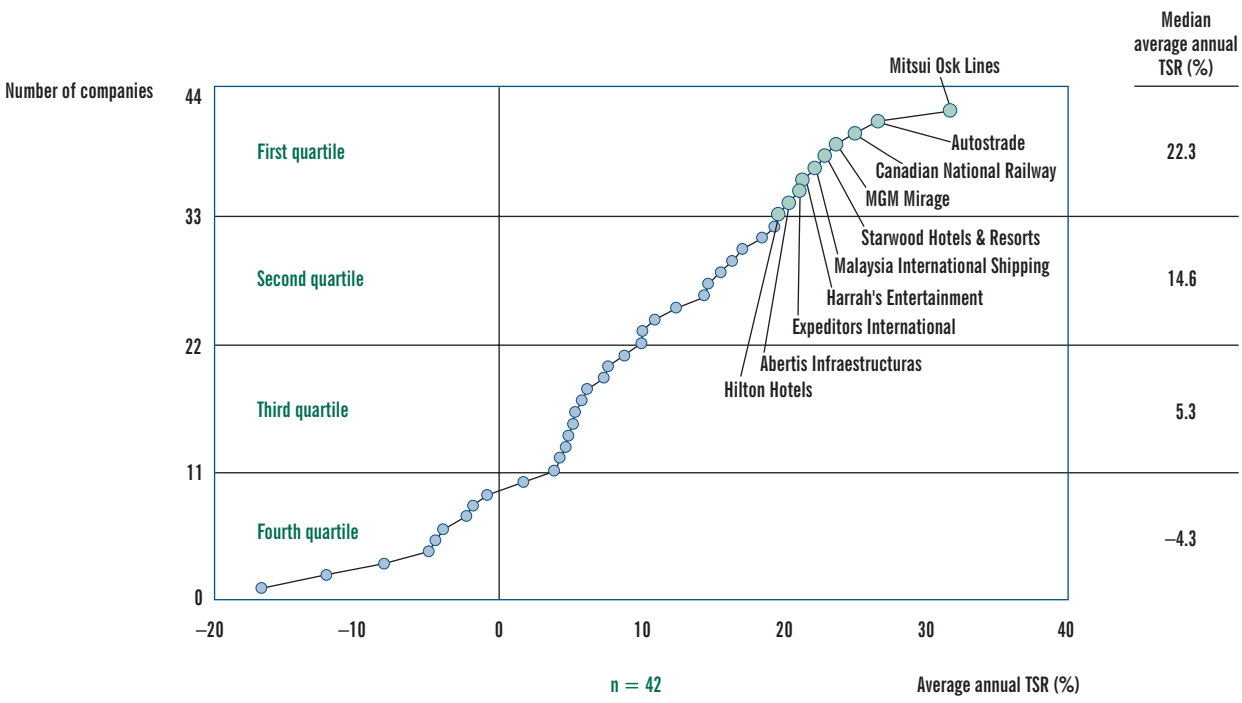
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

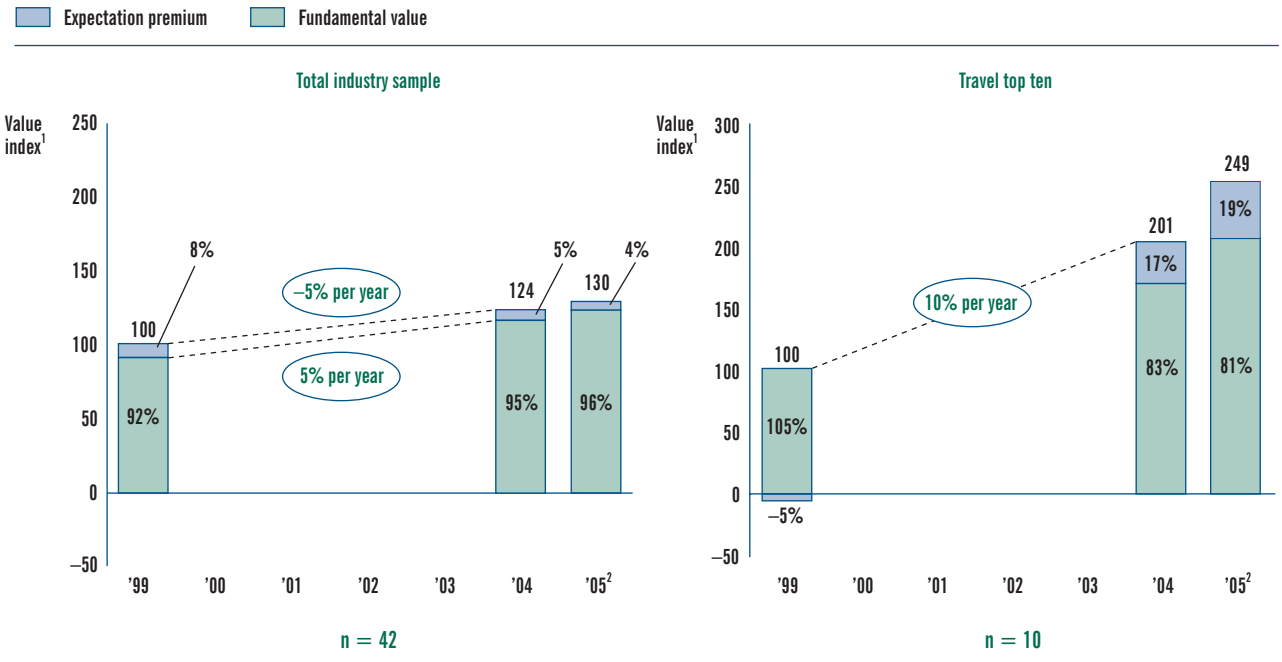
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

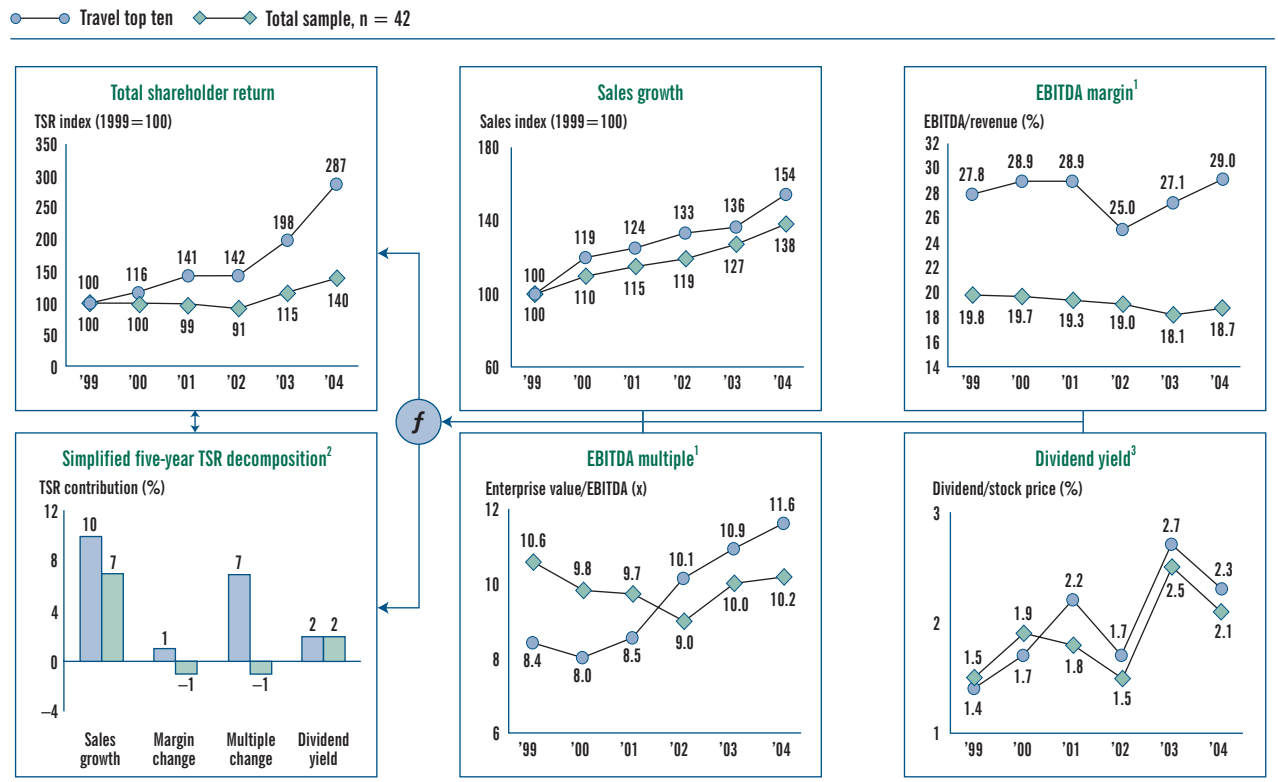


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

THE UTILITIES TOP TEN, 2000–2004

						TSR Decomposition[1]						
#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Expect. premium[4] (%)	Sales growth (%)	Margin change (%)	Multiple change[5] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2005 TSR[6] (%)
1	FORTUM	FINLAND	30.9	14.253	–5	8	10	4	7	–2	4	64.9
2	ENTERGY CORP	UNITED STATES	25.5	15.261	–33	3	4	6	5	2	6	9.3
3	SOUTHERN COMPANY	UNITED STATES	24.7	24.744	7	5	–2	10	6	–2	8	9.5
4	TRANSCANADA	CANADA	24.6	12.316	1	–16	21	4	6	–1	12	23.0
5	EXELON	UNITED STATES	24.3	29.129	1	21	3	4	4	–15	8	25.6
6	PPL CORPORATION	UNITED STATES	22.8	10.072	–17	5	8	3	5	–5	8	22.7
7	SEMPRA ENERGY	UNITED STATES	20.8	8.561	–21	12	–8	10	5	0	2	25.8
8	ENBRIDGE	CANADA	19.6	8.800	14	19	–8	2	4	–2	4	28.5
9	HONG KONG & CHINA GAS	HONG KONG	18.2	11.615	49	7	–3	10	3	2	–2	2.2
10	CINERGY	UNITED STATES	18.1	7.545	–9	–5	8	9	7	–3	3	8.1

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; annual reports; BCG analysis.

Note: n = 58 companies with a market valuation greater than $5 billion.

[1]Contribution of each factor shown in percentage points of five-year average annual TSR; apparent discrepancies with TSR total due to rounding.

[2]Average annual total shareholder return, 2000–2004.

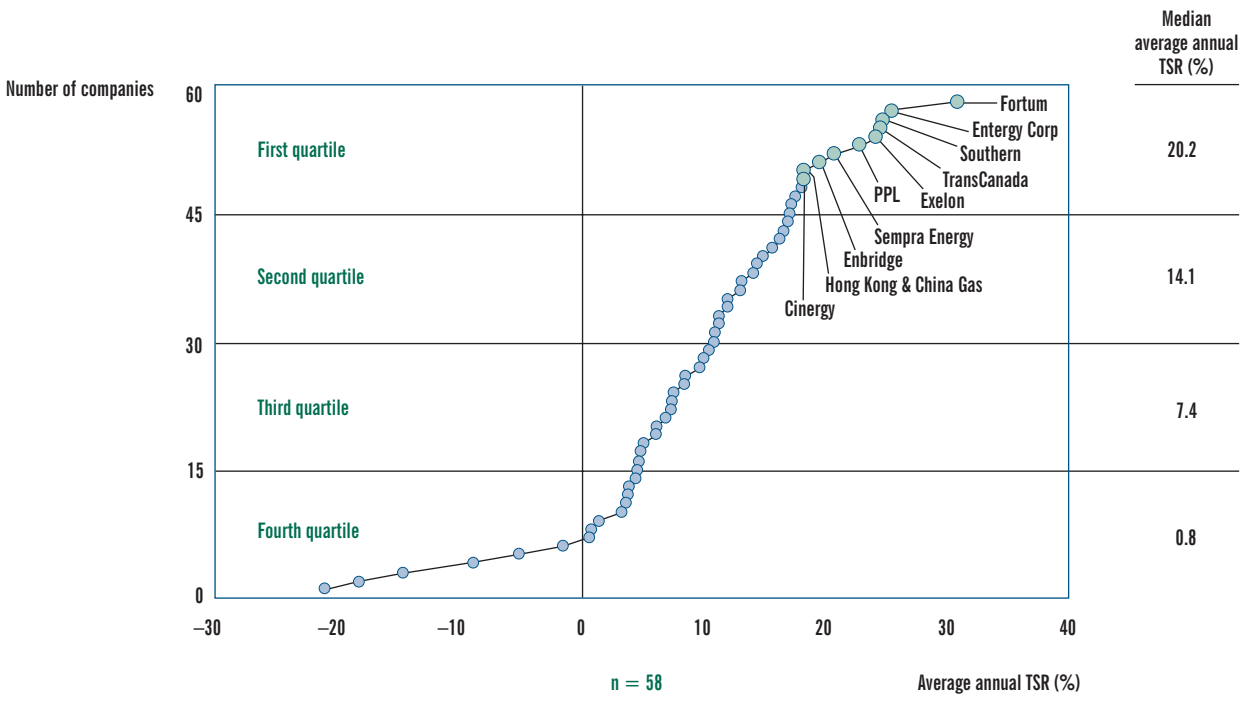
[3]As of December 31, 2004.

[4]Expectation premium as percentage of total 2004 market value.

[5]Change in EBITDA multiple.

[6]As of September 30, 2005.

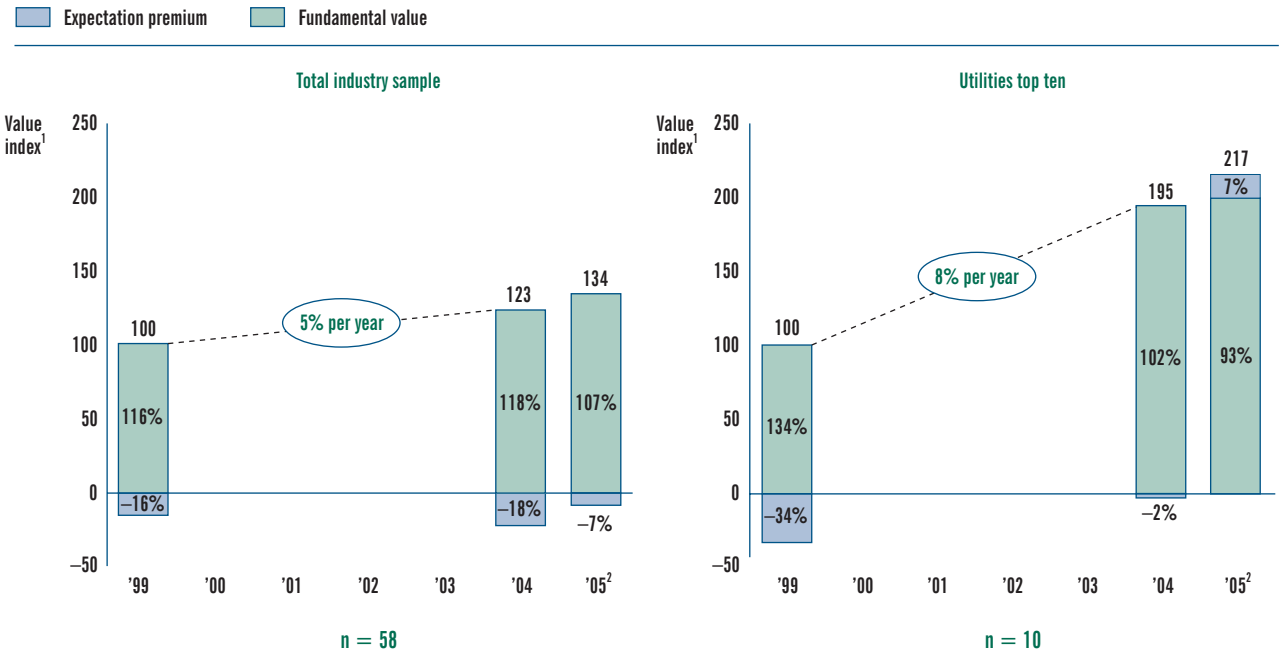
AVERAGE ANNUAL TOTAL SHAREHOLDER RETURN BY QUARTILE, 2000–2004



Sources: Thomson Financial Datastream; BCG analysis.

Note: TSR derived from calendar-year data.

CHANGES IN FUNDAMENTAL VALUE AND EXPECTATION PREMIUMS, 2000–2004

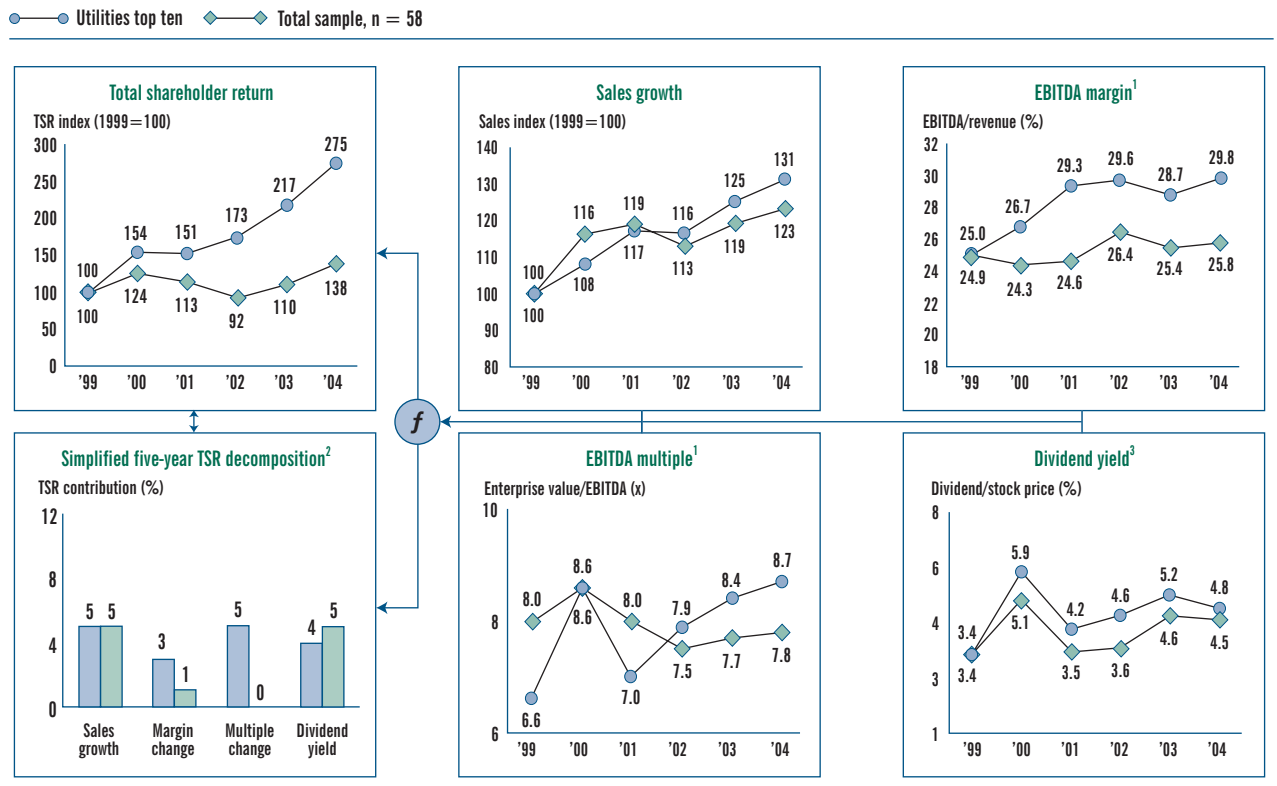


Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Market capitalization plus net debt, 1999 = 100.

[2]Market value as of September 30, 2005; fundamental value estimated using trailing 12-month average data.

VALUE CREATION AT THE TOP TEN VERSUS INDUSTRY SAMPLE, 2000–2004



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.

[1]Industry calculation based on aggregate of entire sample.

[2]Share change and net debt change not shown.

[3]Industry calculation based on sample average.

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