What Is Economic Value Management and How Does It Relate to Organizations Today?
What Is Economic Value Management?

When he gets out of bed on Monday morning and gets ready for the long commute to work, John thinks about the morning staff meeting, the presentation he’ll be making, the reports he’ll need to review, and the people he’ll have to placate and cajole that day. His day is structured by the tasks in front of him, the tasks he is asked to perform, and those he feels compelled to address. Some time during the course of the year he may reflect on it all, but then again he may not, especially as long as he is well paid, likes his colleagues, and finds his job tasks acceptable.

John’s life, the life of everyone, brings to mind the story about human nature that Anthony de Mello, a Jesuit priest, tells in a chapter titled “Profit and Loss”:

And here is a parable of life for you to ponder on: A group of tourists sits in a bus that is passing through gorgeously beautiful country; lakes and mountains and green fields and rivers. But the shades of the bus are pulled down. They do not have the slightest idea of what lies beyond the windows of the bus. And all the time of their journey is spent in squabbling over who will have the seat of honor in the bus, who will be applauded, who will be well considered. And so they remain till the journey’s end.¹

Does de Mello mean by this story that the most important issue related to human nature is work/life balance and “stopping to smell the roses”? I think he means much more. He speaks of everyone’s habitual actions and desires. His story asks us to consider our intention and awareness: What is the intent of our work life’s bus trip? How clearly do we wish to see?

John and his colleagues are like travelers on that bus, scrabbling with their fellow travelers to sit in certain seats. And it keeps them busy and occupied, so much so that John, like his fellow travelers, never thinks to pull up the shades and look outside. And, in fact, they travel along, never pulling up the shades, never looking out, and never really knowing what lies beyond.
As with this tale of everyone, many organizations go about their daily routines, their daily busy-ness, without stopping to look outside—to see beyond what appears in front of them. Similarly, constituents of organizations also develop narrow views of what their relationship to the organization means, narrow definitions that often do not serve them.

To truly see, to really understand, the bus shades must be pulled up and a wide-angle view taken. The viewer must see broadly and be able to zoom in as well. What is this Economic Value Management that can pull the bus shades up, revealing the view outside?

**DEFINITION**

In broad terms, Economic Value Management can be defined as an integrated approach to managing any organization, one that is based on the principle of stewardship (and the inexorable consequences of failed stewardship; see Exhibit 1.1).

This description, which is really quite simple, embodies two key concepts:

1. Economic Value Management is a management approach
2. The foundation for the approach is a set of principles or beliefs

These concepts are important in understanding the true power of Economic Value Management and sorting out whether an organization is using the management approach, and if so, how far along it is.

Many people are already familiar with “economic value added,” although they often mean different things by it and their understanding of the concept varies widely. On an ongoing basis, popular business periodicals or news sources refer to corporate organizations and the concept of shareholder value. Ostensibly, Managing for Shareholder Value (a phrase often emblazoned on a company’s annual report) reflects a management approach focused on the enhancement of shareholder value (i.e., earning returns for the shareholder). Managing for Shareholder Value embodies the concept of stewardship by clearly and explicitly recognizing the importance of the obligation to the shareholder (the capital provider) in the management of the business.

Recently, the Securities and Exchange Commission (SEC), analysts, and institutional investors (who invest mutual funds and retirement savings) have expressed concerns over the numbers reported to investors about company results. Unfortunately, as the SEC has recently pointed out, it is not always easy to judge a company’s performance by its annual report disclosures. At the same time, individuals’ retirement and savings are tied increasingly to the fortunes or misfortunes of the companies in which investments are made. The cost of the ink to say Managing for Shareholder Value is cheap. The real question is: Is the company really doing it and, if so, how?

Fortunately or unfortunately, Economic Value Management impacts people beyond their roles as investors. The fate of a company and its management
What Is Economic Value Management?

“Economic Value Management is an integrated approach to managing any organization, one that is based on the principle of stewardship (and the inexorable consequences of failed stewardship).”

Economic Value Management is a management approach, a series of practices, that are based on stewardship, and that yield economic, value-creating results.

All three words, economic, value, and management, speak to the concept of stewardship and to its consequences. (Definitions come from Webster’s Collegiate and the Oxford English Dictionary.)

Stewardship is defined as the “conducting, supervising or managing of something, especially the careful and responsible management of something entrusted to one’s care,” or “the responsible use of resources, especially money, time, and talents.”

Economic implies not accounting or record keeping, but rather means a process “marked by careful, prudent use of resources,” “yielding advantageous returns or results.”

Value is defined as something “held in high esteem or appreciation,” “having worth,” something that is “valid, sound.” It is a “measurement of relative worth,” “the estimate in which something is held related to principles or standards of what is valuable in life,” and “the quality of a thing considered in respect of its power and validity for a specified purpose or effect.”

Management is defined as the “judicious use of means to accomplish an end,” “the application of skill or care in the conduct of an enterprise,” “the exercise of executive, administrative and supervisory direction,” and “the taking of control of the course of affairs by one’s direction.” It is “the fulfillment of duties,” “handled or directed with a degree of skill,” “treated with care,” “carried on successfully” “to achieve one’s purpose.”

Source: www.thevaluealliance.com website

EXHIBIT 1.1 Economic Value Management

approach can impact everyone: employees, customers, suppliers, and the like. To be empowered, all individuals must actively manage their own participation.

In that sense, and in others, Economic Value Management is much larger than simply “shareholder value” or what is generally referred to as “economic value added.” This book describes these distinctions. As the pages that follow show, Economic Value Management is more encompassing and significantly more powerful.

This book examines Economic Value Management from the perspective of people’s various roles and the organizations to which Economic Value Management may be applied. The book will also highlight the area of financial services organizations—banks, insurance companies, brokers, and investment advisers—which, for a variety of reasons, are often neglected. This is
one key class of organization with which everyone interacts as customers and on whom everyone depends as the direct custodians and managers of their wealth.

To clearly understand the impact of Economic Value Management concepts, it is important to reach a common understanding and provide a definition of the potential constituents of an organization and their roles in more depth.

**IMPORTANCE OF ALL CONSTITUENTS**

Is Economic Value Management only about the investor? The question may seem simple, but it was not so simple to “The Raleigh Organization.” With headquarters located in the United States at a beautiful campus situated among tall trees and lush green lawns, Raleigh is a large global association and a household name in almost every country in the world. For many years, Raleigh has had a large paid management team and has been able to attract bright talent, yet it faced an issue not uncommon in large organizations. Sally, the head of strategic planning, had been asked to spearhead the annual (yes, annual) development of performance measures. These performance measures were used to monitor performance and to pay incentives to the management team. Sally outlined the measurement process that the organization was currently using and some of the difficulties Raleigh was having with it:

*Raleigh has historically struggled with the issue of performance measures and has tried a number of approaches over the last four to five years. We have had a goal of trying to use capital wisely but didn’t know if it made sense or how to translate this into an overall way to manage the association’s business. Unsure of how to proceed, we currently plan to use a new set of measures that have been recommended to us by one of our most powerful members.*

As Raleigh’s history unfolded, the concepts of Economic Value Management entered the discussion. One of the staff in the strategic planning department, Fred, who was somewhat familiar with the concept of “economic value added,” said: “This cannot apply to us! We don’t have shareholders; we have members—and they are more like customers than shareholders. So Economic Value Management can’t apply.” Was he right? Is Economic Value Management only about the investor?

The answer is *no!* Unlike other approaches, Economic Value Management is an approach to managing any organization and can be useful to everyone who interacts with the organization.

Lack of clarity on this point, however, can result in difficulty in understanding the larger benefits and applications of Economic Value Management. To make the relationships clearer, the diagrams in Exhibits 1.2 through 1.8 outline the constituent groups for different types of organizations.
**Community and External Governance**

In each of these exhibits, the uppermost box in the diagram represents the community and external governance for the entity.

The citizen role belongs to every individual in the community, whether the community is the individual’s town or country, or the world as a whole. Of course, citizens can take on other, more specific roles as outlined elsewhere on these charts.

The role of regulator concerns established frameworks such as the government, agencies, or other associations charged with regulating the organization and ensuring its own, as well as the greater community’s well being. In some industries, such as financial services, these entities establish a required level of capital or regulatory capital requirement.

**Providers of Cash Capital**

The leftmost box in each diagram represents the providers of cash capital for the organization. In the case of publicly traded companies, the providers of cash capital include investors and lenders. For private companies, this
The investor role deals with investors who buy stakes in companies and share in the results of the company’s activities. They are providers of cash capital through their purchase of the company’s stock.

Lenders provide cash capital through loans to the company or by the purchase of debt securities but do not share in the results of the activities of the company (or organization or government). Their only concern is with the organization’s ability to generate cash to service its debt.

The owner role belongs to private company investors or owners who hold the stakes in a company and share in its results. They are providers of cash capital in a very direct manner.

The role of member comprises individuals who support an organization by paying dues. Members often share in the benefits of the organization, while their dues provide the cash capital for its operations. Members also have another role as well. They are generally the individuals for whom the
organization runs its activities, and in this role, they are the customers of the organization.

*Policyholders* are individuals who hold insurance policies that have been issued by a mutual company. They share in the results of the company through dividends and provide cash capital through the purchase of insurance policies. Policyholders also have another role as customers of the insurance company.

*Taxpayers* are the individuals who support their government by paying taxes and, generally speaking, share in the benefits that the government provides. (One may say this relationship is not optional. However, as numerous examples show, one may choose one’s jurisdiction. To wit, in the United States, not only are businesses choosing where to locate, but individuals are using location as an element of financial planning as well.) The payment of taxes provides the cash capital for the operation of government.

For social service organizations, *contributors* perform the role of cash capital provider. These individuals usually do not share in the tangible, direct monetary benefits of the organization but rather share in the general intangible good through the gift of contribution.
Suppliers

The middle box in each diagram represents the suppliers of intellectual capital and other inputs that are necessary for the governance and the day-to-day operations of the organization. (This use of the term supplier is broader than that in general usage.)

The Board of Directors deals with the governing body of an organization. In their oversight role, these individuals supply intellectual capital and assess the use of capital in the organization, including cash, regulatory, intellectual, and risk capital.

Managers are responsible for the day-to-day management of the organization. They supply intellectual capital and manage the daily transactions, including the conversion of cash capital to other goods and services. In the management of the conversion process, they make the decisions required to take nonrisky assets and put them at risk to generate returns for the investors while maintaining the ability to pay the lender. In this process, they manage the risk capital of the business and monitor any regulatory capital requirements.

Employees are responsible for the day-to-day conversion of cash capital to other goods and services. They are suppliers of intellectual capital.
The role of **external suppliers** deals with individuals external to the organization who supply materials in exchange for cash capital or directly supply intellectual capital not provided internally. Today, more and more organizations are working in partnership. These partners are a special case of a supplier relationship.

**External Observers**

The bottom box in each diagram is for the external observers of the organization. They may or may not have influence over the outcomes of the organization. At times, they may act in a quasi-regulatory fashion. Generically defined here as **critics**, these outside observers comment on and rate the activities of an organization. They use their intellectual capital to benefit the organization’s internal and external constituents. Some evaluate the firm’s cash and risk capital. Examples of critics include:

- Analysts who comment on and give buy, hold, or sell recommendations for a company’s stock
- Rating agencies that assess the safety of the organization’s bonds
Consumer groups who rate the safety and effectiveness of the organization’s products
Surveyors who rank the company’s employee friendliness
Journalists who provide critiques of the business
Special interest groups who rate the organization’s environmental policies or its ethics

Consumers of the Organization’s Efforts

The right-hand box represents the consumers of the organization’s efforts. The customer role is filled by the customers or clients who act as consumers of the products or services of the organization. Often this consumption is in exchange for some form of cash. Members, policyholders, and citizens represent special cases of customer. Depending on the structure of the organization, members may or may not pay for these services in addition to their dues. Clients of social service organizations or recipients of government services often do not pay cash in exchange for the services that they receive, although they generally do give up their time in this exchange. The
customer relationship with a financial services firm is particularly sensitive, because these firms act as custodians and managers of the customer’s wealth.

As we all know, one individual may, and often does, fulfill multiple roles. An employee of one organization is a customer of another, and may be both a customer and employee of the same organization. Many managers are also investors in the firm, holding a portion of their net worth as stock in the company. Members are often both investors/contributors and customers of an organization. To make it easier, throughout this book the term investor will be used to represent everyone who provides paid-in capital and has the right to share in the benefits that the capital provides. In other words, investor, depending on the organization, will mean policyholder, member, taxpayer, or contributor, as appropriate. Likewise, customer will be used generically, although specifically, the terms policyholder, member, citizen, or client might apply. Critic is already a generic term and will be used to describe the constituents described earlier.

Although there were no shareholders at The Raleigh Organization, the members contributed cash capital to pay for the operations of the organization. They were both consumers of the services and suppliers of the
upfront cash required to run the association. As such, they were concerned not only with the price for services and the nature of those services, but also that the organization was running effectively in order to minimize the need for dues (i.e., additional cash infusions). The members acted as shareholders; however, the open question still is, could Economic Value Management apply? To answer this question, an exploration of the concept of Economic Value Management is in order. However, an even larger question looms: Why bother?

WHY EVERYONE SHOULD READ THIS BOOK

When large organizations fail, fingers start to point. Was it the fault of the auditor (an example of an external supplier)? Was it the fault of the board or the managers? Although blame is usually assigned to one or two parties, all of the constituents (as shown in Exhibits 1.2 through 1.8) have the ability to impact the outcomes of the organizations with whom they interact.

Yes, the auditors, board, and managers may be to blame. What about regulators? Did they perform the required oversight? Employees? Did they continue to work for a firm that was dishonest? Did they alert their managers or the board and, failing that, the media or regulators to potential issues? How about investors? Did they perform due diligence? External observers? Did the press report accurately and dig into the story? Did analysts do their job? Did rating agencies accurately reflect the state of the company’s risk? Did customers seek alternative suppliers if they were being gouged and make their issues known to regulators, the media, and others? When fingers are pointing the blame, usually both hands and all fingers are needed.

Economic Value Management supplies solutions that can help constituents do their job better, remain alert, and see out of the bus window. In addition, the use of Economic Value Management can dramatically impact the outcomes for all constituents. Used by an organization to its full potential, it will have the following effects:

- For investors, Economic Value Management will positively influence the stock price of a company, directly and indirectly. For nonpublicly traded organizations, Economic Value Management will ensure that the capital of the firm is used wisely, thus stretching the value for each dollar of dues, taxes, or contributions.
- For lenders, Economic Value Management will positively impact an organization’s ability to repay loans and obtain additional capital when needed.
- For the Board of Directors, Economic Value Management embodies the concepts of corporate governance and reflects what boards most
need to know to do a good job and, selfishly, to limit their liability. For audit committees, Economic Value Management includes processes to challenge the accounting numbers, and for incentive compensation committees, practices that ensure fair incentives based on true pay for performance.

- For managers, Economic Value Management will mean less waste and more focus. It will unleash the possibility of actually running the business, rather than fighting fires. It will also generate the opportunity to share in the economic gains achieved for investors.

- For employees, organizations that use Economic Value Management practices will be more stable, both financially and strategically. The decision-making processes of the organization will be clearer. In addition, the organization will be more inclusive and provide better opportunities and better environments in which to work.

- For external suppliers, Economic Value Management organizations will be more financially stable and make better partners.

- For customers of financial institutions, Economic Value Management companies provide a stable, long-term relationship. The underlying financial stability and management approach of financial institutions is of critical importance to their customers. (This is also true of other organizations where long-term relationships provide important benefits to the customer.) In practice, Economic Value Management organizations continually reassess service offerings to determine those that are most beneficial (and for corporations, to provide those for which customers are willing to pay). The generally longer-term focus of Economic Value Management companies (compared to many U.S. companies) extends to the view of the organization toward its customers.

- For citizens, regulators, and critics, Economic Value Management organizations are better governed and more financially stable. They are also better able to communicate their true results than other organizations because, in fact, they understand them and recognize disclosure as an important element of stewardship.

**WHY ECONOMIC VALUE MANAGEMENT?**

Economic Value Management is an integrated approach to running any organization. Although the concept seems simple and is based on sound business stewardship practices, the fact is that many organizations do not know if they are being good stewards. The government misplaces battleships. A Big 5 consulting firm loses 40% of its intelligent, hard-working employees every year. Major banks collapse due to the activities of one “lone ranger” trader. Why does this happen? Why aren’t they good stewards?
One reason is that organizations tend to be very inwardly focused. One of the largest social organizations in the United States, “The Magnificence Society” (MS), has volunteer members who serve as regional directors and who set budgets and recruit members for their local areas. Although MS manages millions of dollars in cash and properties, the regional directors lack understanding of their roles and responsibilities. For example, although membership had fallen off considerably in their local areas, their recommendations in terms of programs and budgets remained unchanged. To address this, MS called a special meeting of the regional directors to discuss membership issues. When asked what they were going to do to prop up membership, many of the regional directors did not understand how this related to their roles of providing programs and setting budgets. “We are responsible for budgets and programs, not membership,” they said. “This may technically be true,” Caroline, a board member, explained, “but unless you have a sizable membership, you won’t be able to get the budget to carry on the programs you want.” While this may sound obvious, many of the regional directors were stunned by this revelation and objected vehemently. This is not uncommon, however. This relationship between organizational functions and the capital providers is often missed in social organizations and elsewhere.

A similar issue occurred at “Rural City Bank.” The bank was new and growing in its marketplace. It had attracted capital from individuals across the United States, including a retired president of a major banking institution. There was just one problem. Bill, the CEO of Rural City, believed that capital was free. When a major shareholder suggested that a return to the investors be considered in making decisions, Bill rejected the idea out of hand. He considered the proceeds from issuing stock to be free money. Whenever he wanted to expand, he sought to gain board approval to issue additional stock. To Bill, it seemed, stock was indeed free.

While these examples represent cautionary tales, it is very easy for companies to become systems that are no longer appropriately addressing their constituents’ needs. To become internally focused is natural. The de Mello story of the bus illustrates these natural tendencies—life as a bus where the shades are pulled down and all of the passengers spend their time fighting over where to sit, never seeing the beautiful views outside the bus windows.

What Economic Value Management asks an organization to do is lift the shades, look outside, and then set its goals and objectives. Simple as it sounds or looks, it is not often done. So how is it sparked?

Many processes other than Economic Value Management have attempted to address this. Total Quality Management (TQM), for example, attempts to move organizations outward by focusing some of the business processes more closely on the quality of the product, in the hope that the organization will be rewarded in the marketplace. This focus on the customer and the product is very important, and it is also very beneficial. It just needs the broader context, which Economic Value Management provides.
Companies preparing for an initial public offering (IPO), for example, often recognize quite suddenly the need to look out the bus window. “Petry Meyers,” for example, which had been privately held for many years, decided that the time was right to become publicly traded. Before its decision, Petry had a convoluted and complex strategy that was unclear to the employees. Petry’s organizational structure was dysfunctional, and the reporting relationships were needlessly complex and confusing. Prior to the IPO, reporting relationships were established to ensure that each of the executive partners had their own turf. These “turfdoms,” however, overlapped and crisscrossed to the extent that a strategy to target one customer impacted five to six different line managers, and it was never clear who was responsible for what. This caused issues both inside and outside the firm. Another issue at Petry Meyers was that managers almost never came together to discuss strategy. Each turf was separately maintained (and if the manager were politically astute, enhanced).

As Petry Meyers began to formulate its IPO plans, it suddenly occurred to the executive team that its structure and strategy could be problematic. People inside and outside the company would want to understand its strategy before investing in it. The fact that the IPO would create interest in the company’s business practices caused Petry executives to see their own organization in a new light and made them realize that these problems were not going to be fixed overnight. As a result, the executive team decided, in their words, to “simplify their strategy” so that they could attempt to “explain it to the analysts.”

In another IPO, a mutual insurance company, “The Member’s Group,” went overboard in this regard. After its IPO, the managers, constantly worried about meeting net income goals, were encouraged to spend their time in radically different ways: They were expected to provide very detailed updates of projected revenues and expenses and an explanation of variances on a weekly basis. The Member’s Group forecasting process became so detailed and underwent so much scrutiny by top executives that it was seriously detracting from the ongoing business of the firm. “We don’t have time for our customers or our operations,” Martha, an executive at the Member’s Group, stated. Economic Value Management takes a middle ground. It requires a discipline of sustainable value creation, a focus on the fundamentals, but not a minutiae projection focus!

Economic Value Management encompasses not only stewardship but also consistent stewardship. How is an Economic Value Management organization different from other well-managed organizations? An organization can be well managed while not consciously a value organization. An organization can be well managed but not consistently so. The idea behind Economic Value Management is that it allows good management to be replicated. The change in thought process engendered by Economic Value Management can be replicated and is not based solely on the charisma of a leader. In that way,
Economic Value Management, through its practices, creates a sustained and replicable model of good management; it encompasses a move from super-hero involvement to all involvement. If organizations want internal suppliers (i.e., managers and employees) to act like owners (and reward them as such), internal suppliers will expect to have a voice. Economic Value Management provides an integration of the processes of the organization into an explainable and meaningful framework. This integration is soulful in its stewardship of the various pieces while creating a whole greater than the individual parts.

As an idea, Economic Value Management is simple. In fact, it properly introduces the right level of complexity and eliminates unnecessary complications. These are the complications that take up the bus rider’s time. One example of unnecessary complications was discussed at a winter tax conference held in Boca Raton, Florida. In a morning panel discussion, directors of tax at several major companies discussed how their roles had expanded and how their jobs were more consultative than they used to be. “What are the consultations spent on?” called out an audience member. Gary, one of the tax directors, replied, “I have more conversations with the CEO today than ever before. In most of these discussions, I spend most of the time explaining the accounting rules, book versus tax differences, and how to make things look OK from a book perspective. Although I know we care about paying the least amount in taxes, we also seem to care a great deal about the optics or appearance of book accounting even though these conversations do not impact value creation one bit.” The other panel members nodded in agreement. “Can this be fixed?” another audience member inquired. “Not really,” Gary answered. “This confusion over the accounting measures seems inevitable. I don’t think there is anything to be done.”

While the tax managers felt resigned to spending more and more of their time with CEOs, going over issues that ultimately did not impact the creation of value, the case is not hopeless. Economic Value Management provides the solution and, in time, more organizations and those involved with them will seize the potential it offers.

It is, unfortunately, true that the time from academic thought to widespread implementation can be quite long. As information and technology moves forward, changing the minds and hearts of people is a slower process. Even as late as the 1970s, major, well-regarded U.S. corporations were using financial measures like payback to make decisions, although the science of finance had moved ahead much further. Similarly, it is taking time for organizations to understand that Economic Value Management is a management approach, one that is robust enough to yield significant benefits.

While many organization management teams say they would like to be “value based” or “increase shareholder value,” Economic Value Management is not for amateurs. Anyone can do it; it does, however, require study and experience. As the car ads say, it is a closed road with a professional
driver. Jeff Bezos, CEO of Amazon.com, says his life strategy is *Regret Minimization*. Economic Value Management provides a framework to minimize regrets by providing the information and the best preconditions for success. The driving is then up to the organization and to everyone who interacts with it.

**NOTES**


2. The organizational examples throughout this book are based on real cases. The names of the organizations, the people, and some of the other details presented, however, have been changed to respect confidentiality and make the example clearer. In addition, one organization may appear under different pseudonyms.

3. The term *cash capital* is used here to distinguish providers of cash capital from providers of intellectual or other forms of capital. Later in this book, for simplicity, they will be more generally referred to as capital providers.