CHAPTER ONE

Where Do You Stand?

(Start with the Value Quotient)

Value Leadership is a beacon that executives can use to navigate their companies in the often turbulent waters of business. Chapter One offers a tool, the Value Quotient (VQ), that can help a company maintain its heading on that beacon by helping executives assess how well their company follows the concept of Value Leadership. To achieve this the remainder of this chapter answers the following questions: How does the VQ work? Why is the VQ useful? How can the VQ help your business?

HOW DOES THE VQ WORK?

The VQ transforms an abstraction into specific actions that one can measure and thus quantify. The VQ is based on four levels of analysis: concept, principles, activities, and tactics. The concept of Value Leadership is supported by seven principles (for example, "Value human relationships") that prescribe the way an organization should put value into practice. Each of the seven principles has three to four activities (such as "Adhere to core values") that broadly help an executive realize the principle. Each activity has between five and eight tactics (such as "Define core values") or specific action steps that managers and their employees take to incorporate these activities into the company's daily work.

I based these four levels of analysis on comparing the Value Leaders with their peers as well as my observations from twenty-two years as a management consultant. In many companies change flows from the top down. If the CEO is intrigued by a new concept, there is often a danger that the benefits the CEO expects to flow from the new concept will be blocked by the perceived costs of changing the organization. By focusing on four levels of analysis, I hope that executives will see clearly the full costs—and benefits—of adopting Value Leadership before initiating its adoption.

The four levels of analysis are intended to infuse Value Leadership with meaning by converting it into an organization's daily actions. To do so the concept is made up of *principles.* The principles help executives and managers communicate values to a company's shareholders, employees, customers, and communities. To translate the principles into daily action are specific *activities.* The activities are outwardly focused processes that generally require the cooperation of workers in different departments. I developed the activities by analyzing how Value Leaders conduct their business to realize each of the principles. To incorporate these activities into employee's daily efforts, I have disaggregated them into *tactics.* The tactics are specific action steps assigned to particular workers who agree to complete specific deliverables by deadlines. By articulating these four levels of analysis up front, we provide executives tools for better assessing whether the benefits of adopting Value Leadership outweigh its costs.

As we will see, the VQ is calculated by adding up the scores for the activities and tactics. Later in this chapter, we will discuss how you can estimate your company's VQ at the activity level. Although calculating the VQ at the activity level is less precise, executives can generate useful results relatively quickly. An activity-level analysis can help the executive identify which Value Leadership principles the company does well and which it needs to improve. Should the executive subsequently focus attention on improving the company's performance of these principles, he or she should calculate the VQ at the more detailed, tactic level. Chapters Two through Eight provide worksheets for the tactic-level VQ analysis.

WHY IS THE VQ USEFUL?

The VQ is useful because it melds two critical perspectives on business that are often pursued independently. Management consultants help executives improve corporate performance by evaluating issues of strategy, organization, and operations. Financial analysts evaluate companies for investment based on quantitative analysis of factors likely to influence companies' prospects for profit. Both perspectives are powerful in their own right. By combining the two perspectives, however, investors can gain deeper insights into a company's economic prospects, and executives gain a perspective on how their actions influence investor perceptions.

My business experience combines both perspectives. As a consultant to managers of some of the world's largest companies since 1981, the perspective I've developed on the characteristics that distinguish leading companies from their peers has influenced the development of the VQ.

Based on my consulting experience, I know that leading companies

- Hire and motivate the smartest and most ambitious people
- Offer employees an intense combination of on-the-job and classroom training
- Win by giving customers more value than competitors
- Avoid resting on their laurels, instead maintaining strict standards for growth, profits, and conduct that drive the organization forward
- Invest in pragmatic solutions to customer problems that could become big new sources of revenue, regardless of who came up with them
- Spend shareholders' money frugally

I've observed peer companies that

- Hire and promote people who put their career interests ahead of the teams'
- Shun tying employee evaluation to market leadership and customer satisfaction

- Adapt slowly to changes in their industry
- Encourage competition for resources among functions
- Exercise power from the top down

Beginning in 1995, I applied my management consulting experience to investment analysis. Specifically, I invested in private companies and evaluated investments for TV, print, and online media. Two Web sites, bigtipper.com and validea.com,[1] tracked the change in the value of my recommendations for publicly traded stock investments. As Figure 1.1 illustrates, from 1998 to the first half of 2000, the return on my publicly traded stock recommendations exceeded those of the S&P 500.

Beginning in 2001, I publicly predicted (on TV and in online and print publications such as BusinessWeek Online, TheStreet.com, and others) price declines in several securities. Investors could have profited from these predictions by selling short. In a short sale, investors borrow securities from a broker who sells the shares and holds onto the proceeds. The short seller then has an obligation to repay the broker's loan of the shares, or cover, by buying back the shares on the open market. The short seller bets that the price of the shares will drop; the short seller can then repay the loan with cheaper shares, pocketing the difference. Short selling is very risky because if the share value rises, the short sellers' theoretical losses could exceed the amount of the original investment.

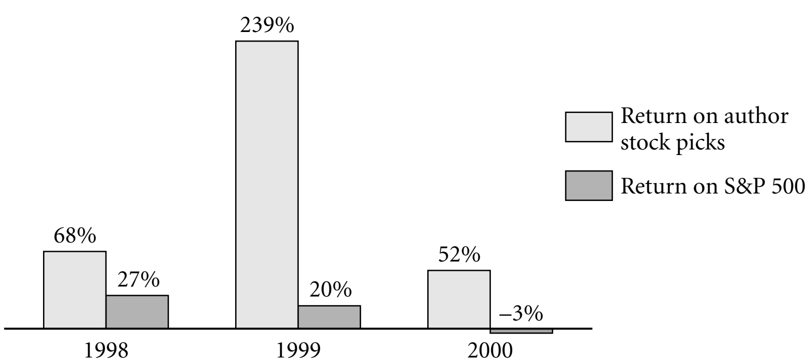

Figure 1.1. Peter S. Cohan Public Stock Pick Returns vs. S&P 500.

Sources: bigtipper.com, valididea.com.

Note: For 1998, 1999, and six months following 2000 pick dates.

My predictions of stock price declines between January 2001 and July 2002 could have generated significant profits for investors. For example, individuals who had sold short the securities of four companies that I had publicly questioned on the date of the following articles' publication and then covered their position on July 25, 2002, would have earned a return of 1,161 percent.[2] Examples include the following:

- *Williams Communications Group.* I recommended shorting this company in March 2001 in an article in the *Oklahoman,* a few weeks prior to its spin-off by Williams Energy (WMB) because it appeared to have too much debt and large net losses in an industry that had too much capacity, leading to substantial price cuts. Furthermore, its management consistently issued public statements that emphasized positive developments while glossing over negatives, denying it would file for bankruptcy almost up until the day in April 2002 when it filed for Chapter 11. In March 2001 Williams Communications Group traded at $9.85. Although the company was bankrupt, its stock still traded at 3 cents a share on July 25, 2002, yielding a 3,273 percent return for those who covered their position that day.
- *VeriSign (VRSN).* I suggested that this stock could tumble in a *Business Week Online* article on March 12, 2002, when it was trading at $32.38. The article argued that VeriSign had overpaid for acquisitions, lacked a clear corporate strategy, was shrinking in its core business, and had dwindling cash. On July 25, 2002, VeriSign stock was trading at $5.64. If readers had covered their position on July 25, 2002, their return would have totaled 474 percent.
- *AOL Time Warner (AOL).* I argued that this stock was overvalued in a June 29, 2002, e-mail newsletter when it was trading at $15. I believed that the value of AOL Time Warner's assets was overstated because approximately 75 percent of the assets were goodwill and intangibles that would need to be written down. I also believed that AOL Time Warner's $28 billion in debt was high relative to its equity. By July 26, 2002, AOL was trading at $9.35 a share. If readers had covered their position on July 25, 2002, their return would have been 60 percent.
- *WMB.* In an article in TheStreet.com on June 5, 2002, I questioned management's credibility based on its actions in driving Williams Communications Group into bankruptcy. I was further concerned about WMB's liquidity and its exposure to the merchant energy sector, which seemed to have diminished profit prospects. At

that time WMB was trading at $9.12 a share. On July 25, 2002, WMB traded at 97 cents. If readers had covered their position on July 25, 2002, their return would have been 840 percent.[3]

The approach I used to forecast the direction of specific stock prices also informed the development of the Value Leadership concept and the VQ. The stock picks were intended to take advantage of broader stock market trends. I recommended buying certain stocks when the overall markets were rising and selling specific stocks when the overall markets were tumbling. I used the following criteria to pick companies whose stocks I believed would rise during the period when the overall market was rising:

- They did business in a fast-growing market segment.
- They were more profitable than other companies in their market segment.
- Their executive team was very talented.
- They were market leaders.

I used the following criteria to pick companies whose stock prices I thought would decline during the period when markets were dropping:

- Their accounting was complex and difficult to understand.
- Their accounting appeared to overstate the health of the company given deterioration in the profit potential of its industry.
- Their management declined to answer questions attempting to clarify the complexity of the accounting or the variance between the financial statements and the condition of the industry.

The management and stock selection criteria I derived from my experience contributed to the formulations of the principles of Value Leadership. As Table 1.1 illustrates, referring to the lists of criteria just described, some of the Value Leadership principles were consistent with leading management and rising-market stock selection criteria. Other principles were the opposite of management criteria for peer companies and down-market stock selection criteria. For example, the principle “Value human relationships” is consistent with these leading

Principle	Linkage with Author's Management and Stock Selection Criteria
Value human relationships	**Agree:** They hire and motivate the smartest and most ambitious people. They offer employees an intense combination of on-the-job and classroom training. Their executive team is very talented. **Oppose:** They hire and promote people who put their career interests ahead of the team's.
Foster teamwork	**Agree:** They offer employees an intense combination of on-the-job and classroom training. They invest in pragmatic solutions to customer problems that could become big new sources of revenue, regardless of who came up with them. Their executive team is very talented. **Oppose:** They hire and promote people who put their career interests ahead of the team's. They encourage competition for resources among functions.
Experiment frugally	**Agree:** They invest in pragmatic solutions to customer problems that could become big new sources of revenue, regardless of who came up with them. They spend shareholders' money frugally. They are more profitable than other companies in their market segment. They are market leaders. **Oppose:** They adapt slowly to changes in their industry, encourage competition for resources among functions, and exercise power from the top down.
Fulfill your commitments	**Agree:** They win by giving customers more value than do competitors and spend shareholders' money frugally. **Oppose:** They shun tying employee evaluation to market leadership and customer satisfaction. They exercise power from the top down. Their accounting is complex and difficult to understand. Their accounting appears to overstate the health of the company given deterioration in the profit potential of its industry. Management declines to answer questions attempting to clarify the complexity of the accounting or the variance between the financial statements and the condition of the industry.
Fight complacency	**Agree:** They avoid resting on their laurels, maintaining strict standard for growth, profits, and conduct that drive the organization forward. They do business in a fast-growing market segment. They are more profitable than other companies in their market segment. Their executive team is very talented. They are market leaders. **Oppose:** They adapt slowly to changes in their industry. They encourage competition for resources among functions. They exercise power from the top down.

Table 1.1. Linkages Between Value Leadership Principles and Peter S. Cohan's Management and Stock Selection Criteria. *(Continues)*

Principle	Linkage with Author's Management and Stock Selection Criteria
Win through multiple means	**Agree:** They win by giving customers more value than competitors. They invest in pragmatic solutions to customer problems that could become big new sources of revenue, regardless of who came up with them. They spend shareholders' money frugally. They are market leaders. **Oppose:** They shun tying employee evaluation to market leadership and customer satisfaction. They adapt slowly to changes in their industry.
Give to your community	**Agree:** Their market leadership extends to their role in the community. **Oppose:** They shun tying employee evaluation to community participation.

Table 1.1. Continued.

Note: Companies that perform the activities after "Agree" support the specific Value Leadership principle; companies that perform the activities following "Oppose" undermine the Value Leadership principle.

company criteria: "Hire and motivate the smartest and most ambitious people" and "Offer employees an intense combination of on-the-job and classroom training." It is also the opposite of peer company criterion "Hire and promote people who put their career interests ahead of the team's." And it is consistent with the rising-market stock selection criterion "Their executive team was very talented."

As we noted in the Introduction, Value Leaders can offer examples that illuminate the concept of Value Leadership. The introduction also clarified the connection between the principles of Value Leadership and the qualitative and quantitative criteria used to select the Value Leaders. Although Value Leaders have performed well in the past, readers should not infer that the specific Value Leaders discussed in this book will continue to perform well in the future. As long as these eight Value Leaders continue to follow the seven principles of Value Leadership, they should continue to perform well. If they diverge from these principles, their performance could deteriorate. Just as the shadows on the cave wall depicted reality of the cave dwellers in Plato's allegory of the cave, the Value Leaders represent a useful way to perceive how the concept of Value Leadership manifests itself in the world.

With that as a caveat, it is worth noting that the eight Value Leaders significantly outperformed their peers in shareholder value, sales growth, and profitability. As Figure 1.2 indicates, Value Leaders increased their stock prices at almost *five times* the rate of the S&P 500 index between 1992 and 2002. This period began with a recession that ended in 1993, was followed by an economic boom from 1993 to 2000, and ended with a recession that began in 2001 and is still under way at this writing. Figure 1.3 shows that Value Leaders grew their revenues 33 percent faster and earned 109 percent higher profit margins than their industries between 1997 and 2002.

As we discussed in the Introduction, the VQ helps executives gauge how well their companies use the seven principles of Value Leadership that have contributed to the Value Leader's excellent track record. The VQ takes the concept of Value Leadership down to the level of principles, activities, and tactics. It helps executives quantify how well their companies follow Value Leadership by comparing their company's

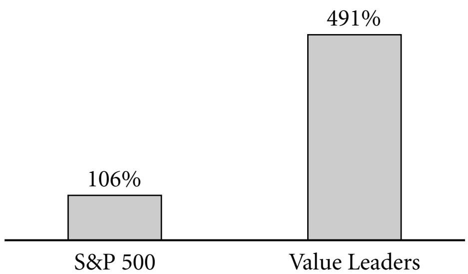

Figure 1.2. Percentage Change in Share Price of S&P 500 and Eight Value Leaders.
Note: Average, June 1992 to June 2002.

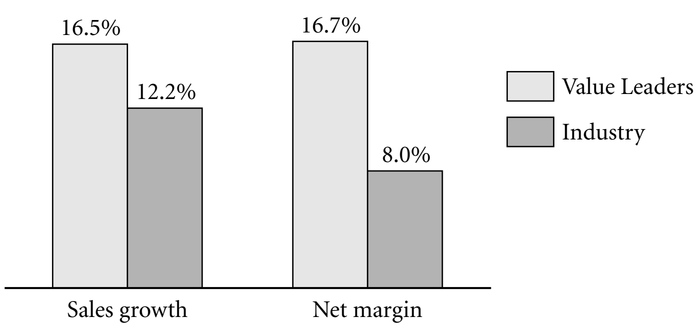

Figure 1.3. Sales Growth and Net Margins of Eight Value Leaders vs. Industry.
Note: 1997 to 2002.

activities and tactics to those of companies that come closest to realizing the concept.

The VQ can be used at two levels. First, it can help executives conduct a relatively quick activity-level diagnostic analysis that pinpoints specific Value Leadership areas in which a company most needs to improve. Second, the VQ can be the focus of a more detailed tactical change initiative designed to develop an organization so that it achieves and sustains superior performance.

HOW CAN THE VQ HELP YOUR BUSINESS?

The VQ can help you make your business more successful by pinpointing opportunities for improvement that have been shown to enhance performance. To demonstrate how the VQ can help, this section first provides an example of how the VQ is applied to Synopsys, a Silicon Valley company. Second, it offers benchmarks of VQ scoring based on a Value Leadership database (as detailed in the Appendix). Third, it describes a process that you can use to apply the VQ to your company. It concludes by showing which chapters of this book can help most, depending on the outcome of your company's VQ.

Gathering data to provide meaningful VQ results requires primary research. In general, the more care and time a company invests in gathering information to generate the VQ scores, the more accurate the results and the more valuable the resulting insights will be. To gather data carefully, executives may seek outside assistance to develop interview guides and conduct interviews with relevant employees, customers, shareholders, and community members. Although internal and external interviews represent a good first step for quickly identifying key opportunities for improvement, more in-depth interviewing and analysis may be required to gain a thorough understanding of how well a company follows specific Value Leadership principles. If an initial VQ analysis makes clear that a company needs to enhance how it follows, say, the principle "Win through multiple means," then more in-depth organizational analysis is recommended as detailed in Chapter Nine. More details about how best to collect and analyze this data are available in the Appendix.

Investors can also benefit from conducting a VQ analysis. Investors place their bets based on an assessment of the likely future value of a company. Although investors can attempt to build such forecasts by extrapolating from the past into the future, it is not uncommon for unpredictable events to throw off such forecasts, making them less reliable for estimating the future value of a company. One way investors can sidestep this problem is to think of a company as a collection of people dedicated to getting and keeping customers. The better the company is at performing this function, the more likely it is to adapt effectively as it is buffeted by such unpredictable events. And the better a company adapts to such changes, the more likely it is to grow profitably and predictably, thus making the company more valuable than its less adaptable peers.

Investors can use the VQ as a tool for seeking value by helping them to assess how well a company in which they might invest adapts to change. They must overcome significant hurdles to develop meaningful data from which to calculate a company's VQ. Rather than dismissing the VQ because of these challenges, investors may wish to look at the challenges as a barrier to entry. Those willing to do their homework can sustain a competitive advantage over those who are not.

Given these challenges, some thoughts on VQ methodology may be helpful. Often the quality of the results is improved by hiring an objective third party to gather the data and to conduct the analysis required to develop the VQ scores. Whether you decide to work with or without outside assistance, to calculate a company's VQ you should take the following four steps:

- *Identify which employees within a company can offer a comprehensive assessment of how closely a company follows the principles of Value Leadership.* Similarly, pick a set of sample customers, shareholders, and community members who can offer their perspectives on the company. Clearly, the CEO of a company will have an easier time tapping into these relationships than an investor. However, because some resourceful investors—particularly investors who sell stocks short—are known for cultivating such relationships within an industry, the challenge for investors is not insurmountable.
- *Develop interview guides for each interviewee along the lines we will detail later.* The interview guides help structure the conversations with key stakeholders. Providing the interviewee with a guide beforehand enables that person to prepare for the conversation, making for a more effective interview.
- *Conduct interviews and summarize results.* The number and scope of the interviews is likely to vary depending on the size of the company. For a very large company, for example, it might make sense to conduct as many as fifty interviews, consisting of a cross section of fifteen to twenty individuals from among the company's employees,

customers, shareholders, and community members. A smaller company might benefit from twenty interviews, similarly distributed among the four groups.

• *Prepare the company's VQ using the worksheet that appears later in this chapter.* To assign the scores, you should assess how well your company conducts each of the twenty-four activities relative to the Value Leaders highlighted in the Appendix. Although the scores are based on judgments, the use of the Value Leaders' scores can be effective benchmarks for calibrating the company's VQ.

VQ for Synopsys

To demonstrate how to apply the VQ, let's review the process followed to analyze Synopsys. As we noted in the Introduction, Synopsys is a leading provider of chip design software. After the company agreed to participate, the author conducted interviews with its CEO, president, and CFO.

For example, the interview guide for Synopsys CEO Aart de Geus included the following questions organized by topic:

CEO Background

- What was your background prior to working at Synopsys?
- Why did you join Synopsys?

Value Human Relationships

- What are the core values of Synopsys?
- How were these values developed?
- How widely and how frequently are these values communicated within Synopsys?
- How do these values influence the way the company hires, evaluates, and rewards employees?

Foster Teamwork

- How does Synopsys encourage teamwork among different departments within the company?
- How does Synopsys manage partnerships within its industry?
- What steps, if any, is Synopsys taking to enhance teamwork?

- How does Synopsys use its performance measurement and compensation systems to influence manager and employee behavior?

Experiment Frugally

- How does Synopsys develop new products and services?
- How does Synopsys measure the effectiveness of its new product development process?

Fight Complacency

- Is Synopsys worried about becoming complacent? If so, how does Synopsys fight complacency?
- What performance measurement and reward processes encourage the company's self-renewal?
- Why does Synopsys make acquisitions, and how does it manage their financial risks and integration issues?
- How is Synopsys developing its next generation of managers and executives? How confident is Synopsys of its executive "bench strength"?

Win Through Multiple Means

- What capabilities contribute most to the company's market leadership?
- How does Synopsys keep competitors from copying these capabilities? How, in general, does Synopsys keep ahead of its competitors?
- What are the two or three most significant risks facing Synopsys, and what processes are in place to manage these risks?

Give to Your Community

- How does Synopsys give to its communities?
- Why is such giving important?

Synopsys CEO de Geus addressed the principle "Fulfill your commitments" in part during his discussion of core values.[4] (A more extensive discussion of the principle occurred during the author interview with Brad Henske, the company's former CFO.)[5]

Based on these interviews, I concluded that Synopsys closely follows the principles of Value Leadership. To support this conclusion, let's first analyze the interviews and then illustrate how to use them to develop a VQ for Synopsys.

CEO BACKGROUND. The core values of Synopsys were clear at its inception. According to chairman and CEO Aart de Geus, prior to founding Synopsys, de Geus worked at General Electric's (GE's) semiconductor R&D unit in Research Park Triangle, North Carolina. De Geus was working to develop tools to improve the semiconductor design process, called synthesis design tools. In 1987 GE decided it would exit the semiconductor business. So de Geus began interviewing for a job with semiconductor companies. In many of his interviews, the companies seemed so interested in synthesis that de Geus decided that he and his GE team should build a business around it. De Geus developed a proposal in which GE would let go of its synthesis technology and provide the initial investment in Synopsys.[6]

The way Synopsys was started reflected its integrity. In de Geus's view, GE was a high-integrity company, which had treated de Geus and his colleagues fairly. De Geus approached GE with the Synopsys business proposal without a second thought; it was the right thing to do and he did it. Although he might have approached other investors to finance the licensing of GE's intellectual property, this option was inconsistent with the value that de Geus placed on dealing straightforwardly with GE. In the end GE's contributions of intellectual property and seed capital, combined with de Geus's ability to turn these resources into a profitable business, transformed what would have been a loss for GE into a big profit after the successful IPO of Synopsys.

VALUE HUMAN RELATIONSHIPS. Synopsys was founded with the intent that it would prosper for a long time rather than being "built to flip." (During the dot-com era, companies with limited revenues and profits often formed very quickly with the intention of "flipping" or being acquired by bigger firms, enabling their investors to realize a quick return on their investment.) With longevity in mind, the Synopsys founders discussed its core values before the company began operating. They asked themselves which companies they wanted to emulate and began by patterning the company after Sun Microsystems and Hewlett-Packard. De Geus attracted a team of people who shared his core values. In light of the often difficult challenges facing a start-up company, such shared values helped determine how well the team would fare when Synopsys was fighting for its survival.

The company's values have been particularly useful in its many acquisitions. During the process of evaluating acquisition candidates, its core values have helped determine whether the process should continue. If an acquisition candidate does not fit with the values, discussions end. On the other hand, Synopsys believes that it must "refresh its DNA," according to de Geus, and that acquisitions offer it new products and new approaches to management that achieve this objective.

To illustrate how Synopsys refreshes its DNA, it is useful to understand the values at the company's core. Synopsys thinks of its core values in the form of a pyramid with a flag on top. At the base of the pyramid is *integrity,* which de Geus says means that "you do what you say and say what you do." As people make verbal commitments and subsequently meet those commitments, they gradually build trust. In the middle of the pyramid is *customer success through execution excellence,* which means finding ever better ways of performing business activities. Execution excellence means that Synopsys is never satisfied with its efforts. It strives to become "best in class" in the way it works; and when it achieves its goal, it sets the bar higher. For example, once Synopsys achieved the highest market share in the electronic design automation market, it set a higher goal of becoming the best $1 billion software company. At the top of the pyramid is *leadership,* which aims at making Synopsys first in its industry by anticipating where the industry is going and meeting the future needs of customers ahead of the competition. In de Geus's view, a great leader can see and grasp the future, and a great manager can execute on how to get there. The flag on the top of the Synopsys pyramid of values is *passion,* which de Geus defines as a sense of caring about work, an inner energy to achieve results. When Synopsys makes an acquisition, he says, its "DNA adapts" as it adds to the capabilities subject to execution excellence.

Synopsys has put in place specific processes for embedding its values into its workforce. Since its founding in 1987, Synopsys has communicated its values throughout the organization, a process that de Geus believes is critical for aligning the organization, and Synopsys has acted according to its values. After Synopsys completed its acquisition of Avant! in 2002, it required all of its managers to attend an internally run two-day management development program. The course, which featured seven or eight different modules, included a two-and-a-half-hour session that de Geus taught, addressing the values and culture of Synopsys.

One of the key themes of de Geus's session was to give managers guidance on how to behave in what he calls "the gray zone." If employees are categorized by the extent to which they embody the Synopsys values and their ability to achieve desired results, de Geus noted that the least desirable managers are the ones who do not agree with the company's values and fail to achieve results. On the other end of the spectrum, managers who agree with Synopsys values and meet their performance targets are the most valuable to the company. He defines the *gray zone* as the awkward challenge facing executives who must decide what to do about managers who either achieve results but behave unethically in some way or who are truthful but get poor results.

The Synopsys hiring process also aligns its organization with its values. By communicating its values to potential employees through the media, Synopsys hopes potential employees will self-select. More specifically, de Geus anticipates that if more potential Synopsys job applicants read about the company and decide that they want to work there, then the company's hiring process will operate more effectively.

To interview candidates Synopsys conducts behavioral interviews. Instead of asking an applicant "Are you good at conflict management?" the Synopsys interviewer says, "Tell me about a situation when you did not do well managing a conflict." If the candidate responds with a story that suggests he does not take responsibility or is not self-aware, the interviewer may have legitimate grounds to reject the candidate. Before making a hiring decision, Synopsys conducts a roundtable discussion with all staff who interviewed the candidate. One might say, "He looked good, but I'm not sure how far he got on the project." This comment might amplify a weak signal that other interviewers had noticed, leading the roundtable to conclude "This guy never finishes anything on time."

The company's employee organizational review process also aligns its organization with its values. Every six months Synopsys senior management meets with business unit general managers and reviews their list of top and bottom performers. Managers base their ranking on behavioral criteria, cultural fit, and financial performance. Management decides which employees have upward mobility within the organization and promotes and trains these select individuals.

FOSTER TEAMWORK. Teamwork is important at Synopsys because its products are complex and must work in different semiconductor design functions and global office locations. In very few situations can an individual working alone solve an important product development problem. Synopsys employs many incredibly talented individuals who generally work in teams. The company has two career tracks: the management track, which takes teamwork into account in evaluating performance; and the individual contributor track, which tends to reward individual technical contribution up to the vice presidential level of Synopsys Fellow. However, even successful individual contributors must be team players, serving as role models within the Synopsys culture. Every year Synopsys management gives out excellence awards intended to promote successful group behavior. As de Geus points out, workers who receive countless bonus payments throughout their career are far more likely to reflect back warmly on receiving an excellence award, because they place such a high value on peer recognition. De Geus has found that employees have a deeper and more positive emotional reaction to peer recognition than to receiving a stream of bonus payments.

Synopsys also has formal processes to encourage strong external partnering, applying the same values to internal teamwork as it does to external teamwork. For example, as de Geus notes, when a customer is making a $10 million purchase, the customer must trust the supplier. Specifically, the customer wants to be confident that the supplier will survive for the long term and that the customer has a personalized relationship with the supplier. Synopsys dedicates an executive sponsor to each of its largest customers. These executive sponsors include Synopsys senior vice presidents, vice presidents, and directors. If a customer has a problem with a Synopsys product or service, the customer calls his or her executive sponsor.

Synopsys pays money for hard results and offers psychological rewards for role-model behavior. Synopsys has found that offering extra monetary rewards for less tangible outcomes, such as doing a great job on a project, tends to create a perception of unfairness. Because the basis of such an award might be seen as subjective, people who thought they did a good job on a project but did not receive such an award would feel that the company was somehow being arbitrary in its rewards, which could generate resentment. To avoid these unintentional side effects, Synopsys pays additional compensation only to those who meet or exceed quantitative targets. Individuals who behave in a way that promotes the company's values get rewarded by being praised for their accomplishment in an all-company voice mail or e-mail from the CEO. The employee gets a memorable and satisfying psychological reward, and Synopsys encourages all its employees to emulate the praised behavior.

EXPERIMENT FRUGALLY. Synopsys develops new product ideas through a process that links customers with a core product development team. According to de Geus, if a company listens to customers the wrong way, it can miss out on important opportunities. Specifically, Synopsys does not come up with new product ideas by listening to customers complain about their current products. Focusing on such complaints may lead a company to make incremental improvements to products whose best years have already passed. Instead, Synopsys works with customers to anticipate their future needs. By getting customers to discuss capabilities that might help them do their jobs better in the future, Synopsys product development teams can better apply their knowledge of cutting-edge technology to inventing products that these customers will value.

Synopsys assesses new product ideas through a core team consisting of representatives from R&D, applications engineering, and marketing. Each function brings a different perspective: R&D is inclined to work on the latest hot technology; applications engineers may look for a more practical solution using more proven technology; and marketing may push for a single product feature that will make it easy to sell.

Synopsys has a novel approach for blending these three perspectives into a prioritized list of new product development projects. Each core team member scores each proposed product development project. Instead of offering a quantitative score or a detailed analysis, the team members summarize their conclusion with a color: red means do not proceed with the project; orange means potentially proceed with the project pending the resolution of open issues; and green means definitely pursue the project. The benefit of this color-scoring approach is that the teams can prioritize the projects quickly without arguing extensively about the rationale for the scoring.

Despite the simplicity of the color scheme, Synopsys has a more complex method of arriving at the answer. First, the teams estimate the approximate value of each project, assigning so-called lucky bucks.

Second, the teams estimate the cost to turn the idea into a marketable product. The first two criteria are combined into a single number, the ratio of lucky bucks to cost. Third, the teams assess whether Synopsys has the capabilities needed to succeed with the development of the product. In addition, Synopsys senior managers review the priorities to make sure they fit with the company's overall product strategy. This review might lead Synopsys to cut projects that might make good individual products but do not fit within its broader product portfolio.

FIGHT COMPLACENCY. De Geus cites the title of Intel chairman Andrew Grove's book, *Only the Paranoid Survive,* to explain how Synopsys fights complacency. Because it sells software to help chip designers, Synopsys sees itself as being at the heart of high technology. The company pays close attention to the industry trade press, specifically *EE Times,* very frequently finding new competitors or new technologies that could be threatening to it. Synopsys structures its staff meetings and its strategic planning discussions to include discussions of new competitors. This structure supplements the natural tendency of Synopsys people to remain constantly paranoid about the competition.

WIN THROUGH MULTIPLE MEANS. Synopsys has made many acquisitions to enhance its competitiveness. De Geus notes that it is hard to make acquisitions succeed and that acquirers know the true risks of the deal only after the transaction has closed. Synopsys needs strategic reasons to justify undertaking these risks, such as the target's technology, positioning, people, or ability to help Synopsys sell more products through its existing distribution channels. In general, acquisition candidates that satisfy these criteria come at a high price.

In order to justify paying high prices, Synopsys must integrate the acquired company successfully. Because of its relatively extensive experience with acquisitions, Synopsys has developed very detailed procedures for managing them. The key step in its methodology is to focus first on integrating the sales and distribution forces. This means that Synopsys decides whether the two companies' sales forces overlap; if so, it eliminates the overlap immediately so that customers are not confused. Second, Synopsys analyzes the acquired company's product line and eliminates overlap. In doing so, Synopsys anticipates and tries to address the annoyance of customers who are currently using the terminated products. Finally, Synopsys assembles a management structure that retains the best managers from the acquired company.

GIVE TO YOUR COMMUNITY. Finally, Synopsys gives to its communities by leveraging its core competencies. Initially, the company's community activities were ad hoc. Its employees cleaned nature trails and led food, blood, and toy drives. As Synopsys became larger, it received requests for money and employee time. After some internal discussion, Synopsys decided it should pick themes that were consistent with what de Geus calls its "corporate DNA," such as learning and education. To that end Synopsys began to sponsor science fairs at schools in the Silicon Valley area. The benefit of such sponsorships was that they inspired students who might not ordinarily have been interested in science to participate in the fairs.

Synopsys employees benefit significantly from community service. For example, at a Safeway in California, a Synopsys vice president was wearing a T-shirt with the company's logo. A woman approached the vice president and asked him if he worked for Synopsys. She described to him how her son had been a poor student. Then her son won a prize at a Synopsys-sponsored science fair. This motivated him to start studying, and he subsequently became an A+ student. The vice president reacted to the woman's story with a great feeling of pride in Synopsys. Although this is just one story, it illustrates how good the company's community activities can make its employees feel.[7]

The purpose of including the case study of Synopsys management practices is to offer executives an example of the information needed to calculate a company's VQ. As Table 1.2 indicates, the VQ for Synopsys is a solid 87 percent.

The Synopsys VQ reveals significant variation in how closely the company follows the different principles of Value Leadership. For example, Synopsys scored highest in valuing human relationships and in fulfilling its commitments. Given the clear way it articulated its core values and the way it applies these values in hiring, its use of the first principle makes sense. In light of the tremendous importance that talented people and long-term customer relationships play in its industry, Synopsys's strong score on the second principle is also expected. By contrast, Synopsys scores less well in the principles "Give to your community" and "Foster teamwork." In the company's defense, the first principle may be less important to its overall success because many Synopsys customers live outside its community. Nevertheless, the company seems to have made a difference in the areas on which it has focused. Synopsys also appears to have done well in promoting teamwork; however, it could enhance its formal processes somewhat.

Principle	Activity: Evaluation	Score
Value human relationships	**Commit to core values:** Core values are clearly communicated.	5
	Hire for values: Hiring approach selects employees who share values.	5
	Balance performance measurement: Balances results and values.	5
	Reward employees intelligently: Money for results, praise for values.	5
	Weighted total (sum times 3)	60
Foster teamwork	**Team training:** Management training reinforces team behavior.	4
	Job rotation: High-potential employees choose job rotations.	4
	Team decision making: Teams drive product development and sales.	4
	Team rewards: Rewards hard results and team behavior.	5
	Weighted total (sum times 3)	51
Experiment frugally	**Grow organically:** Grows by leveraging capabilities to new markets.	4
	Manage development risk: Green/orange/red–light process manages risk.	5
	Partner internally: Core product development teams work well.	5
	Partner externally: Executive sponsors partner with customer.	4
	Weighted total (sum times 3)	54
Fulfill your commitments	**Hire and promote honest people:** Integrity tested by interviews.	5
	Account honestly: Conservative revenue accounting.	5
	Treat employees, customers, and communities fairly: Rewards hard results with cash, model behavior with peer recognition.	4
	Weighted total (sum times 4)	56
Fight complacency	**Plan CEO succession:** Promoted long-time employee to president.	4
	Sustain a healthy paranoia: Believes only paranoid survive.	5
	Attack new markets: Acquisition strategy has been effective.	4
	Weighted total (sum times 4)	52

Table 1.2. Value Quotient Analysis: Synopsys. *(Continues)*

Principle	Activity: Evaluation	Score
Win through multiple means	**Understand the customer:** Executive sponsors know customers.	5
	Build diverse capabilities: Acquisitions add to capabilities.	3
	Sustain competitive superiority: Ambition raises performance bar.	5
	Weighted total (sum times 4)	52
Give to your community	**Inspire employees:** Safeway story demonstrates high inspiration.	4
	Enrich the community: Encourages local interest in science.	3
	Better society: More science interest helps regional economy.	3
	Weighted total (sum times 4)	40
Value Quotient	**(Sum divided by 420)**	**87%**

Table 1.2. Continued.

Key: 5 = excellent; 4 = very good; 3 = good; 2 = fair; 1 = poor. Weighted scores for each principle are calculated by multiplying the activity scores by 3 for four-activity principles and by 4 for three-activity principles.

VQ Benchmarks

The Synopsys analysis offers a useful starting point for thinking about how to apply the VQ to your company. To provide further guidance, we now examine a range of VQ principle–level scores from the eight Value Leaders. As Table 1.3 illustrates, the range of principle-level scores among the eight Value Leaders varies significantly. For example, the range between the highest score and the lowest score on the principle "Value human relationships" is six. The highest scorers, at sixty, include Southwest Airlines and six others that all have very clearly defined core values and that hire, measure, and reward people in a manner very consistent with their core values. By contrast, the lowest scorer, Wal-Mart, at fifty-four, had clearly defined values; however, it allegedly underpaid some employees by allegedly asking them to work hours "off the clock."

VQ Worksheet

The foregoing VQ analysis of Synopsys and the VQ benchmark should help indicate how to apply the VQ analysis to your company. As noted

Principle	Benchmark and Evaluation	Score
Value human relationships	**High:** Clear core values and tight link to hiring, training, and pay (all other Value Leaders).	60
	Low: Strong core values and link to hiring and training, but pay is low given alleged off-book work hours (Wal-Mart).	54
	Range	6
Foster teamwork	**High:** Trains teams, rotates jobs, extensive team decision making, rewards results with values (Southwest, Smucker, Goldman Sachs).	60
	Low: Encourages teamwork in product development, does some training and job rotation, some pay for results and values (Microsoft).	42
	Range	18
Experiment frugally	**High:** Builds off core capabilities, tight risk management, and strong internal and external partnering (MBNA, Wal-Mart).	60
	Low: Internal new product development generated some revenue growth, but big acquisition required for big shift (Smucker).	42
	Range	18
Fulfill your commitments	**High:** Hire for integrity; do conservative accounting; and treat employees, customers, and communities fairly (Goldman Sachs, Johnson & Johnson, Smucker, Southwest).	60
	Low: Evolving value placed on integrity, quality, and information security (Microsoft).	40
	Range	20
Fight complacency	**High:** Effective CEO succession, intense paranoia, growth from new market entry (Wal-Mart, Goldman Sachs, and Johnson & Johnson).	60
	Low: Promoted long-time family member, somewhat comfortable, big growth from acquisition in core market (Smucker, MBNA).	52
	Range	8
Win through multiple means	**High:** Deep customer knowledge, top capabilities, and clear market leadership (Goldman Sachs, Wal-Mart, Southwest, Microsoft, MBNA).	60
	Low: Deep customer knowledge, strong capabilities, and top in many markets (Johnson & Johnson, Smucker, Synopsys).	52
	Range	8

Table 1.3. Value Quotient Benchmarks. *(Continues)*

Principle	Benchmark and Evaluation	Score
Give to your community	**High:** Lets employees choose charity, gives significantly to local community, and attacks big societal problems (MBNA, Johnson & Johnson, Microsoft).	60
	Low: Employees participate in local high school science competition, moderate community enrichment (Synopsys).	40
	Range	20
Value Quotient	**High:** Goldman Sachs	98%
	Low: Synopsys	87%
	Range	11%

Table 1.3. Continued.

Key: 5 = excellent; 4 = very good; 3 = good; 2 = fair; 1 = poor.

More details on the development of this benchmark information are available in the Appendix.

earlier, often the quality of the results is improved by hiring an objective third party to gather the data and to conduct the analysis required to develop the VQ scores. To calculate your company's VQ, you should take the following four steps:

1. *Identify which employees within your company can offer a comprehensive assessment of how closely your company follows the principles of Value Leadership.* Similarly, pick a set of sample customers, shareholders, and community members who can offer their perspectives on your company.
2. *Develop interview guides for each interviewee along the lines detailed in the previous section.* The interview guides help structure the conversation with key stakeholders and, when provided to interviewees beforehand, enable the interviewees to prepare for the interviews, making them more effective.
3. *Conduct interviews and summarize results. The number and scope of the interviews is likely to vary depending on the size of the company.* For a very large company, for example, it might make sense to conduct as many as fifty interviews, consisting of a cross section of fifteen to twenty individuals from among your company's employees, customers, shareholders, and community members. A smaller company might benefit from twenty interviews, similarly distributed among the four groups.

4. *Prepare your company's VQ using the worksheet in Exhibit 1.1.* To assign the scores, you should assess how well your company conducts each of the twenty-four activities relative to the Value Leaders highlighted in the Appendix. Although the scores are based on judgments, the use of the Value Leaders' scores can be effective benchmarks for calibrating your company's VQ.

Depending on your VQ results, you may find that your company is particularly in need of improvement in specific principles and stronger in other principles. You may wish to read this book based on these results, focusing initially on the chapters that discuss principles that your company's VQ indicates the greatest need for improvement. To assist with that process, the following list summarizes which chapters address which principles:

Principle	*Chapter*
Value human relationships	Two
Foster teamwork	Three
Experiment frugally	Four
Fulfill your commitments	Five
Fight complacency	Six
Win through multiple means	Seven
Give to your community	Eight

These chapters discuss each of the principles in depth. The chapters define the principles and show how they support the concept of Value Leadership. They then provide quantitative evidence that companies that adhere to the principles generate superior economic performance. Each chapter presents three or four specific activities that support the principle, listing a set of effective tactics for putting each activity to work in an organization. Each chapter also presents case studies that illustrate the benefit of each activity, often providing a contrasting example of a company that does not perform the activity, and draws from these case studies a set of general principles. Each chapter also includes a longer case study illustrating how a company transformed itself in an effort to follow the principle highlighted in the chapter. Every chapter concludes with a more detailed VQ worksheet to enable the reader to assess his or her company's use of the principle at the activity and tactical levels.

Principle	Activity: Evaluation	Score
Value human relationships	Commit to core values	
	Hire for values	
	Balance performance measurement	
	Reward employees intelligently	
	Weighted total (sum times 3)	
Foster teamwork	Train teams	
	Rotate jobs	
	Make team decisions	
	Reward team behavior	
	Weighted total (sum times 3)	
Experiment frugally	Grow organically	
	Manage development risk	
	Partner internally	
	Partner externally	
	Weighted total (sum times 3)	
Fulfill your commitments	Hire and promote honest people	
	Account honestly	
	Treat employees, customers, and communities fairly	
	Weighted total (sum times 4)	
Fight complacency	Plan CEO succession	
	Sustain a healthy paranoia	
	Attack new markets	
	Weighted total (sum times 4)	
Win through multiple means	Understand the customer	
	Build diverse capabilities	
	Sustain competitive superiority	
	Weighted total (sum times 4)	
Give to your community	Inspire employees	
	Enrich the community	
	Attack big societal problems	
	Weighted total (sum times 4)	
Value Quotient	(Sum divided by 420)	

Exhibit 1.1. Value Quotient Worksheet.

Key: 5 = excellent; 4 = very good; 3 = good; 2 = fair; 1 = poor; 0 = not applicable.

CONCLUSION

The VQ can help your organization assess how well it adheres to the concept of Value Leadership. As this chapter has shown, Value Leadership is a concept that helps companies generate performance measurably superior to their peers. Value Leadership's underlying principles and activities have strong conceptual linkages to eleven criteria used to pinpoint the best-performing companies. Therefore, how well a company adheres to the concept of Value Leadership determines not only how much good it does for employees, customers, and the community but how well it performs for shareholders. The VQ is a valuable way to gauge how closely a company follows the concept of Value Leadership. As such, it can guide executives to focus on improving their organizations by adopting the principles likely to generate the greatest performance improvement.

To take your first step on the road to Value Leadership, read on!