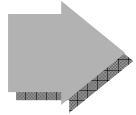

Value Creation in the Connected Economy

**Company
June 4th, 1999**

jean-florent.rerolle@ey.com

(212) 773-5138

Agenda



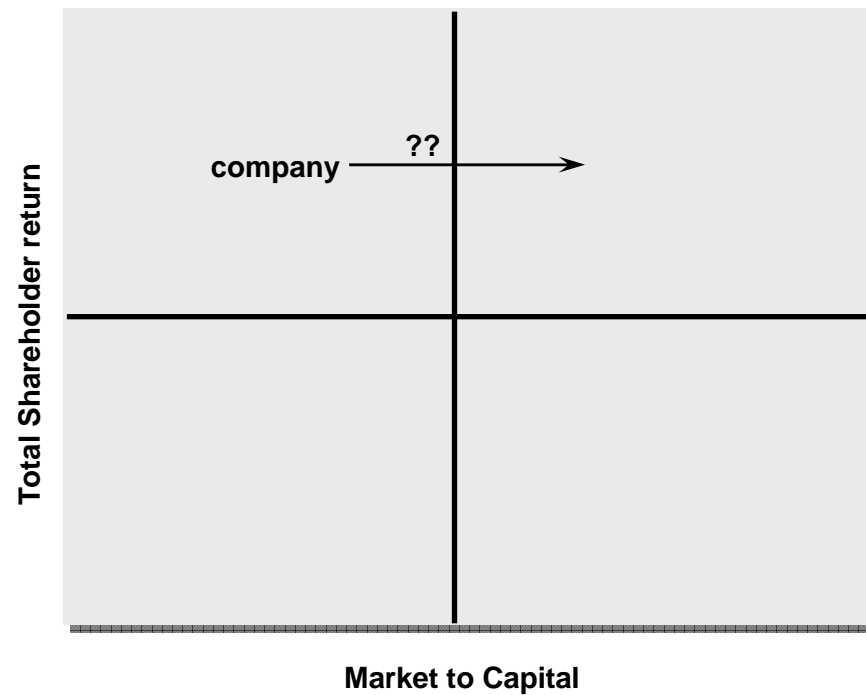
- The value creation issue at company
- A new economy is surging
- Our value mindset has to change
- New management approaches

Creating and Sharing Value is one of the Values of company

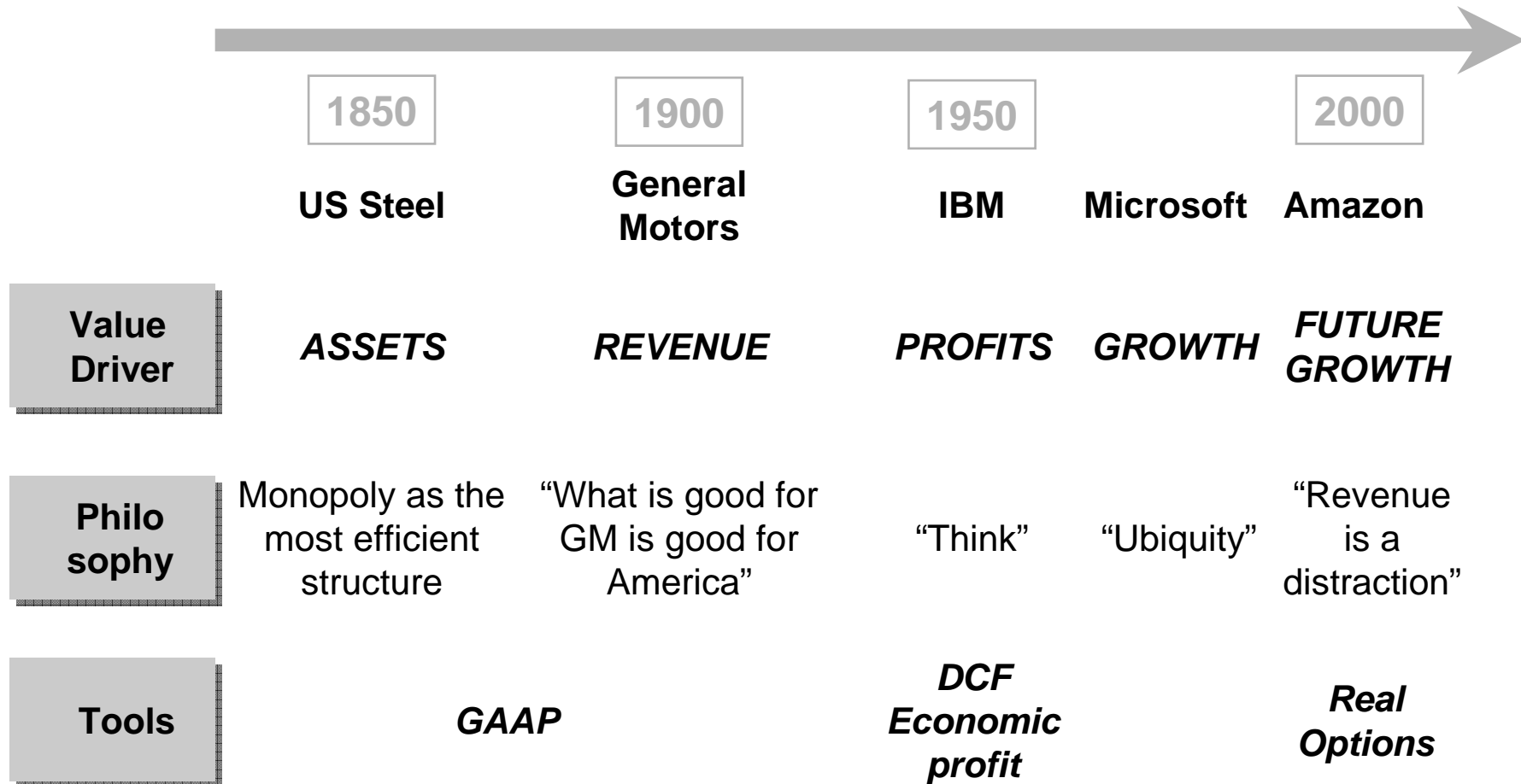
- “company’s goal is the **creation of value** in our sectors and through our growth, which is by nature international in scope. The primary beneficiaries are our **shareholders**, who provide the means to achieve this growth. But value created in the form of profits must also benefit our **employees** through profit-sharing and shareholding schemes, as well as funding our **investments**”
- This objective has been operationalized through :
 - a toolbox and investments procedures
 - an information system (XXX)
 - a value based compensation
- The result is already significant :

How can company keep up that pace and join the top performers ...

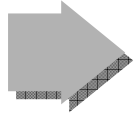
- The company share has outperformed the market by more than 50% over the past year
- But its market value to capital could be improved!



... while the drivers of corporate value are changing



Agenda

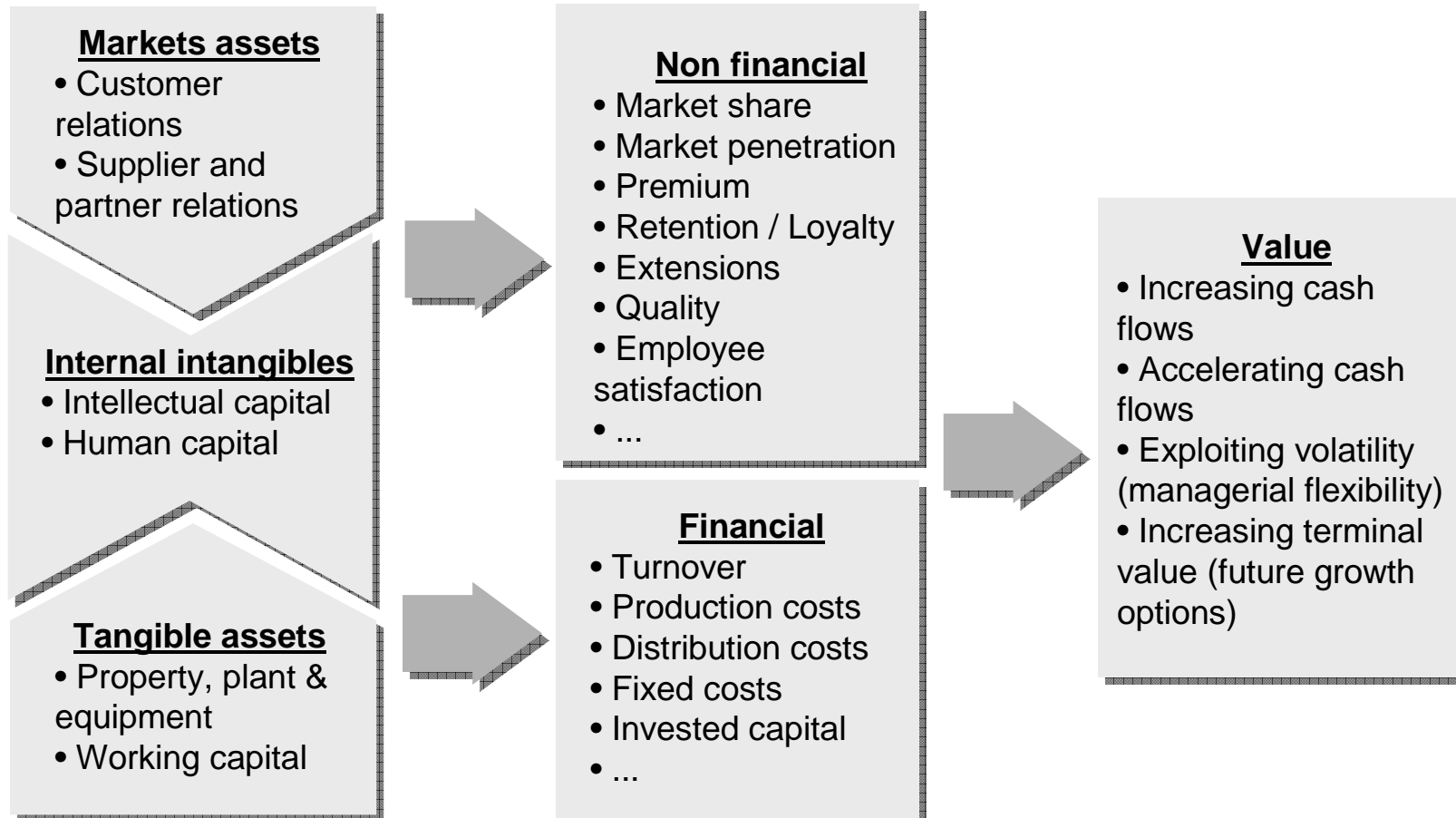


- The value creation issue at company
- A new economy is surging
- Our value mindset has to change
- New management approaches

The New economy Is Driven By Six Major Trends

- The **business web** concept of electronically networking customers, suppliers and partners is a growing reality. Traditional boundaries are blurring and the companies needs to overhaul their business models.
- **Connectivity** allows intimate relationships with customers. Classical middlemen are disappearing. They are replaced by infomediaries. Branding becomes critical.
- **Customers** are the kings of the new economy. Their loyalty is much harder to get. It no longer makes sense to think in terms of products and services; instead, companies should be thinking more broadly in terms of “offers.”
- The business pace is accelerating. **Speed** and **execution** are two major strategic qualities.
- The **competition** is transforming. Every day, a new competitor may pop up and traditional competitors are erupting in Internet. Competitive advantage is easier to create but harder to maintain. “Winner take all” strategies allowed by standards.
- **Knowledge** is the key asset of the new economy. Tangibles assets are becoming liabilities. Intangibles have grown significantly in the economy.

Value mechanisms have not changed...



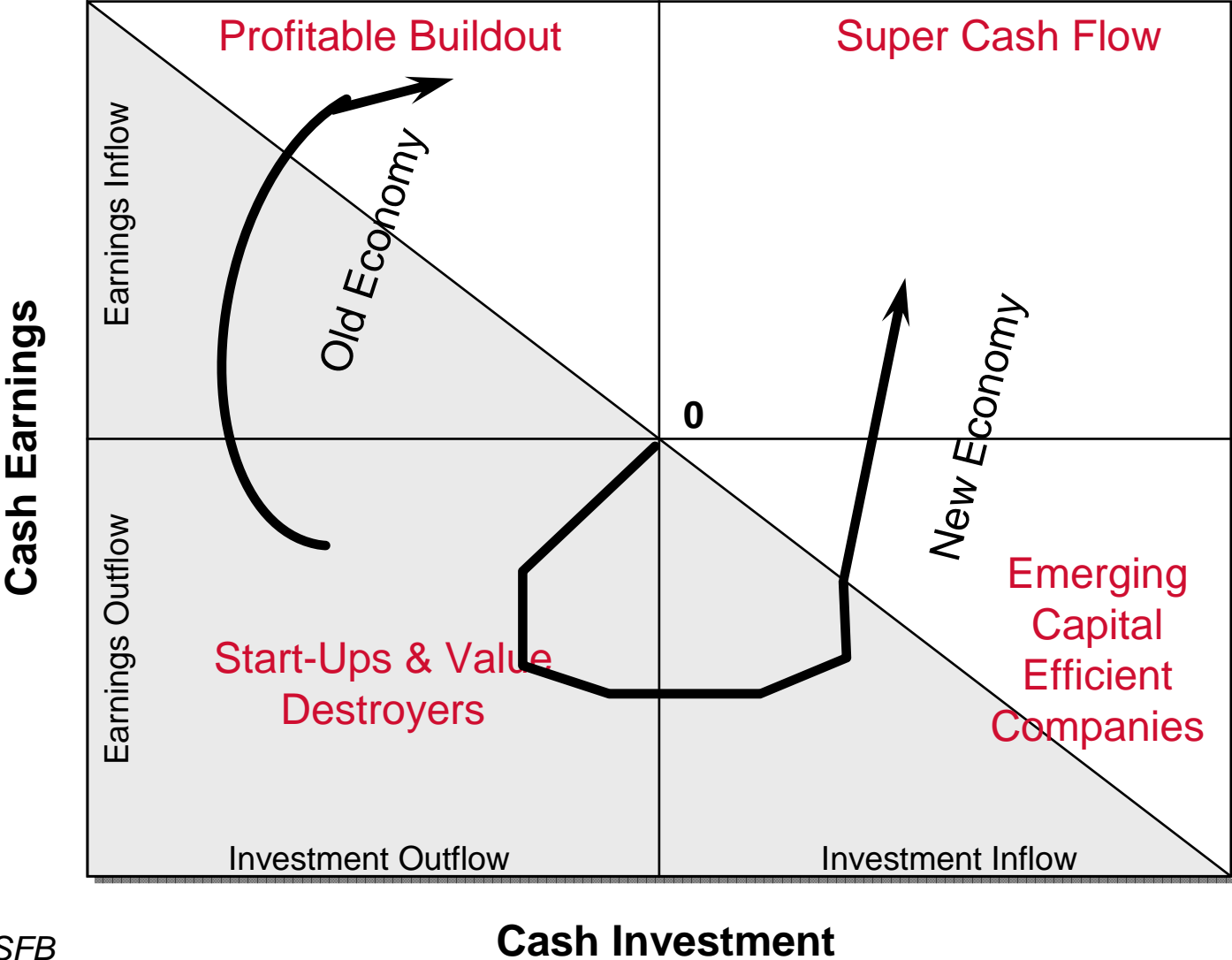
...even for fancy e-companies where an investment in future growth can be a cash inflow!

Amazon.com versus Bricks-and-Mortar Retailer		
<i>(in \$ millions)</i>	Bricks-and-Mortar	Amazon.com
Inventories & receivables	320	35
Accounts payable	<u>-165</u>	<u>-90</u>
Working Capital	155	-55
Fixed PP&E	<u>260</u>	<u>50</u>
Total	415	-5

source: CSFB

In order to generate \$1 billion in sales, a traditional “bricks-and-mortar” book retailer needs to invest \$400 million more than Amazon.com

Cash is still king ... but generated from a different source



source: CSFB

...and Value is becoming harder to define and to create

- Any product shall increasingly include services
- Emotional and informational content of the exchange
- Profitability is more volatile as real markets mimic financial market
- Growing intangible real capital
- Blurring boundaries

Which cash flows ?

Which perimeter ?

- Increasing returns
- Managerial flexibility
- Speed accelerates value migration

Which competitive advantage period ?

The key to success is the ability of a company to change its strategic focus

THE OLD ECONOMY

- **Characteristics**
 - Time
 - Prediction/planning
 - Strategy
 - Organization
 - Tangible asset
 - Investments
- **Focus** : Long term vs. short term

THE CONNECTED ECONOMY

- **Characteristics**
 - Speed
 - Unpredictable/no plan
 - Execution
 - Adaptive organization
 - Intangibles
 - Options and flexibility
- **Focus**: Short term actions for long term visions

...and its strategic framework

How to create value in the

Very Old Economy

Maximize revenue growth
Apply cost controls
Focus on short-term profitability

First "wave" of VBM tools

Old Economy

Allocate capital efficiently
Exceed the cost of capital
Focus on financial ratios

Option Advantage™

New Economy

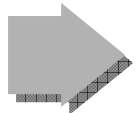
Identify, nurture & manage real options
Maximize knowledge, not physical capital
Grab market share & create switching costs
Constantly innovate
Foster economic "webs" and nurture "complementors"
Focus on long-term profitability & intangibles

↓
"maximize"

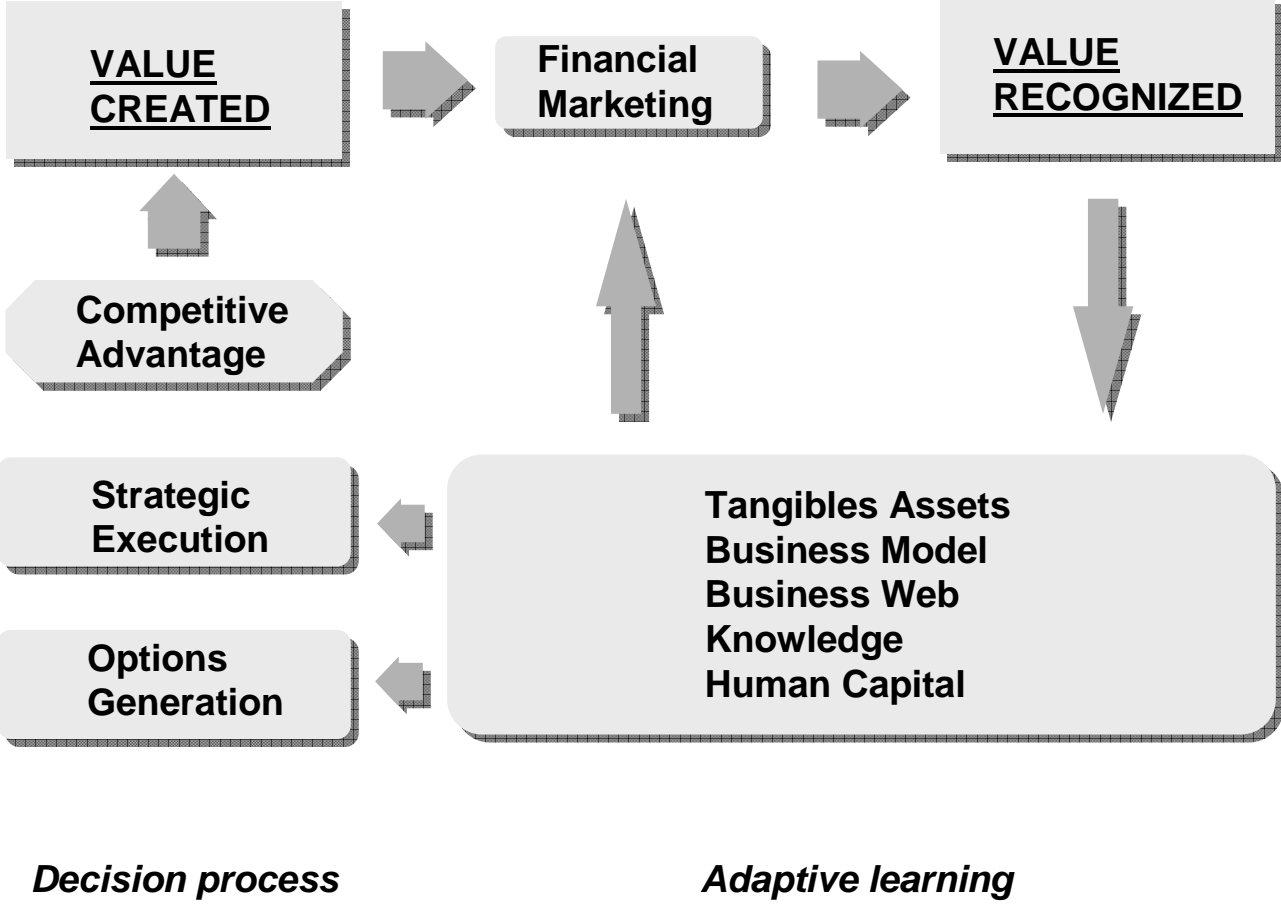
↓
"optimize"

↓
"e-nnovate"

Agenda

- The value creation issue at company
- A new economy is surging
-  • Our value mindset has to change
- New management approaches

A new mindset to create value in the connected economy



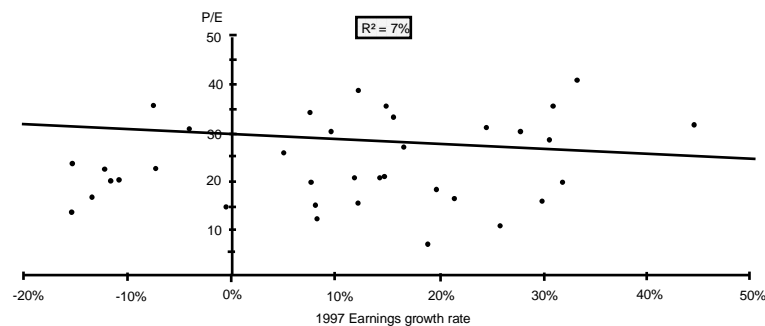
Contrary to conventional wisdom, the market perspective is a long term one

- Conventional wisdom suggests that :
 - Financial market, “Wall Street”, is Short term focused, Accounting based, Irrational and led by minority shareholders
 - and the Real market, “Main Street”, is Long term oriented, Economical, Rational and needs a balance among stakeholders

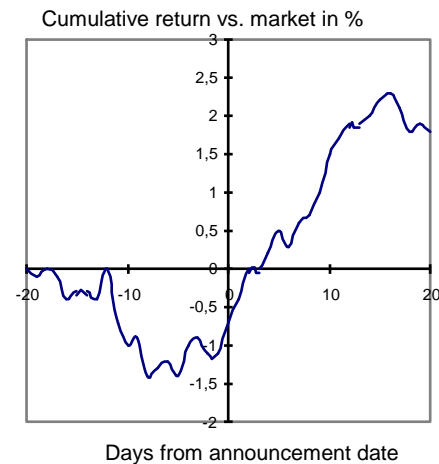
Focusing on shareholder value could jeopardize the future strategic position of a company

- In reality, the market is forward-looking

P/E versus earnings growth for 50 cross-sectional European companies, 1977



Source : CSFB research



Stock market reaction to R&D announcements, average of 62 companies SEC 1985

...and the investors are using extensively non financial measures to make their decisions

- **«Measures that Matter»**
 - 35 % of investment decisions are based on non financial data
 - Analysts' forecasts are improved when they use non financial data
 - Nature and ranking of these indicators are different for each industry and company

THE TOP TEN NON FINANCIAL MEASURES THAT MATTERS

- | | |
|---|--|
| • Strategy Execution | • Market Share |
| • Management Credibility | • Management Experience |
| • Quality of Strategy | • Quality of Executive Compensation |
| • Innovativeness | • Quality of Major Processes |
| • Ability to Attract Talented People | • Research Leadership |

Source: E&Y's Measures That MatterSM Study

Given this market interaction, a company faces three key challenges in delivering shareholder value

Understand investors expectations and measures that matter

- What are the financial expectations of the market ?
- What measures matter most?
- How do investors assess growth?
- What factors are influencing investors' perceptions of risk?

Deliver strategies and growth opportunities the markets requires

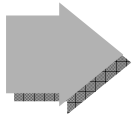
- What are the key drivers of value in the business model?
- How can the portfolio value of tangible and intangible assets be increased?
- Which growth opportunities are more likely to be rewarded by the market?
- How to improve ability to execute on strategy and manage the investors' perception of risk be improved?

Disclose and communicate information investors need

- What type of financial and non-financial information should be disclosed?
- How often should this information be disclosed?
- How to create shareholder's connections ?

Agenda

- The value creation issue at company
- A new economy is surging
- Our value mindset has to change
- New management approaches



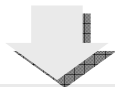
Manage Shareholders' growth expectations

Understand Shareholder's expectations

Characteristics : direct observation of share price and analysis of proxies (analysts, press); financial and non-financial scope; benchmarking

Intermediate outputs :

- Commented analysis of the evolution of the financial market share of the company
- Compared analysis of the financial performance of the company
- Identification of non financial measures that matter for the company and its peers
- Financial expectations of the market (future performance and risk) for the company and its peers
- Identification of lead steers



Shareholder's scorecard

Assess Delivery capabilities

Characteristics : management interviews, self diagnostic, forecast analysis; financial and non financial scope; benchmarking with peer group

Intermediate outputs :

- Financial analysis and assessment of the financial dynamics of the company
- Intrinsic valuation of the company
- Identification of the financial key value drivers (operating and financial)
- Inventory of intangibles assets and future growth options
- Identification of the links between financial KVD and intangibles / options
- Assessment of the Investor relationships policy



Company's value engine

Identify Value opportunities

Characteristics : E&Y workshops and analytics ; brainstorming with management;

Intermediate outputs :

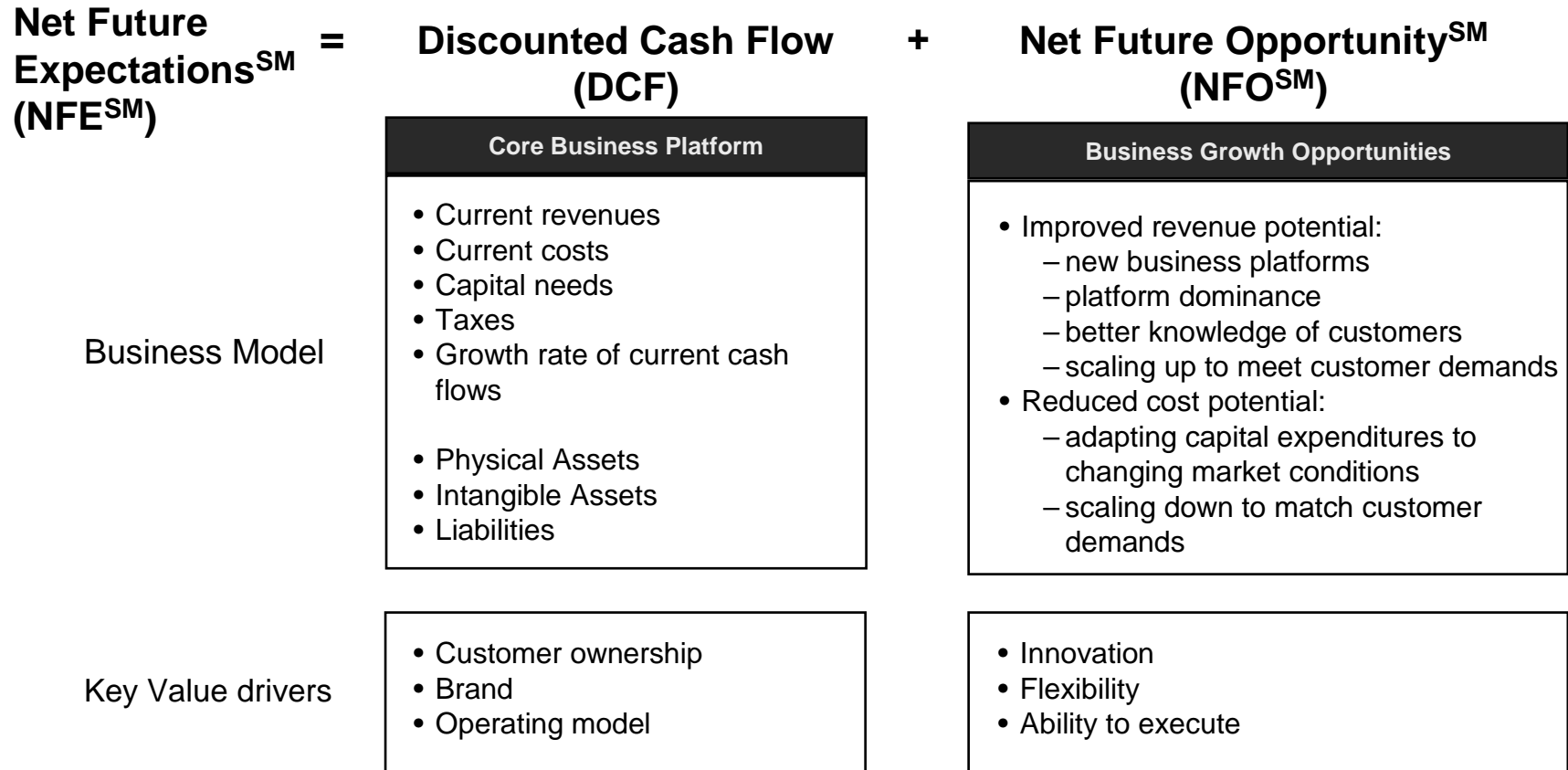
- Gap analysis between Shareholder's scorecard and company value engine
- Definition of a new financial marketing policy : Promise / Price / Placement / Promotion
- Alignment of performance measurement and management
- Options to consider : financial strategy; internal improvement ; strategic actions
- Hypothesis to test : options development ; advice from the financial community



Value improvement portfolio

Focus on Net Future Expectations

Net Future ExpectationsSM - the complete valuation framework



Leverage operating and strategic flexibility

Determinants of value of financial options	Current Value of underlying asset	Strike price of the option	Variance of underlying asset	Dividend paid on the underlying asset	Time to expiration on the option	Riskless interest rate (duration of the option)
Determinants of value of real options	Present value of expected cash inflows	Present value of expected outflows	Uncertainty of expected cash outflows	Value lost by waiting to exercise	Investment opportunity duration	Riskless interest rate
Management of real options	Increase	Reduce	Increase	Reduce	Increase	Keep up with
Examples of associated blurred strategies	Create Business webs with low-cost suppliers	Invest in intellectual capital, not in tangible assets	Accelerate innovation and R&D	Lock-up critical resources	Create Business webs with customers	
	Create standards and platforms	Design assets to be easily reconfigured	Let the market manage offer	Develop structural capital	Maintain technology lead	
	Increase Marketing expenses	Leverage economies of scale	Organize for instability and adaptability	Lock-up customer base	Lock-up distribution channels	