

CHAPTER THREE - EVA AS THE DESIRED MANAGEMENT CONTROL SYSTEM

3.1. Characteristics of A Desired Management Control System

Local Firm is defined as a prominent group of Real Estate Services firms established in Malaysia since late 1970's. It began as a partnership firm by the **Patriarch** i.e. the group founder. When it grows, the **Patriarch** invited several individuals as his **Senior Partners**. Over the years, the **Younger Partners** joined the group. The group has a total of 14 partners i.e. **The Patriarch, 5 Senior Partners and 8 Younger Partners**. All these firms have been incorporated as private limited entities, but the nature of the groups' organization design is still based on partnership management. All the partners have equity crossholding in each of the firms and the **Patriarch** remained as single substantial shareholders.

After the economy crisis, the **Patriarch** had divested his interest and control in one of the valuation services firms to focus on building the brokerage services. During the transition period, warning signals were received and obviously intensified when customers' complaints increased, dropped in revenue and a chain of staff resigned in year 2000. The **Patriarch** was the first to acknowledge the existence of inherent issues and problems in the organization and initiated actions for solution. This study was inspired by his concerns to discover the causes of organization problems and to search for ways in addressing them.

Several brainstorming sessions were conducted with the partners in the **Local Firm** over a period of 18 months to identify the causes of its organizational problems and to develop appropriate solutions for implementation. Three phases of brainstorming sessions were conducted i.e.

- Phase 1 to establish a common frame of reference,
- Phase 2 to explore and identify the causes of the problems, and
- Phase 3 to develop appropriate solutions.

3.2. Phase One Brainstorming

The common frame of reference among the 14 partners is the "Future of The Firm in the K-Economy Era– Equitable Growth and Sustainable Development".

The summary of the result of phase one brainstorming among the partners is to focus on the following prerequisites in meeting the macro and micro challenges:

- a) Equity liberalization forces **Local Firm** to compete with everyone else in the capital market and investors are placing greater emphasis on cash-based shareholders' value. Therefore it is essential to adopt a good management control system;
- b) **Local Firm** must offer competitive service mix focus on niche customers with high service standard and quality delivery system at most competitive cost through simplicity and improve productivity,
- c) **Local Firm** will deploy more Information Technology to improve work processes; communication and dissemination of information to provide feedback on the effects of their decision-making,

3.3. Phase Two Brainstorming

Phase two was a tough sell and education process. It was targeted to discover the causal-effect and misfits among various parts and subsystem of the organization as "Structure ever follows Function".

Currently the firm is organized based on command and control

with mechanical time-based succession tables and less emphasis on performance. It is no longer effective to meet the changing market needs. Most of the **Younger Partners** and staff view the command and control structure as the main barrier to growth and progress. Therefore a group of calibre staff left while the family/team spirit is slowly fading away. Eventually the **Local Firm** will be faced with a shortage of credible internal candidates to sustain its performance and growth.

The **Patriarch** realized the urgency and needs to make the necessary transformation to its organization, i.e.

1. From command and control decision-making authority to common control structure (Gary S. Tjaden, 1995),
2. Institutionalize formal performance measures with pay-for-performance reward system to attract and retain high potential staff (James Brickley, Clifford Smith & Jerold Zimmerman, 1999), and
3. Introduce mechanism of performance-base entry and exit for its key persons (Egon Zehnder International, 2002).

Generally, all the **Senior Partners** refused to see the needs to change as they wish to preserve the command and control structure. Only **four (4)** out of the **eight (8) Younger Partners** welcome such changes to be made with the rest remain anonymous.

Further analysis on their responses revealed that age and exposure are important elements influencing their perspective. All the **Senior Partners** are in their late 50's to early 60's. They have set-in their comfort zone and with local experience in their daily routines. Comparatively, the **Patriarch** is in his late 60's, but due to his international exposure and as a forward-looking leader, he understand that any long-term equilibrium is the result of many short-term adaptations to market signals (Peter Drucker, Edge May 17, 1999) therefore changes are inevitable.

The **Younger Partners** are in their late 30's to late 40's. But some of them focus on brokerage services, which have to deal with clients and associates internationally; while the rest are focus on valuation practices that the effective market area is domestic. Those who work in brokerage services saw the urgency to change to common command structure with open communication and well-disseminated information for speedy decision-making. But those who focus on valuation may recognize the needs to change but fail to see the urgency.

3.4. Phase Three Brainstorming

Phase three brainstorming was actively participated by the **Patriarch and 4 Younger Partners** to develop its strategic orientation, i.e. business strategy and organizational architecture. This study focuses on establishing the criteria for a desired management control tool - performance evaluation and compensation management.

Gap analysis was adopted to discuss and debate on how to close the gap and establish the criteria for the desired management control system. The framework for Gap Analysis was drawn from the work of Dave Ulrich (1998) as shown in Table 2. It covers 6 key aspects, but only the aspect of "Consequence" and "Governance" which related to the desired control management system is presented for this study.

Table 2. Framework For Gap Analysis

Key Elements	Question	Rating	Description of Best Practice	Gap Between Company's current practice & best practice
SHARE MIND-SET	To what extent does our company have the right culture to reach its goals?		<p>Value-based culture focuses on</p> <ul style="list-style-type: none"> • Customer oriented • Systems perspective • Clear Vision & Goals • Quick Adaptation to changes • Innovation & Creativity • Open Communication • Employee Empowerment • Performance & Reward align to creating shareholders' wealth <p>Sources: <i>Abstracted from Fortune Annual Most Admired Companies</i> (S. David Young & Stephen F. Obyrne, 2000) and <i>Managing Without Management</i> (Richard Koch & Ian Godden, 1996)</p>	
COMPETENCE	To what extent does our company have the required knowledge, skills and abilities?		<p>Consulting services are processes and knowledge (the methodology) driven to provide solution to clients' requirements or problems. Therefore, Research & Development is essential to further develop, document and package from the initial model and framework. Such conceptual model and framework must be organized into client-centred value delivery model to be tested, validated, refined thereafter communicated such new knowledge assets for the use of others in the organization.</p> <p>Sources: <i>Adapted from Innovating Professional Services</i> (Souren M. Kaplan, 2000) and <i>Measuring the Information Age Business</i> (Gary S. Tjaden, 1995).</p>	

Key Elements	Question	Rating	Description of Best Practice	Gap Between Company's current practice & best practice
CONSEQUENCE S	(1) To what extent does our company have the appropriate measures?		<p>Formalize Performance Measures to captive information essential for decision making consists of both financial and non-financial metrics such as</p> <ul style="list-style-type: none"> a) Asset Management b) Productivity c) Customer Service d) Behavioural e) Financial <p><i>Sources: Abstracted from EVA & Value-based Management (S. David Young & Stephen F. Obyrne, 2000), Logistic Performance Measurement & Customer Success (Stanley E. Fawcett & M Bixby Cooper, 1998) and Organization Development & Change (Cummings & Worley, 1997)</i></p>	Currently only fundamental financial metrics and annual staff performance appraisers, which subject to bias and limited information for decision-making. Many a times, it is a ritual exercise instead of value enhancing information for decision.
CONSEQUENCE S	(2) To what extent does our company have the appropriate rewards and incentives?		<p>Entrepreneurial wealth leverage to elicit aggressive value creating behaviour such as Pay For Performance, Formula Bonus Target, Leverage Shares Option, Bonus Purchase Grants Option, etc.</p> <p><i>Sources Abstracted from Fortune Annual Most Admired Companies (S. David Young & Stephen F. Obyrne, 2000)</i></p>	Incentive rewards such as management profit and bonus performance are in place except it has no penalty for under-performer and lack of motivation to retain high performers. It is implicit in the path of exit for senior executives and partners, which have adverse impact on its incentive reward system. A scenario where one achieved a certain level of seniority, a drop in performance will have no impact to his/her position reward and incentive.

Key Elements	Question	Rating	Description of Best Practice	Gap Between Company's current practice & best practice
GOVERNANCE	To what extent does our company have the right organizational structure, communication systems, and policies?		<p>The structure of organization is very flat-common control. There is a structure of common information infrastructure to which all have equal access. Coordination of activities is achieved through the free flow of information and open communication.</p> <p><i>Sources: Adapted Measuring the Information Age Business (Gary S. Tjaden, 1995).</i></p>	
LEADERSHIP	To what extent does our company have the leadership to achieve its goals?		<p>The new generation all use leadership techniques ruthlessly, sometimes subtly, but they do not use hierarchy in the traditional way. They use 5 different leadership ingredients:</p> <ul style="list-style-type: none"> a) Charisma & personal integrity in varying blends b) Values-based culture & propaganda c) Industry Knowledge d) Computer-based control e) Unpredictability <p><i>Sources: Abstracted from Managing Without Management (Richard Koch & Ian Godden, 1996)</i></p>	

Key Elements	Question	Rating	Description of Best Practice	Gap Between Company's current practice & best practice
CAPACITY FOR CHANGE	To what extent does our company have the ability to improve work processes, to change and to learn?		<p>Summary of 4 leading practices in fast growth companies are</p> <p>a) Market Practices</p> <ul style="list-style-type: none"> • Quick to anticipate market trends, address market needs with highest quality products/services. • Leverage existing Customer base while market growth to increase profit margin. • Product/Service R & D account for 15-20% of revenues. <p>b) Financial Practices</p> <ul style="list-style-type: none"> • Anticipate fund growth without losing control • Utilise financing vehicles to gain shareholders confident while retaining management control • Selective stock ownership grant with clear long-term ownership objectives. <p>c) Management Practices</p> <ul style="list-style-type: none"> • Collaborative Management decision-making & strategic planning • Establish & develop capacity for entrepreneurs' entrepreneurs. <p>d) Planning Practices</p> <ul style="list-style-type: none"> • Flexibility & change • Performance Control link with business plan • Open communication <p><i>Sources: Abstracted from Leading Practices of Fast Growth Entrepreneurs (Ernst & Young International, 1998).</i></p>	

Generally, the gap existed between the two aspects are interrelated and interdependent. Therefore many aspects will have to be addressed together at the right time instead of doing just one thing right. The desired control management system must have the following characteristics or attributes: -

- The time honoured cliché "If you can't measure it, you can't manage it", therefore performance measure is the essential component in any management control system.
- It is also management reality that "you can not measure what are not rewarded", therefore any management control system has to incorporate the compensation management.
- Performance measure is tied logically and visibly to create shareholders' wealth.
- It must be a genuine continuous improvement metric that the increased in the performance measure will improve the shareholders' wealth.
- It is a framework that guides every decision making from annual operating budgets to capital budgeting, strategic planning, acquisition or divestitures, etc.
- It should be simple but effective in communicating and institutionalizing through out the organization.
- It is also an incentive compensation scheme that reinforces the alignment of managers' and staff interest with those of shareholders.
- It is an internal system of corporate governance that simultaneously motivates all managers and staff to work cooperatively and enthusiastically to achieve the very best performance possible.
- It also acts to attract, motivate and retain high performers.
- It is also used to communicate company's goals and achievement to market at large so that investors can use it to identify companies with superior performance prospects.

3.5. EVA As The Desired Management Control System

EVA is an internal measurement that can be decentralized throughout the company and used as the basis of a completely integrated management system. It allows all key management decisions to be clearly modelled, monitored, communicated and staff/managers can be rewarded according to how much value they add to the shareholders' investment. In short, EVA meets the desirable characteristics of the management control system as stated in Section 3.4.

Table 3 Mapping of Desired Management Control System & EVA

Objectives	Desired Characteristics of A Management Control System	Gap Between EVA & Desired Characteristics
Systems Perspective	Integration of Performance Metrics, Reward System & Daily Decision Making (Financial Management).	Adoption of a fully articulated EVA programme would be a completely integrated management system that guided company in addressing questions such as: <ul style="list-style-type: none"> - How do we evaluate business plans when they come up for review? - How do we allocate resources? - How do we evaluate ongoing operating performance? - How do we pay our people, what is our corporate reward system?
Self-Regulated Internal Corporate Governance = Improve Investor Protection & Reduce Agency Cost	Logically performance metrics and reward system are tied to the creation of shareholders wealth with continuous improvement element i.e. greater performance, greater reward, and greater shareholder value.	Stern Steward believes that without the incentives, EVA becomes just another measure; without incentives, there can be no sustained change in behaviour. The visibility of linkages between reward and performance will change the behaviour of employees to think and act like the owners.
Attract, Retain & Motivate Staff for Higher Performances	High potential staff are ideal candidates to retain for future leadership consideration. They normally are high performers, committed to self-development and growth. They too respond to incentives.	A compensation-structure, which reward the 'doer' more highly and with monies held at risk to lost if improvements in performance are not sustainable. It acted as both "carrot and stick" to drive high potential staff to continue striving for sustainable performances.
Common Language, Simple & Communicative	Provide a common language – internally & externally	EVA allows all key management decisions to be clearly monitored, and communicated in and out of the organization.