What can we learn from companies that have been able to achieve sustainable return on investment and grow their businesses at the same time? How can management teams adapt the strategies and practices of these “high-performance companies” as they consider their own pathways to improving profitability and growth? Let’s take a look.

**RESEARCH ON HIGH-PERFORMANCE COMPANIES**

During the last three decades, there have been many attempts to study and learn from the experiences and practices of high-performance companies. An article in *Harvard Business Review* (Julia Kirby’s “Toward a Theory of High Performance,” July 2005) profiled a number of these studies, including *In Search of Excellence*, the 1982 book by Tom Peters and Robert Waterman, Jr. The question and comment in Kirby’s article suggest that a need exists to further define the meaning of high performance: “What does it mean to be a high-performance company? Twenty-three years after *In Search of Excellence*, we’re still searching—and just maybe getting closer to answers.”

For the past 10 years, I’ve led a research project with Joel Litman called the Return Driven Strategy Initiative that has been attempting to describe what it means to be a high-performance company in terms of performance measures. That goes hand-in-hand with understanding the strategic activities and traits that lead to sustained periods of exceptionally high performance in terms of return on investment, growth, and wealth creation.

The Return Driven Strategy framework, which I’ve written about in the Strategic Management column for this magazine, stems from this research project and is based on three dimensions of performance:

1. Superior and sustainable return on investment (ROI),
2. Growth while maintaining superior return on investment, and
3. Superior total shareholder returns.

The logic of these three dimensions of performance...
begins with ROI. First, a high-performance company would need to achieve superior return on investment and be able to sustain superior ROI performance for a period of 10 consecutive years or more. Second, a high-performance company would be able to grow the business while continuing to achieve superior ROI during the same period. The combination of superior ROI and growth logically leads to superior shareholder value performance, the third level of performance, assuming the company has adhered to the ethical parameters of its constituents and communities. (See “Return Driven Strategy: The Research.”)

But high performance isn’t permanent. Every high-performance company we studied faces the risk of fading. Some have already begun to fade in returns or growth. In every case, the reasons for fade can be charted to how the tenets of Return Driven Strategy began to be neglected or couldn’t be executed. Meanwhile, the elevation of these companies’ performance and the sustainability of high performance can be attributed to attention to these tenets. Companies with mediocre or poor performance demonstrate significant gaps in their business models when viewed through the lens of Return Driven Strategy.

THE RETURN DRIVEN STRATEGY FRAMEWORK
What strategic activities add up to competitive advantage or disadvantage? The Return Driven Strategy framework has been built on a simple theme: If we can better understand how the success or failure of a business is driven by its plans and actions, then we can greatly improve how we value companies and how we run our businesses. The framework describes the pattern of strategic activities shown to drive superior corporate performance. It is composed of 11 core tenets and three foundations that together form a hierarchy of interrelated activities that companies must perform to deliver superior performance.

These tenets and foundations summarize the common activities of high-performance companies and can be used to identify flawed strategies of marginal performers. (For a summary of the framework, see www.returndriven.com and the book by Mark Frigo and Joel Litman, DRIVEN: Business Strategy, Human Actions, and the Creation of Wealth, www.driventhethebook.com.)

LESSONS FROM HIGH-PERFORMANCE COMPANIES
Here are three lessons from high-performance companies that management teams can use in assessing and executing their business strategy:

1. Commitment to Return on Invested Capital and High Integrity. High-performance companies show a strong commitment to and discipline for creating shareholder value by focusing on return on capital. They have goals, performance measures (such as return on invested capital or ROIC), and incentives that are firmly aligned with sustainable ROI. They also find ways to grow their business in a disciplined manner so as not to sacrifice returns. These companies achieve superior returns and growth while adhering to the ethical parameters of their constituents and communities.

A premise of our work in Return Driven Strategy is that the overriding goal of a business entity should be to achieve “superior long-term return on capital.” Why is it important to have this commitment? Michael Porter provides insight on this point: “If you don’t have the right goal of superior return on investment, you lack the anchor that will help you make good choices about how to compete in the marketplace.” (See “The Importance of Being Strategic,” Balanced Scorecard Report, March–April 2002.)

The importance of maximizing shareholder wealth “ethically” is a critical element of the Return Driven Strategy framework. We have found that ethics is a necessary (but not sufficient) condition for maximizing value. As Michael Jensen from the Harvard Business School stated in his work on corporate integrity and its relationship to performance: “A company with a culture of integrity will tend to have performance metrics far above those without integrity.”

Companies like Johnson & Johnson have achieved superior ROI, grown their business, and shown an adherence to ethical standards. J&J is famous for its Credo, which is a foundation for ethical business conduct at the company and focuses on shareholder value through a philosophy of “capital-efficient profitable growth.” One CEO who uses the Return Driven Strategy framework refers to Tenet One as “Doing the Right Things for the Right Reasons.” (Kathy Apple, RN, CEO of the National Council of State Boards of Nursing (NCSBN), referring to Mission Driven Strategy, the application of the Return Driven Strategy model in not-for-profit organizations)

2. Focus on Unmet Customer Needs in Growing Market Segments. High-performance companies have a hypervigilant focus on customer need that’s much deeper than and different from other companies’ focus. To avoid
Return Driven Strategy: The Research

IN 10 YEARS, more than 15,000 publicly traded companies around the world have been screened for deeper study by our research teams, who categorized firms based on their cash flow characteristics. As much as 30 years of cash flow performance of each firm was included in the screening process and in the deeper, company-specific analysis afterward. In each case, the cash flows provided a realistic lens of the economic reality of the business. With this perspective, the Return Driven Strategy Initiative was able to categorize and study the patterns of high-performing firms, mediocre businesses, early-life-cycle companies, turnarounds, cyclicals, perennial poor performers, and outright bankruptcies.

The financial discipline underlying this business strategy research isn’t inconsequential. Many firms that receive substantial press for being highly admired companies are found to have admirable public relations skills but less than superior financial performance. At times, companies regarded as having become “great” have in actuality been great turnarounds. Firms like this are worthy of study for how to dig a business out of a hole, but they are greatly lacking as cases for sustainable high-value achievement.

In our research, companies deemed as having “superior performance” or as “high-performance companies” were required to meet the following stringent tests:

- Cash flow returns, comparable to a very diligently computed return on invested capital (ROIC), had to exceed twice the cost of capital consistently for more than 10 years straight (rate of return on equity (ROE) was used for financial services companies).
- Growth rates in invested capital, the principal of the business, much like a savings account, had to exceed local gross domestic product (GDP) growth rates and industry averages in rates or totals over the same period.
- Total shareholder returns (TSR)—a combination of the share price gains adjusted for any stock splits plus dividends—had to exceed market performance over the time period consistent with high cash flow return and growth levels.

Our research teams and partners also reviewed tens of thousands of articles, books, case studies, and annual reports covering each company. They conducted extensive financial analyses for each company; conducted interviews with managers, customers, vendors, and competitors of the companies; carefully analyzed compensation plans and other corporate governance issues; and examined how the companies created wealth while adhering to the ethical parameters of their communities.
The Ziegler Companies: Charting a New Course

BY JOHN J. MULHERIN

The Ziegler Companies, Inc., is an investment banking and investment services boutique with primary focus in the healthcare, senior living, religious, and education marketplaces. It has been in operation for more than 100 years. Our core businesses are investment banking, asset management, retail investment advice, and other related financial services.

The Challenge

In late 1999, the board of Ziegler found itself needing to reposition the company. As a part of the repositioning process, the board brought me in as CEO to work with its team of dedicated professionals to move the company forward.

After one of my initial board meetings, in which we were discussing strategic alternatives, one new board member, Belverd E. Needles, a distinguished academic and businessperson, told me the board wasn’t hearing my message on the company’s situation and prospects. He suggested that I meet with Mark Frigo, director of The Center for Strategy, Execution, and Valuation at DePaul University, to discuss how we could use the Return Driven Strategy framework to help communicate the strategy to the board as well as develop the strategy to move the company forward.

Assessing and Developing Strategy

We used the Return Driven Strategy framework at Ziegler in two ways: (1) as an assessment tool and (2) as a way to formulate and pursue a new business strategy for Ziegler Companies. During the assessment phase, the Return Driven Strategy framework provided a way to evaluate how forces of change were shaping Ziegler and its competitive position, which included convergence of financial services companies, commoditization of products and services, the Internet, and changing customer needs. We also used the framework to better understand the company’s unique resources and capabilities, which included its people, client relationships, credit expertise, and a strong reputation for quality and integrity. The framework was also useful to us as a tool for convening senior management and in having a productive discussion about the business strategy. It helped us to understand what customer needs and market segments we were best positioned to target and how to organize and align the company.

Ethically Maximizing Wealth

For us, the most important feature of the Return Driven Strategy framework was its focus on customer needs and targeting the right customer groups. Why was that important to us? First, we didn’t have any segments; we were in business everywhere. So we had to step back and ask the basic questions, “What are our markets? What markets do we wish to serve?” Targeting means we had to focus. The framework told us what to do from the perspective of “playing offense,” and it also helped us identify what business segments to retire and not to retire. The decision we made almost two years ago to get into healthcare private equity investing is really based on this idea of Return Driven Strategy.

Following the guidance of Return Driven Strategy, we are targeting market segments where we have the unique capabilities to be a dominant fulfiller of customer needs. We are now emphasizing the core strength and competitive aspect of a small firm—specialization and the knowledge advantage that it brings. We know our space better than anyone else. It has helped us with our allocation of scarce resources and building defensible positions competitively. This approach has increased our chances for success. You still have to execute—but you are operating in a market that has a high need for...
Communication—are aligned with this continuous innovation of offerings. In other words, companies will change offerings only if they believe they will create more value for the customer and receive superior return on investment from the innovation.

PUTTING RETURN DRIVEN STRATEGY TO WORK

During the last several years, those of us working on the Return Driven Strategy Initiative research have seen how the Return Driven Strategy framework has been used by boards of directors, executives, management teams, entrepreneurs, and educators. Let’s look at some of these uses.

Assessing and Developing Strategy

Assessing and developing the business strategy is an ongoing challenge for most companies. The framework has been used successfully to assess the existing business strategy of a company, a business unit, or a specific initiative. It has also been used in strategic planning to guide the development of the strategy in a way that will ensure alignment with the goal of ethically maximizing shareholder value. The case described in this article is a great example of this application.

Communicating Strategy

Communicating strategy is the first step in strategy execution. If this isn’t done well, it can be the root cause of strategy execution failure. Using a common language for describing and communicating strategy can be an effective way to avoid this problem. The Return Driven Strategy framework has been shown to provide a simple, clear language that’s consistent with widely used execution frameworks, such as the balanced scorecard, and it provides a link to how the strategy will drive growth and return on investment. Jim Folkes, former vice president, Strategy & Business Development at Laidlaw Education Services, expresses the benefit of the framework in communicating strategy: “Return Driven Strategy is an elegant framework in that it is marked by both ingenuity and simplicity. And it is also marked by completeness in the way it encompasses all aspects of business strategy.”

Aligning and Leveraging Execution Frameworks

Over the decades, companies have been using a wide variety of execution frameworks whose popularity comes and goes. Examples are Total Quality Management (TQM), Six Sigma, Lean Manufacturing, and reengineering. The Return Driven Strategy framework provides a way to align execution frameworks to achieve the strategic
activities that will drive superior performance. High-performance companies adapt rather than adopt execution frameworks.

Some execution frameworks, such as the balanced scorecard, have achieved a broad level of application and have become a leading strategy execution framework. Companies have used the Return Driven Strategy framework to refine or develop strategy as a logical first step in the development of strategy maps and balanced scorecards. They have also used it to reenergize existing scorecards.

Managing Risk
Risk management is a major concern of boards and executive teams. High-performance companies manage risk and manage the threats and opportunities in forces of change, achieve superior ROI, and grow their business, which can be very risky.

Companies also need to define “risk appetite” as part of their risk management efforts. In the Return Driven Strategy framework, risk appetite is part of the first tenet, “Ethically Maximize Wealth,” which means defining exactly what “maximize wealth” means to the organization and what levels of risk are acceptable for a given set of wealth creation goals. This can provide a systematic approach for defining “risk appetite.” With this approach for defining risk appetite, the framework can be used to examine an entire strategy and any specific initiative.

Another challenge in risk management is identifying key risk indicators. The primary foundation of Return Driven Strategy is “Disciplined Performance Measurement and Valuation,” which should include risk metrics, specifically risk metrics and performance measures that will provide insight into the risk profile of an organization in the context of risk appetite.

Mark Beasley, a board member of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and director of the Enterprise Risk Management Initiative at North Carolina State University, comments about a more strategic approach to risk management: “This framework fully describes the business strategy and activities that drive great financial performance and makes the connection between strategy and shareholder value. It can provide a way for directors and management to evaluate strategic plans and strategic initiatives and identify key risks that could destroy shareholder value while considering the upside of risk in terms of the opportunities.”

Business and Executive Education
The framework also has been used in business and executive education. It’s the foundation for an innovative MBA curriculum in the Kellstadt Graduate School of Business at DePaul University, which is one of the largest part-time MBA programs in North America and is consistently ranked in the top 10 in the nation by U.S. News & World Report. The program is the fastest growing in the Kellstadt GSB.

In corporate universities and executive education programs, the Return Driven Strategy framework has been used as a foundation for executive leaders and management teams. Business educators like its focus on creating shareholder value ethically. Arthur Kraft, former chairman of the board of the Association to Advance Collegiate Schools of Business (AACSB International) and dean at George L. Argyros School of Business and Economics at Chapman University, puts it this way: “The principles and concepts in Return Driven Strategy capture what we as educators and thought leaders should embed in our curricula and teachings in business schools throughout our undergraduate, graduate, and executive education programs. Business schools must focus on the importance of a firm commitment to ethically create shareholder value.”

Moving Forward
How is your company doing? How can you move the company in the right direction? Empowering and enabling managers with a clear way of strategic thinking and a roadmap for execution in today’s changing environment is a necessity. The lessons from high-performance companies are a good starting point and can provide valuable ideas for moving forward.

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