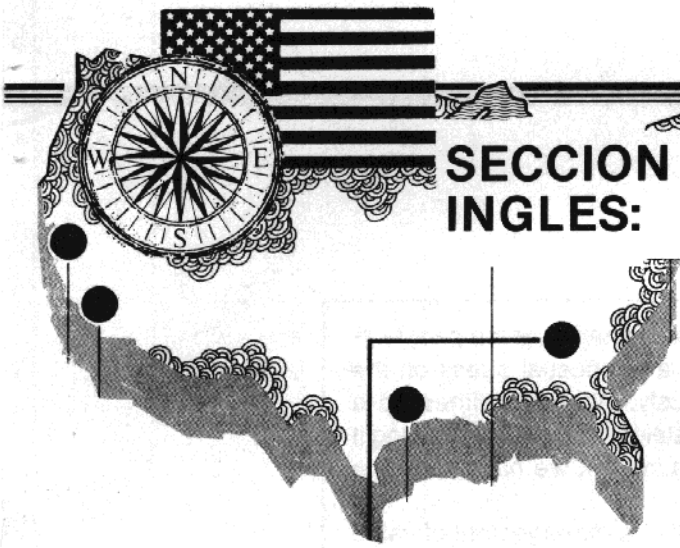

SECCION ESPECIAL EN IDIOMA INGLES:

MANAGING-VALUE: A PERSPECTIVE

BROOKS McCORMICK

A pair of major decisions announced by International Harvester in 1975 are particularly noteworthy because they involve the end of our tenure in two businesses in which we have been engaged for well over half a century. In moving out of a major part of the light-truck business, we ended a 68-year activity. And when the sale of our Wisconsin Steel Division is consummated, an IH activity of nearly 75 years will have been terminated.

But these two decisions have considerably more in common that is not so readily apparent. Without question, their immediate impact on our 1975 business results was sharp.* But their common significance is decidedly more profound. For they happen to be among the more dramatic examples of a radical shift in IH management philosophy that has been developing rapidly since the beginning of this decade.

- It is a philosophy attuned to the increasingly critical need for capital formation as the key to solving our current economic problems and helping to preserve the American system of enterprise.
- It is a philosophy intent upon literally creating capital by deploying it constantly from less productive to more productive areas of the business.
- And it is a philosophy that recognizes in this approach an infinite potential for the formation of free capital.

The new realities

Throughout the life of this nation, it has been the natural role of business and industry to respond to society's demand for a steadily rising standard of living, for greater abundance—the *quantity* of life. Inevitably, such a drive fostered emphasis on the management of volume, an emphasis that has been eminently effective in fulfilling the demand for quantity to an extent no other society has ever known.

Now, in this generation we have seen this fulfillment produce a new demand—the demand for a higher *quality* of life commensurate with the quantity our society has come to take for granted.

Having helped to create this basic change in the requirements of society, the management of volume is unable to cope with it. It is unavoidably flawed by the popular, but misleading, assumption that increasing sales volume can be equated with increasing returns from sales. It is an approach that has ceased to be germane to the new realities of our time.

It should have come as no surprise that the assignment of top priority to quality as well as quantity would place sudden and unusual stress on the resources needed to achieve them simultaneously. We have witnessed a veritable explosion in the demand for energy, material, and capital, making it painfully apparent that their supply is finite. And in turn, we have seen the steep escalation of their value.

In short, we have entered a new era in which the management of value must supplant that of volume—an era in which the management of assets offers the only reasonable and effective means to the ends society now seeks in its unabated desire for quantity in an environment of rising quality.

A return to basics

To make the journey from volume to value is to renew acquaintances with a pair of basic, but often neglected, concepts: (1) that the essential role of enterprise is to convert resources into other forms in which society will find value and (2) that the essential contribution of enterprise to such a conversion is efficiency and innovation—the only means of constantly enhancing that value in the long run.

These, then, are among the underlying considerations that support the distinctly different style of management to which IH has been committed in the present decade and in which I believe our capabilities have been growing steadily. It relies on a management system through which we are confident we can ensure the rational growth and continuing effectiveness of the company under any condition of business or state of the economy.

It is an approach that implies, above all else, a relentless stewardship of value, the sound management of assets. It does *not* mean we have ceased to find relevance in volume and return on sales. It *does* mean we have assigned priority to a different equation in which volume, expressed as asset turnover, multiplies sales margin to reveal the *productivity* of assets. Only in this way can we measure the real effectiveness of our efforts and direct the allocation of assets for an optimum return.

Thus, using this approach, we reached the decisions in 1975 to end our long tenure in steel making and the conventional light-truck business. Assessment of the value of assets needed to remain in these businesses and of the return the assets had been generating and were likely to generate made it clear we had more productive and profitable ways to employ them.

Assessing cost and capital alternatives

Of course, the common factor in both decisions was the shortage of that key resource, capital, into which all other shortages translate directly and which continues to be the central constraint upon the solution of every economic problem.

Given high interest rates and high corporate debt, and given the inability of new corporate stock offerings to raise an acceptable amount of capital per share, two of the traditional sources of capital have virtually been removed—at least for the present—from serious consideration.

This leaves retained earnings—themselves eroded by inflation—as the single remaining viable capital source. And in the final analysis, the only truly dependable generator of increases in retained earnings—the only effective weapon against inflation—is the wise and efficient use of assets that already exist.

Thus in managing value rather than volume, we cannot fail to be impressed with the improved earnings possibilities. Under current economic conditions and with our asset base of nearly $4 billion, the potential to increase earnings through better allocation and use of assets is vastly greater than the potential of new capital appropriations—even though they are now running at an all-time high annual rate of about $200 million.

Our decisions about steel and light trucks were made against this kind of background:

• In steel, an enormously capital-intensive business, we faced the probable necessity of expanding output and the certainty of continuing major expenses—nonproductive in nature—to comply with increasingly stringent environmental standards. Equally important, asset management raises the question of rational product mix, and steel does not fit precisely enough into the capital-goods pattern where our greatest strengths lie.

• In light trucks, on the other hand, we were looking at a market that had undergone a significant change, characterized by growth that was largely attributable to the emerging "second car" status of these vehicles. Clearly, it has become a market far more favorable to trucks derived—unlike ours—from passenger cars and using many passenger car components.

After a thorough assessment of the cost and capital implications of making our Travelall vehicle and conventional pickup trucks truly competitive in a market dominated by Detroit, there could be no doubt it was a situation calling, instead, for redeployment of our light-truck assets.

Meanwhile, market analysis had defined a specialized segment in which our Scout vehicle line, with reasonable redesigning, could be viable. Always more profitable than our conventional light-truck line, it used totally different sheet metal, was manufactured in a different plant, and demanded a much lower value of assets to produce.

To oversimplify, we lengthened the vehicle by 18 inches, increased our Scout model offerings to three, including a pickup, and came out with a completely new concept that is midway between Detroit's conventionals and Japan's minipickups. It is still in character with our overall capital-goods product mix. And it is in a class by itself by virtue of its small size, light weight, exceptional durability, improved fuel economy, and conventional truck options.

But most significantly, it is an example of sound asset management. Leaving the conventional light-truck market freed some $65 million in assets

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for reallocation at our Springfield (Ohio) plant to medium and medium-heavy trucks in which we enjoy a solid market position that is capable of real improvement with the additional assets now available.

In turn, medium-heavy truck production, which had been located at Fort Wayne, Indiana could be moved to space vacated in the conventional light line termination at Springfield. This provided capacity at the Fort Wayne plant to absorb the heavy-duty production of our San Leandro (California) plant. In closing the San Leandro plant, we avoided further duplication of assets used in heavy-duty truck output and opened the door to higher returns from Fort Wayne assets through increases in their productivity.

More to come

But while these are dramatic examples, they are only the tip of the iceberg in our total and rapidly growing asset management effort. It is impossible in limited space to describe comprehensively such a pervasive program of action. But additional examples would certainly include these:

- Increasingly acute analysis of margins and of relationships between anticipated growth and market share, together with application of methods to quantify risk, are giving our divisional managements a sound basis for measuring the contribution of individual products of profit and return on assets. Thus we are, for example, in the process of culling our agricultural equipment line, looking for low-volume, narrow-margin products to be eliminated or placed—on contract or through joint ventures—with outside firms to be manufactured to our specifications and standards. An organization within our Agricultural Equipment Division has the management of these outside products as a specific assignment and the freeing of assets for more profitable deployment as a specific objective.

- Asset orientation, likewise, is exemplified by the combination of construction-equipment and industrial-equipment engineering and marketing in our new Pay Line Division, which has completed its first 18 months of operation under that name. This was a move triggered by market analysis. Our study had revealed that while there is, indeed, a great difference in markets and products between the heavy end of the construction equipment line and the light end of the industrial equipment line, it is no longer possible to locate a midpoint of demarcation between them. Customer demand has been effectively merging the two types of equipment where once there seemed to be a distinct interface in the market. Our organizational response, aimed at serving customer needs more effectively, also served to concentrate our assets in a single, unified engineering and marketing thrust and set the stage for improvement in asset turnover.

- Preoccupation with value as opposed to volume has also led to growing emphasis on:

1. Reducing product diversification.
2. Further expansion of our concept of worldwide models along with worldwide interdivisional manufacturing of components to realize potential economies of scale.
3. Efforts to achieve greater standardization and commonalty of components on a world basis.
4. Gradual, but steady, integration of global operations on a function-by-function basis as illustrated by our accomplished improvements in the coordination of worldwide product line engineering.
5. An ever more precise delineation of line/staff roles and relationships.
6. Innovative development and expansion of our profitable parts production, distribution, and marketing capability.
7. Constantly broadening the scope and raising the quality of our corporate data base through improved techniques in forecasting volume, measuring product profitability, quantifying risk, evaluating competition, and determining the market position and life-cycle stage of products.

The real beneficial impact of our asset management effort can only come from an amalgam of these and hundreds of other actions—most of them quite undramatic—taken in recognition of the value of every business asset and of the pressing need to enhance it.

Common sense and the human asset

At heart, asset management is the application of common sense. But it is common sense applied in an uncommon manner—that is, common sense applied constantly and consistently rather than at random and sporadically. It is common sense controlled and guided by the expanding knowledge and deepening insights that are generated through the discipline of business planning.

Of course, planning is a human function. Knowledge and insight can be possessed only by human beings in the refinement of their own innate intuition. And anytime we find ourselves talking about the use of the tangible assets of enterprise—of its measurable fiscal and physical resources—we are, in reality, talking about that ultimate, *intangible* asset, which factors into no mathematical equation and submits to no precise measurement. We are talking about the human asset—the only asset that is capable of realizing and increasing the value of the others and the only asset of enterprise that cares about its own performance and productivity.

The definitive text on management of this most valuable asset will probably never be written. But wise management will build upon these salient characteristics of the human asset. It will do so by linking the freedom of individual decision and action with the restraint of individual responsibility. It will do so by encouraging the formulation and attainment of personal goals as the only practical means of reaching the predefined and guiding objectives of the enterprise. It will do so by revealing team effort as a rational and voluntary route to useful human accomplishment. And it will do so by recognizing the vital interactions among planning, accountability, and reward.

BROOKS McCORMICK is president and chief executive officer of International Harvester Company. With International Harvester since his graduation from Yale University in 1940, Mr. McCormick was named director of manufacturing in 1954, executive vice-president in 1957, president and chief operating officer in 1968, and chief executive officer in 1971.