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Report

The 2007 Consumer-Packaged-Goods Value Creators Report

The Challenge of Too Much Cash

The Boston Consulting Group

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Note to the Reader

The Challenge of Too Much Cash, the 2007 Consumer-Packaged-Goods Value Creators report, has been adapted from *Avoiding the Cash Trap: The Challenge of Value Creation When Profits Are High,* the ninth annual report in the Corporate Development practice's Value Creators series published by The Boston Consulting Group. In the Value Creators reports, BCG publishes detailed empirical rankings of the stock market performance of the world's top value creators and distills managerial lessons from their success. We also highlight key trends in the global economy and world capital markets and describe how these trends are likely to shape future priorities for value creation. Finally, we share our latest analytical tools and client experience to help companies better manage value creation.

This report addresses a challenge that many global companies currently face: making effective use of record levels of cash flow and profitability to optimize near-term and long-term value creation. It is a particularly acute challenge for consumer packaged-goods companies, which, in general, generate very high returns on capital and in which asset intensity is relatively low. We examine this issue in the context of an integrated approach to value creation. And we describe four specific cash traps and how companies can avoid them.

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Executive Summary

Recent trends in global capital markets confront consumer packaged-goods companies with a seeming paradox. Companies are enjoying record profits. And yet, most market forecasters are predicting lower shareholder returns than in the past.

Many industries are generating far more cash than they can profitably invest. The challenge of too much cash is an especially thorny problem for consumer packaged-goods companies, which tend to have returns well above their cost of capital and very low reinvestment requirements. Few companies have succeeded in fully deploying the cash they are accumulating on their balance sheets. These cash reserves, often combined with unused debt capacity, have become a drag on near-term total shareholder return (TSR) and are exposing companies to additional risks. We call this situation the *cash trap.* At the same time, profitable growth remains the most important driver of long-term shareholder returns—and the key to generating that long-term value creation is to successfully deploy that mountain of cash.

New players in global capital markets are exacerbating the cash trap. In a quest for higher returns, private-equity firms and activist investors are aggressively pressuring companies to improve shareholder value in the near term—in part by pushing these companies to tap into their large cash reserves. Many consumer-packaged-goods companies have recently been "confronted" by such activist investors. As a result, companies' room to maneuver is narrowing. Increasingly, large cash reserves, excess free cash flow, or untapped debt capacity not only depress a company's near-term TSR but also make public companies vulnerable to predatory attack.

Companies face an unavoidable imperative: to create more value in the short term in order to earn the right to create value in the long term. There are times when a company has to focus on the short term in order to maintain control of its destiny. That is the situation today. And yet, at the same time, executives must not become so focused on the near term that they neglect their company's long-term prospects. The solution is to strike a delicate balance—to invest sufficiently in growth for the long term but in a way that also wins favor from investors today.

No company is immune to the cash trap. While all companies are vulnerable to the cash trap, some successful companies have learned how to deploy their cash resources to take advantage of growth opportunities—especially when it comes to building valuable positions in fast-growing economies. The 2007 Consumer-Packaged-Goods Value Creators report focuses on how companies can achieve superior value creation in an era of excess cash:

- We start by reviewing in detail the key trends shaping today's capital markets and how these trends make consumer packaged-goods companies vulnerable to the cash trap.

- Next, we describe the role of cash in value creation and, in particular, explain the indirect impacts of decisions about cash on a company's valuation multiple, the most important driver of near-term TSR.

- We then examine four specific cash traps and how consumer packaged-goods companies can avoid them.

- We also describe how companies can strike a balance between short- and long-term value creation and pursue their long-term plans without being penalized by investors.

- Finally, in the Appendix, we conclude with rankings of the top consumer-packaged-goods value creators worldwide for the five-year period from 2002 through 2006. We looked at all consumer-packaged-goods companies with a market capitalization of $2 billion or higher at year-end 2006. The average annual return for the 107 companies in our sample was 10 percent. Companies in the top quartile averaged at least a 23.2 percent annual return, and the top ten companies averaged a 36 percent return. The very best performers had average annual returns of 50 percent or more. Many consumer-packaged-goods companies have figured out how to drive strong shareholder returns in this era of excess cash.

Plentiful Cash, Modest Value Creation

It's the best of times and the worst of times in global capital markets. Companies enjoy record-high profitability. But forecasted growth in shareholder returns is substantially below that of the recent past. If companies don't figure out how to resolve this paradox, new players will do it for them. Welcome to the cash trap.

The Paradox of "Too Much" Cash

In today's capital markets, many global companies face a seeming paradox. Years of restructuring, offshoring, outsourcing, and low interest rates have strengthened company balance sheets and improved cash flow return on investment (CFROI)—so much so that many companies are producing record levels of cash. In the United States, for example, real earnings per share, adjusted for stock market cycles, have increased by around 25 percent since 2000, while corporate profits as a share of GDP have soared to a record 10.3 percent, the highest level since the early 1960s.

And yet, despite this robust economic health, most forecasters are predicting modest shareholder returns—with estimated market averages running as low as 6 percent and generally no higher than the long-term historical average of 10 percent. For example, in a recent Morgan Stanley survey of 100 CFOs at Fortune 1000 companies, participants reported that they expect equities to deliver an average annual return of only 6.6 percent over the next five years.[1]

What explains this discrepancy between robust profits and modest expectations for shareholder returns? Many companies are finding it difficult to deploy their growing cash reserves in order to create shareholder value. Yet over the long term, the most critical driver of value creation is profitable growth—funded by smart investment of cash reserves. Last year's Value Creators report pointed out that the sustainable growth rate in many industries—that is, the amount of growth that companies could fund with the cash they are currently generating while continuing to pay out dividends at their current rate—is considerably higher than the forecasted revenue growth for these industries.[2] (See Exhibit 1.) This problem is particularly serious in the high-return, low-asset-intensity world of consumer packaged-goods companies. Put simply, in many industries there is too much cash chasing too few growth opportunities. As a result, competition for those opportunities is likely to put pressure on margins, making it even more difficult to create long-term value from organic growth.

Given the constraints on organic growth, more and more companies are turning to mergers and acquisitions (M&A)—witness the heating up of the M&A market in recent years.[3] But while acquisitive growth can be an effective way to create value, increased competition for a limited supply of targets is making growth through acquisition more difficult and more uncertain. For example, the average multiple paid in the ten largest consumer-

1. See "CFO Survey 2006: Sometimes the Little Details Do Matter," Morgan Stanley, September 28, 2006.

2. See *Spotlight on Growth: The Role of Growth in Achieving Superior Value Creation,* the 2006 Value Creators report, September 2006.

3. For a detailed discussion of current trends in M&A, including the numbers cited in this section, see *The Brave New World of M&A: How to Create Value from Mergers and Acquisitions,* BCG report, July 2007.

packaged-goods deals over the past five years is 2 points higher than that paid in the ten largest consumer-packaged-goods deals over the preceding five years.

Competition for deals today is unusually intense owing to many cash-rich corporate buyers chasing too few targets—a problem that has been exacerbated by a strong trend toward industry consolidation, which has reduced the pool of potential targets. (Consolidation deals as a share of the total value of transactions leaped from 48.7 percent, on average, in 1999 and 2000 to 71.4 percent in 2006.) And while the largest deals (those with a valuation greater than $1 billion) are growing the fastest, they are also the least likely to create value, especially in the near term.

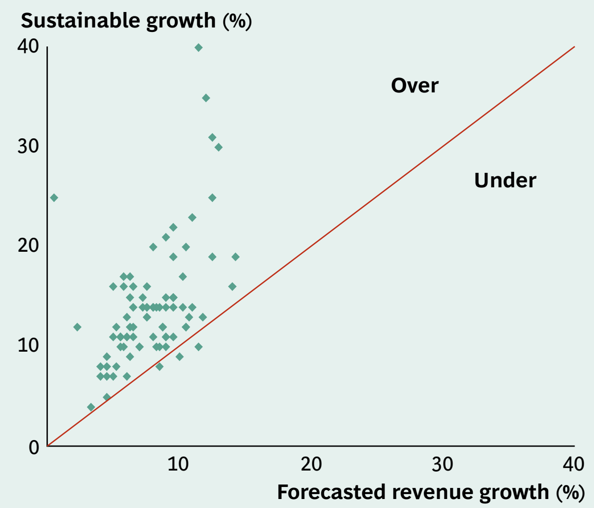
Few companies have succeeded in fully deploying the cash that they are generating.

In response to this situation, many companies have increased dividends and instituted programs to buy back shares in order to give some of their excess cash back to investors. But while such moves are boosting shareholder returns, they haven't really solved the problem. For example, in the U.S. S&P 500, dividends as a percentage of earnings before interest, taxes, depreciation, and amortization (EBITDA) have grown from about 8 percent to just above 10 percent since 2000. But that is still considerably below the long-term historical range of between 15 and 20 percent.

The fact is that relatively few companies have succeeded in fully deploying the cash that they are generating and have been accumulating on their balance sheets. These cash reserves (which, given current low interest rates, typically generate after-tax returns in the neighborhood of around 3 percent) are proving to be a drag on near-term TSR. This drag is exacerbated by the fact that because companies aren't paying out this cash and because growth options, both organic and acquisitive, are uncertain, investors find it difficult to value the future impact of the cash. Indeed, many investors worry that it will be used in ways that destroy value rather than create it. We call this situation the cash trap.

Exhibit 1. The Vast Majority of U.S. Industries Can Fund More Growth Than Markets Can Sustain

Sustainable growth rates versus forecasted revenue growth rates in 85 U.S. industry sectors, 2006



Sources: Compustat; Valueline; BCG analysis.

Narrow Room to Maneuver

There was a time when the existence of so much cash on company balance sheets wouldn't have been much of a problem. Companies could safely hold their cash in reserve and use it to bankroll future growth. Not anymore. In today's capital markets, having large reserves of cash, excess free cash flow, or untapped debt capacity not only depresses a company's near-term TSR but, in some cases, also paints a big target on a company's back, putting it at risk of predatory attack.

The chief consequence of the cash trap is that a public company's room to maneuver is narrowing. At BCG, we believe in creating value over the long term. And, as last year's Value Creators report noted, the key to long-term value creation is profitable growth (that is, growth that generates returns greater than a company's cost of capital).[4]

But sometimes, a company has to emphasize value creation in the short term in order to maintain control of its destiny. Given the realities of today's capital markets, it's no longer good enough sim-

4. See *Spotlight on Growth: The Role of Growth in Achieving Superior Value Creation,* the 2006 Value Creators report, September 2006.

ply to decry the short-term focus of investors. Nor is it prudent always to maximize future flexibility for investment in growth. Rather, companies must increasingly use their capital to ensure near-term value creation—in order to earn the right to create value over the long term.

Doing so is a complex challenge. Deploying cash for maximum benefit to shareholders in an environment of few growth opportunities makes for a difficult tradeoff. Investors often expect very high returns—from the business today as well as from investments in the future of the business. In the absence of high returns, many investors would prefer that companies pay out more cash, rather than invest in growth.

Because today's investors are skeptical that a company's growth plans will pay off, they tend not to give companies full credit today for investments that management believes will deliver above-average growth in the future. And they react quickly—and negatively—to any signs that reinvestment in growth will erode margins and cause current levels of profitability to decline. Put another way, it's not just unprofitable growth that quickly attracts investor displeasure but growth that is "not profitable enough" (in the sense that it is lower than the company's current level of profitability).

This dynamic confronts companies with a tough dilemma. Should they pursue all growth opportunities that deliver returns above the cost of capital for the sake of shareholder value, even if those returns erode current profitability—but at the price of being penalized in the short term by investors? Or should they preserve their current profitability by refusing to invest in growth opportunities that, while profitable, will erode current margins—but at the price of systematically underinvesting in short- and long-term growth?

The best way out of this dilemma is for senior management to differentiate their company in the eyes of investors. Executives need to demonstrate that their company has the people, management capabilities, strategic advantage, financial discipline, track record, and realistic opportunities to deliver above-average profitable growth at levels that will create long-term value. Those companies that can successfully make this case to investors in the near term will have earned the right to grow in the long term.

The Role of Cash in Value Creation

In an environment in which more and more investors are favoring near-term value creation, companies need to understand what drives TSR in the short term. Only by understanding value creation as a dynamic system can executives fully grasp the impact of their decisions about how to use cash.

The Impact of Cash on TSR

In recent Value Creators reports, BCG made the case for taking an *integrated* approach to value creation.[5] We argued that when senior executives define their company's value-creation strategy, it is critical that they understand the linkages and manage the tradeoffs across three dimensions of an integrated value-creation system:

- *Fundamental value,* defined as the discounted value of the future cash flows of a business (based on future growth in margins and sales)
- *Investor expectations,* defined as the differences between stock price and fundamental value and reflected in a company's valuation multiple
- *Free cash flow* that is returned directly to investors in the form of debt repayment, share buybacks, or dividends

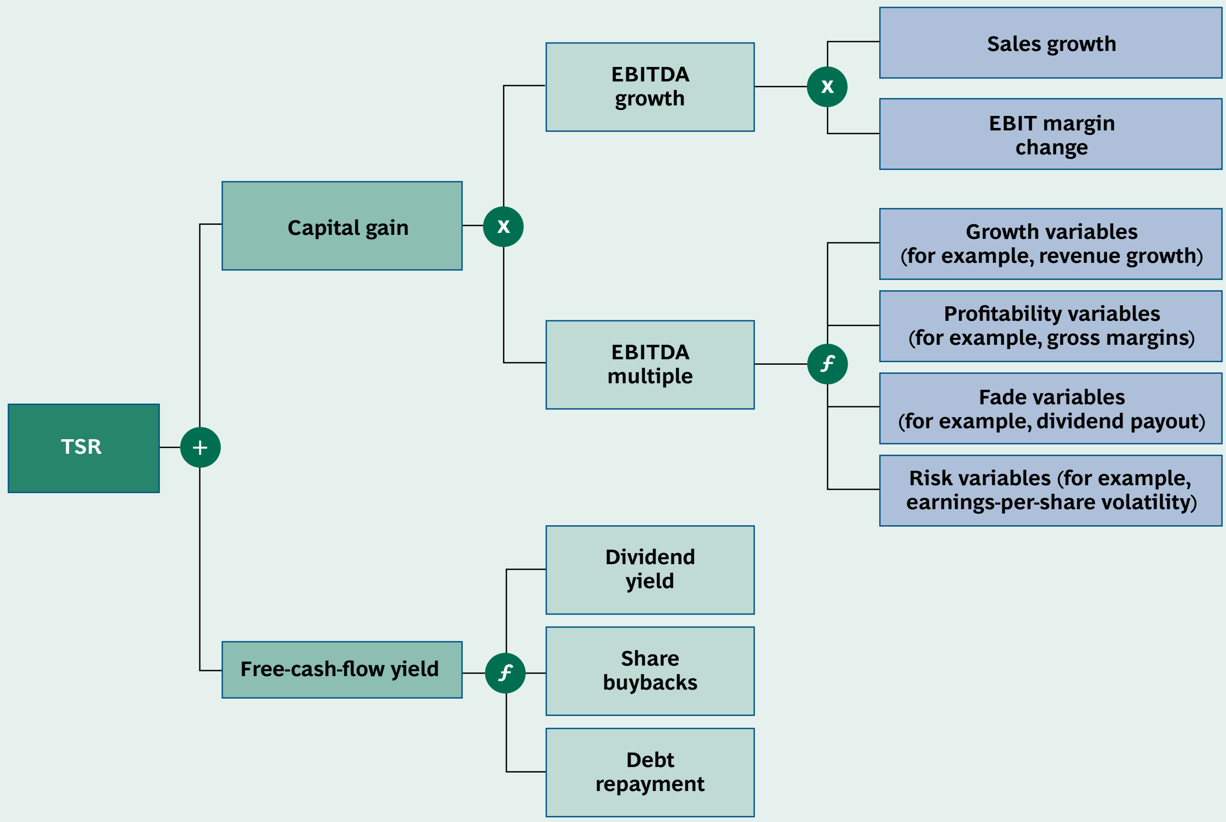
These three dimensions are integral parts of a dynamic value-creation system. Changes in any one can affect the others. The basic challenge of value creation is to understand the linkages among them, anticipate their complex impact on one another, and manage the tradeoffs among them to ensure that management actions are mutually reinforcing rather than contradictory. (For a graphic illustration of the value creation system, see Exhibit 2, page 12.)

Within this system, there are three basic options for the use of cash. A company can accumulate cash on its balance sheet. It can reinvest that cash in the hopes of generating additional profitable growth (either through organic growth in its existing businesses or through acquisition). Or it can return the cash to debt holders and stockholders by paying down debt, repurchasing shares, or paying dividends.

Each of these options has a direct impact on a company's TSR. But they also have an indirect impact through their effect on the company's valuation multiple. Take the example of dividends. Investors have expectations not only for a company's capital gains but also for how much free cash flow it ought to distribute. Whether or not a company pays dividends, and at what level, can help determine its valuation multiple. For example, increasing dividend payout can raise a company's multiple by reducing perceived risk, adding credibility to the quality or sustainability of the company's earnings, and signaling management's commitment to shareholder value. These indirect impacts are especially important in today's environment because, as BCG research shows, improvements in a company's valuation multiple are the largest contributor to near-term TSR.

5. See, for example, *The Next Frontier: Building an Integrated Strategy for Value Creation,* the 2004 Value Creators report, December 2004; and *Balancing Act: Implementing an Integrated Strategy for Value Creation,* the 2005 Value Creators report, November 2005.

Exhibit 2. Companies Must Understand the Linkages and Manage the Tradeoffs Among the Drivers of TSR



Source: BCG analysis.

Understanding Valuation Multiples

Of course, many executives worry about their company's valuation multiple. In particular, they often believe that their multiple doesn't accurately reflect the true value of their business plans. But many also assume that there is nothing much they can do to move their multiple. Or even if they do think they can influence it, they assume there is a simple one-to-one correlation between, say, growth in earnings per share (EPS) and the level of the multiple. Both these assumptions are mistaken.

We believe that executives can anticipate the likely impact of their business plans on their company's multiple, relative to peers. But doing so requires a far more sophisticated and granular understanding of what drives differences in multiples within their industry.

In recent Value Creators reports, BCG described a research technique that we call *comparative multiple analysis.*[6] The methodology identifies the drivers of differences in valuation multiples in a specific industry or peer group by analyzing the statistical correlations between observed multiples and a broad range of financial and other performance data.

In recent years, we have done hundreds of these analyses for clients in many different industries and sectors. This work suggests that a relatively small number of factors can explain anywhere from 80 percent to 90 percent of

6. For a detailed description of this approach, see *The Next Frontier: Building an Integrated Strategy for Value Creation,* the 2004 Value Creators report, December 2004, pp. 29–32; and *Balancing Act: Implementing an Integrated Strategy for Value Creation,* the 2005 Value Creators report, November 2005, pp. 15–18.

the differences in multiples among peers and over time. And the analysis can be applied to evaluate future opportunities.

In the consumer packaged-goods industry, where a strong brand is important, the vitality of a company's gross margins is the most significant factor for differentiating a company's valuation multiple. It counts far more than any type of growth, including revenue growth.

The reason a profitability driver such as gross margins is so important in consumer goods is that success in this industry depends on a company's pricing power—whether derived from strong brands, intellectual property, or other drivers of market-share strength. Strong gross margins indicate that every dollar reinvested will carry a high expected return on investment (ROI) that will distinguish a company from those that may have equivalent growth but at considerably lower margins.

After gross margins, another key value differentiator for consumer packaged-goods companies is operating expense as a percentage of revenue. A low operating expense represents how efficient a company's marketing and distribution activities are. Investors view it as a signal that a company is likely to maintain a higher return on new investments in the future.

The relative riskiness of a consumer packaged-goods company's future cash flows also affects its valuation multiple. In fact, the greater the risk, the more likely that investors will discount a company's valuation. Empirical data have shown that debt levels negatively correlate to multiples. By contrast, dividend payout is a positive differentiator—a strong signal to investors that a company's future cash flows will be stable. In consumer packaged goods, higher dividend payouts are more important than debt as a signal of stability in earnings.

Four Cash Traps—and How to Avoid Them

A valuation discount represented by an inappropriately low multiple is a strong sign that a company may be suffering from a cash trap. But even companies that enjoy a relatively high valuation multiple need to take extra care not to fall into a cash trap that will erode their multiple in the future. The precise causes of a cash trap can vary, so companies must dig deeper. In this section, we examine four situations in which the misuse of cash can have a major negative impact on a company's near-term TSR. Each of these potential traps is particularly acute in consumer packaged-goods companies, given their high returns and low asset intensity.

The Lazy Balance-Sheet Trap

Many senior executives remember a time in the 1980s and 1990s when having a strong balance sheet and a high credit rating were signs of financial strength. They reduced risk, increased flexibility, and were looked on favorably by investors. Often, a premium valuation multiple was the result.

More recently, however, the perceptions of investors have changed. In today's far more modest TSR environment, investors are putting greater emphasis on how companies can boost their near-term value by optimizing the generation and use of free cash flow and other capital resources. Seen from this perspective, what previously looked like a strong balance sheet is increasingly viewed as a *lazy* balance sheet—that is, a balance sheet that underexploits a company's assets, either by holding too much cash that is earning low rates of return or by having too little debt.

For many investors today, a lazy balance sheet is a signal that a management team is maximizing flexibility to a fault, avoiding commitment to a clear course of action, and not focusing on a strategy to deliver maximum TSR. These investors are urging companies to monetize balance sheet strength, either by taking on more debt and paying the cash out to investors (so-called leveraged payouts) or by using ongoing free cash flow to fund more cash payout today—in lieu of preserving the flexibility to fund growth plans that may well exceed the underlying growth rates of the markets that companies serve.

This approach may seem dangerously shortsighted. And yet, in the current environment of high profitability and relatively few growth opportunities, it has a compelling logic. There are high opportunity costs to hoarding cash or reserving debt capacity on the balance sheet in order to maximize future flexibility. The math is quite simple: it is not uncommon today for a company to carry cash and excess debt capacity equivalent to as much as 20 to 30 percent of its market capitalization. Assuming after-tax returns on cash or cost of debt in the neighborhood of 3 to 4 percent and market-average returns of 10 percent (that is, what an investor could get in an index fund if he or she had access to the cash), the opportunity cost of that excess cash and low debt is in the range of 6 to 7 percent. That opportunity cost has a negative impact on annual TSR of 1 to 2 percentage points, on average, which over ten years is equivalent to the difference between top-quartile and average performance. (See Exhibit 3.)

This lost value explains why investors are pushing companies to give back more cash and take on more debt.

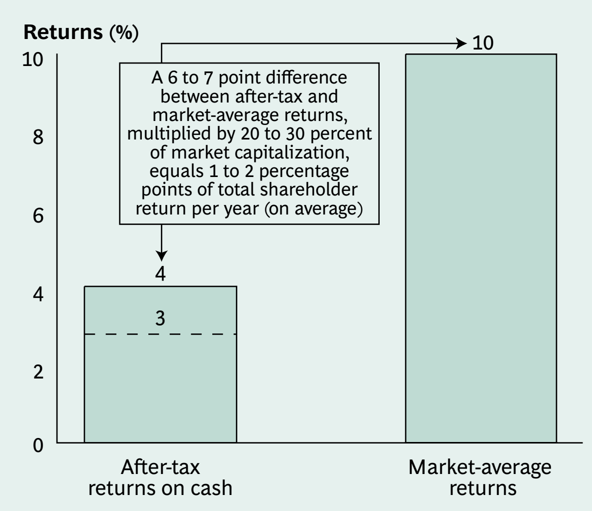
Their view is that a company can always get access to funds, whether debt or equity, to fund organic growth or acquisitions, so there is no sound reason to carry a lot of cash on the balance sheet. And often, they worry that companies that build up unused funding capacity will at some point feel self-imposed pressure to use it for acquisitions that are higher risk or lower return than other ways of using the cash.

In effect, investors want companies to operate much closer to the edge of preserving balance sheet quality than in the past. Today, strong balance sheets, high credit ratings, and excess cash-flow generation are viewed more as near-term opportunities to exploit rather than as long-term strengths that may add value sometime down the road (but not today). Unless a company responds to these concerns, it is likely to pay a price—in the form of a weak valuation multiple, lower stock price, and perhaps even take-over pressures.

It is precisely their use of debt to leverage returns to equity owners and to discipline the operations of their acquisitions that accounts for a large part of the returns that private-equity players have been able to achieve. It's unlikely that public companies will be able to leverage up as much as private companies do and still retain a risk profile that traditional institutional investors will tolerate. But many companies can increase their leverage to a degree that is still consistent with their investors' priorities and then use that cash to repurchase shares or pay a special dividend.

This is not to say that a cash cushion is never appropriate. There are some practical reasons why a company would want to preserve some excess cash or debt capacity as part of its overall TSR optimization strategy. For instance, paying for an acquisition with cash allows a company to act quickly on a potential deal. Using equity to buy a company generally involves a much longer approval process than using cash does. But very few consumer packaged-goods companies seek equity in order to make up for a reduced cash cushion. Their deals are either small enough to be funded in cash or so large that they require equity, whether they have a cash cushion or not.

Exhibit 3. It Can Be Costly When Cash Held Approaches One-Third of Market Capitalization



Source: BCG analysis.

The Reinvestment Trap

Another potential source of a cash trap is how companies reinvest in their current businesses. Investors are increasingly concerned about a company's reinvestment efficiency. They worry that in an environment characterized by too much cash chasing too little growth, companies will not be disciplined enough in ensuring that their capital investments create more value than alternative uses of the cash. This uneasiness is exacerbated by the fact that investors often lack clear insight into where and how companies intend to use their investment dollars.

There are many ways in which a company's reinvestment plans can make it vulnerable to a cash trap. For example, it may get the balance wrong between the amount of cash it reinvests in its current businesses and the amount it returns to investors. Such an imbalance happens when a company invests too much relative to its realistic growth prospects, when high profitability or excess cash leads to too-high spending on corporate functions such as IT, or when a company lacks the internal planning disciplines that allow corporate managers to say "no" when powerful business-unit heads ask for more cash than they can profitably employ.

But even when a company gets the balance between reinvestment and cash paid back roughly right, its TSR can suffer if it misallocates reinvestment across the businesses in its portfolio. Many companies, for example, allocate investment capital far too "democratically," by spreading it more or less equally across their portfolio of businesses—despite each business unit's varying growth prospects or differing contributions to TSR. In other cases, they may give some businesses (often those with the biggest problems) more capital than others—but with little direct linkage to their actual value-creation potential.

Finally, companies can suffer from a reinvestment cash trap even when they invest in opportunities that do generate profitable growth if there is a misalignment between the kind of growth they pursue and the priorities of their investor base.[7] Different types of investors have different priorities for TSR, different appetites for risk, and therefore different expectations for growth. Depending on which investor types dominate a company's investor mix, there can be a disconnect between a company's growth plans and the priorities and expectations of investors. If so, the company is unlikely to realize the value from these plans that executives expect. Investor misalignment is especially common for companies that have a so-called bimodal portfolio that combines high-growth businesses and value businesses, which attract fundamentally different types of investors with conflicting performance goals. Often, a company's stock suffers a systematic discount as a result.

Executives must make sure that resource allocation is aligned with an overall TSR goal.

Inefficient reinvestment strategies are an invitation for increased pressure from outsiders. Traditionally, many management teams have championed long-term investments in businesses to turn them around or increase their growth potential. Senior executives are often loathe to cut off funding in order to boost near-term cash flow. Instead of optimizing value today, these executives focus on building the best future for each business owned by the company.

But activist investors and private-equity acquirers are pushing companies to take a more objective and disciplined approach to reinvestment. They are less concerned with long-term results when short-term value creation can be enhanced. And, unlike a company's senior executives, they have no ties to legacy thinking inside the company, no personal preferences for specific businesses in the portfolio, and no personal relationships with managers of those businesses. Outsiders believe (rightly or wrongly) that they can quickly adjust reinvestment priorities to create near-term value.

Avoiding a reinvestment trap requires executives to think more like outsiders in evaluating a company's reinvestment plan. And yet, at the same time, they must make sure that they do not go as far as undermining the company's long-term capacity for growth. A key step is to define a clear role for each business in the company's overall TSR strategy. And executives must make sure that resource allocation is aligned with an overall TSR goal and the priorities of investors that currently own the company's stock.

The M&A Trap

Given the constraints on growing organically, many executives have turned to M&A to find alternative sources of growth. They tend to cite two reasons why acquisitions are a good way to increase near-term TSR. First, as long as the acquisition provides an ROI greater than the return on marketable securities (currently around 3 percent), it is a more productive use of cash or debt capacity. What's more, when acquisitions are *EPS accretive*—that is, when they add to a company's EPS—they raise a company's stock price (assuming, of course, that the valuation multiple does not fall as a result of the deal).

Unfortunately, this logic is misleading, and if a company isn't careful, it can be yet another pathway into a cash trap. Just because an acquisition provides returns better than the after-tax interest rate that the acquirer was earning on the cash used to fund the deal does not necessarily mean that the returns wouldn't be even better from some alternative use of that capital. Assume for the sake of argument that a proposed acquisition would generate an ROI of, say, 6 percent—double the return of keeping

7. For a more detailed discussion of this subject, see "How Investors Value Company Growth Initiatives" in *Spotlight on Growth: The Role of Growth in Achieving Superior Value Creation,* the 2006 Value Creators report, September 2006, pp. 17–18.

the cash in marketable securities. But that return is still considerably below investors' cost of capital (currently in the neighborhood of 10 percent), which a company could deliver—and at significantly less risk—by using the excess cash to increase payout instead of funding an acquisition.

Finally, the fact that a particular deal may be EPS accretive does not necessarily mean that it will improve a company's TSR. Here, the key consideration is the impact of the deal on the acquirer's valuation multiple. There are situations in which a deal can increase EPS, but because it causes the acquirer's multiple to decline, it ends up *eroding* TSR. By the same token, deals that dilute EPS in the near term but increase the acquirer's multiple can turn out to improve TSR over the long term. Only when executives start evaluating potential acquisitions not only in terms of earnings but also in terms of their comprehensive impact on the entire value-creation system will they be able to assess whether a particular deal really makes sense or not.

Take the example of a CEO of many years at a consumer packaged-goods company who had pursued an acquisitions strategy of buying up a collection of low-tier brands. The brands were growing slowly and had relatively poor margins. But the CEO bought them because they were cheap and they added to EPS in the first year of their acquisition.

However, there were large hidden costs to the CEO's acquisitions strategy. Because the company was trading at a relatively high multiple, investors were expecting both high revenue growth from current products and improved gross margins. Although the new brands did increase revenue at the time of the deals, they actually diluted the company's average organic growth rate and average margins, causing investors to punish the stock and drive the valuation multiple down. As a result, there was no improvement in the company's TSR.

Eventually, the board replaced the CEO responsible for the failed strategy. The new CEO also pursued acquisitions, but of a very different kind. He focused on high-margin and high-growth companies. Although these deals diluted EPS initially, they improved the gross margins of the company and increased profitable growth. Investors rewarded the moves and the company's valuation multiple rose to record levels—which more than offset the effect on TSR of the near-term EPS dilution.

A company can avoid an M&A cash trap by comprehensively assessing the TSR impact of potential acquisitions—that is, their effect not only on earnings or profitability but also on the company's valuation multiple and free-cash-flow yield. Will the valuation multiple rise or fall as a result of this deal? Is the company's cash or debt capacity better used for this deal or for paying out cash to investors?

This approach has two important benefits. First, it ensures that all drivers of future TSR are taken into account—not just EPS—and assesses a deal against alternative uses of capital. Second, it puts the TSR impact of the proposed transaction into a useful risk-reward context. If the base-case TSR for the acquirer is already high, then deals that don't improve it much but carry a lot of uncertainty or risk of execution become less attractive. Conversely, if the acquirer's base-case TSR is low, then more risk may be warranted and acquisitions become a higher priority.

The Share Buyback Trap

Most of the discussion so far has focused on the choice of accumulating or reinvesting cash versus paying it out to investors. But even when a company decides to take the latter route, it can face a cash trap because of the way it returns that cash. The usual debate at most companies is whether to use excess cash flow to increase dividends or to repurchase shares. Indeed, many companies have done both—but without understanding fully their differing impact on TSR.

It's important, first, to make a distinction between one-time distributions of cash flow and ongoing annual programs. When a company has accumulated cash on the balance sheet and wants to make a one-time payment to investors, the only reason to choose one form of payment over another is if it has a tax advantage. One-time distributions, whether in the form of a special dividend or share buyback, increase TSR in the short term. But they have a relatively minor impact on a company's valuation multiple. Ongoing distributions funded out of annual excess cash flow, by contrast, can affect a company's multiple substantially because they have the potential to signal to investors that a company is confident about the long-term health and quality of its earnings. But when it comes to ongoing distributions, whether a company chooses dividends or share buybacks can make an enormous difference in terms of the precise impact.

In our experience, many executives prefer share buybacks because, unlike dividends, buybacks boost EPS above the level that underlying organic growth in net income would on its own. Executives believe that boosting EPS growth raises the valuation multiple and increases TSR. What's more, their incentives are often tied directly to EPS growth, and the value of their stock options depends on appreciations in stock price, not on increases in dividend yield. Another perceived benefit of share buybacks is that, unlike dividends, ongoing share-repurchase programs can be reduced or halted at any time the cash is needed for opportunistic growth investments.

Dividends have a far more positive impact on a company's multiple than share repurchases.

But as our analysis of the drivers of valuation multiples makes clear, EPS growth is not necessarily a differentiator of multiples. And even when it is, investors are extremely sensitive to *how* the EPS is delivered. Increased EPS from share repurchases, which may end up being discontinued the moment a company wants to use the cash for some other purpose, is unlikely to change investors' estimates of long-term EPS growth for a company or induce them to award the company with a bigger multiple. BCG research demonstrates that dividends have a far more positive impact on a company's valuation multiple than share repurchases do. Indeed, in many cases, buybacks can actually *reduce* a company's multiple in the near term.

BCG conducted an extensive event study comparing the impact of increases in dividend payout (as a percentage of net income) with that of annual share-repurchase programs. The study consisted of two samples drawn from the U.S. S&P 500 and S&P MidCap 400. The first sample contained 107 companies that had announced an increase in their dividend payout ratio. To qualify for the sample, a company had to have an existing dividend payout ratio of at least 10 percent of net income preceding the announcement and then had raised that ratio by at least 25 percent. The second sample consisted of 100 companies that had announced an increase in their share repurchases. To qualify for this sample, a company had to have a share repurchase ratio of 10 percent of net income in the 12 months preceding the announcement and then had increased its share repurchases by a minimum of 25 percent in the subsequent four quarters.

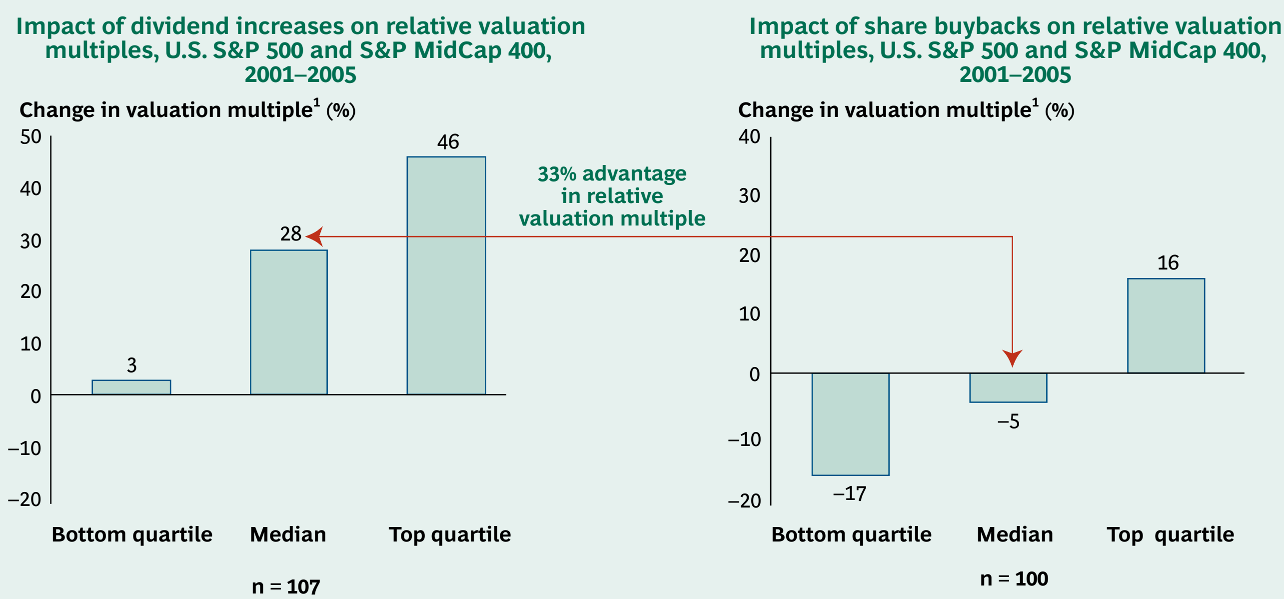
Exhibit 4 portrays the average impact of these moves on valuation multiples for the bottom quartile, median, and top quartile of the two samples. As the exhibit illustrates, dividend increases improved company valuation multiples across the full range of companies in the dividend sample—by 28 percent on average and by a full 46 percent for top-quartile companies. By contrast, share buybacks actually eroded multiples on average, giving the average company in the dividend sample an overall advantage over the average company in the share repurchase sample of 33 percent. And even the top-quartile companies in the buyback sample improved their multiples by only 16 percent—about one-third the improvement enjoyed by top-quartile companies in the dividend sample. The evidence is overwhelming that increased dividend payout raises a company's valuation multiple, and therefore its near-term TSR, whereas annual share-repurchase programs often result in a decline in multiples that dilutes their impact on TSR relative to dividends.

These research results have been confirmed by interviews with hundreds of major institutional investors in consumer packaged-goods companies. The consistent message during these interviews was that investors have a strong preference for dividends over share repurchases. While executives like the flexibility of share buybacks, scaling them back whenever they see alternative uses for the cash (for example, M&A), investors like the certainty of dividends. It's the rare situation when a company raises its dividend only to decrease it in subsequent years. Because dividends are certain and share repurchases are not, investors value dividends more.

The fact that investors favor dividends also means that dividends provide companies with another advantage over share buybacks. Buybacks reward current investors—and, specifically, those who want to get out of the stock. Dividends, by contrast, not only reward current investors but can also attract new investors to a company's stock. Many investment funds set dividend-yield targets as a key part of their portfolio strategy. For example, one large family of U.S. funds has a rule that every portfolio must deliver an average dividend yield that is at least equal to that of the U.S. S&P 500. For every company in the portfolio providing dividend yields below that average, the fund manager must compensate with other companies that provide dividend yields above it. What's more, a company's dividend yield is highly visible when investment funds are doing screens and evaluating stocks. Dividend yield is a metric that financial markets track daily, and it is an obvious trigger for identifying new companies for investment. Put simply, dividends tend to attract more new investors than share repurchases do.

For many executives, the high value put on dividends takes some getting used to. In the high-growth capital markets of the 1980s and 1990s, investors and executives alike tended to view high dividend yield as a failure of management to identify and invest in profitable growth opportunities. But times and priorities have changed. Institutional investors today have lower expectations for how much growth companies can deliver. They are—often, quite reasonably—skeptical of companies that embrace double-digit growth agendas at a time when industry average growth rates are significantly lower. What's more, they recognize that senior executives and boards do not increase dividend payout without high confidence that it can be maintained and that only management with a full commitment to shareholder value and savvy about the drivers of TSR will do so. Those attributes define the management teams that investors want to bet on today.

Exhibit 4. Dividend Increases Improve Valuation Multiples More Than Share Buybacks



Sources: Compustat; BCG analysis.
Note: The dividend sample includes all U.S. S&P 500 and S&P MidCap 400 companies that had a dividend-payout ratio of at least 10 percent of net income and that raised their dividend-payout ratio by at least 25 percent. The share buyback sample includes all companies from the two indexes that had a buyback-payout ratio of at least 10 percent of net income in the 12 months preceding a share-buyback announcement and that increased share repurchases by at least 25 percent in the subsequent four quarters. Both samples exclude companies with price-to-earnings ratios (P/Es) greater than 150 percent of the U.S. S&P 500 average or at which EPS growth was less than zero (in order to exclude companies with P/E increases caused by lower earnings).
[1]This is the change in P/E ratio relative to the U.S. S&P 500 average over the two quarters following the dividend or buyback announcement.

Balancing the Short Term and the Long Term

In this report, we have argued that recent trends in the capital markets have caused investors to focus on near-term value creation and that companies have to respond or risk disappointing investors—and perhaps even losing control of their destiny.

But that doesn't mean that companies can neglect the long term. BCG believes strongly in the imperative of long-term value creation. If a company focuses on immediate pressures to the neglect of developing future growth platforms, it risks undermining its ability to create value in the future. In such a situation, the ultimate result of the cash trap is to damage a company's future ability to generate cash. The solution is to achieve a delicate balance—to invest sufficiently in growth for the long term but in a way that also wins favor from investors today.

Aligning Growth with Investor Expectations

The first step is to make sure that a company's plans for growth are well aligned with the priorities and expectations of its investors. Remember: these expectations will drive a company's valuation multiple, relative to peers, which is the key driver of short-term TSR and an important enabler of—or constraint on—a company's long-term value-creation strategy.

One source of misalignment is the difference in how executives and investors assess future growth opportunities. Most managers evaluate the potential of a growth initiative incrementally—that is, whether it adds to EPS today or has a positive net present value (NPV), given reasonable assumptions about future cash flows and likely risks. But investors tend to focus not just on EPS or on stand-alone NPV but on how a company's growth initiatives fit in with their view of its overall TSR profile. In other words, a specific initiative may deliver returns above a company's cost of capital, but if the return is less than the average return being earned by existing investment, it will erode that average and, therefore, may disappoint investors, who will punish the company's multiple as a result. This is especially the case in today's environment in which investors are sensitive to any indication that current high levels of profitability are being undermined by companies that are overinvesting in order to compete for limited growth opportunities.

To address such misalignments, a company must develop a comprehensive understanding of exactly who owns its shares and engage its dominant investors in a give-and-take dialogue.

Once the dominant investors have been identified, management should take the time to develop an in-depth understanding of these investors' perspectives on and requirements for the company. Fair disclosure rules may limit the depth of information that management can share with these investors. But there is no law against asking investors good questions and listening carefully to their answers. Do current or desired investors find the company's growth plans credible? Are those growth plans in sync with their priorities? Savvy investors have strong—and often extremely well informed—views on such questions.

The purpose of this exercise is not to let investors dictate the company's strategy. Rather, the goal is to be responsive to their perspectives and priorities, as well as to educate them about the strategic logic underlying the company's long-term business plans.

For an example of how a company can recover from a misalignment with investors, consider the recent experience of a U.S. consumer-packaged-goods company. From 2000 to 2005, the company's valuation multiple was consistently at the bottom of its peer group—even though the company was one of the largest and most profitable in its industry. The company's executives assumed that the problem was a perceived lack of growth, so they began to communicate aggressive growth targets and to accumulate cash on the balance sheet in order to fund that growth.

One way to expand a company's opportunities is to improve its capacity for innovation.

But the sources of the company's valuation discount were different from what its senior executives thought they were. Interviews with the company's investors showed that the dominant investors did not reward aggressive growth, and they worried that the company would spend too much on risky or unprofitable growth instead of using its strong balance sheet to increase payouts to investors. A quantitative analysis of peer-group multiples confirmed these findings. The analysis showed that while high profitability was critical, dividend payout was also an important driver of the differences in valuation multiples among companies. By contrast, revenue growth was not that important.

Company executives didn't abandon their long-term plans for growth. But in light of these findings, they realized that their near-term growth targets needed to be scaled back. They started emphasizing profitability and the generation of free cash flow in the company's communications with investors—and at the same time substantially increased dividend payout to return more cash directly to investors. And in a dramatic move, they also announced the divestiture of a core business with low returns and low growth that they had struggled unsuccessfully for years to turn around and that had become a serious drag on the company's overall portfolio.

The impact of these moves on the company's stock price has been extraordinary. Since December 2005, the company's price-to-earnings ratio has grown by 50 percent. Its TSR has outperformed that of its peer group by more than 20 percent and the U.S. S&P 500 by roughly 35 percent. And its market capitalization has nearly doubled, despite the divestiture of a major business unit.

Even more important, the company's improved performance has attracted a new segment of investors, who are more interested in long-term growth. This migration of its investor base has better positioned the company to be rewarded for its long-term growth strategy. Recently, the company has embarked on an acquisition plan to add some new high-growth businesses to its portfolio.

Expanding Growth Opportunities

Given the constraints on growth in their core markets, many companies will also need to look for new ways to create growth. Identifying new opportunities for growth has the advantage not only of creating more profitable outlets for deploying excess capital but also of establishing more rigorous internal competition for company resources (thus contributing to increased discipline around capital allocation). There are at least three places a company can look for new growth opportunities.

Innovation. One essential way to expand a company's opportunities is to improve its capacity for innovation. Given the current mismatch between cash available to fund growth and most companies' growth opportunities, it should be no surprise that more and more companies are focusing on innovation. For example, in a BCG survey of senior executives at global companies (including consumer packaged-goods companies), the vast majority of respondents (more than 90 percent) considered organic growth through innovation necessary for success in their industry, a full 72 percent ranked it as one of their top three strategic priorities, and 40 percent said it was their top priority.[8]

They are right to make it so. Innovation translates into superior long-term value creation. The 25 most innovative

8. See *Innovation 2006,* BCG Senior Management Survey, July 2006.

companies (as defined by our survey respondents) had a median annualized return of 14.3 percent from 1996 through 2005—a full 300 basis points better than the S&P Global 1200 median.[9]

Megatrends. Another important way for a company to expand its growth horizons is to understand the impact of what we call *megatrends* on the current—and future—portfolio. Megatrends are very long-term social, economic, or demographic changes that are likely to have a transformational effect on business across a wide range of industries. Examples might include the rise of China as a major industrial power, rapid urbanization, global warming, increasing energy scarcity, or the revolution in the life sciences. Many executives, of course, are familiar with these trends. But relatively few have thought through the specific second-order implications for their business.

Such megatrends will decisively redraw the map of opportunity in many industries. Those companies that are able to figure out how to exploit them are likely to be the winners—and value creators—of the future. When companies carefully examine the implications of these megatrends for their capabilities and core business positions, they are often able to define evolutionary pathways for those businesses, as well as identify entirely new areas of opportunity that will be important sources of future growth.

Acquisitions. Finally, for many companies, building long-term growth platforms will almost certainly involve a plan for more actively creating value through M&A. Experienced acquirers consistently outperform companies that limit themselves to organic growth strategies or that pursue acquisitions only occasionally.[10] In our experience, successful acquirers manage M&A like they do any other business process. Among the key components are a compelling strategic logic, rooted in a detailed understanding of the competitive dynamics of a company's industry and the company's value-creation opportunities and challenges; a rigorous process for valuing potential targets; clear structures for M&A process management; and systematic postmerger integration.[11]

Only when a company has this full set of capabilities in place will it be likely to create enduring value through acquisition. If M&A needs to become a critical part of a company's long-term value-creation strategy, it is imperative to start building these capabilities now.

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9. For a detailed description of BCG's approach to innovation, see James P. Andrew and Harold L. Sirkin, "Innovating for Cash," *Harvard Business Review,* September 2003; and James P. Andrew and Harold L. Sirkin, *Payback: Reaping the Rewards of Innovation* (Boston: Harvard Business School Press, 2007).

10. See *Growing Through Acquisitions: The Successful Value Creation Record of Acquisitive Growth Strategies,* BCG report, May 2004.

11. For a detailed description of BCG's thinking on M&A, see *The Brave New World of M&A: How to Create Value from Mergers and Acquisitions,* BCG report, July 2007; and *Powering Up for PMI: Making the Right Strategic Choices,* BCG Focus, June 2007.

Ten Questions That Every CEO Should Know How to Answer

In conclusion, we offer ten questions about value creation in an era of excess cash that every CEO should know how to answer. The questions synthesize the basic arguments and recommendations made in this report in a concise format.

1. *What is your long-term TSR aspiration?* Is that aspiration appropriate given the expectations embedded in your stock price and the ability of your business plans to deliver improved performance?

2. *How much growth do you need?* How close can the non-growth drivers of TSR get you to your goal? What is the remaining gap that growth must fill?

3. *Do you have a clear long-term growth strategy?* Are your management team, board, and investors aligned around the optimal role for growth in achieving your TSR objectives? If not, do you have a plan for creating such an alignment?

4. *Are you looking beyond traditional sources of growth?* How robust is your innovation process? How will broad social and economic trends affect the evolution of your core markets? What is the potential of M&A to contribute to long-term growth?

5. *How "efficient" is your capital investment?* Is capital being allocated appropriately across your internal businesses and your opportunities for profitable investment? Or do internal practices result in resource allocation that erodes your value-creation potential?

6. *Do you know the opportunity cost of capital to your investors?* Does your corporate strategy recognize that the same hurdle must be cleared whether you use debt, cash, or shares to fund growth?

7. *What drives the differences in valuation multiples in your industry?* Are investors discounting your multiple? If so, do you understand why and what to do about it?

8. *Are you vulnerable to a cash trap?* Is your desire to maintain flexibility in your uses of cash or debt for the long term exposing you to possible pressure from activist investors or private-equity firms?

9. *Do investors think you have a lazy balance sheet?* What is the appropriate balance of equity and debt for your company, given your industry and your current debt-to-capital ratio?

10. *Do you know how much cash you can realistically return to investors?* What is the right balance of reinvestment and payout in order to optimize near-term and long-term value creation? What will the impact of increasing cash payout be on your valuation multiple?

Appendix:

The 2007 Consumer-Packaged-Goods Value Creators Rankings

The 2007 Consumer-Packaged-Goods Value Creators rankings are based on an analysis of total shareholder return at 107 global companies for the five-year period from 2002 through 2006.

To arrive at this sample, we began with TSR data for nearly 500 companies from 44 countries provided by Thomson Financial Worldscope. We eliminated all companies that were not listed on some world stock exchange for the full five years of our study or did not have at least 25 percent of their shares available on public capital markets. We also eliminated all companies that are not part of the packaged goods subsegment of the consumer industry. We further refined our sample by establishing an appropriate market-capitalization hurdle of $2 billion (at year-end 2006) to eliminate the smallest companies.

The rankings are based on five-year TSR performance from 2002 through 2006. We also show TSR performance for 2007, through September 19. In addition, we break down TSR performance into six key investor-oriented financial metrics.

The average annual return for the 107 companies in our sample was 10 percent. What improvement in TSR was necessary to achieve top-quartile status, given the sample average? Exhibit 1 shows the 107 companies in our global sample according to their five-year TSR performance. To achieve top-quartile status, companies needed to post an average annual TSR of at least 23.2 percent. The very best performers had returns of 50 percent and higher.

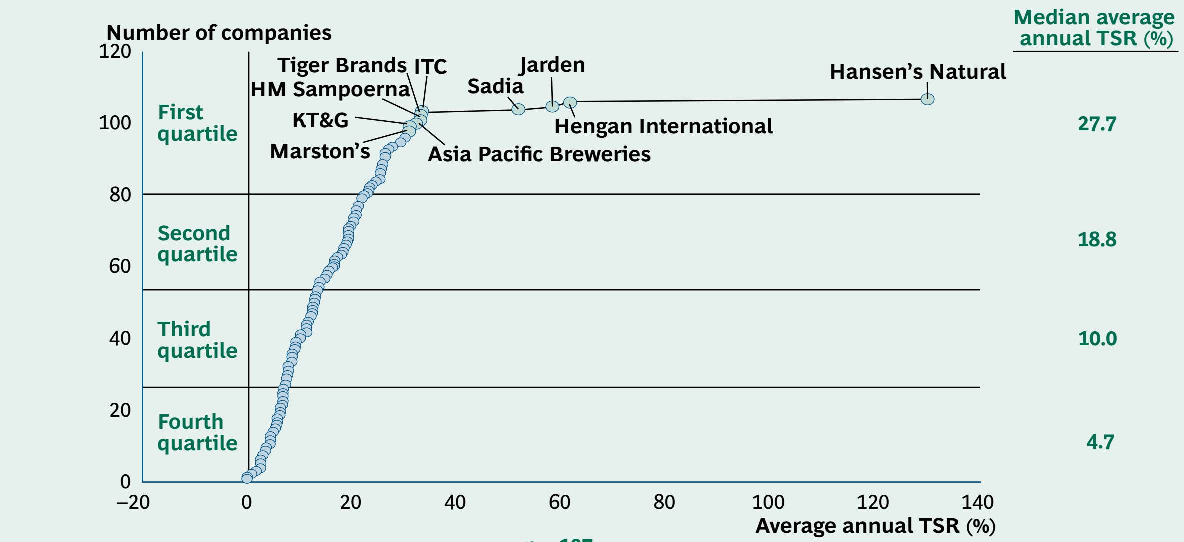
What differentiates the sample's top performers from the rest? The top ten generated an average annual TSR of 36 percent during the period under study, in contrast to an average annual return of 10 percent for the total sample. Exhibit 2 compares the TSR profile of the top ten companies in our 107-company sample with that of the sample as a whole.

Value creation for the most successful companies came from each of the three major dimensions of the value creation system described in this report: improvements in fundamental value, increases in valuation multiples, and distributions of free cash flow. In most cases, the top ten's performance was driven by substantial sales growth (responsible for 15 points of TSR), which occurred while they were maintaining or growing profit margins.

The top ten's average dividend yield remained higher than that of the sample average over the five-year period from 2002 through 2006 and accounted for 5 percentage points of TSR. Profitable growth, combined with significant payouts of free cash flow, led to improvements in valuation multiples for the top ten performers, equivalent to an additional 14 percentage points of TSR.

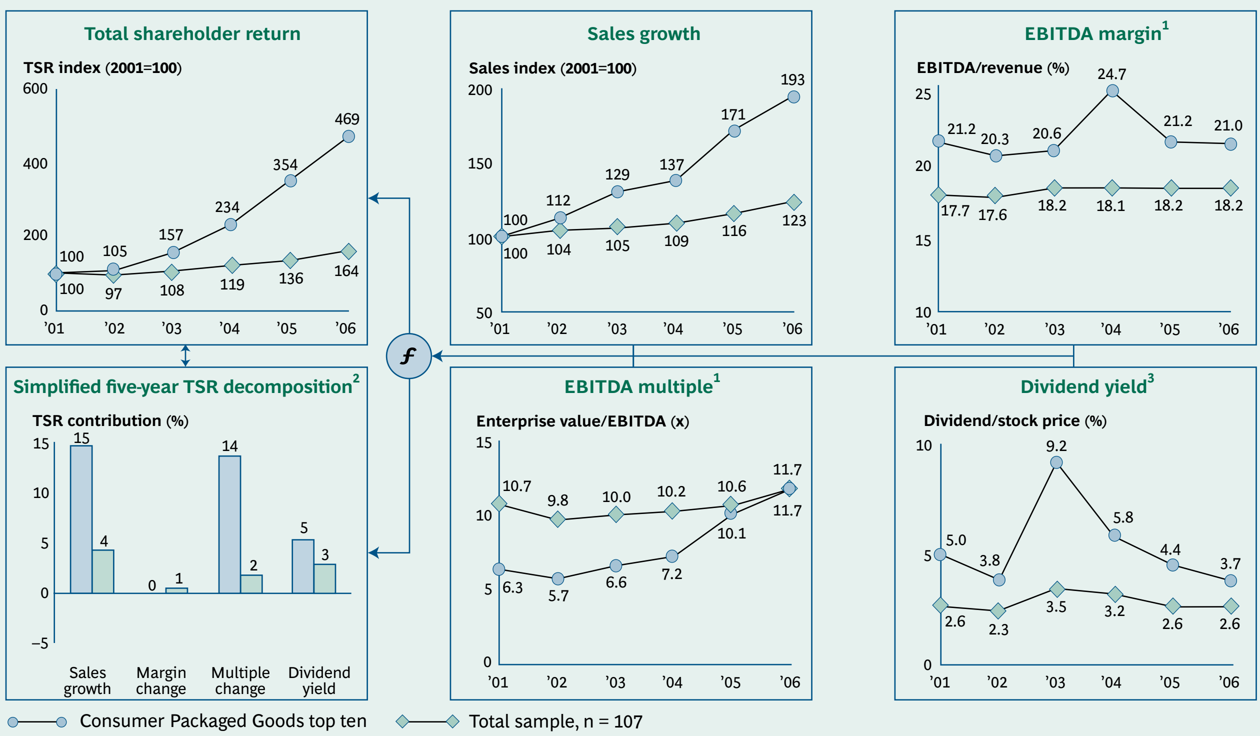
Nine of the top ten performers have a market capitalization of less than $10 billion (ITC being the only exception). Exhibit 3 lists the top ten performers with a market capitalization greater than $2 billion. The top ten companies with a market capitalization greater than $10 billion are listed in Exhibit 4. Five-year TSR performance for these companies ranged from 23.4 percent to 33.3 percent. In Exhibit 5, we exclude tobacco companies from our list of companies with a market capitalization greater than $10 billion in order to make these rankings relevant to as many consumer companies as possible.

Exhibit 1. Average Annual Total Shareholder Return for Consumer Packaged-Goods Companies by Quartile, 2002–2006



Sources: Thomson Financial Datastream; BCG analysis.
Note: TSR is derived from calendar-year data; the total global sample contains 107 companies with market valuations greater than $2 billion.

Exhibit 2. Value Creation at the Top Ten Consumer-Packaged-Goods Companies Versus the Industry Sample, 2002–2006



Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.
Note: The total global sample contains 107 companies with market valuations greater than $2 billion.
[1]The industry calculation is based on the aggregate of the entire sample.
[2]Share change and net debt change are not shown.
[3]The industry calculation is based on the sample average.

Exhibit 3. Top Ten Consumer-Packaged-Goods Companies with Market Capitalization Greater Than $2 Billion, 2002–2006

					TSR Decomposition[1]						
#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Sales growth (%)	Margin change (%)	Multiple change[4] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2007 TSR[5] (%)
1	Hansen's Natural	United States	129.8	3.060	65	38	23	0	–2	5	40.0
2	Hengan International	Hong Kong	61.7	2.679	29	1	30	8	–2	–6	49.3
3	Jarden	United States	58.4	2.347	63	0	10	0	–18	3	–14.3
4	Sadia	Brazil	52.1	2.324	13	–12	22	13	0	15	38.4
5	ITC	India	33.3	14.938	20	–4	13	2	0	2	–12.1
6	Tiger Brands	South Africa	33.0	4.149	0	11	13	4	–1	5	14.0
7	HM Sampoerna	Indonesia	32.8	4.727	14	1	5	8	1	3	14.3
8	Asia Pacific Breweries	Singapore	31.9	2.590	9	4	18	5	0	–3	–11.8
9	KT&G	South Korea	31.0	8.958	9	3	11	7	0	1	24.4
10	Marston's	United Kindom	31.0	2.722	1	4	14	6	4	1	–17.2

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.
Note: The total global sample contains 107 companies with market valuations greater than $2 billion.
[1]The contribution of each factor is shown in percentage points of five-year average annual TSR; apparent discrepancies with the TSR total are due to rounding.
[2]Average annual total shareholder return, 2002–2006.
[3]As of December 31, 2006.
[4]Change in EBITDA multiple.
[5]As of September 19, 2007.

Exhibit 4. Top Ten Consumer-Packaged-Goods Companies with Market Capitalization Greater Than $10 Billion, 2002–2006

					TSR Decomposition[1]						
#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	Sales growth (%)	Margin change (%)	Multiple change[4] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2007 TSR[5] (%)
1	ITC	India	33.3	14.938	20	–4	13	2	0	2	–12.1
2	Japan Tobacco	Japan	29.8	48.289	1	7	14	1	2	5	6.2
3	Grupo Modelo	Mexico	27.1	18.047	8	1	13	3	0	1	1.5
4	Imperial Tobacco	United Kingdom	26.4	26.648	17	1	6	5	–3	1	17.2
5	AmBev	Brazil	26.3	30.010	21	9	1	5	–10	0	30.2
6	Reynolds American	United States	26.1	19.353	6	3	22	8	–9	–3	2.1
7	British American Tobacco	United Kingdom	25.8	58.156	–3	4	13	6	1	4	21.9
8	Orkla	Norway	25.0	11.774	3	0	6	7	0	7	62.1
9	SABMiller	United Kingdom	23.9	34.560	31	–2	6	4	–13	–2	7.7
10	Pernod Ricard	France	23.4	20.861	6	8	7	3	–5	4	13.1

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.
Note: The total global sample contains 107 companies with market valuations greater than $10 billion.
[1]The contribution of each factor is shown in percentage points of five-year average annual TSR; apparent discrepancies with the TSR total are due to rounding.
[2]Average annual total shareholder return, 2002–2006.
[3]As of December 31, 2006.
[4]Change in EBITDA multiple.
[5]As of September 19, 2007.

Exhibit 5. Top Ten Consumer-Packaged-Goods Companies with Market Capitalization Greater Than $10 Billion, 2002–2006 (Excluding Tobacco Companies)

#	Company	Country	TSR[2] (%)	Market value[3] ($billions)	TSR Decomposition[1]: Sales growth (%)	Margin change (%)	Multiple change[4] (%)	Dividend yield (%)	Share change (%)	Net debt change (%)	2007 TSR[5] (%)
1	Grupo Modelo	Mexico	27.1	18.047	8	1	13	3	0	1	1.5
2	AmBev	Brazil	26.3	31.010	21	9	1	5	–10	0	30.2
3	Orkla	Norway	25.0	11.774	3	0	6	7	0	7	62.1
4	SABMiller	United Kingdom	23.9	34.560	31	–2	6	4	–13	–2	7.7
5	Pernod Ricard	France	23.4	20.861	6	8	7	3	–5	4	13.1
6	Christian Dior	France	21.4	18.905	5	–1	0	3	–3	18	20.4
7	Reckitt Benckiser	United Kingdom	21.2	28.483	8	6	3	3	0	0	18.3
8	Fortune Brands	United States	20.3	12.972	10	5	6	2	–1	–3	–2.6
9	Kirin Holdings	Japan	16.3	14.543	1	4	8	1	1	1	–1.0
10	Henkel	Germany	14.0	21.486	0	2	10	2	0	1	6.3

Sources: Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; annual reports; BCG analysis.
Note: The total global sample contains 107 companies with market valuations greater than $10 billion.
[1]The contribution of each factor is shown in percentage points of five-year average annual TSR; apparent discrepancies with the TSR total are due to rounding.
[2]Average annual total shareholder return, 2002–2006.
[3]As of December 31, 2006.
[4]Change in EBITDA multiple.
[5]As of September 19, 2007.

For Further Reading

The Boston Consulting Group publishes many reports and articles on corporate development and value management that may be of interest to senior executives of consumer goods companies. Recent examples include:

Avoiding the Cash Trap: The Challenge of Value Creation When Profits Are High
The 2007 Value Creators report, September 2007

The Brave New World of M&A: How to Create Value from Mergers and Acquisitions
A report by The Boston Consulting Group, July 2007

Powering Up for PMI: Making the Right Strategic Choices
A Focus by The Boston Consulting Group, June 2007

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