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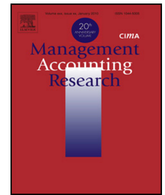

Drivers of value creation—The role of value-based management and underlying institutions

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ABSTRACT

While the performance effect of value-based management (VBM) has been debated in practice and academia, recent research suggests that little is known about contingency factors influencing this effect. In this study, we contribute to the understanding of contingencies that could explain variations in VBM performance outcomes. Specifically, we (1) test whether VBM relates to higher firm performance, and (2) we examine the external institutional conditions that may magnify the performance effect of VBM. We empirically analyze our research question using data on 4288 firm-years of firms from the MSCI Europe Index and the S&P 500 Index between 2005 and 2010. After controlling for various possible confounding effects, we find that VBM relates to higher firm performance and provide evidence that complementary external institutions at the firm and national levels amplify the performance effect of VBM. Furthermore, our findings exhibit an interrelation between external institutions and indicate a complementary relationship between VBM, financially-oriented ownership, and national shareholder orientation, increasing value creation.

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1. Introduction

There has been an increased use of value-based management (VBM) among firms in both the United States and Europe (Biddle et al., 1999; Davies, 2000; Fiss and Zajac, 2004; Malmi and Ikäheimo, 2003). VBM is a holistic managerial approach that aims to align corporate action with value creation. By means of a superordinate value-based metric (which integrates the cost of capital), VBM should align strategy, firm processes and systems, decision making, performance measurement, and mindsets with value creation (Burkert and Lueg, 2013; Ittner and Larcker, 2001; Malmi and Ikäheimo, 2003). Based on this, numerous success stories of VBM adopters have fostered the notion that VBM is beneficial to firm performance (Ittner and Larcker, 2001; Lueg and Schäffer, 2010; Malmi and Granlund, 2009; Ryan and Trahan, 2007). Nevertheless, previous research (Ittner and Larcker, 2001; Lueg and Schäffer, 2010) suggests that the assumed performance effect of VBM calls for a more thorough investigation where various potential contingencies for this effect should be considered.

Although various empirical studies have analyzed the economic consequences of VBM implementation (e.g., Cordeiro and Kent, 2001; Grifftith, 2004; Hogan and Lewis, 2005; Ittner et al., 2003; Rapp et al., 2011; Ryan and Trahan, 2007; Van Den Bosch et al., 2011; Wallace, 1997), empirical evidence on whether VBM is associated with better firm performance is inconclusive: positive (Ittner et al., 2003; Rapp et al., 2011; Ryan and Trahan, 2007; Wallace, 1997), non-significant (Cordeiro and Kent, 2001; Hogan and Lewis, 2005), and even negative (Grifftith, 2004; Van Den Bosch et al., 2011). Therefore, Lueg and Schäffer (2010) parsed empirical research on VBM to identify "best practice" studies. They concluded that the most studies reveal positive effects of VBM on firm performance, but they also suggested that the consideration of contingency factors affecting the relationship is a fruitful avenue for future VBM research.

Simultaneous to the development in VBM research, the role of institutions has become of greater interest in management accounting research (Burns and Scapens, 2000; Conrad and Uslu, 2011; Goretzki et al., 2013; Scapens, 1994; Soin et al., 2002; Tsamenyi et al., 2006), particularly, the intra-organizational process by which the institutionalization of management accounting systems shapes organizational change (Burns and Scapens, 2000; Soin et al., 2002). In this process of institutionalization, a successful implementation of a new management accounting system purportedly depends on whether "changes do not clash with prevailing institutions" (Burns and Scapens, 2000; Ribeiro and

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Scapens, 2006). As such, different extra-organizational settings may explain performance differences within management systems because interdependencies between the institutional environment and the organization mutually determine the efficacy of internal control systems (Aguilera, 2003; Aguilera et al., 2008; Peng, 2003), in this case VBM use. For this purpose, an analysis of the interdependencies between external institutions and VBM could improve the understanding of variations in the outcome of VBM and other management accounting systems. No studies have to our knowledge investigated institutional influences on VBM success. Consequently, this study takes up this call by way of addressing the following research question: *Is VBM beneficial to firm performance, and how is this relationship influenced by the impact of and interrelation with external institutions?*

To identify external institutions that complement or clash with the use of VBM, we draw on the initial indications of the comprehensive case study by Malmi and Ikäheimo (2003). Their findings suggest that the impact of VBM may depend on an institutional environment that shares the objective of value creation with VBM. More precisely, they find that VBM has less impact in an organization where shareholders are not financially oriented and when organizations act in markets where regulations do not prioritize shareholder value creation. Specifically, we focus on two external institutional factors in relation to VBM implementation: financially-oriented ownership at the firm level and shareholder-oriented national regulations and institutions (hereafter, national shareholder orientation) at the national level.

We maintain that financially-oriented ownership occurs if the predominate investor is a "professional money manager" without potential business ties in the invested firm, thus exhibiting a clear financial orientation, more willingness to monitor, and greater financial expertise (e.g., Cornett et al., 2007; Ferreira and Matos, 2008). Based on these characteristics, we expect that financially-oriented ownership shares the objective of value creation with VBM and supports its effective use. National shareholder orientation characterizes an institutional context where interests of shareholders are encouraged by national regulations and institutions. We argue that high national shareholder orientation stems from greater investor protection (La Porta et al., 1998), stronger accounting and accountability (Leuz et al., 2003), and increased director liability (Djankov et al., 2008). Given this focus on shareholder interests, we maintain that national shareholder orientation provides a congruent goal with VBM and contributes to the effective integration of a shareholder-oriented management system such as VBM.

We examine our research question empirically by investigating a longitudinal panel of 4288 firm-year observations between 2005 and 2010 of firms in 16 Western European countries and the United States. Based on the prediction that VBM enhances firm performance, we test whether the two external institutions providing a congruent goal to VBM and supporting its effective integration increase the positive association between VBM and firm performance. Our results suggest that financially-oriented ownership at the firm level as well as national shareholder orientation at the national level act as a complementary external institution to VBM, thus increasing VBM's positive effect on firm performance. Subsequently, we consider the interrelation between the two institutional levels to investigate a complementary relation comprising VBM, financially-oriented ownership, and national shareholder orientation. In this context, we predict that the positive impact of national shareholder orientation on the performance effect of VBM is more pronounced in the presence of financially-oriented ownership. Our empirical results support this prediction.

Our study contributes to research by linking the effects of VBM with its concurrent external institutions. Given that research in management accounting focuses mainly on the process of change within the organization, this study takes a different perspective by examining the interdependence between external institutions and the outcome of management accounting systems. Moreover, we respond to the call in the VBM literature for consideration of contingencies of the VBM performance effect (Lueg and Schäffer, 2010). In this context, we extend the single-country focus of previous VBM research by examining the influences of national differences on the VBM performance effect. Finally, we contribute to the debate concerning more comprehensive empirical analyses in VBM and management accounting research by investigating a large longitudinal and multinational sample (Ittner and Larcker, 2001; Zimmerman, 2001).

In the next section, we review previous research and develop our hypotheses. We then present the dataset, key variables, and the conceptual channels through which we expect the effects to operate. Subsequently, we present the results and robustness tests. The final section discusses and concludes the paper.

2. Literature and hypotheses

VBM can be defined as an integrated management approach based on several elements, including management control systems, that put value creation at the center of the company's strategy (Ameels et al., 2003; Burkert and Lueg, 2013; Claes, 2006; Copeland, 2002; Ittner and Larcker, 2001; Malmi and Ikäheimo, 2003). Specifically, VBM should (1) provide a general framework through which managers can define, implement, and enforce value-creating strategies inside the firm and (2) provide owners with means for monitoring and aligning managerial actions. The key feature of VBM are value-based metrics that combine the costs of invested capital and the firm's profitability (Copeland, 2002). These metrics and a related set of connected value drivers are meant to replace traditional accounting measures as the key financial indicators in a company and to serve as the firm's primary performance indicators. Based on this, value-based metrics should aid in developing strategies, allocating resources and setting financial targets, thereby aligning internal goals with the creation of shareholder value. In doing so, the integration of value-based metrics within the companies' compensation system should further encourage the alignment of properly incentivized managers.

2.1. Value-based management and firm performance

The positive effects of VBM on firm performance are based on several factors that foster organizational commitment to and alignment with value creation. First, VBM should decrease agency costs because it aligns managerial with shareholder interests, particularly when management compensation is linked with value-based metrics (Claes, 2006). Based on this, the investment decisions of the firm's managers will be improved and thus be associated with an increase in shareholder value (Balachandran, 2006). Second, the integration of a value-based metric and its subsequent linkage with value drivers should serve as an important tool for managers, enabling them to develop and enforce value-creating strategies. Finally, as a holistic control system that brings transparency, accountability, and value orientation to all levels of a corporation, VBM should further facilitate access to capital and effective financing (Beck and Britzelmaier, 2012; Höpner, 2001) and produce positive spillovers for other stakeholders (Hillman and Klein, 2001; Jensen, 2010; McSweeney, 2007).

Although the characteristics of VBM suggest a positive performance effect, empirical evidence regarding the effect of VBM on firm performance is mixed (Ittner and Larcker, 2001; Lueg and Schäffer, 2010). To provide a more differentiated answer to the question of whether VBM improves firm performance, Lueg and

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