Historical Equity Spreads within the Chemicals Industry (1976-91)

Source: Value Line Investment Survey (1992), Marakon Associates analysis.
The M/B vs. E/B Graph

PUBLISHING COMPANIES (10-Year Strategic Horizon) | OLD COMPANIES (15-Year Strategic Horizon)

Figure by MIT OCW. *Based on historic (five-year average) values. Source: Compustat, McKinsey analysis.

Is there a value gap in your company?

- Are there any businesses in the portfolio that significantly underperform competitors?
- Are there any businesses that are out of their start-up phase and still losing money?
- Are there any businesses that would clearly be worth more to someone else due to synergy or operating economies?
- Are resources allocated to businesses in a way that reflects their profitability potential, or do you tend to overfund losers and underfund winners?
Is there a value gap in your company? (cont’d.)

- Is performance measured by using average cost, asset, and debt allocations, and an arbitrary corporate hurdle rate?
- Are any of your long-term incentives tied directly to relative stock performance or indirectly to the drivers of shareholder value?
- Is capital spending driven mostly by capital budgeting rather than the strategic planning process?
- Is the company underleveraged? Could the company be taken private in an LBO at today’s stock price?
- If the company did go private in an LBO, which assets would be sold to repay debt? How much overhead could be cut without damaging the long-term health of the company?
The Profitability Matrix

- **Return on equity (ROE)**
  - **Profitable** (ROE > $k_E$)
  - **Unprofitable** (ROE < $k_E$)

- **Business cost of equity capital** ($k_E$)

- **Market growth** ($G$)
  - **Losing share** ($g < G$)
  - **Gaining share** ($g > G$)

- **Growth** ($g$)
  - **Losing share** ($g < G$)
  - **Gaining share** ($g > G$)

- **Cash neutrals**
  - + Spread
  - + Cash
  - - Share

- **Cash Generators**
  - + Spread
  - + Cash
  - + Share

- **Cash Users**
  - - Spread
  - - Cash
  - + Share

An Alternative Profitability Matrix

Figure by MIT OCW. Adapted from Marakon Associates. “The Marakon Profitability Matrix,” Commentary No. 7, 1981.