



REFOCUSING ON GROWTH

COMPANY BACKGROUND

Alcoa is the world's largest producer of primary aluminum, fabricated aluminum, and alumina with more than 350 operating locations in 40 countries. The company is active in all major aspects of the industry, including technology, mining, refining, smelting, fabricating, and recycling. In 2002 Alcoa generated more than \$20.3 billion in revenue and employed 127,000 people.

In a review of capital budgeting allocations, Alcoa learned that while capital expenditures continued to increase with sales between 1998 and 2002, much of the increase in spending was absorbed by the environmental health and safety (EH&S) budget. More detailed analysis confirmed fears that growth projects were being "crowded out" as they had fallen from 44 percent of capital expenditures in 1998 to 36 percent in 2002. To turn the tide, the CFO set a stretch target of 40 percent for growth projects.

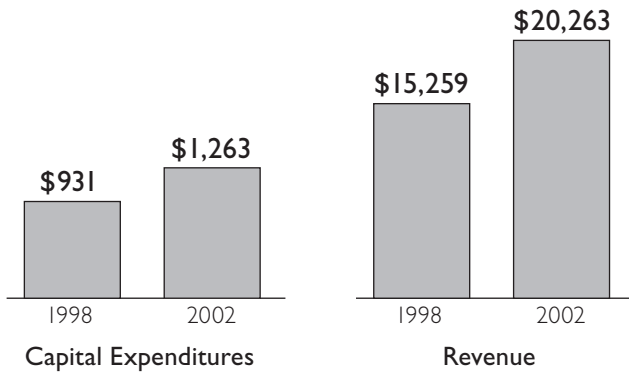


SEIZING THE OPPORTUNITY TO TRANSFORM CAPITAL BUDGETING

Alcoa faced rising capital spending...

Increases in Capital Expenditures and Revenues

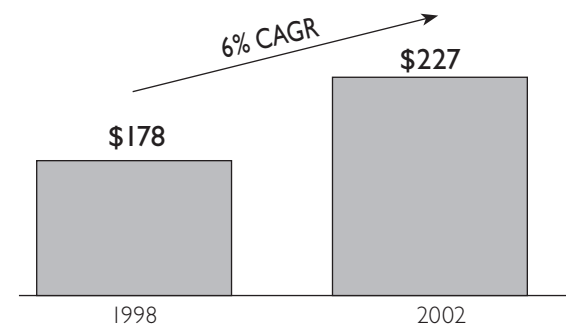
Millions



...increased EH&S expenditures...

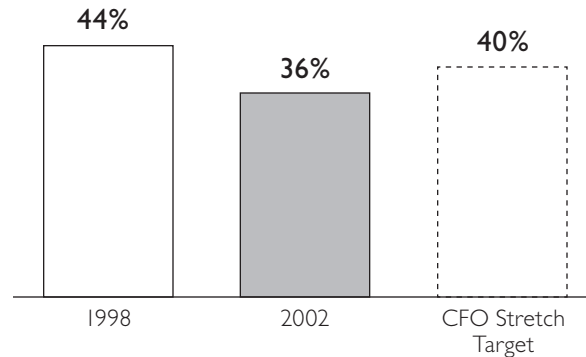
Environmental Health and Safety Capital Expenditures

Millions



...and a shrinking growth allocation, prompting the CFO to establish a stretch target for growth

Growth Projects: Percentage of Capital Budget



Source: Alcoa, Inc.; Working Council for Chief Financial Officers research.



GROWTH POOL CRITERIA

Of Alcoa's approximately \$1 billion in capital expenditures, the amount reserved for growth projects is determined by the following four criteria:

- (1) Comparison of capital expenditures with best-in-class peers
- (2) Assessment of new revenue streams necessary to meet Alcoa's stretch targets
- (3) Analysis of funding constraints given cash flows and debt ratios
- (4) Aggregation of committed business unit spending

The 35 percent of the budget reserved for growth projects in 2003 is a floor, not a target, and Alcoa can invest more if appropriate. By creating a growth pool, Alcoa ensures that a minimum and meaningful amount is invested in true growth opportunities.

Once the growth pool is funded, there is explicit competition for disbursements based on "right to grow" criteria. At Alcoa, the "right to grow" is a function of:

- (1) Attractiveness of business units' target markets
- (2) Strength of business units' competitive positions
- (3) Past-project performance

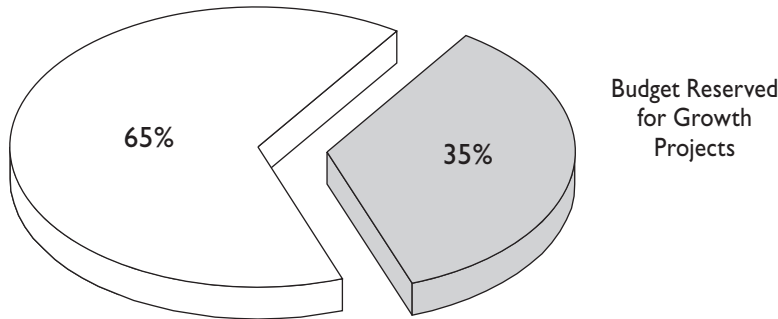
Post-project reviews are particularly important and include a comparison of actual results versus original business case of similar investments from prior years and an evaluation of a business unit's historical returns versus the IRR of the proposed project. The criteria are transparent, and project proposals are reviewed taking into consideration a business unit's past, present, and (anticipated) future performance.



SETTING ASIDE GROWTH DOLLARS

Alcoa establishes a growth pool...

Capital Budget Categories*



GROWTH POOL SIZING CRITERIA

- External benchmarking vis-à-vis “best-in-class” peers
- Calibration of new revenue streams needed to meet “stretch” targets
- Analysis of capital restraints and targeted financial ratios (Debt/Capital)
- Aggregation of spending already committed at BU level

...with explicit internal competition for funds from this pool

Schematic of “Right to Grow” Criteria

GROWTH POOL DISBURSEMENT CRITERIA

Allocations based on “Right to Grow” defined by:

- Attractiveness of BU’s Market**
 (defined by growth rates, margins)
- Strength of BU’s Competitive Position**
 (defined by cost efficiency versus peers, market share, ownership of distinctive technology, and other sources of advantage)
- Past-Project Performance**
 (actual results versus original business case of similar investments in prior years; historical BU returns versus proposed IRR)

* Budget approximately \$1 billion.

Source: Alcoa, Inc.; Working Council for Chief Financial Officers research.



SEGMENTED PROJECT EVALUATION

Recognizing that different types of projects necessitate different treatment and analysis, Alcoa set spending targets for its three major categories of investment—growth, EH&S, and Alcoa Business System (sustaining and cost savings projects)—and created separate expert teams to review projects using category-specific criteria. The EH&S and Alcoa Business System teams each have between 8 and 10 members with a variety of financial, legal, engineering, and technical backgrounds. The growth expert team has fewer participants and includes the CEO, CFO, Vice President of Planning, and business unit presidents as appropriate.

The expert teams use category-specific evaluation criteria, which ensure that each type of project is reviewed using a consistent methodology and approach, thereby improving allocation decisions. For example, “right to grow” criteria dominate allocation decisions in the growth category, while technical reviews and trends in “non-compliance” events are incorporated into EH&S reviews, and adherence to Alcoa Business System principles (Alcoa’s continuous process improvement program) applies to the ABS category. Growth project proposals above \$250,000 and EH&S and Alcoa Business System proposals above \$5 million are forwarded to the CFO and CEO for final approval.

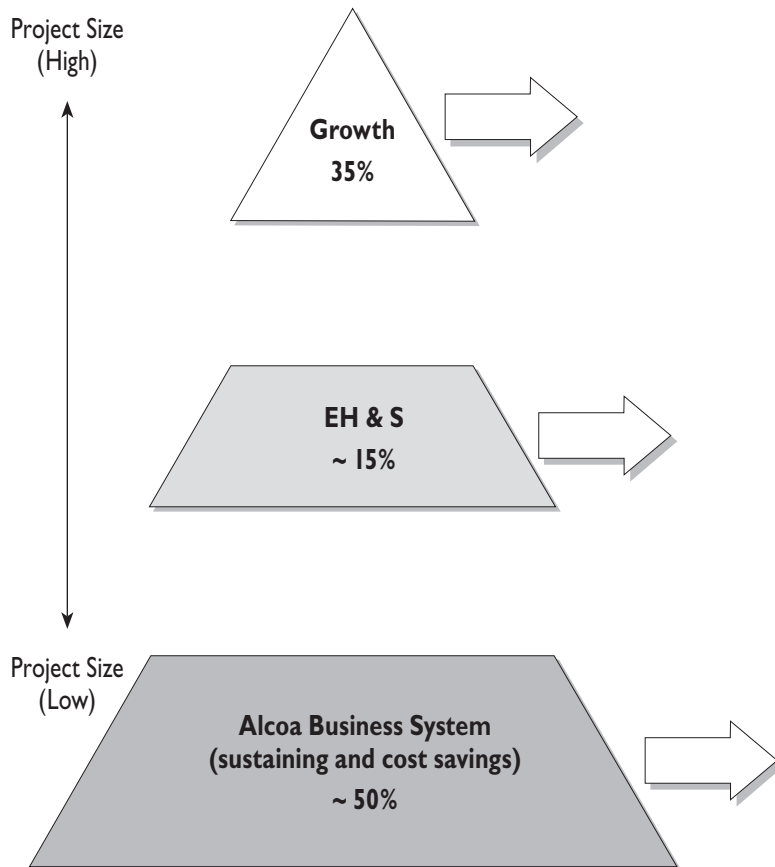
One advantage to the lower authorization threshold for growth projects is the opportunity to incorporate senior-level feedback on these critical investments.



EXPERT PROJECT EVALUATION TEAMS

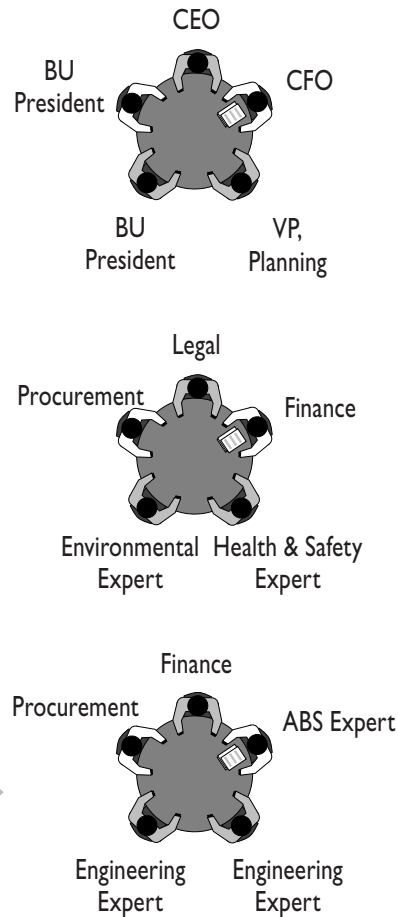
Alcoa establishes investment target allocations...

2003 Capital Budget by Major Category



...creates expert teams for each spend category...

Schematic of Expert Teams by Major Category



...and segments evaluation criteria

Excerpted Evaluation Criteria by Category

- “Right to Grow”
- Projects >\$250K require CFO and CEO approval

- Relation to EH&S goals
- “Non-compliance” events
- Technical reviews
- IRR/NPV
- Projects >\$5M require CFO and CEO approval

- IRR, NPV, ROC
- Best practice rollout
- Procurement involvement
- Risk-based analysis
- Post-project reviews
- Support of Alcoa Business System (reengineering)
- Projects >\$5M require CFO and CEO approval

Source: Alcoa, Inc.; Working Council for Chief Financial Officers research.



INITIAL RESULTS

Using teams of experts to critically evaluate project proposals has helped Alcoa reduce capital expenditures overall while renewing the company's commitment to growth projects. Capital expenditures have decreased since 2001, while the percentage spent on growth investments increased from 20 percent of budget in Q1 2001 to 38 percent in Q1 2003.

While ensuring increased allocation to growth projects, Alcoa's expert teams have also applied best practices and lessons learned across each investment category to improve allocation decisions. The results have been impressive. In EH&S alone, 70 percent of projects have been aggressively re-scoped or altered. Alcoa has also accelerated the returns from its cost-reduction projects; the cost savings run rate for Q1 2003 is up sharply from the first quarters of 2001 and 2002.

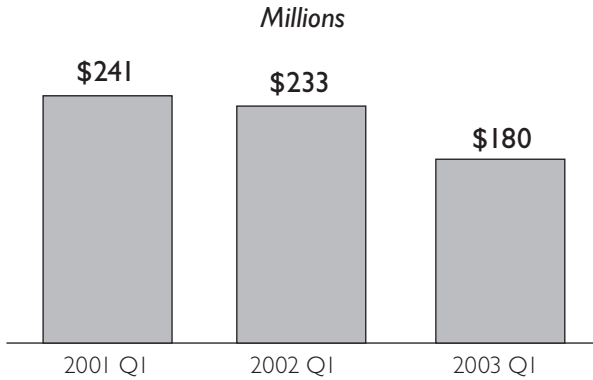


EARLY DAYS AND ALREADY A SUCCESS

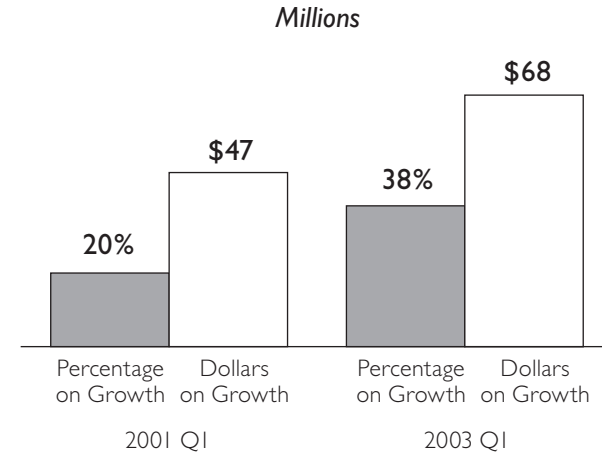
Teams drive lower overall capital expenditures...

...while ensuring increased allocation to growth projects

Capital Expenditures by Quarter



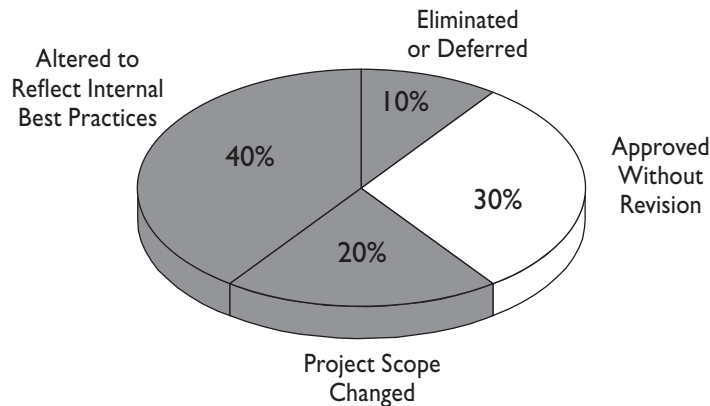
Growth Projects: Percentage of Budget and Dollar Amount



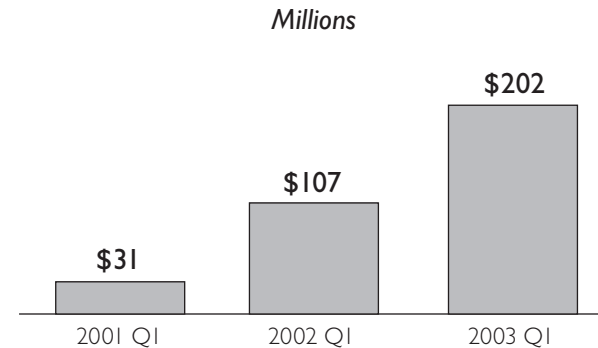
Alcoa improves the efficiency of EH&S spending...

...and accelerates returns from cost-reduction initiatives

Outcomes from EH&S Project Review:* 2003 Q1



Cost Savings Run Rates Since 2001



* Sixty projects reviewed.

Source: Alcoa, Inc.; Working Council for Chief Financial Officers research.

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