We need to do **far more** than just **optimize** our existing portfolio of businesses.

We know that in order to achieve our goal of 10 percent sustainable earnings growth we need to do far more than just optimize our existing portfolio of businesses. The disciplines imposed by global markets mean that customers will only pay for the best possible performance in every element of the chain of business activities by which value is created. It is critical that we benchmark our performance against the world's pacesetters. A great deal of effort is underway to reengineer our principal functions to better assure that we can meet these performance criteria. We know that we must materially reduce the cost of quality. Our goal is total savings of $150 million by the end of 1998. We also have a major initiative underway to change the way we work with our suppliers. We know from practical experience that the best long-term approach is to shape relations in which we can create true partnerships from which we all benefit by drawing on our collective creativity. This program has already trimmed costs by $40 million beyond our normal ongoing activities.

ıajor programs are underway to bring our information technology systems up to the most reaching current standards in order to eliminate all unnecessary routine administrative expense and to enhance our ability to make the right decisions more quickly. In the area of overall financial functions, our goal is to reduce annual expenses by one-half of one percent of sales. These investments in information technology and reengineering are building a robust infrastructure which both enables and supports higher sustainable growth.

Perhaps the most challenging goal we have set for ourselves is to shape a corporate culture more aligned with the requisites of the global market. We know that we have to become more agile, more responsive and less risk averse. The biggest mistakes we can make today are being late to market, late to respond to customer needs and late to make critical decisions.

As we have thought about the imperatives of competing successfully in global markets, we have distilled some fundamental beliefs: 1. We have to avoid "zero-sum games." Those are situations in which we take actions which do not ultimately result in any increase in shareholder value. An example is trading for higher sales volumes by compromising margins. Another pitfall is to try to rationalize the price of an acquisition in terms of its apparent strategic benefits to the point that a purchase hurts the owners' interests. .ır goal must be increasingly to move our discretionary resources into areas where we can capitalize on opportunities to create sustainable increases in shareholder value. 2. We have to be willing to move first in order to be rewarded by the market for discretionary investments and risk taking. Followers are, in fact, engaged in defensive actions. 3. Since the market rewards innovations only for finite periods of time, an enterprise must keep moving forward in the most dynamic manner possible.

In 1997, our actions reflected our strategic priorities.

In last year's report, we candidly acknowledged that we were disappointed with our 1996 earnings. We stated clearly that if we were to achieve our goal of earnings per share of $8 by the year 2000, we needed a marked improvement in our operational performance. Eaton's managers responded in an outstanding fashion to this challenge. If we look at our earnings from operations, we see an improvement of 31 percent to $6.45 per share. Driving this marked improvement was the success of our efforts to complete the consolidation of Westinghouse's distribution and control business into Cutler-Hammer and the favorable turnaround and successful integration of the CAPCO acquisition into our Truck Components business. In addition, we benefited from the improved performance of other businesses that had been lagging and from restructuring moves made at year-end 1996. We were particularly pleased that we achieved these earnings despite costs associated with our strategic initiatives, which lowered earnings per share by 90 cents in 1997.

One of the principal elements of our growth strategy is to bring our strong businesses into those countries that are rapidly industrializing. Notwithstanding the current crises in some of the Asia/Pacific countries, which could spread to other developing areas, we remain convinced that these emerging markets represent substantial long-term opportunities for our products.