

Key Metrics That Measure Real Value Creation

by *Mark Van Clieaf*

Restoring Investor Confidence

Too often key metrics are overlooked. But when they are part of the organization structure and compensation system, IROs can show that the company is a good *longer-term investment*.

Too much emphasis in the recent past has been focused on EBITDA (earnings before interest, taxes, depreciation and amortization) and EPS (earnings per share). Witness Enron, WorldCom, and Kmart, which have been able to engineer positive EBITDA, EPS and multimillion dollar executive compensation payouts while destroying shareholder value.

Overlooked Metrics

To restore investor confidence, companies and their IR executives need to measure and communicate true corporate performance using often overlooked metrics such as

- Net Operating Profit After Tax (NOPAT)
- Weighted Average Cost of Capital (WACC)
- Economic Profit = (NOPAT minus WACC)

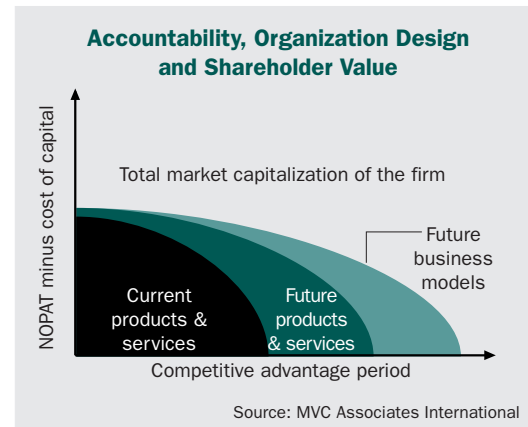
- Return on Invested Capital (ROIC)

IROs can communicate to shareholders and customers how these metrics are linked to accountability, compensation, innovation and growth.

A company in the pharmaceutical industry, for example, can demonstrate accountability at each senior management level. Investor relations professionals can show how executive performance contributes to shareholder value by illustrating accountability for innovation and Economic Profit at each level of work.

1. Director level accountability should be measured based on performance of **current products and services** (patented drugs).
2. VP/SVP level accountability should be measured on performance of **new products and services** (drugs in clinical trial).
3. President level accountability should be measured based on performance of a possible **new business model** (proteomics and genomics for drug discovery).

Economic Profit = Invested Capital X (ROIC minus WACC). For share-



holder value to be created this must be positive. To attract investors – Economic Profit must also be greater than the risk-free rate of 4% earned from inflation indexed government bonds.

A company that demonstrates it includes ALL THREE levels of innovation and growth with financial performance measured by Economic Profit and ROIC, will usually have a higher market capitalization versus a company with an organization design primarily focused on quarterly EPS from its current products. ☒

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