

# METRIC

MARKETING BATTLES ERUPT AS  
STERN STEWART AND RIVALS SEEK  
YOUR HEARTS, MINDS, & DOLLARS

# WARS

**"Forget EPS, ROE, and ROI. The true measure of your company's performance is EVA!"**

*-Stern Stewart & Co. magazine advertisements*

**"CFROIs are ideally suited to displaying long-term track records, whereas a Stern Stewart-type EVA is in millions of dollars, heavily influenced by asset size, and unadjusted for inflation-induced biases."**

*--HOLT Value Associates partner Bartley J. Madden, writing in the National Association of Corporate Directors newsletter*

**C**ould Coke and Pepsi compete any harder than this? Spurred by lucrative fees and Corporate America's frenzied search for shareholder value, consultants are scrambling over each other to help companies install new value-based performance metrics to replace the old standbys of per-share earnings, return on equity, and return on investment. In the Coca-Cola role is the New York-based Stern Stewart pow-

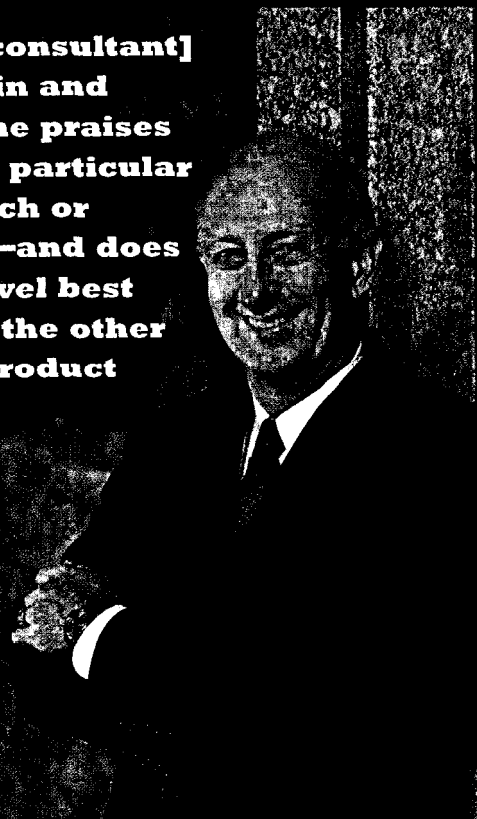
erhouse, promoting its proprietary Economic Value Added and EVA's companion performance measurement, Market Value Added (MVA). Offering the "challenge" are The Boston Consulting Group (BCG), whose Chicago-based experts combine cash flow return on investment, or CFROI, with a concept they call Total Business Return (TBR); Chicago-based CFROI proponent HOLT Value Associates; various purveyors of EVA look-alikes; and such other marketers of the non-glamour metrics as LEK/Alcar Consulting Group and its Shareholder Value Added (SVA).

"It's usually a bake-off between three or four or five of us," says BCG vice president Eric Olsen, who also bears the title of value-management practice leader. "Once in a while it's just us and Stern Stewart; we've become known for offering two state-of-the-art services."

Stern Stewart's response to such an appraisal? Don't flatter yourself, Boston Consulting. To Stern Stewart senior partner and co-founder G. Bennett Stewart III, CFROI is "a technology in search of a problem, as opposed to a system designed to be integrated into a company's culture in the way real people make business decisions." For the uninitiated, that latter reference is to EVA. Stewart adds: "CFROI is literally a consultant's concoction. It was quite an imaginative development by a consulting firm, but it is not well grounded in the basic elements of corporate finance theory. CFROI attempts to

**Steve Stetz, vice president for financial planning and analysis, Monsanto Co.:**

**"Each [consultant] comes in and sings the praises of their particular approach or metric—and does their level best to take the other guy's product apart."**



B Y R A N D Y M Y E R S

## METRIC WARS

measure shareholder wealth—which is not clearly related to maximizing shareholder wealth.”

**COKE FOR A CLIENT**

Even within the narrower world of consultants marketing EVA clones, though, “the field is very crowded,” says E. Mark Gressle, a former Stern Stewart partner who left with some colleagues to form Finegan & Gressle, in New York City. He is now a Stern Stewart competitor, along with a number of Big Six accounting firms and others. “It’s unbelievable,” he says. “Everybody has an EVA group.”

There’s little question that Stern Stewart is outmuscling its rivals, as its principals are quick to remind potential clients. Since being founded in 1982, some 250 corporate customers have hired it to install EVA systems—companies whose total worldwide revenues exceed \$400 billion. Among their clients are such behemoths as AT&T Corp., Eli Lilly, TransAmerica, Georgia-Pacific, and, yes, Coca-Cola Co., which has seen its stock increase more than tenfold since adopting EVA in the early 1980s. All but about 25 of those full-fledged customers have signed on in the last three years, and Stern Stewart predicts continued robust growth next year. Indeed, perhaps the most notable marketing clash in the contest—between EVA and CFROI—is better compared to Coke versus Dr Pepper. (Boston Consulting estimates that about 100 companies, also with hundreds of billions of dollars in global revenues, have gone with its CFROI program HOLT is only now beginning to target corporate clients.)

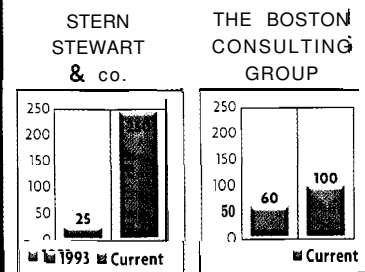
But some corporate executives who have waded through the competitive hype and heard the formal pitches say that, much as in the Cola Wars, the similarities between EVA, CFROI, and other new metrics are at least as great as the differences. Virtually all are rooted in the concept that companies should look not at reported earnings, which are subject to accounting distortions, but at how a company’s returns exceed its cost of capital. And each uses the

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Eric Olsen, vice  
president and  
value-management  
practice leader,  
The Boston Con-  
sulting Group



**COLLECTING CLIENTS**  
THE TWO TOP PURVEYORS  
OF METRIC SYSTEMS HAVE  
BEEN GROWING FAST



Source: Stern Stewart, BCG

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G. Bennett Stewart III, senior partner  
and co-founder, Stern Stewart & Co.



principles of discounted cash flow.

To be sure, differences among the metrics command the close attention of potential customers. EVA measures a company’s aftertax profit from operations, less the cost of all capital employed to produce that profit. CFROI is an efficiency measure that compares cash flows with the total assets employed to generate those flows. An inflation-adjusted measure calculated in a manner similar to internal rate of return. CFROI was first used as an investment tool. So there’s far more to picking a metric approach than giving each a simple “taste test.”

Still, assume impartial financial executives and even some money managers see it, neither EVA nor CFROI should be unpalatable if properly implemented and properly supported.

CFROI fan Peter Woodworth, a senior vice president and portfolio manager for Boston’s State Street Research & Management Co., thinks corporate managers would do better selecting his favored measurement over EVA. But he concedes that “EVA seems to be the more predominant [metric] if you go out and talk to businessmen, as I do all the time, probably because EVA is a simpler concept and can be run directly off the books of the corporation.” He’d much rather see managements use EVA, he says, than no value-based performance metric at all.

**GETTING THE HARD SELL**

Such dispassionate views rarely come from those who are trying to convert corporate finance managers to one performance measurement or another. Rather, suggests Monsanto Co.’s vice president for financial planning and analysis, Steve Stetz, they get an aggressive hard sell tinged with attacks on their rivals.

“Each comes in and sings the praises of their particular approach or metric—and does their level best to take the other guy’s product apart,” Stetz says. “Then they try to convince you that if you were to even remotely consider going with the other person’s product, you

# A STUDY IN SNIPING

A UNIVERSITY OF WASHINGTON CRITIQUE OF EVA MAKES THE ROUNDS—WITH HELP FROM STERN STEWART'S RIVALS?

In the crossfire between Stern Stewart & Co. and its rivals, anything reflecting poorly on EVA's performance-measuring abilities can quickly become ammunition. Take, for instance, a new study from the University of Washington's business school—harmlessly enough titled "Evidence on the Relative and Incremental Information Content of EVA, Residual Income, Earnings and Operating Cash Flow."

The professors who prepared the 25-page report start by documenting the lavish claims made for EVA. After discounting earnings growth as a measurement, for example, Bennett Stewart is quoted as proclaiming that "EVA stands well out from

the crowd as the single best measure of wealth creation on a contemporaneous basis," and boasting that "EVA is almost 50 percent better than its closest accounting-based competitor in explaining changes in shareholder wealth."

The report's authors—Washington professors Gary C. Biddle and Robert M. Bowen, and James S. Wallace of the University of California, Irvine—say the study was motivated both by the metric and by the "increasing use of EVA by firms, increasing interest in EVA among academics, and potential interest in EVA among accounting policymakers"—not to mention the widespread positive publicity the metric has received in the business press. Three years ago, *Fortune* magazine branded EVA "the real key to creating wealth." And an American Institute of Certified Public Accountants workshop on the future of financial management actually predicted that EVA will replace EPS in the regular stock and earnings reports in the *Wall Street Journal*.

The Washington study raises questions about such a future for EVA, however. It concludes that while EVA may add "incremental information in some settings," as a performance measure it can't even outperform basic income before extraordinary items. "In contrast [to Stern Stewart's claims of superiority], all of the evidence points to earnings having at least equal [and

often higher] relative information content," according to the report.

Stern Stewart disputes elements of the methodology. Senior vice president Stephen F. O'Byrne argues that the authors failed to adjust for two real-world anomalies when correlating EVA to stock prices over five-year periods. "First, they didn't recognize that the market puts a higher

multiple on positive EVA than it does on negative EVA," he says. "Second, they didn't recognize that the multiples on capital under EVA decline with the company's size." O'Byrne expresses some sympathy with the difficult task taken on by the researchers, who presented the report August 12 before the

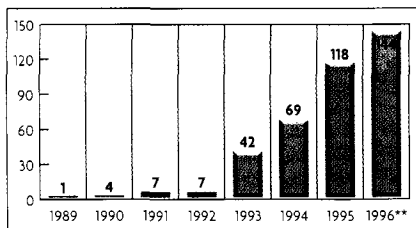
American Accounting Association. "It took us a number of years to figure this stuff out," he says. "It's only in the last number of years that we understood the adjustments you have to make."

Professor Bowen's response to Stern Stewart's criticism: "We did do considerable sensitivity analysis in our study, and we used standard academic methodology. We treated every performance metric equally." If any equations could benefit from revisions, he adds, "we'd be happy to attempt to improve the study by making adjustments." The authors purchased the basic data used in the research directly from Stern Stewart, but the professor says Stern Stewart didn't respond to their questions about EVA during the work on the report.

The study seems destined to become a lightning rod, at least among those companies shopping for metric help among Stern Stewart and the Chicago-based marketers for its main rivals, The Boston Consulting Group and HOLT Value Associates. In the course of reporting this month's cover story, a *CFO* editor mysteriously received a copy of the report in the mail. Throughout the document, negative statements about EVA were marked with a half-dozen yellow tags and highlighted with an orange marker.

The envelope had no return address, but it was postmarked Chicago.—Roy Harris

## EVA IN THE NEWS\*



\*Number of Lexis/Nexis references to Economic Value Added, as cited in University of Washington study, "Evidence on the Relative and Incremental Information Content of EVA, Residual Income, Earnings, and Operating Cash Flow," August 1996. \*\*Projected.

would be doing your corporation a disservice and would be out of step with how the market acts and reacts."

Stetz became the big chemical company's point man on metric matters when CFO Robert Hoffman decided early last year that Monsanto needed a new way to measure performance and frame business decisions. After the company made known that it was interested in moving away from traditional accounting yardsticks, its St. Louis headquarters were besieged by the top guns of the metric world. Bennett Stewart and BCG's Olsen flew in from New York and Chicago, respectively; HOLT president Robert Hendricks popped in from Chicago; and a McKinsey & Co. consultant made the trip, too—all eager to get Monsanto to bank completely on their particular acronym.

It didn't work out that way, though few of the supplicants went away totally disappointed. For what none could have counted on was Monsanto's tenacity in sorting through their marketing spiels and producing a hybrid it believed was appropriate for its purposes.

"We frustrated the hell out of the consultants," Stetz says. "We asked ourselves a fundamental question: What really defines and drives value in a business enterprise, and what drives stock price?" To get the answer, his team tore apart what he calls "an extremely complex TBR/CFROI model and a somewhat simple EVA model," and, he says, mathematically proved that they are identical in their discounted cash-flow technology. In other words, if you establish the right premises for cash flows going forward and for dis-

count rates, you come up with the same net present value--"to four decimal points." Stetz figures--no matter which of those two systems you use.

"The first thing that happened was that we quickly took off the table the consultants saying, *Your* product is inferior or *your* product is inferior," he says. "Then we focused on the strengths of each particular model or metric and what it really brought to

the party." Using data from a sampling of its competitors, suppliers, customers, and St. Louis neighbors, Monsanto also did its own analysis to find out how well the two measures correlated with actual stock market performance over a 20-year period.

"This almost sounds like B.S.," says Stetz, employing one acronym not in the consultants' lexicon, "but we actually got well over 85 percent correlation, on average, with CFROI.

The Stern Stewart model was never as good in terms of predictive ability as was the BCG model."

#### THE DISCOUNT THAT WASN'T

Comments like that are music to a CFROI booster's eyes. But far from booting Stern Stewart out the door, Monsanto hired both Boston Consulting and Stern Stewart last December, choosing the latter's EVA as the metric that would be pushed down through the corporation to the company's line managers and touted to shareholders in the annual report. The TBR/CFROI system was adopted for the lower-profile job of defining at the corporate level the EVA targets its managers would have to meet. For good measure, Monsanto brought in HOLT to help it understand how money managers use CFROI to value corporations, and how to communicate effectively to investors about use of the new performance metrics. (Monsanto also employs a balanced-scorecard framework, into which it fits its various EVA and CFROI measurements.)

"TBR/CFROI is an extremely sophisticated model that is just about unusable down in your line organization, whereas EVA is a very easy metric to communicate to your operating people," Stetz says. "If a secretary tells you she's buying supplies a year ahead of time to get a 4 percent discount, and you tell her she has to earn 12 percent (approximately Monsanto's cost of capital) on what she spends, it's easy to see the 4 percent discount doesn't make it."

The cost of Monsanto's blend of EVA and CFROI the first year: \$3 million. "not counting somebody doing something for me down at the division level," says Stetz. Stern Stewart says its larger customers can pay fees of \$2 million to \$3 million, with smaller outfits paying in a range that is down to \$200,000 or so. Boston Consulting's typical *Fortune* 500 client company spends at least \$500,000 in fees over a 12-to-18-month period, with \$1.2 million to \$1.5 million at the high end. And Finegan & Gressle typically charge from \$125,000 to \$500,000 for each

## THE ACRONYMIC A-LIST

METRIC DEFINITIONS

**EVA:** Stern Stewart & Co. describes Economic Value Added as a company's net operating profit minus an appropriate charge for the opportunity cost of all capital invested in an enterprise. In equation form, EVA equals net operating profit after taxes, minus the company's book capital, multiplied by its cost of capital. According to Stern Stewart, EVA is an estimate of a company's true "economic" profit, or the amount by which earnings exceed or fall short of the required minimum rate of return investors could get by investing in other securities of comparable risk.

**CF ROI:** Cash flow return on investment compares the cash flow of a firm to its owners with the total assets employed to generate those flows. HOLT Value Associates calculates CFROI in two steps. First, it measures the inflation-adjusted cash flows available to all capital owners in the firm and compares that with the inflation-adjusted gross investment made by the capital owners. HOLT then translates the ratio of gross cash flow to gross investment into an internal rate of return by recognizing the finite economic life of depreciating assets and the residual value of nondepreciating assets such as land and working capital.

**MVA:** Market Value Added, a measure created by Stern Stewart, is the difference between total market value--what investors can take out of the company--and the total capital invested. A positive MVA indicates that a firm has created wealth. Stern Stewart calculates MVA by adding the capital taken in by a company during its lifetime through securities offerings, loans, and retained earnings, then makes some EVA-like adjustments (such as capitalizing and amortizing R&D expenditures), and subtracts the total from the current value of the company's stock and debt.

**TSR and TBR:** Total Shareholder Return represents the change in capital value of a company over a one-year period, plus dividends, expressed as a gain-or-loss percentage of the beginning value. Total Business Return, as used by The Boston Consulting Group, is that measure as calculated for private companies or business units for which stock prices aren't available. To figure beginning and ending values, BCG uses the unit's CFROI and the growth in invested cash.

**ROI, ROE, ROA, ROCE, and RONA:** Return on investment is a generic term referring to the efficiency of a business in producing income (or cash flow) in relation to its capital employed. Common accounting ROI measures include return on equity, which is net income divided by owner's equity; return on assets, or net income divided by total assets; return on cash employed, or earnings divided by book capital; and return on net assets, or net income divided by net assets.

**Sources:** Stern Stewart & Co., The Boston Consulting Group, HOLT Value Associates, and *The Portable MBA in Finance and Accounting*, John Wiley & Sons, New York, 1992.

of its 3-to-6-month projects. HOLT markets CFROI mainly to money managers as a tool for making investment decisions. It worked with both money managers and corporations before selling the corporate planning division to Boston Consulting in 1991, and now is beginning to get back into corporate marketing in a limited way.

In its pitch, Boston Consulting Group "spends a good bit of their time trying to tell you that EVA misses something," says Stetz. "After they go through that exercise, they say, 'We recognize TBR/CFROI is extremely complex and difficult to push down through the organization, so let us offer you this milieu of measures we can make work with CFROI sitting on top.'"

But Boston Consulting's hard work countering the merits of EVA may reflect Stern Stewart's long lead—with recognition and success gained through seminars around the world, numerous articles in trade and financial journals, and Bennett Stewart's book *The Quest for Value*.

**REMEMBERING "SVEN"**

"Stern Stewart is preeminent; they're the best marketers," says Katherine Hudson, president and chief executive officer of W.H. Brady Co. in Milwaukee, a \$350 million manufacturer of industrial and commercial signs, labels, and tapes. Hudson partly credits Stern Stewart seminars for her firm's decision to embrace EVA,

though her company internally developed its own system, called Shareholder Value Enhancement, or SVE. Brady scarcely entertained the idea of actually hiring Stern Stewart, deeming it far too expensive for a company that size.

The midwestern company used some homespun ingenuity to construct its own SVE system—one with a decidedly un-Stern Stewart look. Sven, a sword-bearing Viking warrior

very well—but also the balance sheet; you're not only trying to create margins, but utilize the assets in your company."

Brady's creation of Sven illustrates what Boston Consulting thinks may be a weakness in the Stern Stewart model. "Our marketing approaches are quite different," says BCG's Olsen. "Stern Stewart has a specific mousetrap and they really drive to that; they've built a good case



**"Almost [any metric] is good if you understand it and translate it to your own experience, and it represents at least some attempt to get close to generation of economic value."**

**Katherine Hudson, president and CEO, W. H. Brady Co.**


mascot, storms through company literature and employee newsletters, for example, making the Brady program seem very approachable to the rank-and-file. He's also around for the games of "Brady Bingo"—in which business units win green dots for being SVE-positive and showing a year-to-year improvement, and have to live with yellow or orange dots for lesser performance.

Brady, like Monsanto, doesn't buy into the idea that any one performance metric can be a panacea for every company. "Almost anything is good if you understand it and translate it to your own experience, and it represents at least some attempt to get close to generation of economic value," says Hudson. "The key for me is that it has to take into account not only the income statement—which American business has learned


around that mousetrap, and they're very aggressive about pushing it." But they are "probably far less flexible in terms of tailoring it because they come with only one way of doing these things. We're much more flexible." Olsen believes. "Clients who want to go through the mental effort to review the pros and cons [of competing metrics] should come up with a better answer."

**"FOUR PEOPLE" VERSUS 100**

Mark Gressle, the Stern Stewart expatriate whose new outfit, Finegan & Gressle, attempts to deliver specialized EVA-style programs, hones in on his competitor's supposed inflexibility. "EVA failures in the past have occurred essentially because somebody pulled the template off the shelf and said, 'OK, here's EVA; go forth.'" And they didn't understand the



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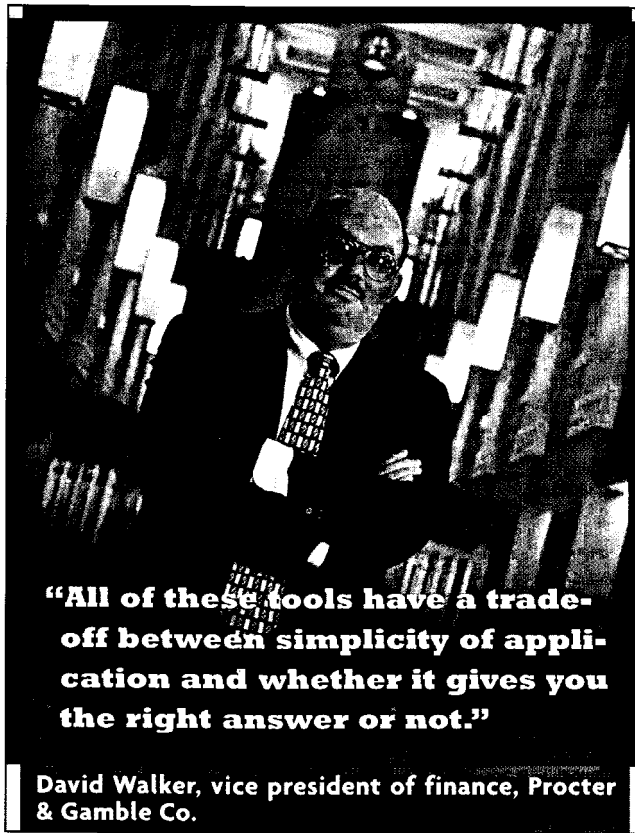
E. Mark Gressle,  
Finegan & Gressle

unique situation the company was in," he says. Now that EVA is being better understood by companies, "today companies are coming to us and saying 'We know how to calculate EVA and we think we can link it to compensation, but implementation is another matter. We want you to bring in your skills and whatever you need to change the way this organization thinks about creating value.'"

But such criticism piques Bennett Stewart. "How many people do they have working there? Probably about 4. We have 100 people," he says. (Of Stern Stewart's 100 employees worldwide, 60 to 65 are professionals. Finegan & Gressle has 10 professionals.) Finegan & Gressle says Stewart has "attempted to piggyback off what

we've created, and are saying to companies, 'Now that you understand EVA and MVA we can help you integrate this more deeply into your decision-making. They're able to do that essentially only after a company has embraced the EVA/MVA methodology.'"

Indeed, Stern Stewart has many rabid supporters, among them Brady's Milwaukee neighbor, Harnischfeger Industries Inc. The manufacturer of papermaking machinery, mining equipment, and materials-handling equipment adopted Stern Stewart's EVA as a performance measurement



and EVA was what was recommended by the group, unanimously," says Harnischfeger's executive vice president of finance and administration, Francis M. Corby Jr.

Its simplicity was key, as was Stern Stewart's assurance that long-term corporate development wouldn't suffer. "Our experience has been that people haven't backed off investing in their businesses: in fact, since implementing EVA, our company has tripled in size, largely through acquisitions made within the context of EVA—where people were betting future bonuses that aftertax returns would exceed our 12 percent cost of capital." Harnischfeger's stock price also has moved up sharply, to 38<sup>3</sup>/<sub>8</sub> from 18 when it began using EVA.

tool for its fiscal year ended October 1993, linking incentive compensation to EVA the following year.

"We had a number of folks in our finance group who went to different seminars put on by different people. It gives you the right answer or not."

**P&G CHOOSES CFROI**

So why even consider any other system if you can afford EVA? "All of these tools have a trade-off between simplicity of application and whether it gives you the right answer or not."

says David Walker, vice president of finance at Procter & Gamble Co. The Cincinnati consumer-products giant began testing TRR and CFROI in its U.S. food and beverage business in 1994, and was so pleased with the results that it changed over the rest of its U.S. businesses last summer. It's now incorporating TBR in its international

**MERCHANTS OF METRICS**  
SOME CONSULTANTS THAT DEAL IN MEASUREMENTS

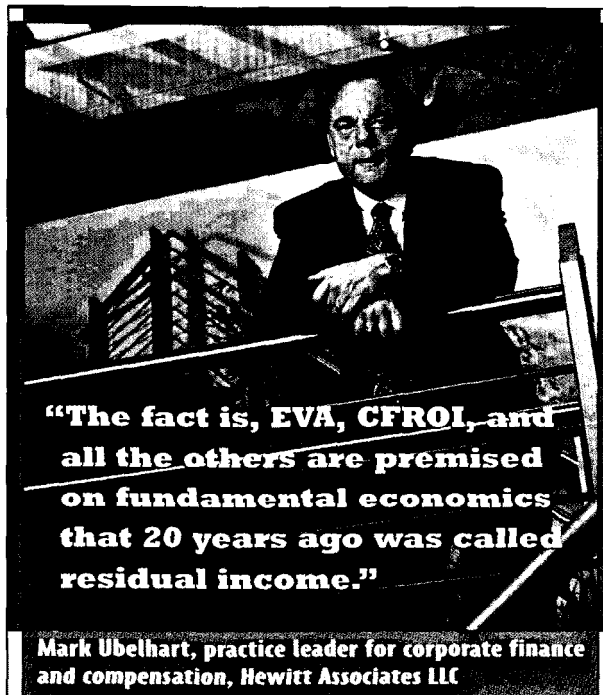
| COMPANY                     | LOCATION       | PREFERRED MEASUREMENTS                                  |
|-----------------------------|----------------|---|
| The Boston Consulting Group | Chicago        | CFROI, CVA  |
| Braxton Associates*         | Boston         | Various programs, including CFROI and EVA-like measures |
| Finegan & Gressle           | New York       | EVA variants  |
| HOLT Value Associates       | Chicago        | CFROI   |
| KPMG Peat Marwick           | New York       | "Economic Value Management"                             |
| LEK/Alcar Consulting Group  | Chicago        | "Value Based Management"                                |
| Marakon                     | Stamford, CT   | Various financial and strategic measures                |
| Price Waterhouse            | New York       | CFROI and various performance measures                  |
| Stern Stewart & Co.         | New York       | EVA, MVA  |
| Vanguard Partners           | Ridgefield, CT | EVA variants  |

\*Unit of Deloitte & Touche Consulting Group

operations, a job it expects to complete by January.

What Procter & Gamble likes about TBR "is that it places an enormous value on growth, not just on improving short-term financial returns. A lot of people don't think of us as a growth company, but we are growing very fast: the plan is to double our business every 10 years in real unit-volume terms." Says Walker. "You can make EVA growth go up by cutting investments, and that's what concerned us about the simplistic use of that tool."

Besides Procter & Gamble's argument and Monsanto's experiment with using both EVA and CFROI, some companies don't buy the conventional wisdom that the EVA model is that simple. When AGCO Corp., a farm-equipment manufacturer in Duluth, Georgia, acquired the international division of Massey Ferguson, another farm-equipment maker, in 1994, Massey had been using EVA for two or three years. "In certain areas they felt like it had been successful--but not lower in the organization," observes Allen Ritchie, president of the finance and adminis-



**"The fact is, EVA, CFROI, and all the others are premised on fundamental economics that 20 years ago was called residual income."**

**Mark Ubelhart, practice leader for corporate finance and compensation, Hewitt Associates LLC**

trative group at AGCO. "A lot of employees were being improperly motivated and didn't fully understand what the objective of EVA measurements was. Maybe it was the fact that [Massey Ferguson] had not done a good enough job in the education process and implementation phase, but we found it much more appropriate to focus back on the principal corporate finance objectives on which EVA is based. And that really

came around to return on net assets (RONA) for the most part." Having unwound Massey's EVA program, AGCO non-employs a RONA-based performance measurement system that Ritchie says has been easy to apply across all of its operations.

Mark Ubelhart has worked with numerous corporations—among them little Valmont Industries Inc., a metal-structures manufacturer in Valley, Nebraska—linking executive pay to value-based performance metrics in his role as practice leader for corporate finance and compensation at the Lincolnshire, Illinois, compensation consulting firm of Hewitt Associates LLC (see

"Do It Yourself: How Valmont Industries Implemented EVA," March 1996). Ubelhart says differences between the varying metrics are frequently narrowed in real-world applications anyway. CFROI may indeed be more complicated, he says, "but the full-fledged EVA, with all their adjustments, is also quite complicated." Indeed, Stern Stewart offers about 160 possible variations of it. And neither EVA nor CFROI "in the pure form is very often implemented," he says.

"The fact EVA, CFROI, and all the others are premised on fundamental economics that 20 years ago was called residual income," Ubelhart continues. "Those things don't change."

W.H. Brady CEO Hudson agrees, noting that the basic research behind EVA, and even her own SVE clone, "is actually old: you can go back to [Merton] Miller and [Franco] Modigliani and their paper on the price of a stock being related to economic value generated," Hudson says. "I was in college in the 1960s, and this was required reading."

She adds: "One thing a consultant can't give you is common sense." ■

*Randy Myers is a contributing editor of CFO.*

**Some employees who had used EVA at Massey Ferguson "were being improperly motivated and didn't fully understand what the objective of EVA measurements was."**



**Allen Ritchie, president of the finance and administrative group, AGCO Corp.**