January 2010

ONE EIGHTY

Upcoming 2010 Events

- CAM-I First Quarter Meeting
  Clearwater FL
  March 7-10
- APQC 15th Annual Knowledge Management Conference
  Houston TX
  April 26-30
- Budgeting for Government Performance Institute
  Arlington VA
  February 22-26

People in the News

- Bob Misch, Grant Thornton, winner of the 2009 Bob Bonsack Award in recognition of his distinguished contribution to the field of Cost Management
- Congratulations to LJ and Lisa Giuliani on the birth of their first child, Leila Jade. Congratulations to me on becoming a grandfather

Return on Investment

We've all heard the question from business managers and others a hundred times. What's the ROI?

We ask the same question ourselves when presented with a personal investment opportunity.

Business is all about earning a profit and getting a return on invested capital. The business of the business is to manage revenues, assets, and costs to achieve a return commensurate with the investment risk.

The basic textbook ROI computation is simple and straight forward. Profit (net income) divided by investment (total assets) equals ROI.

Known as the DuPont Formula, another way to calculate ROI is to multiply net profit margin (net income as a percentage of sales) times the asset turnover (sales divided by total assets).

In either computation the calculated ROI is the same.

The investment community uses EBITDA (earnings before interest, taxes on income, depreciation, and amortization) to measure earnings and cash flow generated from operating a business.

Although it does not meet the accounting definition of ROI, EBITDA as a percentage of operating assets (working capital and fixed assets) is a useful ROI type measurement.

This investor model of ROI is useful because it only includes that portion of costs and assets that operating people can control.

Managers control the markets they select to compete in, the customers they target, and the products and services offered. Pricing can't be directly controlled, but the selection of markets, customers, and product/service offering has direct impact on company's ability to price.

Managers control and authorize the day to day, ongoing expenses of the business.

Managers control the capital decisions they make and the capability and capacity of their intellectual capital, plants, equipment, systems, and networks. They also have control over working capital like inventory and accounts receivable.

In application and use, consistency and comparability in the ROI calculation are crucial.

Tends in ROI are only useful when the calculations are consistent between periods.

To be meaningful, ROI must be compared to industry peers, capital market competitors, and other standards of performance.

To be relevant ROI must be compared to the Cost of Capital.

Only when the ROI exceeds the Cost of Capital is value created for the shareholder…

John A. Miller

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