

# SMART MANAGING

BEST PRACTICES, CAREERS, AND IDEAS

## AMERICA'S GREATEST WEALTH CREATORS

*The top two firms stay the same—but Intel is on a rocket.* By Richard Teitelbaum

WHEN GOLDMAN SACHS' CRACK RESEARCH CHIEF Steven Einhorn issued a bullish stock market report recently, he didn't prattle on about the usual S&P 500 benchmarks—P/E ratios, dividend yields, and the like. Instead, he based his forecast on a single measure: economic value added, or EVA.

It was just the latest evidence that EVA has moved from buzzword to financial phenomenon. As a performance measure, as an analytic tool, and as a management discipline, EVA is cropping up all over: Community hospitals harness EVA to improve efficiency. Lots of money managers use it to pick stocks. Even

### WHO CREATES VALUE?

Taken from a list of 1,000 companies ranked by MVA, here's how the 200 largest, based on market capitalization, stack up.

### WHAT MARKET VALUE

ADDED MEANS TO YOU  
MVA, in effect, shows the difference between the capital investors have put into a company and the money they can take out.

### WEALTH PREDICTOR

EVA is after-tax net operating profit minus cost of capital. A growing EVA is a good sign that a stock will soar.

### THE REAL STORY

Does the return on capital exceed the cost of capital? If so, then the company is using investors' money wisely.

MVA RANK <sup>1</sup>			COMPANY <sup>2</sup>	MARKET VALUE ADDED \$ millions	ECONOMIC VALUE ADDED \$ millions	Capital \$ millions	Return on capital	Cost of capital
1997	1996 <sup>2</sup>	1992 <sup>2</sup>						
1	1	4	COCA-COLA	\$124,894	\$2,442	\$10,814	36.0%	9.7%
2	2	6	GENERAL ELECTRIC	\$121,874	\$2,515	\$53,567	17.7%	12.7%
3	5	14	MICROSOFT	\$89,957	\$1,727	\$5,680	47.1%	11.8%
4	12	74	INTEL	\$86,481	\$3,605	\$17,483	36.4%	13.6%
5	3	2	MERCK	\$78,246	\$1,688	\$22,219	23.0%	14.5%
6	4	3	PHILIP MORRIS	\$66,608	\$3,119	\$42,885	20.1%	12.5%
7	9	12	EXXON	\$55,532	\$1,334	\$88,396	12.0%	10.4%
8	8	10	PROCTER & GAMBLE	\$55,102	\$576	\$25,032	14.3%	11.9%
9	6	7	JOHNSON & JOHNSON	\$51,119	\$1,327	\$18,138	21.8%	13.3%
10	11	5	BRISTOL-MYERS SQUIBB	\$42,910	\$1,515	\$14,107	24.1%	12.8%
11	14	11	PFIZER	\$42,391	\$1,139	\$13,828	23.5%	13.1%
12	28	165	CISCO SYSTEMS	\$38,341	\$794	\$2,805	50.1%	13.8%
13	25	25	GILLETTE	\$37,611	\$447	\$9,042	16.9%	10.7%
14	10	1	WAL-MART STORES	\$34,734	\$427	\$31,051	11.3%	9.9%
15	15	8	ABBOTT LABORATORIES	\$32,077	\$1,187	\$9,748	26.8%	11.8%

<sup>1</sup>Calculations are based on figures as of the previous year-end. <sup>2</sup>Historical rankings reflect alterations due to mergers and other financial changes. CONTINUED

<sup>3</sup>The rankings exclude electric utilities, banks, and financial and real estate firms.

## Rebound At IBM

Tough? Sure, but CEO Lou Gerstner of IBM led 1997's most dramatic turnaround, to No. 25 from No. 997 last year.

MICHAEL O'NEILL

997  
1996  
rank



25  
1997  
rank

# AMERICA'S BEST WEALTH CREATORS

These companies aren't always the biggest or even most profitable. But an innovative performance measure shows who's tops—and who flops—where it really counts. **■ by Laura Walber**

**\$** WHAT'S the best measure of corporate success? Which number most tellingly reveals how well or how badly a company has been run? The usual candidates—sales, profits, return on stockholders' equity, market value—convey important information but carry flaws that sometimes portray doggy performers as stars and vice versa. Now a measure devised by the New York City consulting firm Stern Stewart looks like the best way yet to express corporate success or failure in a single figure.

The measure is called market value added (MVA), and it shows how well managers have performed their most important function: increasing the value of the capital that investors have entrusted to them. The concept is straightforward. First add up all the capital that has been put into a company—invested by shareholders, lent by bondholders and banks, and retained from earnings. Then see how the market evaluates the company today by checking the value of its outstanding stock and adding in its debt. If the company's market value is greater than all the capital invested in it, then it has a positive MVA. That means the managers have done their job—they've created wealth. But in some cases the market value of a company is actually less than the capital put into it. These companies have a negative MVA. That means their managers have destroyed wealth.

The methodology is winning wide acceptance. Dozens of companies—AT&T, Coca-Cola, Quaker Oats, Scott Paper, Transamerica, and many others—pay close attention to their MVAs. So do major investors. Dale Hanson, CEO of the California Public Employees Retirement System (assets: \$79

billion), says, "At IBM, for instance, the problems were evidenced in the Stern Stewart approach much earlier." Michael Jensen, a professor at Harvard business school, says, "Creating value is the right objective, not growing sales or the number of employees or even increasing earnings. That's not what creates value in a stock."

So which companies are best at creating wealth? Stern Stewart looks at the 1,000 nonfinancial companies with the largest total market capitalization and calculates their MVAs. The list presented here shows the 200 largest of those companies, with their rankings in the group of 1,000. The results are enlightening. Wal-Mart Stores is the champion, having created \$64.1 billion of wealth for investors. IBM sits at the list's bottom with an MVA of negative \$23.7 billion. That is, IBM's market value is \$23.7 billion less than the capital that was put into the company—a breathtaking display of wealth destruction.

Because MVA varies with market value, it of course rides with the tides of the stock market. At times a stock might be sailing unjustifiably high as the subject of Wall Street adoration. Stocks can likewise tumble dramatically when Wall Street feels despair. MVA can also be distorted by inflation; some of General Electric's capital went into the company over a century ago, for instance, while Microsoft's is no older than 15 years. In practice this distortion isn't as great as it might seem, since the low cost of old assets is offset by the high cost of maintaining and running them.

Nonetheless, it is the trends and relationships in MVA, rather than the bare numbers, that are most telling. For example:

■ America's most successful carmaker by a mile is

Chrysler (No. 405), with an MVA of \$55 million. Ford (No. 998) and GM (No. 999) remain impressive wealth destroyers with deeply negative MVAs.

■ You don't need a lot of capital to produce a substantial MVA. Exxon and Microsoft rank No. 11 and No. 12, with similar MVAs. Yet Exxon created its \$22.2 billion of MVA with \$78.6 billion of invested capital, while Microsoft created its \$21 billion of MVA with just \$2.4 billion of capital.

■ The only retailer remotely near Wal-Mart in MVA is not one of its general-merchandise rivals, Kmart or Sears, but Home Depot at No. 14.

■ The real star of the computer hardware industry is Hewlett-Packard (No. 45). Digital Equipment, unsurprisingly, is No. 99.

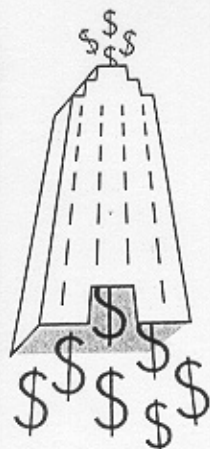
**T**HE MVA VIEW of the world highlights the deficiencies of other performance measures, emphatically including plain market value. For example, GM had a total market capitalization at year-end 1992 of \$75 billion, much higher than Coca-Cola, with \$58 billion. Yet GM reached that market cap by taking in even more capital and then annihilating much of it. Coke, by contrast, is a mammoth wealth creator. This list puts them in the proper places.

MVA is a close relative of economic value added (EVA), a concept that growing numbers of companies are using to gauge performance (see FORTUNE, September 20). EVA, an annual figure, is a company's after-tax operating profit minus the cost of the capital employed in the business. Sounds simple enough—yet many companies don't even know their true cost of capital. Without that knowledge, they can't know whether they are really creating value and thus increasing their MVAs. Says Richard Spitzer of the consulting firm Boston Consulting Group: "I feel very strongly about the use and applicability of EVA. If you

**"Creating value is the right objective, not growing sales or the number of employees or even earnings. That's not what creates value in a stock."**



# WHAT IS MARKET VALUE ADDED?



■ Stern Stewart computes a company's MVA by combining its debt and the market value of its stock, then subtracting the capital that has been invested in the company. The result, if positive, shows how much wealth the company has created; if negative, how much the company has destroyed.

MARKET VALUE ADDED RANK*		1993	1988	COMPANY	MARKET VALUE ADDED	ECONOMIC VALUE ADDED	CAPITAL	RETURN ON CAPITAL	COST OF CAPITAL
					\$ millions	\$ millions	\$ millions		
1	6	WAL-MART STORES	\$64,061	\$957	16,938	18.8%	11.1%		
2	7	COCA-COLA	\$51,179	\$1,203	6,871	29.7%	10.5%		
3	8	PHILIP MORRIS	\$49,423	\$3,261	38,966	18.6%	10.0%		
4	1	GENERAL ELECTRIC	\$42,480	(\$304)	44,487	12.5%	13.2%		
5	3	MERCK	\$41,952	\$1,606	8,944	35.1%	13.2%		
6	16	BRISTOL-MYERS SQUIBB	\$26,175	\$980	9,969	23.0%	12.3%		
7	953	AT&T	\$25,453	(\$891)	64,349	9.5%	11.0%		
8	17	JOHNSON & JOHNSON	\$25,161	\$628	10,727	18.8%	12.5%		
9	23	PROCTER & GAMBLE	\$23,939	\$538	20,497	14.0%	10.9%		
10	27	PEPSICO	\$23,939	\$533	17,394	13.3%	9.7%		
11	93	EXXON	\$22,162	(\$2,640)	78,569	6.2%	9.5%		
12	58	MICROSOFT	\$21,011	\$645	2,405	53.5%	13.8%		
13	18	ABBOTT LABORATORIES	\$20,341	\$777	5,536	27.1%	11.8%		
14	222	HOME DEPOT	\$20,013	\$135	3,269	18.2%	11.7%		
15	25	WALT DISNEY	\$17,458	\$132	8,206	14.3%	12.5%		
16	20	WMX TECHNOLOGIES	\$17,104	\$63	13,215	11.3%	10.8%		
17	55	PFIZER	\$16,400	(\$15)	8,675	13.3%	13.5%		
18	19	AMERICAN HOME PRODUCTS	\$16,302	\$965	6,382	29.5%	11.7%		
19	14	MINNESOTA MINING & MANUFACTURING	\$13,377	\$285	10,677	13.9%	11.0%		
20	29	KELLOGG	\$13,305	\$353	2,922	22.7%	10.9%		
21	987	GTE	\$13,024	(\$893)	39,683	7.3%	9.6%		
22	28	MCDONALD'S	\$11,491	\$150	11,862	11.2%	9.9%		
23	56	INTEL	\$11,274	\$548	6,594	25.4%	15.0%		
24	74	SARA LEE	\$10,641	\$94	7,087	12.9%	11.3%		
25	65	GILLETTE	\$10,598	\$217	3,570	18.3%	11.7%		
26	22	ELI LILLY	\$10,417	\$368	7,567	18.8%	13.2%		
27	45	SCHERING-PLOUGH	\$9,918	\$470	3,464	26.1%	11.7%		
28	24	ANHEUSER-BUSCH	\$9,829	\$235	8,403	14.3%	11.3%		
29	49	GENERAL MILLS	\$9,103	\$270	3,183	19.5%	10.3%		
30	53	TOYS "R" US	\$8,668	\$100	4,508	14.5%	11.7%		
31	122	E.I. DU PONT DE NEMOURS	\$8,637	(\$4,022)	37,282	0.2%	11.7%		
32	40	H.J. HEINZ	\$8,396	\$110	4,827	12.9%	10.2%		
33	281	AMGEN	\$8,370	\$339	787	74.1%	12.2%		
34	986	SOUTHWESTERN BELL	\$8,210	(\$561)	21,806	7.8%	10.4%		
35	30	EMERSON ELECTRIC	\$8,111	\$77	5,692	14.4%	13.0%		
36	12	DUN & BRADSTREET	\$7,902	\$185	4,214	15.1%	10.7%		
37	700	BELL ATLANTIC	\$7,679	(\$669)	25,677	6.9%	9.5%		
38	103	CAMPBELL SOUP	\$7,603	\$141	3,798	16.8%	12.7%		
39	90	SCHLUMBERGER	\$7,572	\$20	6,078	12.6%	12.3%		
40	237	NOVELL	\$7,439	\$217	890	51.4%	15.3%		
41	64	LIMITED	\$7,218	\$140	5,106	14.9%	11.8%		
42	465	AMERITECH	\$7,107	(\$361)	20,116	8.0%	9.8%		
43	670	BELLSOUTH	\$6,809	(\$832)	28,889	7.2%	10.1%		
44	59	TELE-COMMUNICATIONS	\$6,456	(\$379)	13,473	5.8%	8.6%		
45	13	HEWLETT-PACKARD	\$6,257	(\$501)	13,174	10.9%	15.1%		
46	69	MOTOROLA	\$6,217	(\$191)	9,824	11.3%	13.4%		
47	216	ATLANTIC RICHFIELD	\$6,195	(\$302)	22,965	7.1%	8.4%		
48	139	UST	\$6,137	\$226	628	51.7%	14.0%		
49	60	AUTOMATIC DATA PROCESSING	\$5,902	\$162	2,224	22.8%	11.9%		
50	91	KIMBERLY-CLARK	\$5,885	\$97	4,885	13.0%	10.9%		

\*The 200 companies on this list are the largest in the Stern Stewart Performance 1,000, an analysis of the 1,000 U.S. companies with the biggest total market capitalization. MVA ranks given here show each company's standing in the 1,000-company group. MVAs are as of 12/31/92. EVAs and rates are for 1992.