

## Defining a Simple Measure of “Returns on Corporate Capital”

Your views will be appreciated to guide the final development of a standard “Returns on Corporate Capital” (“ROCC”) measurement. Initiated a month ago as a subordinate task in our workshop project to define metrics for analyzing stock buybacks,<sup>1</sup> the effort to make it simple proved to be surprisingly complicated.

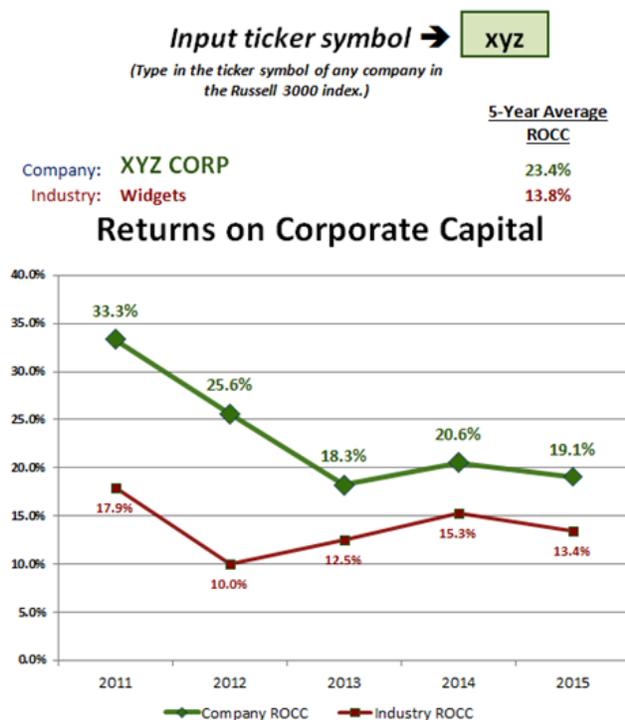
What we propose is a calculation based purely on GAAP-defined numbers, as reported by companies in their SEC filings:

$$\frac{\text{net income plus interest expense and income taxes,}}{\text{divided by}} \\ \frac{\text{the prior year's ending balance of total assets}}{\text{less current liabilities other than short-term debt}}$$

The **use of standardized, GAAP-defined terms** is important to allow collection of consistent data from all SEC-registered U.S. companies, so that they can be meaningfully compared over time and with each other, and with industry or other groupings of companies. This also allows anyone to obtain the same source data from publicly accessible SEC records, as well as from research services, so that they can independently perform or confirm a ROCC analysis.

This ROCC definition is of course similar to many definitions of “ROIC” (return on invested capital), but avoids both the confusion and debates resulting from all the GAAP and non-GAAP variations of ROIC calculations among research services, analysts and companies that present their own “right” way.<sup>2</sup>

Please use the **test version of a ROCC graphing tool**, illustrated here and now embedded on a [website established for our “metrics” workshop](#), to review the measurement and consider its applications to whatever analyses you may want to perform. The



To use the workshop test graph online, click [here](#).

<sup>1</sup> See the [May 9, 2016 Forum Report: Workshop for “Metrics” to Analyze Stock Buybacks](#).

<sup>2</sup> See the previously cited [May 3, 2016 Wall Street Journal: "The Hottest Metric in Finance: ROIC."](#)

currently posted online tool is of course designed only for workshop development use, as you’ll see from its slow responses and limited universe of companies. We will be trying to establish specifications for a final public version during the next couple of weeks, so will welcome any advice you can offer to guide our refinement of the graphing tool as well as the ROCC analysis.<sup>3</sup>

These are some of the questions we are currently considering:

1. Should the calculation of ROCC be further refined?
2. Should the universe of companies include all SEC-registered U.S. companies, or only a subset such as the Russell 3000 or S&P 1500?
3. Should calculations of industry comparisons exclude the subject company, as currently specified, or include the subject company in the total?
4. Should industry classifications be based on the Global Industry Classification Standard (GICS) codes assigned by the Standard & Poor’s staff, which are used by many financial professionals, or on the Standard Industrial Classification (SIC) codes identified by companies themselves in their SEC filings, which are more broadly established?

It will also be very helpful to know how you would like to be able to use ROCC analyses. For example, while our interest in it was stimulated by the need for rational evaluations of stock buyback proposals, some of our workshop participants are primarily interested in applying ROCC analyses to executive compensation policies. We want the analysis, and the tools for its use, to be readily applicable to any kind of corporate performance analysis.

Our objective is to focus on a practical measure of profits generated from using corporate capital in the competitive production of goods and services. That, as the Forum has emphasized, is the only real foundation of corporate value, and of economic prosperity.

*GL – June 16, 2016*

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<sup>3</sup> Special thanks are due to workshop participants Mark Van Clieaf of [Organizational Capital Partners](#) and Stephen F. O’Byrne of [Shareholder Value Advisors](#) for volunteering their considerable efforts to develop the analytical model for the test graphing tool, and particularly to Mr. O’Byrne for his contribution of the Compustat-derived database on which the test graph operates.