Economic Value Added

Handbook F-6

February 2001
Transmittal Letter

A. Explanation. This is a complete revision of Handbook F-6. Intended for use by participants in the Economic Value Added (EVA) Variable Pay Program, this handbook provides the mechanics of the EVA performance measurement and the EVA-based incentive awards. This revision obsoletes Handbook F-6 dated August 1997.

B. Distribution.
   1. Initial. This document is distributed to areas, performance clusters, and Headquarters.

C. Comments and Questions.
   1. Submit questions and comments about the content of this directive in writing to:
      MANAGER BUDGET AND FINANCIAL ANALYSIS
      US POSTAL SERVICE
      475 L'ENFANT PLZ SW RM 8309
      WASHINGTON DC  20260-5220
   2. You may also send cc:Mail to “EVA Answer Line.”

D. Effective Date. This handbook is effective immediately.

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Vice President, Controller, Finance

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1-1 Handbook Organization

Handbook F-6, *Economic Value Added*, as revised, explains Economic Value Added (EVA). This is a dollar measure that incorporates all factors of financial performance — operating revenue generation, expense control, and capital usage. National EVA funds the EVA Variable Pay Program. Specific information on the EVA Variable Pay Program is available in the EVA Variable Pay Program Management Instruction (MI), MI EL-470-1999-6, *Fiscal Year 2000 EVA Variable Pay Program*. MI EL-470-1999-6 is also available on the corporate intranet at [http://blue.usps.gov/cpim/ftp/manage/e470996.pdf](http://blue.usps.gov/cpim/ftp/manage/e470996.pdf) and [http://blue.usps.gov/hrisp/comp/var-pay.htm](http://blue.usps.gov/hrisp/comp/var-pay.htm). The Postal Service reserves the right to make changes to Handbook F-6 at any time subject to the obligation to consult with the management associations when required to do so by law.

Each chapter explains a basic element of the EVA program:

- Chapter 1 explains why the Postal Service has adopted EVA as a financial measurement tool.
- Chapter 2 defines EVA and basic EVA calculation and reporting.
- Chapter 3 shows how EVA is managed through the EVA driver analysis process.
1-2 Economic Value Added

Economic Value Added (EVA) measures operating performance, funds the incentive credit, and when combined with CustomerPerfect!™ goal achievement, rewards employee performance.

1-2.1 CustomerPerfect!

The Postal Service implemented EVA as a way of managing our business to meet the challenge of our increasingly competitive environment. CustomerPerfect! has set three goals based on customer needs and the competitive environment:
- Improve customer satisfaction.
- Strengthen employee and Postal Service effectiveness.
- Improve financial performance.

With CustomerPerfect!, the Postal Service is a more customer-driven organization with products that provide the best value in America. Our goal is to become a premier provider of postal communications. To accomplish this, we developed a performance measurement that focuses decision making equally on creating the best value for customers, employees, and the organization. We adopted the following three critical measures of our success:
- Voice of the Customer (VOC).
- Voice of the Employee (VOE).
- Voice of the Business (VOB).

This handbook focuses on the financial measure of EVA.

1-2.2 Voice of the Business

Voice of the Business measures financial performance. Initially, we measured VOB success at all levels of the organization through improvement in EVA. In FY 2000, we adopted other compensable indicators for VOB in lieu of EVA. The VOB indicators are explained in greater detail in the EVA Variable Pay Program management instruction (MI EL-470-1999-6, Fiscal Year 2000 EVA Variable Pay Program). We will soon publish technical and system aspects of EVA in a separate handbook.
Advantages of EVA

National EVA is used to fund the incentive award program. EVA is also calculated at the performance cluster and area levels.

Postal employees share in the financial successes measured by national EVA and their organizational CustomerPerfect! goal attainment. Employees are encouraged to build the value of national EVA. To encourage sustained performance and promote continuous EVA improvement, the incentive sharing with employees is paid out over several years based on EVA results in those years. Accordingly, long-term value enhancement is emphasized rather than short-term actions that may improve current operating results to the detriment of long-term value.

The advantage of EVA is that it is a single number that is applied across the full spectrum of Postal Service operations. It makes financial performance more relevant to all postal employees.

EVA emphasizes managing the whole business and creating value. Our traditional focus on measuring annual performance against budget has been transformed to recognize and include a measure of the returns required on investments and operating performance. Management attention is directed beyond short-term profitability to long-term return on total assets and investments.

EVA directs our efforts toward growing our business and producing long-term value through additional investments. It causes us to challenge existing deployments of capital and turn our focus toward continuous profitability improvement.

When linked to an incentive award system, EVA provides a measure to evaluate success and a catalyst for continued performance improvement. EVA links operating performance with customer satisfaction and employee commitment because the funds generated by national EVA are shared by Postal Career Executive Service (PCES) and executive and administrative schedule (EAS) employees based on their organizational CustomerPerfect! goal achievement. The benefits of increased efficiency and improved service are passed on to our customers through smaller and less frequent rate increases.
EVA is a management tool to help all postal employees to do their jobs better and, thus, the business runs more effectively. It is used to set goals, measure progress, and to correct our course when required.

1-3 Questions on EVA

Employees should direct questions about EVA to Headquarters Finance. Employees may also direct EVA calculation questions to the cc:Mail address: EVA Answer Line. Questions on the EVA Variable Pay Program should be directed to local personnel offices.
2-1 EVA Defined

Economic Value Added (EVA) is a comprehensive measure of operating performance. Put simply, EVA measures the change in financial worth of an enterprise from one year to the next. It is a more comprehensive financial measurement tool than net income (revenues minus expenses) alone, because it includes the cost of the capital used to generate that income. EVA is superior to other measures of financial performance because of the following:

- EVA links the use of capital with unit financial performance and provides a business focus for unit management.
- EVA provides an incentive to employees to minimize expense and capital employed rather than to maximize the amount of budget resources available.
- EVA empowers employees who are accountable for producing maximum results and minimizing resources used.

EVA is calculated at the performance cluster, area, and national levels. Since the beginning of FY 2000, EVA is not a compensable target under Voice of the Business (VOB) because it funds the entire EVA Variable Pay Program. Used in concert with the existing capital investment approval process and a related incentive compensation system, EVA becomes an evaluation tool for decision making by focusing on the long-term costs and benefits of actions taken. It changes the focus from short-term accounting results to long-term value creation. The impact of each decision on EVA can be explicitly calculated. If the result improves EVA on a long-term basis, then the action will benefit the Postal Service and should be taken.
2-2 **EVA Formula**

EVA measures what was earned over and above the cost of the capital used. The national formula shown below explains it:

<table>
<thead>
<tr>
<th>Unadjusted Net Operating Income</th>
<th>(+/-) Economic Adjustments (see Section 2-3)</th>
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<td>(+/-) Indexing Adjustments (see Section 2-3)</td>
<td>(=) Net Operating Income</td>
</tr>
<tr>
<td>(-) Capital Charge (see Appendix A)</td>
<td>(=) National EVA</td>
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This formula is the essence of EVA — net operating income (NOI) minus the cost of capital used to generate that income. The components of the EVA formula are explained in sections 2-3 through 2-5.

The logo depicts the EVA drivers: revenue, expenses, and capital.

2-3 **Net Operating Income**

Net Operating Income or NOI is a means of expressing pure operating results. In other words, financial results of NOI do not have the impact of financing (borrowing), investing, or accounting adjustments, which can distort a purely operational analysis. NOI is the amount of money generated exclusively from operations.

To obtain such a measure of operating income, it is necessary to make the following adjustments to net income reported in the Postal Service’s financial statements.
EVA — A Financial Measure

- **Economic adjustments.** Economic adjustments include nonoperational costs, noncash accruals, capitalized costs, and unusual costs. For example, we add the account, *increase in bad debt allowance*, because this is a noncash accrual. We add the account, *capitalized research and development expense*, because it is capitalized. We add the account, *inspector general expense*, because it was introduced after the 1997 base year for EVA and is classified as unusual. We subtract from net income amortized research and development because it is an expense.

    Adjustments of this nature create a more objective representation of economic operations than does the standard accounting treatment for producing postal financial statements. Standard accounting statements include nonoperating items and require judgments regarding the future outcomes of current events. Nonoperating adjustments are limited almost exclusively to the national EVA calculation. The single nonoperating adjustment affecting field units is described in section 2-6.

- **Index adjustments.** Indexing adjustments remove the effect of rate increases and add the inflation index as determined by the consumer price index for all urban consumers (CPI-U). Indexing mitigates the impact of the rate cycle and our break-even constraints. CPI is used as a proxy price cap and the focus is to keep rates below the rate of inflation. Adjustments are calculated using operating revenue.

### 2-4 Capital

All the economic resources invested in a business unit to enable it to operate and create economic value are collectively referred to as capital. For EVA purposes, capital is very broadly defined. It consists not only of plant, property, and equipment (PP&E) but also the working capital (cash, accounts receivable, inventories, minus short-term liabilities such as payrolls and amounts owed to vendors) and certain other assets and liabilities. For an enterprise to prosper, it must earn a return on its capital investment in excess of the cost of capital.
To facilitate capital management, capital statements are produced at the performance cluster, area, and national levels. A briefing on capital resources called capalloc.zip is available on the Finance home page on the corporate intranet (http://blue.usps.gov/finance).

2-5 Cost of Capital

The cost of capital, expressed as a percentage, represents a minimum acceptable return on the Postal Service’s capital investments. Accordingly, we can view it as a target for creating value. The Postal Service’s overall return on capital investments must meet or exceed this rate to create economic value. An overall return on capital of less than the cost of capital means that our capital resources have not been optimally used. The cost of capital is assessed against capital employed at the performance cluster, area, and national levels. The Postal Service EVA cost of capital is currently 12 percent. The method used to develop the cost of capital percentage is described in Appendix A.

2-6 Performance Cluster EVA

EVA is calculated for each performance cluster (i.e., an organizational unit of the Postal Service). To calculate NOI at the performance cluster level, a method to allocate revenue based on workload has been developed. An allocation process is necessary to compensate for revenue being recorded in one location and the work being performed in various locations. Revenue is recorded on the Postal Service’s account books at the post office where the mailer is assigned which is usually, but not necessarily, the point of origin of the associated mail. The majority of the workload associated with mail volume, however, is incurred at the destinating end of the process. This disparity between revenue recordation and workload necessitates a revenue reallocation mechanism to “level the playing field” across geographic areas. Without a direct relationship between workload and the associated revenue credit, dysfunctional behavior such as competition between organizational units for revenue might occur. The intent of reallocating revenue is that all parties recognize that the Postal Service is a national network and that success of individual units must not come at the expense of the organization as a whole.
Expenses for performance cluster EVA are essentially identical to those found on the Postal Service Financial Report (PSFR) with one exception. The financing component of lease expenses is deducted from total expenses for EVA purposes. EVA is an operating measure, and all leases include an embedded financing cost that is equivalent to interest expense. Since this “interest” is not an operating expense, it is inappropriate to include this expense in a calculation of net operating income.

2-7 Area EVA

An EVA calculation is made for each area. Area EVA is essentially an aggregation of the performance cluster EVA calculations within the area, plus the expenses and capital of the area office and any organizational units that report directly to the area office but are not a part of any performance cluster.

2-8 National EVA

A separate EVA calculation is made at the national level. This calculation comprises all area calculations and all Headquarters-related activities and resources, including operating costs, such as air transportation and unfunded retirement costs, that are charged at the national level only.

2-9 EVA Reporting

EVA is calculated on an accounting period (AP) basis to allow employees to plot progress during the year. Evaluation of EVA is based on year-end EVA calculations. The national EVA results and the performance cluster and area EVA calculations are included in the corporate information system, under Option 15, along with details of the net operating income and capital calculations.

The Finance home page on the corporate intranet (http://blue.usps.gov/finance) also reports EVA results.
3-1 Overview

The Postal Service has integrated Economic Value Added (EVA) by making it available for managers and employees to use as a comprehensive financial measure of performance. EVA incorporates into the management equation the concept that capital has a direct and measurable cost in all parts of the organization. To survive in an increasingly competitive environment, the returns from capital invested must exceed the cost of that capital. EVA helps managers explicitly demonstrate those decisions that increase value and those that diminish value. (See Appendix B, EVA Drivers.)

3-2 EVA Improvement Concepts

The objective of the Postal Service is to generate positive and growing EVA. This is done in the following ways:

- Increase profitable revenue while maintaining expense and capital levels.
- Reduce expenses while holding capital constant to produce the same level of revenue.
- Increase revenue and hold down expenses using the same capital.
- Achieve combinations of changes to revenue, expense and/or capital management that increase net EVA.

The framework for using EVA analysis methods to make operating decisions is simple: grow, operate, or harvest. These terms are explained as follows:
Economic Value Added

**grow** — Activities or products the Postal Service wants to *grow* are those in which additional capital investments generate net operating income in excess of the cost of capital.

**operate** — Activities or products the Postal Service wants to *operate* are those that may not merit additional capital resources but can realize better returns from the capital currently in use.

**harvest** — Activities and products the Postal Service wants to *harvest* are those that neither gain from additional capital nor can be operated to provide returns that exceed the cost of capital in the business.

### 3-3 Strategic Investments

Some decisions are controlled at the highest levels of the Postal Service. Some investments consistent with the Postal Service public service mandate may not be attractive if evaluated exclusively from an EVA perspective. Further, there are organizational performance investments that may not enhance EVA at the performance cluster level yet are necessary for the good of the Postal Service as a whole.

Operating managers may be concerned that using EVA as a decision-making tool discourages certain investment opportunities even though the Postal Service benefits in the long term. For this reason the Postal Service uses the existing capital investment review and approval process to determine the economic basis for strategic and economic investments. However, operating managers should understand the impact of EVA because they ultimately are responsible for generating EVA incentives. The impact of planned strategic investments is incorporated into the Voice of the Business (VOB) goals.

### 3-4 EVA Drivers

EVA drivers are causal factors that create or destroy enterprise value. Identifying the relevant Postal Service EVA drivers helps managers determine the appropriate action to improve performance, create value, and increase EVA.
EVA drivers are classified in the following three primary categories:

- Revenue.
- Expense.
- Capital.

Altering one driver without altering the other drivers changes EVA. Each EVA driver can be subdivided into specific, manageable levels of value. For example:

- Increasing revenue and, at the same time, holding expenses and capital constant increases EVA.
- Reducing expenses while holding capital constant and maintaining the same revenue base results in productivity and efficiency that increases EVA.
- Decreasing total capital invested (through a reduction of net property, plant, and equipment employed in the business) with revenues and expenses held constant increases EVA. Similarly, increasing capital by investing in capital that returns expense reductions greater than the cost of capital results in increased EVA.

Appendix B provides an additional explanation of EVA drivers with an example detailing the effects on EVA of a change in one value driver.

3-5 EVA Management Summary

EVA promotes accountability. Decisions can be evaluated within an EVA framework to determine whether the decision increased, maintained, or decreased EVA.

The EVA financial management and incentive system provides a well-defined measurement that managers can use to assess the impact of their decisions. Therefore, EVA provides an element of control and is not subjective. It is self-funding because reserve accounts increase only if there is positive EVA. It provides managers and employees with the financial measurement tools and the personal and corporate accountability to achieve continued success.
A-1 Cost of Capital Calculation

The cost of capital is the rate of return an investor in a business like the Postal Service would expect to earn, compared with other investments of equal risk. Therefore, investments the Postal Service makes in capital should meet or exceed this rate if they are to provide value to the business. At a minimum, the cost of capital must be earned if an investment is to increase Economic Value Added (EVA).

Exhibit 1 graphically illustrates the relationship between increases in equity risk and increases in required return.

Exhibit 1
The Relationship Between Equity Risk and Required Return

The required return on any investment begins with a risk-free investment — for example, long-term U.S. Treasury bonds. As risk increases, so must the required return on investment. Thus, an investment in a high-risk business must provide a considerable premium over long-term Treasury bonds.
As used in EVA, the cost of capital is determined using an implied level of risk and a blend of debt and equity capital derived from peer group analyses. Given the nonstandard capital structure, tax status, and competitive posture of the Postal Service, a different approach was required to determine an appropriate cost of capital.

A comparison of our own internal requirements for capital investment returns and the level of other firms’ cost of capital indicates that a rate of 12 percent is adequate for the Postal Service to ensure value creation through EVA. This is the cost of capital rate we adopted for the initial year of the EVA-funded incentive program. The Postal Service will review this rate annually for changes in market conditions. The rate of return used to calculate the cost of capital is communicated separately, along with other aspects of the EVA program that are determined annually.
Appendix B
EVA Drivers

This appendix provides a discussion of Economic Value Added (EVA) drivers and how the drivers are linked to the decision-making process.

B-1 EVA Value Drivers

EVA drivers provide decision makers with the means to assess the impact of business decisions on the economic value of a corporation or business unit. By disaggregating the components of the EVA formula (operating revenues, operating expenses, and capital charge) to a more detailed level, managers can identify performance measures under their direct control. Once identified, managers can focus on how these measures affect, or drive, bottom-line EVA results.

Value drivers that may affect EVA, some of which are depicted in Exhibit 2, may or may not have a direct dollar dimension. Inventory and accounts receivable, for example, are quantifiable in dollar terms while other drivers such as innovation may not have a definable dollar dimension. EVA driver analysis requires decision makers to fully assess the consequences of their actions, thus allowing managers to know the business better in all of its value dimensions.

The EVA measure is derived from a combination of the financial statements of an enterprise and the cost of capital invested in the business. The combination of the income statement and capital statement reflects enterprise growth, operating efficiency, and asset management effectiveness.
Exhibit 2
EVA Value Driver Pyramid

EVA

Asset Management
- Replacement Cycle
- Capital Purchases
- Cycle Time

Operating Efficiency
- Delivery Time
- Overtime
- Labor Cost
- Network Economics

Growth and Rationalization
- Vehicle Maintenance Cost
- Total Quality Management
- Employee Mix
- Procurement

EVA Drivers Pyramid

New Product/Service Development
- Higher Margin Products
- Pricing Policy
- Selling for Value
B-2 Calculating EVA for Operating Management

The components of EVA (revenues, expenses, and the capital charge) define the primary driver categories. Within these categories exist the entity-specific value levers that managers can use in the decision-making process. The EVA equation for the operating manager follows:

\[
\text{Revenues} - \text{Operating Expenses} - \text{Capital Charge} = \text{EVA}
\]

As previously noted, the EVA measure, and thus the drivers, are derived from a combination of the financial statements of an enterprise and the cost of capital invested in the business. The income and capital statements in Exhibit 3 summarize the primary components of the income and capital statements of a typical performance cluster and provide the basis for the value driver decision-making example below.

The capital charge or the cost of capital invested is defined as:

- The rate of return expected on capital employed in any investment of equivalent risk to that of the business.

multiplied by

- The amount of capital employed in the business.

A financial objective of every business is to undertake both projects and investments that provide a return that exceeds the capital charges. The goal for operating managers is to increase EVA by increasing revenues, decreasing expenses, or decreasing capital charges.
As illustrated in the EVA formula, EVA equals revenue, less operating expenses, less a capital charge. Exhibit 4 illustrates the EVA calculation for a sample performance cluster. The calculation is based upon the financial statements presented in Exhibit 5 with adjustments for nonoperating expenses. The sample performance cluster generates $27.2 million in net operating income (NOI) for the example fiscal year and, based upon average capital employed during the year of $55.8 million, which includes the present value of non-capital leases, incurs a capital charge of $6.7 million. The result for the year is the creation of value (EVA) in the amount of $21.8 million.
B-3  Income Statement and Capital Statement Components

The EVA calculation as illustrated in Exhibit 4 can be outlined in a driver schematic that illustrates reaction channels that managers can pursue to create value. The schematic defines the drivers as the components that, when changed, affect the income statement or capital statement and, thus, EVA. Managers should focus on the value levers over which they have control and which will result in the greatest impact in value to the enterprise. For example, a manager focusing on expense drivers by reducing controllable selling and general and administrative expense will cause EVA to increase.
The interaction between the income statement and capital statement can be further reduced into controllable value drivers as depicted in Exhibit 6 (e.g., working capital charge is a function of the cost of capital and the day’s revenue outstanding of all working capital items).
Exhibit 6
Example Detail EVA Drivers Schematic

Note: Sum of parts may not equal totals due to rounding.
B-4 Effect on Performance Cluster EVA of a Ten Percent Decrease in Fixed Assets

Exhibit 7 illustrates how a change in one value driver — a 10 percent decrease in total property, plant, and equipment employed in the business — with all other factors remaining constant, affects EVA.

Exhibit 7
Case Study

<table>
<thead>
<tr>
<th>Net Operating Income ($000s)</th>
<th>Capital Charge ($000s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Allocated Revenue</td>
<td>Avg Working Capital</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>Avg PP&amp;E</td>
</tr>
<tr>
<td>Unadjusted NOI</td>
<td>PV Non-Cap Leases</td>
</tr>
<tr>
<td>Adjustments</td>
<td>Avg Capital</td>
</tr>
<tr>
<td>Net Operating Income</td>
<td>Cost of Capital %</td>
</tr>
<tr>
<td></td>
<td>Capital Charge</td>
</tr>
<tr>
<td>$232,599</td>
<td>$1,176</td>
</tr>
<tr>
<td>–205,393</td>
<td>37,255</td>
</tr>
<tr>
<td>27,206</td>
<td>13,234</td>
</tr>
<tr>
<td>1,323</td>
<td>51,665</td>
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<tr>
<td>$28,529</td>
<td>×12%</td>
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Less

<table>
<thead>
<tr>
<th>New EVA ($000s)</th>
</tr>
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<tr>
<td>$28,529 – $6,200 = $22,329</td>
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<table>
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<tr>
<th>Increase in EVA ($000s)</th>
</tr>
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<tbody>
<tr>
<td>New – Old</td>
</tr>
<tr>
<td>$22,329 – $21,833 = $496</td>
</tr>
</tbody>
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The previous analysis in Exhibit 7 can be summarized in the EVA driver schematic format of Exhibit 8. Components of the schematic that changed due to the 10 percent decrease in property, plant, and equipment are outlined in bold.
Exhibit 8
Case Study

Economics Value Added

Operating Revenue to Operating Revenue = 100.00%
Operating Expenses to Operating Revenue = 88.30%
Interest Expenses on Non-Cap Leases = –0.57%
Capital Charge to Operating Revenue = 2.67%

Net Operating Revenue ($000s) = $232,599
EVA Margin = 9.60%
EVA ($000s) = $22,329

Cash = 1.62
A/R = 0.11
Inventory = 0.49%
Land to Operating Revenue = 1.90%
Net Building to Operating Revenue = 7.76%
Net Leases to Operating Revenue = 5.69%
Net CSE* to Operating Revenue = 0.22%
Net PSE* to Operating Revenue = 0.67%
Net MPE* to Operating Revenue = 2.61%

12% = DSO = 364

DSO = 1.84

Net CSE* = Customer Service Equipment; PSE = Postal Support Equipment; MPE = Mail Processing Equipment
area — For administrative purposes, the Postal Service is divided into geographical territories called areas. The areas encompass the entire domestic service territory.

balance sheet — An accounting summary of an organization’s assets, liabilities, and net worth as of a certain date.

capital — Historical measure of the investment made in the operations of the business. EVA uses a broader than traditional definition of capital. For example, EVA capital includes expenditures undertaken to improve future performance such as research and development (R&D) expense.

capital charge — An amount deducted from net operating income to derive EVA. Represents a charge for the operating capital used by an operation. Equals total average capital times cost of capital.

capitalization — Transformation of an expense into an asset.

cost of capital — The rate of return required to compensate investors for investing in the business. It represents the rate of return that an investor could earn by choosing another investment with equivalent risk. It is also calculated using a weighted average of a firm’s debt and equity capital.

defered retirement costs — Postal Service employees are covered under two retirement systems: the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS). FERS is dynamically funded; in other words, the Postal Service pays as it goes. CSRS is not dynamically funded; hence, CSRS incurs additional liabilities each year as the sum of the contributions made by employees and employer do not fully fund the future retirement liabilities created.

drivers — Specific causal factors that affect or “drive” EVA performance results.
fiscal year (FY) — An accounting term for a year that ends on a date other than December 31. The Postal Service uses two types of FYs: a government FY that ends on September 30 and a postal FY that ends 364 days after the close of the preceding postal FY.

net operating income (NOI) — Used in the calculation of EVA; equal to all revenue from operations, less all expenses from operations.

nonoperating adjustments — For the EVA calculation, accounting net income is adjusted by removing all nonoperating items. For the Postal Service, these adjustments include items such as OBRA expense, interest income and interest expense, and noncash accruals.


ODIS — Origin–Destination Information System. A performance measurement system used to record service transit times and mail volumes between selected service territories.

performance cluster — An administrative unit used by the Postal Service to assess performance. It is the smallest geographic area for which EVA will be measured.

present value (PV) — A calculation that permits evaluation of alternative financial actions by reducing future streams of cash flows to a single number.

refinancing expense — A prepayment penalty charge taken by the Postal Service in order to restructure its debt.

reserve account — An account maintained for each EVA program participant containing the total accumulated incentive credits that have not been disbursed. Reserve accounts are created to promote sustained performance and continuous improvement.

revenue allocation — Because postal services are not always provided at the point of revenue receipt, some method of estimating and allocating the amount of revenue earned by areas and performance clusters is necessary. EVA calculations use revenue allocations based on ODIS volume flows and workload cost statistics.
**self-funding** — A descriptive term for an incentive program that creates its own pool of funds available for payment solely through improved performance. The EVA program is self-funding.

**sharing ratio** — The manner in which the incentive fund is distributed among different employee groups. The ratio is higher for individuals in employee groups that have greater levels of responsibility and have a greater portion of their pay at risk.

**strategic investment** — Certain investments, necessary for the long run and for the well-being of an institution, can have a short-run diminishing effect on the amount of annual EVA. In the Postal Service incentive program, these are evaluated on a case-by-case basis, and an adjustment may be made to the EVA calculation so as not to penalize appropriate behavior.