

CORPORATE OVERVIEW

THE DCM INDEX: A STEP-BY-STEP GUIDE



1. The DCM Index for a firm is compiled by first obtaining its quarterly revenue and cost data for a particular time period. For Inforte's initial data set, we compiled data from Q1 1999 to Q3 2001, but you can build your Index over any time period you choose. However, it is important to note that the longer the time period, the greater the accuracy of the Index, as any short-term deviations will be smoothed within the long-term trend.
2. The revenue and cost data should be entered into an Excel spreadsheet (to use its correlation function). Use any of the prepared files as a template.
3. For public, US-headquartered companies, quarterly revenue and cost data can be found in a firm's "10Q" (i.e. Quarterly Report). This report is found online in the SEC's EDGAR database: <http://www.sec.gov/edgar/searchedgar/formpick.htm>.
 - a. Once you are on the EDGAR website, enter the company name, choose 10Q for quarterly reports, and specify the time frame. You will be able to gather data for the first three quarters of a firm's fiscal year by looking at the 10Qs for those quarters. [Note: We'll address fourth quarter data in Step 6.]
 - b. Finding quarterly information for private or foreign firms is much more difficult. It can sometimes be found by looking on the company's website but these firms are not required to make quarterly data.
4. Revenue = total sales from operations
5. Costs & Expenses = Cost of Goods Sold (COGS) plus Selling, General and Administrative Expenses (SG&A Expenses).
 - a. Some firms will include both of these categories into one area called Operating Expenses. Others will break them out into separate line items.
 - b. It is important that "Costs & Expenses" line on the DCM Index capture all expenses, as Inforte's DCM message is that demand should drive all decisions a firm makes. Therefore, you may have to add these categories together to get a "total" expense line. If you have any questions about which line items to include from a particular report, please contact Julia Dickson (312.540.0900) to discuss it. Consistency across all Indices produced is critical.
6. Because firms are only required to make quarterly data publicly available for the first three quarters of the year, to get fourth quarter data for any given year, you must subtract the first three quarters from the annual figures.
 - a. Annual data can also be found on the EDGAR website. Follow the instructions from above but choose "10K" (the annual report) instead of "10Q" (quarterly report) from the drop-down box.
 - b. Occasionally, the information in the 10K is difficult to read or the financial information is difficult to find. As most companies post their annual reports on their corporate website, it is sometimes easier to find annual data this way.
7. After obtaining the revenue and cost data, the next step is to calculate the change in revenue and costs on a quarterly basis. If you have used the Dow 30 Index file as a template to enter the data, these calculations should occur automatically in the two rows below the revenue and cost lines. This creates two arrays — one indicating quarterly revenue changes over the specified time period and one indicating quarterly cost changes. For example, the first number in each array should be Q2 1999 Revenue (Cost) minus Q1 1999 Revenue (Cost). These two data sets are then graphed and correlated to produce the DCM Index. The charts can be found in the template on the second sheet, named Dow 30 Charts.
8. If you have not used the template, or if the correlation function has been deleted/changed in the template, you can produce the correlation coefficient using Excel functions.
 - a. To produce a correlation coefficient in Excel: go to Insert -> Function. In the "Function Category", select "Statistical". Then select "CORREL" for the function name. Next, enter the "Revenue Change" data set for Array 1 and the "Costs & Expenses Change" data set for Array 2. Select "OK".

9. Additional notes about the Indices
 - a. As a correlation coefficient, the DCM Index assumes a value from -1 to 1, depending on the degree of the relationship. Plus and minus one indicate perfectly positive and negative relationships, whereas zero indicates that revenues and costs are not at all correlated. The “higher” a firm’s score — the closer it is to one — the more positively correlated costs are to revenues (i.e. costs fall when revenue falls and vice versa) and the more demand driven the firm. Conversely, a “low” score indicates that a firm is not very successful at managing by demand.
 - b. The major exception to the accuracy of the Index in predicting ability to manage by demand is that an organization that is able to do what all firms dream of doing — growing revenues while at the same time reducing costs — will end up with an “unjustifiably” low DCM Index. In fact, a firm that can do this perfectly (i.e. follow a 30% rise in revenue with a 30% decline in costs) will have a score of negative one as their costs are negatively correlated with revenues. However, a perfectly negative correlation can also indicate that a firm has increased costs to the exact degree that revenues have fallen.
 - c. For this reason and others, it is also important to include a graphic rendition of a firm’s Index in the spreadsheet as well.

10. Any questions or issues regarding the creation, interpretation and use of the DCM Index should be initially directed to Julia Dickson. All completed Indices should be sent to her (julia.dickson@inforte.com), as well, for sharing with others across the firm.