A very brief history of Economic Evaluation (Business Evaluation)

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Economic Evaluation (Business Evaluation) was created about 50 years ago.

Because it involved computations involving money it was managed by chief accountants and most of the work was done by accountants. They began with their income statement, balance sheet and cash flow statement and 'worked up backwards' to compute NPV. Originally they were by hand-calculator.

The resultant would have been taken as indisputable. The most important inputs of price, forex, production, opex and capex would have been provided by 'indisputable experts' and taken as absolute and exact. The correct but convoluted accounting methodology to compute NPV was very difficult for management, production and technical professionals to follow.

Then a few technical/operational professionals slowly managed to infiltrate the activity. Fortunately the Accountants had more than enough to keep them very busy and allowed this intrusion.

In the 1990's several mega-companies made very poor major investment decisions. Some Boards and top management were replaced and economic evaluation professionals were recruited from companies perceived as having better practices.

This began the transition to economic evaluation being managed by seasoned production and technical professionals, and the modelling being performed by people with production, engineering and technical backgrounds.

The more competent companies focussed on the 'big picture' of how the business works rather than on the mathematics of calculations. They understood that NPV is derived from opinions and judgements.

- I have seen the single page manual computation used by the Board of one of the world's biggest companies to justify buying approx one third of the gigantic, high purity, fabulously valuable, Mt Newman JV in iron ore in the 1970's. It was in a couple of sheets of paper and so concise anyone could work through. Everyone could immediately appreciate the key drivers and the key assumptions behind the NPV.

- Decades later, I have reviewed sophisticated, long, detailed, convoluted evaluation models. They had strings of logic that ran back and forth through multiple worksheets, employed numerous advanced Excel functions and could do a variety of computations using draw-down menus. Each one took days or weeks to unravel and audit. Only a handful of specialists but none of the management could understand the models. Strangely, most of the creators of these business models were so terribly proud of their 'trophies'. They felt so skilled, accomplished and clever.

Which were making decisions with "eyes wide open?"

As a discipline/career path, Economic Evaluation/ Business Evaluation falls between accounting, production, marketing and technical. It suffers from having no global education and no professional standards. Sadly anyone can set themselves up as a ‘professional’ and tout for business. Sadly anyone can set themselves as an expert and run courses.

Many people on the periphery of the profession talk of “financial modelling” or “financial analysis”.
Even worse, some engineers call it “cost modelling”.
They are wrong!
It is like calling an electrician a plumber.
Financial modelling is the study of how to fund the project or business.
How should the money be raised by the company? What mix of equity and debt?
The first step should be to use the economic evaluation to decide if the project/business is a healthy investment regardless of ownership and financing? The second step should be to feed the data from this model into the financial model to work through alternatives for funding.
They are complementary activities but economic evaluation is done first.

Some people then talk about financial modelling using 100% equity. Again they are confused!

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