

Strategic Performance Management & Business Valuation

(Paper 20 of Final Course - Syllabus 2016)

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Earnest Gratitude

Dedicated to my grandfather Late Shri Sushil Chand Gupta who has been a constant source of inspiration for me throughout....

Special mention of my brother CA Mukul who has been a great support always...

Last but of course not the least my mother Meenakshi Gupta whose untiring efforts have always bore fruits for me... Thanks Mom!!

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Conceptual Framework Of Performance Management

Performance management is a continuous process of identifying, measuring and developing performance in organizations by linking each individual's performance and objectives to the organization's overall mission and goals. Two important elements of performance management are that it is a continuous process and is linked to missions and goals. Performance management focuses mainly on the achievement of results.

The Performance Management Cycle



Components of Performance Management

1. **Performance Planning:** Performance planning is the process of deciding the targets and the key performance areas for a year. Performance planning is jointly done by the employee (appraiser) and employer (reviewer) in the beginning of a performance session. Every employee is given certain key performance indicators (KPI) / Key Result Areas (KRA), which are to be adhered to by the employees.
2. **Performance Appraisal and Reviewing:** The appraisee fills up the self appraisal form and also describes his/her achievements in quantifiable terms. After the self appraisal, the appraiser / reviewer offers the final ratings for the achievements of the employee being appraised. The appraisals are normally performed twice in a year in an organization in the form of mid reviews and annual reviews which is held at the end of the financial year.
3. **Feedback on the Performance followed by personal counseling and performance facilitation:** This is the stage in which the employee acquires awareness from the appraiser about the areas of improvements and also information on whether the employee is contributing the expected levels of performance or not.
4. **Rewarding good performance:** During this stage, an employee is publicly recognized for good performance and is rewarded. This stage may have a direct influence on the self esteem and motivation.
5. **Performance Improvement Plans:** In this stage, fresh set of goals are established for an employee for the next appraisal cycle and new deadline is provided for accomplishing those objectives. The employee is clearly communicated about the areas in which the employee is expected to improve and a stipulated deadline is also assigned within which the employee must show this improvement
6. **Potential Appraisal:** Potential appraisal forms a basis for both lateral and vertical movement of employees. Potential appraisal provides crucial inputs for succession planning and job rotation.

Performance measurement tools - Productivity and Efficiency

Performance – Performance may be measured using two tools Productivity and Efficiency.

Productivity - Productivity examines the relationship between input and output in a given production. Hence $\text{productivity} = \text{Output} / \text{Input}$.

Efficiency - While the terms productivity and efficiency are often used interchangeably, but they are not same. Efficiency may be defined as the highest productivity level from each input level is recognized as the efficient situation. Hence efficiency occurs if a firm obtains maximum output from a set of inputs.

Financial Performance Analysis - Financial performance analysis is the process of identifying

- the financial strengths and weaknesses of the firm by properly establishing the relationship between the items of balance sheet and profit and loss account.
- short-term and long term growth prospects

Areas of Financial Performance Analysis

1. Working capital Analysis
2. Financial structure Analysis
3. Activity Analysis
4. Profitability Analysis

Techniques/Tools of Financial Performance Analysis

1. Ratio Analysis - Ratios express the numerical relationship between two or more things. This relationship can be expressed as percentages (25% of revenue), fraction (one-fourth of revenue), or proportion of numbers (1:4). Ratio analysis plays an important role in determining the financial strengths and weaknesses of a company relative to that of other companies in the same industry. The analysis also reveals whether the company's financial position has been improving or deteriorating over time. Ratios can be classified into four broad groups on the basis of items used: (i) Liquidity Ratio, (ii) Capital Structure/Leverage Ratios, (iii) Profitability Ratios, and (iv) Activity Ratios.

2. Common-Size Financial Analysis

Common-size statement is also known as component percentage statement or vertical statement. In this technique net revenue, total assets or total liabilities is taken as 100 per cent and the percentage of individual items are calculated likewise. It highlights the relative change in each group of expenses, assets and liabilities.

3. Trend Analysis

Trend analysis indicates changes in an item or a group of items over a period of time and helps to draw the conclusion regarding the changes in data. In this technique, a base year is chosen and the amount of item for that year is taken as one hundred for that year. On the basis of that the index numbers for other years are calculated. It shows the direction in which concern is going.

Ratio Analysis

The importance of ratio analysis lies in the fact that it presents data on a comparative basis and enables the drawing of inferences regarding the performance of the firm. Ratio analysis helps in concluding the following aspects:

Liquidity Position - Ratio analysis helps in determining the liquidity position of the firm. A firm can be said to have the ability to meet its current obligations when they become due. It is measured with the help of liquidity ratios.

Long- Term Solvency - Ratio analysis helps in assessing the long term financial viability of a firm. Long- term solvency measured by leverage/capital structure and profitability ratios.

Operating Efficiency - Ratio analysis determines the degree of efficiency of management and utilization of assets. It is measured by the activity ratios.

Over-All Profitability - The management of the firm is concerned about the overall profitability of the firm which ensures a reasonable return to its owners and optimum utilization of its assets. This is possible if an integrated view is taken and all the ratios are considered together.

Inter- firm Comparison - Ratio analysis helps in comparing the various aspects of one firm with the other.

Financial Ratios and their Interpretation

Sl. No.	Category	Types of Ratio	Interpretation
1.	Liquidity ratios	Net Working Capital = Current assets-current liabilities	It measures the liquidity of a firm.
		Current ratio = Current Assets / Current Liabilities	It measures the short term liquidity of a firm. A firm with a higher ratio has better liquidity. A ratio of 2:1 is considered safe.
		Acid test or Quick ratio = Quick assets / Current Liabilities	It measures the liquidity position of a firm. A ratio of 1:1 is considered safe.
2.	Turnover ratios	Inventory Turnover ratio = Costs of good sold / Average inventory	This ratio indicates how fast inventory is sold. A firm with a higher ratio has better liquidity.
		Debtor Turnover ratio = Net credit sales / Average debtors	This ratio measures how fast debts are collected. A high ratio indicates shorter time lag between credit sales and cash collection.
		Creditor's Turnover ratio = Net credit purchases / Average Creditors	A high ratio shows that Accounts are to be settled rapidly.
3.	Capital Structure Ratios	Debt-Equity ratio = Long term debt / Shareholder's Equity	This ratio indicates the relative proportions of debt and equity in financing the assets of a firm. A ratio of 1:1 is considered safe.
		Debt to Total capital ratio = Long term debt / Permanent Capital Or Total debt / (Current liabilities + Permanent capital) Or Total Shareholders' Equity / Total Assets	It indicates what proportion of the permanent capital of a firm consists of long-term debt. A ratio 1:2 is considered safe. It measures the share of the total assets financed by outside funds. A low ratio is desirable for creditors. It shows what portion of the total assets is financed by the owners' capital. A firm should neither have a high ratio nor a low ratio.
4.	Coverage ratios	Interest Coverage = Earning before Interests and Tax / interest	A ratio used to determine how easily a company can pay on outstanding debt. A ratio of more than 1.5 is satisfactory.
		Dividend Coverage = Earning after tax / Preference Dividend	It measures the ability of firm to pay dividend on preference shares. A high ratio is better for creditors.

Sl. No.	Category	Types of Ratio	Interpretation
		Total Coverage ratio = Earning before interests and tax / Total fixed charges	It shows the overall ability of the firm to fulfill the liabilities. A high ratio indicates better ability.
5.	Profitability ratios	Gross Profit margin = Gross profit / Sales $\times 100$	It measures the profit in relation to sales. A firm should neither have a high ratio nor a low ratio.
		Net Profit margin = Net Profit after tax before interest / Sales Or Net Profit after Interest and Tax / Sales	It measures the net profit of a firm with respect to sale. A firm should neither have a high ratio nor a low ratio.
6.	Expenses ratios	Operating ratio = Cost of Goods sold + other expenses / Sales	Operating ratio shows the operational efficiency of the business. Lower operating ratio shows higher operating profit and vice versa.
		Cost of Goods sold ratio = Cost of Goods sold / Sales	It measures the cost of goods sold per sale.
		Specific Expenses ratio = Specific Expenses / Sales	It measures the specific expenses per sale.
7.	Return on Investments	Return on Assets (ROA) = Net Profit after Taxes / Total Assets $\times 100$ Or (Net Profit after Taxes + Interest) / Total Assets $\times 100$ Or (Net profit after Taxes + Interest) / Tangible Assets $\times 100$ Or (Net Profit after Taxes + Interest) / Fixed Assets $\times 100$	It measures the profitability of the total funds per investment of a firm.
		Return on Capital Employed (ROCE) = (Net Profit after Taxes) / Total capital employed $\times 100$ Or (Net Profit after Taxes + Interest) / Total capital employed $\times 100$ Or (Net Profit after Taxes + Interest) / Total capital employed – Intangible assets $\times 100$	It measures profitability of the firm with respect to the total capital employed. The higher the ratio, the more efficient use of capital employed.
		Return on Total Shareholders' Equity = Net Profit after Taxes / Total shareholders' equity $\times 100$	It reveals how profitably the owner's fund has been utilized by the firm.
		Return on Ordinary shareholders equity = Net profit after taxes and Pref. dividend / Ordinary Shareholder's Equity $\times 100$	It determines whether the firm has earned satisfactory return for its equity holders or not.

Sl. No.	Category	Types of Ratio	Interpretation
8.	Shareholder's ratios	Earnings per Share (EPS) = Net Profit of Equityholders / Number of Ordinary Shares	It measures the profit available to the equity holders on a per share basis.
		Dividend per Share (DPS) = Net profits after interest and preference dividend paid to ordinary shareholders / Number of Ordinary Shares outstanding	It is the net distributed profit belonging to the shareholders divided by the number of ordinary shares.
		Dividend Payout ratio (D/P) = Total Dividend to Equityholders / Total net profit of equityholders Or Dividend per Ordinary Share / Earnings per Share	It shows what percentage share of the net profit after taxes and preference dividend is paid to the equity holders. A high D/P ratio is preferred from investor's point of view.
		Earnings per Yield = Earnings per Share / Market Value per Share	It shows the percentage of each rupee invested in the stock that was earned by the company.
		Dividend Yield = Dividend per Share / Market Value per Share	It shows how much a company pays out in dividends each year relative to its share price.
		Price- Earnings ratio (P/E) = Market Value per Share / Earnings per Share	It reflects the price currently paid by the market for each rupee of EPS. Higher the ratio better it is for owners.
		Earning Power = Net profit after Taxes / Total Assets	It measures the overall profitability and operational efficiency of a firm.
9.	Activity Ratios	Inventory turnover = Cost of goods sold / Average Inventory	It measures how quickly inventory is sold. A firm should neither have a high ratio nor a low ratio.
		Raw Material turnover = Cost of Raw Material used / Average Raw Material Inventory	It shows the velocity at which raw material converted into goods ready for sale. If this ratio is high then the company is efficiently converting raw materials into finished goods.
		Work in Progress turnover = Cost of Goods manufactured / Average Work in process inventory	
		Debtors turnover = Net credit sales / Average trade debtors	It shows how quickly current assets i.e receivables or debtors are converted to cash.
10.	Assets Turnover Ratios	Total Assets turnover = Net sales / Total Assets	It measures the efficiency of a firm in managing and utilizing its assets.
		Fixed Assets turnover = Net sales / Fixed Assets	Higher the ratio, more efficient is the firm in utilizing its assets.
		Capital turnover = Net sales / Capital Employed	
		Current Assets turnover = Net sales / Current Assets	

Supply Chain Management involves planning and management of all activities involved in sourcing, procurement, conversion and logistics management activities. It also includes coordination and collaboration with channel partners, which can be suppliers, intermediaries, third party service providers, and customers.

Objective of Supply Chain Management:

- To ensure smooth functioning of every element of distribution / supply chain - from supplier and manufacturing facilities through warehouses and distribution centers to retailers and stores.
- Minimise cost related to transportation and distribution to inventories of raw materials, work – in- process and finished goods
- efficient integration of suppliers, manufacturers, warehouses and stores; to ensure seamless activity

Component of Supply Chain Management:

(June 2009)

1. **Plan:** In this step a business organisation strategises for managing all the resources that go toward the meeting customer demand for your product and services.
2. **Source:** Choose the suppliers that will deliver the goods and services you need to create your product. Develop a set of pricing, delivery and payment processes with suppliers and create metrics for monitoring and improving the relationships.
3. **Make:** This is the manufacturing step. Schedule the activities necessary for production, testing, packaging and preparation for delivery.
4. **Deliver:** This is the part that many insiders refer to as logistics. Coordinate the receipt of orders from customers, develop a network of warehouses, pick carriers to get products to customers and set up an invoicing system to receive payments.
5. **Return:** The problem part of the supply chain. Create a network for receiving defective and excess products back from customers and supporting customers who have problems with delivered products.

Customer Relationship Management (CRM) - CRM is a business strategy comprised of process, organizational and technical change whereby a company seeks to better manage its enterprise around its customer behaviors. It entails acquiring and deploying knowledge about customers and using this information to increase revenue and achieve cost reduction through operational efficiencies.

(June 2017)

Objectives of CRM

- Understand the customer
- Retain customers through better customer experience
- Attract new customer
- Win new clients and contracts
- Increase profitably
- Decrease customer management costs

Advantages and benefits of CRM

(December 2013, June 2017)

- satisfied customer does not consider leaving
- product development can be defined according to current customer needs
- a rapid increase in quality of products and services
- the ability to sell more products
- optimization of communication costs
- proper selection of marketing tools (communication)
- trouble-free run of business processes
- greater number of individual contacts with customers

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- more time for customer
- differentiation from competition
- real time access to information
- fast and reliable predictions
- communication between marketing, sales and services
- increase in effectiveness of teamwork
- increase in staff motivation

Types of CRM

- **Analytical Customer Relationship Management :** It is basically Customer Data Analysis, its evaluation, modeling and prediction of customer behaviour. In real life situation, Analytical Customer Relationship Management can gather all the data about customers by using data mining and serves as some sort of help during decision-making.
- **Operative Customer Relationship Management:** Operative Customer Relationship Management mainly supports the actual contact with customers conducted by front office workers and general automation of business processes including sales of products, services and marketing. All the communication with the customer is tracked and stored in the Data Base.
- **Collaborative Customer Relationship Management:** Collaborative Customer Relationship Management enables all companies along the distribution channel, as well as all departments in a company, to work together and share information about customers. The goal of Collaborative Customer Relationship Management is maximum sharing of relevant information acquired by all departments with the focus on increasing the quality of services provided to customers.

Illustrations

Illustration 1: Calculate the trend % from the following figures of Rahul Ltd. taking 2008 as the base year and interpret

Year	Sales Revenue (Rs. Rs.000)	Inventories (Rs. Rs.000)	EBT (Rs. Rs.000)
2008	1,992	729	331
2009	2,450	801	455
2010	2,765	836	478
2011	3,131	964	548
2012	3,878	1,264	692

Illustration 2: The following are the Balance Sheet of Maharaj Ltd. as on 31.03.12 and 31.03.13:-

Particulars	31.03.12 (Rs.)	31.03.13 (Rs.)
Current Assets :		
Cash and Bank Balance	23,600	2,000
Debtors	41,800	38,000
Inventory	32,000	26,000
Other Current Assets	6,400	2,600
(A)	1,03,800	68,600
Fixed Assets :		
Land and Building	54,000	34,000
Plant and Machinery	62,000	1,57,200
Furniture	5,800	9,600
(B)	1,21,800	2,00,800
Long term investment (C)	9,200	11,800

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