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财务管理策略

Financial Strategies for the Manager

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内 容 简 介

本书专为非财务经理们学习财务理论而准备。内容包括财务管理中的一系列重要问题。包括财务报表分析、系统的财务评估方法、资产流动性管理与销售增长、流动资本管理、预算、外汇与利率风险管理以及一个非常有用但不易理解的工具——经济增值（EVA）。

图书在版编目(CIP)数据

财务管理策略＝Financial Strategies for the Manager: 英文 / 王锦程，(加)普莱斯特(Priester, C.)著. —北京：清华大学出版社，2009.12

ISBN 978-7-302-19092-9

Ⅰ.财… Ⅱ.①王… ②普… Ⅲ.财务管理-英文 Ⅳ.F275

中国版本图书馆CIP数据核字(2008)第196824号

责任编辑：陈朝晖

责任校对：赵丽敏

责任印制：孟凡玉

出版发行：清华大学出版社　　**地　址**：北京清华大学学研大厦A座

http://www.tup.com.cn　　**邮　编**：100084

社 总 机：010-62770175　　**邮　购**：010-62786544

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质 量 反 馈：010-62772015，zhiliang@tup.tsinghua.edu.cn

印 装 者：北京雅昌彩色印刷有限公司

经　销：全国新华书店

开　本：153×235　**印　张**：14.25　**字　数**：313千字

版　次：2009年12月第1版　**印　次**：2009年12月第1次印刷

印　数：1～2000

定　价：45.00元

本书如存在文字不清、漏印、缺页、倒页、脱页等印装质量问题，请与清华大学出版社出版部联系调换。联系电话：(010)62770177转3103　产品编号：025600-01

Foreword

This book was written well before the worldwide financial crisis of 2008 that plunged the world into a major economic recession. Yet the key messages, conclusions, suggestions and recommendations that are embodied in this book remain valid today.

The fundamental and essential contributing factor that led to this crisis was the excessive reliance on debt financing on the part of individuals, banks and certain governments.

There was a widely held belief that economic growth would continue in most countries and thereby support the strongly rising values of real estate, energy and most industrial resources.

Banks and home owners felt confident that property values would continue to rise, so little thought was given to the possibility of default of property loans. Unfortunately the boom in property, energy and industrial materials prices came to an end and their prices plunged rapidly which in turn led to the worldwide financial crisis with which we are all so familiar.

A major consequence of the financial crisis was that individuals and some banks were forced into a wrenching "financial de-levering" process in which their reliance on borrowed money was reduced significantly. This produced painful consequences, as their balance sheets shrank like snow in the sun, often resulting in bankruptcy.

A by-product of the financial crisis is the serious erosion of trust between debtors and creditors. Trust is a necessary and crucial ingredient that is required if financial and commercial markets are to function smoothly and that trust has been damaged severely by the crisis.

The result has been that seekers of credit have found it very difficult to find it and when found, it comes with far more strings attached – and usually for lesser amounts.

Another financial sector that has been hard hit by the crisis is that sector where Mergers and Acquisitions were being facilitated, particularly those that were initiated by private equity players (see unit eleven).

The main focus of this book has been the financial management of small to medium sized companies whose shares are often privately held and are not publicly traded on exchanges. There is no doubt that conditions for success, and even survival of such companies, have become far more difficult. Not only do they face a market where it has become far more difficult to generate sales, but their bank loans and trade credits (accounts payable) terms and conditions have become more onerous and difficult to obtain.

The same often applies to a company's ability to raise equity capital from external sources. In short, external financing has become much harder to find. This means that companies need to rely more on internally generated funds, which in turn means that very close attention must be paid to their operational efficiency and profit margins.

In addition, policies that emphasize sales growth at the expense of profit margins need to be re-examined (see unit three and five).

Focusing on the company's assets, the manager needs to question constantly the justification of the company owning its assets. "Can the company do without?" should be a constantly asked question.

In particular, a clear understanding of the lessons of Economic Value Added (EVA) analysis will prove particularly useful in trying to survive in these difficult times (see unit ten).

While this book cannot guarantee a company's success, especially in uncertain times like these, it can help managers improve the performance of their company, which will put the company in a stronger position than those that do not and help it weather the tide of tight markets and difficult financial times.

Preface

The book has been written for those who wish to achieve a basic understanding of financial management at either undergraduate or postgraduate. It is aimed primarily at students who are not majoring in financial management but who, nevertheless, are studying introductory-level financial management as part of their course in business, management, economics, computing, engineering or some other area. Students who are majoring in financial management should also find the book useful as an introduction to the main principles which can serve as a foundation for further study. In addition, the book should also give managers of smaller enterprises who do not have a background in Finance a better understanding of the financial strategies and give them the practical tools that can be used to improve the performance of their companies.

The book clearly explains the story that is told by a company's Balance Sheet, its Income Statement and its Flow of Funds Statement. This in turn allows the reader to determine the financial "health", pinpoint the underlying weaknesses and discover the potential strengths of the company that are revealed by those numbers. The book also explains the advantages and disadvantages of various strategies that can be used to improve a company's performance. Attention is given to liquidity management, asset productivity, margin analysis and the dangers and benefits of leverage. Since managing working capital are daily concerns of most managers particular attention is paid to operating cash, receivables, inventory and payables management. Several strategies to maximize their benefits and minimize their costs are described. The threat of liquidity problems, which often plague rapidly growing enterprises, receives specieal attention and strategies to minimize their occurrence are introduced. Calculating the benefits and costs of purchased and/or leased capital assets is made simple through the use of example spreadsheets. Particular attention is paid to the Powerful analytical tool of "economic value added" or EVA. This technique allows managers to maximize the operational and financial performance of the company or assets for which they are responsible.

The book is written in a concise and accessible style by which you are introduced to each topic carefully and there is a gradual building of knowledge, minimizing the use of technical jargon. Where technical terminology is unavoidable, we try to provide clear explanations. All these key terms are listed alphabetically with a concise definition in the glossary towards the end of the book. In addition, mathematical formulae have been kept to a minimum. Through the use of numerous examples, exercises and solved case studies the reader will develop a good grasp of the material as well as learn how to apply the lessons learned.

The author's Banking background sharpened his ability to evaluate companies' strengths, weaknesses and potentials for future success and this is a major focus of this book. His subsequent career in post secondary and graduate management education gave him the skill to share his practical business experience with his students and now with the readers of this book.

Contents

1 Goals of Financial Management

Unit Objective: To understand why a grasp of fundamental financial strategies is important to your employer as well as to yourself. To learn the twin goals of financial management.

Key Words: Assets, Liabilities, Equity, Balance sheet, Income Statement, Flow of Funds Statement

1.1 Introduction

In Finance, we look at a company as a bundle of resources (tools, you may say), whose purpose is to generate income.

These resources are bought with funds from *two* sources—money from *lenders* and *owners*—who in turn demand a "rent" from the company for the use of their money.

This situation is clearly visualized in the Balance Sheet of the company.

A Company's Balance Sheet

<table>
<tr><td rowspan="2">Assets

A bundle of resources that are financed by</td><td>Liabilities

Funds which come from lenders, and</td></tr>
<tr><td>Equity

Funds which are provided by the company's owners</td></tr>
</table>

Left Side Total	=	Right Side Total
A Company can earn Revenues by putting its Assets to good use. In this process it also incurs Expenses.		A Company must pay rent for the use of these funds.

Financial management is divided into two tasks, each associated with one of the two sides of the Balance Sheet.

Task 1: To generate as much income (or benefits, productivity, profitability, yield) as possible from a company's assets, with due regard for the risks involved (left side of the Balance Sheet).
Task 2: To obtain the most economical supply of funds from lenders and owners, with due regard for the risks involved (right side of the Balance Sheet).

The bigger the difference between the "yield percentage earned in Task 1" and the "rent percentage incurred in Task 2," the better the financial performance of the company, as long as that difference is positive, i.e,. greater than zero.

A brief example may clarify this statement. Let us compare two companies, Company x and Company y.

Company x Balance Sheet

Its assets yield a return of 18%, which produces an income of $1.8 million.

Assets $10 million	**Liabilities** $4 million
	Equity $6 million

Its liabilities and equity require an average rent of 15%. This is called Average Cost of Capital.

Company y Balance Sheet

This Company's Asset Yield is 20%, (produces an income of $2 million).

Assets $10 million	**Liabilities** $4 million
	Equity $6 million

This Company's Average Cost of Capital is 12%.

We note that the difference between the "Asset Yield" and the "Average Cost of Capital" of Company y is 20% – 12% = 8% and of Company x is 18% – 15% = 3%. Other values being equal, *and this is an important proviso*, we can conclude that Company Y's financial performance is better than Company x.

Task 1

Let us return to Task 1 and look at the performance of Company x. Remember that its assets generated an income of $1.8 million. Suppose that this company, through superior asset management (for instance, by getting its assets to work harder, by getting rid of unnecessary assets, and/or by smarter asset utilization), succeeds to earn the *same* income of $1.8 million, but at the same time manages to *reduce* its assets from $10 million to $8 million. This would raise the asset yield to ($1.8 mil/$8mil) 22.5% from the original 18%, and the *difference* between "Asset Yield" and "Average Cost of Capital" would rise from the original 3% to a new higher value of (22.5% – 15% =) 7.5%.

Furthermore, the \$2 million reduction in assets would enable the company to do several things; it could reduce the right side of its Balance Sheet by lowering liabilities and/or equities, or it could invest the \$2 million in more productive and profitable new assets that promise to generate even higher asset yields than the 22.5% produced now.

This, in a nutshell, is the aim of financial management—*improve asset yield and minimize the cost of capital in the long run.*

Observation: Let us look again at the underperforming Company x. Assume that the managers improve the Asset Yield (A.Y.%) and Average Cost of Capital (ACC%) by 5%. This would raise A.Y.% to $1.05\% \times 18\% = 18.9\%$ and lower ACC% to $0.95 \times 15\% = 14.25\%$. Notice that the new, improved difference between A.Y.% and ACC% is now $18.9\% - 14.25\% = 4.65\%$ compared to the original difference of 3%. We can see that the company's overall financial performance has increased dramatically by $(4.65/3) - 1 = 55\%$.

Conclusion: Small improvements in A.Y.% and ACC% can significantly improve overall performance.

Exercise #1A

Z Corporation has \$9 million in Assets and \$9 million in Liabilities and Equity. Its Assets generate an operating income of \$1.44 million and the company's Cost of Capital is 15%.

Suppose that through better Asset utilization and operational efficiencies, the company manages to reduce its need for Assets by \$1 million without affecting its operating income.

The management decides to reinvest the \$1 million into a new venture that generates \$200 k in operating profits.

Required: What is the effect of these events on the company's overall financial performance? (See Appendix A for solutions of all exercises)

FINALLY: It should be noted that this whole process also works in reverse. In the event that Asset Yields decline, their effect on the company's overall performance also gets magnified.

Exercise #1B

A company's Asset Yield is 17.5% and its Cost of Capital 14.9%

- Suppose the Asset Yield improves by 8% and the Cost of Capital improves (i.e., falls) by 5%. Calculate the percentage change in the company's overall performance (i.e., the difference between Asset Yield % and Cost of Capital %).
- Do the same if Asset Yield worsens by 10% and Cost of Capital worsens by 5% (based on the original scenario).
- Do the same if Asset Yield worsens by 4% and the Cost of Capital worsens by 10%.

So far we have focused only on Task 1.

1.2 Getting More Mileage Out of a Company's Assets

This will be the major focus of this course because you, as a manager of your company's resources (i.e. Assets), can influence their productivity and thereby affect the yield that these assets produce.

Let us now focus on the right side of the Balance Sheet, i.e., the source of funds with which these assets were obtained. Remember that on page 1 – 2 we said that the second aspect of Financial Management is the task of trying to *minimize the cost of capital in the long run*. This will be the *minor* focus of this course because most line managers usually do not involve themselves *directly* with this task. Of course, *indirectly* you can have a tremendous impact on this task if you, as a manager, can *reduce* your need for assets while maintaining the "output" for which you are responsible.

1.2.1 Important Observation

Maximizing Asset Productivity And Profitability

The search for a higher Asset Yield (doing more with less) is a universal phenomenon. It has made the world of business increasingly less hospitable to the average company.

In the nobler past, a moderately well-run company, whose Asset Yield was steady and comfortably exceeded its Cost of Capital, could happily survive for years.

In today's demanding and relentless business climate, such companies do not survive. You either continuously improve your Asset Yield, just to keep up with your competitors, or you go under. The winners in this new, tough business climate are the companies that manage to produce a growth rate in Asset Yield that is faster than their competitor's growth rate. This new reality pervades the entire industrial world, and today's business entity has to do well in this new reality.

One final observation about Asset Yield and Cost of Capital: the world's financial markets decide what a particular company's Cost of Capital will be. Successful companies are popular with investors and lenders, and as a result they enjoy lower costs of capital. Unsuccessful companies are punished by disappointed investors and lenders with higher costs of capital. This is the cruel reality of the market place—learn to perform well or else!

The good aspect of trying to maximize the difference between Asset Yield and Cost of Capital is that even small improvements in these two percentages are magnified and result in much bigger improvements in the difference between the two percentages.

Readers who are familiar with accounting may safely ignore the material starting with 1.3 up to and including exercise 1D.

1.3 What Information Do the Financial Statements Convey to the Manager

Unit Objective: To be able to interpret the essential information conveyed by a company's Financial Statements so that informed decisions can be made.

1.3.1 A Close-Up of the Financial Statements

Broadly speaking, the purpose of Accounting is:

"To portray the financial course of events of a company and its financial status from time to time."

This portrayal has two aspects:

1. *The recording of economic events as they occur*—basically the function of keeping the books. *There are eight types of economic events*. They are:

(a) The Earning of Revenues,
(b) Incurring of Expenses,
(c) Acquiring of Assets,
(d) Disposing of Assets,
(e) Incurring Debts,
(f) Repaying Debts,
(g) Raising Share Owners' Equity, and
(h) Lowering Share Owners' Equity.

Periodically the cumulative totals from events (a) and (b) are transferred (closed out) to the Owners Equity section of the Balance Sheet. This is called "closing the books."

2. The preparation of financial statements (the Balance Sheet, Income Statement and Flow of Funds Statement).

1.3.1.1 The Balance Sheet

Let us begin by focusing on the Balance Sheet. This statement gives you the state of affairs at a *moment* in time. It freezes the action, so to speak. It shows you:

What you own	What you owe
	What you are worth

Or

alternatively you can say it shows:

What you do	Where the money came from (Lenders)
with the money	and (Owners)

To use more common accounting terminology, the Balance Sheet portrays a company's:

<table>
<tr><td rowspan="2">Those things that a company owns in order to conduct its business</td><td rowspan="2">Assets</td><td>Liabilities</td><td>Money lent to you by Creditors</td></tr>
<tr><td>Equity</td><td>Money invested in the company by the Owners</td></tr>
</table>

A brief aside:
The "Rent" for the use of those two "pools of money" provided by creditors and investors (interest and dividends respectively) are treated totally differently by the Tax Man.

Interest: is a tax deductible expense to the party paying it, whereas
Dividends: are not tax deductible to the payer. The company must pay dividends out of its after tax profit. *This different tax treatment has very important consequences*; more about this later.

Let us return to the Balance Sheet.
Assets are usually portrayed in order of liquidity. A common sequence used is:

Current Assets:
Cash,
Short Term Investments,
Receivables,
Inventories,
Other Current Assets,
such as prepaid expenses.

In a merchandising or manufacturing company, these current assets reflect the transformation of the resources that result in the sale of goods.

Fixed or Capital Assets:
Furniture, Fixtures,
Rolling Stock,
Equipment,
Buildings,
Land.

These are the assets that *enable* you to conduct your business. They are not sold but used.

And

Intangibles: (such as Goodwill, Copyrights, Trademarks, etc.)

On the right side of the Balance Sheet we find:
Liabilities: (shown in order of maturity)
Short-Term Debt
Medium-Term Debt