PERFORMANCE MANAGEMENT

Centre	Responsibility
Revenue centre	Generate revenue
Cost centre	Control costs
Profit centre	Generate revenue and control costs
Investment centre	Separate division/business unit Generate revenue, control costs, make investment decisions

Transfer Pricing:

- Price which one division/business unit sells goods/services to another
- The price will impact the profit made by each division/business unit so it can distort performance

Methods for calculating transfer price:

- Variable cost (a loss will be made by selling division)
- Full cost: variable and fixed costs (no profit will be made by selling division)
- Cost plus: costs plus an agreed mark-up/margin to be made by selling division
- Resale minus: final selling price minus agreed amount
- Opportunity cost: revenue which would have been made by selling goods/services to someone else

ROCE/ROI: % return on investment in division/business unit

$$\frac{\text{Operating Profit}}{\text{Equity + Net Debt}}$$

Residual Income		
Profit	X	Profit of division/business unit
Cost of capital (capital investment x cost of capital %)	(X)	Capital = Net Assets of division/business unit
Residual Income	X	Absolute (not relative %) so difficult to make comparisons

- Managers should only be assessed on factors under their control
- Need to prevent conflict between divisions and encourage collaboration
- Need to prevent performance distortions
- Need to prevent dysfunctional decisions cause by transfer pricing and ROCE/RI

PERFORMANCE ANALYSIS (P&L)

REVENUE			
NUMBER		**REASON**	**TREND/FURTHER ANALYSIS**
Total Revenue Revenue by Stream† Revenue Mix by Stream	v PY* v Budget* v Other streams v Competitor v Market	All streams growing/declining Commercial reason from exam scenario (market growth/decline/ new product/advertising/competitors) Price change and/or volume change (demand (in)elastic to price change)	Best performing stream Growth rate accelerating/slowing Decline accelerating/slowing/stabilising Specific customer/product causing change: Revenue per Customer/Product/Employee Expected to continue / Strategic position
Net Asset Turnover: $\frac{\text{Revenue}}{\text{Equity + Net Debt}}$ Revenue generated from resources	v PY v Budget v Other streams v Competitor v Market v Other industry	Share issue Debt issue Asset revaluation	Growth rate accelerating/slowing Decline accelerating/slowing/stabilising Specific customer/product causing change Expected to continue / Strategic position

†Revenue Streams: Region/Division/Store/Product/Service

*Consider changing basis of comparison to ensure like-for-like comparison (volume/period)

<u>REVENUE</u>

Overall revenue has increased (decreased) impressively (disappointingly) by £x (x%) due to growth in all revenue streams†. Stream A is the best performing stream. This is a strong performance compared to market growth of x%.

Stream† A revenue has increased (decreased) impressively (disappointingly) by £x (x%) due to **reason** (reason from exam scenario / price change and/or volume change).
Comment on the **trend** (growth rate accelerating) / **further analysis** of numbers (specific customer or product causing increase or decrease) / significant movements / future impact.

Stream† B revenue has increased (decreased) impressively (disappointingly) by £x (x%) due to **reason** (reason from exam scenario / price change and/or volume change).
Comment on the **trend** (growth rate accelerating) / **further analysis** of numbers (specific customer or product causing increase or decrease) / significant movements / future impact.

Stream A now accounts for the largest share of revenue (2023% v 2022%) whereas Stream B now has the smallest share (2023% v 2022%).

TOPIC	QUESTIONS
FS Analysis: Performance and Position	M22 Q1.2 Doiry D21 Q1.1 Olib S21 Q1.2 Ordio S20 Q1.1-1.3 Deez Kitchens M20 Q1.2 Nyon (brand positioning) D19 Q1.2 Lumina **J19 Q1.1 Precision Laser Machines – Video Class (view here)** S18 Q1.1 Innotoy **J18 Q1.2 Ten Ten Burgers – Video Class** **M18 Q1.2 Just Houses – Video Class** [redacted]

FINANCIAL APPRAISAL / PROPOSAL EVALUATION

- Revenue:
    - compare size to existing activities/competitors/market
    - consider recent performance of business
    - potential new revenue streams/markets

- Costs:
    - [redacted]

- Profit margin
    - compare size and margin to existing activities/competitors/market

- Rate of return (ROCE/ROI)
    - [redacted]

- Cash
    - [redacted]

- Break-even analysis/margin of safety (see below)
- Question assumptions/identify bias/flex numbers (sensitivity analysis)
- [redacted]
- Identify [redacted]
- Identify [redacted]
- Strategic, Operating and Financial issues (see table)
- Conclusion on action to take with reason
- Recommendations: [redacted]

BREAK EVEN ANALYSIS	**£ Per Unit**	**Units**	**Total**
Revenue (selling price)	X	X	X
Variable costs	(X)	(X)	(X)
Contribution to Fixed Costs and Profit	**X**	**X**	**X**
Fixed Costs			(X)
Profit/Loss			**X/(X)**

Number of units to be sold to break-even (no profit or loss):

Fixed Costs
Contribution per unit

Number of units to be sold to reach a certain profit:

[redacted]

Amount of revenue to break-even/target profit:

Fixed Costs (+target profit)
[redacted]

Margin of safety: [redacted]

If resources are limited then prioritise products/services which have highest contribution per limited resource

STRATEGIC	OPERATIONAL	FINANCIAL
Industry: ▪ Growth potential ▪ Barriers to entry (capex, brand) ▪ Supplier/customer power ▪ Substitute products/services ▪ Competitor rivalry ▪ Exit costs ▪ External factors (PESTEL) ▪ Industry life cycle ▪ Experience/resources/competencies	Supplier: ▪ Capacity ▪ Consistency/reliability ▪ Lead times/delivery ▪ Quality/Expertise ▪ Technology ▪ Integration/collaboration ▪ Flexibility ▪ Inventory (Just In Time) ▪ Dependency/relationship ▪ Overseas (risk, regulation, tariffs, culture)	Revenue ▪ Other streams / potential new streams ▪ Future changes ▪ Seasonality
Company strategy: [redacted]	Production: [redacted]	Costs [redacted]
Growth opportunities: ▪ New products/services ▪ New markets/customers ▪ Diversification (synergies, risk) ▪ Focus on core business ▪ Overseas (risk, regulation, tariffs, culture) ▪ Standardised product v local adaption	Staff: [redacted]	Profit ▪ Margins (GPM/OPM) ▪ ROCE
Control: [redacted]	[redacted]	Cash ▪ Receivables, payables, inventory ▪ Capex ▪ Future changes
[redacted]	Technology: [redacted]	Financing [redacted]