

## 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

Operating Profit

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	v PY*	All streams growing/declining
Revenue by Stream†	v Budget*	Commercial reason from exam scenario (market growth/decline/new product/advertising/competitors)
Revenue Mix by Stream	v Other streams	Price change and/or volume change (demand (in)elastic to price change)
	v Competitor	
	v Market	
Net Asset Turnover: <u>Revenue</u> / Equity + Net Debt	v PY	Share issue
Revenue generated from resources	v Budget	Debt issue
	v Other streams	Asset revaluation
	v Competitor	
	v Market	
	v Other industry	

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

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

**REVENUE**

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%.

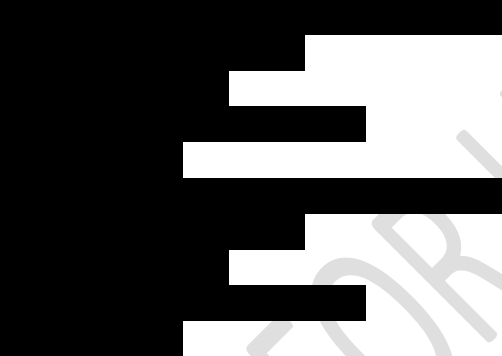
Stream† A revenue has increased (decreased) impressively (disappointingly) by £x (x%) due to **reason** (reason from exam scenario / price change and/or volume change).

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
<p>FS Analysis: Performance and Position</p>	<p>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  <b>J19 Q1.1 Precision Laser Machines – Video Class (view <a href="#">here</a>)</b>  S18 Q1.1 Innotoy  <b>J18 Q1.2 Ten Ten Burgers – Video Class</b>  <b>M18 Q1.2 Just Houses – Video Class</b></p> 

SAMPLE NOT FOR USE

## FINANCIAL APPRAISAL / PROPOSAL EVALUATION

- Revenue:
  - compare size to existing activities/competitors/market
  - consider recent performance of business
  - potential new revenue streams/markets
  
- Costs:
  
- Profit margin
  - compare size and margin to existing activities/competitors/market
  
- Rate of return (ROCE/ROI)
  
- Cash
  
- Break-even analysis/margin of safety (see below)
- Question assumptions/identify bias/flex numbers (sensitivity analysis)
- 
- Identify
- Identify
- Strategic, Operating and Financial issues (see table)
- Conclusion on action to take with reason
- Recommendations:

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

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

$$\frac{\text{Fixed Costs}}{\text{Contribution per unit}}$$


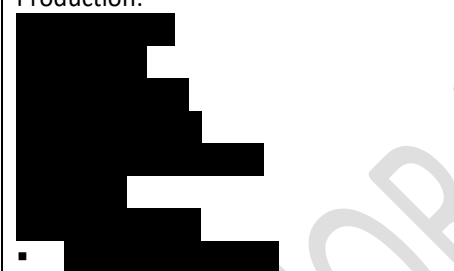






Number of units to be sold to reach a certain profit:

Amount of revenue to break-even/target profit:

$$\frac{\text{Fixed Costs (+target profit)}}{\text{Contribution per unit}}$$

Margin of safety:

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

STRATEGIC	OPERATIONAL	FINANCIAL
<b>Industry:</b> <ul style="list-style-type: none"> <li>▪ Growth potential</li> <li>▪ Barriers to entry (capex, brand)</li> <li>▪ Supplier/customer power</li> <li>▪ Substitute products/services</li> <li>▪ Competitor rivalry</li> <li>▪ Exit costs</li> <li>▪ External factors (PESTEL)</li> <li>▪ Industry life cycle</li> <li>▪ Experience/resources/competencies</li> </ul>	<b>Supplier:</b> <ul style="list-style-type: none"> <li>▪ Capacity</li> <li>▪ Consistency/reliability</li> <li>▪ Lead times/delivery</li> <li>▪ Quality/Expertise</li> <li>▪ Technology</li> <li>▪ Integration/collaboration</li> <li>▪ Flexibility</li> <li>▪ Inventory (Just In Time)</li> <li>▪ Dependency/relationship</li> <li>▪ Overseas (risk, regulation, tariffs, culture)</li> </ul>	<b>Revenue</b> <ul style="list-style-type: none"> <li>▪ Other streams / potential new streams</li> <li>▪ Future changes</li> <li>▪ Seasonality</li> </ul>
<b>Company strategy:</b> 	<b>Production:</b> 	<b>Costs</b> 
<b>Growth opportunities:</b> <ul style="list-style-type: none"> <li>▪ New products/services</li> <li>▪ New markets/customers</li> <li>▪ Diversification (synergies, risk)</li> <li>▪ Focus on core business</li> <li>▪ Overseas (risk, regulation, tariffs, culture)</li> <li>▪ Standardised product v local adaption</li> </ul>	<b>Staff:</b> 	<b>Profit</b> <ul style="list-style-type: none"> <li>▪ Margins (GPM/OPM)</li> <li>▪ ROCE</li> </ul>
<b>Control:</b> 		<b>Cash</b> <ul style="list-style-type: none"> <li>▪ Receivables, payables, inventory</li> <li>▪ Capex</li> <li>▪ Future changes</li> </ul>
	<b>Technology:</b> 	<b>Financing</b> 