Strategic Financial Management

Lecturer: Alexander I. Zaporozhsky

Course description
Currently, the theory and practice of financial management offers a variety of metrics to measure corporate performance. However, most of companies use the system of the operational control based on the comparison of planned and actual results. However, application of this approach provides limited possibilities to estimate the success of long-term strategic tasks implementation.

This course is focused on the strategic aspects of the corporate management and methodological issues for development of value-based management systems. A special attention is devoted to measures and approaches of the corporate strategy effectiveness evaluation and strategy monitoring.

Teaching objectives
- Understand the limitations of the traditional corporate performance metrics
- Get an overview of the Value-Based Management (VBM) concept
- Examine major approaches to the firm valuation and learn their practical applicability
- Examine the most widely used VBM measures and models, understand their advantages and limitations
- Examine the issues of VMB methods implementation in practice
- Get acquainted with the key principles of the financial modeling to assess the firm’s value and make the strategic decisions.

Teaching methods
The learning process is organized in the form of the seminars i.e. in the form of an interactive discussion. The course also envisages individual learning of some of the materials.

Assessment
The group case involves building financial model, valuation exercise and calculation of the major VBM metrics based on the real company data. It is assumed that the case will be solved by a small group of students (4–5 persons).
The final exam consists of 2–3 open questions in the format of an essay and
1–2 problems (similar to the problems discussed during the seminars). The
maximum score is 20 (50% — for open questions, 50% — for the problems).
In case of talking/cheating suspicion during the exam — a student receives
the penalty of –5 points for the first warning, exam results are cancelled after
the second one.

Grade determination
The final score consists of the following components:

• 10% — participation in the seminar discussions
• 25% — homework
• 25% — group case
• 40% — final exam

Main reading
1. Коупленд Т., Муррин Дж. Стоимость компании: оценка и управление.
М.: Олимп-бизнес, 2007
2. Ameels A., Bruggeman W., Scheipers G. Value Based Management: An
3. Madden B. CFROI Valuation Model. // Journal of Investing, 7 (Spring
4. Copeland T., Dolgoff A. EBM: Outperform Expectations with Expectations-
Based Management™
5. Ottosson E., Weissenrieder F. CVA, Cash Value Added — a new method
for measuring financial performance // Gothenburg Studies in Financial
6. Ивашковская И.В. Управление стоимость компании: вызовы российскому
113–132.
7. Ивашковская И.В. Управляемая стоимость. // Журнал секрет фирмы,
4 (20) — 2003.
8. Ивашковская И.В. Шпаргалка для собственника. // Журнал секрет
Course outline

1. Value-based Management (VBM) — A New Paradigm of the Financial Management

1. Corporate investment and financing decisions. Sources of financing: dept and equity capital. Financial intermediaries and financial market: opportunities and limitations for the companies. Corporate Finance and its role and function in the company.


3. Major components of VBM. Corporate value management cycle.

4. The VBM development factors.
   (a) Influence of the intra-business processes. The phenomenon of the financialization.
   (c) Corporate dissatisfaction with existing performance measurement systems: problems with traditional accounting and cash flow measures.
   (d) Activism of the consultancies in marketing VBM as a consulting product.

5. Value maximization as a corporate objective function: fundamental assumption of the VBM. Corporate objective function. Value maximization theory. Stakeholders theory. Definition of «stakeholder». Arguments for value maximization theory.

Required literature:


Recommended literature:


4. Ивашковская И.В. Система стоимостных координат. // Журнал секрет фирмы, 6 (22) — 2003.


2. Value in Strategic Financial Management

1. What is company’s value and how it can be measured? Importance of shareholder value creation. Technology of contemporary firm valuation. Major approaches to firm valuation: income, market and cost approaches.


5. The link between corporate strategy and firm’s value. Firm’s value as a corporate strategy efficiency criterion. Financial assessment of the corporate strategy. What should be managed: intrinsic value or market capitalization?

Required literature:


Recommended literature:


3. Corporate investment decisions and their performance analysis

1. Investment project: main characteristics and types. Free cash flows as a base for project efficiency analysis. The elements of free cash flow at different stages of investment project realization: initial investments, operating cash flows during the life of the project, terminal cash flows. Sunk costs and their treatment in investment analysis. Treatment of depreciation and amortization and other non-cash expenses. The role of investment in working capital. Interrelations of projects and cannibalization effect. The role of time factor in investment projects payback analysis.

2. Investment project criteria: Net Present Value (NPV) of the project, payback period, discounted payback period, internal rate of return (IRR), profitability index. Limitations and pitfalls of the investment criteria. Competing (mutually exclusive) projects and the IRR rule.

3. Investment criteria for competing recurrent projects (long- versus short-lived equipment): chain and equivalent annual cost methods.
Required literature:


Recommended literature:


4. Corporate financing decisions. Debt and hybrid capital of the firm and its valuation

1. Type of debt capital: main characteristics. Nominal and real interest rate. Bank loan and credit facility (credit line). Effective interest rate. Floating and fixed interest rate. Secured and unsecured debt. Types of collateral.


Required literature:

5. Financial Modeling: The Fundamentals and Practice


6. Typology of VBM models. Change in shareholder wealth-based models: TSR, TBR, MVA, ER


2. Total Shareholders Return (TSR) model. Description and calculation formula of TSR metric. Value creating/destroying criterion in TSR model. Area of applicability, advantages and limitations of TSR model.


Required literature:


Recommended literature:


7. Residual-income based VBM models. EVA/EP


Required literature:


Recommended literature:


8. **CFROI model**

   CFROI model. Genesis of the model. Description and calculation formula of CFROI metric. List and economic reasoning for major adjustments. Value creating/destroying criterion in CFROI model. Area of applicability, advantages and limitations of CFROI model.

   Required literature:


9. **Cash Value Added (CVA) and Modified Cash Value Added (MCVA) models.**


Required literature:


4. Запорожский А.И., Ивашковская И.В. Оценка деятельности: новый взгляд // Журнал «Управление компанией» №3, 2006

10. Expectations-Based Management™ (EBM) model

1. EBM™: definition, calculation formula. Major characteristics of the model. Comparison of EVA® and EBM™ models. Definition of TSR from EBM™ perspective.


Required literature:

1. Copeland T., Dolgoff A. EBM: Outperform Expectations with Expectations-Based Management™


### Distribution of hours

<table>
<thead>
<tr>
<th>#</th>
<th>Topic</th>
<th>Total hours</th>
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<td>Value-based management — a new paradigm of the financial management</td>
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<td>Value in Strategic Financial Management</td>
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<td>3.</td>
<td>Corporate investment decisions and their performance analysis</td>
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<td>4.</td>
<td>Corporate financial decisions. Debt and hybrid capital and its valuation</td>
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<td>5.</td>
<td>Financial modeling: The fundamentals and practice.</td>
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<td>6.</td>
<td>Typology of the VBM-models. Change in shareholder wealth-based models: TSR, TBR, MVA, ER</td>
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<td>7.</td>
<td>Residual income-based VBM models. EVA/EP</td>
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