Strategic financial management

Topic to be covered

1. Financial strategy and planning
2. Project planning and control
3. Risk evaluation and capital budgeting
4. Dividend and retention policies
5. Valuation of business
6. Analysis of risk and un certainty
7. Business restructuring and industrial sickness
8. Designing capital structure
9. Operating and financial leverages

What is strategy?

- **Strategy** :- where the organization want to go to fulfill its purpose and achieve its mission , it provides a frame work for guiding choices which determine the organizational nature and direction and these choices relates to the organizations products or services , markets , key capabilities , growth , return on capital and allocation of resources
- in short it is declaration of intent of the organization

What is Strategic Planning?

- A systematic analytical approach which reviews the business as a whole in relation to its environment with the object of the following .
- Developing an integrated , coordinated and consistent view of the route the company wishes to follow
- Facilitating the adaptation of the organization to environmental changes
- Process to establish priorities on what you will accomplish in the future
- Forces you to make choices on what you will do and what you will not do
- Pulls the entire organization together around a single game plan for execution
- Broad outline on where resources will get allocated

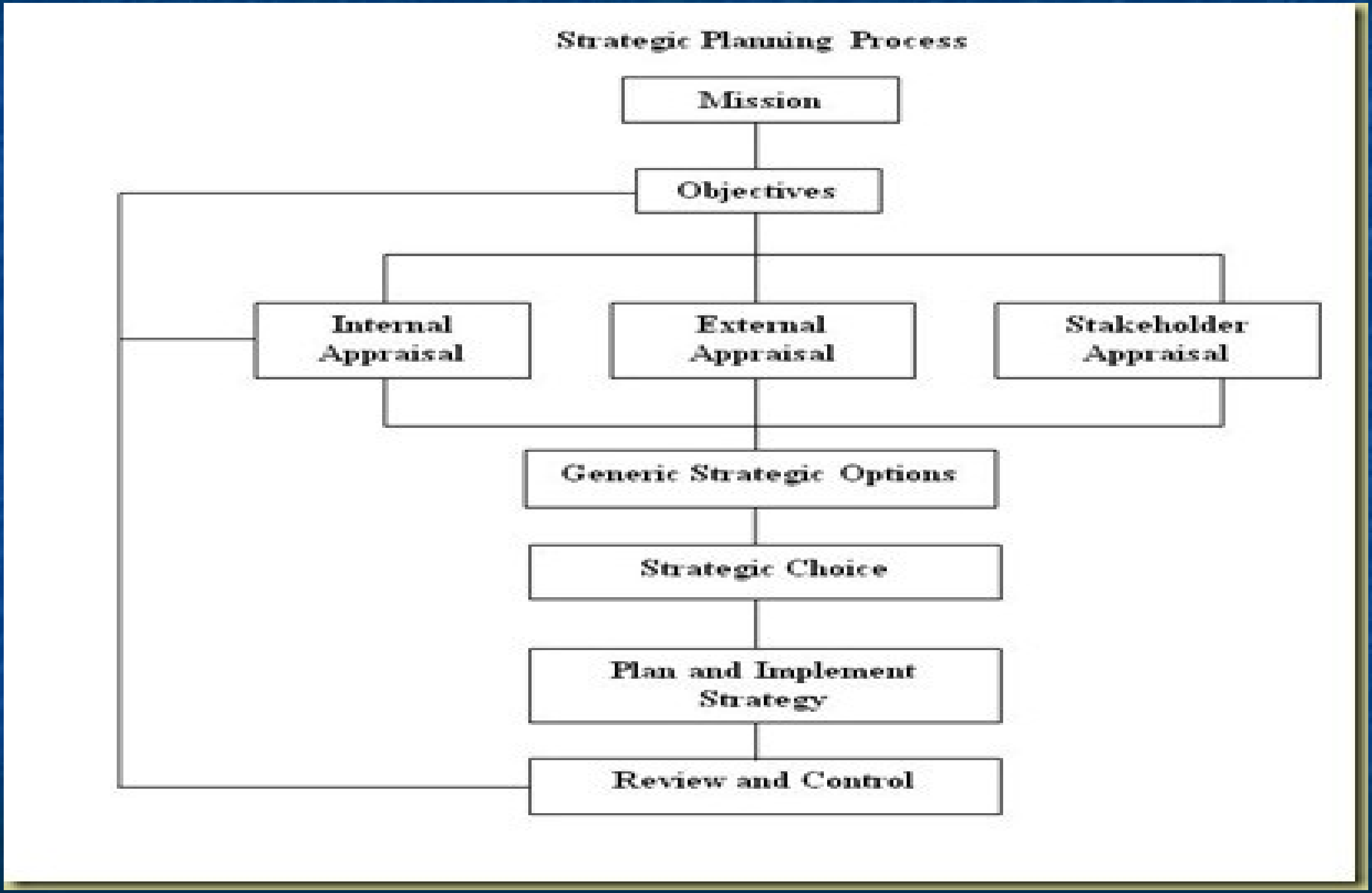
Competitive forces for formulating and implementing business strategy :-

1. The threat of new entrant.
2. The threat of substitute product or services.
3. The rivalry amongst the existing players of industry.
4. The bargaining power of supplier.
5. The bargaining power of consumer.

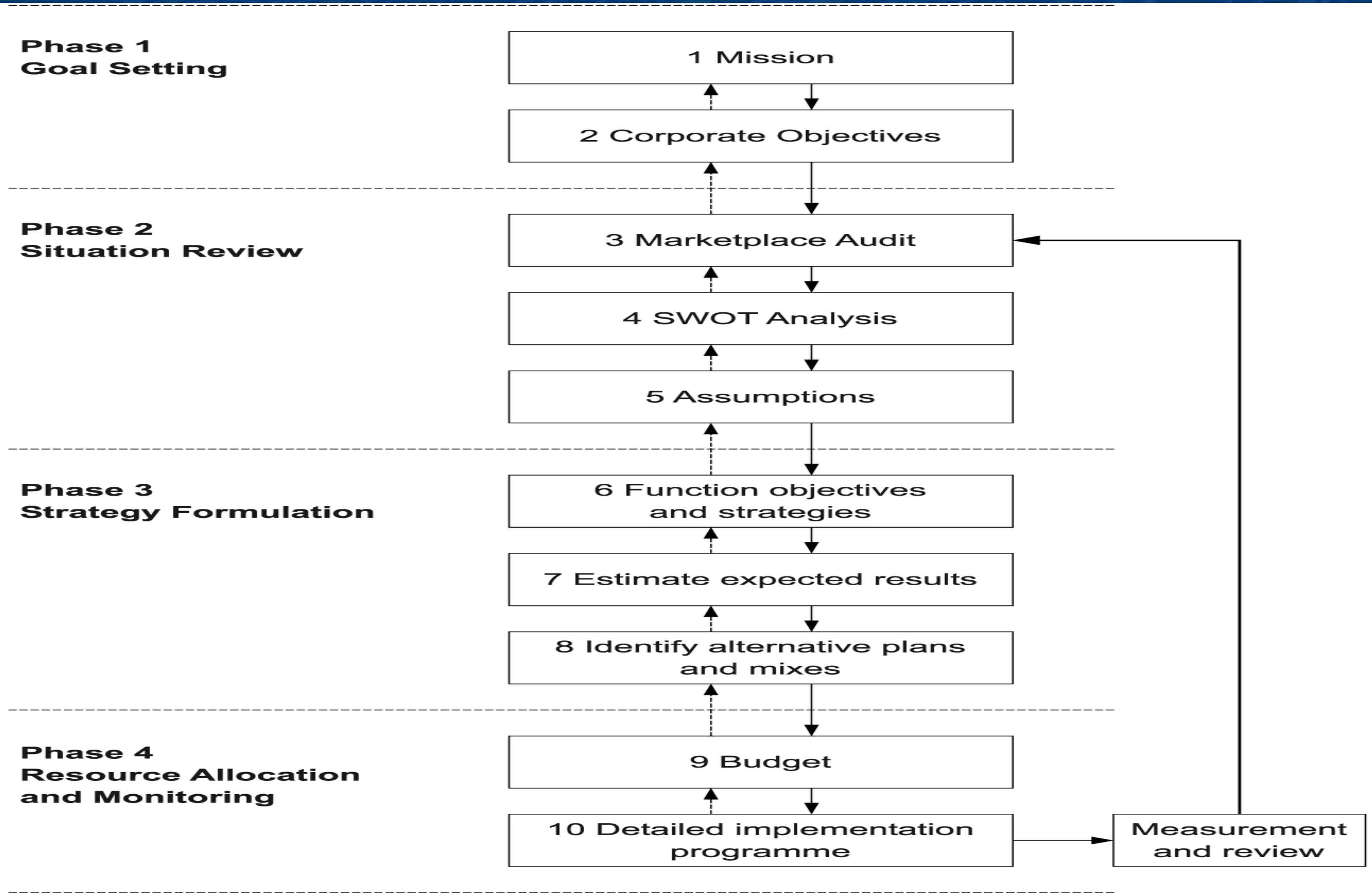
Strategic planning Process

- Study the external and internal environments.
- Identify marketplace opportunities and threats.
- Determine how to use core competencies.
- Use strategic intent to leverage resources, capabilities and core competencies and win competitive battles.
- Integrate formulation and implementation of strategies.
- Seek feedback to improve strategies.

Strategic planning process



Strategic planning process of McDonald



Source: Adapted from McDonald (1996)

Economic environment of the business

International factors

- Develop communities like European union
- Foreign exchange rates of countries
- Inflation, interest and wages rates
- Economic and trade agreement
- Entry barriers
- Globalization and liberalization of trade
- Double taxation relief agreements
- BOP and BOT
- Monetary and economic policy
- Personal and corporate tax rates
- Political situation

Internal factors

- Inflation rate
- GDP
- Personal and corporate tax rates
- BOP and BOT
- Foreign exchange rates of countries
- Monetary and economic policy
- Government policy and subsidy
- Fiscal deficit
- Entry and exit barriers
- Un employment rates
- Availability of technology
- Man power

Organizational factors

- Nature of business
- Size of business
- Expectation of market return
- Assets and liability structure of firm
- Efficiency of the firm
- Ownership pattern
- Age of the business
- Liquidity of the firm
- Technology adapted
- Efficiency of human resource
- ROI generated

Strategic financial management

- It is a long range in the scope and mainly focus on the organization on whole. the concept is based on the present scenario organization and setting up the target to achieving the context of an intelligent and knowledgeable anticipation of changes in the environment.
- It should enables the firm to allocation of funds, capitalizations of relative strength, mitigations of weakness, early identification of shifts in environment counter action, reduction in financial cost. etc

What is Financial Forecasting?

- It is a Part of Planning process.
- They are inferences as to what the future may be.
- Extends over a time horizon.
- Based on:

i. Economic assumptions (interest rate, inflation rate, growth rate and so on).

ii. Sales forecast.

iii. Pro forma statements of Income account and Balance sheet.

iv. Asset requirements.

v. Financing plan.

vi. Cash Budget

Techniques of Financial forecasting.

- Performa Financial Statements.

:- Percent of Sales Method

:- days sales method

:- Income statements and balance sheet

- Cash Budgets. Operating Budgets. Sales Budget
- Simple linear Regression method
- Multiple regression method
- Projected fund flow
- cash flow method

Performa Financial Statements

- A comprehensive look at the likely future financial performance.
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- Pro forma Income Statement. (Represents the operational plan for the whole organization.)
- Pro forma Balance sheet. (Reflects the cumulative impact of anticipated future decisions).

Preparation of Pro Forma Income Statements

Percent of Sales Method

- Assumes that future relationship between various elements of cost to sales will be similar to their historical relationships.
- These cost ratios are generally based on the average of previous two or three years.
- For example, Cost of Goods sold may be expressed as a percentage of Sales.

Performa Financial Statements

- Day sales method

It is traditional method used to forecast the sales by calculating the number of days sales and established its relation with the balance sheet items to arrive at the forecasted balance sheet. Specially emphasized on firms funs requirements

Pro forma Balance sheet

Projections for Balance sheet can be made as under:

- Employ Percent of Sales method to project items on the asset side, except “Investments” and “Misc Exp & Losses”.
- Expected values for Investment and Misc exp can be estimated using specific information.
- Use Percent of sales method to project values of current liabilities and Provisions. (Also referred to as ‘spontaneous liabilities’)
- Projected values of R & S can be obtained by adding projected retained earnings from P&L Performa statement.

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5. Projected value for Equity and preferential capital can be set tentatively equal to their previous values.

6. Projected values for loan funds will be tentatively equal to their previous level less repayments or retirements.

5. Compare the total of asset side with that of liabilities side and determine the balancing figure. (If assets exceed liabilities, the balancing figure represents external funding requirement. If liabilities exceeds Assets, the balancing item represents 'surplus available funds')

Cash budget, operating budget and sales budget.

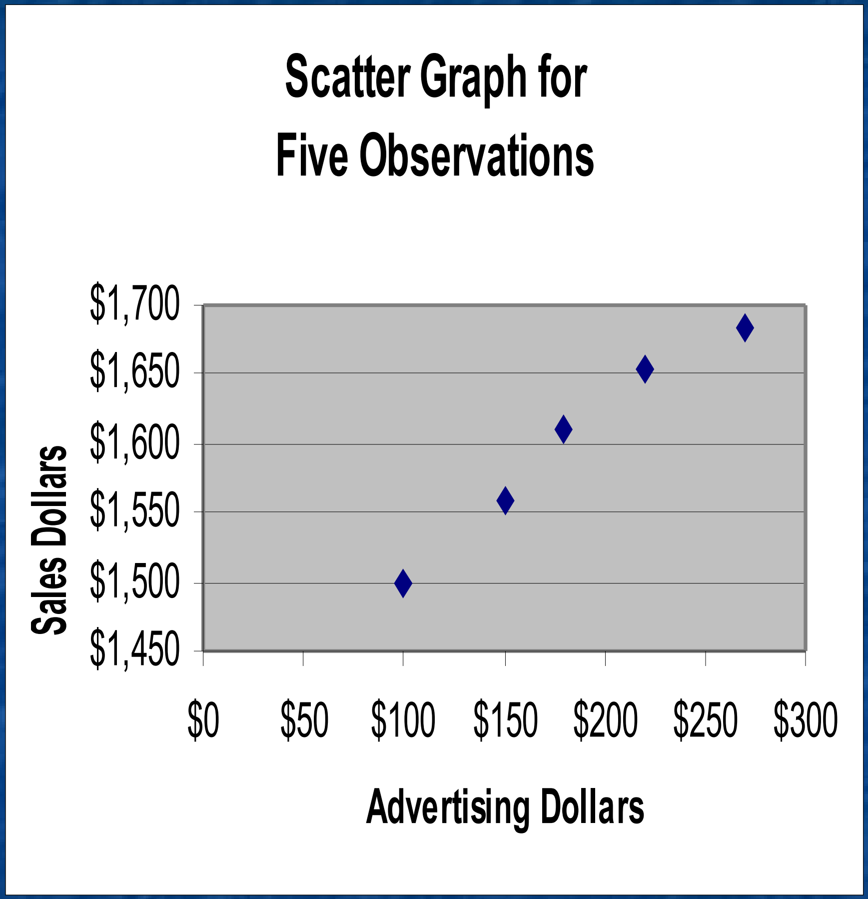
- A good example of short-term financial planning is the Cash Budget. The Cash Budget is an estimate of future cash inflows and outflows. Cash Budgets are often included with the Budgeted Balance Sheet. However, it should be noted that Cash Budgets are not widely used as a general forecasting tool since they are specific to one account, namely cash. Instead, Cash Budgets are often used by Cash Managers and Treasury personnel for managing cash.

Simple linear & Multiple regression method

- A statistical approach can be used for forecasting. We can rely on the average relationships between a dependent variable and an independent variable. Simple regressions look at one independent variable (such as sales pricing or advertising expenses) whereas multiple regressions consider two or more variables (such as sales pricing and advertising expenses together). Regression analysis is very popular for forecasting sales since it helps us find the right fit over a range of observations. For example, if we plot out the following observations, we can prepare a scatter graph and find the right fit:

Example of regression method

Advertising Exp. Dollars	Sales
$ 100	$ 1,500
$ 150	$ 1,560
$ 180	$ 1,610
$ 220	$ 1,655
$ 270	$ 1,685



Projected fund flow and cash flow.

- It is a detailed projected statements of income realized in a cash as well as credit income and expenditure of a firm. cash flow mainly focus on cash inflows and out flows of various details represents in balance sheet and income statements
- Fund flow mainly focus on working capital requirement and application of various sources of fund and utilization of that resources of the firm affecting balance sheet format.