

Corporate Financial Health Check - Principles

When assessing a corporate's financial health and sustainability, focus should be on a firm's profitability, operating efficiency, state of liquidity and solvency. Ideally, such checks should also help to determine whether the underlying business will create shareholder value long-term.

There are numerous ways to determine current value creation as well as its future potential for both, a corporate as such, as well as its shareholders. To start with, from a strategic point of view, a firm's positioning within its market segment and vis-à-vis its competition is key: This is usually assessed qualitatively. Michael Porter, among others, has undertaken groundbreaking research in this area. His 5-forces framework helps to evaluate the strength of a firm's current position as well as develop sustainable business strategies.

In this context, value maximization may be just one of the goals of a firm: For an investor community increasingly focused on ESG (environmental, social, governance matters), long-term sustainability, for instance, is becoming ever more relevant. - Some of the oldest firms in Asia or Europe have been around for centuries. Whereby the prime reason for their sustainability is found in their unique corporate cultures: The ability to reinvent, swiftly absorb and adapt to a changing environment as well as spot and grab opportunities.

Also, commonly quoted drivers for value creation, such as revenues, costs or investments and related financial metrics can't capture the entire spectrum of value-enhancing aspects, also including qualitative parameters (e.g. customer loyalty and satisfaction, product quality). - In any case, a solid and profound corporate strategy will link corporate objectives with specific employee activities and support them. A range of management tools such as balanced scorecards can help monitoring, correcting and designing incentives.

A company is generally regarded as fundamentally "healthy" if it creates value medium- and long-term. Implicitly, this should ultimately also be reflected in value accretion for its shareholders, not least by the generation of free cash flows, with returns of

committed capital higher than its respective costs. - Whereby shareholder value creation may not immediately translate into a firm's higher stock price: Long-term, this should tend to be the case, though, as ultimately a stock price is an interpretation by the market.

By times, stocks can be under- or overvalued, not least caused by supply or demand overhang, or by an industry having come into or going out of fashion, or merely by some difficult to follow, perhaps even irrational psychological phenomena. It is corporate management's task to be on top of these dynamics, also having a clear understanding of investors' motives, not least: Is the firm's shareholder base giving preference to stable dividends or expecting an increase in the stock price? - Observations like this do not only underline the importance of investor relations, but may also justify transactions with a focus on unlocking value, such as restructurings, spin-offs or a re-levering of the balance sheet.

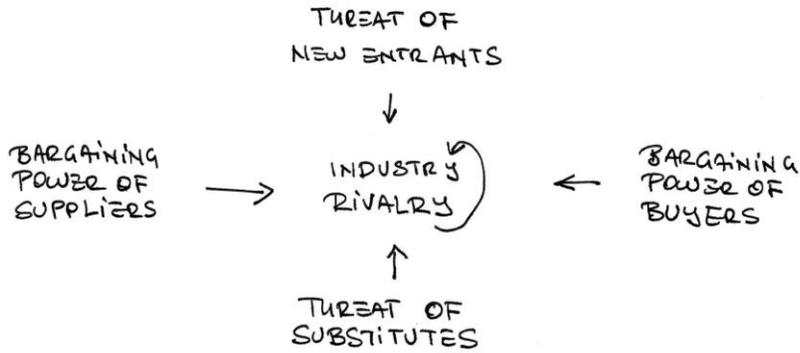
Shareholder value creation can be measured by parameters such as (disclosed) economic profit or the generation of Economic Value Added (EVA). Whereby, most likeminded approaches in this context are forward-looking, based on future, expected cash flows: For outsiders, especially retail investors, lacking access to crucial data and information, such methodologies are often difficult or impossible to apply.

Reasonably fast-to-apply financial health check tools should provide a momentary snapshot and answer following questions:

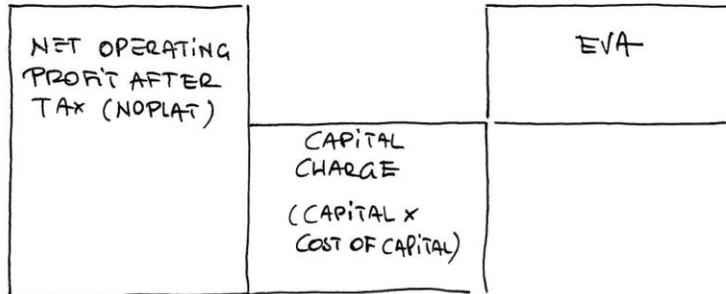
- Is the company an attractive investment for a shareholder?
- Does it make sense to continue the firm's business and operations?
- Are creditors sufficiently safe?
- Is the firm reasonably liquid?
- Does the firm have access to additional liquidity and funding, if needed?

Of course, there are numerous additional aspects one may want to investigate, such as: The sustainability of a firm's dividend policy, its ability to fund further growth, or how its cost of capital could be further optimized. However, a brief 5-minute analysis (see following sections) should already provide valuable first insights.

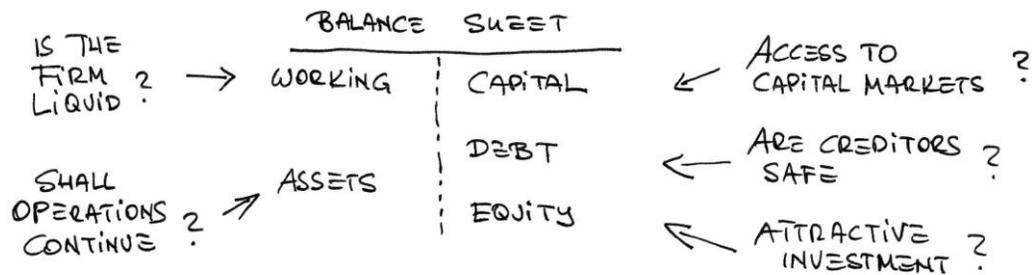
PORTER'S FIVE FORCES FRAMEWORK



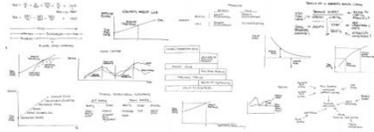
ECONOMIC VALUE ADDED (EVA)



CORPORATE HEALTH CHECK - BASICS

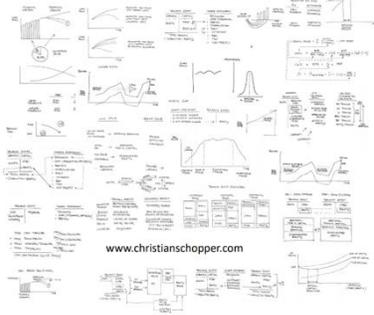


For more concepts click on:



Corporate Finance Concepts

Christian Schopper



COPYRIGHT www.christianschopper.com - DO NOT COPY OR PASTE