

A Book Review of “Strategic Financial Management : Managing for Value Creation” by Dr. Prasanna Chandra

* *Kiran Kumar K. V.*
** *P. S. V. Balaji Rao*

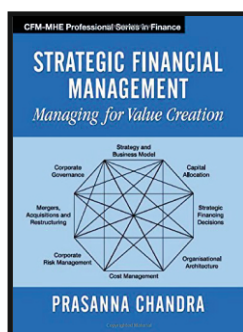
Abstract

Percolation of finance theory, frameworks, and concepts into corporate strategic corridors is presented with a macro, yet a step-by-step approach using the “Eight Levers” of “Value Octagon”. Each lever is interconnected with each other, symbolically and literally in the book - *Strategic Financial Management: Managing For Value Creation* - written by Dr. Prasanna Chandra. This book review explains the three broad sections of the text and explains the concept of the value octagon with highlights from the book. The aim of this book review was to appreciate the author's thought process of fitting the finance function into realms of strategy and thereby create a path for firms to approach the objective of value maximization. The thrust area of this book review was to further the discussions of strategy formulation and implementation, while finance is unseparated from the process. The review also discussed examples of real-life companies as well as opinions of various other authors and consulting groups on the subject-matter, in addition to the author's opinion. The review concluded that the value octagon and its eight value-driving levers proposed by the author encapsulate the broad areas of top management agenda in their pursuit of maximized intrinsic value.

Key words : strategic finance, intrinsic value, value octagon

JEL Classification : G30, G31, G32, G34, M10, M190

Paper Submission Date : January 20, 2016 ; **Paper sent back for Revision :** June 3, 2016 ; **Paper Acceptance Date :** September 10, 2016



Book :	Strategic Financial Management : Managing for Value Creation
Author:	Prasanna Chandra
Publisher:	McGraw Hill Education (India) Private Limited
Edition:	First Edition
Price:	₹ 674
Pages:	433 Pages
Binding:	Paperback

Corporate strategy and planning were, for a long time, viewed as a function of top management, and finance, like any other function, was only a subsidiary that provided requisite inputs. The finance function was restricted in most cases to be a day-to-day funds controller. Over the years, thanks to engineered solutions emerging from the domain, the larger issues of corporates get addressed. The superseding growth of

* *Associate Professor - Finance and Research Scholar*, International School of Management Excellence (ISME), 88, Chembanahalli, Near Dommasandra Circle, Sarjapur Road, Bangalore - 562 125. E-mail: kirankvknet@gmail.com

** *Professor and Head*, Dept. of MBA, Vidyavardhaka College of Engineering , Gokulam, 3rd Stage, Mysore - 570 002, Karnataka. E-mail : psvbalajirao@gmail.com

investment finance over corporate finance has also contributed heavily towards giving a strategic perspective to the finance function. Theories of strategic cost management have brought out the important principle that effective cost management will throw light on the strategic course of action that a company has to follow, and in turn, the strategic action will dictate the type of cost records one will need to monitor (Parasuraman, 2014). Porter's value chain analysis, strategic positioning analysis, and competitive strategies propositions impressed upon consuming financial inputs for value maximization. It is in this context the text book : *Strategic Financial Management: Managing for Value Creation* (Chandra, 2014) was written by Dr. Prasanna.

Dr. Prasanna Chandra is currently the Director of Centre for Financial Management (www.cfm-india.com), who was a Professor of Finance at Indian Institute of Management, Bangalore for nearly two decades. Having been a veteran teacher in finance area and also being a member of boards of several companies and committees of regulatory bodies, the author seems to have derived a contextual view of organization running. He is able to dissect the dynamics of the same into a set of tasks and present the same with a broader, and at the same time, step-by-step perspective. This being his eighth text draws content from his previous books as well.

The author presents a top management checklist for strategic planning whose underlying principles are derived from the finance way of thinking. The book is based on the universally accepted premise that businesses operate to maximize the intrinsic value of a company in a legal, ethical, socially conscious, and environmentally responsible manner.

Finance, as a discipline, can be broadly sub-divided as corporate finance and investment finance, the former dealing with the dynamics of the functional role played by the managerial staff of a company. He uses finance and its concepts to find solutions for problems faced by firms. Whereas, the latter, investment finance, deals with the role of an outsider, say an analyst, valuer, lender, banker, regulator, or even a trader trading in the stock of a firm, who is constantly wanting to be updated on the actions of the firm as well as attempting to project the future courses the firm will take. His use of finance concepts would enable a reader to understand the firm's competencies in generating value addition in the foreseeable future. Strategic finance for investment financiers is to understand the strategic take of a company under analysis ; whereas, for the corporate financier, it is about how to create such a positive outlook through right decisions.

More precisely, given that outsider stakeholders are expecting the decision-makers to maximize the intrinsic value of a firm, the decision-makers' focus narrows down to all those decisions that create such a value-addition. The book provides the framework (through the value octagon) for decision-makers to focus on all these aspects as well as only those decision areas that enhance the intrinsic value of a firm.

Objective of the Book Review

The book marries strategy and finance for eternity, and that's something which intrigues the reader. The book is also an effective read because simple English with contemporary examples are used. The aim of this review is to appreciate the author's thought process of fitting finance function into realms of strategy and thereby create a path for firms to approach the objective of intrinsic value maximization.

Three Sections of the Book

Strategic financial management is not any new jargon in the world of financial academia. There are thousands of publications across the globe on the subject matter. While most texts re - title the subject of financial management as SFM, that - from one perspective - is veracious, there are significant most publications calling cost management to be SFM. These are mostly those who have linked regular financial management practices to that of business strategy. This book stands apart on this count. It acts as an extension to the financial management practitioner's

already existing knowledge that puts forth certain 'levers' - as the author calls them - that drive the value of a firm.

The plot of the book is entangled through a web of eight levers that drive the value of the firm - named as the *Value Octagon*. The consensus here is that a corporation's ability to be optimum in handling these levers will decide a firm's potential of maximizing its intrinsic value. The web is depicted in the Figure 1.

The book can be broadly classified into three sections. The first section brings the consensus between the author's conceptual understandings of business finance basics upon which the value drivers are being discoursed in the book. The section contains three chapters – “Corporate Valuation,” “Corporate Objective,” and “Performance Measurement and Analysis”. The chapter of “Corporate Valuation” primarily presents the five approaches to valuation, though not in-depth. The chapter on “Corporate Objective” leads the discussion of defining the objective of businesses being intrinsic value maximization, dissecting the elements that have driven corporations over ages from lame profit maximizing to shareholder wealth maximizing objectives. The third chapter clarifies the way performances are measured and analyzed in practice through approaches like balanced scorecard, McKinsey's generic health metrics, and the like. The section must be said to have put the foundations for discussing the constituents of the value octagon by laying on all that is prerequisite knowledge and only so much.

The second section, which forms the crux of the book, is structured to discuss the value octagon. Eight chapters discuss eight levers of value creation. The subsequent section of this book review discusses the value octagon in detail.

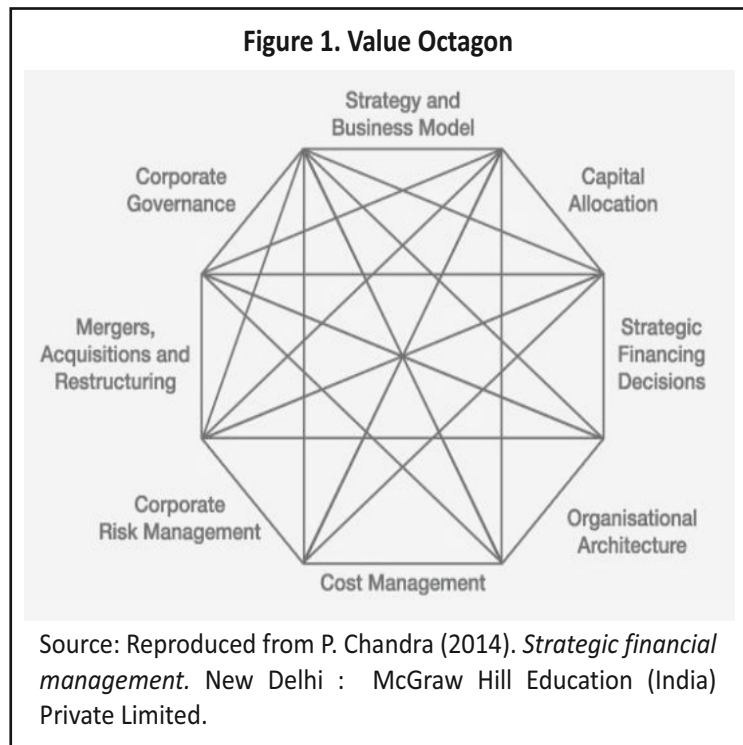
The third section, consisting of two chapters, provides evidence from real world firms that have delivered high value to their owners and the way the value octagon has percolated into their strategy making. The chapter on “Value Based Management” presents different approaches built by global consulting firms for goal-setting and performance measurement that set the goals and measure the performance in value terms. The frameworks discussed include Marakon, ALCAR, McKinsey, Stern-Stewart's EVA, and BCG approaches, which are not new, but gives the readers a new perspective to think of value-based management to be the only sustainable approach. The chapter on “Value Creators” is an innovative module that is dedicated to discuss a set of illustrious corporations from around the world that have successfully delivered value to their shareholders. Calling them stellar value creators, the author goes ahead to give empirical illustrations on how the value octagon is indeed a reality. Corporations like Berkshire Hathaway, Microsoft, Infosys, Goldman Sachs, Piramal, and L&T are exemplified as value creators.

Value-Based Management Approach

The changed perspective of viewing a corporate's objective from mere profit maximization to shareholder wealth maximization and now to maximizing the value for shareholders has brought about the way corporate handlers of finance function to look at ways and means to create value in every action they take. Value is said to be, in simple terms, what an investor in an asset is ready to pay to buy the asset. While this depends on a number of factors beyond a firm's control, it cannot be negated that a firm's actions have a huge bearing in perception creation in the market, be it relating to the current profitability or the sustainability of profits over a period.

According to Damodaran, the three decisions of finance function - the investment decision, the financing decision, and the dividend decision come together to maximize the value of a firm. Thus, when we make the argument that an action by a firm (such as investing or financing) increases a firm's value, this increase in firm value will necessarily translate into increasing stockholder wealth and stock price only if the more restrictive assumptions hold (Damodaran, 2014). Hence, strategic finance has more to do with those managerial decisions of the top management, including the approaches adopted, that enhance a firm's value (or, “enterprise value”). The book presents this in a framework, and makes it look as a process than an intelligent thought process.

The rationale for demand for value based framework can easily be devoted to the changing perception



regarding the purpose of existence of businesses. The business world has been effusively convinced to move away from the lame profit maximization objective to the shareholder wealth maximization objective as the sole purpose of its existence. It's being further reframed as intrinsic value maximization of the company's ownership stakes. Such an approach of a management to focus on value delivers greater accountability and result-oriented performances, which in turn ensures that corporate governance is being taken care of. As the value maximization objectives are being accepted universally, the fundamental question arises, 'what is value?' In the words of the world famous investor Warren Buffet (Buffet, 1996) :

Intrinsic value is an all-important concept that offers the only logical approach to evaluating the relative attractiveness of investments and businesses. Intrinsic value can be defined simply: It is the discounted value of the cash that can be taken out of a business during its remaining life. (p. 1.3)

He also highlighted the two problems with determining this value – (a) We don't really know what future free cash flow will be nor the willingness and ability of the management to use it wisely; (b) We really don't know what the cost of capital is for a firm, particularly the cost of equity (Buffet, 1996). The owner mindset in the shareholder community is no more interested in sheer profits that the firm is generating. Instead, it is demanding sustainability of the profit generating capacity of a firm and its management team. Thus, we understand that value is one parameter that the management team needs to focus on – either creating value, adding value, or nurturing those pockets of its business that enhance value (Kumar, 2015). The value octagon presented in the book puts this into a framework.

The “Value Octagon”

As mentioned above, the value octagon is a strategic checklist in the hands of the top management to be put up on

their agenda board and needs to be poked into in target setting, problem situations, or during performance evaluation. It provides eight levers that are supposed to have demonstrated success in the real world. The value octagon framework, its elements, and the way each element or the value drivers are interconnected to each other are depicted in the Figure 1. The author discusses in detail each of these levers by dedicating a chapter each to the eight levers. The discussions are pragmatic, contemporary, structured, and holistic that makes it a handy tool in the hands of decision makers. Below is a snapshot of the eight levers of the value octagon proposed by the book :

(1) Strategy and Business Model : One of the examples the author quotes is that of branded designer wear brand Zara's strategy of '*delivering fresh fashion on a weekly basis*,' and Zara is able to do this by bringing in effective control over every aspect of its operations - design, production, and supply chain. From defining what strategy means to the possible pitfalls in strategy building to how the business model in its entirety should work in tandem to execute such a corporate strategy, the author takes a circumferential view of business modelling of strategy. In his words (Chandra, 2014) :

Every strategy must be assessed in terms of its contribution to its shareholder value. A symbiotic relationship exists between strategy formulation and strategy valuation. Strategies have a bearing on shareholder value and such value, as a corporate objective, guides the search for and selection of strategies. (p. 4.24)

It must be noted that no one would disagree with strategy being separated as a different function altogether ; instead, it is something fluidly flowing inside every function. Finance, especially, transacts with the strategy makers, by both providing inputs as well as taking inputs. For instance, a 'going public' decision for an emerging company like Snapdeal or Flipkart requires inputs from the finance department as to the capital structure modification, capability to service the existing debt, and the overall impact on the cost of capital. At the same time, strategy makers would also need to foresee the stakes of external investing community and align their strategies and the communication of the same to satisfy the latter. Thus, today's decision-makers operate in a business ecosystem, rather than a simple environment.

(2) Capital Allocation : The author uses a term 'resource-allotraction' after discussing a series of pitfalls that decision-makers embark during their capital budgeting decisions and methods to overcome the same. Resource allotraction is a term the author uses to refer to the approach of resource dedication of the new economy, that has twin focus - one, extracting optimal value from the existing business model and two, challenging the status quo by nurturing innovative business models that result in newer value-creating dynamics. As requoted by the author – “The winning organisations of the future will be those that successfully harmonize their management of resource allocation and resource attraction”(Chandra, 2014, p. 5.24).

It is no more a simple positive NPV criteria in appraising projects. Firms need to take a critical view of the capital decisions. The higher is the ability of decision-makers to understand the consequences - both monetary and qualitative - the higher is the value that the project creates for investors. Increasing focus on real option approach to capital budgeting, the newer challenges are beyond the identification of options, evaluation of the uncertainties, and valuing the options. A clear pathway with triggers to exercise the options (or decision to not exercise) as well as the responsibility centers for the same need to be established in advance.

(3) Strategic Financing Decisions : Capital structure decisions have moved beyond the relevance and irrelevance theories and have begun dealing with costs of financial distress, costs of agency, signaling, and the like. The author breaks certain myths with regards to financing decisions, like that of share buybacks resulting in increased EPS. When the firm's goal is maximizing the intrinsic value, EPS maximization through an exercise to bring down the

denominator seems just to be window-dressing. Capital structure and dividend payout decisions need to be carefully crafted, and in the words of the author of the book - "Strategic financing decisions do more to prevent value erosion than to enhance value" (Chandra, 2014, p. 6.1).

Going beyond the theoretical frameworks that assume a perfect market for financial products, firms need to be consistently conscious of their capital structure's sensitivity to changes in the market. In what circumstances will a decided structure may have to be reviewed, other than just the lapse of a financial year? What kind of investment option deserves an all-equity ownership? Should the traditional pecking order of retained earnings, debt finance, and external equity be applied in all decisions? What is the rationale for buyback and dividend decisions? And finally, what is the effect on value of the firm with each financing decision? All these practical questions need to be addressed by the new-age decision-maker within the context of theoretical frameworks, say the arbitrage mechanism.

(4) Organizational Architecture : Talking of incentives as a powerful tool in enhancing performance, the author quotes the example of FedEx that moved from moral suasion and threats to get the loading done on time to an incentive plan that paid the employees on shift basis and night shift employees were let go home after the task was complete. An organization structure is not just about having positions and designations in an interlinked format; rather, it is the sum total of individual behavior influencers, decision-making authority, performance measurement system, the compensation plan, and corporate culture. Quoting the author (Chandra, 2014) :

Value is created or destroyed by the thousands of business decisions made in a company every day. Obviously, all these decisions - which range from the mundane to the critical - cannot be made by a single CEO or a small group of executives in the company. So, it behooves on every company to establish an organizational architecture or performance management system that encourages value maximizing decisions throughout the organization. (p. 7.1)

The organisation structure is not a hierarchical arrangement of designations and the schedule of reporting and subordinating responsibilities. It must be a design that encompasses the decision authority assignment, compensation system, and performance measurement system, all focused towards execution of the corporate strategy. The cognizance of value contribution through such architecture in itself can lead to value creation.

(5) Cost Management : Hindustan Unilever's example of bringing about an annual savings of ₹ 1000 crore in packaging ; Dabur's example of having its own media planning agency that saved 25% of its promotional costs are just two of the simple examples that the author mentions on cost management initiatives enhancing value for the firm as well as for its customers. The author lists the four ingredients of a system of total cost management to be – total cost consciousness, total cost measurement, total cost measurability, and total cost improvement.

Cost management goes beyond cost reduction and cost control. Cost management becomes a routinely embedded element of responsibility across the organization. Each process and person will have to be conscious of the cost dynamics. How value-chain activities are carried out determine costs and affect profits (Porter, 1985). It must also be noted that performance measures do influence the managerial behavior. As author Jiambalvo put it, you get what you measure! (Jiambalvo, 2015).

(6) Corporate Risk Management : The author suggests different approaches to enumerate, measure, prepare for risky events by business houses. In the VUCA (volatile, uncertain, complex, and ambiguous) world, enterprises are bound to focus on risk management as a strategic top-level priority, else compromise on overall firm value. Case studies from across the world and India are discussed to bring forth the point. In the words of the author

(Chandra, 2014):

In coping with the complex problems of managing corporate risks, the following guidelines need to be borne in mind: (a) manage risks in an integrated manner, (b) align risk management with corporate strategy, (c) employ a mix of real and financial methods, (d) spread risk ownership throughout the company, and (e) reduce vulnerability. (p. 9.26)

Understanding that risk is something that's inevitable with every strategic decision will lead to develop mechanisms to manage the same. A constant look out for newer solutions emerging through financial re-engineering throughout the globe for mitigating or transferring of risk seems to be a hygiene factor. Increasingly, businesses are establishing risk management functions/departments that are dwelt into such a process. Organizations like Infosys have successfully adopted risk management as an integral part of its business model though its PSPD model (predictable, sustainable, profitable, and de-risked) of enterprise risk management. Countries like Singapore have developed and mandated for organisations' strict adherence to the Risk Management Standards and Codes (OECD, 2014). While risk-taking is a fundamental driving force in business and entrepreneurship, the cost of risk management failures is still often underestimated, both externally and internally, including the cost in terms of management time needed to rectify the situation. Corporate governance should, therefore, ensure that risks are understood, managed, and, when appropriate, communicated (OECD, 2014).

(7) Mergers, Acquisitions, and Restructuring : M&As and other forms of restructuring are becoming the given modes of value creation in the modern economy. If an organization is not restructuring for value creation, the organization is restructuring for sheer survival. The chapter on this details various frameworks for M&A decisions, including the ones available for determining the purchase price using quantitative and qualitative information. Quoting the author (Chandra, 2014), “To improve the prospects for creating value, the acquiring company must (a) focus on right targets, (b) estimate synergies properly, (c) negotiate in a disciplined manner, and (d) plan and control the integration” (p. 10.16).

In addition to a professional approach to deal-making, M&As require a fair amount of due diligence and pre-preparation. Financial satisfaction becomes the prime focus, while strategic perspectives may still supersede financials. BCG, an eminent consultancy group negates certain myths about M&As: (a) M&As can destroy value, but it can also create substantial returns; (b) higher acquisition premiums do not necessarily destroy value; (c) private equity firms pay lower multiples and lower acquisition premiums than strategic buyers (as against the popular belief otherwise); (d) bigger is not necessarily better; (e) it does not always pay to be friendly; and (f) cash-only transactions have a much more positive impact on value than deals that rely on stock, a mix of stock and cash, or other payment combinations (Cools, Gell, Kengelbach, & Roos, 2007). Picking up the pace of M&As requires big changes in a company's processes and organization - even if the deals are smaller and corporate deal making has a new look - smaller, busier, and focused on growth (Uhlener & West, 2008).

(8) Corporate Governance : One of the credentials Warren Buffet is famous for is his transparency, and the author abstracts the same through the words of Laura Rittenhouse :

You can tell he wrote the letter. Its personal. Its specific. He talks about problems and takes responsibility for them – something most other CEOs don't do. Buffet promises investors that he'll communicate candidly because, he's said, a CEO who misleads in public will eventually mislead himself in private. (Chandra, 2014, p. 11.27)

The discussion on corporate governance is holistic as it commences from reference to Adam Smith's connotation of the agency problem in the *Wealth of Nations*, to the “Quality Financial Reporting” article by Paul Miller and Paul Bahnson while talking of evolution of corporate governance in the business world. The author presents the format for path-to-growth report as an enabler for a management in articulating its future plans.

Corporate governance need not necessarily be viewed as a system for regulatory formality. It must be a part of organizational culture and permeate into every system as a commonality. What corporate governance brings on to the table of strategic management cannot be overlooked. Strategy formulation becomes a meaningful process when the effect of such decisions on all the stakeholders is evaluated, and corporate governance integrates the interests of all stakeholders internally and externally (Babu, 2012).

Conclusion

Thus, the value octagon and its eight value driving levers encapsulate the broad areas of top management agenda in their pursuit of maximized intrinsic value. It must be observed and meaningfully interpreted that each of these levers are interconnected, suggesting a complex set of ties between each of these. The eight levers may need to be approached or controlled separately, but the outcome would be one - value creation.

It must be noted that no manager or analyst would be able to ascertain the true value of his/her firm, nor they would be able to determine the accurate quantum of enhancement (or deceleration) of value from any of his/her actions. As long as decision-makers are cognizant of the direction the intrinsic value might take with every decision of theirs, it does not matter whether they are able to quantify it.

References

- Babu, K. V. (2012, December 3). *Role of corporate governance in strategic management*. DOI: <http://dx.doi.org/10.2139/ssrn.2184235>
- Buffet, W. (1996, June). *Official Home Page*. Retrieved from Berkshire Hathaway Inc.: <http://www.berkshirehathaway.com/ownman.pdf>
- Chandra, P. (2014). *Strategic financial management*. New Delhi : McGraw Hill Education (India) Private Limited.
- Cools, K., Gell, J., Kengelbach, J., & Roos, A. (2007). *The brave new world of M&A : How to create value from mergers & acquisitions*. The Boston Consulting Group, USA. Retrieved from <https://www.bcg.com/documents/file15069.pdf>
- Damodaran, A. (2014). *Corporate finance: Theory and practice* (2nd ed.). New Delhi : Wiley India Pvt. Ltd.
- Jiambalvo, J. (2013). Two key ideas in managerial accounting. In J. Jiambalvo (ed.), *Managerial accounting* (Fifth Edition ed., pp. 11-13). New Delhi, India: Wiley India Pvt. Ltd.
- Kumar, K. K. (2015). Are Indian FMCG companies adding economic value to its owners? *The Management Accountant*, 50(11), 90-93.
- OECD. (2014). Singapore: The corporate governance framework and practices relating to risk management. In OECD (ed.), *Risk management and corporate governance*. Paris : OECD Publishing. DOI : 10.1787/9789264208636-en

- Parasuraman, N. R. (Ed.) (2014). *Financial management - A step-by-step approach* (1 ed., pp. 151-152). India: Cengage Learning India Pvt. Ltd.
- Porter, M. E. (1985). *Competitive advantage*. New York: The Free Press.
- Uhlener, R. T., & West, A. S. (2008). Running a winning M&A Shop. *McKinsey on Finance: Perspectives on Corporate Finance and Strategy*, Number 27 (Spring 2008), 6-11.