Value Based Management Framework

Short introduction

Timo Nurminiemi

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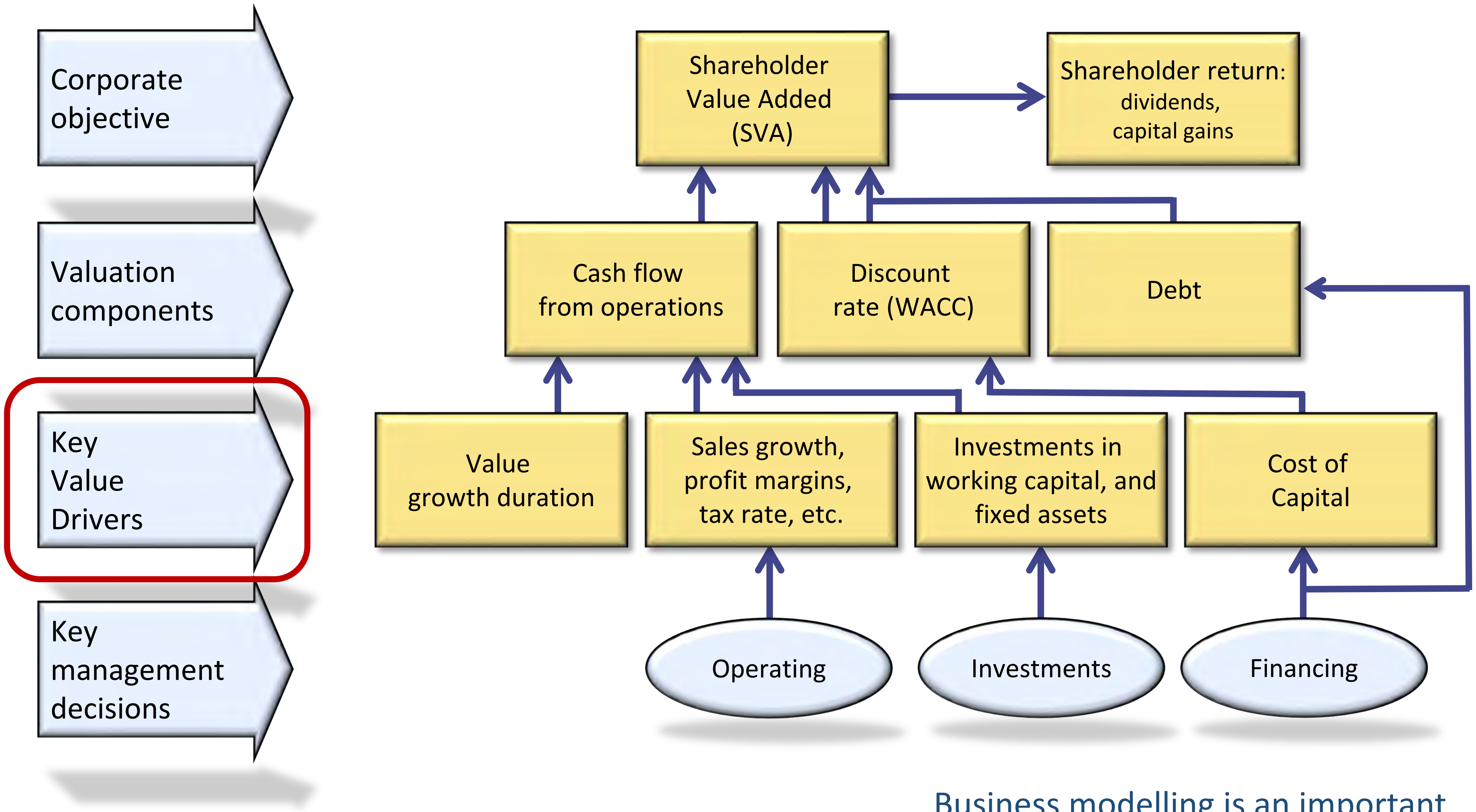
Value Based Management (VBM) framework

- **Value Based Management combines the analysis of the Key Value Drivers and cash flow with the modern valuation techniques, various processes and decision-making situations**
- The subject of VBM process can be:
  - Strategy planning, forecasting, rewarding, investment, divestment, acquisition, strategy, or any capital investment, corporate reorganization, or any equivalent transaction.
- **Business modelling and cash flow are the key components of the VBM processes**
  - VBM combines cash flow-based modeling of a company, or its business with its financial value
  - Business modeling and **analysis** related to VBM process generates **Key Value Drivers**, which are important factors in VBM process. A Value Driver is any variable that affects the cash flow and value of the business, is controllable and measurable from month to month.
  - Economic value is defined by discounting the company's, or business's **future cash flows** with the company's, or business's cost of capital (WACC, Weighted Average Cost of Capital)
- An analysis and **financial model** based on Value Based Management is the most useful tool when it is combined with the operative and strategic decision-making of the management and the monitoring of the implementation of decisions
  - VBM is an integrative process designed to improve strategic and operational decision making throughout the organisation by focusing on the key drivers of economic value

Value Based management Framework



Business modelling is an important part of Value Based management!

Source: Alfred Rappaport; Creating Shareholder Value, The Free Press 1998

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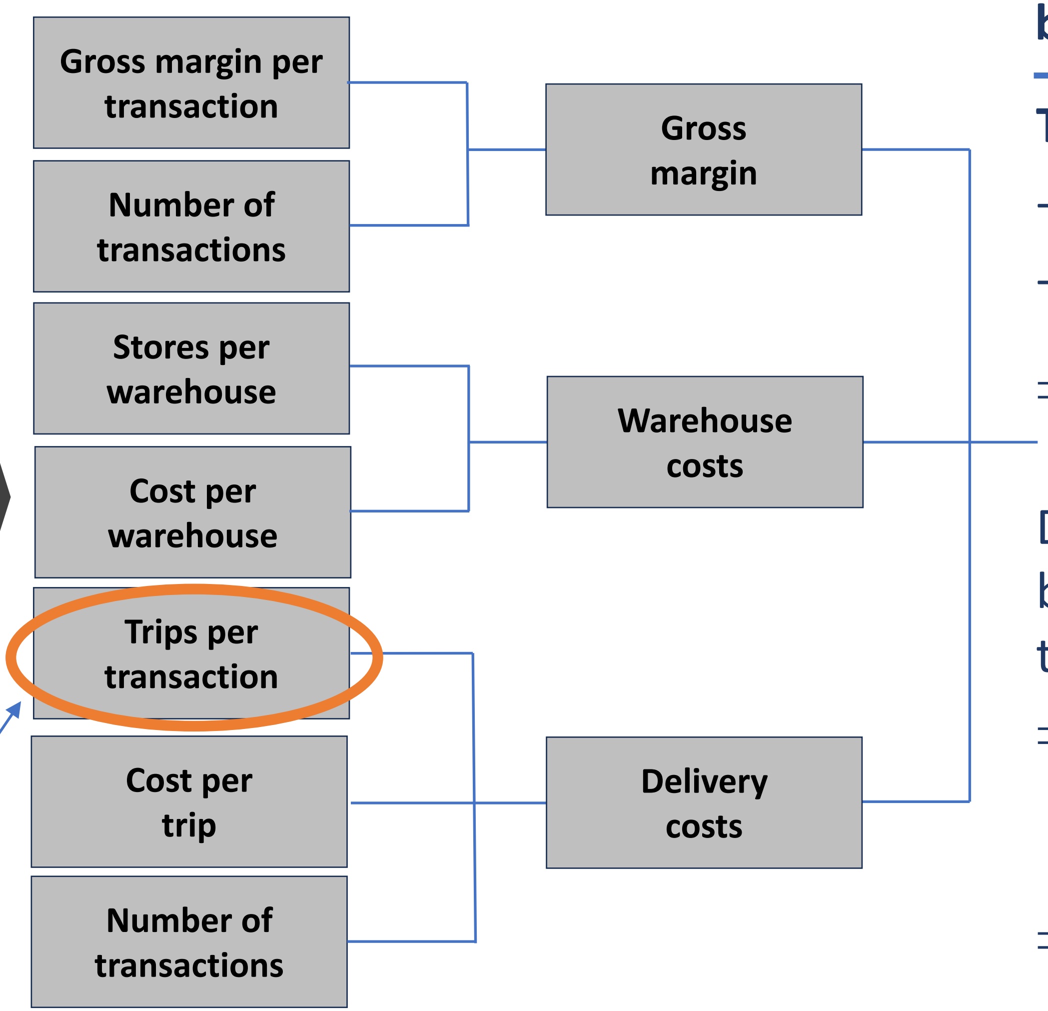
Key Value Drivers supporting operational management

(Example: Retail business)



One of the Key Value Drivers

Actions to be taken based on the analysis:

Trips per transaction:

- Current situation 1,5
- Theoretical minimum 1,0

⇒ **Action/target to reduce to 1,2 withing a year**

Dont’t forget the actions to be taken to reach the target!

⇒ **Include the factor in normal operational (monthly) reporting**

⇒ **Cash flow increases 10%**

⇒ **Value increases X%**

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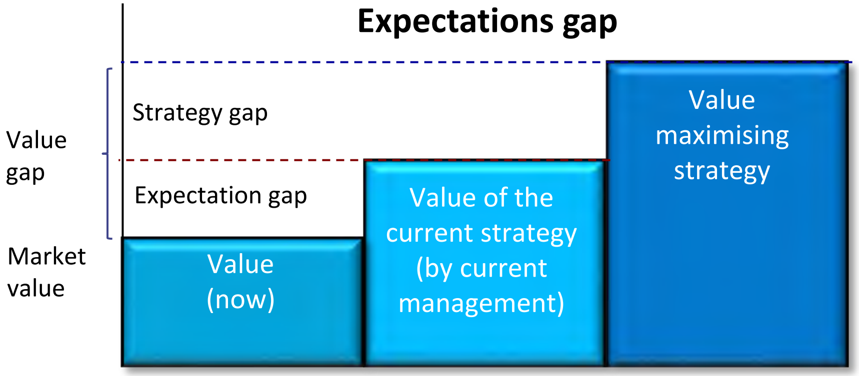
Managing Value Gaps - essential part of VBM

- Why Value Gaps arise?
  - **Expectation gaps** - Quite often due to failure in (market) communication:
    - Investors are unaware of the strategy, or
    - Investors don't believe in the strategy because they:
      - Doubt the company's (management's) ability to execute and deliver
      - Believe the cash flow created will be less than the management is expecting to deliver even though the strategy would be successful
      - Don't believe in the timing of cash flows (delays expected)
  - **Strategy gap**
    - Is the difference of value maximising strategy and value of the current strategy

Value gap = Strategy gap + Expectations gap



- Sometimes the implementation of a strategy that maximizes the company's value is only possible for a completely new owner. <u>The value for the new owner can be significantly higher than for the current owner</u>.
- The best way to minimize and mitigate value gaps is to identify the value of your own company and the key value drivers affecting the value long before the planned **EXIT**
  - Defining, evaluating and managing value gaps is an essential part of the **EXIT planning**

Miksi Arvonhallinta ja sen ylläpitäminen on tärkeää?

"If You do not know
the values of the components of your business,
you will find yourself
in the hands of someone who does"

An (unnamed) investment banker

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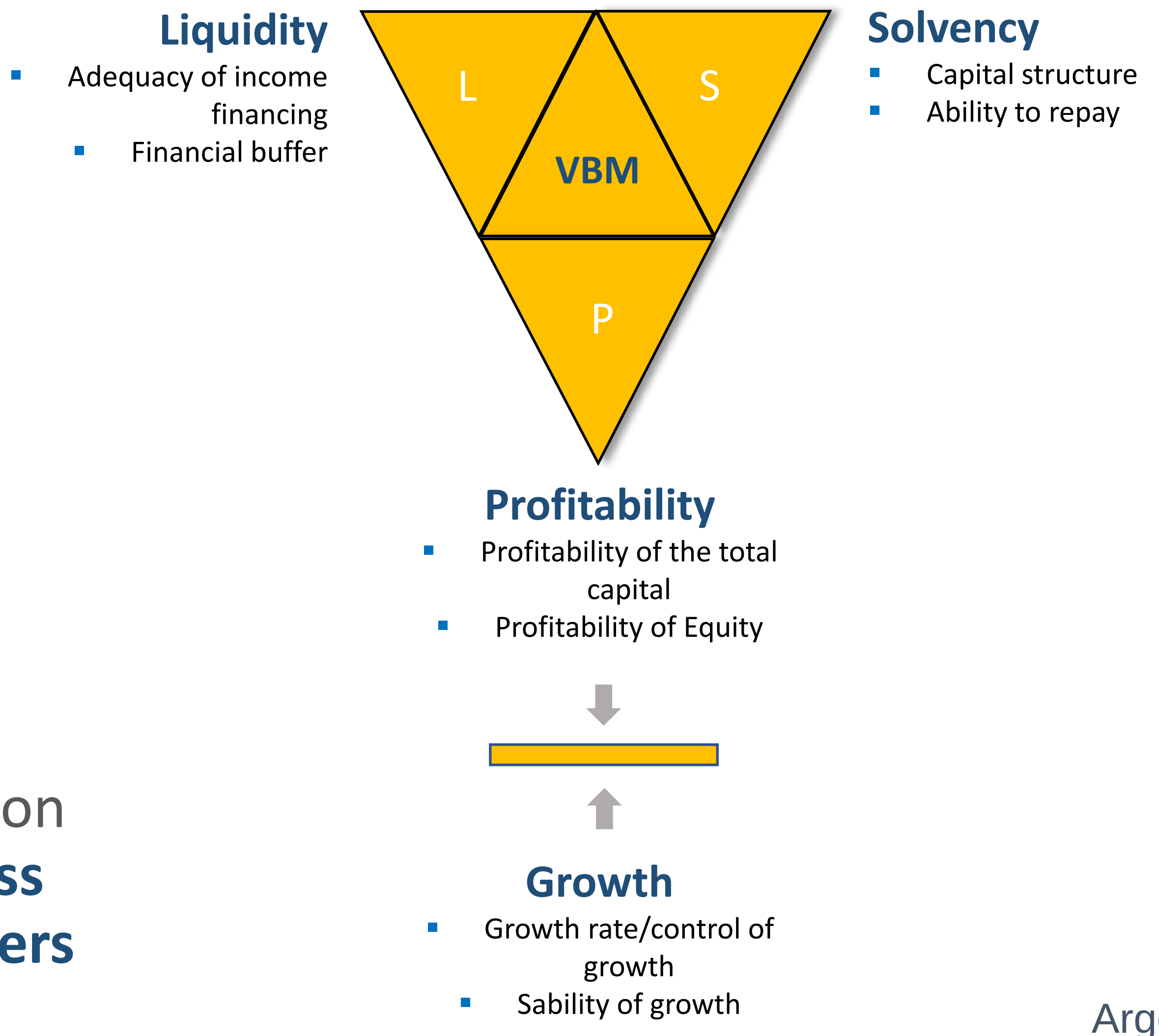
VBM as the fourth support pilar in business and finance?

The fourth support pillar in business and finance…

- **Value management of a company, or business** (Value Based Management, VBM) has become the fourth support pillar and success factor of a successful business…
  - …however, it's essentially dependent on the first three pillars
    - …but the model is based on the importance of **business modelling, key value drivers** and (positive) **cash flow!**



Business modelling is a starting point for Value Based Management

- Value Based Management (VBM), or tools used in it can be utilized in various operational and strategic tasks, processes and projects
- Business modelling is a good start for Value Based Management initiative

Argon Pro Ltd

www.argonpro.com

+358 400 66 25 33

timo.nurminiemi@argonpro.com

@Argon_Pro

@TimoNurminiemi

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