Answers

This solution is intended to assist candidates by providing an indication of the possible content of an answer. In using the solution for study purposes candidates should note that other relevant material would also be awarded marks.

1 (a) (i) Needs of institutional investors

As indicated by Tom Singh's comment, there is some evidence that instutional investors may have a greater focus on short term measures of performance. This tends to arise because there is a need for institutions to report investment performance on an annual basis. Given that institutional investors possess a high degree of expertise and can achieve greater diversification than is usually available to individual investors, it is reasonable to expect consistently good performance from institutional investors.

Such performance must, of course, be considered in the context of the overall performance of the stock market.

These two factors mean that institutional investors may face pressures that can be avoided by individual investors who are able to take a long term view.

In the recent past, the pressure on institutional investors has increased due to the combination of lower stock market returns and a change in the way pension funds are accounted for by companies. The need to recognise the current value of pension obligations on a conservative basis, combined with the falling value of the assets held to meet such obligations has led to a number of companies facing substantial deficits on pension funds.

As a consequence, institutional investors may feel a need to report constantly improving performance – or in periods when overall market performance is poor, performance which is less negative than the market – leading to a focus on short term performance.

(ii) Needs of private shareholders with a long term perspective

It is important to note that not all private shareholders may be able to take a long term view. In some cases income may be an investor's prime concern, and this will tend to mean that the shareholder will have a short term focus. Those shareholders with a long term perspective are likely to be less concerned with annual results and more concerned with ensuring that management decisions are taken in order to achieve long term growth. In some cases, such as Tom Singh, the shareholder may also be the founder of the company. This may lead to a strong sense of commitment to the company, which is unlikely to apply to institutional investors. This sense of commitment may lead to the shareholder seeking objectives which are measured by means other than what may be referred to as 'traditional' financial analysis.

It is also possible that private shareholders with a long term perspective may be actively involved in the management of the company, and have a strong influence on its culture and value system. When combined with the commitment discussed above, this will tend to lead to a belief that these values will drive the company forward. A reliance on such values will not be a factor in the decision making of institutional investors, who may be more likely to move investment funds to companies or sectors which are experiencing fewer short term problems.

(b) Company Performance

As noted above, institutional investors will tend to be more concerned with short term measures. It should be noted, however, that such investors will not be exclusively concerned with the short term.

Measures which will be of interest to institutional investors and the results for the two years are:

	2003	2002
Return on capital employed	58·2%	57·3%
Net profit margin	13·4%	11·04%
Asset turnover	4·31 times	5·19 times
Earnings per share	27·9p	19·8p
Gearing	10·96%	24·09%
Working capital cycle	15·7 days	12·05 days
EBITDA	£111·8m	£86·7m

Private shareholders with a long term perspective may focus attention on the following:

	2003	2002
Trend in sales revenue	+9·9%	
Stock turnover period	30 days	30·25 days
Asset utilisation		
Fixed asset turnover	5·5 times	5·8 times
Return on gross assets	36·6%	31·2%
Interest cover	66·5 times	28·1 times
Dividend cover	3·2 times	2·8 times

The relevance of each of these measures to the respective investors is discussed below:

Institutional Investors

Return on capital employed (ROCE)
It could be said that the primary objective of institutional investors is to obtain a reasonable and consistent return on the funds invested on behalf of their own investors. For this reason, ROCE is an important measure. Each individual investment could be assessed against the benchmark of the market as a whole, the industry, and against other investments in the portfolio.

Net profit margin/Asset turnover
The net profit margin is one element of the ROCE measure. As such, it assists in establishing if the trend in ROCE is due to changes in trading performance, as assessed by the net profit margin, or utilisation of assets, as assessed by asset turnover. For institutional investors it will be important to keep these measures under review, as any adverse change will impact on the return on capital employed.

Earnings per share (eps)
There is evidence that analysts pay particular attention to the eps of current and potential investees. This measure is widely regarded as a key measure of performance, as it assesses the earnings available to shareholders, independent of dividend policy. For institutional investors the need to ensure that investees are producing a healthy level of earnings is extremly important. Such earnings will provide funds for future growth (if re-invested) or income for re-investment (if distributed as dividends).

Gearing
As a measure of financial risk, gearing is an important measure for institutional investors. While such investors can spread risk through diversification, there will be a need to measure risk on individual investments to ensure that the portfolio is properly balanced.

Working capital cycle
The length of the working capital cycle measures how quickly the firm is generating working capital. This will be important to an institutional investor which seeks a strong return in the short term, particularly when the investee operates in a fast moving environment such as fashion retailing. Any lengthening of the working capital cycle would be a matter for concern, and is likely to signal that a sale of the investment should be considered.

EBITDA
As it is a close proxy for cash generated, earnings before interest, tax, depreciation and amortisation is closely scrutinised by institutional investors. While the ability to generate cash is important for all companies (and therefore of interest to all investors), some decisions may have the effect of reducing the short term generation of cash with the objective of improving the long term results. For this reason, a focus on EBITDA may lead to a short term focus.

Private investors (with a long term focus)

Trend in sales revenue
Although the year on year trend in sales revenue may be considered as a short term measure, a private investor will be concerned with the trend over a longer period. In a fashion retailer such as New Look, the ability to achieve sales is of paramount importance. If the company is successful in building its level of sales, it is much more likely to achieve long term success.

Stock turnover period
Although it could be argued that stock turnover is a short term measure, and is therefore inappropriate for use by shareholders taking a long term view, there can be no doubt that in fashion retailing, the need to maintain the 'freshness' of the customer proposition is of critical importance. Any adverse trend in this measure may signal an underlying deterioration in performance, and the need for action. The importance of this measure is not diminished by the desire to take a long term view.

Fixed asset turnover
One of the company's stated objectives is 'the continuing expansion of our trading space, and especially the development of larger stores in key markets'.

Such continued investment may mean that this measure will deteriorate in the short term, as the asset base expands but no return has yet been generated. However, such continued investment is essential in order to ensure that long term performance can be sustained. By assessing the effectiveness of the use of assets, this measure provides an important indicator of performance. In particular, by tracking the trends in the measure, shareholders will obtain an indication of whether the investment continues to be well managed.

Return on gross assets
The company will need to achieve a suitable balance between the investment in fixed assets and the investment in current assets. This ratio measures how effectively the total assets are being utilised.

Interest cover/Dividend cover
Payments of interest and dividends reduce the funds available to the company for development. A shareholder with a long term perspective will be concerned with the ability of the company to create value by generating – and retaining – profits. If profits are generated, but not retained, the company will have to borrow more in order to finance development. A long term perspective – and the commitment to the company that this displays – means that the shareholder will be content to see funds retained within the company. An institutional shareholder on the other hand, will be less concerned about this.

However, both sets of investors will wish to see the company generating sufficient funds to ensure that both dividend payments and interest payments can be sustained.

Assessment of performance

It should be noted at the outset that, as discussed below, assessment of performance is restricted as data available is only for two years of trading. It would be more useful to be able to place the performance in the context of the company's performance over a longer period, or to compare performance with competitors or the market sector in which the company operates.

Profitability

If a key objective is to obtain a return on the investment made, we can see that the company has performed at a consistent level over the two years, as measured by ROCE. A return of almost 60% in each of the two years is, by any standard, sound. There is some evidence that this represents a distinct improvement in performance, as the balance sheet reports a debit balance on the profit and loss account. The debit balance brought forward (as reported in note 21) represents almost two years retained profits based on the 2003 figure and almost three years, based on 2002. Clearly the company's trading has not always been strong. This is an issue on which there will be a clear difference in attitude between investors with a short term perspective and those with a long term view. Investors seeking a short term return are less likely to invest in the company, or retain their investment, when the company is reporting losses. An investor with a long term perspective is more likely to be prepared to wait for the company to return to profitability.

Looking at the constituent elements of ROCE, we can see that while the net profit margin has improved to 13·4%, asset utilisation, as measured by asset turnover has fallen from 5·2 times to 4·3 times. As discussed above, a fall in asset utilisation may result from continued investment in assets in anticipation of future returns. However, such a fall may not be welcomed by investors seeking returns in the short term. While the ROCE indicates that the company was able to manage the combination of profitability and asset utilisation to maintain ROCE, investors with a short term view may conclude that improved profitability was due to the increasing consumer confidence and low interest rates of the period around 2003. This may lead to the fall in asset utilisation being viewed as a deterioration in performance, which in turn may lead to the company being encouraged to defer, or abandon, investment plans.

The improvement in profitability is also reflected in eps. Both groups of investors will be interested in this figure, and the improvement is a further indication of improved performance. It is also interesting to note that there is almost no difference between basic eps and diluted eps. From the point of view of both groups of investors, this is welcome, as it indicates that their investment is not at risk of losing value as a result of any future issue of shares at less than full value.

Cash generation

As measured by EBITDA, cash generated has increased by almost 30% to £112m. This is a strong performance, and would be positively viewed by all investors. There is a slight danger that a company which is generating strong positive cash flows could be viewed as potential takeover target by an investor seeking short term returns. This could lead to an institutional shareholder becoming a 'profit taker' by selling the investment held with the result that the company is managed for the short term benefit of the new investor.

Financial structure

The fall in gearing from 24% to almost 11% is, at first sight, significant. On closer examination, it can be seen that this is mostly due to the increase in equity due to the retained profits.

For both categories of investors, this would be welcome. However, it is possible that in the recent past, the situation may have been different. For example, if we assume that the level of debt in 2001 was similar to 2002, and that the equity in 2001 was around £60·2m (£85·5m in 2002, less retained profit £25·3m), the gearing would have been approximately 34%. This level of gearing is more significant, and may have been a concern for investors with a short term perspective. A shareholder with a long term perspective on the other hand, may have been less concerned, particularly if such an investor is party to, and has confidence in, the company's detailed plans. Such an investor may be prepared to accept the level of financial risk arising from higher gearing in the short term in anticipation of an improvement in performance in the medium to long term.

Interest cover is closely linked to gearing. All other things being equal higher gearing will lead to higher interest charges, which will reduce interest cover. As payments of interest reduce the funds available for reinvestment, high levels of interest may be a matter of concern to a shareholder seeking to build value in the long term. In the case of New Look, the interest payments in each of the two years are not significant, and would give no cause for concern to either group of investors.

Dividend policy

Although dividends are paid to shareholders and as such they are part of the overall return, there may be a difference in attitudes between the two groups of investors. Institutional investors will of course wish to achieve capital growth, but in some cases they may prefer a reasonable level of dividend payment as this provides cash for continuing investment. In theory, such cash may be re-invested, meaning that the funds effectively remain within the company. However, this may not be the case in practice. Institutional investors will tend to spread their funding over a number of companies, and this will mean that 100% reinvestment of dividends is unlikely. A private investor with a long term view will be more committed to the company, and will therefore be more content to receive a return by way of capital growth. This is more likely to be achieved if funds are retained within the company.

This means that both groups are likely to be satisfied with the fact that at 3·2 times in 2003, the dividend cover has improved slightly on the level in 2002, and indicates that sufficient funds are available to comfortably pay future dividends. However, an investor with a long term view may be less comfortable with the fact that the same figures expressed as the dividend payout ratio is around one-third. Such an investor may take the view that the level of dividend payout is 'profit-taking' and that the company's long term prospects may be better served by retaining more funds within the company.

Asset utilisation
The improvement in profitability has contributed to an improvement in the return on gross assets. For investors with a long term view this will provide an indication that the company is continuing to achieve a good balance between fixed assets and current assets. It would be expected that if profitability can be maintained in the future, this measure should improve further.

The improvement in return in gross assets also offsets the negative trend in performance as measured by fixed asset turnover. As already discussed, this is likely to be a result of the company's continued investment in fixed assets to develop the trading capacity for the future. However, not all the assets may be generating the expected return. The short term view would be that performance is weakening, while the long term view is likely to be that the company is well placed for the future.

Working capital
One of the key issues for a retail fashion chain is to ensure a fast stock turnover. Inability to purchase stock which will meet customer needs will lead to a loss of both profitability and cash. The time horizon on which performance is judged is likely to be of little consequence when considering this issue.

Both types of investor will welcome the year on year growth in sales of 9·9%, although this may be of greater significance for short term returns. If we remember that in the reporting period, the general level of inflation was low, this indicates a strong growth in real terms.

In that context the fact that the stock turnover period has remained virtually unchanged at 30 days indicates that the company has been able to grow sales, and continue to meet customer needs. In addition, the fact that the gross profit margin has increased by 1·4% to 23·7% indicates that the company is aware of the needs of its customers.

The lengthening of the working capital cycle from 12 days to 15 days would cause a degree of concern to investors seeking a short term return, as the need to fund an extra three days working capital may lead to an increase in borrowing and a consequent reduction in profitability.

However, a closer look at the result shows that the increase is entirely due to the reduction of four days in the creditors payment period. While we cannot be certain why this reduction has occurred, the fact that the gross profit margin has improved, suggests that the company has negotiated keener prices in return for prompt payment to suppliers. The ability to maintain good relationships with suppliers, and to achieve a constant gross profit margin, will place the company in a strong position for the future, and would be viewed positively by both types of investor.

Conclusion
From the perspective of investors seeking returns in either the short term or the long term, the company's performance has improved in the 2003 year. The absence of an external benchmark (see below – 'Limitations of Using Published Information') means that more detailed conclusions are not possible. Nevertheless, we can observe that in a number of instances, there is some evidence that the long term investor may be more satisfied. This means that it is possible that a tension could arise in the future if investors seeking short term returns are able to influence the company's policies.

(c) Limitations of Using Published Information

Benchmark
As noted above, the only benchmark which is provided by published information is the performance of the previous year. Whilst this can be useful, it is somewhat limited. For example it has been noted that the company has recorded losses in the past. This means that in a period where the company's performance has improved as it moved from loss to profit, performance will seem to be good. However, this may be based on comparison with poor performance. For example, the gross profit margin has improved from 22·3% to 23·7%. Whilst this is to be welcomed, it begs the question of what level of gross profit is earned by others in the sector. If competitors are earning 20%, the company's performance is to be applauded. On the other hand, if competitors are earning 30%, the company's improved margins are not good enough.

Trend
It is widely accepted that it is necessary to review results over a longer period than two years in order to obtain an overview of the trend. An example of this is provided by ROCE. There has been a marginal increase of 0·9%. While positive, this is not a significant increase. However, if we could see the trend over say four years, and this showed a consistent annual improvement of around 1% we could conclude that performance is positive.

Accounting issues
The company has chosen to finance some of its fixed asset requirements by operating leases. This means that although the reported profit reflects the cost of the assets (by charging the lease rentals against profit), the asset base does not include the value of the assets. In that sense the asset base is understated, and this will lead to a higher ROCE than would be the case if an alternative method of finance was used. This also means that even if we had data from a competitor, or the industry sector, the comparison is less valid.

A further point here, which is related to the issue of benchmarks, is the company's policy on depreciation. From note 1 of the financial statements we can see that the depreciation policy for fixtures and equipment is 'three to fifteen years according to the estimated life of the asset'. As fixtures and equipment comprises 71·4% of fixed assets, the range in useful life could be significant. A short term view may lead to a longer useful life for a particular asset. This would reduce the depreciation charge and increase profitability. A long term view may encourage a more prudent view of useful life, leading to higher depreciation charges and lower profits in the short term.

Strategy
It could be argued that the most valid comparator for assessing performance is the company's strategy. The introductory information provides little detail regarding the company's objectives. Whilst this is likely to be reflected in the report of the chief executive, it is not explicitly part of the published information. For example, the chief executive refers to 'key markets', but it is difficult to see what markets the company regards as 'key'. He also refers to 'continuing expansion of our trading space'. As discussed below sales per square metre is an important measure in the retail industry. However, this measure cannot be calculated from the published information.

Share price
The lack of information on share price means that some important measures such as the P/E ratio and the dividend yield cannot be calculated. Given that most of this discussion has been in the context of the expectations of shareholders, this is potentially important information. It could be argued that the real test of performance is the share price, but the publication of this information is not required.

2 The significance of the concept of shareholder value to the investors is that it is based on the assumption that equity shareholders invest in a company in order to obtain a return on their investment. Such returns are assumed to be a combination of income (i.e. dividends) and capital growth (through share price appreciation). While that may seem to be an obvious statement, it has important implications. The first is that the relative importance of each form of return to shareholders can be difficult to define. The second is that it is also widely accepted that in order to achieve success, an organisation cannot simply seek to meet the needs of shareholders, but must meet the various needs of a range of stakeholders.

This latter view may seem to be at odds with the objective of maximising shareholder wealth. However, it is possible to reconcile the two views by noting that it is precisely by meeting the needs of other stakeholders – primarily customers – that an organisation is likely to achieve maximum wealth for shareholders. The need to ensure that stakeholders' needs are met will mean that organisational objectives should focus on the long term rather than the short term.

Shareholder value can be measured by the following:

Profit	A company which is generating increasing profits is more likely to be able to pay dividends to shareholders. Profitable companies are also likely to be attractive investments, and this will lead to share price appreciation.
eps	If a company is growing, it is important to ensure that the growth in reported profit is keeping pace with the additional investment which will have been made to finance the growth. Earnings per share measures the level of earnings relative to the number of shares in issue. Any fall in eps will reflect a fall in the value of the shareholders' investments.
Return on investment	As noted under eps, the level of profit should be considered in the context of the level of the investment. By considering return on investment it is possible to assess whether a satisfactory return is available to investors. An assessment of the return on investment achieved can be considered in the context of the general business risk and risks which are associated with the specific industry and the organisation.
Economic value added	The usefulness of return on investment as a measure of shareholder value is derived from the fact that it links the return with the level of investment. However, the measure is still problematic as both returns and investment are influenced by a number of factors. For example, accounting policies and measurement bases will influence both aspects of ROI, as will the chosen method of financing fixed assets – for example New Look have chosen to acquire fixed assets through operating leases. This means that the value of the assets is not reflected on the balance sheet. By calculating the excess of reported profit over and above an economic profit (which is based on the economic value of assets employed) economic value added seeks to overcome the problems of accounting policies and measurement bases as well as methods of finance.

Non-Financial Performance Measures
It is clear from the discussion above that there is no single measure which is sufficient to assess performance. Rather what is needed is a range of measures which will reflect as many influences on performance as possible.

When considering a range of suitable measures, it is generally accepted that non-financial measures can be particularly useful as they can encompass both qualitative and quantitative aspects of performance.

For a fashion retail group such as New Look, the following non-financial measures would be relevant:

Available retail space
Average store size
New markets entered
Relative market share
Customer retention
New customers
Time taken to bring new designs to market
Number of lines offered in store
Proportion of customers who make a purchase
Returns to manufacturer

The significance of each of these measures is considered below:

Available retail space
This would be measured as the total amount of floor area available in all the company's stores.

Achieving an increase in trading space is identified as a key objective by the chief executive of New Look. This measure is important because in the increasingly competitive retail environment, additional space will attract more potential customers. Fashion retail stores will achieve sales, and therefore profit, by making it easy for potential customers to locate and visit stores. The importance of this is indicated by a perusal of the websites of any of the major high street chains. While the website is used as a point of sale, there is invariably a link to the 'stores location' section. This indicates that customers still like to be able to visit stores and handle products before deciding to purchase. New Look does not seek to create an exclusive appeal, but to offer a wide range of products to as many customers as possible, therefore it is important that potential customers find it easy to gain access to a wide range of merchandise.

Average store size
The chief executive alluded to the importance of larger stores when he qualified the objective of expanding the trading space with the comment 'especially the development of larger stores in key locations'.

By dividing the total floor area by the number of stores it is possible to ensure that there is a balance between the large 'flagship' stores and smaller 'satellite' stores. As has already been noted, the nature of New Look's business is to offer a wide range of products. This can best be achieved in larger stores, and the success of such stores will create a customer demand that will benefit smaller stores.

New markets entered
It is important to clearly define 'new markets'. One useful definition would be geographical regions. As has been noted above, customers prefer to visit stores in order to view merchandise. Therefore a new market could be defined as a location where the company does not have an existing store within a certain radius. The radius could be defined in terms of population density. For example, it may be quite possible to sustain two stores in a medium sized town, but only one in a smaller town. As the company builds a reputation in one location, it will create a demand from customers for stores in different locations.

The chief executive of New Look has specifically referred to expansion in France. Therefore the new markets may also be defined by national boundaries, but unless one of the company's objectives is to become established as an international retailer, trans-national expansion may not be of critical importance.

Relative market share
This would be measured as the company's share of a particular market, relative to its competitors.

This is an important measure as it assesses the company's success in attracting customers within a particular market, and also takes account of the level of competition in that market.

New customers
Clearly 'new customers' are those who are making purchases for the first time. The ability to attract new customers is a key element in building customer loyalty. This is an important element of building turnover and profitability.

Customer retention
It could be argued that achieving repeat sales is more important than simply attracting new customers. This is because it is essential to build customer loyalty by understanding and meeting customer needs. When customers' needs are met it is more likely that they will visit stores on a regular basis and buy products at normal retail prices. There is little point in attracting new customers by special offers as such offers will mean a loss of margin.

Customer retention could be measured on a regular basis by monitoring the number of customers who had previously bought products from the company. It would be important to specify both of the time periods over which performance is to be assessed. For example, the measure could be 'customers in the last month who had bought products in the last six months'.

Time taken to bring new designs to market
Trends in fashion retailing change quickly. In order to continue to meet customer demand, it is essential that new product lines can be developed and offered in stores quickly. By measuring the time period between the beginning of the design cycle and the final product being offered in stores the company can ensure that it is well placed to respond to such changes. In addition, if the company can gain a reputation for offering new product lines quickly, it is more likely that potential customers will visit the stores on a regular basis.

Number of lines offered in store
As has already been discussed, a critical success factor is the ability to offer a wide choice to customers who visit the stores. Monitoring the number of product lines on a store by store basis will ensure that customers continue to be offered a wide choice.

This would be measured as a straightforward count of the number of lines in store. A higher number of lines would indicate that customers are being offered a wider choice.

Proportion of customers who make a purchase
By monitoring the number of potential customers who visit each store and expressing customer transactions as a percentage of this number, a measure of the effectiveness of the customer proposition can be obtained. If a growing proportion of customers who visit the store do not make a purchase, this will signal that the company is failing to continue to meet customer needs.

Returns to manufacturer
If goods are not of the required quality, New Look will lose both reputation and sales. By measuring the number of items which do not meet the required standard at the goods inwards stage, the quality standards of each manufacturer can be assessed. This will lead to an improvement in the overall quality, which will increase customers' satisfaction, leading to increased sales.

This would be measured as the number of items returned as a % of items received from manufacturers.

Overall
It is important to note that none of these measures can be viewed in isolation. Rather the purpose of the measures is that they allow a range of aspects of performance to be assessed. By ensuring that no one aspect of performance becomes dominant, the company will be better placed to meet the needs of customers and achieve shareholder value.

Benchmarking
Put simply, benchmarking is a technique which seeks to improve performance. This is done by monitoring key areas of performance and comparing that performance to a standard or benchmark. The benchmark could be a competitor or a similar operating sector of the business. It would also be appropriate to assess performance of one region or store against other regions or stores. The actual operating units chosen for comparison will depend on the structure of responsibility centres within the company.

The major advantage of benchmarking is that it allows performance to be assessed against realistic and relevant targets. Such targets can be useful for motivation.

However, care must be taken in choosing the benchmark. If a company aspires to market leadership, it is important that the benchmark does not reflect average performance. Another problem is that it may be difficult to obtain useful comparative information regarding the performance of competitors. As fashion retailing is extremely competitive, there may be a reluctance from competitors to share information. For that reason, the most appropriate benchmark may be other sectors of the business.

It is important to measure a range of outcomes to ensure that decisions are not taken which may improve the benchmarked measure, but will lead to a deterioration of overall performance. For example, if a store manager improves the performance of an individual store by selling stock at less than marked price, performance measures such as proportion of customers making a purchase and stock turnover will improve, but at the expense of profitability.

Suggested activities which should be benchmarked include the measures discussed above, but could also include the following:

Customer proposition
Customer requests not met
As discussed above, the need to offer a wide range of choice to customers is of the utmost importance. By monitoring any instances where customers do not find a satisfactory purchase, the effectiveness of purchasing decisions can be assessed. This could be done by maintaining a record of items not in stock but requested by customers. Initial monitoring would highlight those stores in which there may be problems with the lines offered to customers. More detailed analysis would reveal if there is an opportunity to be exploited by introducing a new line.

Sales achievement
Number of lines sold as a percentage of lines stocked
It is important to maintain a fast stock turnover across the entire product range. By comparing the performance of each store on this measure, it is possible to highlight those stores which are less efficient in presenting appropriate stock to customers. This would be measured by comparing lines sold and lines stocked on a regular (perhaps weekly) basis.

Average spend per customer
By dividing total sales revenue by the number of transactions in the same period, it is possible to assess the extent of customer satisfaction. If individual customers are spending more, this will indicate that they are finding that the store meets their needs. If this measure begins to decline, it will provide an early warning that customers are less satisfied with the range and value for money of the goods offered.

Sales per square metre
This would be measured as the value of sales achieved divided by the floor area of stores. The measure is important as it acts as a counterbalance to the available floor space measure discussed above. Retail floor space is an expensive resource. If floor space is simply expanded without any attention to the effective use, profitability and shareholder value will decline.

Reporting sales per square metre will ensure that floor space is adequately used, and will encourage a balance between ensuring that a wide range of merchandise is presented to customers and allowing sufficient space for customers to view the products.

Customer satisfaction
Customer retention has already been discussed above, and assessment of this aspect could be enhanced by considering the level of customer complaints unresolved at store level within 24 hours.

It goes without saying that customer satisfaction is of critical importance. If customer complaints are dealt with quickly and resolved at store level, the result is likely to be a high degree of customer satisfaction. On the other hand, if complaints take a long time to be resolved, and it is necessary to pass them 'up the line', customers are likely to be dissatisfied.

A simple measure of the number of complaints unresolved at store level within 24 hours will highlight stores which may have problems with customer satisfaction.

The measure could also be developed to reflect relative performance by measuring the number of such complaints as a percentage of either the number of complaints received or the number of sales completed.

Level of customer returns
Measuring the value of sales returns as a percentage of sales in a particular period will provide an indication of customer satisfaction. If customers find it necessary to return products, they are clearly less than satisfied with their purchases.

Stock management
Stock turnover period
In fashion retailing, it is extremely important to achieve a short stock turnover period. This measure must be closely monitored to ensure that any deterioration in performance is highlighted and dealt with quickly.

Level of sales at less than full retail price
As noted in the introductory comments to this section, there will be little point in achieving a satisfactory stock turnover period if this is at the expense of profitability. Monitoring the percentage of sales revenue at less than full retail price will indicate if a store has allowed surplus or slow moving stock to be built up.

It should be noted that none of the measures discussed above should be viewed in isolation. The management reporting system should include a range of measures which are designed to direct the attention of managers to the key performance areas of the business, and interpretation of the measures reported will require application of managers' skill and experience.

Appendix
Calculation of key measures from financial statements

	2003	2002
EBITDA	**£m**	**£m**
Operating profit	84·6	63·7
+ Depreciation (note 3)	24·8	20·8
Amortisation (note 3)	2·4	2·2
	111·8	86·7

ROCE

$$\frac{£84·6 + £1·9}{£148·5} \times 100 = 58·2\% \qquad \frac{£63·7 + £0·9}{£112·7} \times 100 = 57·3\%$$

Net profit margin

$$\frac{£86·5}{£643·4} \times 100 = 13·4\% \qquad \frac{£64·6}{£585·4} \times 100 = 11·04\%$$

Asset turnover

$$\frac{£643·4}{£148·5} = 4·3 \text{ times} \qquad \frac{£585·4}{£112·7} = 5·19 \text{ times}$$

Gearing

$$\frac{£13·7}{£125·0} \times 100 = 10·96\% \qquad \frac{£20·6}{£85·5} \times 100 = 24·09\%$$

Working capital cycle
Stock t/over

$$\frac{£40·3}{£490·9} \times 365 = 30 \text{ days} \qquad \frac{£37·7}{£454·8} \times 365 = 30·25 \text{ days}$$

Creditors period

$$\frac{£19·2}{£490·9} \times 365 = 14·3 \text{ days} \qquad \frac{£22·7}{£454·8} \times 365 = 18·2 \text{ days}$$

Total 15·7 days 12·05 days

NB Debtors not included as not material

Fixed asset turnover

$$\frac{£643·4}{£116·9} = 5·5 \text{ times} \qquad \frac{£585·4}{£99·8} = 5·8 \text{ times}$$

Interest cover

$$\frac{£86·5}{£1·3} = 66·5 \text{ times} \qquad \frac{£64·6}{£2·3} = 28·1 \text{ times}$$

Dividend cover

$$\frac{£55·5}{£17·4} = 3·2 \text{ times} \qquad \frac{£39·3}{£14} = 2·8 \text{ times}$$

Diploma in Financial Management – Module A
Project DA2 incorporating subject areas:
Interpretation of Financial Statements and
Performance Management

Project Marking Scheme
Issue date February 2005

1	**(a)**	Needs of	institutional shareholders			
			1 mark per comment to a MAXIMUM of		3	
			private shareholders			
			1 mark per comment to a MAXIMUM of		3	6
	(b)	Ratios	for each group:			
			justification:	1 mark per ratio	10	
			calculation:	1 mark per ratio	10	
					20	
		Interpretion	1 mark for each comment to a MAXIMUM of		12	32
	(c)	Limitations:				
		1 mark for each comment to a MAXIMUM of			6	
		1 mark for each illustration from the financial statements			6	12
						50
2	**(a)**	1 mark for each comment to a MAXIMUM of			7	
		Format			1	8
	(b)	for each measure:				
		explanation of significance and means of measuring –				
		1 mark per comment, to a MAXIMUM of			22	
		Format			2	24
	(c)	explanation of benchmarking in retail environment				
		1 mark per comment to a MAXIMUM of			5	
		Format			1	
		measures:				
		2 marks for each measure to a MAXIMUM of			12	18
						50
					Total	**100**