INSEAD

Accounting & Control Area

Course Calendar

Period 3 - (January-February)	**Campus**	**Credits**
FINANCIAL STATEMENT ANALYSIS	Europe & Asia	1
Period 4 - (March-April)	**Campus**	**Credits**
CORPORATE GOVERNANCE	Europe & Asia	0.5
STRATEGIC COST MANAGEMENT & CONTROL	Europe & Asia	0.5

FINANCIAL STATEMENT ANALYSIS - P3 - FULL ELECTIVE

Course Objectives:

The primary objective of the course is the development of a framework for linking value creation to firms' financial statements. Value creation is the fundamental objective of any business and the financial statements are a key source of information about business performance.

Our goal throughout the course is to integrate the three phenomena discussed below into a framework that is: (1) *rigorous* and, thus, durable over time; yet, (2) *intuitive* and, thus, easy to understand, remember, and explain to others.

1. Analysing ROIC – we develop an in-depth understanding of how to calculate and evaluate return on invested capital (i.e., ROIC) and its components. **We focus on ROIC because it is the key financial-statement-based indicator of value creation.** Hence, we have the following objectives:

   - Understand the central importance of ROIC.
   - Understand how to use financial statement numbers to calculate ROIC and its components (i.e., ratios).
   - Understand the relative advantages and disadvantages of accounting-based performance indicators (e.g., ROIC) and cash-based performance indicators (e.g., cash flow return on investment - i.e., CFROI).
   - Understand how to use our intuition and knowledge about a firm to evaluate ROIC and its components.
   - Understand why we focus on ROIC instead of ROE (i.e., return on equity) and why ROE is often a misleading indicator of value creation.

2. Accounting analysis – ROIC is a useful indicator of value creation but it is based on accounting numbers. Hence, if the accounting does not reflect the underlying business activities, ROIC is a poor indicator. In light of this fact, we use the following three-step approach for evaluating accounting quality.

   - First, understand the economics. Why did management enter into a particular transaction or arrangement? What did they hope to accomplish? How well are they executing their plan?
   - Second, understand the accounting. How is the transaction or arrangement accounted for? Does this make sense? Does it reflect the economics?
   - Finally, if the accounting doesn't reflect the economics, adjust the numbers so that ROIC and its components are more meaningful.

We practice implementing the above approach by discussing several cases. Some of the cases focus on key transactions and business arrangements such as: (1) the purchase and use of long-lived, tangible and intangible assets; (2) joint ventures and alliances; (3) mergers and acquisition; etc. Other cases focus on general approaches for identifying low-quality earning such as "red flags" analysis, etc.

It is important to note that throughout the discussion we focus on developing an intuitive understanding of accounting. This is not difficult. In particular, accounting is just a way of keeping score so, if you understand the "game," you understand the accounting. In this case, the game is just a particular business, so the key to accounting analysis is to know the business.

3. Valuation – We begin by reviewing the discounted cash flow model (i.e., DCF), which shows that value is equal to discounted expected future cash flows. Next, we show that expected future cash flows are determined by expected future ROIC. This is extremely useful because it allows us open up the DCF "black box." In particular, **we can link value to ROIC, which, in turn, can be decomposed into ratios that relate to specific business**

activities. Hence, we can directly integrate our knowledge and intuition about the business into our value estimate. After developing these links we use them to improve our understanding of:

- The forecasting process. In particular, we discuss how to forecast future ROIC and how to convert these forecasts into value estimates.
- How to use scenarios to evaluate different possibilities and alternative choices.
- How to interpret various valuation multiples such as price-to-earnings.

CORPORATE GOVERNANCE – P4 – MINI ELECTIVE

Course Objectives

Corporate governance is critical to organizational success and failure. It underlies all organizational objectives and how they are achieved on behalf of owners and stakeholders. The purpose of this course is to equip you with the understanding of the frameworks and best practices how corporate governance is enacted, structured, actively changed and will evolve should you ever serve as (or interact with) someone that performs a governance role (e.g., director, governor, advisor, executive) in any organization.

Learning Goals

After completing the course, you will be able to:

- Understand the governance roles, stakeholder tensions and governance approaches across many countries and organizational types and predict how these shape organizational outcomes.
- Critically evaluate what is good corporate governance, including structural, incentivisation and monitoring choices available to organizations, and how these choices lead to organizational successes or governance failure.
- Appraise alternative governance structures and actions for a board when presented with a strategic choice or when under attack, including activism campaigns and hostile takeover attempts and defences.
- Appraise the current state of corporate governance practice and its recent developments and devise the skills and attributes current and future directors need to be successful.

Who Should Take This Course?

Anyone who intends to serve as an executive, or as a director or advisor on any board, be it a publicly listed firm, new venture, family firm, government enterprise, non-profit or charity. Further, anyone who intends to be an investor or an important stakeholder for any of these organizations. Finally, anyone who intends to provide services (e.g., consulting) to C-suite executives or board of directors. Accelerating demand for director education programs at INSEAD proves that governance skills are both lacking and will continued to be highly valued by organizations.

Course Overview

Corporate governance is the set of control mechanisms to enable achievement of organizational objectives and dissuade potentially self-interested managers from activities detrimental to the welfare of owners and stakeholders. Good corporate governance is therefore a key element of corporations' desire to create value. Time and again corporate governance has been on the forefront of public and political debate. While many critics argue the ineffectiveness of current corporate governance practices, due to factors such as dispersed ownership, detrimental activism by active investors, management entrenchment and short termism, or narrowly focused corporate objectives; there is also an absence of fundamental frameworks in this discourse to understand effective corporate governance and evidence-based logics that can inform best practices. In this course, we introduce these frameworks and provide evidence-based best practices that can be implemented across all types of organizations, operating in all types of institutional settings.

STRATEGIC COST MANAGEMENT & CONTROL - P4 - MINI ELECTIVE

Course Objectives

The purpose of this course is to enable you to hone your skills in extracting relevant information from companies' accounting systems and using it to make sensible decisions. Both are more difficult to do than most people think – i.e. they underestimate the difficulties of the tasks.

I believe that the ability to do this should be part of the 'managerial reflexes' of an INSEAD MBA student – something you can do quickly, automatically and faultlessly.

Surprising as it may seem, companies have poor 'cost knowledge' – the data are confusing, incorrect and incomplete – and executives and experts are unaware, a case of familiarity breeding insouciance. Evidence for this state of affairs can be found in Financial Instruction Manuals, budgets, product costs, etc. and during class discussions of our executive education programmes.

While there is nothing particularly new about the situation, the stakes are higher than before. It is impossible to open a copy of the *Financial Times* or *The Wall Street Journal* without encountering articles on companies that have embarked on significant initiatives to reconfigure their business models, restructure, reduce costs or prepare to confront disruptive strategies of new entrants.

The challenge facing companies is that they have business models, management accounting systems and mindsets, that allow them to prosper in good times, but leave them struggling in bad. There are of course notable exceptions such as Southwest Airlines. Its success is the stuff of legend. There are decades when the company made more profits than the rest of the American airline industry put together.

The importance of good 'cost knowledge' has rarely been greater.

<u>Consequently the objectives of the course are to</u>:

- Consolidate what you learnt in Period 1 & 2 core courses;
- Provide an opportunity to practise applying your conceptual knowledge in more realistic and complex settings than you have encountered so far;
- Help you avoid making the 'unforced errors' so prevalent among managers and companies irrespective of seniority, sector and size.

The course has four segments:

<u>Recap</u> We begin with two sessions which revisit, consolidate and deepen material that you first saw in Periods 1 & 2. They will allow you to calibrate what you already know and provide a taste of what is to come. If you sail through them, you probably don't need to take the elective.

<u>Architecture</u> Two sessions are devoted to examining how companies acquire resources ('costs nature of expense') and transform them into products and services ('costs by final cost object'). The integrity of the final data depends on the degree to which the cost system maps the business model (the manner in which work is performed by the organisation). Executives appear to be unaware of the notion of architecture and consequently that bad or inappropriate architecture compromises the accuracy and relevance of cost data.

Decision-making The next two sessions look at the vexed issue of using accounting information for making decisions. Executives do this, in one way or another, every day of their working lives. More often than not, they are given the wrong data, they use the wrong concepts and tools, they believe the experts have got it right and they ask the wrong questions. Recently, executives from a well-known consumer goods company, when confronted with a product cost, pricing, profitability case said that company procedures didn't allow them to do it the theoretically 'correct' way. Consequently, they either missed opportunities or made downright bad decisions.

Measuring performance Virtually all organisations attempt to track performance, compare this with expectations/commitments contained in budgets and decide whether corrective action is required. These systems are also frequently used as inputs to incentive systems that determine bonuses and career progression. A senior consultant, from one of the top three companies, ventured the opinion that all his assignments involved issues around poor alignment of metrics and incentives. These issues are discussed in this session.

At the end of this mini-elective you will be able to:

1. Understand the content and relevance of management accounting documents [budgets, product costs, profitability of business units, etc.].
2. Modify, if necessary, and use accounting information to weigh up the merits of alternative courses of action.
3. Develop the knowledge and skill to ask the right questions of the experts – accountants and controllers.
4. Synthesise the disparate information into a coherent story that makes sense of the situation under consideration.

This may sound obvious, somewhat dry and dull; maybe highly technical. It is none of these.

Recently I asked a group of mid-level executives from major corporations [household names] whether they understood where the data they received came from and how they had been produced. None of the fifty replied in the affirmative.

The mini-elective is an opportunity for you to hone your skills in a domain where companies are woefully lacking and mistakes egregious. These 'unforced errors', leading to destruction of value, are as unfortunate as they are unnecessary.

We will use case studies, some relatively new, some old, none very long, and none what they seem to be.

I believe that picking out facts in business situations is relatively easy; the difficult task is to understand their significance, to place them in proper perspective, to detect patterns and so be able to tell the story. It is this 'sense making' skill that case analysis encourages and MBAs should be good at.