

## *Using the Owners' Money Wisely – Bill Beedles*

### Overview

“We treasure what we measure.” Some clichés hold great truth, and that is the case here. Unless we measure our financial performance, we have dreams rather than a business plan. The purpose of this session is to learn how to implement the two premier measures of financial returns that can be applied in public and private organizations. (1) Return on Equity (ROE) is strictly an accounting-based measure. (2) Residual Income combines data from accounting and the capital markets.

Course Topics At the end of this session, everyone should be able to:

- Isolate the parts of financial statements that are most important to the owners of the enterprise.
- Distinguish earnings from cash flow.
- Use those data to compute Return on Equity.
- Measure and interpret the three components that can be managed to increase ROE:
  - Profit margin measures cost management.
  - Turnover measures asset management.
  - Equity ratio measures financial management.
- Apply the concepts by interpreting ROE and components in a cross-industry analysis.
- Identify the risks and returns of major asset classes articulating the effects of:
  - Inflation on short-term U.S. Government obligations.
  - Interest rate risk on long-term Governments.
  - Default on corporate bonds.
  - Variability on corporate shares.
  - Liquidity on small companies.
- Estimate the required return of owners based on three components.
  - Returns available from risk free investments.
  - The return premium provided by an average risk investment.
  - The discount or premium provided by investments that are not average
    - Conservative.
    - Aggressive.
    - Counter-cyclical.
- Compute the Residual Income of an actual company.
  - Distinguish Net *Operating* Profit After Tax (NOPAT) from accounting earnings.
  - Estimate the Weighted Average Cost of Capital.
  - Find the carrying cost of capital.
  - Determine Residual Income.
- Discuss applications of the measures that have been used to solve various real world problems.