

Strategic Valuation in the New Economy

Mark L. Frigo, Ph.D., CMA, CPA, CGMA

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Q&A

Asking Questions



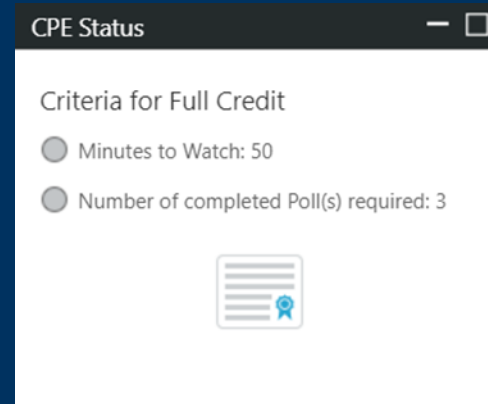
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Moderator

Terry Mormile, CPA, CAE
Director,
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IMA



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Featured Presenter

Mark L. Frigo, Ph.D., CMA, CPA, CGMA
Professor
DePaul University



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Mark Frigo's Biography

- Dr. Mark Frigo is founder of the Center for Strategy, Execution and Valuation and the Strategic Risk Management Lab and Ezerski Endowed Chair of Strategy & Leadership Emeritus in the Driehaus College of Business at DePaul University in Chicago.
- He is the author of seven books and over 125 articles published in leading business journals including Harvard Business Review. He is also the co-author of the book *DRIVEN: Business Strategy, Human Actions and the Creation of Wealth*, which describes the strategic activities of high-performance companies as described in the Return Driven Strategy framework and a recent COSO report *Creating and Protecting Value: Understanding and Implementing ERM (2020)*.
- Dr. Frigo is a leading expert in the evolving discipline of Strategic Valuation. You can reach Mark at mfrigo@depaul.edu.

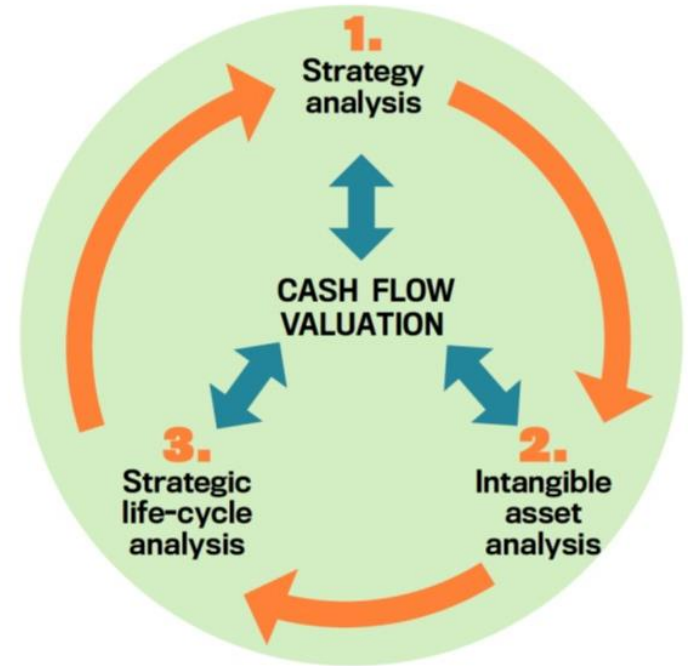
Learning Objectives

1. Describe each step in the Strategic Valuation process and the benefits of the Strategic Valuation approach in the new economy.
2. Identify how Strategic Valuation can be used to develop and validate the key assumptions (return on investment, margins, asset turns, and growth) in traditional quantitative valuation models.
3. Recognize how to apply the Strategic Valuation process to assess sustainability strategies and investments in sustainability initiatives.
4. Explain how to use strategic valuation for valuing a company (or operating unit) in M&A analysis and investment decisions.

Agenda

1. What is Strategic Valuation? What are the Benefits?
2. The Three-Step Strategic Valuation Process
3. Strategic Valuation for Sustainability/ESG Strategies
4. Strategic Valuation of M&A and Investment Decisions
5. Conclusions and Key Take-aways

FIGURE 1: THE STRATEGIC VALUATION PROCESS



What is Strategic Valuation?

What is Strategic Valuation Analysis?

- A qualitative and analytical valuation process,
- A logical foundation for properly valuing a company (or business unit);
- Used to help develop and validate the key assumptions and value drivers (return on investment (ROI), margins, asset turns, and growth) in the traditional quantitative valuation processes and models
- Used in capital and resource reinvestment decisions.

Why is Strategic Valuation Needed Today?

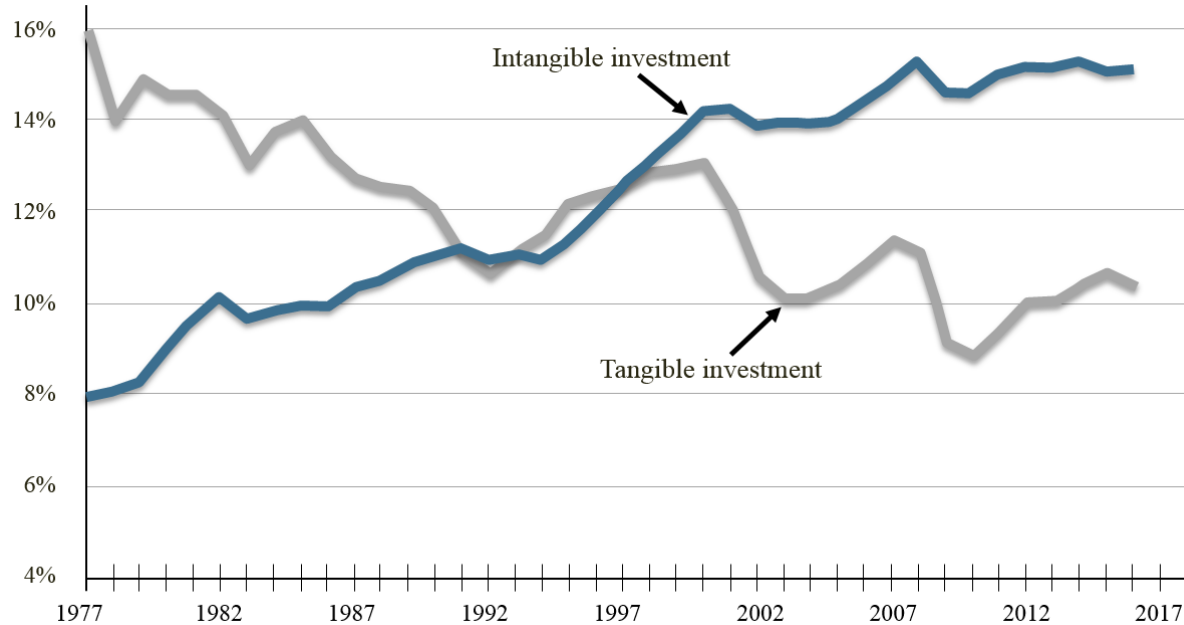
Management accountants and finance professionals need new skills in evaluating intangibles in the new economy.

- Valuation of a company has always been an important role and challenge for CFOs and management teams.
- It's an even greater challenge today in the new economy where intangible assets drive most of the value creation and the valuation of a company.

Why Strategic Valuation?

- Based on the basic premise that strategy should drive capital investments and resources allocation.
- Ensures that strategy will drive resource allocations to create long-term value.
- Helps companies avoid the common problem of allowing operating plans and budget targets (rather than strategy) to inadvertently drive capital investment decisions that work against long-term value creation and lead to short-termism.
- A key question to address: How well are capital expenditures evaluated, with rigorous attention to how the capital expenditure will create long-term financial value through the strategy?

Intangibles Drive Most of the Value Creation and Valuation in the New Economy



Source: Carol Corrado and Charles Hulten: American Economic Review

Benefits of Strategic Valuation for CFOs and Finance Organizations

Strategic Valuation can be a useful tool to explain how Intangibles and reinvestments create long-term value to shareholders and a first step in valuing a company.

1. Finance teams can incorporate the Return Driven Strategy framework and Competitive Life Cycle Analysis framework to guide reinvestments and resource allocation in intangibles (R&D, Brand, People).
2. CFOs can use strategic valuation to brief the Board of Directors on how the company intends to create long-term sustainable value.
3. CFOs can use strategic valuation in earnings calls and presentations to investors.

Poll Question 1:

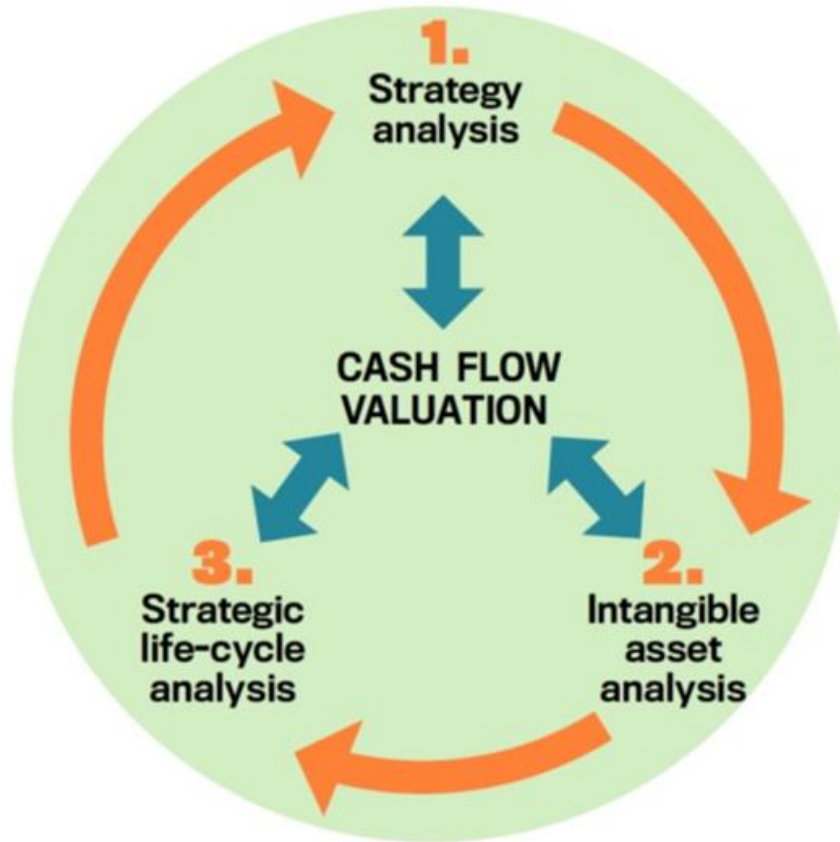
Does your company conduct annual valuation analysis of the company (or business unit)?

- a. Yes
- b. No
- c. Not sure

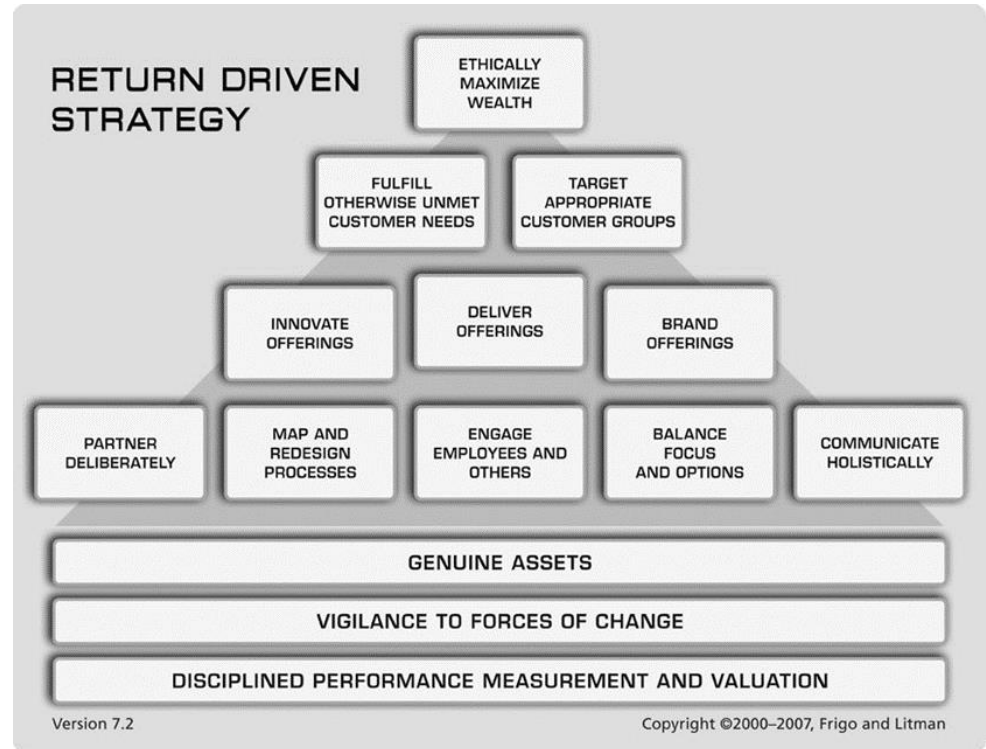
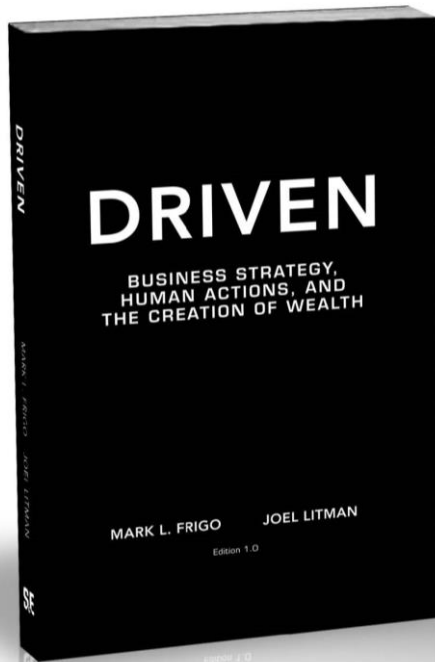
Poll Question 1 Results: (Placeholder)

The Strategic Valuation Process

The Strategic Valuation Process

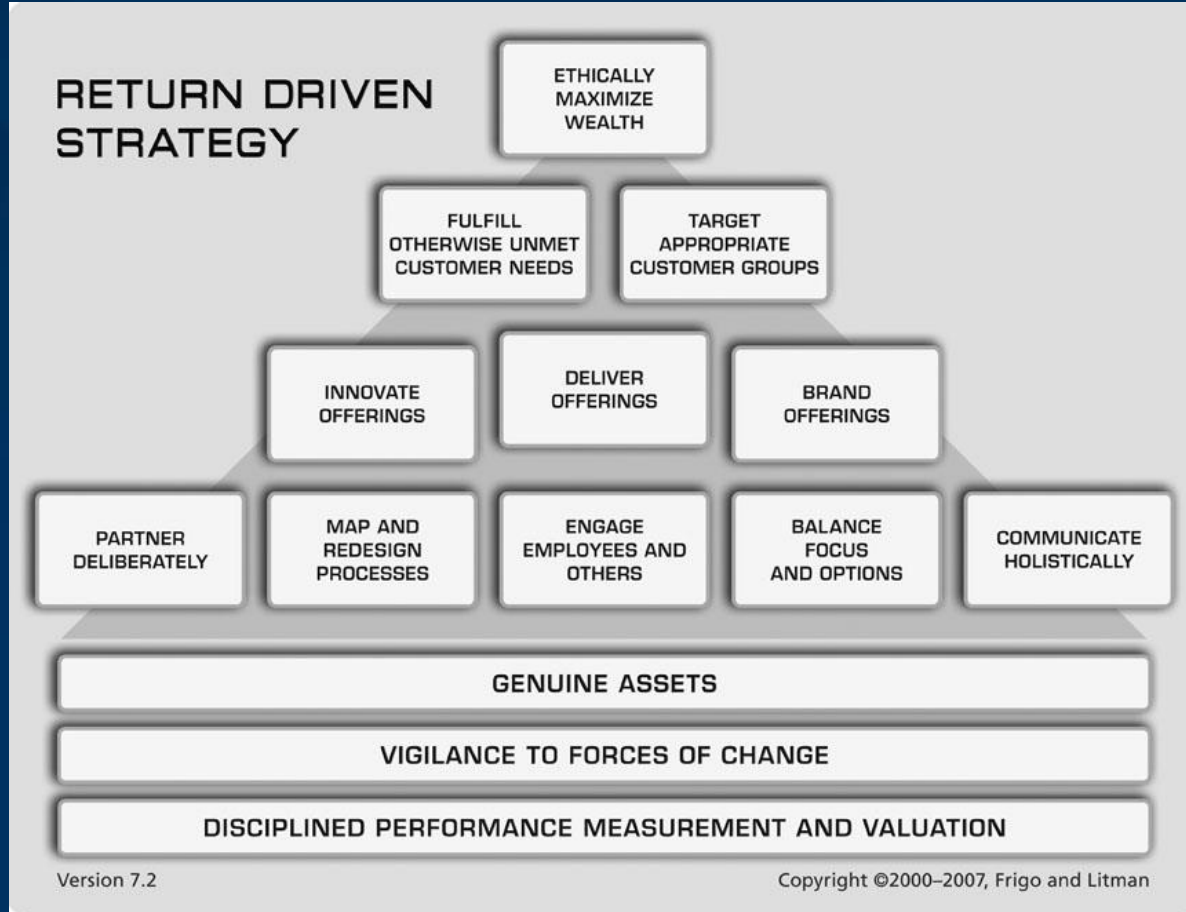


Return Driven Strategy: The Foundation of Strategic Valuation

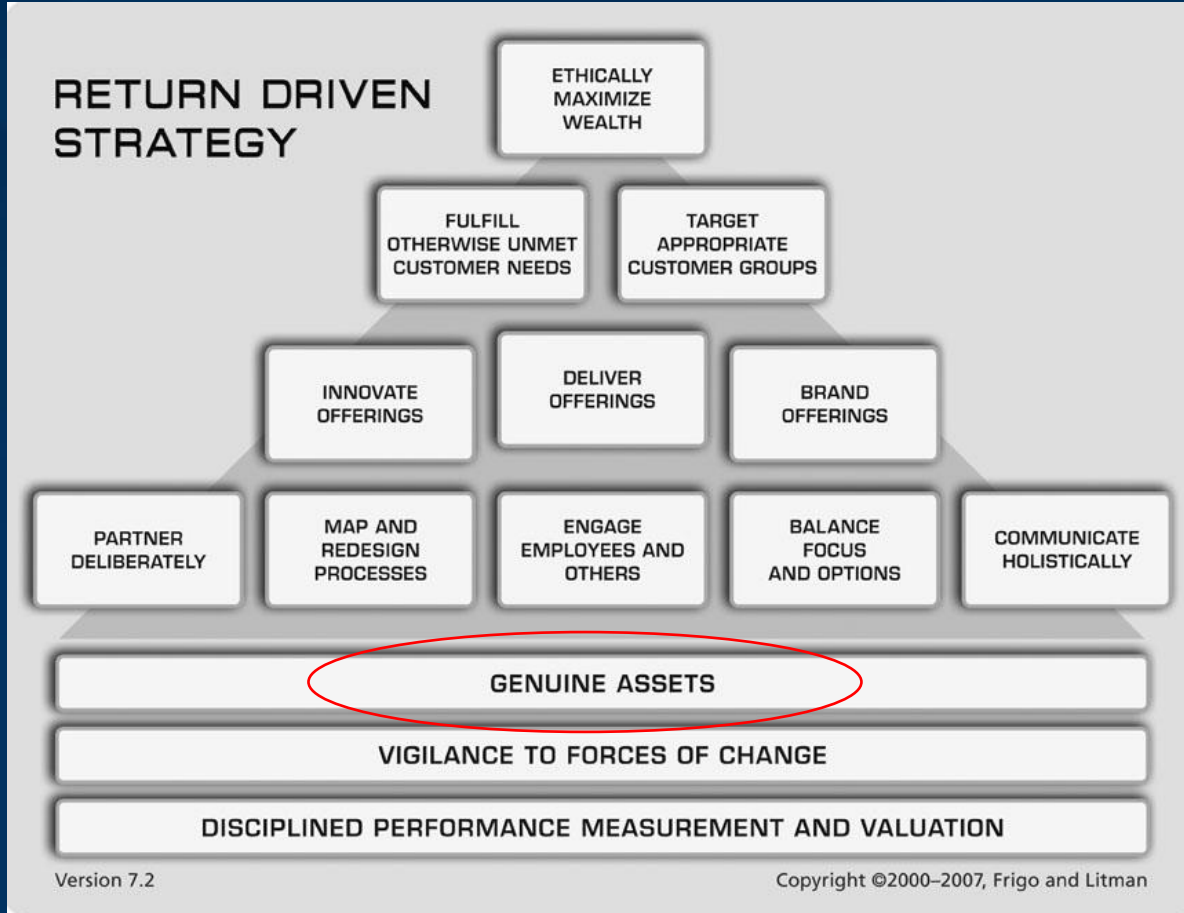


“DRIVEN: Business Strategy, Human Actions the Creation of Wealth”
Mark L. Frigo and Joel Litman

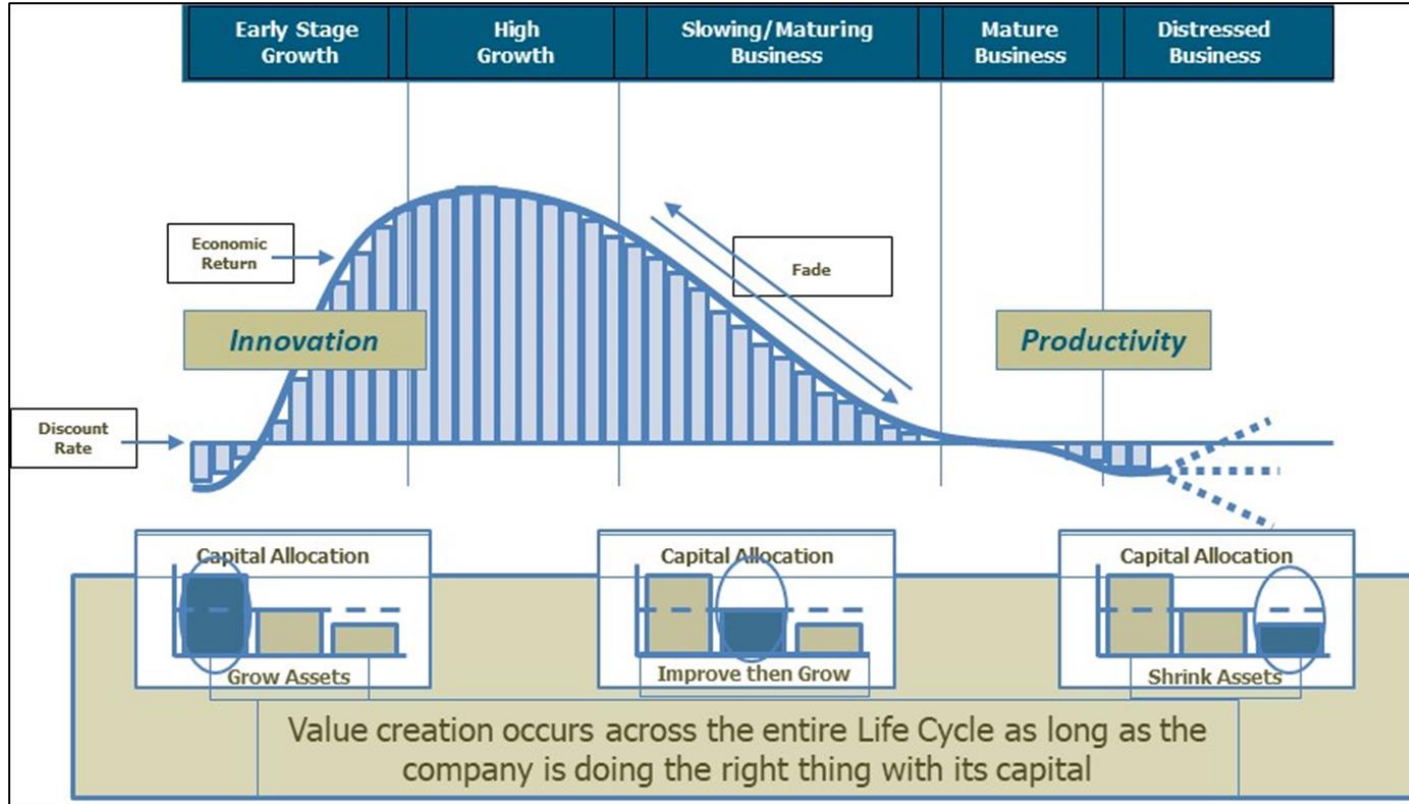
Step 1: Strategy Analysis



Step 2: Intangible Asset Analysis



Step 3: Strategic Life Cycle Analysis



Step 3: Strategic Life Cycle Analysis

LIFE-CYCLE REVIEW CHECKLIST FOR CFOs AND FINANCE ORGANIZATIONS



✓ CONDUCT LIFE-CYCLE REVIEWS

Use life-cycle reviews as a critically important, CFO-directed tool to improve decision making and to continually refine how intangibles are treated (e.g., capitalizing R&D expenditures) in calculating an adjusted return on capital or economic return.



✓ MONITOR AND COMMUNICATE RETURNS AND REINVESTMENT RATES

Assess key insights about a business unit's financial performance by showing both historical and forecasted financial results in terms of the life-cycle variables—economic returns and reinvestment rates.



✓ KNOW WHERE TO REINVEST

Analyze the forecast given the business unit's track record and the skills of competitors. Is the business unit's strategy and resource allocation consistent with the business unit's position on the life cycle?

“Strategic Life-Cycle Analysis: The Role of the CFO” Strategic Finance (October 2020) Frigo and Madden

Step 3: Strategic Life Cycle Analysis

THE STARTING POINT FOR LIFE-CYCLE REVIEWS



STEP 1

A productive debate/discussion about strategy and resource allocation begins with a common valuation language provided by life-cycle reviews.



STEP 2

Learn and master the life-cycle language of economic returns, reinvestment rates, and cost of capital, which are logically sound and pragmatic as depicted in the life-cycle framework.



STEP 3

Once agreement is reached on where a business unit is on the life cycle, a conversation can focus on the key issue determining the future value creation of that business unit.

“Strategic Life-Cycle Analysis: The Role of the CFO” Strategic Finance (October 2020) Frigo and Madden

Poll Question 2:

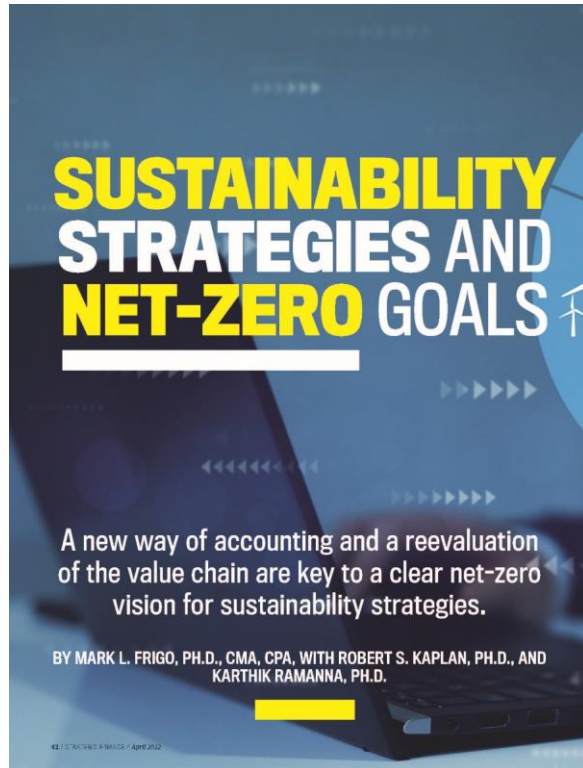
Does your company conduct a “Strategic Analysis” of the company (or business unit) to develop or validate key assumptions in traditional quantitative valuation analysis?

- a. Yes
- b. No
- c. Not sure

Poll Question 2 Results: (Placeholder)

Strategic Valuation for Sustainability/ESG Strategies

Sustainability Strategy Tool Kit for CFOs and Finance Organizations



Sustainability Strategy Tool Kit

- **Strategy risk assessment: an action plan for sustainability strategies, related metrics, and any identifiable risks**
- **Strategic valuation: how zero-carbon strategies can drive innovation, growth, and effective risk management**
- **Strategic life-cycle analysis: how the company invests in sustainability strategies and evaluates ROIs and reinvestments**



“Sustainability Strategies and Net-Zero Goals” Strategic Finance (April 2022) Frigo, Kaplan and Ramanna

Describing How Sustainability Strategies Create Value

Here are some other factors to consider:

- How the United Nations Sustainable Development Goals (SDGs) can be reflected in the strategy and reporting of the company, demonstrating long-term financial value and impact to investors
- Include sustainability strategies and related Sustainability Accounting Standards Board (SASB) metrics in the strategic valuation process
- Use the strategic valuation process to understand and communicate how their zero-carbon strategies can drive more effective innovation, growth, competitiveness, and risk management.

Poll Question 3:

Does your company conduct an “Intangible Assets Valuation Analysis” of the company (or business unit) as part of its valuation analysis?

- a. Yes
- b. No
- c. Not sure

Poll Question 3 Results: (Placeholder)

Strategic Valuation of M&A and Investment Decisions

How to Use the Strategic Life Cycle Analysis as Part of a Strategic Valuation Process for Valuing a Company

FIGURE 1: THE STRATEGIC VALUATION PROCESS

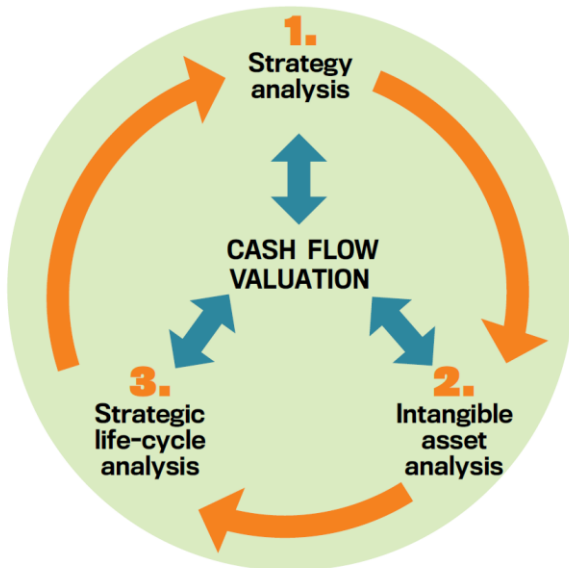
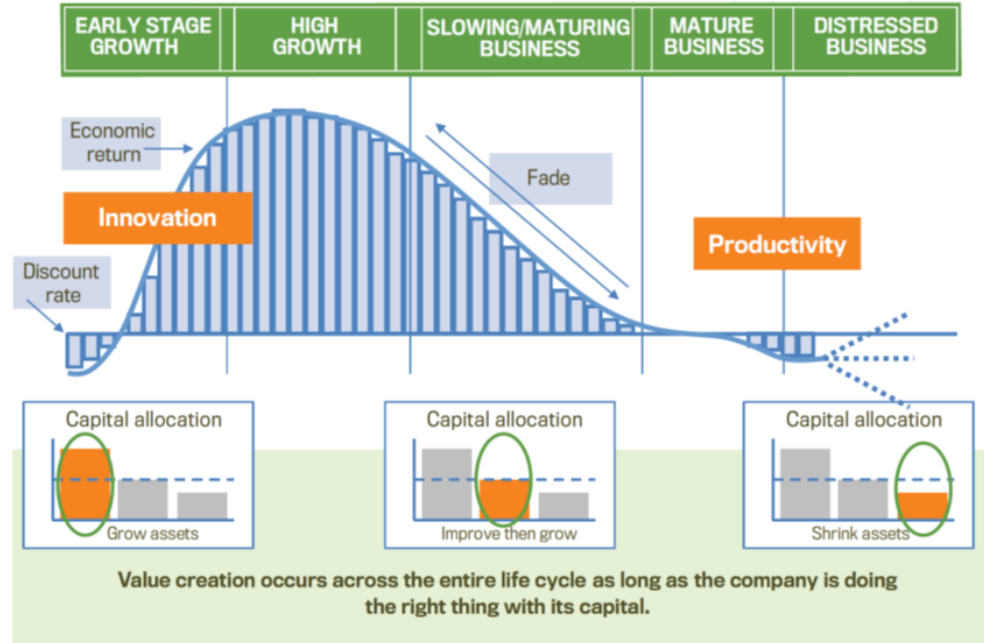


FIGURE 2: LIFE-CYCLE CAPITAL ALLOCATION GUIDE



“Strategic Valuation in the New Economy” Strategic Finance (October 2021) Mark L. Frigo

Describing How Intangible Assets Create Value

Strategic Finance: How does Baruch Lev and Feng Gu's "Strategic Resources & Consequences Report" on the items that create a sustained economic advantage inform strategic valuation?

Frigo: Companies can develop their own internal Strategic Resources & Consequences Report as part step 2 in the strategic valuation process. This can help the CFO and finance organization develop performance measures and incentives that are more highly aligned with long-term sustainable value creation.

Applications of Balanced Scorecard Strategy Maps

Strategic Finance: How can balanced scorecard strategy maps be used in the strategic valuation process?

Frigo: Balanced scorecard strategy maps can be very useful in steps 1 and 2 of the strategic valuation process to develop the cause-and-effect linkages between intangible assets and financial value creation.

The architecture of the balanced scorecard and Return Driven Strategy framework are consistent, so we can use strategy maps to describe and connect the strategic objectives and performance measures in the four perspectives of the balanced scorecard: financial, customer, internal processes, and innovation and growth.

Poll Question 4:

Does your company conduct a “Strategic Life-Cycle Analysis” of the company (or business unit) as part of its valuation analysis?

- a. Yes
- b. No
- c. Not Sure

Poll Question 4 Results: (Placeholder)

Conclusions and Key Take-Aways

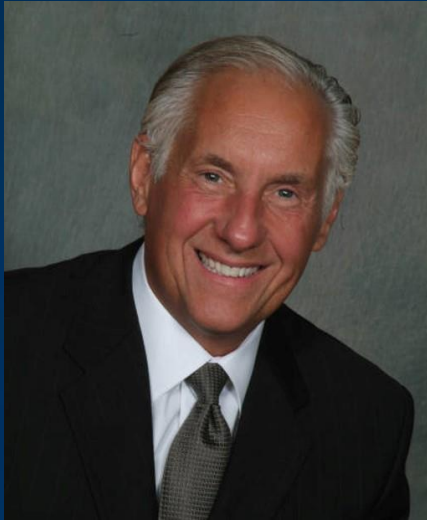
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“ Management accountants and finance professionals need new skills in evaluating intangibles in the new economy

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Questions and Answers



Mark L. Frigo, Ph.D., CMA, CPA, CGMA
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DePaul University



Terry Mormile, CPA, CAE
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IMA

Thank You to Our Presenter!

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Final Reminders

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Thank you!



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