# CHAPTER 6

# GROWTH IN SALES AND VALUE CREATION IN TERMS OF THE FINANCIAL STRATEGY MATRIX

## 6.1 INTRODUCTION

It is very important for all companies to manage growth. It is possible for a company to grow without adding value, and the quality of the growth, or lack of it, is revealed by the calculation of the EVA for that particular company. A positive EVA (or NPV) for an expansion project indicates that the growth in assets and sales in terms of that project will add value after taking into account the full cost of capital. This issue has been dealt with in detail in previous chapters.

Another aspect of growth that is vital to an organization is the pace at which it grows. As long as a company has easy access to additional shareholders' funds or borrowed funds, it can increase its assets (and therefore also its sales) almost as rapidly as it likes, provided the demand is large enough. If the company does not want to raise new shareholders' funds to finance growth, it can use internally generated funds plus an amount of borrowings (limited by the target capital structure).

Managers are often reluctant to issue new shares for a number of reasons. The most important reasons are the possibility of a loss of control when new shareholders take up shares, and the fact that new issues are expensive due to flotation costs. Consequently, it is preferable to finance growth from retained

income as well as an appropriate amount of debt, in order for the target capital structure to remain the same.

Hawawini and Viallet (1999:506) define the sustainable growth rate of a company as follows: “The self-sustainable growth rate is the maximum rate of growth in sales a business can achieve *without* changing its financing policy (same debt-to-equity ratio, same dividend payout ratio, and no new issue of equity or share repurchase) or modifying its operating policy (same operating profit margin and same capital turnover).”

In this chapter it is shown that the rate at which a company can (consistently) grow its sales is determined by its financial performance and its financial policies. The discussion shows that growing sales at a rate faster than the SGR could cause cash shortfalls and that sales growth at a lower rate than the SGR could lead to cash surpluses.

The discussion on sales growth is followed by the introduction of the financial strategy matrix as a financial tool, incorporating both value management and growth management (sales growth relative to the SGR percentage).

## 6.2 FINANCING REQUIRED FOR SALES GROWTH

It is a well-known axiom that it takes money to make money. This means that in order to increase sales, a company also needs to increase its fixed assets, debtors and inventory to produce and support the additional sales. There obviously also needs to be a spontaneous increase in trade creditors to provide the additional short-term finance needed. Consequently, additional finance is needed to finance extra fixed assets, plus extra net working capital. The total amount of net assets (referred to above) is also described as the “total net assets”.

Many inexperienced and overly optimistic entrepreneurs have found that companies can actually “grow them to death” by increasing their sales too rapidly.

If sales grow too quickly, there is not enough spontaneous finance from retained income and debt (to maintain the target financial gearing ratio) to finance additional fixed assets and to supply the net working capital needed. This causes a cash shortfall that accumulates rapidly if the growth in sales is not limited to a sustainable level.

Cash shortfalls can be overcome by extra borrowings (which may weaken the financial structure) and/or by new issues of shares (new issues of shares are expensive and may have unwanted control implications). These remedies could provide temporary solutions, but they are not sustainable in the long term.

The SGR is a measure that financial institutions use for different purposes, such as to evaluate the creditworthiness of companies. If the actual growth rate in the sales of a company is greater than the SGR, financial institutions are prepared to advance loans to the company or to assist in the issue of shares in order to provide the capital needed. If the actual growth rate of sales is consistently lower than the SGR, the cumulative cash surpluses would need to be invested and the financial institution may offer investment products to the company.

## 6.3 SGR

Zakon, of the Boston Consulting Group, developed the SGR. The SGR is also referred to as Zakon's formula (Correia *et al*. 2003:6-14). The SGR formula is the following:

$$SGR = D/E\,(R - i)\,p + Rp$$

where

D = debt
E = equity
R = percentage return on assets after tax
i = percentage interest on debt after tax
p = proportion of earnings retained

When one analyses the components of the formula, it is clear that the SGR is determined in terms of a company's profitability, as well as its financial policies regarding financial gearing and dividends. The formula was derived as illustrated below, in a simple example, which is then expanded.

### 6.3.1 SGR with no debt and no dividends

The growth rate that a company can sustain when it has no debt and does not pay any dividends can best be described by using an example.

So, for example, assume a company has total net assets of R100 million at the beginning of the year and a rate of return of 30% on the assets before tax. The tax rate is 30%, therefore the earnings before interest, after tax (EBIAT) is 21%.

As there is no dividend payment, the retained income is R21 million and the total net assets at the end of the year amount to R121 million. The amount of total net assets at the end of the year is 21% larger than the amount at the beginning of the year. This means that the bigger investment in assets can be used to generate 21% more in sales. Therefore the SGR is 21%.

The formula can be used to determine the SGR as follows:

$$
\begin{aligned}
SGR &= D/E\,(R - i)\,p + Rp \\
&= 0/100\,(21\% - 0\%) \times 1 + 21\% \times 1 \\
&= 0\% + 21\% \\
&= 21\%
\end{aligned}
$$

The answer shows that if there is no debt and there are no dividends, the SGR is equal to the after-tax return on assets (the amount of assets at the beginning of the year).

### 6.3.2 SGR with no debt and some dividend payment

Using the same information as that used in the example in Section 6.3.1, one can investigate the effect of a dividend policy on the SGR. If all the after-tax earnings of R21 million were paid out as dividends, the retained earnings would be zero and the SGR would be zero as well.

If half of the profits are paid out as a dividend, the retained income is R10,5 million and the retention ratio, (p), is 0,5. The total net assets at the end of the year are R110,5 million, which is 10,5% higher than the amount at the beginning of the year. The bigger asset base therefore generates 10,5% more sales during the next year. The SGR in this case is 10,5%.

This example shows that the dividend policy plays an important role in the determination of the SGR. The smaller the portion of profits paid out as dividends (the dividend payout ratio), the higher the retention ratio and the higher the SGR.

### 6.3.3 SGR with debt and dividend payments

When a company uses borrowed capital, the SGR can be increased by means of the leverage effect on profits and the fact that some debt can be added to the retained income to maintain the target capital structure.

To illustrate this scenario, the same information is used as before. It is also assumed that 40% of the assets are financed by debt, with a 15% interest rate, and that the dividend payout ratio is 0,5. The financial position and results are the following:

| | R million |
|---|---|
| Equity | 60 |
| Debt | 40 |
| Total assets – beginning of year | 100 |
| | |
| Earnings before interest and tax 30% x R100 million | 30,0 |
| Interest on debt 15% x R40 million | 6,0 |
| Earnings before tax | 24,0 |
| Tax 30% x R24 million | 7,2 |
| Earnings after tax | 16,8 |
| Dividends 50% x R16,8 million | 8,4 |
| Retained income | 8,4 |

The amount of additional debt that can be added to maintain the target capital structure is calculated as follows:

| | | |
|---|---|---|
| Additional debt | = | Retained Income x Debt / Equity |
| | = | R8,4 million x 40 / 60 |
| | = | R5,6 million |

Therefore assets and sales can be increased by R14 million, (the retained income of R8,4 million plus the additional debt of R5,6 million). The SGR is therefore 14%.

The result of 14% shows that the company could increase its SGR (from 10,5% to 14% in this instance) by using more debt financing instead of equity. The main determinants of the SGR formula are discussed below.

### 6.3.4 Factors that determine the SGR

The SGR of any company is determined by the following four factors (Ross *et al*. 1996:94):

- profit margin (an increase in the profit margin increases the firm's ability to generate funds internally and thereby increases its sustainable growth);

- net asset turnover (an increase in the firm's net asset turnover increases the sales generated for each Rand in assets; this decreases the firm's need for assets as sales grow and thereby increases the SGR – notice that increasing the net asset turnover has the same effect as decreasing capital intensity);

- financial policy (an increase in the debt/equity ratio increases the firm's financial leverage; and since this makes additional debt financing available, it increases the SGR); and

- dividend policy (a decrease in the percentage of net profit after tax paid out as dividends increases the retention ratio, in turn increasing internally generated equity and thus increasing sustainable growth).

The SGR formula is a valuable planning tool because it emphasises the relationship between the four factors described above and the SGR. It is also clear that if a company does not want to issue shares or change its profitability, asset turnover, financial gearing or dividend policy, it has only one SGR.

The SGR formula can also be used to determine what a specific variable needs to be in order to attain a particular SGR. So, for instance, if the basic information from the last example in Section 6.3.3 is used and it is furthermore assumed that profitability will change so that the SGR increases to 18%, the required return on assets, (R), can be calculated.

The information can be inserted in the SGR formula. R can then be calculated as follows:

$$SGR = D/E\,(R - i)\,p + Rp$$
$$18\% = 40/60\,(R - 10{,}5\%) \times 0{,}5 + R \times 0{,}5$$

18% = 0,33R – 3,5% + 0,5R
0,83R = 21,5%
R = 25,8%

The result from the example shows an SGR of 18% if the after-tax return on assets increases to 25,8%. This can be done by increasing the profitability relative to sales and/or increasing the asset turnover and/or decreasing the effective tax rate.

### 6.3.5 Short formula for SGR

The formula given for the SGR can be presented in a shorter version by multiplying the ROE by the retention ratio as follows:

SGR = ROE x p

Using the information in Section 6.3.3, the ROE can be calculated as follows:

ROE = Earnings after interest and tax / Equity at beginning of the year
= R16,8 million / R60 million
= 28%

SGR = 28% x 0,5
= 14%

An even shorter version of the SGR formula uses the retained income and divides it by the equity, as follows:

SGR = Retained income / Equity
= R8,4 million / R60 million
= 14%

The shorter versions of the SGR formula are valuable when an answer is required quickly and there is no need to highlight the main factors that play a role in the determination of the rate. These short formulae can also be used when there is not sufficient information available to allow the use of the longer formula. In the next section, it is shown how sales growth at rates above or below the SGR cause shortfalls or surpluses in cash.

## 6.4 SALES GROWTH RATES ABOVE AND BELOW THE SGR

Knowing the percentage of the SGR, and the main SGR determinants, is critically important to a company. The information in Section 6.3.3 and 6.3.5, with an SGR of 14%, allows the impact on cash flow of growing sales at different rates to be investigated. The different sales growth rates explored are

- equal to the SGR, which is 14%;
- above the SGR, say, at 17%; and
- at a rate below the SGR, say, at 11%.

**Amounts in R millions**

| | | | | |
|---|---|---|---|---|
| Actual growth rate in sales | | 11% | 14% | 17% |
| Additional assets required | (A) | 11,0 | 14,0 | 17,0 |
| | | | | |
| Available financing resources: | | | | |
| Retained Income | | 8,4 | 8,4 | 8,4 |
| Additional debt | | 5,6 | 5,6 | 5,6 |
| Total | (B) | 14,0 | 14,0 | 14,0 |
| | | | | |
| Surplus / (shortfall) (A) – (B) | | 3,0 | - | (3,0) |

The example above shows that if the company grows more slowly than the SGR, there is a surplus of cash, which builds up cumulatively if this scenario continues.

If sales increase by 11%, and the SGR is 14%, there is a cash surplus of 3% of net total assets (or R3 million).

If a company wants to grow its sales at a rate higher than the SGR, there is a shortfall of cash, which also builds up continuously if that scenario is perpetuated. If sales increase by 17%, and the SGR is 14%, there is a cash shortfall of 3% of the net total assets (or R3 million).

## 6.5 VALUE CREATION AND GROWTH MANAGEMENT

In the preceding chapters, the importance of economic profits (particularly EVA) have been discussed, as well as the link between EVA and a company's external indicator of value creation, its MVA. Furthermore, the repercussions of growing sales and assets too quickly have been addressed in Section 6.4 of this chapter, along with the reasons why companies should try to grow sales at a rate close to the SGR in the long term.

In this section, the main thrust of what has been discussed above is combined in a "financial strategy matrix" which links an organization's ability to create value with its management of growth and cash. Hawawini and Viallet (1999:507) introduced the financial strategy matrix concept. It represents a diagnostic tool that can be used to evaluate and navigate through the financial progress of a company.

The financial strategy matrix set out in this chapter maps the current situation of a company or industry in terms of value creation and growth management by ranking and placing it in a certain quadrant on the matrix. Once this has been done, the matrix can be used to determine appropriate strategies to improve the situation of the company and to move it to a preferred quadrant, and ultimately, to the quadrant it would most like to occupy.

The return spread, a percentage differential, is the difference between the ROIC and the WACC and is used as the measure of value creation. A positive return spread indicates value creation, while a negative return spread indicates value

destruction. As it is a relative measure and not an absolute measure, there is no need to standardize it.

Growth and cash management are measured by taking the difference between the SGR and the actual growth rate in sales. If this difference is positive (SGR > actual growth rate in sales), it indicates that there is a cumulative cash surplus. A negative difference (SGR < actual growth rate in sales) means that the company is accumulating cash deficits.

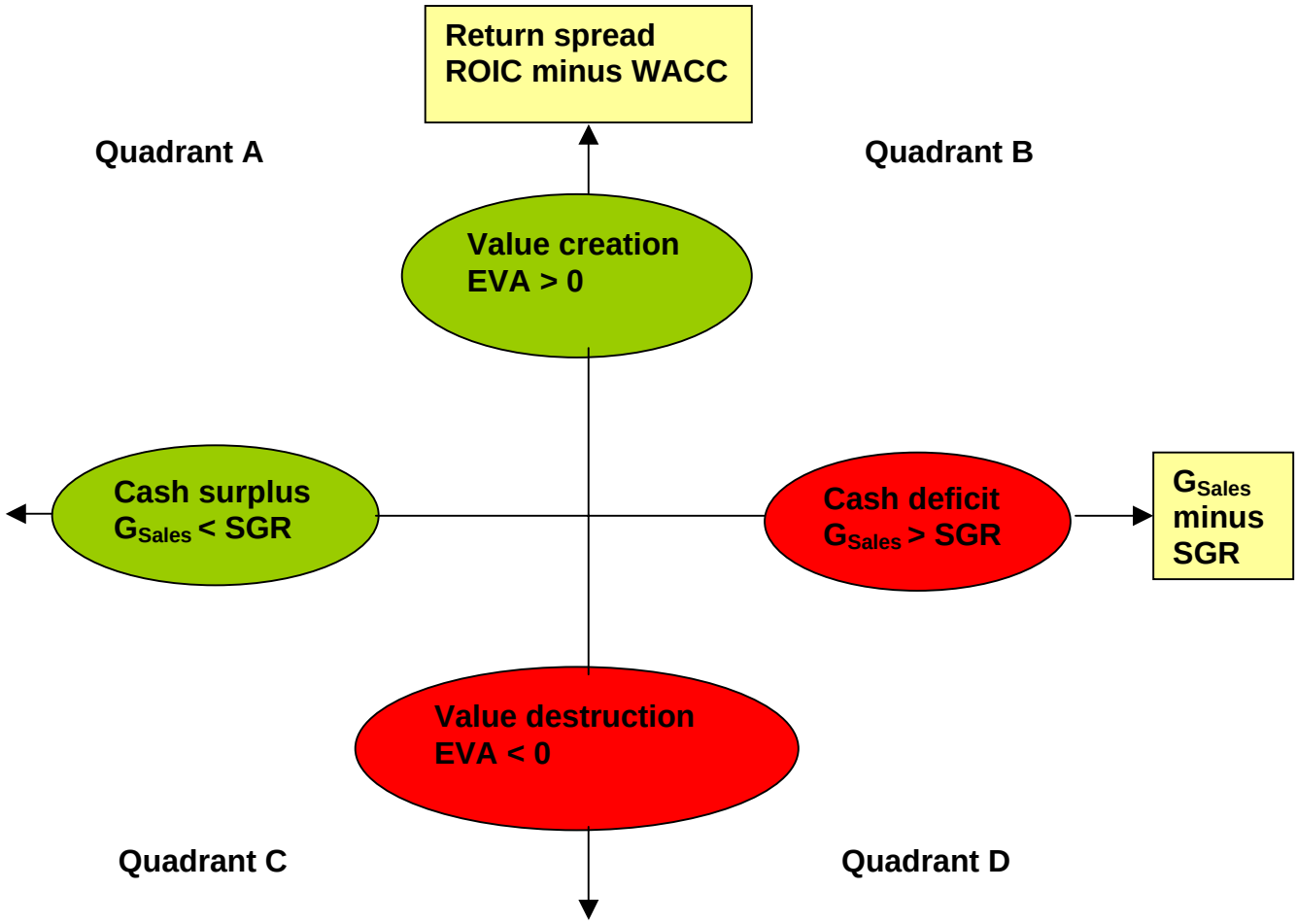
For a company with several departments or business units, it is possible to place each business unit or department on the financial strategy matrix in order to decide what course of action it should take in future. The strategic options open to a company or one of its businesses in one of the four possible quadrants is illustrated.

### 6.5.1 The financial strategy matrix

The financial strategy matrix introduced by Hawawini and Viallet (1999:507) indicates value creation (positive or negative) on the vertical axis. The measure used is the return spread (the ROIC minus the WACC). In order for comparisons between companies of different sizes to be made, the indicator of value needs to be measured relative to IC. The return spread is already a relative measure. In fact, standardizing the EVA by dividing it by the IC results in the return spread.

The pace at which a company grows, which may result in cash surpluses or cash deficits, is indicated on the horizontal axis. If the company grows too rapidly, its actual growth rate in sales is more than the SGR and the company will run up cash deficits. This situation would be reflected by a position to the right of the horizontal axis. If, on the other hand, the company's sales and assets are growing at a pace slower than the SGR, there is a build-up of cash surpluses and this situation is indicated by a position to the left of the horizontal axis. The financial strategy matrix is set out in Figure 6.1.

**Figure 6.1: Financial strategy matrix**




Source: Adapted from Hawawini and Viallet (1999:507)

*6.5.1.1 Quadrant A: positive EVA and cumulative cash surpluses*

This quadrant represents the best possible position to be in. Companies in this quadrant are adding value, as reflected by their positive EVA, and they are also not growing too quickly. They do not run up cash deficits. It is fairly obvious that these companies should strive to increase their EVA even more and should also try to make use of the cash surpluses building up each year.

The positive EVA of Quadrant A companies should result in a positive MVA for shareholders as well, unless the market believes that the current positive EVA will turn around and become negative in future. These companies can embark on specific strategies as discussed below.

The first priority of a company in this situation is to use its cash surplus to accelerate the growth of the business. This can be accomplished by expanding the company internally or by acquiring similar or related businesses. If there are no opportunities to grow internally or to negotiate appropriate acquisitions, the company may be tempted to opt for unrelated, diversifying acquisitions. Historically, it has been shown that this kind of unrelated acquisition rarely works. A company should rather avoid it, as a general rule.

If the surplus cash cannot be invested at a return that is higher than the cost of capital, the company has no choice but to return excess capital to shareholders. This provides shareholders with an opportunity to re-invest the funds in an investment of their choice. The surplus cash can be returned to the shareholders by means of a special dividend, or by means of a share buy-back scheme.

In short, the following strategic options are open to companies in Quadrant A:

- **Use cash surplus to grow faster.**
  - Make new investments (organic growth).
  - Acquire related businesses.
- **Distribute the cash surplus.**
  - Increase dividend payments.

- Repurchase shares.

#### *6.5.1.2 Quadrant B: positive EVA and cumulative cash deficits*

Quadrant B companies do create value (as indicated by a positive EVA), but are growing too fast. They run up cash deficits. There are two obvious options in this situation. The first is to reduce or eliminate dividend payments if the company is paying a dividend. It would be easier for a company to cut the dividend paid to a parent company than the dividend paid to other shareholders.

The second obvious option is to inject new capital into the business by borrowing, or by issuing shares. Extra borrowing would place an additional debt burden on the company and increase the annual cash deficits. Furthermore, it would weaken the capital structure, so it is usually not a viable option. Equity capital is the only remaining alternative to raise the funds needed. It is easier to approach a parent/holding company to invest more capital in the business than to approach other shareholders.

If it is a listed company, new shares can be issued to the public, and a rights issue would be considered first, before an open invitation to take up shares is given. A rights issue ensures that the current shareholders have a choice in deciding about maintaining their percentage shareholding or allowing it to become diluted by not taking up their rights.

If there is a new issue of equity shares, there is also an opportunity to borrow funds to the extent of maintaining the capital structure of the company. If the debt-to-equity ratio is 6:4 and the new equity capital is R6 million, an additional amount of R4 million can be borrowed so that the capital structure remains the same.

If it is not possible to raise new capital, the company has no other choice but to cut back on some of its operations or to reduce the overall growth rate to the company's SGR. The products and services to be eliminated or scaled down

would be those with the lowest profitability and the lowest capital turnover (the smallest EVA).

Such a cutback strategy may even enhance the value-creating capacity of remaining activities, because of the greater focus on a smaller market segment. However, there is some danger that competitors with cash surpluses could enter the market and put pressure on profit margins.

The options open to Quadrant B companies can be summarized as follows:

- **Cut dividends.**
- **Raise funds.**
  - Increase new equity.
  - Increase borrowing.
- **Reduce growth in sales to a sustainable level.**
  - Eliminate low margins and low capital turnover products.

#### *6.5.1.3 Quadrant C: negative EVA and cumulative cash surpluses*

Companies in this category are destroying value, but are also generating cash surpluses. Hawawini and Viallet (1999:508) suggest that these companies should alter their financial policies quickly, before the cash surplus runs out. They advise that part of the excess cash be returned to shareholders and that the rest of the cash be used to restructure the company in such a way that the returns on IC are increased to a level above the cost of capital.

As indicated earlier, ROIC can be increased by increasing either profitability relative to sales or the asset turnover. Profitability on sales can be improved by increasing volume and/or selling prices and/or by cutting operational expenditure. Asset turnover can be improved by more efficient use of fixed assets, but mostly by decreasing the investment in the net working capital. A decrease in the

investment in debtors and inventory would be the most likely steps to be taken, and will have the greatest impact.

The return spread can also be improved by trying to decrease the WACC. This can be accomplished by changing the capital structure if it is not yet at an optimal level. Moving closer to the target debt ratio will have the effect of lowering the WACC. In this situation, it is vital that one should carefully discern whether further investment in the company is feasible or not. If there is little chance that the company can be turned around by the current management, the sale of the business to someone who can perhaps create value with it would be in order.

The strategic steps that can be taken by a Quadrant C company are the following:

- **Distribute part of the cash surplus and use the rest to improve profitability.**
  - Raise the efficiency with which assets are managed.
  - Increase the operating margin (higher volume, higher prices and tighter control over expenses).
- **Review capital structure policy.**
  - If the current capital structure is not optimal, modify the debt : equity ratio in order to lower the WACC.
- **If the above fails, sell the business.**

#### *6.5.1.4 Quadrant D: negative EVA and cumulative cash deficits*

A Quadrant D company destroys value and runs up cash deficits. This is the worst situation to be in and it requires immediate attention from and fast action by management. Drastic restructuring is probably required. Some of the assets of the business must be sold in order to raise cash immediately. Furthermore, the other operations have to be scaled down to change them into value-creating activities.

If there is little chance that the remaining operations can be turned around quickly, it would be better to sell the business (unit). Care should be taken not to use surplus cash funds generated by other successful business units to finance the remaining operations of the business unit(s) in trouble. Business units that are allowed to remain in this situation too long may affect the long-term survival of the company as a whole.

The only two options available for Quadrant D companies are the following:

- **Attempt drastic restructuring.**
- **Simply exit the business.**

### 6.5.2 Example of companies placed in each quadrant

In this section four hypothetical companies were analysed in terms of value creation and cash generation and then placed in the financial strategy matrix. The information about the companies was chosen in such a way that there is a company in each category or quadrant. The company in Quadrant A is $A_1$, with $B_1$ in Quadrant B, $C_1$ in Quadrant C and $D_1$ in Quadrant D.

The vertical axis of the financial strategy matrix has been calibrated in percentage points, where a positive return spread is indicated as a positive percentage differential towards the top of the vertical axis. A negative return spread is indicated as a negative percentage differential towards the bottom of the vertical axis.

On the horizontal axis, also calibrated in percentage points, the sales growth minus the SGR is shown as a percentage differential. If the actual sales growth rate is higher than the SGR, the differential is positive and it is indicated to the right of the horizontal axis. If the sales growth is smaller than the SGR, the differential is negative and it is indicated to the left of the horizontal axis.

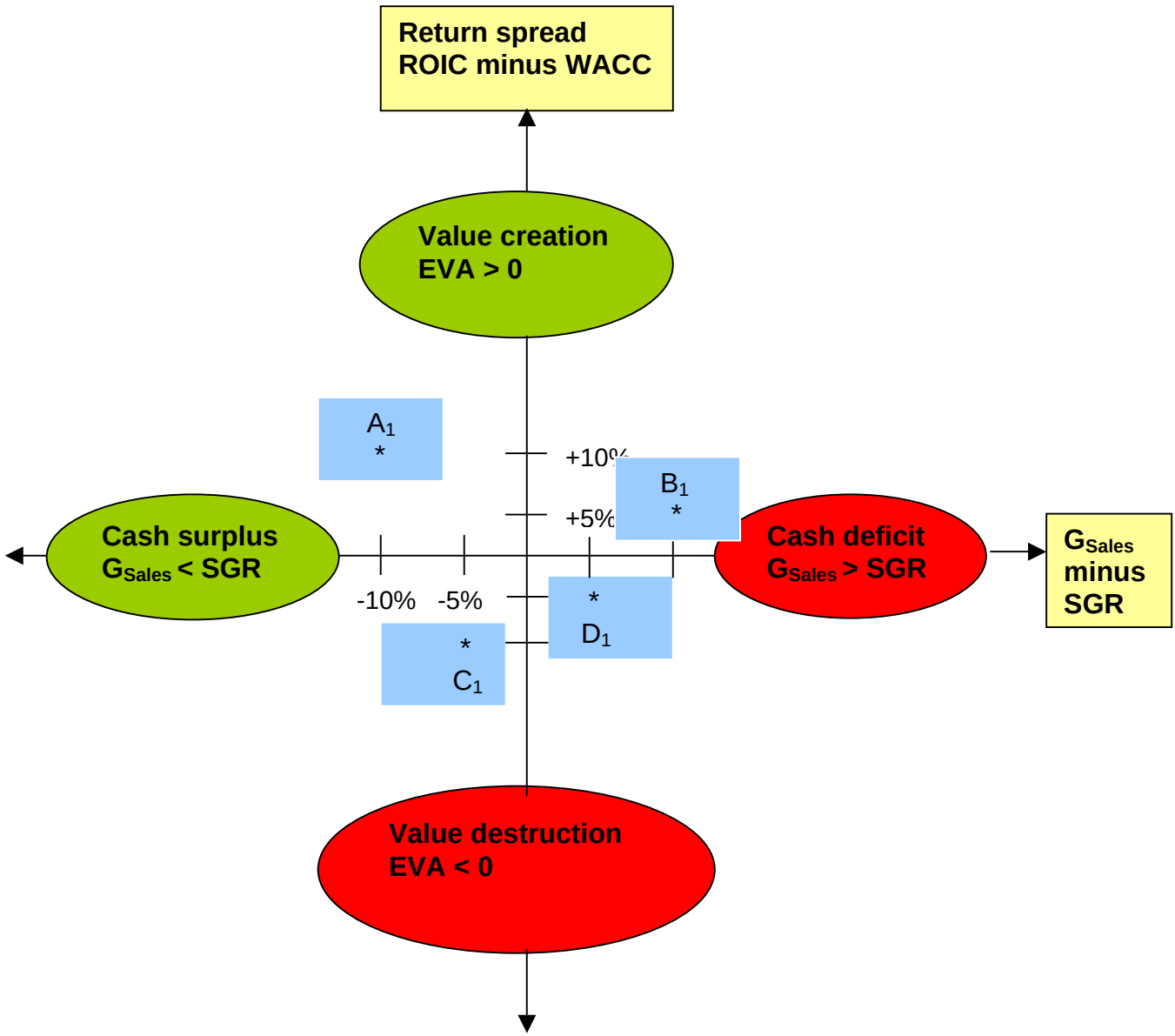
The values required for the placement of the four companies are summarized in Table 6.1.

**Table 6.1: Information for the placement of the four companies**

| Company | ROIC | WACC | Return spread | Sales growth | SGR | ($G_{sales}$-SGR) | Quadrant |
|---|---|---|---|---|---|---|---|
| $A_1$ | 25% | 15% | +10% | 20% | 30% | -10% | A |
| $B_1$ | 17% | 12% | + 5% | 35% | 25% | +10% | B |
| $C_1$ | 4% | 14% | -10% | 15% | 20% | -5% | C |
| $D_1$ | 11% | 16% | - 5% | 20% | 15% | +5% | D |

The percentage differentials for the return spread and for the sales growth above or below the SGR can now be used to place each company in the financial strategy matrix. The matrix is depicted in Figure 6.2.

**Figure 6.2: Four companies placed in the financial strategy matrix**




Source: Adapted from Hawawini and Viallet (1999:507)

The financial strategy matrix in Figure 6.2 shows that Company $A_1$, which has a positive return spread of 10% and actual sales growth of 10% below its SGR, is creating value and generating cash surpluses. It is therefore placed in Quadrant A. Company $B_1$ has a positive return spread of 5% and actual sales growth of 10% above its SGR. It is creating value, but also generating cash deficits. Based on this, it is placed in Quadrant B.

Company $C_1$ has a negative return spread of 10% and actual sales growth of 5% below its SGR. The company is destroying value, but it is generating cash surpluses and therefore it is placed in Quadrant C. Lastly, Company $D_1$ has a negative return spread of 5% and actual sales growth of 5% above its SGR. It is destroying value and generates cash deficits and is therefore placed in Quadrant D.

According to its placement on the financial strategy matrix, a company in each quadrant would be able to identify the specific strategy that would be most effective in improving its position. It could be that considerations other than value creation and cash management may determine the future strategy implemented by the management of each company.

There would also be other possible strategies that could improve the situation of each company. However, the greatest value of the financial matrix to management is the fact that the optimal future strategy for the company can be determined, taking into account the current position of the company and the most preferred position to be in.

## 6.6 CONCLUSION

Spectacular sales growth and increased profitability are attractive, but pursuing them poses a real threat to companies, especially companies with high capital intensity and working capital requirements. The problem is that it takes additional assets to generate the increase in sales. The internally generated funds plus loans (where applicable) may not be enough to finance the additional assets required.

It is therefore important for a company to know at what rate it can grow its assets and its sales at a sustainable rate so that it does not accumulate cash shortfalls. This maximum growth rate is the SGR and its main components are the company's profitability relative to sales, the asset turnover, the after-tax interest rate, the debt : asset ratio and the earnings retention ratio.

The formula for the SGR can be reduced to a shorter version by multiplying the ROE by the retention ratio, p. As shown above, an even shorter version of the SGR is determined by dividing the retained income by the equity at the beginning of the year. These shortcuts can be used when it is not necessary to analyse the main components of the growth rate, or when the values of the components of the long formula are not available.

Sales growth at a rate higher than the SGR leads to cash shortfalls, while sales growth at a lower rate than the SGR leads to cash surpluses. Both the shortfalls and surpluses are cumulative in the long term and therefore it is in the interests of a company to manage its sales growth so that it stays more or less in line with the SGR.

From a financial management perspective, the greatest challenge in any company is to allocate scarce financial resources optimally. Consequently, companies or business units that destroy value need to be liquidated, sold or eliminated if they cannot be turned around quickly. Companies that do create value should strive to create even more value and therefore need to know the real drivers of value.

The pace at which a company grows relative to its SGR can have a significant impact on the company's cash position. Sales growth (and asset growth to deliver the additional sales) faster than the SGR causes a company to generate cash deficits. Sales growth at a pace slower than the SGR causes a build-up of cash surpluses.

The financial strategy matrix was introduced in this chapter. It is a diagnostic tool that shows the company's value creation and sales growth relative to its SGR.

Companies that are creating value (as indicated by a positive EVA) and also generate cash surpluses (because they grow at a pace slower than their SGR), find themselves in the best situation and are categorized as Quadrant A companies. These companies can use their cash surpluses to invest in even more value-creating projects in order to improve their situation.

Companies that create value (as indicated by a positive EVA), but are also generating cash deficits because they grow too quickly, are classified as Quadrant B companies. These companies need to overcome their cash flow problem by either cutting their dividends or by raising cash by borrowing or by issuing shares. Ultimately, they need to decrease their sales growth so that it is more in line with their SGR.

Quadrant C companies destroy value (as indicated by a negative EVA), but also generate cash surpluses. The only option available to them is to return part of the cash surplus to shareholders and to use the rest of the cash to restructure operations. The restructuring should ensure that both profitability and asset efficiency is improved so that there can be positive value creation. If restructuring does not have a good chance of succeeding, the company must be sold or liquidated.

Quadrant D companies destroy value (as indicated by a negative EVA) and also build up cash deficits because they grow too fast. The only strategic options open to companies in this category is quick, drastic restructuring, or stopping doing business.

Any company should aim to maximize shareholder wealth. This is reflected best not by size in terms of market value, but by increases in the share price, or by the company's MVA. EVA is the fuel that drives MVA and therefore it is vital that EVA is measured and managed, not only at company level, but also at business unit level. Linking the remuneration of managers to EVA obviously gives them an incentive to act as if they were the owners of the company.

Monitoring the current situation and progress of a company by mapping its position on a financial strategy matrix helps managers ensure that they allocate scarce funds wisely. Furthermore it ensures that growth and cash generation are managed well and that the strategic options open to the company in the quest to maximize value for the shareholders are constantly evaluated and considered.

The next chapter contains the empirical research, starting with the research design and then showing the placement of listed companies and sectors on the financial strategy matrix.