

ASOS PLC

A Financial Analysis

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INTROUCTION

Asos is a British online fashion and cosmetic retailer, founded in 2000 in London, by Nick Robertson, Andrew Regan, Quentin Griffiths and Deborah Thorpe. The headquarters are in Camden Town, at Greater London House with additional offices in Paris, New York, Berlin, and Birmingham.

Originally as AsSeenOnScreen , with the tagline "Buy what you see on film and TV", in 2003, shareholders agreed to change the names of AsSeenOnScreen Holdings PLC and AsSeenOnScreen Limited to ASOS plc and ASOS.com Limited.

The company sells over 850 brands of clothing, accessories, and beauty and ships to all 196 countries from fulfilment centres in the UK, US and EU. Since 2001 the Company was admitted to the Alternative Investment Market (AIM) on the London Stock Exchange.

The mission is become the world's number-one destination for fashion-loving 20-somethings, through the best online customers experience, through values as creativity, positivity, democracy, inclusivity, integrity and drivers like customer-obsessed, on-point personalisation best in class fulfilment, localised experience.

Asos' business model is based on two different sides: consumers, with their need to buy latest fashion trends and fashion companies, that produce fashion for possible buyers. The third part is about a niche component which refers to 20s years old people. The business model is supported by five value proposition:

- 1) Accessibility: through *Asos Market Place*, the company is offering 50.000 unique vintage fashion items, from 900 boutiques in 40 counties.
- 2) Customisation: different websites for different countries
- 3) Price: local pricing strategy
- 4) Cost reduction: free delivery and free returns
- 5) Convenience: next-day delivery options, express delivery services, live delivery updates to receive real-time information on details such as driver's name and expected delivery time.
- 6) Brand status: 80,000 different products, with over 3,000 new lines added each week, between menswear and womenswear, accessories and footwear, and beauty and jewelry.

Asos also said that the company could be saddled with £25m of extra costs from World Trade Organization tariffs in the event of a no-deal end to Brexit transition in January.

Sales rose by 19% to £3.3bn, the top end of expectations, in the year to 31 August 2020 and the company said the increasing popularity of beauty products and less fitted clothing had led to fewer items being returned, helping to boost profits by £45m. The company started to invest £5m on social distancing safety measures at its warehouse after criticisms of the treatment of workers when the coronavirus crisis hit the UK. The company has also paid back about £3m in furlough pay which it initially claimed for 1,000 workers in April.

The company is known as the most valuable retailer in UK focused on only online channels, so market studies use to analyse its competitor considering variables as fashionability, target and range of price. The main competitor is Booho, a UK-based online fashion retailer, aimed at 16–30 year olds. That business was founded in 2006, and had sales in 2019 of £856.9m.

In 2016 Asos has been forced to pay out almost £20m to two European retailers due to an alleged infringement of the trademarks on their names.

During 2019 Asos' pre-tax profits fell 87% to £4m for the six months to 28 February against the same period in 2018, caused by some marketing changes created a fall in visits to its websites and a drop in its search engine rankings. At the end of the same year, 2019, Asos warned on profits, saying that cutting prices to match rivals had not led to a significant increase in sales, sparking a 40% fall in the share price. Anyway at 31st August 2019, Asos counts 20.3 million of activate customers, an increasing of 10 % compared with the previous year (18.4 millions).

FINANCIAL PERFORMANCES - Key Financial Ratios

Profitability Ratios

Profitability is different from profit, because it does not consider money as variable, but it is analysed as ratio, a percentage. A profit of £ 1,000.00, for instance, does not mean high or low profitability: that one explains the quantity of output is possible to get involving a specific amount of an asset. Profitability should be considered as guideline supporting decision-making process between actions and/or ventures¹.

PROFITABILITY RATIOS	Formula	ASOS 2020	ASOS 2019	ASOS 2018	ASOS 2017	ASOS 2016	BOOHO 2020
<i>Gross Profit Margin</i>	Gross profit	1,547.4 £m	1,334.3 £m	1,237.1 £m	958.3 £m	722.2 £m	449.2 £m
	Sales	3,263.5 £m	2,733.5 £m	2,417.3 £m	1,923.6 £m	1,444.9 £m	816.5 £m
		0.474	0.488	0.511	0.498	0.499	0.55
<i>Operating Margin</i>	Operating Income	151.1 £m	35.1 £m	101.9 £m	79.6 £m	63.0 £m	395.5 £m
	Sales	3,263.5 £m	2,733.5 £m	2,417.3 £m	1,923.6 £m	1,444.9 £m	816.5 £m
		0.046	0.012	0.042	0.041	0.043	0.48
<i>Net Profit Margin</i>	Net Income	113.3 £m	24.6 £m	82.4 £m	64.1 £m	51.4 £m	47.4 £m
	Sales	3,263.5 £m	2,733.5 £m	2,417.3 £m	1,923.6 £m	1,444.9 £m	816.5 £m
		0.034	0.008	0.034	0.033	0.035	0.058

A) *Gross Profit Margin*

Gross Profit Margin is related to the company's financial health, calculating the amount of money left from product sales after considering the cost of goods sold (COGS). The higher gross profit margin is better, even if it depends on the type of business: for the fashion retailer Asos the higher value is shown on 2018 as 51,1%, an increase from 2016. The current Gross Profit Margin for 2020 as 47,4% and this decrease respect previous year is related to higher costs of freight and duty in its warehouse, price cuts during lockdown and also changes in the product mix. During the pandemic, consumer demand shifted away from occasion wear into more casual, lockdown-relevant products. To improve its Gross Profit Margin Asos could increase sales volume without increase costs of goods, so the fixed manufacturing cost becomes smaller in front of a larger production.

Booho, even with lower sales than Asos, shows a value as 0.55 and that should be linked to active customer numbers in the last 12 months increased by 34% to 17.4 million, with an exceptional increase during lockdown (+10% increase in the number of items per basket). Also, thanks to the acquisition of two new brands, Oasis and Warehouse, and the remaining minority interest in PrettyLittleThing allowed the company to make larger the offer.

B) Operating Margin

Operating Margin is related to pure operations profits, do not considering interests and taxes. This percentage expresses each £ remained after the company has paid for variable and fixed expenses. Looking at Asos' values, it is shown a decrease from 2016 to 2018, within a difference between 1 - 2%. In 2016 distribution costs increased by 30bps to 14.9% of revenue, driven by the expansion of the delivery proposition particularly in relation to EU free returns and US standard delivery days global. The most significant percentage value is registered in 2019 by 1,2% from 4,2% of the previous year: this could connected to an elevated capital investment in transformation over the last three years. In 2020 there is an increase until 4,6%, because the reduction in distribution costs was principally driven by the change to local fulfilment, especially in US background and the benefit from lower returns rates driving lower return parcel volumes. Reduces in marketing costs as well allowed one more higher performance, thanks to a strategy that achieved the main goals during the first half of the year. To improve its Operation Margin Asos could focus on more economy of scales, to evaluate in which areas the system will save time consolidating processes.

Booho shows a value as 0.48 in 2020, related especially in investments for the need to improve the supplier function. Since 2019 the company planned changes in its Agenda, after an independent report found widespread instances of *dangerous working conditions* and underpayment of staff. The improvement has been about new softwares and principles, including the creation of Garment and Textiles Community Trust, providing support to garments workers in Leicester.

C) Net Profit Margin

Net Profit Margin measures the company success, related to the performance in converting sales into actual profit. Net Profit Margin is different from Gross Profit Margin, because in the last one fixed costs are excluded, while the Net Profit Margin includes all costs. This ration explains as well how the company is managing in a good way its operations, against its competitors. Asos' Net Profit Margin has oscillated from 2016 to 2018, from 3,5% and 3,3%. In 2019 the value decreased until 0,8%. As Chief executive Nick Beighton said 2019 was more disruptive than originally anticipated. Regarding operational issues, especially for the logistics transformation programme and warehouse implementations. The firm's diluted earnings per share fell 70% in the year to August to 29.4p, down from 98p a year earlier. Also, in the same year of 2019, company net debt position was about £90.5m. to improve its Net Profit Margin Asos could reduce the labor costs, maybe through more partnership with developing countries and reduce locally operational costs in making more green warehouses.

Considering the proportion between Asos and Booho sales, Booho's value is 0.058, representing an increase by 45% to £816.5 million (2019: £564.9 million). Even reducing marketing costs to improve distribution costs across the group, Booho customers reached numbers in the last 12 months increased by 34% to 17.4 million, keeping the largest market to be the UK, accounting for 53% of revenues.

Liquidity Ratios

Liquidity refers to company's ability in achieving short-term obligations (that are expected to be paid off within a year) and it is a sign for a possible sickness of the company. A low liquidity may be considered as fever for the same company, as symptom of financial difficulties. Evaluate liquidity is especially useful by creditors' perspective, because a poor liquidity could be translated in a poor credit risk, but in the same time company will not be able to make principles payments.

LIQUIDITY RATIOS	Formula	ASOS 2020	ASOS 2019	ASOS 2018	ASOS 2017	ASOS 2016	BOOHO 2020
Current Ratio	Current Assets	1,019.8 £m	623.2 £m	503.6 £m	514.5 £m	446.0 £m	551.0 £m
	Current Liabilities	854.1 £m	772.2 £m	558.0 £m	544.2 £m	428.6 £m	334.1 £m
		1.19	0.80	0.90	0.94	1.04	1.64
Quick Ratio	Current Assets - Inventory	487.4 £m	86.4 £m	96 £m	191.2 £m	188.3 £m	383 £m
	Current Liabilities	854.1 £m	772.2 £m	558 £m	544.2 £m	428.6 £m	334.1 £m
		0.57	0.11	0.17	0.35	0.43	1.14
Cash Ratio	Cash	407.5 £m	0.00	42.7 £m	160.3 £m	173.3 £m	344.9 £m
	Current Liabilities	854.1 £m	772.2 £m	558 £m	544.2 £m	428.6 £m	334.1 £m
		0.47	0	0.07	0.29	0.40	1.03

D) Current Ratio

Current Ration explains how company's able to solve the short-term debts, that need to be repaired within the next one year. Dividing the current assets for the current liabilities, that ratio is responding to the answer for how many £ in current assets could cover each £ in current liabilities. In 2016 Asos' Current Ration was 1.04, meaning that Current Assets > Current Liabilities, showing a favourable situation. From 2017 to 2019 Current Assets < Current Liabilities and the results show a problematic situation for the obligations. During these period the company has seen an increase in inventory and stock and in the same time a decrease in *cash and securities*. UK debt for the company has been as 172.500 £m during 2019. In 2020 Current Ration is 1.19, coming back to the favourable situation, thanks to the improvement in *cash and securities*. To improve Current Ratio Asos could delaying any capital purchases that requires cash payments and sell assets that are not generating return.

In 2020 Booho's Current Ratio is 1.64, indicating a good short-term financial strength. During the past 8 years, Boohoo's highest Current Ratio was 3.66. The lowest was 0.91 and consequently the median was 1.83. The current value presents Booho as debt free at the moment, as five years ago. For the current year 2020, the both companies should not struggle to pay off their short-term liabilities, even if Booho looks superior from a liquidity standpoint.

E) Quick Ratio

Quick Ratios may be considered as a *continuum* of the Current Ratio. The investor starts investigate around the company by the Current Ratio, to know in how many time the same company can pay back the short-term obligations. Through the Quick Ratio the investor keeps analysing accurately the ability of the company, taking into account the current assets except inventories, because that one takes more time to translate itself into cash to pay back debts. The decision to take off inventories in the calculating depends on the fact that no one knows the specific period of time the company will liquidate the inventories into cash. The favourable result for the ratio should be Quick Ratio > 1; from 2016 to 2019 Asos showed a decrease in that value arriving at 0.11 in the previous year. In 2020 the Quick Ratios has been 0.57, a consistent increase related to the past data. To improve Quick Ratio Asos could improve the inventory turn over ratio, through a faster conversion of inventory into cash. One more suggestion could include sweep accounts, within the possibility to sweep, moving, idle cash into an account which brings interest when the finance is not required and sweeping them back into the working account when it is required.

Due Boohoo's higher Current Ratio, appears more than understandable that its 2020 Quick Ratio is higher again, introducing the company stronger than Asos: that one is afflicted by a larger stock of inventory.

F) Cash Ratio

Cash Ratio is related to company's ability in covering short-term obligations just through cash and cash equivalents. It is calculated dividing the total reserves of cash and near-cash for the total of liabilities. That ratio considers the most liquid resources for the company, as deposits, market accounts funds, saving accounts etc. the favourable result should be Cash Ratio = 1, in which the company has the exact amount of cash to pay off liabilities. In the last five years Asos didn't arrive at 1, but the value oscillated around 0 (zero). From 2016 to 2019 the Cash Ratio decrease from 0.40 until 0.00, meaning difficulties to pay off liabilities just considering liquidity by cash. In 2020 the value is up at 0.47, as the company incurred costs from its credit facility, supporting elevated capital investment in the previous year. To improve its Quick Ratio Asos could use long-term debts, instead of short-term, to get benefits as smaller monthly installments and lower interest rates.

2020 Cash Ratio for Boohoo is 1.03, demonstrating again the superiority of the company related to Asos in terms of liquidity and thanks to a smaller liability base. In fact at 31 August 2020, there are no contingent liabilities, which in the opinion of the directors are expected to have a material adverse effect on its liquidity or operations.

Gearing Ratios

Gearing Ratios are a good indicators for a more long-term financial stability of companies. That type of ratio compares owner's equity , or general capital provided by shareholders, to debt, with the main goal to demonstrate the measure in which the financial leverage is supported by shareholder's funds versus creditor' funds (debt). Higher Gearing Ratio is not always good, because indicates a higher degree of financial leverage, meaning that the company has larger amount of debt compared to shareholder's equity.

Gearing Ratios	Formula	ASOS 2020	ASOS 2019	ASOS 2018	ASOS 2017	ASOS 2016	BOOHOO 2020
Debt-Equity Ratio	Total Debt	1,179.1 £m	791.9 £m	568.2 £m	553.3 £m	449.6 £m	351.3 £m
	_____	_____	_____	_____	_____	_____	_____
	Total Equity	810.3 £m	453.6 £m	438.8 £m	287.1 £m	200.4 £m	407.4 £m
		1.45	1.74	1.29	1.92	2.24	0.86
Debt-to- Capital Ratio	Total Debt	1,179.1 £m	791.9 £m	568.2 £m	553.3 £m	449.6 £m	351.3 £m
	_____	_____	_____	_____	_____	_____	_____
	Total Equity + Total Debt	1,989.4 £m	1,245.5 £m	1,007 £m	840.4 £m	650 £m	758.7 £m
		0.59	0.63	0.56	0.65	0.69	0.46

G) Debt-Equity Ratio

It is also known as *risk* ratio and it describes the relation between creditors and shareholders funds, through the company's financial leverage. It is calculated dividing the total debt by the total shareholder's equity and describes in which measure operations are funded by investors and creditors. A higher result ratio indicates that there is a larger use of creditors funds, bank loans for instance and the reason why could be that company is seeking enough cash to pay off its obligations. The highest value for Asos has been registered in 2016 as 2.24, meaning a high risk for the company. Debt-Equity Ratio gradually decreased until 1.29 in 2018. From that year until 2020 the company reached 1.45, increasing Equity and extending its debt facilities to ensure go through Covid-19 emergency. To make lower Debt-Equity Ratio Asos could increase profitability by strategies in sales; also managing the inventory to ensure not many wastes.

For Boohoo the latest value shows 0.86 for Debt-Equity Ratio, due a lower long-term liabilities base. For both oh the companies short-term assets exceed long-term liabilities.

H) Debt-to-Capital Ratio

The ratio is calculated dividing the total debt by its total capital, based on total debt plus total shareholder's equity. Debt-to-Capital Ratio suggests to investors if the company could be a suitable investment: high ratio describes high risk, meaning the company is funded by more debt than equity. Following that prospective looks how Asos decreased its ratio from 0.69 in 2016 until 0.59 in 2020, showing an increase since 2018. Some strategies to reduce Debt-to-Capital Ratio could involve restructuring debt, when the company is paying high interest rates for its loans, and current interest rates are significantly lower, it can seek to refinance its existing debt, increasing its stores of capital.

For Boohoo Debt-to-Capital Ratio in 2020 is 0.46, meaning that its level of debt is low relative to its total equity. The Company is not taking on too much debt commitment, which may be constraining for future growth.

Efficiency Ratios

Efficiency Ratios describe how well the company is using its assets, even managing its liabilities, in the current period or in a general short-term. In this case company's ability is about in exchange the asset into revenue, generating income. That kind of ratio, takes in consideration different aspects of the company, for instance: the time it takes to collect cash from customers or the time it take to convert inventory into cash. This the reason the why improving Efficiency Ratio means improve the profitability of the company.

Efficiency Ratios	Formula	ASOS 2020	ASOS 2019	ASOS 2018	ASOS 2017	ASOS 2016	BOOHO 2020
<i>Asset Turnover</i>	Sales	3,263.5 £m	2,733.5 £m	2,417.3 £m	1,923.6 £m	1,444.9 £m	816.5 £m
	_____	_____	_____	_____	_____	_____	_____
	Total Assets	1,989.4 £m	1,245.5 £m	1,007 £m	840.4 £m	650 £m	758.7 £m
		1.64	2.19	2.40	2.28	2.22	1.07
<i>Fixed Asset Turnover</i>	Sales	3,263.5 £m	2,733.5 £m	2,417.3 £m	1,923.6 £m	1,444.9 £m	816.5 £m
	_____	_____	_____	_____	_____	_____	_____
	Fixed Assets	969.6 £m	622.3 £m	503.4 £m	137,4 £m	72.2 £m	186.5 £m
		3.36	4.39	4.80	14	20	4.37

I) Asset Turnover

Comparing Sales and Total Assets, that ratio tells about the company ability to generate revenue exploiting its assets. A higher ratio describes a more efficient utilisation of the asset, giving specific indication about internal management for investors' decision process. Analysing Asos' Asset Turnover seem the company has been through a gradual decrease from 2.22 in 2016 and 2.28 in 2017, reaching the highest value in 2018 of 2.40, to become more low in 2019 (2.19) and 2020 (1.64). Reaching a low value, Asos has shown the typical strategies used to improve the ratio, as an increase in revenue and the liquidation of of obsolete and unused assets; one more profitable way could be the leasing os assets, instead of buy them.

Boohoo Asset Turnover for 2020 is 1.07, meaning a decrease because Boohoo's Total Assets for the quarter that ended in August 2020 was \$867 with an Asset Turnover of 1.24.

J) Fixed Asset Turnover

It describes the operating performance, comparing net income, sales, and fixed assets and reveals how efficient a company is at generating sales from its existing fixed assets, namely property, plant, and equipment (PP&E). A high Fixed Asset Turnover ratio does not tell anything about a company's ability to generate profits or cash flows, but implies that management is using its fixed assets more effectively. Asos Fixed Asset Turnover in 2016 was 20, highest value and meaning that he company is generating more sales than fewer assets. In 2017 FAT was 14, but the interesting fact is the decrease starting in 2018, passing at 4.8: on February 2018 the company started the process to move production in US, opening the warehouse in Atlanta. From 2019 to 2020 the FAT decrease from 4.39 to 3.36, meaning the company is again exploiting PP&E efficiently.

Boohoo showed for 2020 a FAT of 4.37, in line with the average of past years; the company's strategy, in this case, has been to don't upgrade its equipment, deciding to concentrate its competitive advantages just in products.

MARKET - Opportunities

Apparel market in UK is growing consistently, especially in the last seven years, with 2021 expected market revenues until 62.2 billion of euros. According to UK's Office for National Statistics, annual expenditure of clothing (considering the volume) increased until 59.3 £ billion in 2019, with a large contribute from women's apparel. The market is full of many competitors as leading brands, Asos for example, which are creating digital strategies more than ever focused on the increase of individual online purchasing, that reached 60% of customers in 2019. Apparel manufacturing is also growing, and it has allowed a rise of exports over 7 billion in 2019. According to UK's Office for National Statistics survey, in UK more women than men shop online, including sports clothing: in the last 12 months, 62% of online customers were women, segmented into a young age. Fashion is main the need satisfied online, followed by restaurant deliveries and other fast-food chains. Uk consumers are driving online fashion sales in Europe, with the highest average annual spending in 2018.

New investment:

Project A:

Year	Projected Cash Flows (£m)	Cumulative Cash Flow (£m)	Cost of Capital 10.5%
0	-85	-85	
1	10	-75	$-75/(1+10.5\%)^1 = -68$
2	20	-55	$-55/(1+10.5\%)^2 = -45$
3	40	-15	$15/(1+10.5\%)^3 = -11$
4	55	40	$40/(1+10.5\%)^4 = 27$

Project B:

Year	Projected Cash Flow	Cumulative Cash Flow	Cost of Capital 10.5%
0	-90	-90	
1	25	-65	$65/(1+10.5\%)^1 = -59$
2	30	-35	$35/(1+10.5\%)^2 = -28$
3	35	0	0
4	40	40	$40/(1+10.5\%)^4 = 27$

- Payback Period (PBP) refers to the amount of time the firm takes to recover the cost of investments, reaching break-even point. Profitability of investments is straightly linked to payback period, meaning their attractiveness through the shorter ones. PBP's formula counts the years the firm takes to get back funds, so it doesn't take in consideration the time value of money, and ignoring also what happens after the current payback.

PBP Project A

To reach the break-even point the company needs 3 full years to get 85 £m in income, and so its PBP has to be considered between the 3rd and 4th year. At the end of the 3rd year it gets 70 £m plus one portion of 15 £m (85 - 70) from the 55 £m on the 4th year, so:

$$11/55 = 0.2$$

The PBP for A it will be: 3 (full years) + 0.2 = **3.2**

PBP Project B

The company will be reach the break-even point at the end of the year 3, because:

Year 1 + Year 2 + Year 3 = 90 and because PBP doesn't consider future profit over the recovery.

The PBP for B it will be exactly **3**, because cumulative cash flows for year 3 is 0 (zero).

The most suitable situation for Payback Period is B, because it is more economically satisfactory since its return is more faster than A.

- Accounting rate of return (ARR) reflects the annual percentage rate of return expected on an investment, or generally on asset, in comparison to the initial investment's cost. Usually ARR doesn't consider cash flows and time value of money, but these aspects could be integrated to as surplus. Could be considered a comparison between multiple projects , this is the reason why ARR is also a fundamental metric included in the *capital budgeting*, meaning the plan through the companies analyse which projects could be efficient and how finance them.

ARR Project A

Considering year 0 as costs (-85 £m) and cash flows from year 1 (10 £m), through year 2 (20 £m) and year 3 (40 £m), until year 4 (55 £m), it will be:

Total cash inflows: 10 + 20 + 40 + 55 = 125 £m

Total costs: 85 £m

Total profit: 125 £m - 85 £m = 40 £m

Average annual profit: 40 £m / 4 years = 10 £m

ARR's formula approach divides the average annual profit by total costs, and so:

$$10 \text{ £m} / 85 \text{ £m} = 0.117 \times 100 = \mathbf{11.7\%}$$

ARR Project B

Analysing costs as 90 £m and the amount of the years 1, 2 ,3, 4, in 130 £m, ARR for B will be:

Total cash inflows: 25 + 30 + 35 + 40 = 130 £m

Total costs: 90 £m

Total profit: 130 £m - 90 £m = 40 £m

Average annual profit: 40 £m / 4 years = 10 £m

$$\text{ARR: } 10 \text{ £m} / 90 \text{ £m} = 0.111 \times 100 = \mathbf{11.1\%}$$

A second approach in the study of ARR suggests that the result could be achieved dividing the average annual profit by the average investment, calculated considering the book value of year 1 + the book value at the end of useful life / 2:

$$\text{ARR A: } 10 \text{ £M} / [(85 \text{ £m} + 0) / 2] = 10 \text{ £M} / 42.5 \text{ £m} = 0.23 \times 100 = \mathbf{23\%}$$

$$\text{ARR B: } 10 \text{ £m} / [(90 \text{ £m} + 0) / 2] = 10 \text{ £m} / 45 \text{ £m} = 0.22 \times 100 = \mathbf{22\%}$$

In these situations the prospect A seems to be more profitable, because with ARR 23%, means the investment would improve an average of 23% on annual accounting during investment period.

- Net Present Value (NPV) is one more metric for capital budgeting, referred to the difference between present value of cash inflows and present value of cash outflows, into a specific period of time. A positive result in NPV means that projected earning by investment exceeds costs, so it will be more profitable than negative one.

$$\text{NPV A: } -85 + (-68) + (-45) + (-11) + 27 = \mathbf{-182}$$

$$\text{NPV B: } -90 + (-59) + (-28) + 0 + 27 = \mathbf{-150}$$

The both negative NPV results for prospects A and B suggest that for Asos will not be profitable to invest cash and resource in none of them. At the same time it is important to specify the difficulty in quantifying future benefits: an investment could appear negative because it doesn't make anything better, but negative analysis is important as positive ones to evaluate the least negative one. It could be read as an opportunity to improve the track performance after the investment, and following this direction the prospect B seems more favourable in terms of efficiency, and generating profitability.

OVERVIEW

The *investment appraisal* uses quantitative techniques to take under control the feasibility of projects. Some of these techniques are:

Payback Period - PBP

- PBP is relatively the simplest analysis for making comparisons between projects characterised by a short payback period, and this is the reason why the study does not take into consideration effects of the value of money. This method is simple to use and understand, driving into quicker solutions, as first step to analyse which direction will be better for the healthy investment. The calculation of the risk means to condensate the degree of uncertainty, reducing the risk to get into an obsolete project. At the same time that method presents some limitations: the fact that it does ignore time value of money could make distorted the real value of cash flows; also the same cash flows are considered until the period in which the payback is done, don't considering the possibility of profit in later years. PBP's reputation reveals that is not realistic, in other words during the calculation are not offered usual business scenarios, in which the real investment is not just through one time, but often they are protracted in more times.
- ARR method considers the entire life of the project, passing through all cash flows levels, and it is very close to management accounting's skills as basic measure to relate the return on investment. Main attention is reserved to profitability, denominator for the most strategies decisions and shareholders. Its results can be straightly understood and integrated in the comparison lists of project, particularly useful when the funds available are limited. Also it doesn't consider the timing for cash flows and that is a limitation, since when in the case of two projects showing similar ARR there, one of them could pay back quicker than other one. ARR also doesn't consider the increasing of the risk in the long-term projects, and consequently the possible impacts of other operations.
- NPV's method is based on the idea that one pound today is more worth than a pound tomorrow; also it is able to explain in which measure the investment will create value for the organisation. That method allowed assumptions for reinvestment, for example reinvesting the cash flows into IRR, and considering all the cash flows. The aspect more interesting is that NPV is able also to estimate other factors risks, such as discount rates, business risk, financial risk, and operating risk. Limitations about NPV regard an high level of expectations, when the cash flows considered might be too high; it is not able to consider the *sunk cost*, as the cost incurred before starting a project in capital budgeting. Also short-term projects with higher NPV could maybe not increase earnings per share, in terms of return of equity.

The investment appraisal is also based on non-financial factors, creating new input in the decision-making process. According to Kaplan and Norton (1992) the *balanced scorecard* set a bridge between financial measure and non-financial ones (customers, innovation, learning), with the main goal to give a 360 degree framework to manager in understanding the whole situation. Matching high standards for the company means improving internal situation as well, favouring relations between staff, suppliers and customers, for example, even though the value chain analysis that creating activities of engagement develops the competitive strategies (Porter). Also the improvement of business reputation, through relations with local communities, could develop capabilities for the company in dealing with present and future threats, but especially making better the *benchmarking* (Hoque), as a tool assisting the organisation to promote the competitive awareness, including vision and strategy for the performance.

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