

# Case 7.3

## TurnAround

TurnAround produces paper-based consumer products such as diapers, incontinence products, female hygiene products and various consumer tissues such as cleaning napkins and toilet paper. Turnaround is organized into three business units: adult care, family care and child care. The managers of these units are responsible for most of the activities of their particular unit and are currently evaluated on 'earnings before interest expenses and taxes'. For a couple of years, the corporate profitability has declined and a new CFO was appointed. She suggested a redesign of the entire management control system, beginning with changes to the management control structure: 'We are in a business where low margins are common so we also need to address the assets employed. The divisions should be responsible for profit, including marketing, but also for the assets employed in their business unit,' she said. This also brought to the fore the issue of how to measure the performance of the established investment centres. The CEO knew that return on investment (ROI) was a quite common performance measure in other organizations and suggested the use of that measure. However, the CFO emphasized that residual income (RI) or economic value added (EVA<sup>®</sup>) were more appropriate performance measures for investment centres. She estimated that the cost of capital to be used in the RI calculations was 12 per cent and the cost of capital to be used in the EVA<sup>®</sup> calculations was 11 per cent. The CFO also made a few initial adjustments of the financial accounting numbers to be used when calculating EVA<sup>®</sup>. These adjustments were primarily related to capitalizing R&D expenses and brand-building activities. The financial figures of the three divisions are shown in the table below.

	Child care division	Adult care division	Family care division
Non-current assets (Book value)	1600	1600	1750
Non-current assets (Adjusted)	3800	3100	2100
Working capital (Book value)	1100	700	2000
Working capital (Adjusted)	1300	1000	2200
Earnings before interest expenses and taxes (Book value)	650	720	850
Adjusted net operating profit after taxes	550	525	650

### Questions

- a**
- (i) Calculate ROI for the three divisions and analyse the levels. Make explicit your calculations.
  - (ii) Calculate RI for the three divisions and analyse the levels. Make explicit your calculations.
  - (iii) Calculate EVA<sup>®</sup> for the three divisions and analyse the levels. Make explicit your calculations.
- b** Compare, analyse and discuss the results of question (a) when calculating the performance of the divisions via the three approaches (ROI, RI, EVA<sup>®</sup>).
- c** The CEO and the CFO of TurnAround also want some additional information about the three approaches (ROI, RI, EVA<sup>®</sup>). Explain and discuss the potential benefits and drawbacks related to each approach.