The Importance of Management Assessment

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Management assessment is important, but more difficult to measure than other KSFs

In an increasingly global and more competitive business environment, a strong management team plays an even greater role toward ensuring a company's success. In spite of its importance, it is a challenge to evaluate a board of management's performance. In analyzing a company's business profile, PEFINDO methodology uses a number of **key success factors (KSF)** as parameters. In business risk assessment of corporates and financial institutions, management assessment is one of the KSFs, such as market position and diversification. There are also other KSFs such as investment and cost structure analysis (for financial institutions), or raw material procurement, marketing and distribution, and quality of service (for corporates), but they are not as widely used as the previous three (management, market position, and diversification).

Among the KSFs, management assessment is the most qualitative aspect, making it more difficult to judge and score in comparison to other KSFs. For instance, market position analysis could focus on market share data, width of business products, or market share of peers. Distribution channel assessment could focus on the number of offices and networks available, geographical locations of those offices, and the development of electronic channels. In short, with other KSFs, we could use ratios, comparison data, and historical figures that are more tangible. Management assessment, however, due to the variety of mission, vision, and targets of those companies, requires much more in-depth knowledge and perspective.

Nevertheless, in spite of the difficulties, we are of the view that management assessment is just as important, if not arguably more so, as decisions would ultimately impact and further shape a company's credit profile and its worthiness.

The criteria of management analysis

Management analysis includes a review of four major criteria: strategic positioning, risk management, organizational capability, and oversight capacity.

Strategic positioning could be described as how well a company develops and executes its strategic plans, along with keeping track of the progress. It includes the process of formulation of such strategies, consistency with the company's strengths and weaknesses, as well as market conditions, and the company's flexibility to adjust and control the implementation stages of such plans. This stage includes a review of the company's business plans and assumptions, the strengths of its main products and those of its main competitors, and the ability of the management team to adjust its plans amid changing business conditions. PEFINDO will view positively if a company shows a track record of achieving most or all of its robust business targets, along with strong market leadership, and continuous efforts to improve product innovation.

Risk management is about managing a company's risk appetite and tolerances. It includes comprehensive financial policies and standard operating procedures, as well as risk parameters and controls that have been established and followed. It is very important at this stage to understand the management's approach toward applying its risk management practices, whether aggressive, moderate, or conservative, to obtain an accurate observation on the consistency of the implementation of those risk management standards. At this stage, PEFINDO reviews the financial and risk management policies of the company, for instance, the consistency of capital and liquidity management policies, the establishment and application of early warning systems during a market downturn, specialized industry analysis, and the monitoring of maximum credit limits. PEFINDO will view positively if a company shows it has applied comprehensive risk management standards on a consistent basis and has managed to keep the risk tolerance level at an acceptable level at all times.

The next two factors, organizational capability and oversight capacity, have more qualitative aspects compared to the previous factors. Organizational capability is an assessment of the management team's expertise and experience, along with its depth and breadth. Not only is it imperative for a management team to have the necessary knowledge and skills, but also to prepare for the key man risks, or the risk of business disruption on the loss of key personnel. Here, the analysis focuses on the success of the company's business lines, as well as the stability of the management team. PEFINDO will view positively a track record of success of all or most of a company's business lines, which could be measured by its contribution over time. In addition, stability in the board of management, without sudden or questionable changes to the management structure, would also be a positive factor.

In oversight capacity, the discussion focuses on supervision and governance issues, such as the relationship between management and shareholders/stakeholders, company culture, regulatory requirements, internal and audit controls, as well as financial reporting and transparency. The analysis is more evidence-based in this segment. It will be viewed negatively when a board of management shows failure to meet those criteria, for instance: lack of independence from shareholder influence, clear violation of regulatory requirements, or negative audit findings.

Strong management is not a guarantee of a strong business profile

Having strong management is not a guarantee of a strong business profile. Although strong management is a key factor, it is not a replacement for a strong business. We believe that a company without clear advantages in the market might still be overwhelmed by external market conditions.

On the other hand, PEFINDO is of the view that deficiencies of management could be masked, at least temporarily, if the company possesses strong business advantages. For instance, a strong market presence could provide the company additional time to address some management issues while preserving its market share intact. In fact, PEFINDO notes a few such cases with several regional development banks (BPDs) in its portfolio. In spite of a prolonged management transition process, it seems the business profile of those banks remained intact due to the strength of their captive market. Nevertheless, this will not last indefinitely. Ultimately, a lack of management leadership and direction will be a liability to a company's overall business profile. As such, this highlights the importance of management analysis when assessing a company's business profile, as it is not very often that a company can display such a distinct business advantage over its peers.