A detailed case study on the rolls-royce company

Evolution of Rolls-Royce

The glorious inception of car manufacturing business was pioneered by F. H. Royce and C. S. Rolls when they met in 1904 and in 1906 the company ROLLS-ROYCE Ltd was formed to unveil the six-cylinder Silver Ghost which, within a year, was acclaimed as ‘ the best car in the world’. In 1914 the First World War necessitates aero engine – the Eagle, designed by Royce was used in the air war by the allies. Later the company underwent diverse advancement towards improved aero-engine, gas turbine. Subsequently after acquisitions and mergers of other companies Rolls-Royce emerged as the only company in Britain proficient in delivering power for use in the air, at sea and on land. (See appendix for details) Rolls-Royce (2010)

1. 2 Rolls -Royce at the present

ROLLS-ROYCE GROUP PLC is a public limited company incorporated on 21st march 2003 and is registered in England under the UK companies Act 1985 having registered office in 65, Buckingham Gate, London in United Kingdom. The registration number of the company is 04706930. (Companieshouse 2010). ROLLS-ROYCE GROUP PLC is listed on LSE. It is a global conglomerate and world-leading provider of power solutions for consumer in aerospace, marine and energy markets. Today it is the world’s second largest civil aero engine company, the world’s second largest defence aero engine company, a global leader in marine propulsion and a leading supplier of energy solutions.

1. 3 Stakeholders and Rolls-Royce

Stakeholders are the person or group or organization that has direct or indirect stake in organization because it can affect or be affected by the organisation's actions, objectives, decisions and policies. (Freeman, 1984, pp. 25) Stakeholders are Shareholders, customers, suppliers and distributors, employees, local communities. Management holds fiduciary relationship with its stakeholders and work for retaining interest of stakeholders at large. (Friedman & Miles, 2006, p. 1)

The board of directors manages work of the company on behalf of the company. In Rolls-Royce the board is accountable to company's stakeholders regarding performance of company, the approval of certain matters which affect the shape and risk profile of the Company like the annual budget and performance targets, the financial statements, payments to shareholders, major capital investments and any substantial change to balance sheet management policy etc. Shareholders, customers, suppliers, employees constitute essential part of stakeholders in Rolls-Royce. Suppliers are valuable to the Rolls – Royce Group and it follows the Supply Chain Relationships in Aerospace (SCRIA) to protect the interest of the suppliers as it provides the best possible terms from suppliers and when entering into binding purchasing contracts, gives consideration to quality, delivery, price and the terms of payment. As the Company is a holding company and does not itself trade, it owed no amounts to trade creditors at December 31, 2009 and therefore the number of creditor days required to be shown in Annual report to comply with the provisions of the Companies Act 2006 is nil. (Rolls-Royce, Annual Report, 2009, pp. 78)

Financial statements are prepared by Rolls – Royce in accordance with IFRSs, GAAP as adopted by the EU and UK respectively and as per requirements of the Companies Act 2006; and, as regards the Group financial statements, Article 4 of the IAS Regulation. Rolls-Royce maintains an effective corporate governance framework that protects investors and aspires to deliver long-term value to shareholders. (Rolls-Royce, Annual Report, 2009, pp. 70-71)

Rolls-Royce in AGM highlighted key business developments during the year and discussed about crucial matters like declaration of dividend, appointment of directors and auditors, consider accounts, giving shareholders opportunity to ask questions regarding the company they are holding. (Rolls-Royce, Annual Report, 2009, pp. 75-76)

COMPANY AND INTERACTION WITH STAKEHOLDERS

2. 1 Legal Form

As a whole trading entity can be branched out as Sole traders, Partnerships, Limited partnerships, Limited liability partnerships, Limited by Guarantee companies, unlimited companies, Public companies. As per UK Companies Act four types of companies exist.

Formation of company helps the owner to limit the liability as company differs from the person as far as concept of corporate personality (separate legal entity which is distinct from the owner) is concerned. But when it is necessary to protect the stakeholders’ interest from fraud and deception of management the corporate veil of company is lifted.

In limited liability companies the owner or partners are not personally answerable and liable for potential losses of the company. Unlike these companies, sole traders and partnership firm cannot exercise the scope of funds for expansion (Black, 2004, p. 67). RR is public limited company with option of raising fund from public and preferred to be group of companies.

When a company holds the shares of another company, former company is ' holding' company that owns shares in ' subsidiary' company, the later one. In group of company under one holding company various subsidiary companies inhabit. Sometimes group of companies appear as a result of the merger and acquisition of a new company. When a company merges with or acquires numerous companies E+W+S+N. I. it is quite unmanageable to keep accounting books and records, prepare annual accounts and to hold an Annual General Meeting of shareholders for those companies under one company head. Establishment of group companies reduces hazards of risky business through a subsidiary to limit the group's exposure to the risk. (The National Archives, 2010)

Options/Help

RR is the holding company and does not trade on its own account. The group's chief operating subsidiary is RR. Entire business actions of the group are performed by RR and its subsidiaries. RR shares its registered office with RR group PLC but with different company registration number 1003142 under the UK companies Act 1985. Other companies which are indirectly held by the group incorporated within the UK and outside UK can be segregated under different heads like civil aerospace, marine, energy, corporate. There are also a variety of companies which can be held as Joint venture and associates. (See Appendix 2) (Rolls-Royce, 2010)

2. 2 Corporate Governance in Rolls – Royce

Recent corporate scams and fraudulent activities of large company like Enron in US, Polly Peck plc and Mirror Group plc in UK became noticeable and consequently Sarbanes-Oxley Act appeared in July 2002. To prevent the deception and misleading activities of company's strong presence of corporate governance with constituent like participation of BOD and committees are essentials.

RR prioritises corporate governance at highest level for the reason that stakeholders' interest is controlled, managed and directed by the company. The Company is exposed to the Combined Code on Corporate Governance published in June 2008 by the Financial Reporting Council (the Combined Code). (Rolls-Royce, Annual Report, 2009, pp. 66) It is the board which is responsible for managing company and day to day operation of business and accountable to stakeholders. The BOD of Rolls-Royce comprises of fourteen directors with the non-executive Chairman, the Chief Executive, eight non-executive directors and four other executive directors thereby complying the regulation regarding corporate governance.

Board Effectiveness

The board takes special care to retain independence of non executive directors to strengthens corporate governance and protect stakeholders because the non-executive directors represent stakeholders' interests. One of the most important facts is that the non-executive directors are not employees and do not participate in the daily business management of the Group. (Rolls-Royce, Annual Report, 2009, pp. 70) The non executives are highly considerable as they are independent in character and judgment with relevant expert knowledge and determination of good governance and high standard of investor relation. (Dunne & Morris pp7-10)

Different committees have been set up to determine effective and successful governance practice with corporate responsibility towards stakeholders. These Committees play a critical role reviewing, formulating and recommending governance principles concerning business.

COMMITTEES

These committees support the company for improved business maneuver. Along with this company has properly identified various risks which are properly mitigated through measure for better governance. (Details in section 4)

In Annual report of Rolls-Royce disclosures are made fulfilling the factors as depicted by the Company's Act 2006 (applied to the Plc which is listed in LSE) such as Business review must contain information on future development, performance and position of the business environmental issues, employees and social issues contractual and other arrangement (Rolls-Royce, Annual Report, 2009, pp. 1-65) and in addition to this the company website contains annual report and accounts, results of the polled votes at AGM and result of the fact that the company gives certain minority shareholders the right to require independent scrutiny of any polled vote to abide by the regulation.(Rolls-Royce 2010)

Abovementioned administration of corporate governance not only helps the shareholder to identify the company’s risk profile, structure, culture, vision and course of action to invest further but also helps other stakeholders to meet their needs and obligations.

3. FINANCIAL ANALYSIS

R&R uses pre tax discount rate for the present value calculation of future cash flows and inventory, work in progress is calculated in first in first out basis. R&R has considered net realisable value is selling price minus costs incurred by marketing, selling and distribution. Cash flow projection in goodwill calculation is under assumptions of defined discount rates, growth rates, foreign exchange rates and WACC at 12. 75. In order book calculation R&R has excluded the future order option on top of the placed orders. These best practices are common for going concern and conforming Section 418 of the Companies Act 2006. (Annual report, 2009)

3. 1 Financial Statements

In this report financial analysis is done through ratio analysis of provided financial statements. Financial statements have been prepared based on IFRS, which is issued by IASB. This preparation is common for EU and onset of UK GAAP. (Institute of Chartered Accountants in England and Wales, 2003)

3. 2 Ratio analysis

Ratio analysis is a tool for financial analysis to evaluate firms, industries. Ratio analysis helps to find the trend as well as to compare among the competitors using the financial statements. Mainly five types of ratios are helpful to judge different financial aspects. These ratios are liquidity, asset management, debt management, profitability and market value. All the ratios are important but value and importance differ with the company and industry. Like debt management ratio will be important for higher borrowed firm to judge the bankruptcy risk. (Brigham & Houston, 2009)

Revenue, Gross Profit and Operating Profit have increased from 2008 to 2009. In 2009 R&R has turnaround from loss to huge profit. Even company earning changed from negative to positive. This change in profit is mainly due to the huge decrease of financing costs from 3186 million £ to 491 million £. In 2009 R&R has managed to get big amount of financing income. There is a no significant change in balance sheet item except the considerable amount of reduction of other financial liabilities. Net asset of R&R has changed significantly due to the noticeable decrease in liabilities.

(Historical Prices, 2010)

RR has outperformed both LSE and BOE return for last 12 months period. From our previous financial analysis we found RR’s good performance and growth in revenue which is mainly based on accounting figures but ultimately reflected in market also. RR is the market leader and main competitors are Dassault Aviation, Saab AB and MTU Aero Engines. RR’s aero engine business serves two distinct market segments like new engine sales to Boeing and Airbus Industries & engine parts sales to maintenance companies. So RR caters both primary and secondary markets. In this market the competition is distributed in commercial and technical side, which is also catered by General Electric and Pratt & Whitney. Company has increased market share from10% in 1970 by investing in R&D for new engine development and also for better services. Overall the market is oligopolistic and capital intensive. The key determinants for sustainable competitiveness are technology, R&D outcome. (Annual report, 2009)

3. 4 Strategy & Recommendation

RR has five key strategies like four market segments, better technology, competitive portfolio, increasing market share and value added services. RR has strong brand, domain knowledge, integrated system and operational excellence to implement these strategies. (Our strategy, 2010)

SWOT

(Porter, 2008)

RR is in such industry where the numbers of buyers are very less so this is quite price maker's type market or more easily can be said that the price of products of RR is set by buyers. But recently with increase in global carriers the demand is uptrend but here life long guarantee in engines are desirable. In supplier side RR follows the dual sourcing strategy so the power of supplier's reduced and high precision can be reached. Very high entry barrier is there to this industry, where brand reputation and domain knowledge is very key determinants of success. There is no substitute of engines and aerospace. (Data source from Annual report, based on own analysis and see exhibit 5 for details)

Recommendation

From above strategic and financial analysis, it is recommended that RR is strong in operation but few segments are not performing well, so few strategies are to be taken to increase the key indicators.

4. INTERNAL PROCESS AND STRUCTURES

Some companies operate better in competitive environment than other due to implementation of their strategy on organization. Organisational structure does not mean only having best team with best skills to execute particular achievement but organistional effectiveness can be attained by closely interacting and interlinking them through finding creative solutions to execute business operation. “ Organisational Effectiveness is the result of effective interplay of a company’s vision and strategic goals with the chosen structural design, processes, assigned responsibilities, available skills, knowledge and capabilities, and reliable performance measure”. (Dressler pp. 43) Combination of strategic perspective and core categories of Organisational Effectiveness creates strategic framework. Strategic management process is completed by carry out strategic direction setting, strategic alignment and strategic control.

4. 1 Internal control and risk management

Internal control and risk management procedure of Rolls Royce is very neatly framed to detect, monitor, manage and mitigate risks arising both from financial and operational viewpoint. The internal control system manages and thrives to eliminate failure of attainment of business goal. The risk committee is observant to the system of risk management and is responsible for reporting the principal risks , for implementing the Board’s policies on risk and internal control and reviews the results of the risk management process to diminish them. The audit committee reviews credit, market or liquidity risks. The ethics committee reviews those risks which significantly affects ethical part happens to be threats to reputation to esteemed company. The day-to-day management activity involves risks and risks which operates at all levels in the Group flows from upper section of management towards subordinate It is every manager’s responsibility is to be attentive to indulge in risk mitigating activities whatever business decision they takes. (Rolls-Royce Annual Report 2009, pp74)

4. 2 Procedure of Risk management

Risks are recognized and identified to update in framework of risk register so that management can review to assess them for subsequent reduction of risk.

The company has followed a consistent strategy for twenty years and investment in technology for future growth in a good way. As a result of this strategy, Rolls-Royce today has a broad customer base comprising more than 600 airlines, 4, 000 corporate and utility aircraft and helicopter operators, 160 armed forces, more than 2, 000 marine customers, including 70 navies, and energy customers in nearly 120 countries, with an installed base of 54, 000 gas turbines. Rolls-Royce having 38, 000 skilled employees in offices, manufacturing and service facilities with presence in 50 countries the group is thriving for developing employee skills. (Rolls-Royce)

The company is continuing in sustaining development of the Company’s strategy to bring long term value for investor within an acceptable risk profile. It also keeps eye on the monitoring of the strategy implementation along with retaining safeguard of the values of the Company, including its brand and corporate reputation and the safety of its products.

4. 3 Implementation in Rolls-Royce

Aforementioned diagram shows the strategy for entire business process as a whole highlighting on technology, infrastructure, and development of competitive portfolio of products and services, closeness to customer, brand, organic growth, partnership and acquisition through last twenty years.

4. 4 Balance score Card

Balance score card is a set of measures that gives top managers a fast but comprehensive view of business, a tool for measurement of business performance. (Kaplan and Norton, 1992) the model has four perspectives – Financial perspective, Customer perspective, internal business perspective, Innovation and learning perspective.

The customer perspective detects “ goals for time, quality, performance and service” which has effect on the customer. (Harvard Business Review, 992, p. 73). Internal business perspective recognizes the processes and competences are identified arising from the most important issues for customers. (Harvard Business Review, 1992, pp. 74-75). Innovation and learning perspective is “ referring to the ability of a company to innovate, improve and learn ties directly to the company’s value” (Harvard Business Review, 1992, p. 76). From the financial perspective, financial performance indicating company’s strategy, implementation and execution are measured to measure profit improvement (Harvard Business Review, 1992, pp. 77). All perspectives categorise goals and measures to be made available. Through the Balanced Scorecard, the strategy of a business can be communicated clearly and ensured that all employees follow the same goals (California Management Review, 1996, p. 57).

Training in RR improved employee skills, which helps to maintain the core competencies of RR in tradition. This Internal quality along with higher productivity and online delivery gives limited customers of RR to maintain long term relation. ROCE of last three years is on an average consistent, which is maintained due to this cascading effect. (California Management Review, 1996, p. 66)

CONCLUSION

Rolls-Royce emphasizes transparency and high standard of governance, ethics and integrity. The brand of Rolls-Royce symbolizes reliability, integrity and innovation and is most valuable asset of the company than their engineering excellence. Fabricating grand product and delivering services is not enough in current competitive market but it is the trust which is established through years by virtue of response of Rolls-Royce to the needs of customers building enduring relationships with customers, partners and other stakeholders consequently made them world’s leading-edge, international power system company. Financial position is improving from last year but key indicators and from strategic point of view Rolls-Royce should think of market portfolio. Product line and services are as per leaders approach but except civil aerospace, other segments are with lesser growth and prospect.

ANNEXURE

6. 1 References

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6. 2 GLOSSARY

Financial statements are Income statement, balance sheet, cash flow statement and statement of changes of equity.

Turnover = Revenue from continuing operations, the figure is available from profit &loss account.

Operating profit= Profit on operations OR Profit from continuing operations

Operating profit margin =(Operating profit / Turnover) x 100

Return on capital employed (ROCE) = (Operating profit/TALCL) x 100

TALCL= Total assets less current liabilities

Asset turnover = Turnover/ TALCL

Current ratio = Current assets/ Current liabilities

Gearing = Long term borrowing/ TALCL x 100

Interest Cover = Profit before interest/ Interest payable

Dividend Yield = Dividend per share/ Share price

Earnings per Share (EPS) = Profit before dividends/ Number of ordinary shares

Price/Earnings Ratio = Share price/ EPS

Dividend Cover = Profit after tax / Dividends

Stock Turnover = Sales/ Stock

Debtors Turnover = Sales/ Debtors

Creditors Turnover = Sales/ Creditors

Working Capital Turnover = Sales/ Working Capital

Quick or ‘ Acid Test’ Ratio = Current assets – stock/ Current liabilities

Debtors’ Collection Period = 365/ Debtors Turnover

Creditors’ Payment Period = 365 / Creditors Turnover

Du-Pont analysis = Financial leverage * Net profit margin * Total asset turnover

Financial leverage = Total asset / Common stock equity

Net profit margin = (Net profit / Turnover) x 100

Total asset turnover = Total revenue/ Total assets

SOX is US Sarbanes-Oxley Act 2002

Order book

EU= European Union

IFRS= International Financial Reporting Standards

IASB= International Accounting Standards Board

GAAP= Generally Accepted Accounting Practices

Group= Company and its subsidiaries together referred to as the ‘ Group’

WACC= weighted average cost of capital

6. 4 APPENDICES

Appendix 1

Profitability of Rolls-Royce is measured through Return on capital employed, Operating profit can be found from Profit and Loss account but total assets less current liabilities is available at Balance sheet. Efficiency of Rolls-Royce is measured through Asset turnover, Stock Turnover, Debtors Turnover and Creditors Turnover and Working Capital Turnover. Liquidity of Rolls-Royce is measured through Current ratio. Current assets and Current liabilities figure are available at Balance Sheet. Liquidity can measure through Debtors' Collection Period, Creditors' Payment Period. Structure of Rolls-Royce is measured through Gearing or using Dividend Cover, Earnings per Share (EPS), Price/Earnings Ratio, Dividend Yield and Interest Cover. Higher value of acid test ratio, creditor's payment period, EPS, Dividend cover, interest cover ratio, price earning ratio is better but lower value debtor's collection period is good for business.