

«BENCHMARKING» AND

«PEER GROUP»

ANALYSIS:

...A FOCUS ON

EXTERNAL-DATABASE

BENCHMARKING



What is Benchmarking?

**... the continuous search for and adaptation of significantly better practices that leads to superior performance by investigating the performance and practices of other organizations
(R. Camp, executive at Xerox USA in 1979)**

...in 1979, Xerox USA realized that a Fuji-Xerox photocopier was sold for what it cost Xerox to produce one of its own photocopiers
=> Xerox used benchmarking to reduce manufacturing costs.



Types of Benchmarking

- **Internal benchmarking**: comparison against another area *within the organization*

- **External benchmarking**: comparison against *other organizations*
 - **Database benchmarking**: based on large firm-level (or establishment-level) databases
 - **Intra-industry (positioning benchmarking)**
 - **Competitive benchmarking**: comparison against direct *competitors*
 - **Best practice benchmarking**: comparison against the *best performing* organization
 - **Positioning benchmarking**: comparison against given moments of the industry distribution: mean, median, interquartile range, etc.
 - **Inter-industry**

External (database) Benchmarking

Objective: Comparison of given (usually operating) metrics in a peer group (the comparable "universe")=> you against the "target" companies.

Main Tool: "Peer Group" Analysis, use of large databases (panel data)

Steps:

- **Select the "Peer Group" (i.e. target firms, benchmark partners, competitors):** database (...as rich as possible!); consider: sector of activity, type of firms (size, location, independence, growth history, etc...)
- **Compute the key indicators:** choose and compute the indicators for yourself and the target firm(s) (median, IQ range, etc...)
- **Comparison with the target firm(s):** evaluate your position against the others

External (database) Benchmarking

Examples of applications

- **Performance and positioning**: performance indicators (e.g., financial indicators, profitability-liquidity ratios) evaluated against those of direct competitors and potentially all comparable companies in the same sector/country/region (i.e., best practice analysis).

- **Tax Data Analysis**: Comparability Analysis (...“peer-group”)
 - ⇒ **Transfer Pricing**: application of the CUP (Comparable Uncontrolled Price) method
(OECD Guidelines, Provvedimento Agenzie delle Entrate - ITA/ENG)

 - ⇒ **Patent Box**: evaluation of “reddito agevolabile” (“subsidizable” income)
(Ref. [D.M. 30/07/2015](#))

External (database) Benchmarking

Example 1: Performance and Positioning – “fashion retail industry”

REGION	# FIRMS
<u>Abruzzo</u>	216
Basilicata	55
Calabria	247
Campania	1100
Emilia-Romagna	338
Friuli-Venezia G	56
Lazio	1512
Liguria	111
Lombardia	729
Marche	156
Molise	44
Piemonte	193
Puglia	547
Sardegna	156
Sicilia	636
Toscana	394
Trentino-Alto A.	51
Umbria	95
Veneto	312
TOTAL	6948

CASE STUDY: «COMPANY X» located in «**Abruzzo**», Fashion Retail Industry, Tailored Suits

Database: AIDA (BvD), Italian Companies

For each company compute a number of key ratios (for example):

- Profitability indicators:

ROE: Return on Equity

ROI: Return on Investment

- Productivity indicators:

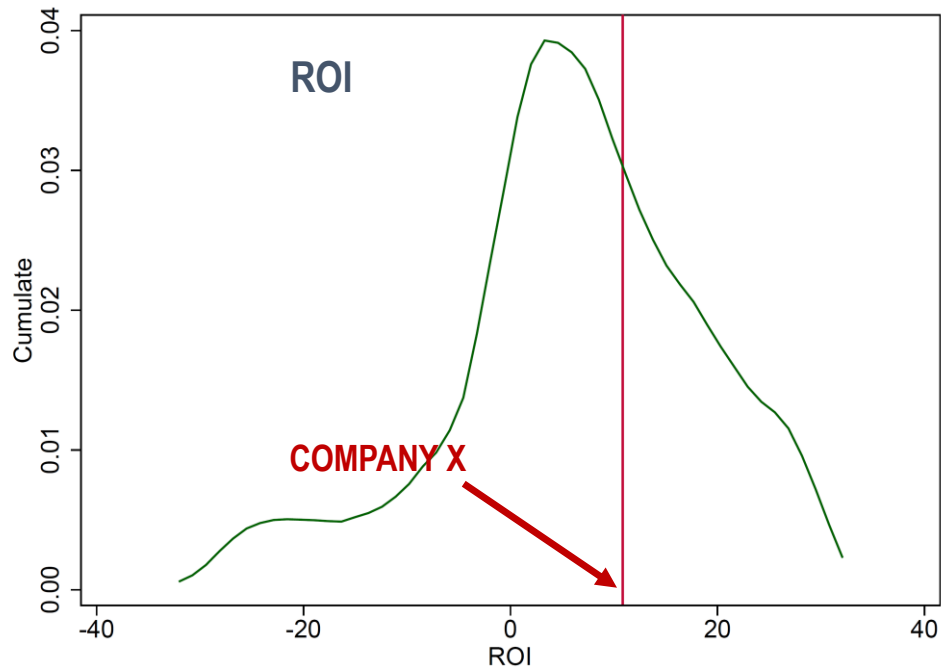
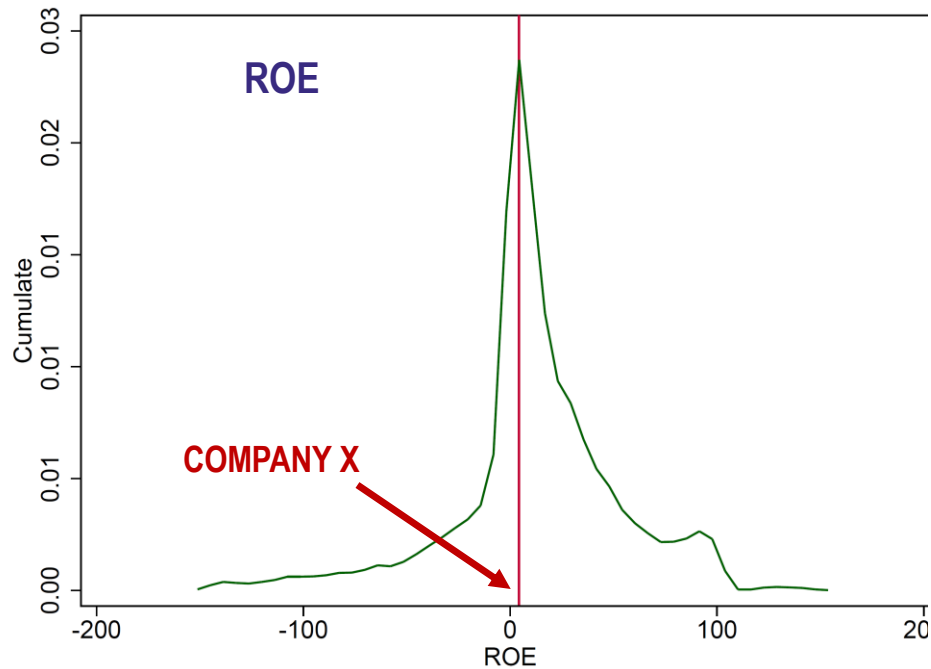
Revenues/Labor

Value Added/Labor

External (database) Benchmarking

Example 1: Performance and Positioning – “fashion retail industry”

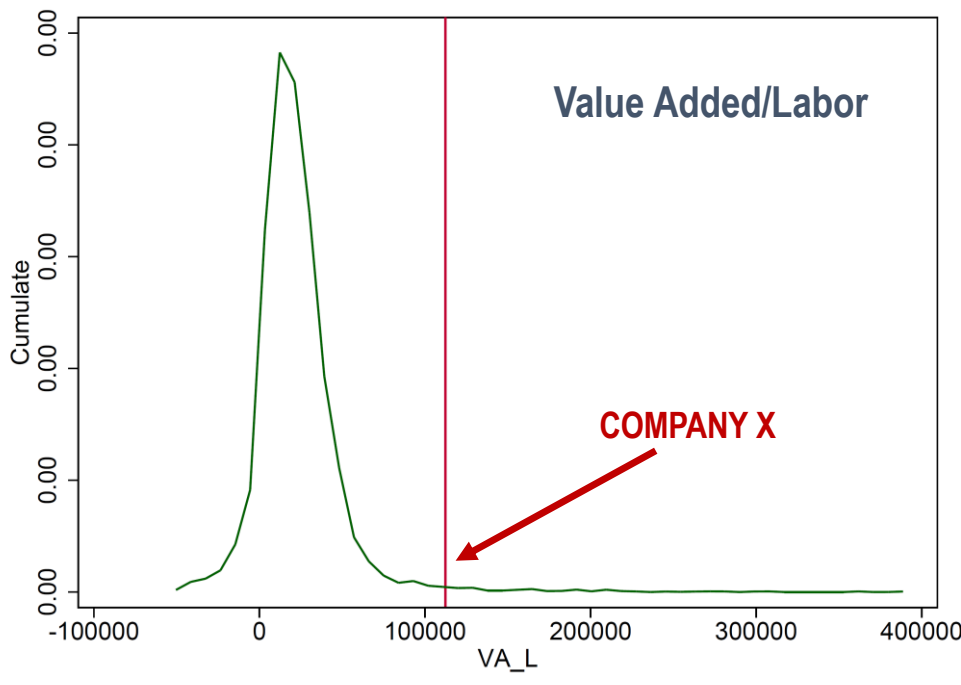
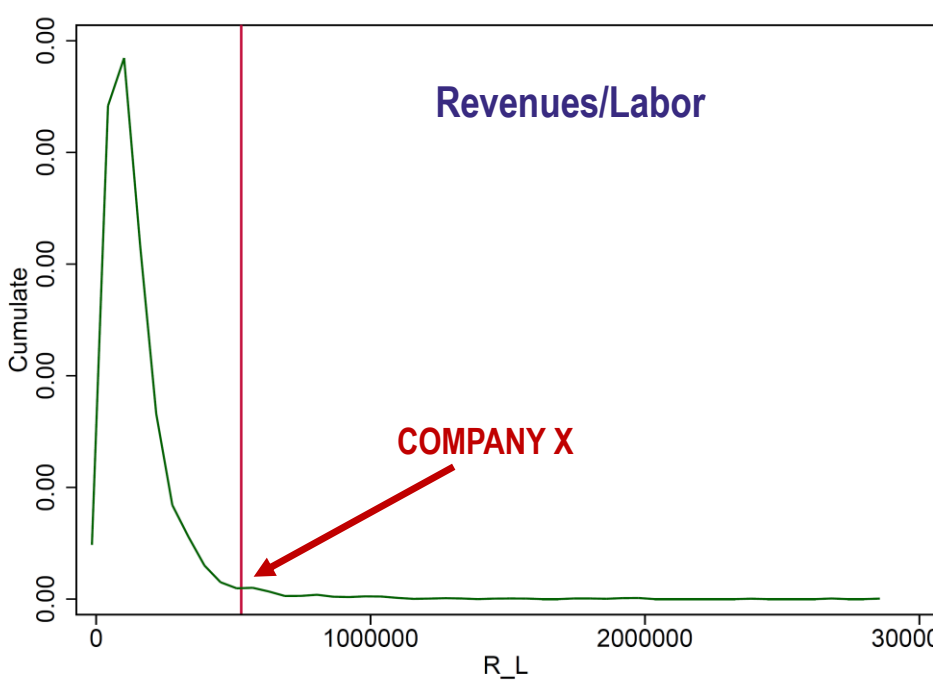
Where does Company X stand?



External (database) Benchmarking

Example 1: Performance and Positioning – “fashion retail industry”

Where does Company X stand?



External (database) Benchmarking

Example 1: Performance and Positioning – “fashion retail industry”

Where does Company X stand?

Abruzzo	ROI	ROE	R/L	VA/L
25th percentile	-4.02	-1.265	57410	9380
Median	4.98	6.715	107775	16955
75th percentile	11.02	31.015	156215	27350
Company X	10.85	4.17	529010	112260

Compared to other companies in Abruzzi, **COMPANY X** is:

- outstanding in terms of profitability (top 25%);
- very good in terms of ROI (although not in the top 25%);
- not so good in terms of ROE (below the median) => why?

External (database) Benchmarking

Example 2: Transfer Pricing – “fashion retail industry”

A transfer price is the price that a division of a MNE charges for the provision of goods or services to another division of the same group.

Profit shifting (to low corporate tax rate countries) by setting the price at a different level compared to the price that market forces would have set.

«**Arm’s Length Principle**»:

« [where] conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly»

(Art. 9 OECD Model Tax Convention)

External (database) Benchmarking

Example 2: Transfer Pricing – “fashion retail industry”

How to establish whether the conditions of controlled transactions are consistent with the “arm's length” principle?

➤ **Transfer pricing methods:**

- “traditional transaction methods”:
 - resale price method
 - cost plus method
 - comparable uncontrolled price method (“CUP” method)
=> requires Competitive Benchmarking (Peer Group Analysis)
- “transactional profit methods”
 - transactional net margin method (“TNMM”)
 - transactional profit split method

External (database) Benchmarking

Example 2: Transfer Pricing – “fashion retail industry”

“Peer Group” Analysis for the application of the “CUP method” (comparability analysis):

- Focus on Fashion Retail, abstracting from economically significant characteristics of the given company and relevant context factors
- AIDA Database (Bureau van Dijk), Italian, Active, Independence: foreign property $\leq 25\%$; exclude companies with a negative performance of at least 3 years => 10856 companies
- Key indicator: Operating Margin (OM) = operating income / net costs
- Evaluation: median, IQ range, etc...

⇒ **Operating Margin lower than the median => potential evidence of transfer pricing**

External (database) Benchmarking

Example 2: Transfer Pricing – “fashion retail industry”

Peer group IQ Range

p50=peer-group median

# EMPLOYEES	PERCENTILE			# OF FIRMS
	p25	p50	p75	
<= 5	-3.513	1.719	4.982	7243
5 - 20	0.021	1.943	4.010	2787
21 - 50	0.610	2.015	3.766	525
51 - 150	-1.138	1.537	3.339	120
151 - 500	-0.003	2.010	4.963	53
> 500	-12.033	0.039	4.762	128
avg	-1.988	1.787	4.558	10856

INDEPENDENCE	PERCENTILE			# FIRMS
	p25	p50	p75	
high	-2.512	1.705	4.437	6984
low	-1.353	1.946	4.772	3872
Total	-1.988	1.787	4.558	10856

=> The OM threshold varies by, e.g., # of employees or degree of independence

External (database) Benchmarking

Example 2: Transfer Pricing – “fashion retail industry”

Where does Company X stand in the ranking?

...in a random sample of 15 companies with branches => two are potentially involved in TP practices

(...anonymized)

Company Name	OM	size class	reference OM values		
			p25	p50	p75
Company 1	1.178398	1	-3.51267	1.718881	4.982461
Company 2	2.92463	1			
Company 3	-0.79425	2	0.021	1.942967	4.009849
Company 4	1.640447	2			
Company 5	2.428776	2			
Company 6	3.109431	2			
Company 7	3.302618	2			
Company 8	4.410429	2			
Company 9	15.90522	2	0.610116	2.014794	3.765659
Company 10	0.592395	3			
Company 11	1.837795	3	-1.13804	1.536621	3.338765
Company 12	12.11118	4			
Company 13	4.760151	5	-0.00321	2.01009	4.962893

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