Industry analysis

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The economic sector

- Start with NAICS codes – two digit
- Examine growth of the sector
  - Changes in overall economy
  - Performance of the sector
  - Trade publications – Forbes, Business Week – as well as government sources
  - Don’t forget the associations (e.g. NAM)
What about your industry?

- What business are you really in?
- Industry growth
  - In revenues and employment (minimally)
  - Go back before the dot-com bubble
  - Use company annual reports where possible, average across them
- Make sure you know the change in GDP overall
Industry life cycle

- New: lots of opportunities, but all are a tough sell
- Expanding: many new entrants, including some of the “big boys”
- Stable: the “Big Three” (or not?)
- Declining: Even the large ones are in trouble. Foreign competition, large market forces. Steel. But NuCor
A sample of strategies

- “Establish credibility”
- “Gain a foothold”
- “Differentiate from the competition”
- “Build market share”
- “Cannibalize weakened competitors”
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The common feature? Agility!
A small voice from the side

- With a $100 million company, I’m tuned in to what is happening in the industry...so I can take marketing and pricing steps that will lead my competitors...I look at least six months ahead...know when to pull back...when you can see the bottom of a downturn, resume a more aggressive approach.

- Andre Tatibouet, President of Aston Hotels
Larger economic conditions

- Interest rates
- Levels of unemployment
- Low or high inflation
- Strong or weak dollar
- Housing starts
- (Proportions of dual-earner households)
- (Changes in family mobility)
Other industry factors

- Seasonality - make sure it is in the financials
- Technological change - especially manufacturing, customer service, and marketing/communication
- Regulation - FDA, OSHA, EPA, and of course, homeland security
- Supply and distribution channels
Jargon assistance: wines

From p. 82

“This is a capital-intensive industry; inventories are expensive to maintain. You get a low asset turnover because your inventory has to sit around in barrels for a long time. … Stay on top of the payables and receivables turnover, the gross profit margin, the inventory turnover ratio.”
Jargon assistance: wines

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- Which all means exactly what?
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Asset Turnover Ratio

- Assets: resources the business owns, such as cash, inventory, fixed assets
- How effectively were these used in a year? (Or some other fixed time.)

\[
ATR = \frac{\text{Annual Sales Revenue}}{\text{Total Assets}}
\]
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Payables, Receivables

- Payables: stuff ya gotta pay out (employees, supplies under contract, equipment delivered).
- Receivables: stuff that others owe ya for (wine shipped, but not collected). This is why stores like your plastic.
- Turnover: every month ya pay some, ya get some; next month ya do more of the same.
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Gross Profit (Margin)

- Sales revenue less cost of goods sold
- How much you received for the bottle of wine, less how much it cost you to make it (including aging it)

In “ratio” form:

\[
GPM = \frac{Sales - Cost\ of\ Goods}{Sales}
\]
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Inventory Turnover (Ratio)

- An “activity” ratio
- Perhaps best understood in units
- In ratio form,

\[ \text{ITR} = \frac{\text{Total \# Of Units Sold}}{\text{Average \# Of Units In Inventory}} \]
Time To Talk To People

- You *may* be able to get industry-level financial information from a sample of Annual Reports
- But you may not...
- So this is the likely beginning of “I’m a student…”
- If your team finds a particularly useful informant, cultivate him/her
One Last Thing…

- The sample industry analysis is useful
- But notice the one element of the sample on page 85 that is *not* discussed in the chapter itself:
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- The *barriers to entry by others*