

# A financial analysis of 3m finance essay



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Currently, 3M operates in more than 65 countries. The company produces a large variety of products, such as: adhesives, abrasives, laminates, passive fire protection, dental products, electronic materials, electronic circuits and optical films.

3M started operating on the North Shore of Lake Superior in Two Harbors, Minnesota in 1902. Five businessmen (Henry S. Bryan, Hermon W. Cable, John Dwan, William A. McGonagle, Dr. J. Danley Budd) came together to mine a mineral deposit used for manufacturing grinding-wheels. As it turned out, the deposit didn't have much of a value, so they opted to concentrate on sandpaper products.

In 1914, 3M launched its first exclusive product: Three-M-ite cloth. Few other innovative products followed: waterproof sandpaper, masking tape, and the very well known Scotch brand tape. In 1929, 3M decided to expand its business internationally and started operating in Europe. The same year, the company's stock was first traded over the counter. In 1946 the company went public on the New York Stock Exchange (ticker symbol MMM). The company is a component of the Dow Jones Industrial Average and of the S&P 500.[1]

## **1. 2 Company Profile**

3M Company is an American transnational enterprise based in Maplewood, Minnesota, and represents one of the major players in the conglomerate industry.

Below are presented some of the highlights that compose the company's profile:

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## **3M Co.[2]**

3-M Center

St Paul, MN 55144-1000

Index Membership: Dow Jones Composite

Dow Industrials

S&P 100

S&P 500

S&P 1500 Super Comp

Sector: Conglomerates

Industry: Conglomerates

Employees (last reported count): 74, 835

### **1. 2. 1 Organizational Structure**

3M's general offices and research laboratories are located in St. Paul, Minnesota. Locally, 3M has nine sales offices and operates 74 manufacturing facilities. Outside the United State, 3M has 148 sales offices and 93 manufacturing . 3M owns all of its physical properties.[3]

#### **Key Executive:**

Bellow, there are presented few of the key people that are currently running this enterprise:

Mr. George W. Buckley, Chairman, Chief Executive Officer and President

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Mr. Patrick D. Campbell, Chief Financial Officer and Senior VP

Mr. Inge G. Thulin, Executive VP of International Operations

Mr. Brad T. Sauer, Executive VP of Health Care Business

Mr. Jean Lobey, Executive VP of Safety Security & Protection Services  
Business.[4]

## **2. Major lines of business[5]**

3M serves its customers through six business segments:

1. Consumer and Office (15% of total sales).

3M is providing its customers with a large variety of products such as house cleaning materials and office supplies. Some of the most popular ones are: Post-it®, Scotch®, Scotch-Brite®, Filtrete™, O-Cel-O™, Nexcare™, and Command™

2. Display and Graphics (13. 5%).

As a top technological innovator, 3M provides its customers with products such as: display enhancement films; reflective materials, graphics, and projection systems.

3. Electro and Communications (9. 8%).

Due to its continuous innovative efforts, 3M managed to provide solutions for customers in many fields: electrical, electronics and communications. They contribute to reliable sources of electrical power, high-performance electronic devices, and reliable, high speeds telecommunications network.

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#### 4. Health Care (18. 6%).

3M is considered a global leader in medical and oral care products, drug delivery and health information systems, providing its customers with innovative and trustful products that help care professionals improve the quality of care services.

#### 5. Industrial and Transportation (30. 8%)

The company supplies a large variety of innovative products such as tapes, abrasives, adhesives, specialty materials and filtration systems to different markets: from automotive to aerospace to renewable energy to electronics.

#### 6. Safety, Security and Protection Services (13. 8%).

3M's products-personal protective equipment, safety and security products, substantially contribute to the safety, security and productivity of people, facilities and systems around the world.

## **1. 3 Operating Strategies**

### **1. 3. 1 Mission Statements and Management Objectives:**

The main mission statement and management objectives, as presented in the company's annual report are:

Demonstrate uncompromised honesty and integrity in all activities and relationships.

Promote individual initiative , innovation and leadership,

Establish and maintain a culture dominated by fairness and trust, where respect and responsibility, are valued and recognized.

Create a safe workplace for 3M employees.

Satisfy customers with high quality products and services.

Provide investors with an attractive return.

Respect the social and physical environment worldwide.

### **1. 3. 2 Business model and Strategies**

3M' business model is based on “ the ability to not only develop unique products, but also to manufacture them efficiently and consistently around the world (3M). ”[6]

3M is a diversified technology enterprise with an international presence in different businesses, such as: industrial and transportation, healthcare, display and graphics, consumer and office, safety, security and protection services, and electro and communications. The industrial and transportation business includes products such as food and beverage, personal care, and automobiles. Industrial products include polyester, foil, and tape.

Transportation sector provides the market with different types of insulation components and catalytic converters. The health care segment produces supplies and equipment for medical and dental use. The display and office business supplies stationary products, and home-improvement products.

Besides the already mentioned business sections, 3M also manages a safety segment and an electro and communications segment.

In order to remain a respected leader in its field, 3M employs a series of strategies. The company is continuously trying to increasing market share and the popularity of their brands. Also they make significant efforts to maintain existing customers and attract new ones. This is a very important issue considering the number of substitute products currently available on the market. Besides the already mentioned strategies that 3M employs in order to run a successful business, they also practice a very interesting hedging strategy . Instead of concentrating on a single industry, 3M operations are spread over a large variety of sectors. So, at any point in time, the effect of a slow growth sector is counteracted by the prosperity of another sector. Due to this hedging strategy, the company stock price manages to maintain relative stability.[7]

Also, they continue to spend significant amount of funds on R&D, which is critical for their image as a leading innovator, pay dividends, buy back stock and raise shareholders equity, the chief aim being the ability to offer a good return to all their investors. This is a solid company, with a very high degree of liquidity in an extremely good financial health.

Another strategy that makes 3M well known is there acquisition strategies. On an average, the company performs ten to twenty acquisitions every year. This enables 3M to continuously grow, penetrate new markets and explore new technologies.

Other strategies that 3M employs refer to continuous innovation, in order to introduce new products to various markets that company operate in, gaining

market share in the existing markets and aiming to become more and more important to the end customers.

## **1. 4 SWOT Analysis**

SWOT is a strategic planning method used to evaluate the strengths, weaknesses, opportunities and threats involved in a business.[8]

3M SWOT analysis:[9]

Strengths:

The company operates in a large variety of business sectors: industrial and transportation, healthcare, display and graphics, consumer and office, safety, security and protection service, electro and communication.

Strong research and development capabilities. (According to 3M 2009 Annual Report, the company spent more than a billion dollars in R&D).

Multinational presence. The company operates more than 65 countries.

Solid financial condition. (A complete Income Statement and Balance Sheet are presented in the annexes).

Weaknesses:

Low inventory turnover, which impacts inventories and margins.

Some key segments are registering inferior performance.

Strong and aggressive competitors.

Opportunities:

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Acquisitions in key operating areas. 3M performs an average of 20 acquisitions every year.

Continued global expansion.

Healthcare spending levels in the US are increasing.

Security concerns caused by a weak US economy, combined with some unfortunate events that are threatening the safety of American people, (9/11/2001, N1H1 virus infection) brings new opportunities for 3M security business.

Threats:

The fluctuation of commodity and energy prices (increasing). In order to mitigate this risk, the company is engaging in a multitude of forward physical contracts and price agreements.

Exchange rates fluctuations. The company operates worldwide, so the exchange rates and any fluctuations of it may negatively impact the company's results.

Environmental regulations. People are becoming more and more aware of the importance of respecting the environment. Any new rules and regulation may require additional funds to be invested in order to “work green”.

## **1.5 Core competencies**

A core competence represents “the company's collective knowledge about how to coordinate diverse production skills and technologies” (C. K. Prahalad and Gary Hamel).[10]

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3M runs an extremely diversified business, spread over numerous sectors: industrial, transportation, display and graphics, security etc. In order to manage and keep all this different types of businesses together, the company holds competencies in substrate, coating and adhesives. Besides possessing these competencies, the company also created a multitude of ways to share and apply them. The result of such combination of technology, skills and knowledge, allows 3M to participate on a multitude of businesses and markets.

The literature points out that the core competencies of any company should benefit the end customer of the product and should be very difficult to copy by the competitors. 3M is aware that the stronger the customer perception in recognizing the superiority of their products, the less likely the threats of substitutes. The company makes continuous efforts to differentiate its products among the multitude of similarities offered by the competitors and their efforts are successful due to the fact that they are supplying high quality, innovative and reliable products at competitive prices.

Moreover, it is a company's core competencies that keeps the businesses together. This aspect is crucial for 3M, as the company operates in multiple business sectors, worldwide.

It seems that 3M fully understood this concept and its enormous advantages, because they are investing consistently in their core competencies and ability to innovate, the chief aim being to provide the market and the end customers with innovative products that really stand out.

## **2. Industry analysis**

### **2.1 Industry Definition, Structure and Major Competitors.**

The Industrial Conglomerate industry consists of “ large organizations engaged in multiple business lines within the industrial sector, where at least two business lines comprise a substantial portion of the company’s total operation” (The New York Times, Oct 1, 2010).[11]The industrial conglomerate industry contains the following sectors:

Basic Materials,

Consumer Cyclical,

Consumer Non-Cyclical

Energy,

Health care,

Industrials and Transportation,

Technology,

Telecommunication,

Utilities.

### **Exhibit1. Direct Competitor Comparison[12]**

#### **MMM AVY DD JNJ Industry**

Market Cap: 63. 58B 4. 02B 42. 30B 174. 16B 9. 47B

Employees: 74, 835 31, 300 58, 000 115, 500 28. 26K

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Qtrly Rev Growth (yoy): 17. 70% 15. 40% 21. 80% 0. 60% 14. 50%

Revenue (ttm): 25. 39B 6. 31B 30. 43B 62. 59B 10. 28B

Gross Margin (ttm): 48. 78% 28. 26% 29. 94% 69. 98% 33. 80%

EBITDA (ttm): 7. 03B 695. 10M 5. 42B 19. 70B 1. 63B

Operating Margin (ttm): 23. 18% 6. 96% 13. 08% 26. 90% 12. 29%

Net Income (ttm): 3. 94B 250. 90M 3. 13B 13. 53B N/A

EPS (ttm): 5. 48 2. 37 3. 43 4. 84 1. 92

P/E (ttm): 16. 28 16. 04 13. 60 13. 06 19. 15

PEG (5 yr expected): 1. 28 1. 44 1. 61 2. 09 1. 28

P/S (ttm): 2. 50 0. 63 1. 38 2. 78 1. 27

AVY = Avery Dennison Corporation produces pressure-sensitive materials, office products, tickets, tags, labels, and other converted products.

DD = El DuPont de Nemours & Co. (DuPont) operates as a science and technology company worldwide.

JNJ = Johnson & Johnson engages in the research and development, manufacture, and sale of various products in the health care field worldwide. The company operates in three segments: Consumer, Pharmaceutical, and Medical Devices and Diagnostics.

Industry = Conglomerates

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## **Exhibit2. Comparison between 3M, the Conglomerate Industry and the direct competitors, benchmarked against DOW and S&P 500.**

Source: <http://finance.yahoo.com>

### **2. 2 Industry profitability and growth.**

In order to get an idea about the main characteristics of the players in this industry, I have selected few key statistics. The financial indicators listed bellow shows the fact that this are large companies, highly leveraged (most of them), providing the investors with a small to average return.

Market Capitalization: 366B

Price / Earnings: 13. 5

Price / Book: 4. 1

Net Profit Margin: 7. 5%

Price to Free Cash Flow: 27. 4

Return on Equity: 12. 5%

Total Debt / Equity: 242. 3

Dividend Yield: 2. 4%

## **Exhibit 3. Comparison between the evolution of 3M common stock and the industry.**

Source: <http://finance.yahoo.com>

## **2.3 PEST Analysis of the External Factors affecting the Industry**

“PEST analysis stands for “Political, Economic, Social, and Technological analysis” and describes a framework of macro-environmental factors used in the environmental scanning component of strategic management.”[13] Performing such an analysis and applying the findings will give any company a significant competitive advantage.

The model identifies four factors that have a major impact on the company’s macroeconomic environment:[14]

Political

Economical

Social

Technological

Political Factors: Among the most significant political factors that can affect 3M’s business are: tax policies, employment laws, environmental regulations, trade restrictions and tariffs, and political stability.

3M is making all the necessary investments in order to comply with these laws. In 2009, 3M spent around \$15 million for projects regarding the protection of the environment. The mentioned funds have provided among other things, pollution control devices at all its properties.

Economical Factors: economic growth, interest rates, exchange rates, inflation rate.

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Due to large geographical presence, and the fact that 63 percent of its revenue is generated from outside the United States, the company's results may be affected by exchange rates and their fluctuation. In order to mitigate this risk, the company engages in a multitude of forward contracts. Also, the Company's business may be negatively affected by other factors, both internal and external that are beyond its control, such as instability and downturns in financial markets or economies in some countries or regions, in which the Company operates.

Social Factors: population growth rate, age distribution, health and safety awareness, career attitude.

“ 3M, through its business policies is aiming to create a safe workplace, to encourage individual initiative and innovation in an atmosphere of flexibility, cooperation and trust, promoting a culture where promise keeping, fairness, respect and personal accountability are valued, encouraged and recognized”. [15]

Technological Factors: R&D activities, automation, technology incentives, rate of technological change. Research and development activities constitute an important part of 3M's business and have been a significant contributor to the company's sales growth. Research, development expenses accounted for \$1. 2 billion in 2009, \$1. 4 billion in 2008 and \$1. 3 billion in 2007. [16]

## **2. 4 Porter's Five Forces Analysis of the Industry Competition**

Porter's five forces is a framework for the industry analysis developed by Michael E. Porter of Harvard Business School in 1979 . The model is based on

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the idea that “ competitive advantage came from the ability to earn a return on investment that was better than the average for the industry sector”(Thurlby, 1998).

The model identifies five forces which would impact on an organization’s behavior in a competitive market:

The rivalry between existing sellers in the market.

The threat of new entrants on the market.

The threat of substitute products available in the market

The bargaining power of the suppliers.

The power of the customers in the market.

Full comprehensions of each of these five forces and the impact they have on the company’s business, provide organizations with the necessary information to enable them to choose the right operating strategy in order to be successful in their market.[17]

#### 2. 4. 1. The rivalry between existing sellers in the market

The conglomerate industry, although very complex, extending over a multitude of business, seems to be dominated by few key players, and 3M Co is one of them. In order to gain competitive advantage, 3M is aiming to stay ahead of the trend by continuously providing the market with new products and technologies. Given its strong balance sheet, the company is able to react fast to any negative changes in the market (lower the price of its



products), in order to maintain existing customers and attract new ones. Moreover, in facing competition the company is offering well differentiated products, well known and trustful brands, the chief aim being extra value added products and services for the end customers.

#### 2. 4. 2. The Threat of new entrants

The threat of new entrants is dictated by the market entry barriers. “ The entry barriers exist whenever it is difficult or not economically feasible for an outsider to replicate the incumbents’ position” (Porter, 1980b; Sanderson, 1998). Such barriers refer to:

**Cost of entry:** In order to enter this industry and compete against the existing firms, the cost of capital required would be extremely high. 3M is a well known company, with an aggressive mergers and acquisition strategy, holding an impressive market share.

**Distribution channels:** 3M products are sold through numerous distribution channels, including wholesalers, retailers, and dealers in many countries around the world. The company has established a large and very well defined distribution network, developed through long association with skilled marketing and sales representatives.

**Cost advantages not related to the size of the company,** like contacts and expertise play a major role in the company’s performance.

**Government legislations:** for example, introduction of new laws might weaken company’s competitive position; 3M had to improve their environmental performance via new environmental, health and safety

policies in order to comply with new government standard and regulations. Many times this requires additional funds, changes into production processes, products, and that some firms may find it difficult to do so without increasing the prices of their products and services.

Differentiation: 3M is a well known brand that already gained customer respect and loyalty and the products that represent this company have a high ratio of value to price.

#### 2. 4. 3. The Threat of Substitutes Products available on the market

Although the threat of substitutes in this sector is high, due to the fact that there is a large number of a substitute product available in the market, 3M products differentiate themselves through superior quality and innovativeness. The firm invests strongly in R&D, in order to insure that they deliver extra -added value products, and the existing customers will not be tempted to choose from the many available substitutes. Other aspects that should be considered when trying to mitigate the risk of losing customers to substitute products refer to: relative price performance of substitute, buyer switching costs, ease of substitution, substandard product, and quality depreciation.

#### 2. 4. 4. The bargaining power of suppliers

In the conglomerate industry, the power of supplier is relatively modest, due to the fact that the companies in this industry are very large corporations. This companies act on an international scale, having access to an increase number of suppliers and the buying is done in bulk, immense quantities.

There is still some risk regarding the price fluctuation of commodities, like oil, oil derivatives, energy, due to possible shortage. 3M is trying to mitigate this risk engaging in prices agreements and forward physical contracts.

#### 2. 4. 5. The bargaining power of buyers.

When trying to assess the power of buyers, two aspects need to be considered: size and concentration of the customers correlated with the concentration of the competitors. In the conglomerate industry, the bargaining power of the buyers is relatively high due to the fact that all the players in the market are targeting the same customers via similar products. Also, the end customers are more and more informed, and their expectations are continuously growing. Another aspect that should be considered in this case is that the cost of switching between suppliers is relatively low. A buyer has many options; therefore 3M makes a continuous effort to insure that their products are permanently aligned with customer preferences and needs.

## **2. 5 Summary**

The nature of competition in an industry is strongly affected by the above mentioned forces. As a rule we can state that, whenever buyers and suppliers have high degrees of power, the result translates into a high competitive industry.

The industry of conglomerate is moderate to high competitiveness, due to the fact that new entries are difficult (high capital requirements), but this effect is counteracted by the fact that the players in this sector are

extremely large and diversified corporations, with solid resources and very aggressive financial strategies.

### **3. Economic Outlook**

#### **3.1 Global Outlook**

There is no doubt that we are on the path of economical recovery, but the speed of things moving in the right direction is slow, considering the severity of the financial crisis.

In advanced economies, such as U. S., small improvements in labor markets, housing markets, and corporate bonds market generated some positive developments in the overall economy. In the emerging and developing economies, (such as China, India, and Brazil) the recovery process seems to be much faster. Even among the advanced economies, the recovery process happens at different speeds, depending of the way that the local government has chosen to deal with the crisis. If we compare The United States with Europe or Japan, we see that the American economy is doing much better than the other two. This phenomenon may have something to do with some of the following: fiscal stimulus was larger in US, the nonfinancial corporate sector is less reliant on bank credit, bond markets have improved which stimulated investments, and many financial and nonfinancial organizations went radical restructuring and improved productivity. In Japan, due to the appreciation of the yen, the country's exports fell dramatically, which ultimately impacts the recovery process. Similar situation can be observed in Europe. Some of the economies of this region suffered a major contraction, not only because of the financial crisis, but the real estate too. Overall the economical and financial conditions present themselves as fragile and

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difficult. There are some signs of recovery, especially in the emerging economies, and is expected that this will help along the recovery process of the advanced economies.[18]

### **3. 2 Regional outlook**

“ Asia is leading the global recovery and the region’s contribution to global growth will continue to exceed that of other regions in the next two years,” (Source: The International Monetary Fund).

China registered 8. 4 percent growth last year, and the projections for the next year are similar (9%growth in GDP for 2010). In the region, the GDP has increased 6. 8 percent in 2009. The recovery process has been driven by exports combined with low internal demand and ultimately low household consumption. The inflow of capital in the region has increased, stimulating investments and speeding up the recovery process. According to IMF, for the next period of time, “ Asia’s main policy challenge will remain to achieve a rebalancing of growth from external to domestic sources”. On global level, there is a political and economical issue regarding the Chinese government decision not to appreciate their local currency, and the way this decision is affecting the world trade.

Europe, especially the emerging nations, was strongly hit by the financial crisis. In this region the GDP decreased by approximately 4. 6 percent in 2009. The projections for 2010 GDP show an increase of 2. 3 and 2. 2 percent in 2011. The growth rates in most economies in the region will remain slow, due to major contraction in exports and weak capital inflow. Besides the already mentioned factors, other variables such as : high

unemployment, real estate crisis, bank restructuring operations, tight credit policies, and high interest rates will also restrain the recovery process.

Other regions, such as Latin America and the Caribbean seem to be dealing with the crisis a little bit better than other countries . The last year GDP registered a 2. 6 percent drop, and the prognosis for 2010 and 2011 are quite optimistic showing a growth of 3. 1 percent and 3. 6 percent, respectively. The recovery process is still relatively slow, due to weaker investment and not enough tourism, both important sources of external finances. The lack of tourism may be explained by high unemployment in United States and other high-income countries.

The Middle East and North Africa region experienced, an overall GDP growth slowing to 2. 9 percent in 2009. The forecasts for 2010 show an increase in GDP of 3. 7 percent in 2010 and 4. 4 percent by 2011. These projections regarding the recovery process are based on few assumptions such as: the global demand for oil will increase, and oil prices will stabilize.

The financial and economical crisis and their effects were not felt as deep in the region of South Asia. In this area, the GDP registered 5. 7 percent growth in 2009. This represented a slowing of growth comparing to the boom period, mainly due to a significant decrease in investments, correlated with low domestic demand. The projections for 2010 and 2011 look optimistic: 6. 9 and 7. 4 percent respectively.

### **3. 4 Local outlook**

According to the U. S. Bureau of Economic Analysis (BEA), the US economy is still growing, but at a slower pace than the first quarter of 2010(2. 4% versus

3. 7% in the first quarter of 2010). Some of the reasons that will restrain the recovery process are the following:

The financial institution will need to recover from losses due to loan defaults. In order to boost the recovery process, the government offered numerous stimulus packages.

The housing market registered slight improvements, but failed to meet the expectation. The main disruption in the housing sector was caused by a dramatic drop in house prices, and hou