Limitations of porters five forces economics essay

By analyzing a business and its financial performance for a period of three years, I had an opportunity to apply my theoretical knowledge on a practical scenario. Furthermore the analysis of financial aspects of an organization will help me in enhancing my analytical skills. This topic will help me in practicing and enhancing all the important skills that one should have namely Ratio analysis for evaluating the performance of an organization, using Strengths, Weaknesses, Opportunities and Threats (SWOT) analysis to asses' organization position and performance and Porter five forces analysis for enhancing decision making skills etc.

In today competitive world one should have a very good and sound decision making skills. Since evaluating an organization business and financial performance leads to Strategic planning and operational decision making thus this topic is helpful in developing good decision making skills. Moreover, I believe that by applying the theoretical knowledge on a real world scenario will greatly broaden my knowledge of various financial analysis techniques.

Company:

Before selecting Google Inc for my Research and Analysis Project I have examined different companies and check the feasibility and other important issues that I felt will be necessary in order to better analyze the business and evaluate its final position.

I selected Google Inc as a much better company for me to analyze. Google is a global technology focusing on improving the ways people connect and use the information. They are operating to organize the world's information and make it easily accessible and useful to everyone. Google web search and advertising have made Google one of the most recognized brands of the world. (Google, 2011). Google Inc generates revenue by delivering relevant and cost effective online advertising and providing other products.

Some of the reasons because of which I opted for Google Inc are that Google annual reports are easily available over the websites and various other press releases. It is one of the recognized brands according to the web searches and advertising. It is a growth oriented and believes in Innovation Company. The information is easily available and the scale of operations of the company is quite large. Its operations impact the well being. Similarly availability of well designed reports and useful data was another reason because of which I selected Google Inc.

Aims and Objectives:

This Research and Analysis Project aims at examining both the business and financial performance of Google Inc. The project aims at recognizing the major business elements that are important to its performance.

This paper represents a detailed analysis of the business of Google Inc and its performance for a period of three years. The period under consideration is December 2009 to December 2011. For financial statements analysis ratio analysis has been used.

This report also investigates the Non-financial data. For Non financial data analyses, a Strategic planning tool known as SWOT analysis has been employed. SWOT analysis focuses on the strengths, Weaknesses, opportunities and threats of the company. Furthermore Porter Five forces analysis has been carried out. Similarly one of the objectives of this report is to evaluate whether the company has enough resources to meet its obligations and continue operating. In the end a conclusion is represented by keeping in view the analyses and different data in mind, So that this report is helpful for investors and they can make a good knowledgeable decision regarding investment in the company.

SWOT analysis:

For Non-Financial data analysis, A strategic planning tool known as SWOT has been employed. SWOT stands for Strengths, Weaknesses, Opportunities and Threats. In the 1960 and 70's Albert Humphrey has developed this tool (Eva Chen). Through SWOT analysis , users are able to analyze that in which way the company is moving , and What are the available opportunities that may be utilized in order to effectively and efficiently achieve the goal of the company.

SWOT analysis focuses on the internal as well as external attributes of the company. Strengths and weaknesses are the internal attributes. Strength helps the company in achieving its goal, whereas weaknesses are those internal attributes that are harmful to the organization in achieving its goal. Opportunities and threats are external factors. Opportunities are the factors which if utilized can be fruitful and helpful for the company in achieving the goal whereas threats are the external factors that are harmful in achieving the company's objective.

Limitation of SWOT analysis:

SWOT analysis framework focuses on the four elements, namely strengths, weaknesses, opportunities and threats. However it does not provide any guidance to the manager that how they can find these four elements for their company. Strategic planners may not have the guidance to identify its organizations strengths, Weaknesses, opportunities and threats.

Porter Five Forces

Company analysis from strategic perspective is an important part of this project. In order to carried out strategic analysis of Google Inc , Porter five forces analysis has been used. The model of the Five Competitive Forces was developed by Michael E. Porter in his book “ Competitive Strategy: Techniques for Analyzing Industries and Competitors” in 1980 ((Recklies).

Porter’s model is based on the approach that a corporate strategy should meet the opportunities and threats in the organizations external environment. This framework checks the influence of five forces on the industry. A good business manager needs to understand and analyze this model through his analytical skills and abilities. The firm can get an edge over its competitors by using Porters five forces analysis. Porter’s five forces include bargaining power of supplier, bargaining power of buyers, Threat of new entrants, Threat of substitutes and competitive rivalry.

Limitations Of Porters Five Forces:

There are some limitations of porters Five forces analysis. This model assumes a classic perfect market. The model assumes a relatively static market structure. Furthermore this model does not take into account strategic alliances, electronic linking of information system of all companies along a value chain etc. Model is based on the idea of competition; it further assumes that companies try to achieve competitive advantage over other players in the market as well as over suppliers and customers.

Sources Used

Information gathering was one of the important step in this project. The importance of unbiased information is very necessary. It is very essential that the information gathered should be accurate and provide neutral view of the company and the market. Selection of the sources of information was one of the important parts of this project. The sources used to collect; compute and analyzed data are mentioned below

Annual accounts of Google Inc: For ratio analysis, the data has been collected from the annual accounts of Google Inc. The most important source of financial data on which the key ratios are based and are necessary in analyzing the financial situation of the company are the annual accounts of Google Inc.

Annual accounts of Microsoft: Microsoft financial data is also collected in order to draw comparative analysis. For this data has been collected from annual accounts of Microsoft.

The official Google Inc website: The official website of Google Inc was also used in collecting, computing and analyzing data.

Books: Different books have been consulted and used for analyzing the collected data.

Accounting and Business Techniques:

In order to better understand the business and analyze the data, different accounting and business techniques have been employed. The techniques used include Ratio analysis, SWOT analysis and Porter's five forces.

Ratio analysis:

Ratio analysis is used to investigate the financial position of a company. It reflects the performance of a company. Ratio analysis is helpful in measuring, comparing, and evaluating the financial condition and performance of a company. It facilitates the manager to recognize trends in the company condition and performance and weigh against it with the industry averages of similar businesses.

There are different kinds of Ratio analysis. This includes

Liquidity ratio :

The easiness with which assets are turned into cash is known as liquidity ratio. Liquidity ratio assists in finding answers to questions like whether the business is capable of meeting its short term debts as they come due, Is the business capable of generating enough cash etc. Liquidity ratio includes the Current Ratio, Quick Ratio, and Working Capital.

Leverage Ratio:

Leverage ratio is another ratio used to determine the financial health of the business. Leverage ratio is related to the debt the company have on its balance sheet. The more debt means the stocks are riskier. It indicates the level to which business is relying on debt financing. Leverage ratio includes Debt to equity ratio and interest coverage ratio.

Profitability ratio:

Profitability ratio is another measure of analyzing the business. It measures a company's capability to generate sales relative to sales, assets and equity. Profitability ratio evaluates the ability of a company to generate profits and cash relative to some metric frequently the money invested.

Efficiency Ratio

This ratio measures how well a company uses its assets and administers its liabilities internally.

Efficiency ratio includes accounts receivable turnover, fixed assets turnover, sales to inventory, sales to net working, accounts payables to sales and stock turnover ratio. These ratio when compared to other business ratios helps in interpreting which business is managed well relative to other. Also an improvement in this ratio usually leads to improved profitability.

Stability Ratio:

This ratio focuses on the long term health of a business. It is more concerned with the effect of capital structure on the business. Stability ratio helps in deciding how much the company is stable.

Limitations of Ratio Analysis:

Ratio analysis also has some limitations. Some of the limitations of ratio analysis are as follow

Different companies apply different accounting procedures. These policies and procedures are different from other companies. For example different methods of depreciations will lead to different accounting profits figures. Thus these companies cannot be compared until and unless necessary adjustments are made.

Ratio analysis cannot show on their own whether company’s performance is good or bad. It just provides a clue to the company’s performance or its financial position. Therefore these clues should be interpreted carefully. Different interpretation will lead to different results.

Most up to date results cannot be found as the figures in the company’s latest annual reports are several months old.

If comparison on the basis of ratio analysis is made over alonger period of time then this comparison may mislead the interpretation as with the passage of time inflation rates changes as well. This indeed changes the purchasing power.

Analysis

Ratio analysis

Sales Growth Revenue :

Google Inc has done quite well in growing their sales over the last few years. Google Inc sales have increased by 8. 5% from the year 2008 to 2009. Sales revenue has been increased by 23. 97% from 2009 to 2010. Similarly Google Inc has done well in increasing revenue by 29. 275% in the period between 2010 to 2011. This increase in revenue shows that market condition is good.

One of the reasons of this growth in sales can be the quality of service Google Inc is providing. Google Inc has been good in expanding the product line, which also leads to increase in revenue. The expansion in Google products and services can be a contributive factor in the growth of sales revenue.

Microsoft is one of the toughest competitors of Google Inc. Microsoft is competing Google Inc in the area of search engine, browser etc. (deep). Comparing the growth in sales of Google Inc with the sales of its competitor, Microsoft, we came to know that Microsoft sales have increased by 3. 28% from 2008 to 2009. Sales raised by 6. 92 % in 2009-2010 and it grow by 11. 93% in 2010 to 2011. If we compare the growth in Google Inc sales with the growth in Microsoft sales, it is evident that Google has done well. Google has almost outclass Microsoft with respect to growth in sales revenue.

Profitability Ratio:

Gross Profit Margin (GPM)

Gross profit margin is an indicator used by many companies in order to calculate the gross margin on all goods sold. Gross profit is a difference of Sales and cost of goods sold. If the selling price does not change significantly then the firm gross profit can increase only if it can control its material and other manufacturing costs.

The gross profit margin calculated for Google Inc is 62. 6% in 2009. In the period 2009-2010 the gross profit raised by 1. 75% reaches to 63. 7% in 2010. In the period 2010-2011, Google Inc has done well. Its gross profit raised by 2. 35% reaches to 65. 2% in 2011. This indicates that Google Inc

Gross profit margin is growing by a constantly increasing rate for a period of 2009 to 2011. The gross profit margin (GPM) was calculated for Microsoft as well. In 2009 the GRM came out to be 85. 7%. In 2010 the gross profit has declined by 13. 65 % . Gross profit margin calculated came out to be 74%. However in the period 2010-2011 Microsoft has done well in increasing the gross profit by around 5. 03%. The margin reached by 29. 26%.

By comparing Google Inc and Microsoft it is evident that Google Inc has done well in steadily growing its gross profit margin. But on the other hand Microsoft gross margin was quite high in the year ended 2009. It does fell down in 2010 , but Microsoft has managed to raise it again in 2011. In short we can say that Google Inc gross profit margin is lesser than Microsoft, but they enjoy a constant earning. In contrast Microsoft gross profit margin is quite high but it is not consistent.

Operating profit Margin (OPM)

Operating Profit margin is another profitability ratio. This ratio measures operating profit in relation to the Net sales. It is helpful in knowing that how well a company can convert its sales into profit from day to day activities. Mostly this ratio is calculated for competing companies in the same industry to know which company is performing well and more efficient with respect to its operations. This ratio gives analyst a knowhow of how much the company makes on each dollar of sales before interest and taxes.

The operating profit margin was calculated for Google Inc for a period of three years. In 2009 the Operating profit margin was 0. 351. In 2010 operating profit margin raised by 0. 85%. In 2010 the operating profit came out to be 0. 354. In 2011 the ratio came out to be 0. 309 representing a 12. 71% decrease. The reason of the decrease in operating profit is evident in the increasing cost of research and development. In a nutshell we can say that in 2009 for every $1 revenue Google Inc is making $ 0. 351. In 2010 it is making $0. 354 and in 2011 it is making $ 0. 309 for every $1 sales.

In comparison Microsoft is constantly increasing its operating profit margin. In 2009 the operating profit margin is 0. 348; leading to 0. 385 in 2010 representing a 10. 36% increase in operating profit margin. In 2011 this ratio increased a bit and reached to 0. 388 representing 0. 77% growth. Thus we can say that in 2009 Microsoft is earning $ 0. 348 for every $1 revenue, in 2010 it is making $0. 385 and in 2011 it is making $0. 388 for every $1 revenue.

Net profit margin:

Net profit margin is another important ratio used to measure the profitability of a company. This ratio measures Net earning in relation to to the Net sales. This ratio helps in finding out how much net profit remains out of each dollar of Sales after all expenses has been paid out. In other words this ratio tells the management’s ability to carry a dollar of sales down to the bottom line for the stockholders. In a nut shell we can say that net profit margin is the amount left over after all expenses has been paid.

The Net profit margin was calculated for Google Inc . In 2009 The ratio came out to be 0. 276. Indicating that Google Inc is earning $0. 276 on every $1 sales. Google has done well in the period 2009-2010 , they were able to increase their Net profit margin by 5. 01%. therer net profit margin for the year 2010 is 0. 29 representing $ 0. 29 earning on every $ 1 sales.. However in 2011 the ratio calculated was 0. 256 representing 11. 02% decrease in the Net profit margin. This shows that in 2011 Google Inc is making $0. 256 for every $1 sales.

Similarly Net profit margin for Microsoft was also calculated. In 2009 the result indicates 0. 249 , 0. 3002 in 2010 and 0. 330 in 2011. In other words Microsoft is earning $0. 249 for every $1 sales in 2009, 0. 3002 in 2010 and $0. 330 in 2011 for single dollar sales. Thus we can say that Net profit margin has increased by 20. 56% in the period 2009-2010. Microsoft has done well to keep increasing the Net profit margin by 9. 92% in the period 2010-2011. We can conclude that in the period under consideration Microsoft has done well than Google Inc.

Total Asset Turnover Ratio

Asset turnover ratio is another important measure of financial analysis of a company. This ratio indicates that how well a company is able to convert its assets into revenue. Total assets turnover ratio is concerned with the revenues made and not profit. For measuring profit relative to assets another ratio, Return on Assets is used, is used. This ratio is useful in knowing how efficiently company manages its assets and convert them back to sales revenue. According to Kaplan Financials ‘ Asset turnover measures management’s efficiency in generating revenue from net assets utilised by the business’ (Kaplan Financial, 2007).

Total Assets turnover ratio was calculated for Google Inc and Microsoft. For Google Inc the ratio came out to be 0. 584 in 2009, 0. 5068 in 2010 and 0.

522 in 2011. This means that in 2009 Google Inc earned $ 0. 584 for every $1 invested in assets. In 2010 Google Inc has earned $ 0. 5068 for every $1 invested in assets and in 2011Google Inc has earned $ 0. 522 for every $1 invested in Assets. Similarly the ratio calculated for Microsoft came out to be0. 750 in 2009, 0. 725 in 2010 and 0. 6434 in 2011. This means that Microsoft is earning $ 0. 750 for every $1 invested in Assets. In 2010 it is earning $ 0. 725 for every $1 invested in assets. And in 2011 its earning further decreases and reaching to $ 0. 6434 for every $1 invested in assets. Keeping the above things in mind, it can be inferred that in comparison to Microsoft, Google Inc is performing well. Microsoft earning is constantly decreasing for a period of three years under consideration. Google Inc earning does decrease in 2009-2010. However in 2011 they manage to increase it.

Fixed Assets turnover

Fixed assets ratio is another important ratio. This ratio measures effective and efficient company is in generating sales by using fixed assets. This ratio is concerned with the productivity of fixed assets in generating revenues.

Fixed assets ratio calculated for Google Inc came out to be 2. 04 in 2009. In 2010 the ratio declined to 1. 80 representing a 11. 76 % decrease, showing that in 2010 Google Inc has overinvested in the property plant and equipment. In 2011 Google Inc has done well in increasing the fixed assets ratio to 1. 912 representing a 6. 22% increase. Microsoft fixed ratio came out to be 2. 042 in 2009, In 2010 they have done well in growing the sales to fixed assets by 2. 052 representing 0. 48% increase. In 2011 the ratio calculated came out to be 0. 249 representing 0. 87% increase. Thus comparatively we can say that Microsoft Fixed assets ratio is steadily growing. However Google Inc fixed assets ratio is higher than Microsoft, indicating that Google Inc has less money tied up in fixed assets for each unit of sales.

Basic Earning Power Ratio:

Basic earnings ratio was calculated for Google Inc and Microsoft. This ratio tells the percentage of earnings relative to total assets indicating how effectively and efficiently company uses its assets to generate revenue.

For Google Inc the ratio calculated came out to be 20. 52 % in 2009, 17. 9 % in 2010 and 16. 17% in 2011. The data shows that the ability of Google Inc to generate operating income in 2009 was 20. 52% which decrease by 12. 76%. Similarly the company ability to generate operating income decreased in 2011 by 9. 66%.

Microsoft Basic Earning Power ratio came out to be 26. 1% in 2009. In 2010 it raises to 27. 9%. In 2011 the ratio has declined to 24. 9% . Thus the ability of Microsoft to generate operating income in 2009 was 26. 1%. In 2010 it raised by 6. 89%. In 2011 the ratio declined by 10. 75%.

Return On Assets:

Return on Assets ratio tells how efficient the company is in using its asstes to generate income. It shows how profitable a company is relative to its total assets. ROA calculated for Google Inc came out to 16. 10% in 2009, in 2010 the ratio has declined to 14. 7% and in 2011 the ratio further decreases to 13. 4%. Similarly the ratio calculated for Microsoft over the period of three years came out to be 18. 7%, 21. 7% and 21. 2%. So Microsoft is comparatively doing well in utilizing its assets in generating revenue.

Return on Equity

Return on Shareholders' Equity is another important measure of profitability. It measures how efficient the firm is in generating profit from share holder's investments. A rising ROE means firm is efficient in generating profit and thus need little capital to earn profit. Return on Equity calculated for Google Inc is found to be 0. 181 in 2009. In 2010 the ROE has raised slightly to 0. 1839. However in 2011 the ratio has decline to 0. 167. This shows that in 2009 Google Inc is making $0. 181 for every $1 invested; in 2010 company is making 0. 1839 for every $1 sales. In 2011 the company earning has decline to 0. 167 for every $1 sales.

Microsoft ROE came out to be 0. 368 in 2009, in 2010 ROE raised to 0. 406. And in 2011 the ratio rises to 0. 4055. Thus Microsoft is making $0. 368 for every $1 invested by common stockholders. In 2010 the ratio shows company is making $0. 406 for every $1 invested. Similarly the earning raised to $0. 4055 in 2011.

Current Ratio:

Current ratio is used to test the proportion of current assets available to cover current liability. Main theme of this ratio is to check out whether a company has enough short term assets available to pay off its current liabilities. The higher the current ratio the better the firm performance is.

After calculating current ratio, It was found that the current ratio for Google Inc over the period of three years is 10. 61: 1, 4. 15: 1 and 5. 91: 1. Whereas the current ratio of Microsoft is 1. 82: 1 and 2. 12: 1 and 2. 603: 1. Acceptable Current ratio differs from industry to industry, however current ratio of 2: 1 is considered to be acceptable. The higher the current ratio the better the company is in paying off its obligations. Comparatively Google Inc is doing quite well. In comparison to Google Inc, Microsoft is facing some problem in paying off its debt.

Earnings per Share (EPS)

Earnings per share are an excellent measure of profitability of any company. It shows the profit a company earns on each share outstanding. When compared with other companies EPS, it can be inferred that which company is doing well. Similarly EPS is compared over the period to know whether the earning capacity of the company on per share has increased or decreased.

EPS calculated for Google is 20. 62 in 2009. It has increased to 26. 29. Representing 29. 43% increase in earnings for the company on per share basis. The Earning per share has increased to 30. 17 in 2011 representing 13. 03% increase. Microsoft earning per share has decreased from 2. 73 to 2. 13 representing a 21. 79% decrease in earnings per share. Similarly the E. P. S calculated for Microsoft in 2011 declines to 1. 63. Thus Google is doing well in earning more profit on a per share basis as compared to Microsoft.

SWOT Analysis

Strengths

Strengths are the internal factors that help organizations in achieving its goals and objectives. Some of the strengths of Google Inc are as follow.

Google is already a number one search engine. It has established a brand name. Brand name is one of the important strength of the Google Inc.

The Speed of the search engine of Google Inc is remarkable. Its real time response is one of the important factor because of which Google Inc has attracted more customers. Customers can get information within no time. Google has hired PhDs who are working harder in order to make Google search engine faster and relevant.

Google has the provision to integrate with various languages. Through Google search engine the page can be translated in to various languages.

Google Inc supports innovation. It is well known about Google Inc that each employee has to give out 20% of their time in developing their own projects.

Google Inc is currently the market leader. It has captured the market.

Google has easy to use interface and it gives wide-ranging results without confusing its users.

Google uses low cost UNIX web servers for indexing Millions of web pages across the Internet. This lead to low operation cost.

The technology Google Inc uses for its web search engine are simply awesome. They use state of the art search technology in order to index pages regularly. Similarly Google also uses Page Rank technology in order to rank the webpages and thus give its users access to most important pages first.

“ Search by Location” services are another important strength of Google. This is the localized search facility provided by Google Inc

The number of innovative products offered by Google Inc is strength of it. It offers a wide range of products. These includes Google maps, finance, news, book search, picnic etc

Weaknesses

Weaknesses are the internal factors that affect organizations in achieving the goal and objective. Google Inc is facing some problem in its internal environment as well. Some of the weaknesses of Google Inc are as follow.

Since a search engine can’t check the credibility of all the information, thus It is difficult to differentiate between real good content, good content and average content.

Many products of Google Inc like Google Maps, Finance, News, book search and picnic etc are not yet known to all the users.

Spammers are very active in changing the Google’s ranking technology by creating dummy sites with thousand of links to pages that they wants to rank higher. Google ranking does effected by these dummy sites.

Google’s link-based ranking did not uses the actual traffic analysis.

Google charges Cost per click advertising and ranking policy is confusing. It is difficult for marketers to forecast how their ads would be positioned and how much they would cost.

At times Google's search engine make mistakes as Google's contextual search algorithms are not 100% perfect.

Sometimes automated indexing of Google's localized search algorithms also results in errors.

Google's business model is quite complex. It is difficult to understand.

Google's does not have highly personalized search by which it could charge users with switching cost if they decide to leave Google's services.

Opportunities

Opportunities are the external elements that if utilized well will help the company in achieving its goals and objectives. Some of the opportunities exist for Google Inc are as follow.

Goolge has acquired more than 90 companies including youtube, Picassa, Android etc. Googel has sucha a huge user base that any addition it does immediately become more popular than the original idea. For example Picasa user base has almost double when it was acquired by Google. There are tsill opportunities for Google to acquire new companies.

Google is earning quite a bit of money through advertisements. They offer programs known as adwords which charges users on pay per click basis. Similarly programs such as Adsense are offered in which publishers earn a portion of the revenue for placing Google sponsored links on their site. These two programs are the major revenue generators for Google. There are still opportunities for Google to offer such programs and earn money via advertisements.

Google can increase switching cost and earn money. This can be done by tracking users search histories with their permissions and could remind them via email about any updates per their personal interest.

There is an opportunity for Google to add sticky like chat rooms and email systems to attract users. Since yahoo and MSN is already offering chat room services. SO it is in the best interest of Google to offer chat room services in order to survive the tough competition.

Google can also start new services like multimedia, product search, private database and print media.

There is also an opportunity to merge with an established mass-market portal to lock in large number of users and advertisers.

There is also an opportunity of offering full-fledged services on hand held mobile devices to capture markets beyond conventional internet.

Threats

Threats are the external factors that are harmful in achieving the company's objective and goal.

Google is facing following threats

Google is facing stiff competitions from other search engines like Yahoo, Bing etc. They have done well especially in Chineese and Russian market.

Change in user preferences is another threat to Google. Now users are expecting more quality of work than ever. Yahoo is doing well in following the user preferences .

One of the serious threat to Google is that its 10 years old now. So if new technology came, then it will be very difficult for Google to cope up with that technology. It would take time for them to get settle with the new technology.

Google is also dependent some portals like AOL. If these contracts are terminated then Google would lose significant share of its revenue.

Entry barriers for this business no longer exist. So many competitors can come forward in coming years. They may provide better services and better interface. Thus they can capture Google market.

Google ranks web pages on the basis of number of clicks and they charge on cost per click bases. This charging policy disappoints the advertisers as the ranking on this basis is quite confusing.

Some of the competitors of Google like Yahoo provide more services and solutions with conventional search than Google do. Google may start losing customers. Similarly MSN is coming up with its new operating system known as “ Longhorn”, which would be having implicit query feature. This will allow users to search the web, blogs, new sources, the hard drive files, emails and attachments all from the keyboard without using a browser. Users will be able to search from the already established programs like MS word. This certainly will affect the Google market share.

If Google is aiming to become a portal than it may lose its simplicity an