

Case of unidentified industries assignment



HBS – The Case of the Unidentified Industries -2006 With The Case of Unidentified Industries, William E. Fruhan Jr. wants us to visualize the balance sheets belonging to fourteen unknown companies and connect them with the suitable industries. In order to determine which balance sheets belong to which industry, we studied several companies in those industries. Using a number of different sources such as Yahoo Finance, Google Finance, Wikipedia and Investopedia, we were able to link the unidentified firms balance sheets with their associated industries. In order to give structure to our analysis, we will have two main parts.

In part one we will analyze the Service oriented companies and in the second part we will turn towards the Product oriented companies. I. Service Oriented Companies We were able to distinguish the Service oriented companies by looking at their Inventories. Being those kinds of companies they showed zero inventories and “ not applicable” (NA) inventory turnover. The first service-oriented company was E, the advertising agency. We were able to see that the accounts receivable and the accounts payable were almost equal. Which reflects how advertising agencies do business and what Lamar Advertising & Co (LAMR) had.

Advertising agencies are usually paid for their services when the campaign or assignment is done. And they usually pay their media buys or media buying companies at the end of the assignment. Furthermore, LAMR also showed a big percentage of their assets as intangible ones. Which is logical for a service company like an advertising agency and is what company E shows on its balance sheet. Their sustainable competitive advantage is based on their human resources creativity, which could be kept as assets in

the form of patents (e. g. design patents). The second company was company G, the Health Maintenance Organization (HMO).

We noticed that the accounts receivable represent 51%, which explains perfectly the complexity of the medical billing system between the patients, the HMOs and the health insurance companies (e. g. AETNA, Medicare, Medicaid, Blue Shield). Furthermore, the low complexity of medical care relevant to an HMO can also be seen by the low percentage attributed to the PP&E. The other interesting financial data are the return on assets (line 23) and the two profit ratios (line 24, 25). We can see that the ROA shows very high earnings generated from the invested capital.

However, the two profit ratios show low profit margins that are linked to a HMOs business plan. Which explains why HMOs are usually relying on grants and loans from the U. S. Department of Health and Human Services to operate. Another service-oriented business would be company M, an Airline. From all the other service businesses, the only difference shown in this company is the high percentage of assets that are being put into PP&E (airplanes and other aviation vehicle). The airline industry being very competitive, and primarily based on price strategy, explains the very low returns on net worth (ROE).

Seeing as the accounts receivables are very low, we can understand that clients pay either by cash or credit card. Which is concurrent with an airlines' business plan. The last service business is the company N, which is a commercial bank. The most noticeable financial data is the receivables collection period, which is 4, 071 days. In other words, it will take over

eleven years for the company to get its money back. This data combined with the accounts receivables (90% of total assets) confirms that this company is a commercial bank issuing loans to its customers: loans that will be repaid in approximately eleven years.

In addition, the notes payables' high percentage (73%) are concurrent with the banks way of making money by " borrowing" their clients money to generate more money (through investments).

II. Products Oriented Companies
The company A could be an online bookseller, similar to what Amazon. com (AMZN) was at its creation in the 1990's. The low PP; E should mainly account for servers and some computers. Which goes perfectly with the characteristics of an online business. The low inventory and fast inventory turnover are also main characteristics of an online business.

Furthermore, we can see that the inventory holds the same percentage as the accrued items. This could mean that the suppliers of the books present in our inventories will be paid later on (best after the number of days necessary for inventory turnover). In other words, the online bookseller will be paid for the books sold before paying the book supplier. This equality also means that the online bookseller is pushing efficiency with a just-in-time distribution process. Which in retrospect, explains why the percentage of assets detained in cash and marketable securities is so high (54%).

Company B, which we attributed to the bookstore chain, is mainly recognizable by a high inventory percentage. In addition, the bookstore chain needs several stores and equipment. All of this explained by the high percentage of PP; E visible in its balance sheet. The company B, like its

competitor company A, pays its suppliers after having sold the books. Which explains the percentage of accrued items (22%). When we compare the accrued items to the inventory we can see that the latter is higher than the former. Meaning that the company, being a physical bookstore, can't be as efficient as company A with a just-in-time distribution process.

Furthermore, with competitors like company A, company B should have issues with its inventory turnover. Which is exactly what the balance sheet displays. This situation explains why some big bookstores are going out of business when confronted with online companies like Amazon. So the company B could be in the same situation as Borders bookstore (BGPIQ. PK) is in right now. The third company is company C, an online direct factory to customer PC vendor. The high accounts receivable (24%) explains that half of the sales are B-to-B (Business-to-Business).

In addition, the note in the case adds that “ most manufacturing [is] outsourced”. Which explains why PP&E and inventories are so low and why the inventory turnover is so high. The pharmaceutical manufacturer was identified as being company D. The very high amount in other assets could be pinpointed to patents on drugs. Furthermore, the profit margin (15. 8%) of this company is very close to the ones that pharmaceutical companies, like Novartis (ADR), would get. And company D has a high percentage of common stocks, which could be linked to its big market capitalization, characteristic of pharmaceutical manufacturers.

The company F could be a computer software developer. The balance sheet shows a very low level of inventory and PP&E (servers, computers), which

concurr with the way of doing business of a software company. Furthermore, like companies like Microsoft (MSFT) it has a high percentage in other assets. Usually a sign of several patents characterizing this type of business (e. g. user interface patents, design patents, function patents) Like Microsoft, company F has a very high percentage of liabilities placed in common stock.

And it is one of the most profitable companies of all fourteen, with cash and marketable securities representing 49% of its total assets. The next company is company H, identified as the family restaurant chain.

Restaurants usually have quick inventory turnover due to its inventory perishability, which is seen in the company's balance sheet. The customers are paying either in cash or credit cards, explaining the low receivables collection period (the lowest of all fourteen companies). Furthermore, restaurants chains have the need for high PP; E, which is the case here with 81% of the total assets (restaurants, machines).

The company I, a retail grocery chain, shows high inventory and PP; E. Characteristics needed in the grocery business, with the need for stores and high grocery quantities. This inventory percentage is equal to the one from the accounts payable, showing us that the products are quickly in turnover. Which concurr with the fact that grocery stores should have fresh produces. In addition, the low receivables collection period characterizes the retail industry as well as the high revenue to total assets and low profit to revenue. This indicates high volume selling but with small profit margins.

All of these financial data concurr with a company like Wal-Mart (WMT), one of the leaders in the retail business. By comparing it to WMT we can also

make a connection with the company's I ROA and WMT ROA, which are both very high. We identified company J as being the department store chain. The high Inventory and PP&E goes along with the retail business. The receivables collection period is high, which can be explained by the use of the "own brand" charge card permitting the customers to pay later. The inventory turnover is slow, but this is characteristic of department stores which usually non-perishable products.

Company K could be a retail drug chain. From what we have seen so far in the retail business, inventories and PP&E of company K are also high. Since this company sells drugs (over-the-counter and prescriptions drugs) it has to deal with the complex medical billing system with the health insurances. Situation that we can observe with high accounts receivable. As we can see with the high volume to assets and low profit to revenue, this retail company sells high volume with a low profit margin. Which could make us think of the retail drug chain Walgreen's (WAG).

The last company, company L, is the electric and gas utility. "With 72% of its revenue from electricity sales and 28% of its revenue from natural gas sales" we can understand that the 2% of the total assets concerns gas. Energy utilities indicate high investments in PP; E, which is the case in this company (66%). Following the same reasoning, it is not surprising that the long-term debt is high. In addition, the receivables collection period is 40 days, which concurs with what the delay that clients pay their utilities (a little over a month).

While there are clear differences in the financial structures of different firms within a single industry, we were able to identify typical financial data associated to specific industry like the airline industry, the bank industry and much more. This case also made us realize that service oriented firms and products oriented firms are easily distinguishable by comparing at their inventory account and their inventory turnover. This exercise summarizes how firms are always pushing the barriers of profit margin and sales within a fixed financial environment tied to the industry they are operating in.