Business Drivers of Industries
An Analytical Framework

This course requires that you can and want to analyze financial statements. If your accounting and analysis skills are rusty, refresh them before taking this course, or expect to spend a significant amount of time figuring out the "numbers" underlying business drivers analysis.

Please contact NYU IT (askit@nyu.edu, 212-998-3333) or NYU Stern IT (helpdesk@stern.nyu.edu, 212-998-0180) for all ZOOM/email/NYU Brightspace/Admin/CapitalIQ issues. Please do not copy/contact me. Brightspace sends all emails to the @nyu.edu (not @stern.nyu.edu) address, while Stern class mail lists send emails to @stern.nyu.edu. You must check BOTH emails and use the correct browser profile. Please contact IT to figure this out. Do not write to Almaris or me if you do not get Almaris emails because this issue is between NYU and you.

Specializations

MBA INTA-GB-2306 specializations:

- Strategy

- Accounting

Undergrad MULT-UB-0056 concentrations:

- Management and Organizations

- Accounting

Undergrad track: Management Consulting

Overview

As global competition intensifies and technology forces rapid changes, executives and managers need to understand the key strategic business drivers to lead and manage a business. Consultants and investors need to analyze the competitive position and evaluate the quality of strategic execution to suggest improvements and allocate capital. Bankers need to scan the changing business landscape to identify potential synergies and suggest mergers and acquisitions.

We illustrate a streamlined and structured framework to analyze business drivers of companies from a wide range of industries, excluding financial services. This framework helps us understand their business model, drill into their financial statements, and assess competitive advantage.

The analysis proceeds as follows:

1. We apply the **Six-Pack Framework** for top-down and comprehensive analysis of financial statements to extract six key valuation inputs – Size, Growth, Margins, Asset intensity, Business risk, and Financial risk.

2. We analyze how these inputs depend upon a company's strategy by computing the **Competitive Advantage Score** that ranks competitive drivers and scores strategic strength per those drivers.

The analysis of a wide range of companies will expand your strategic horizons to enable you to foresee challenges and opportunities due to changing competition, technology, and the economy. The framework and the perspective will sharpen your ability to lead value creation as an entrepreneur or executive or to understand value creation as an investor, banker, analyst, or consultant.

Takeaways

Learn a framework to analyze business drivers to understand and lead value creation:

1. **Six-pack Analytical Framework (SPF)**: Identify and extract the six key valuation inputs – Size, Growth, Margins, Asset intensity, Business risk, and Financial risk.

2. **Competitive Advantage Score (CAS)**: Link these six key inputs to the choice and execution of a company's strategy by identifying, weighing, and scoring competitive drivers.

3. **Strategic vision**: Expand your strategic horizons by examining how a wide range of companies create shareholder value so that you can grow your business in new dimensions.

4. **Question conventional wisdom and raise your Business IQ**: Dispel misperceptions about businesses to develop uncommon common sense; understand the business models of both parties to a deal to negotiate effectively.

Motivation for the course

Let us take a walk around your neighborhood. Start with a CVS or Walgreens. You notice that the actual prescription drug pharmacy is at the back of store and occupies a small percentage of the total store space. Would you be surprised to know that around 67% of store sales come from prescription drugs? You may wonder why they do not get rid of the front store and run a small pharmacy to increase profit per square foot? To be "business literate," you should know the business drivers of a pharmacy store and understand its layout.

You then decide to eat something. You think that fast food businesses are highly competitive and probably have low margins. Here is some data from 2012.

Company name	Operating margin
Red Robin Gourmet Burgers	4.20%
Jack in the Box	7.00%
The Wendy's Company	7.30%
Darden Restaurants	9.00%
Starbucks Corporation	13.70%

Domino's Pizza	16.50%
Yum! Brands	16.50%
Chipotle Mexican Grill	16.90%
Burger King Worldwide	23.10%
McDonald's Corp	30.30%

Surprised?! McDonald's margin seems to be more than double that of Starbucks.

"OK," you say, "I read more about tech companies. I know how they work." How about the table below for 2012?

Company name	R&D costs	R&D costs/Sales
Apple	3,381	2.2%
IBM	6,258	5.9%
Intel	8,350	15.5%
Dell	856	1.4%
Pfizer	9,112	13.5%
Google	6,793	13.5%

Apple did not spend that much on R&D, while Intel outspent Pfizer in R&D as a percent of sales.

I find it fascinating to peek at the basic financial and operational characteristics of a wide range of businesses. It is a step towards making sense of businesses financially. This course is about sharing that fascination with you.

Materials

- I use my materials. Therefore, there is no required textbook, and you need not purchase anything.

- The link to the class materials is on NYU Brightspace.

Attendance and penalty for missing classes

Requiring attendance is necessary for several reasons. First, you incorrectly assume that you can catch up on a missed class by watching a recording (if available). Videos do not engage your brain as much as a live class. Second, less than 20% of you watch the recording (if available). You are then lost in class, which provides wrong signals to me as an instructor. Third, your absence hurts class discussions. Fourth, you miss out on feedback if you do not work through the questions I pose in class. Fifth, I lose the feedback since there are fewer questions.

The policy below will be in effect only after the add/drop period.

Without mandatory attendance, attendance is often below 50%. Therefore, though I dislike doing this, I penalize absences. If you anticipate being absent for good reasons, please email me well in advance. Please enter "Excused" on the attendance sheet described below to avoid the penalty if I approve. If you miss a class due to emergencies and cannot tell me in advance, do not panic. Take care of the emergency first, and then email me. I will permit you to change the "Absent" to "Excused." But, if you miss a class without a valid reason, there is a penalty, as stated below.

For sections meeting in 150-190 minute sessions, you would lose one grade (A to A-, A- to B+, B+ to B, B to B-, and so on) for EVERY missed session unless you were explicitly excused via email. Thus, if you miss two class sessions, you would lose two grades, and so on.

For sections meeting in 75-80 minute sessions, you would lose one grade (A to A-, A- to B+, B+ to B, B to B-, and so on) for EVERY TWO missed sessions unless you were explicitly excused via email. Thus, if you miss four class sessions, you would lose two grades, and so on.

Please sit in the same seat in every class and display your name tags. For zoom classes, you must keep your video on AT ALL TIMES. You must also have a good working headset or mic as it is extremely rude to be inaudible and force me to ask you to repeat yourself. After entering the class, please mark yourself present in the first 20 minutes on the OneDrive sheet (link posted on Brightspace). **You will be marked absent if you are more than 20 minutes late unless it is because of factors beyond your control (traffic, subway, interviews running late). You will also be marked absent if you leave the class early unless you have my permission or get it afterward. You will get an F in the course if you are caught cheating on the attendance sheet.**

Grading

- There are no quizzes, midterm, final exams, or presentations.

- **Please read about the penalty for missing classes above.**.

- Group assignments: **25%**
    - I will provide a spreadsheet template and document/report template.
    - You fill out the spreadsheet with the company data and the document template with your analysis.
    - You send the spreadsheet and the document to the TA, who checks it for accuracy and provides pointers for improvement.
    - You make final changes and upload them to the OneDrive class submissions folder.
    - I discuss your spreadsheet and document in class.

- Final project report: **75%**
    - It is a group project.
    - The write-up and analysis are like the class submissions. However, a more detailed competitive analysis is expected.
    - The team chooses the company. I do not assign it. However, you have to get the company approved by me. I reject companies that have been picked too many times in the past.

Help and Office

- Me: dgode@stern.nyu.edu, 212-998-0021, Office: KMC 10-86.

- TA: Check NYU Brightspace

Prerequisites and expectations

Prerequisite: Any student who has taken the Core financial accounting course can take this course.

Please take this course if you expect the following:

- You enjoy class discussions (sometimes unstructured) that bring together insights from business economics, strategy, and analysis of financial statements.

- You are prepared to put in the time to analyze companies assigned to your team during the course and do a final project.

- You work well in a team.

- You value constructive criticism of your work in front of your peers.

- You understand that the class is about guiding you towards discovering the challenging process of business analysis. Mastering this process requires extensive practice. The class starts you on that journey. However, it takes time to develop the skills to identify business drivers.

Please do **NOT** take this course if you expect the following:

- You think there is a quick process or a magic formula to identify business drivers of an industry comprehensively.

- You expect a structured class with PowerPoint presentations highlighting the business drivers of each industry.

- You dislike reading company financial statements.

System requirements

- You need to be in the following systems:

  - Albert

  - NYU Brightspace

  - If you are a non-Stern student, Stern automatically creates a Stern account for you when registering for a Stern course. All class emails are sent to your Stern email, not NYU email. Please forward your Stern email to your NYU email.

  - I do not control your access to dgode.stern.nyu.edu. It is linked to whatever Stern has entered in the class roster. I cannot override it.

- Please bring a laptop to every class.

- If you are blocked from accessing these systems, please ask the administration to expedite matters. Given the complexity of these systems, I cannot manually add you to any system.

- Only registered students can attend. I cannot override this NYU rule.

How this course differs from existing courses

Strategy

We will illustrate the application of frameworks you have learned in your strategy courses to a wide array of companies and industries.

Financial statement analysis (FSA)

The focus of my course is on a broad financial overview of industries, not on a detailed analysis of financial statements. The latter is reserved for the FSA course.

Modeling

We will not build any financial statement models in the course. However, you will use excel for certain assignments — basic knowledge of excel is sufficient. This course will help you understand how to extract inputs for valuation models by reading financial statements.

Valuation

We will discuss value drivers, but we will not discuss valuation theory or build valuation models.

The Six Pack

The course highlights how and why businesses differ along the six key drivers listed below:

1. Size

2. Growth

3. Margins

4. Volume or net asset turnover

5. Business risk

6. Financial risk

1. Size

How do we measure size? Market cap, sales, assets, or the number of employees? What are the merits or demerits of each metric? Is the industry fragmented, or do a few large firms dominate it? What are the reasons for such

patterns? For example, how do economies of scale and scope affect the distribution of sizes? What role do network externalities play in industry consolidation? How do the bigger firms differ from smaller firms in the industry? How does size affect risk and return?

2. Growth

What are the drivers of growth? How does growth affect the business model of a company? How does growth affect the financing of a company? What do we know about the rate at which a wider market adopts an innovation?

3. Margins

What are the major components of costs as a percentage of sales? What are the drivers of margins? For example, is the margin driven by pricing power, conversion efficiency, or purchasing power? Is the success driven by R&D, efficient production, or effective marketing? How do the margins change as a company matures? How do companies offset low margins with high volumes and vice versa? How does that affect its hiring and management practices?

4. Volume or net asset turnover

How asset-intensive is the business model? Does it create barriers to entry? What risks does it create? How does it affect the financing needs of the companies in that industry? Are the revenue-generating assets listed on the balance sheet?

5. Business risk

How does the extent of fixed costs, i.e., operating leverage, affect the company? Does the operating leverage lead to ruinous price competition in a down cycle? Which costs are fixed in the short-run versus the long-run? How does a company mitigate the risks arising from fixed costs?

Is the business cyclical? What do we know about business cycles? What risks do they create? How does fiscal and budgetary policy change in response to business cycles? How does that affect the business we are trying to understand? Is its business model sustainable enough to survive the downturn of a business cycle? Can and how does a company mitigate the risk of down cycles? How does cyclicality affect the financing of a company?

Is the business regulated? Why? What aspects of regulation must it manage to be successful? How does that affect risk?

6. Financial risk

How much financial leverage do companies in the industry have? Is there a wide variation? How have the business risk, industry cycle, corporate performance, and financial policy affected the leverage? What types of debt do the companies have? How does leverage change over the life cycle of a company? Why do industries differ in their

borrowing costs? What is the company's credit rating? How have the business risk and the extent of leverage affected the borrowing costs? How has debt structuring affected the interest rate?

Companies

The schedule depends on the number of teams, which depends on the number of students in class. The following list should give you an idea of what will be covered. The exact details will be provided via a spreadsheet on OneDrive.

#	Industry	Subsectors
1	Overview	The analytical framework and tools
		▪ Grocers
		▪ Supply and Distribution
		▪ Pharmacies
2	Retail	▪ Department stores
		▪ Online retailers
		▪ Luxury retail
		▪ Mall owners and operators
		▪ Hospitals
		▪ Diagnostic labs
		▪ Medical supply and distributors
3	Healthcare	▪ Health insurers
		▪ Drug manufacturers
		▪ Pharmacies [Already covered as part of retail]
		▪ DNA Sequencing
4	Real estate	▪ Residential REIT
		▪ Commercial REIT
5	Energy	▪ Oil and gas
		▪ Upstream
		▪ Midstream
		▪ Downstream
		▪ Oil and gas services

6	Renewable energy and utilities	▪ Coal ▪ Solar ▪ Wind ▪ Utilities
7	Automobiles and rentals	▪ Car manufacturers, including electric vehicle manufacturers ▪ Car dealers
8	Transportation	▪ Airlines ▪ Rail ▪ Trucking and package delivery
9	Marketing intensive industries	▪ Branded products ▪ Luxury products
10	Services	▪ Education ▪ Consulting ▪ Fast food ▪ Cruises
11	Technology	▪ Chip manufacturers ▪ Packaged software ▪ Social media and advertising-based revenues
12	Final project	Company of your choice