

Business Drivers of Industries

An Analytical Framework

Please read this important note about in-person classes by [clicking here](#).

Specializations

Spring 2021: Thursdays 6-9 PM via Zoom.

MBA INTA-GB-2306 specializations:

- Strategy
- Accounting

Undergrad MULT-UB-0056 concentrations:

- Management and Organizations
- Accounting

Undergrad track: Management Consulting

Overview

As competition becomes more intense and global and as technology brings about rapid change, executives and managers need to understand the key strategic business drivers to lead and manage a business. Consultants and investors need to analyze competitive position and evaluate the quality of strategic execution to suggest improvements and to 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 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 a 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 weighs competitive drivers and scores strategic strength along 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 environment. 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 for an analysis of 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 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 the store and occupies a small percentage of the total store space. Would you be surprised to know that around 67% the store sales come from prescription drugs? You may then wonder why they do not get rid of the front store and simply 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
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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 percent of sales.

I find it fascinating to peek at 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 have written my own materials. They will be distributed electronically. You need not buy any materials.

Grading

- There are no quizzes, midterm, final exam, or presentations.
- Assignments: **25%**
 - I will provide a spreadsheet template and document/report template.
 - You fill out the spreadsheet with the company data and also fill out 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 to the OneDrive class submissions folder.
 - I discuss your spreadsheet and document in class.
- Attendance and class participation: **25%**
- Final project report: **50%**
 - This is a group project.
 - The write-up and analysis is similar to the class submissions. However, more detailed competitive analysis is expected.
 - The company is chosen by the team. 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.

Attendance

- This is a hands-on course and your attendance in each class is required unless you have sought prior permission to be absent. Valid reasons for being absent are recruiting, weddings, and medical or family emergencies.

- I am not comfortable being videotaped and it constrains what I say in class. Videotaping also encourages absenteeism. **Therefore, the classes will not be videotaped.**
- If you have a qualified disability and will require academic accommodation during this course, please contact me directly.

Help and Office

- Me: dgode@stern.nyu.edu, 212-998-0021, Office: KMC 10-86.
- TA: Check NYU Classes
- Administrative assistant: Justin Pilozo jpilozo@stern.nyu.edu 212-998-4143, Office: Suite 10-185A, KMC 10th Floor, left-hand corne as you enter the department.

Prerequisites and expectations

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

Do 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 will take business experience to develop the skills to identify business drivers.

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 Classes
- If you are a non-Stern student, then Stern automatically creates a Stern account for you when you register 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.
- In case 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. This is a school rule that I am not allowed to override.

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, or sales, assets, or 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 the 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 an innovation is adopted by a wider market?

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 company primarily driven by the success of its R&D, the efficiency of its production, or the successful marketing of its products to customers? 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 business model of a company? Does it lead to ruinous price competition in a down cycle? Which costs are fixed in the short-run vs. 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 cyclicity affect the financing of a company?

Is the business regulated? Why? What aspects of regulation must it manage in order 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 the 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 <ul style="list-style-type: none"> ▪ Grocers ▪ Supply and Distribution ▪ Pharmacies
2	Retail	<ul style="list-style-type: none"> ▪ Department stores ▪ Online retailers ▪ Luxury retail ▪ Mall owners and operators ▪ Hospitals ▪ Diagnostic labs ▪ Medical supply and distributors
3	Healthcare	<ul style="list-style-type: none"> ▪ Health insurers ▪ Drug manufacturers ▪ Pharmacies [Already covered as part of retail] ▪ DNA Sequencing
4	Real estate	<ul style="list-style-type: none"> ▪ Residential REIT ▪ Commercial REIT
5	Energy	

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