

Strategic Management

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BUSINESS



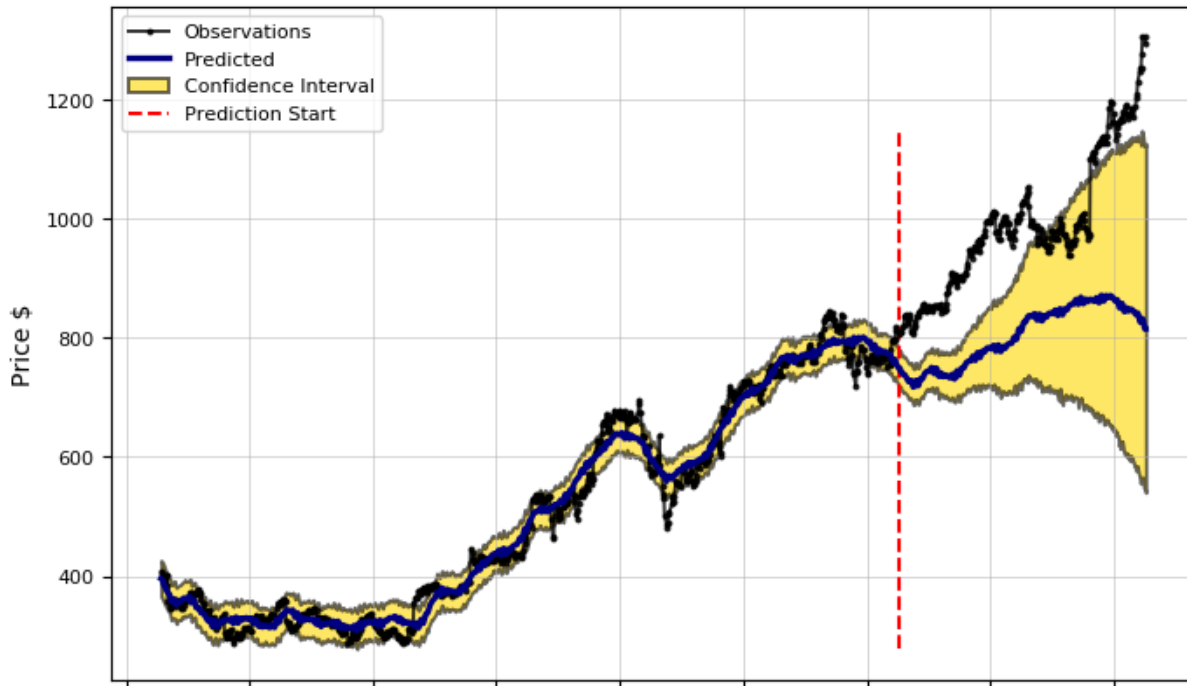
Chapter 2

Organizational Performance



Company's value

The real company's value is its future value as expected by investors.





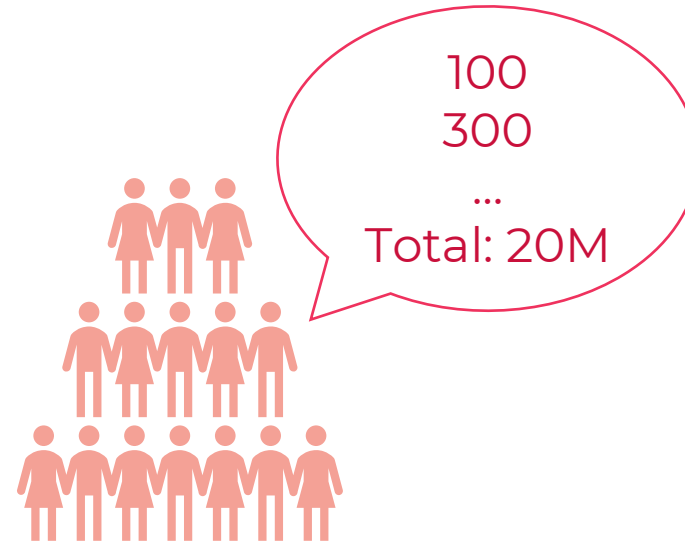
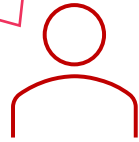
IPO



Is this a real company value?

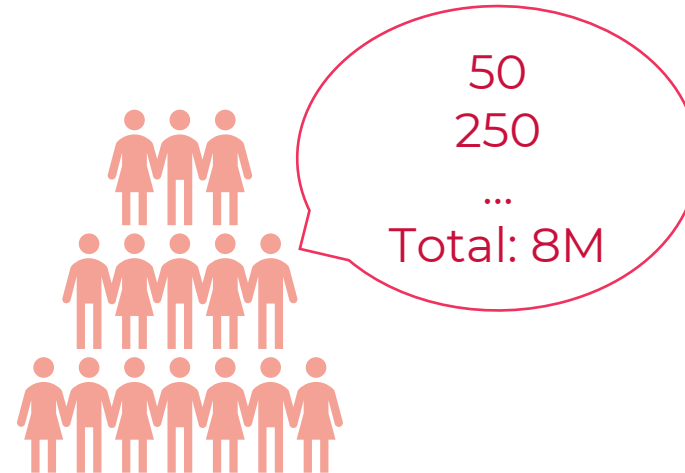
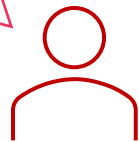
Book of interest

If we sell \$15 per share,
how many shares are
you going to buy?



$$20\text{M} \times \$15 = \$300\text{M}$$

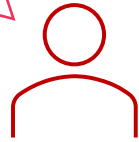
How about \$25
per share?



$$8\text{M} \times \$25 = \$200\text{M}$$

Book of interest

How about \$20 per share?



$$18M \times \$20 = \$360M$$

OK, we will enter the market with 18M shares, \$20 each.





IPO



Does this mean the company was underperforming, or the company overestimated itself?

Share prices change based on demand & supply.

And demand/supply reflect investors' perceptions of the company's future value.

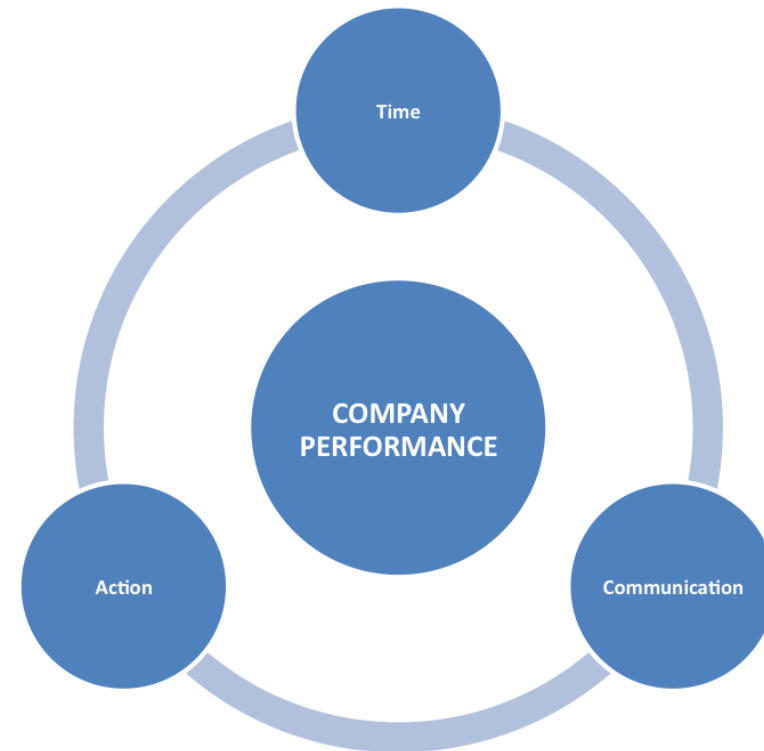
Of course, the current organizational performance does affect the expected future value.

Organizational performance

Performance is a multi-dimensional construct with a variety of sources which sometimes conflict with one another.



Presented by Tomas Ucol Ganiron Jr.



Presented by Inés Cibrián

Estimated value

For a **public-held firm**, a company's value at any specific moment can be “**estimated**” from the current share price.



As a real company's value is in the future, the current share price would partly reflect the company's performance in the past.

For a **private-owned** firm, an estimate company's value can be difficult to measure.

(Tangible) Assets

- Equipment
- Factory
- Office
- Inventory
- ...

- Cash and things that can be converted into cash
 - Short term
 - Long term
- Things a company uses to operate a business to generate profits and revenues



Depreciation (tools & equipment)

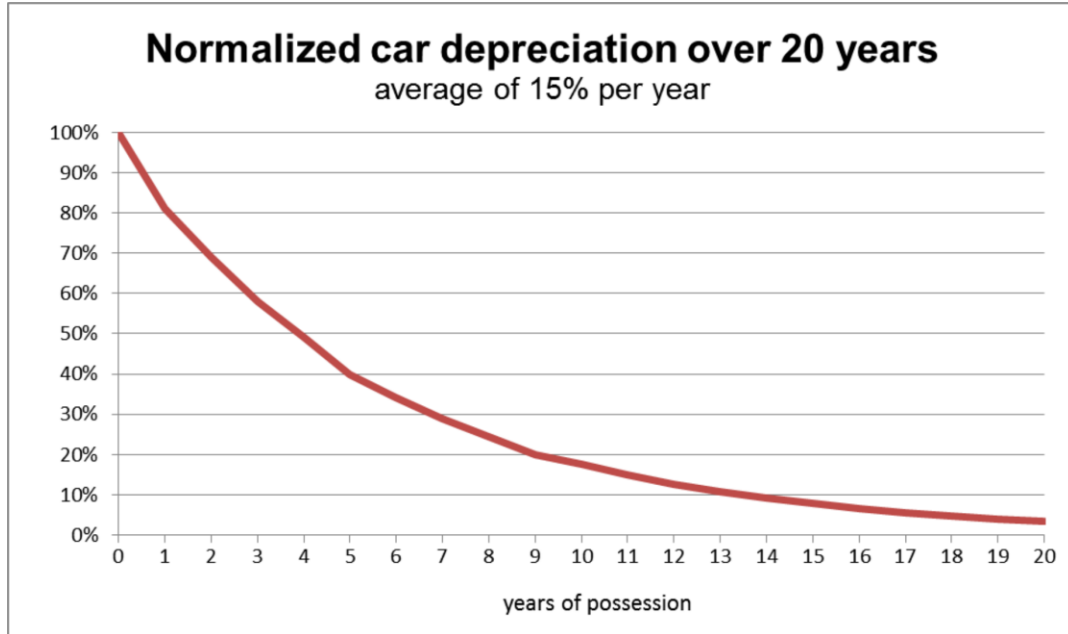
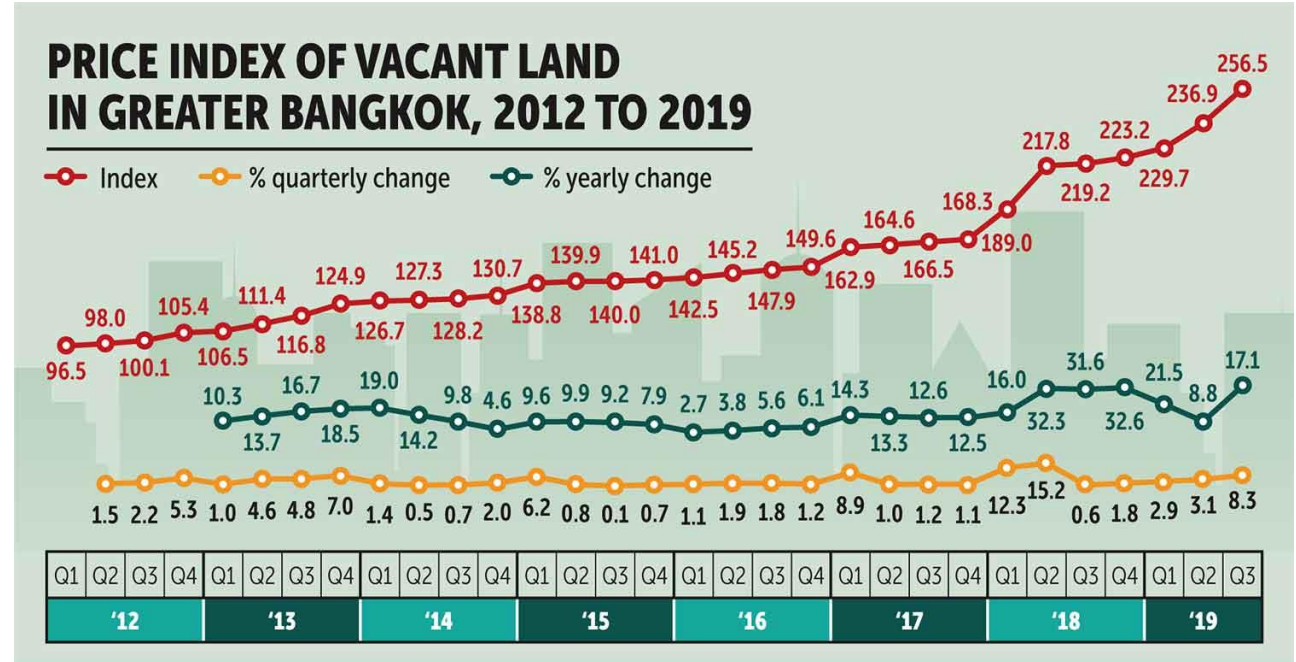


Image by João Pimentel Ferreira from Wikimedia Commons



Property prices



Source: Real Estate Information Center

BKPgraphics



Profitability – Profit per baseline (sales, asset, equity)



Firm 1: Profit \$350,000 from \$10,000,000 sales **(3.5% on each \$)**

Firm 2: Profit \$100,000 from \$2,000,000 sales **(5% on each \$)**



Knowledge-intensive industry

Firm 3: 11% profit per asset

- High labor costs (*skilled labor*)
- Low fixed asset costs (*can work from home*)

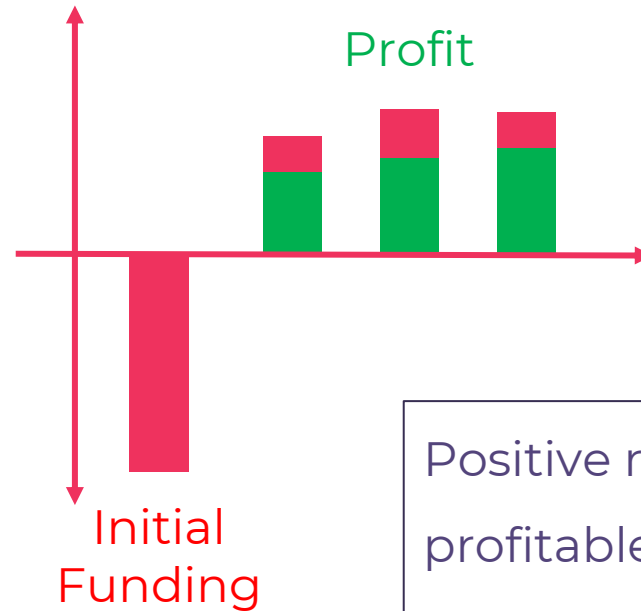
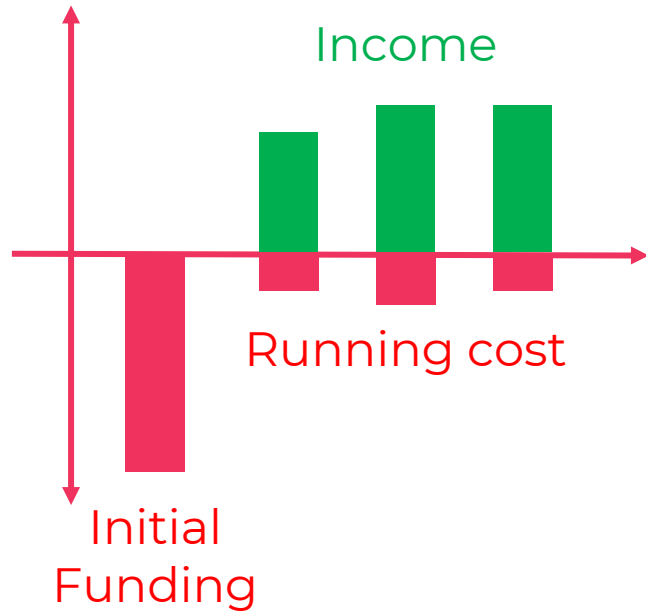


Retail business

Firm 4: 10% profit per asset

- Low labor costs
- High fixed asset costs (*stores*)

Profitability – Rate of return



Rate of return =

$$\frac{\text{Profit after a year (3 quarters)}}{\text{Initial funding}}$$

Positive rate of return means the company is profitable. We could attract more investors if our rate of return is greater than competitors.

If we assume a certain future, no additional capital is required.



In reality, the future is uncertain.

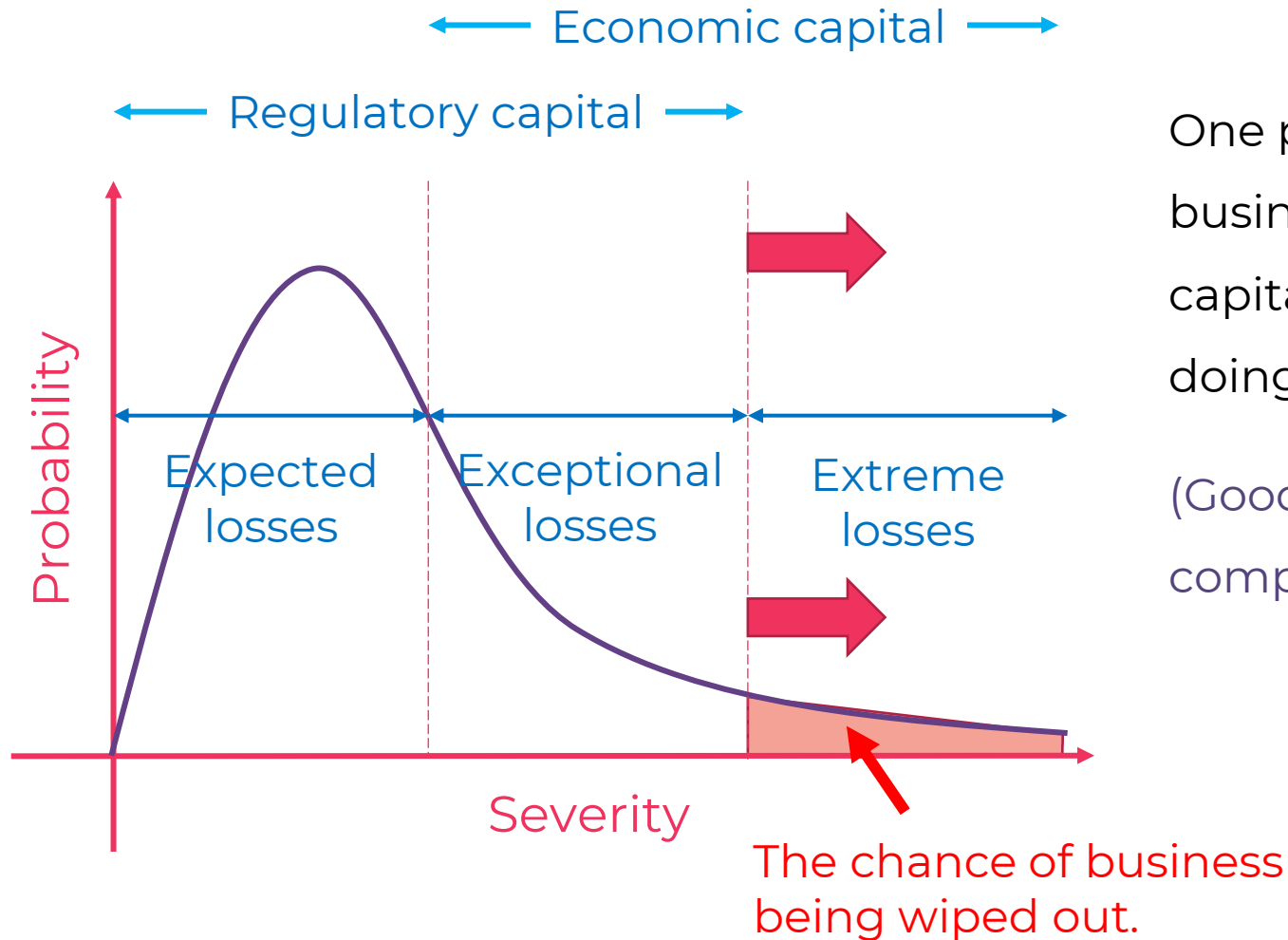
Problems range from common issues to worst-case scenarios.



Image by Herzi Pinki from Wikimedia Commons



Regulatory capital & Economic capital



One possible way to minimize the chance of business being wiped out is to increase the capital. But investors don't like that because doing so will lower their benefits.

(Good at securing your business but bad in competition.)

Non-financial businesses

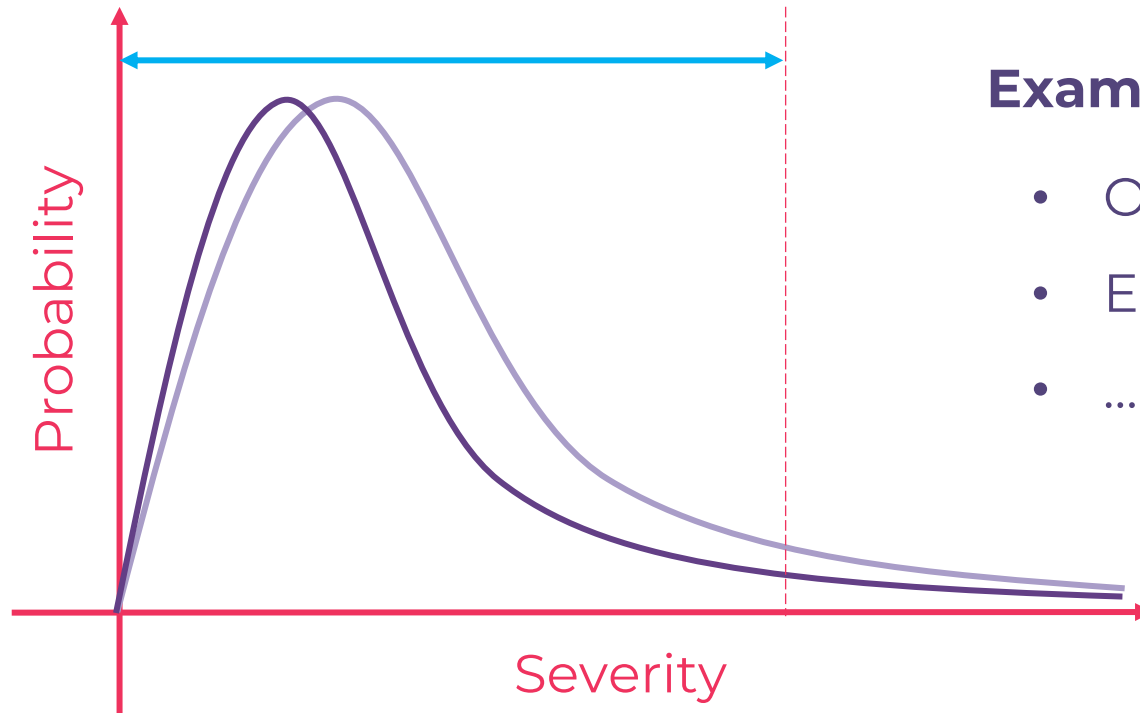
- Owners decide the level of capital

Financial businesses

- Regulators decide the level of capital

Risk management

Reduce the chance of extreme losses to occur instead of increasing a capital level.



Example: Restaurant business

- Offer delivery services on several platforms.
- Establish outlets in gas stations
- ...



Misrepresentation of profitability



Overstatement

- To increase company's value
- To meet bank covenants
- To hide poor operational performance
- To hide the theft of inventory
- ...



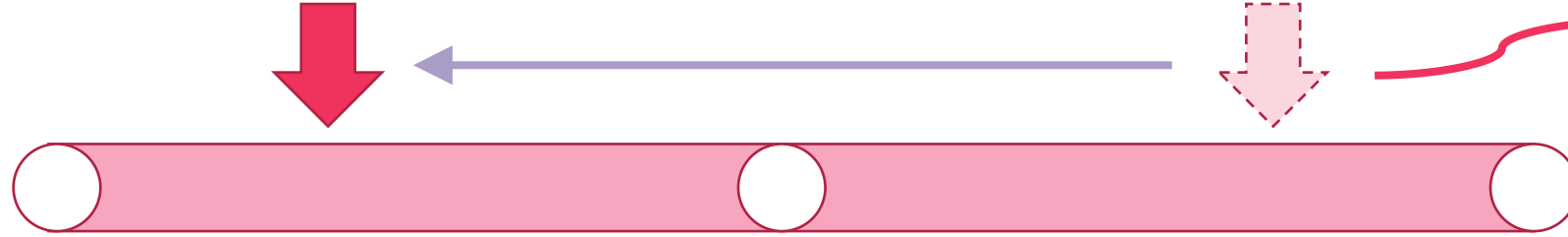
Understatement

- To avoid tax
- ...

Complete the transaction earlier

Collect payment later

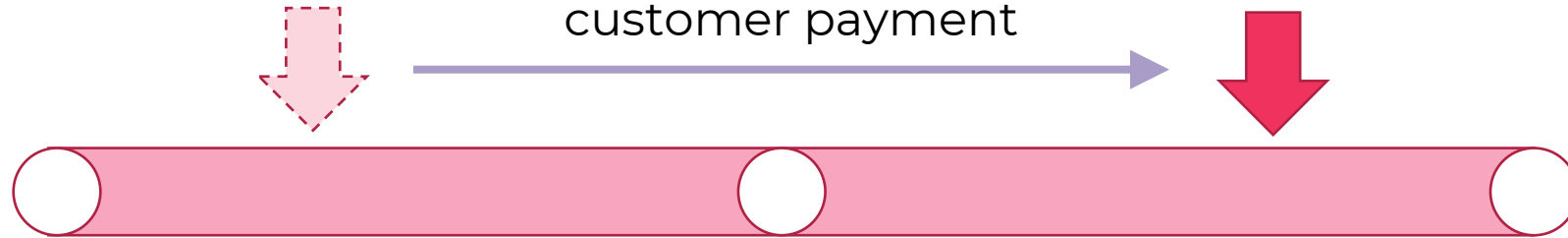
Removed from the next evaluation



Performance Evaluation

Postpone the customer payment

Accumulate on the next tax period

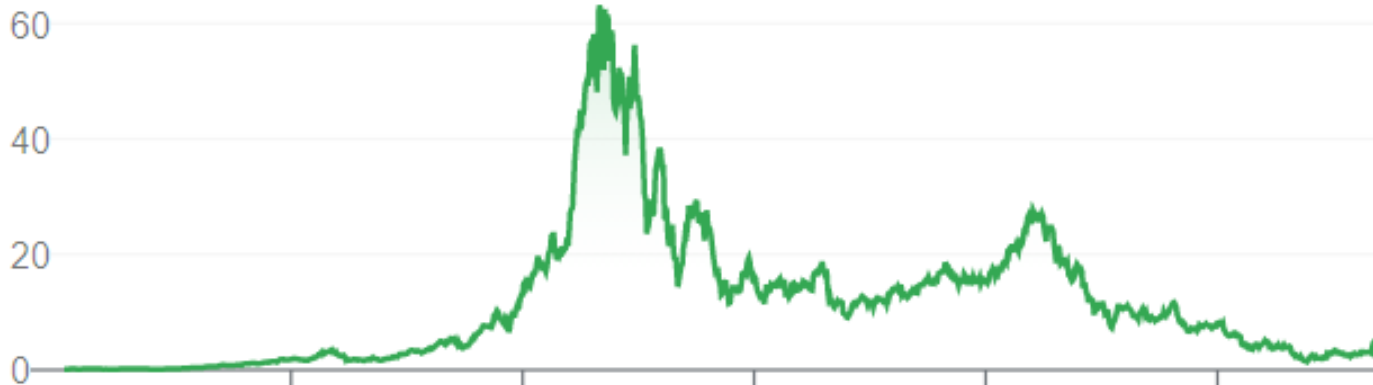


Tax

Performance over time



NOKIA



Have you recognized these brands?

ExxonMobil



AT&T

IBM



Microsoft



Walmart 

Top 10 firms with the highest **Profits** in the United States

1980
1. Exxon (Energy)
2. IBM (Computer)
3. General Motors (Automotive)
4. Mobil (Energy -> Exxon)
5. Chevron (Energy)
6. Texaco (Energy)
7. Amoco (Energy)
8. General Electric (Energy+)
9. Gulf Oil (Energy)
10. BP America (Energy)

1996
1. General Motors (Automotive)
2. General Electric (Energy+)
3. Exxon-Mobil (Energy)
4. Altria Group (Tobacco)
5. IBM (Computer)
6. Ford (Automotive)
7. Intel (Computer)
8. Citigroup (Financial)
9. Merck (Chemicals)
10. DuPont (Chemicals)

2017
1. Apple (IT)
2. Berkshire Hathaway (Mixed)
3. Verizon (Telecom)
4. AT&T (Telecom)
5. JPMorgan Chase (Financial)
6. Comcast (Telecom)
7. Wells Fargo (Financial)
8. Pfizer (Pharmaceutical)
9. Microsoft (IT)
10. Exxon Mobil (Energy)

Top 10 firms with the highest **Revenues** in the United States

1980
1. Exxon (Energy)
2. General Motors (Automotive)
3. Mobil (Energy -> Exxon)
4. Ford (Automotive)
5. Texaco (Energy)
6. Chevron (Energy)
7. Gulf Oil (Energy)
8. IBM (Computer)
9. General Electric (Energy+)
10. Amoco (Energy)

1996
1. General Motors (Automotive)
2. Ford (Automotive)
3. Exxon (Energy)
4. Wal-Mart (Retail)
5. AT&T (Telecom)
6. IBM (Computer)
7. General Electric (Energy+)
8. Mobil (Energy -> Exxon)
9. Chrysler (Automotive)
10. Altria Group (Tobacco)

2017
1. Wal-Mart (Retail)
2. Apple (IT)
3. Berkshire Hathaway (Mixed)
4. Exxon Mobil (Energy)
5. United Health Group (Insurance)
6. McKesson (Healthcare)
7. Amazon (e-commerce)
8. CVS Health (Healthcare+)
9. AT&T (Telecom)
10. General Motors (Automotive)

Top 10 firms with the highest **Assets** in the United States

1980
1. Exxon (Energy)
2. General Motors (Automotive)
3. Mobil (Energy -> Exxon)
4. IBM (Computer)
5. Ford (Automotive)
6. Chevron (Energy)
7. Texaco (Energy)
8. Gulf Oil (Energy)
9. Amoco (Energy)
10. General Electric (Energy+)

1996
1. Fannie Mae (Financial)
2. Citicorp (Financial)
3. Ford (Automotive)
4. Bank of America (Financial)
5. General Electric (Energy+)
6. Prudential Insurance (Insurance)
7. General Motors (Automotive)
8. Salomon Brothers (Financial)
9. JPMorgan (Financial)
10. Chase Manhattan (Financial)

2017
1. Fannie Mae (Financial)
2. JPMorgan Chase (Financial)
3. Bank of America (Financial)
4. Freddie Mac (Financial)
5. Citigroup (Financial)
6. Wells Fargo (Financial)
7. Goldman Sachs (financial)
8. Morgan Stanley (Financial)
9. Prudential Financial (Financial)
10. Berkshire Hathaway (Mixed)

Performance from a variety of perspectives

$$\text{Return on Sales} = \frac{\text{After-tax Profit}}{\text{Total Sales}}$$

$$\text{Return on Assets} = \frac{\text{After-tax Profit}}{\text{Total Assets}}$$

$$\text{Return on Equity} = \frac{\text{After-tax Profit}}{\text{Total Firm Equity}}$$

$$\text{Earning per Share} = \frac{\text{Net Profit} - \text{PS Dividends}}{\text{Common Shares Outstanding}}$$

$$\text{Cash Flow per Share} = \frac{\text{After-tax Profit} + \text{Depreciation}}{\text{Common Shares Outstanding}}$$

$$\text{Gross Profit Margin} = \frac{\text{Total Sales} - \text{Cost of Goods}}{\text{Total Sales}}$$

$$\text{Net Profit Margin} = \frac{\text{Total Sales} - \text{Total Expense}}{\text{Total Sales}}$$

$$\text{Price/Earning Ratio} = \frac{\text{Stock Price per Share}}{\text{After-tax Earning per Share}}$$

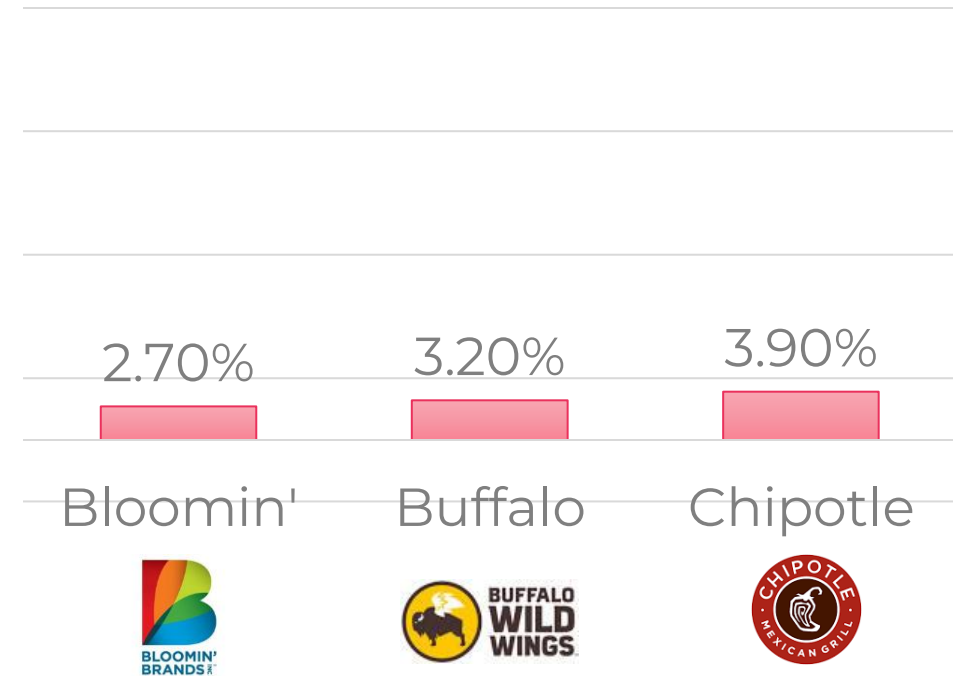
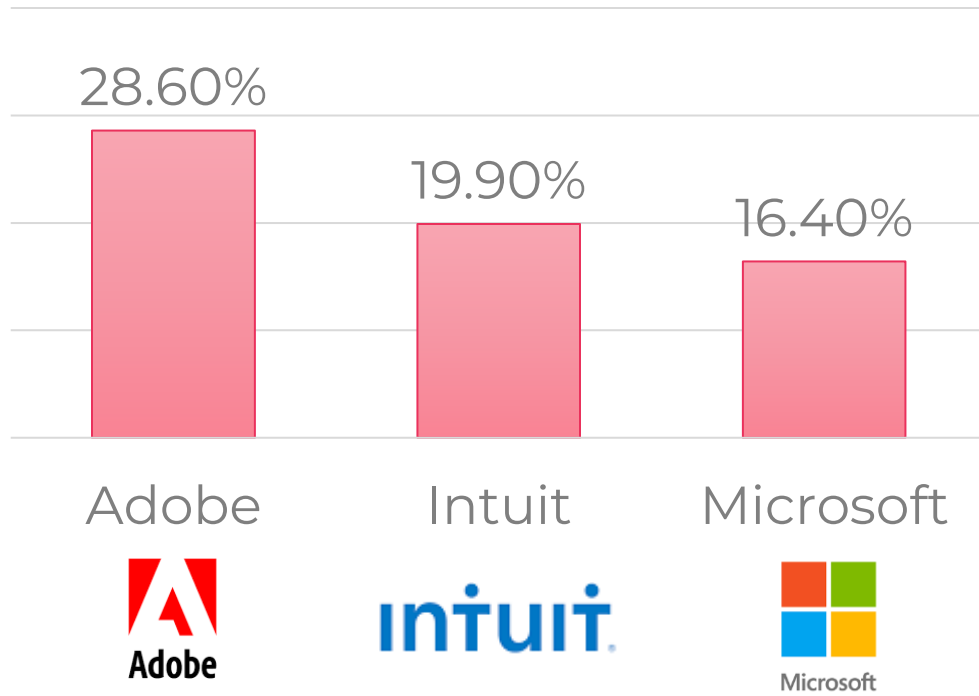
$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\text{Debt to Total Assets} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

$$\text{Debt to Total Equity} = \frac{\text{Total Debt}}{\text{Total Equity}}$$

Performance in context

Net profit margins in 2017

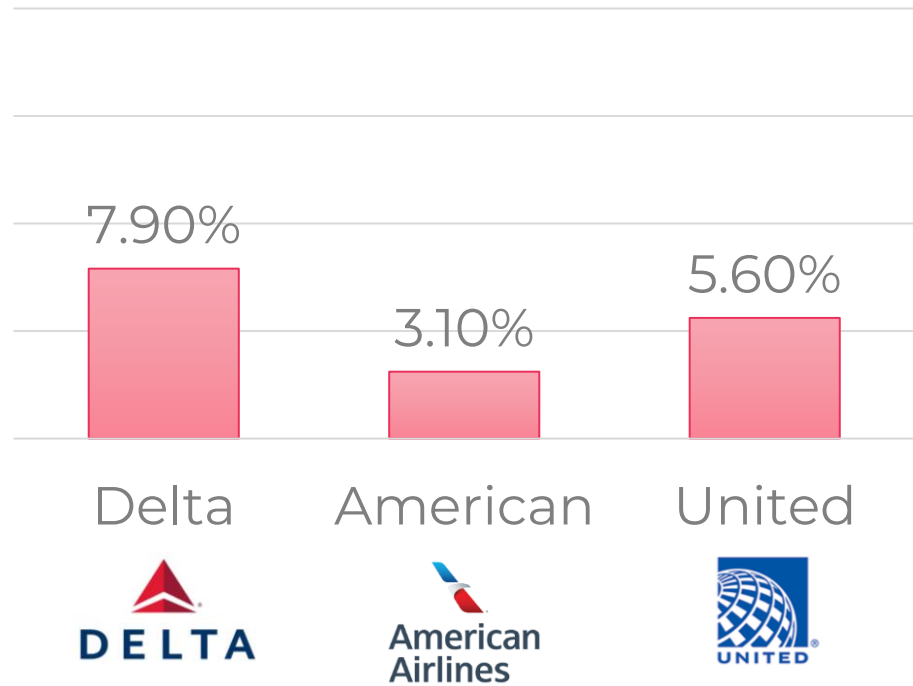


Overall return on sales

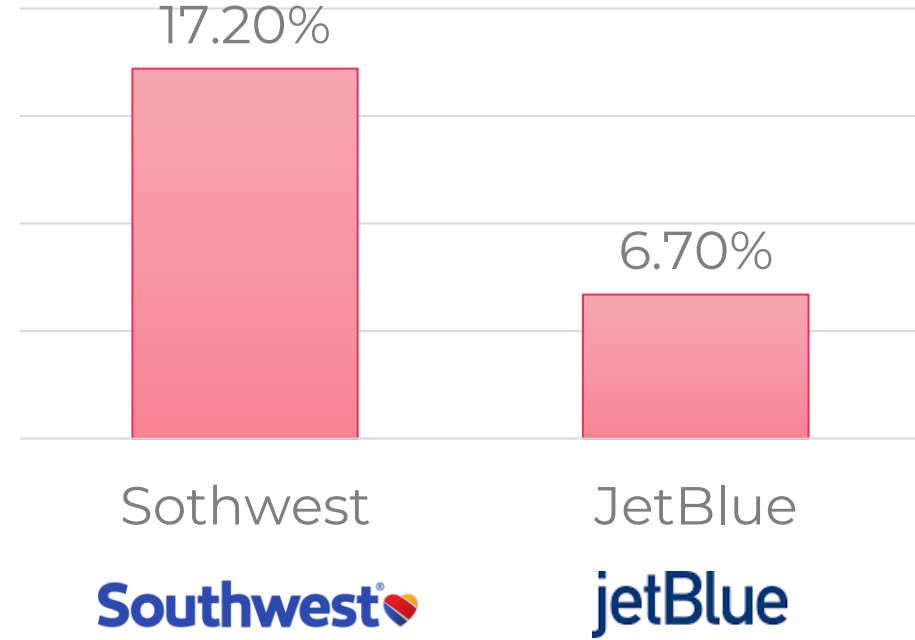
IT industry = 10.43%

Restaurant industry = 8.1%

Net profit margins in 2017



Full-service

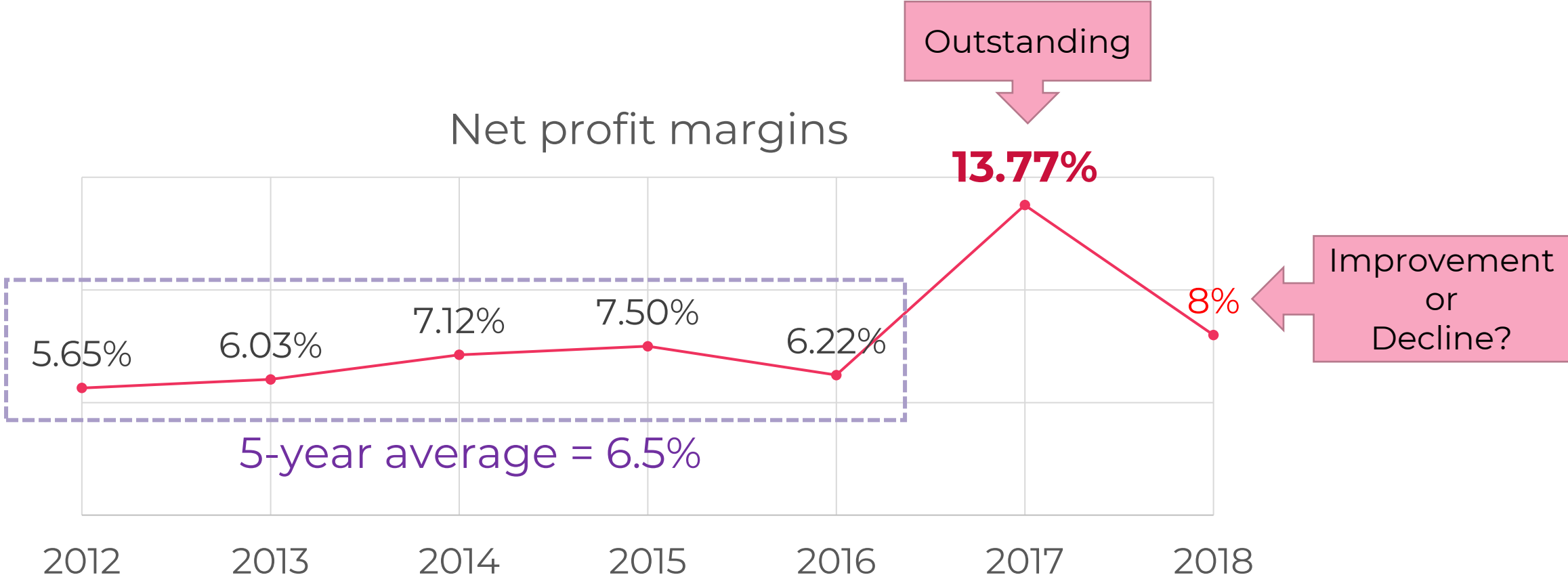


Low-cost

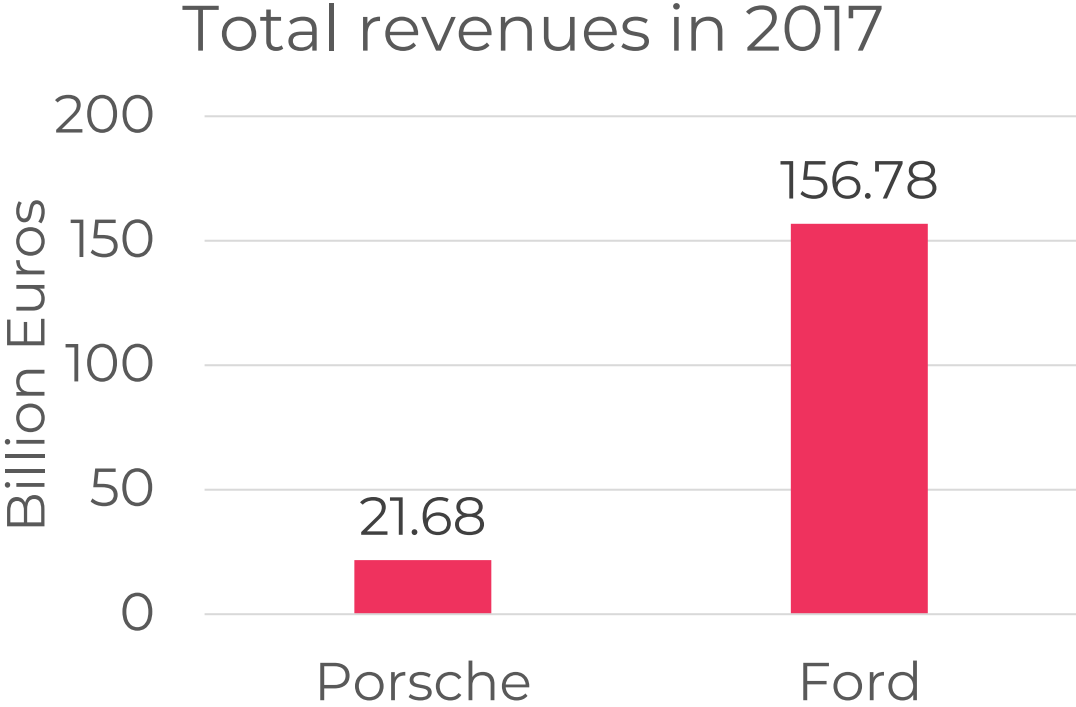
Overall return on sales

Aviation industry = 6.7%

Missing of an industry benchmark



Purposes, Values, and Mission





PORSCHE

“Our vehicles should always be something special. ... , we rely on employees and managers who think just like Ferry Porsche did and who are always willing to go that extra mile.”



“Ford's vision is people working together as a lean, global enterprise for automotive leadership. Where leadership is measured by the satisfaction of our customers, employees, investors, dealers, suppliers, and communities.”



“We exist to glorify God by being a faithful steward of all that is entrusted to us and to have a positive influence on all who come in contact with Chick-fil-A.”

Chick-fil-A stores are closed on Sunday to allow their employees to go to the church. The company is sacrificing 14%, or 1/7 of its potential revenues and profits for its corporate values.

Product Mission: To make, distribute, and sell the finest quality, ice cream, ..., natural ingredients and promoting business practices that respect the earth and the environment.

Economic Mission: To operate the company on a sustainable financial basis of profitable growth, increasing value for our shareholders ..

Social Mission: To operate the company in a way that actively recognizes the central role that business plays in society ...





“We have always believed Starbucks can and should have a positive impact on the communities we serve. One person, one cup, and one neighborhood at a time.”



Image by Matthew Anderson from Flickr



Starbucks Community Service

PROJECTS VOLUNTEERS STORIES

Let's make our communities thrive.

By working together, we can create positive change in our own communities and around the world. Join us in reaching our goal of 1 million community service hours per year by 2015.



Image from starbucks melody.com

Chapter

END

